

ECLAC THINKING

SELECTED TEXTS (1948-1998)

Ricardo Bielschowsky
Compiler



UNITED NATIONS

ECLAC

Alicia Bárcena
Executive Secretary

Antonio Prado
Deputy Executive Secretary

Ricardo Pérez
Chief, Publications and Web Services Division

LC/G.2699

ISBN: 978-92-1-058575-0 (pdf version)

Copyright © United Nations, December 2016

All rights reserved

Web-only publication

S.15-01407

Applications for authorization to reproduce this work in whole or in part should be sent to the Economic Commission for Latin America and the Caribbean (ECLAC), Publications and Web Services Division, publicaciones@cepal.org. Member States of the United Nations and their governmental institutions may reproduce this work without prior authorization, but are requested to mention the source and to inform ECLAC of such reproduction.

CONTENTS

PROLOGUE	5
Alicia Bárcena	
FIFTY YEARS OF ECLAC THOUGHT: A REVIEW	7
Ricardo Bielschowsky	
BIBLIOGRAPHY	39
THE ECONOMIC DEVELOPMENT OF LATIN AMERICA.....	45
Raúl Prebisch	
ECONOMIC SURVEY OF LATIN AMERICA 1949	85
ECLAC	
THEORETICAL AND PRACTICAL PROBLEMS OF ECONOMIC GROWTH	109
Raúl Prebisch	
THE GROWTH AND DECLINE OF IMPORT SUBSTITUTION IN BRAZIL	129
María da Conceicao Tavares	
DEVELOPMENT AND UNDERDEVELOPMENT	141
Celso Furtado	
AN INTRODUCTION TO THE TECHNIQUE OF PROGRAMMING	149
ECLAC	
INFLATION AND ECONOMIC DEVELOPMENT IN CHILE AND MEXICO	165
Juan F. Noyola Vásquez	
INFLATION IN CHILE: AN UNORTHODOX APPROACH	173
Osvaldo Sunkel	
THE LATIN AMERICAN COMMON MARKET	195
ECLAC	
REPORT BY THE SECRETARIAT	
TOWARDS A NEW TRADE POLICY FOR DEVELOPMENT	211
Raúl Prebisch	
ECONOMIC DEVELOPMENT IN LATIN AMERICA	
SOCIOLOGICAL CONSIDERATIONS	239
José Medina Echavarría	
TOWARDS A DYNAMIC DEVELOPMENT POLICY FOR LATIN AMERICA.....	255
Raúl Prebisch	
TRANSNATIONAL CAPITALISM AND NATIONAL DISINTEGRATION	
IN LATIN AMERICA	277
Osvaldo Sunkel	
NATURE AND IMPLICATIONS OF THE "STRUCTURAL HETEROGENEITY"	
OF LATIN AMERICA	303
Aníbal Pinto	
STYLES OF DEVELOPMENT IN LATIN AMERICA	315
Aníbal Pinto	

THE QUITO APPRAISAL	341
ECLAC	
POWER AND DEVELOPMENT STYLES	359
Jorge Graciarena	
APPROACHES TO DEVELOPMENT: WHO IS APPROACHING WHAT?	375
Marshall Wolfe	
ADJUSTMENT POLICIES AND RENEGOTIATION OF THE EXTERNAL DEBT IN LATIN AMERICA	401
ECLAC	
CHANGE AND CRISIS: LATIN AMERICA AND THE CARIBBEAN 1950-1984	431
ECLAC	
INDUSTRIALIZATION IN LATIN AMERICA: FROM THE "BLACKBOX" TO THE "EMPTY BOX"	451
Fernando Fajnzylber	
CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY THE PRIME TASK OF LATIN AMERICAN AND CARIBBEAN DEVELOPMENT IN THE 1990s	473
ECLAC	
EDUCATION AND KNOWLEDGE: BASIC PILLARS OF CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY	487
ECLAC/UNESCO	
THE EQUITY GAP LATIN AMERICA, THE CARIBBEAN AND THE SOCIAL SUMMIT	493
ECLAC	
OPEN REGIONALISM IN LATIN AMERICA AND THE CARIBBEAN: ECONOMIC INTEGRATION AS A CONTRIBUTION TO CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY	501
ECLAC	
LATIN AMERICA AND THE CARIBBEAN: POLICIES TO IMPROVE LINKAGES WITH THE GLOBAL ECONOMY	513
ECLAC	

PROLOGUE

To commemorate the 50th anniversary of the creation of the Economic Commission for Latin America and the Caribbean (ECLAC), in 1998 the anthology *Fifty years of ECLAC thought: selected texts*, was published in Spanish and Portuguese, as a selection of the Commission's classic works spanning the period from its inception through to the 1990s.

Since then, that volume has become an obligatory reference in studies on Latin American development for readers who are familiar with either of those two languages; and it has been widely used in the region's university courses, both in economics and in social sciences generally. The book's excellent reception reflected the fact that it provided a good sample of the intellectual path followed by ECLAC during its first 50 years of existence.

Now, in response to great demand from academics and others interested in ECLAC's work, it gives us great satisfaction to publish a version in English, which will allow it to be more widely disseminated throughout the world.

A perusal of the selection of ECLAC writings compiled in this volume will reveal their unity based on a *sui generis* "historical structuralism" approach, applied to the trends of Latin America's production patterns and social structures. The reader will also find that it involves a body of thought that is organized around three pillars: international engagement (centre-periphery and external vulnerability); domestic structural conditions (socioeconomic); and interaction between State and market in support of development projects.

The introductory chapter serves as a reader's guide to the texts, by framing them in the historical moment in which they were written and placing them in the context of the Commission's work as a whole.

The anthology compiles texts representing five stages of ECLAC thought, each of which broadly corresponds to one decade. These stages are distinguished as the bearers of different "key ideas" or fundamental messages: industrialization (the 1950s); reforms to eliminate obstacles to development (the 1960s); reorientation of development styles (the 1970s); adjustment with growth (the 1980s); and changing production patterns with equity (the 1990s).

The book includes selected fragments of texts written by Raúl Prebisch, Celso Furtado, Aníbal Pinto, Osvaldo Sunkel, Juan Noyola Vásquez, Maria da Conceição Tavares, José Serra, José Medina Echavarría, Fernando Henrique Cardoso, Enzo Faletto, Jorge Graciarena, Marshall Wolfe and Fernando Fajnzylber, together with various official ECLAC works published in the 1980s and 1990s.

It is worth mentioning that only some of the texts had to be translated into English for this publication, because the others had already been translated when originally published.

It is a pleasure to be able to offer this book in electronic format, giving readers simple and immediate access to the work.

Alicia Bárcena

Executive Secretary

Economic Commission for Latin America and the Caribbean (ECLAC)

FIFTY YEARS OF ECLAC THOUGHT: A REVIEW ¹

Ricardo Bielschowsky

I. INTRODUCTION

In 1998 ECLAC celebrated 50 years of activity. Throughout that period, it was the world's main source of information and analysis on the economic and social reality of Latin America. It was also the only intellectual centre anywhere in the region capable of generating a *sui generis* analytical approach, and moreover one that has remained valid for the last half-century.

This review introduces the texts that have been selected for this commemorative volume. It reconstitutes the intellectual path followed by the institution during that period; and it directs the reader to the most important theses and selected texts, setting them in their historical context and in the work of the institution as a whole.²

The reconstitution starts by presenting a table that synthesizes the Commission's analytical output during the period. The table contains the plans of analysis that were common to all stages of the institution's intellectual course, dividing the ideas generated in it into historical periods, based on the succession of "key ideas" or "messages" that guided its output.

Next, a brief description is made of the analytical cornerstone of the thought generated in ECLAC, namely the historical-structuralist method. The following sections review the theses underlying the institution's output in each period.

¹ The CEPAL Review is publishing a modified version of this article simultaneously with this study. The author wishes to thank Octavio Rodríguez for invaluable collaboration in producing the text, and for his patience over any differences in interpretation. He also thanks Alfonso Aguirre, Renato Baumann, Alfredo Calcagno, Carlos Mussi and Pedro Sáinz for their valuable comments, and Maria Pulcheria Graziani, Patricia Pérez and Carmen Vera for efficiently identifying and searching documentation. It goes without saying, however, that the text is the author's entire responsibility.

² As the ECLAC bibliography is very extensive, the present text has been forced to omit many important references. There are also many studies that evaluate the institution's thinking, such as Hirschmann (1963), Cardoso (1977), Rodríguez (1981), Gurrieri (1982), Pazos (1983) and Hodara (1987).

II. CHARACTERIZATION: MAIN ANALYTICAL PLANS AND STAGES OF THOUGHT

Any understanding of the Commission's contribution to the history of economic ideas must start by recognizing that it represents a specific body of analysis, applicable to historical conditions that are specific to the Latin American periphery. Possibly for that reason, there are few references to ECLAC thought in the main compendia of the history of economic theory. At best these are limited to the thesis of deteriorating terms of trade and the structuralist theory of inflation. The absence of other references often results in ignorance of the explanatory power of that body of analysis, which stems from a fertile blend between an essentially historical and inductive method on the one hand, and a specific abstract-theoretical reference —the structuralist theory of Latin American peripheral development— on the other.

In one of the introductory chapters to his monumental history of economic analysis, Schumpeter distinguishes between the main subject of study (the history of economic analysis) and the other domain of the history of economic thought, namely political economy systems, viewed as “a comprehensive set of economic policies that its author advocates on the strength of certain unifying (normative) principles, such as the principles of economic liberalism, of socialism and so on” (Schumpeter, 1954, p. 38). The Commission's contribution —and those of the so-called “development economics” in general— belong to that second group. Their “normative” principle is the need for the State to contribute to the organization of economic development in the conditions prevailing in the Latin American periphery. In short, it is the Latin American development paradigm.

Adolfo Gurrieri (1982) starts his compilation of Prebisch's work in ECLAC with a definition that is worth repeating here, since it helps to understand ECLAC thinking as a whole in its half-century of existence:

“There can be no doubt that what Raúl Prebisch proposed in his early years at ECLAC is a paradigm or programme, because it constitutes an organized scheme of a problem field —Latin American development— constructed in counterpoint to the then predominant scheme, based on which he organizes the search for and accumulation of knowledge in a collective and socially organized way (...) His programme (...) also forms the basis for creating and consolidating the institutions that will serve as an environment to nurture the growth and dissemination of his ideas, and above all, the probe with which he penetrates reality to understand and change it” (p. 13).

Two other characteristics of the ideas generated and disseminated by ECLAC are that it was never an academic institution, and its audience consists of Latin American policymakers. For that reason, the unity and scope of the “ECLAC political economy system” passed unknown for a long time. The difficult task of bringing together the ideas of Prebisch and ECLAC, which were not always clearly linked, was first undertaken by Aníbal Pinto in 1968, for the Commission's twentieth anniversary (ECLAC, 1969). Later, following a request by Prebisch himself, Rodríguez (1981) produced a much more detailed and complete study for the same purpose.

The systemization produced here of the Commission's 50 years of work is made easier by two key characteristics of the institution's thinking.

Firstly, the methodological approach is the same irrespective of the number of stages into which it can be subdivided. What changes is the real history that is being analysed, and the ideological background against which it unfolds. This calls for emphases to be continually fine-tuned and interpretations renewed, to adapt to new historical contexts.

Four analytical features can be identified as common to the five decades: the first relates to the method, the historical-structuralist approach, based on the idea of the centre-periphery relation.

Two others concern thematic areas: the analysis of international engagement and the analysis of domestic structural constraints (on growth and technical progress), and the relations between these, employment and the income distribution.

The fourth and last feature is the analysis of the needs and possibilities for State intervention.

Secondly, systemization is made easier by the fact that the ideas are “historically determined”, even in their details almost, and because they can be organized around “transforming messages”. Five stages can be identified in the Commission’s work, based on “key ideas” or “messages”. By chance each stage lasted roughly one decade; and as will be seen below, they closely follow the historical evolution of the Latin American region.

- (a) Origins and the 1950s: industrialization
- (b) The 1960s: “reforms to unblock industrialization”
- (c) The 1970s: reorientation of development “styles” towards social homogenization and pro-export diversification
- (d) The 1980s: overcoming the external debt problem through “adjustment with growth”
- (e) The 1990s: changing production patterns with social equity

Note that the first two stages are fully encompassed in the global post-war expansionary cycle; and the last two span the irregular period between the end of that cycle, in 1973/1974, and the present, which was dominated by lacklustre global growth and major uncertainties. The correspondence is only imperfect in the 1970s, owing to the global crisis in the middle of that decade. Nonetheless, the crisis did not prevent ECLAC thought from maintaining a reasonable degree of organizational unity on the issues addressed during the decade, since the new emphases only reflected the new historical conditions.

Table 1 uses those elements to record the main theses that they generated. It gives an idea of the set of analytical tools that the approach provides; and it serves as a starting point to guide the intended reading of this text.

It should be noted that classifying the theses and reflections according to “plans” of analysis does not imply a lack of unity of thought: the different plans and theses are perfectly “tied together” by the historical-structuralist method, and by the key ideas that led to the production of the theses in each period.

■ Table 1

SYNTHESIS OF THE ANALYTICAL ELEMENTS COMPRISING ECLAC THOUGHT

Permanent elements		Historical-structuralist analysis	
Periods and Topics	Interaction with the world economy (centre-periphery and external vulnerability)	Domestic structural conditions (economic and social) of growth/technical progress, and of employment/income distribution	State action
1948-1960 (Industrialization)	Deterioration of the terms of trade: structural deficit in the balance of payments; regional integration	Substitutive industrialization process; perverse tendencies caused by specialization and structural heterogeneity; structural inflation and unemployment	Deliberately steer industrialization
1960 (Reforms)	Dependency; regional integration; international policy for reducing vulnerability in the periphery, anti-industrial export bias	Agrarian reform and income distribution as a requirement for reigniting the economy; structural heterogeneity; dependency	Reform to make development viable
1970 (Growth styles)	Dependency, dangerous debt levels; export insufficiency	Growth styles, production and distribution structure and power structures; industrialization that combines the domestic market and export effort	Make viable the style that leads to social homogeneity; strengthen industrial exports
1980 (Debt)	Financial strangulation	Adjustment with growth; opposition to adjustment shocks, need for income policies and possible convenience of stabilizing shocks; social cost of the adjustment	Renegotiation of the debt for adjustment with growth
1990-1998 (Changing production patterns with social equity)	Ineffective export specialization and vulnerability to capital movements	Difficulties for effectively changing production patterns and reducing the equity gap	Implement policies to strengthen the change in production patterns with social equity

Source: Prepared by the author.

III. THE HISTORICAL-STRUCTURALIST METHOD, BASED ON THE “PERIPHERAL STATUS” ARGUMENT

ECLAC developed as a school of thought specialized in analysing medium- and long-term economic and social trends in Latin American countries. Prebisch imprinted that basic feature on the institution from the outset. The corresponding “cultural space” was occupied by a plethora of thinkers who are among the leading economic historians of Latin America.³

The original motivation for the Commission’s inclination towards historical trends is well known. The discussion and research programme inaugurated by Prebisch in 1949 stemmed essentially from the diagnostic of the profound transition seen in the underdeveloped Latin American economies, which were evolving from the outward-looking commodity-export growth model, to the inward-looking urban industrial model.

The historical approach was powerfully articulated by Prebisch’s “structuralist” theory of peripheral underdevelopment.⁴ The structuralist perspective was placed at the centre of the analyses, as a direct consequence of the object of discussion being proposed by the institution. This was to examine how the “inward” transition occurred in Latin American countries — a transition that was thought to stem from the condition that the production process moved in the framework of an underdeveloped economic and institutional structure, inherited from the export era.

³ Authors of classic volumes on the economic history of the region’s countries either belonged to ECLAC or were within its direct field of influence, such as Aníbal Pinto (1956) for Chile, Celso Furtado, (1959) for Brazil and Aldo Ferrer (1979) for Argentina

⁴ Rodríguez (1981) was the author who best systemized Prebisch’s foundational analysis in ECLAC, highlighting its theoretical elements.

In other social science disciplines, such as linguistics and anthropology, where “structuralism” originates, this concept typically corresponded to a synchronous or an ahistorical methodological toolkit. In the Commission’s economic analysis, however, structuralism is essentially an approach that is guided by the search for diachronic, historical and comparative relations, which is better suited to the “inductive” method than to a “positive heuristic”. This lays the essential foundations for the theoretical construction of ECLAC historical comparative analysis: the underdeveloped structures of the Latin American periphery constrain, rather than determine, specific behaviours, of paths that are unknown *a priori*. For that reason, they deserve and demand studies and analyses in which universal-type economic theory can only be used with reservations, to be able to incorporate those historical and regional specifics.

In other words, the ECLAC historical-structuralist approach implies a method of knowledge production that closely observes the behaviour of social agents and the path of institutions, which is closer to an inductive process than to traditional abstract-deductive approaches.

Freed from rigid and schematic deductive frameworks, ECLAC thought is thus able to adapt easily to the evolution of events, by continuously revising its interpretations, which does not mean losing political-ideological coherence, or analytical consistency. Moreover, part of ECLAC research is a critical reflection based on an introspective view of its own analytical developments.

The richness of the ECLAC method thus stems from a fertile interaction between the inductive method and the theoretical abstraction originally formulated by Prebisch.

The opposition between “periphery” and “centre”, which played a dual analytical role, illustrates this point.

Firstly, it served to affirm that the aforementioned structure determined a specific pattern of engagement in the world economy as “periphery”, a producer of goods and services for which international demand is undynamic, an importer of goods and services for which domestic demand is expanding rapidly, and an assimilator of consumption patterns and technologies adapted to the centre, but frequently unsuited to resource availability and income levels in the periphery.

Secondly, it led to the idea that the socioeconomic structure of the periphery determines a unique way of industrializing, introducing technical progress and growing, and a specific way of absorbing the labour force and distributing income. In other words, in its key characteristics, the process of growth, employment and income distribution in the periphery would be different to what happens in the central countries. The differences must be found in the fact that the peripheral economies possess a poorly diversified and technologically heterogeneous structure, in contrast to the pattern seen in the central countries. In the latter, the production apparatus is diversified; productivity is uniform everywhere; and there are mechanisms for creating and disseminating technology and the social transmission of its fruits which are non-existent in the periphery.

It was not a matter of comparing peripheral underdevelopment with the past history of the central economies, as Rostow (1956) wanted, but to identify the unique historical unfolding of the specific nature of their experiences, in which different sequences and results could be expected than occurred in central development. Already in his inaugural text of 1949, Prebisch was warning of the specific nature of the growth process in the structural and peripheral circumstances of Latin American countries, and he called for an analytical space to study it (Prebisch, 1951): “One of the most conspicuous deficiencies of general economic theory, from the point of view of the periphery, is its false sense of universality (...) An intelligent knowledge of the ideas of others must not be confused with that mental subjection to them from which we are slowly learning to free ourselves” (p. 4).

Furtado was the thinker who worked hardest to clothe the ECLAC analysis with the garments of historical legitimacy. His books on Brazilian and Latin American economic history (1959 and 1970) — certainly the two texts on the region’s economic history that are most widely read throughout the world— are masterpieces of the ECLAC structuralist method, which had the deliberate function of defending the importance of understanding underdevelopment as a specific historical context that demands its own theorizing. The idea is expressed with full intensity in the book “Development and underdevelopment” (Furtado, 1971, text 5), written in the late 1950s, which is the key period in which the historical problem of underdevelopment was explicitly conceptualized:

“Underdevelopment is not a necessary stage in the process of formation of the modern capitalistic economies. It is a special process due to the penetration of modern capitalistic enterprises into archaic structures. The phenomenon of underdevelopment occurs in a number of forms and in various stages. (...) underdevelopment, specific phenomenon that it is, calls for an effort at autonomous theorization. Lack of such an effort has led many economists to explain by analogy with the experience in developed economies problems which can be properly expressed only through full understanding of the phenomenon of underdevelopment” (pp. 1176-1177).⁵

It should be recalled that the historical-structuralist method, which is eminently inductive, benefited from the analytical formulation of Prebisch’s theory of peripheral underdevelopment, the main features of which are summarized below. The method was thus articulated by the simultaneous and complementary use of the three analytical spheres mentioned: international engagement, the trends and internal contradictions of growth in the periphery, and State intervention. The following sections discuss the presence of those spheres in the evolution of ECLAC thought.

IV. INAUGURATION AND THE 1950s: LEGITIMIZING AND GUIDING INDUSTRIALIZATION

1. The historical context

In the years following the Second World War, the Latin American economies were fully embarked on the industrialization and urbanization process, driven by rapid economic growth of 5.8% per year between 1945 and 1954, and by an easing of the external constraint which allowed imports to expand by 7.5% per year in that period. This opened up space to strengthen the industrializing ideology, which was just awakening in the region. Moreover, the idea spread that traditional exports were tending to recover as post-war normality returned, and this stimulated the restoration of the liberal ideology that had predominated until the 1930s. From the academic standpoint, this was based on the theory of the international division of labour founded on Ricardian comparative advantages, or advantages arising from relative factor endowments.

In response to the liberal ideology, in the immediate post-war period the defence of development through industrialization had the disadvantage of being poorly articulated analytically. For the advocates of industrialization, there was a sort of “theoretical vacuum”; and scepticism towards existing economic theory generated perplexity at the lack of theories that could be adapted to the economic and social realities that needed to be understood and transformed.

⁵ The author would later improve the formulation by integrating it into the idea that underdevelopment represents a historically determined “cultural” way of using the “social surplus”, in which the consumption patterns of the central economies —and, inevitably, the technological patterns that accompany them— are absorbed by the local elite, but do not filter through to the bulk of the population owing to lack of income and low productivity. The bibliography on that idea includes a self-evaluation made by the same author in a World Bank compilation (Furtado, 1984).

There was thus a degree of discord between economic and social history and the construction of its counterpart in the ideological and analytical spheres.⁶

ECLAC theorizing fulfilled that role in Latin America. It would be the regional version of the new discipline that was installed vigorously in the Anglo-Saxon academic world, in the “ideological” wake of the Keynesian heterodox hegemony, in other words the regional version of development theory. For ECLAC, the 1950s were years of great creativity and capacity to dare and influence. Prebisch and intellectual daring are synonyms in Latin America. Supporting him, either within ECLAC itself, or in its proximities, were none other than Celso Furtado, José Medina Echavarría, Regino Botti, Jorge Ahumada, Juan Noyola Vázquez, Aníbal Pinto, Osvaldo Sunkel and other well-known scholars of the Latin American reality.

The messages were innovative and there was fertile ground for disseminating them. In terms of historical convenience, the ECLAC ideology was in perfect harmony with the political projects of several of the continent’s governments. On the analytical front, the general message was fully synchronized with the core of the new “development theory”: underdeveloped countries warranted an independent theoretical formulation, or at least an adapted one, because they functioned differently than developed countries in significant ways.

Essentially, with different concepts and ways of formulating the issue, all conveyed the same central message —the need to implement industrialization policies as a way of overcoming underdevelopment and poverty. ECLAC manoeuvred admirably in that context. Not only did it become an essential reference when discussing Latin America, but it also developed its own theorizing which consistently combined a large number of conceptual innovations.

Although the ideological terrain was not always supportive, in the academic sphere it was; and, to some extent, it also was on the international organization circuit. This included a sympathetic attitude to the development perspective from the World Bank —which also lasted until the end of the 1970s, when Anne Krueger replaced Holis Chenery as director of its economic consulting arm. Nonetheless, as Pollock (1978) describes, the ideas of Prebisch and ECLAC were viewed with a great deal of suspicion by the U.S. State Department throughout the McCarthyism period of the Cold War. Although that may not have prevented ECLAC thinking from being disseminated, it probably explains the nearly always cautious tone in which the ideas were expressed.

2. The inaugural vintage and its extensions

The Economic Commission for Latin America and the Caribbean was created in 1948, as a result of a decision approved by the United Nations General Assembly in 1947. This occurred against the backdrop of Latin American complaints about the region’s exclusion from the Marshall plan, and lack of access to “scarce dollars”, which made it difficult to replace the region’s worn-out production apparatus. Despite that transitory “incentive”, there seemed to be a widespread perception that the new organization was doomed to become another of the numerous featureless and bureaucratized international agencies that already existed. Nonetheless, with Prebisch, its history was to be very different.

Having previously served as general manager of the Argentine central bank, Raúl Prebisch only became Executive Secretary in 1950, but he arrived in Santiago in 1949 as a consultant responsible for contributing to the 1948 *Economic Survey*. As Celso Furtado describes in his 1985 work *Fantasía organizada*, at a certain moment in the first half of 1949 Prebisch suddenly withdrew a first version of the text he had just written for inclusion in that edition of the *Survey*.

⁶ Aníbal Pinto drew attention to this point in *El pensamiento de la CEPAL* (1969), a compilation of classic texts from the institution’s first two decades.

He spent some time shut away in his office, doubtless examining the recent data published by the United Nations on the deterioration of the terms of trade. He then published the work that Hirschman would dub “the Latin American manifesto”, namely *The economic development of Latin America and its principal problems* (Prebisch, 1949, text 1).

A few months later, although still in 1949, he would relaunch the same ideas with minor modifications, in the conceptual part of *Economic Survey of Latin America, 1949* (ECLAC 1951a, text 2). This was the first document devoted to appraising economic trends in the main Latin American countries. Then in 1950, Prebisch would write the first five chapters of the *Economic Survey of Latin America, 1950*, titled “Theoretical and practical problems of economic growth” (ECLAC, 1951b, text 3).

That set of documents already contained all of the elements that would serve as the great ideological and analytical reference for Latin American development scholars.

Firstly, he argues that the spontaneous industrialization that was currently under way had a special significance in the history of humanity, since it represented the chance for the vast underdeveloped Latin American region to obtain the fruits of global technical progress, which had hitherto been confined essentially to the industrialized countries.

Secondly, he presents the elements of the analytical matrix that forms the basis of ECLAC thought. These include both the analysis of international engagement by the peripheral economies and their consequent external vulnerability, and the analysis of the problematic conditions and perverse tendencies with which growth in the Latin American periphery is internally processed.

Lastly, he makes an initial incursion into the topic of State intervention, which is strengthened by proclaiming the problematical nature of industrialization under the structural conditions prevailing in the periphery, which the market has no way of resolving spontaneously.

(a) *Interaction with the world economy.* One of the basic tools of ECLAC analysis is the didactic provided by the contrast between the way growth, technical progress and international trade occur in the economic and social structures of the “peripheral” countries, and how the same processes unfold in the “central” countries.

In the case of international trade analysis, the contrast is used to highlight the interdependencies that exist between the behaviour of the “centre” and that of the “periphery”, and the problems that are generated for the latter.

Prebisch was using the expression “peripheral countries” well before joining ECLAC (Love, 1980). Until then he used the term to analyse Latin America’s vulnerability to the cyclical crisis of the 1930s, which fuelled inflationary processes with a strong exogenous component and tendencies towards domestic contractions which, politically, spawned inadvisable macroeconomic solutions.⁷

In ECLAC, the argument gained weight in the inaugural texts, because it was accompanied by the thesis of deteriorating terms of trade, which contradicted the liberal postulate of the virtues of international free trade. Contrary to what the theory of comparative advantages promised, the slower pace of technical progress in primary products than in industrial products in the twentieth century was not causing the former to become relatively more expensive.

⁷ The abrupt contraction of import capacity in the 1930s and its repercussions on the Latin American economies constituted the main historical reference for which Prebisch would develop the distinction between the functioning of the industrialized economies and those that specialized in primary products. Hodara (1987) reviews Prebisch’s ideas contained in the annual reports of the Central Bank of the Argentine Republic between 1936 and 1942. Felipe Pazos (1983) characterizes the 1930s and 1940s as the phase of Latin American thought oriented towards counter-cyclical monetary policies.

The thesis had two versions, both structuralist and both centred on the idea of the dynamic comparative advantages of industrial production — or the dynamic comparative disadvantages of specialization in commodity products. In the Latin American manifesto, this was linked to the cycles, and the way the periphery's underdeveloped structure of production and employment prevented it from retaining the fruits of its technical progress, unlike what happened in the "centre". In the countries of the latter, organized labour unions and a concentrated production structure succeeded in preventing the nominal prices of industrial goods from falling in the cyclical downturn, thereby more than offsetting the gains that the periphery obtained from primary products in the upswing phase.⁸

The second version arises in the second of the three texts mentioned and is consolidated in the third. It contemplated the "potential" trend towards deterioration, owing to the excess supply of labour in the underdeveloped agriculture of the periphery, which could not be transferred to the central countries since they were closed to immigration. Its eventual employment in export activities would result in an expansion of supply that would depress international prices, resulting in a lower value despite the larger volume produced.⁹

That argument was used to defend the "economicity" of industry and justified the resort to protectionism: although industrial production was less efficient in the periphery, it was more efficient than allocating production resources to agriculture.

It was then claimed that the industrialization process would not alleviate external vulnerability, because the Latin American periphery would for long remain an exporter of commodities, of inelastic demand in the central countries, and as an importer of industrial products, for which demand in the periphery was highly elastic. He believed that until the industrialization process was complete, the balance of payments would always tend towards a structural deficit, for while the substitution process "alleviated" the demand for imports, it also imposed new demands stemming both from the new production structure that it created and the income growth it generated. Thus, only the composition of imports was changed, and the problem of foreign exchange shortage was perpetuated.

That argument on the tendency towards a structural deficit in the balance of payments takes centre stage in several ECLAC arguments of the time.

Firstly, it subordinates the very concept of industrialization to that of "import substitution". The argument is fully developed in a much later text by Maria da Conceição Tavares (1964) (text 4), but it already appears in the inaugural texts. The substitution dynamic describes how the economy reacts to successive balance of payments bottlenecks. Owing to the progressive compression of the list of imports, industrialization moves from sectors of "easy" installation that require little in terms of technology, capital and scale, to increasingly sophisticated and demanding segments.¹⁰

⁸ Singer (1950) put forward the same analysis simultaneously and independently.

⁹ The same argument would later be elegantly developed by Lewis (1960), in his classic text on the limited supply of labour. Only much later, would Prebisch (1959) produce an academically rigorous version of the idea, apparently stimulated by Chenery.

¹⁰ For a long time, Latin American thinking was dominated by the absolute belief that import substitution was the way to industrialize in Latin America, and that the substituting dynamic was the region's growth model. Around the mid-1970s, the School of Campinas in Brazil, consisting of intellectuals of ECLAC origin, for the first time opposed the idea that industrialization and import substitution were equivalent: the industrialization process would be the bearer of a logic and dynamism that were independent of mere import substitution. This was because it was projected owing to capital accumulation decisions aimed at forming a supply capacity without a demand repressed by import constraints.

The idea, widely disseminated by liberal economists, that what ECLAC was proposing was an “autarky”, is completely wrong. On the contrary, it was repeatedly stated that the substitution process only altered the composition of imports. Furthermore, economic growth would inevitably suck in additional imports, and the central countries only stood to gain from the periphery’s industrialization and greater openness to importing products originating there. Accordingly, it was argued that there was a broad “intrinsic solidarity” between industrialization and the expansion of international trade.¹¹ Moreover, as noted below, from the 1960s onwards, ECLAC would repeatedly defend the need to implement policies to stimulate and diversify exports.

Secondly, and contrary to what is often assumed, concerns about external imbalance led ECLAC to stress the importance of stimulating exports, from its inception and particularly since the 1960s.

In that sphere, ECLAC played a central intellectual role in two very important institutional initiatives. In the second half of the 1950s, it participated in the creation of the Latin American Free Trade Association (LAFTA); and in the early 1960s, Prebisch himself would be the leading player in creating the United Nations Conference on Trade and Development (UNCTAD).

The ECLAC argument in favour of LAFTA contained the idea of initiating a process of export diversification by its own efforts, through the theoretically easier route of intra-regional trade. More importantly, according to the introductory sections of the inaugural ECLAC text on the topic (ECLAC, 1959, text 9) written by Prebisch himself, the Latin American Common Market would expand the size of the market for industrial sectors that were demanding in terms of scale, thereby helping to intensify the substitution process.

UNCTAD itself was born from ideas that had been discussed in the 1930s and 1940s, concerning the need to attenuate the cyclical vulnerability of the peripheral countries, by applying international intervention mechanisms that were concerted with the central countries. At the time of the institution’s creation, the emphasis on the need to diversify and expand exports, including industrial ones, was spreading from the limited scope of the regional market to another, more ambitious domain of the world market. The document that Prebisch (1964, text 10) presented at the second conference of the new entity is, possibly, the moment when the idea of international cooperation to strengthen periphery development through international trade agreements was at its strongest.

Thirdly, the idea of permanent balance-of-payments strangulation is also central to the structural inflation thesis, which was developed by Juan Noyola Vásquez (1957, text 7) and finessed by Osvaldo Sunkel (1958, text 8) and Aníbal Pinto (1960). The structural deficit of the balance of payments appears in those texts as the “basic” structural cause of inflation which, along with the rigidity of agricultural supply, triggers a process driven by “accumulation factors” and by “propagation mechanisms”.

Fourthly, in 1954, given the growing balance-of-payments difficulties caused by the ending of the Korean War, the idea of external strangulation reappears in discussions on the advisability of attracting inflows of private foreign capital —in other words, of not being constrained to obtaining capital from public funds. Prebisch defended this stimulus, but drew attention to the danger of expanding the countries’ external liabilities and subjecting them to exaggerated debt service; so he considered it more prudent to expand financing from official organizations. The text *International Cooperation in a Latin American Development Policy* (ECLAC, 1954) is the first incursion into a topic that would prove to be long-lived in Latin America.

¹¹ On mistaken criticisms of ECLAC, see Assael (1984) for example.

With variations that are adapted to the different contexts of world trade and the various conditions of international financing, the external vulnerability argument is present throughout the five decades of ECLAC thought. In the 1960s, it would be called “financial and technological dependency”; and, in the 1970s, the notion of “dependency” would be analytically upgraded by reviewing the role of transnational firms in the peripheral economies. In the 1980s, external vulnerability would be equivalent to the practice of financial “suffocation” caused by the external debt; and in the 1990s, vulnerability would be treated as a dual problem, in other words production and technical specialization of little dynamism in the world market and overexposure to external debt, particularly in the short term.

(b) *Internal structural conditions.* Let us now return to the inaugural texts to identify the analytical framework in terms of the “domestic” structural constraints on growth and employment. Here the Latin American economies were also contrasted with their industrialized counterparts.

It should be recalled that while spontaneous industrialization was welcomed as a highly significant event in the history of the global spread of technical progress, the process was considered intrinsically problematic, because it was founded on underdeveloped economic and institutional structures.

The argument was based on two central features of those structures. First, there was a legacy of an economic base specialized in few export activities, which was poorly diversified and displayed very little intersectoral complementarity and vertical integration. There were serious constraints on making up for those shortcomings. The new demands for imports could not be satisfied given the scarcity of exports and lack of external financing. Moreover, demands in terms of domestic effort were frustrated by insufficient saving to simultaneously generate all of the investments that industrialization required.

The other characteristic was the low level of productivity prevailing throughout the economy outside the export sector. That “structural heterogeneity” —the expression would actually only be coined by Aníbal Pinto in the 1960s, but is applied to the formulation of the 1950s— included a large current and potential surplus of labour and low average per capita productivity, which reduced the chances of raising saving rates in those economies, thereby limiting capital accumulation and growth. The situation was further complicated by the lack of public-sector saving capacity, owing to an obsolete fiscal structure and, in the case of private-sector saving, to the luxury consumption patterns indulged in by the wealthy classes, a habit that would tend to worsen as “demonstration effects” intensified.

In short, the peripheral economies were facing serious problems of insufficient saving and a shortage of foreign exchange. That “two gaps model” steered discussions in ECLAC since its inception, although the expression would not appear in the main texts, nor was it given the formal treatment that it would later receive from Chenery and others.¹²

The continuity of the “new state of dissemination of technical progress” would always be threatened by the problems that are characteristic of peripheral economies. Given the distinctive features of the production structures of those economies, namely specialization and technological heterogeneity, the ongoing process would cause three perverse trends that would play a basic role in the dynamic context: the structural deficit in the balance of payments, inflation and unemployment.

¹² The ECLAC economists always agreed on the analytical treatment of the external gap, but did not always agree on the analysis of the saving gap. Prebisch, Furtado and, perhaps, a majority stressed the gap as a fundamental obstacle to growth; whereas economists who worked along the lines of Aníbal Pinto preferred to stress difficulties of investment “financing”, denying, à la Keynes, that insufficient saving was the problem. The latter included the influential Brazilian economists who were at ECLAC at the start of the 1960s under Pinto’s orientation, namely Conceição Tavares, Antônio Barros de Castro and Carlos Lessa. The two last mentioned are the joint authors of the work *Introdução a economia, uma abordagem estruturalista* (Castro and Lessa, 1967), for which Pinto wrote a foreword.

It should be remembered that the structural deficit in the balance of payments arose from the import needs of industrializing economies specialized in a few export activities and facing a low elasticity of demand for their products. Specifically, because they were poorly diversified, they were under permanent pressure to expand imports beyond what export growth permitted.

The inflationary tendency stemmed both from the balance-of-payments deficit and from the other shortcomings that industrialization processes face in poorly diversified economies (agricultural rigidity, energy and transport shortage, etc.).

Most “developmentalists” rejected stabilization policies that implied recessionary adjustments, as symbolized by the action of the International Monetary Fund (IMF) in the region, because they believed that such policies obstructed ongoing economic development, considered as a fundamental historical transformation. As is well known, in the frequent situations in which price increases and external deficit have occurred simultaneously, the IMF did not hesitate to recommend a sharp devaluation of the exchange rate, and an attempt to neutralize the inflationary effect of that measure with drastic fiscal and monetary contractions. The structuralists, apart from counter-attacking with heterodox suggestions such as multiple exchange rates, offered an analytical weapon, with the aforementioned theorizing by Noyola (1957) and Sunkel (1958), which, at that time, had a significant influence on the stance that opposed recommendations for stabilization involving recessionary adjustment. According to the structuralist vision, the money supply grows almost passively as the monetary authorities’ response to price rises of a structural origin; and it would therefore be wrong to consider this as a cause of inflation. The only way to prevent inflation would be to change the structural conditions that cause it, and this would have to be done through a continuous and planned growth effort. Tight credit and fiscal policies not only fail to deal with inflation, but by causing recession they strengthen the structural inflationary trends that manifest themselves when growth revives.

Lastly, unemployment reflected both the inability of export activities to absorb surplus labour and the insufficient absorption capacities of modern activities serving the domestic market.

For the latter to be able to absorb the underemployed, capital formation would need to grow at rates that would be extremely challenging in the conditions of the peripheral economy: structural heterogeneity limited capacity to generate surpluses, because only a small fraction of the economy was operating at high levels of productivity. Specialization reduced export capacity and generated heavy import pressures; lastly, according to the argument, the production techniques imported from the central countries would not absorb enough labour (later the argument would be expanded to incorporate the idea that the new composition of industrial production also tended to absorb less labour).

In each of those dimensions, and in its analysis of external vulnerability, ECLAC thinking would evolve in the ensuing decades and become more sophisticated, adjusting to the new historical circumstances. Nonetheless, the core of its discourse would remain the different way in which growth and technical progress unfold in the economic and institutional structures of the underdeveloped countries and the different way in which they impact international trade and employment.

(c) *Planning*. The Commission’s work has been policy-oriented ever since its inception. State action to support the development process appears in ECLAC thinking as the natural corollary of the diagnostic of structural problems in terms of production, employment and income distribution under the specific conditions prevailing in the underdeveloped periphery.

In the 1950s, the key concept used to make the policy proposals coherent and systematic was that of “planning” or “programming”.¹³ At that time, and to some extent also in the 1960s, the emphasis on planning had an additional meaning, which was to overcome the huge technical shortcomings in most of the region’s governments.

The starting point for providing technical assistance to governments on planning was the preparation of technical guidelines on programming, supported in several countries by trial applications of the techniques in question.¹⁴ In 1953, a preliminary study on the technique of programming economic development would be published, which was revised in *An introduction to the technique of programming* (ECLAC, 1955, text 6). As explained in the introduction to the 1955 document, programming consisted of the “logical stage” that followed the recognition of development problems—in other words, the need to rationalize the spontaneous industrialization process that was unfolding.

The key author of the conceptual part of those documents on programming was Celso Furtado. Then a tradition was launched which would be spread by Jorge Ahumada, Pedro Vuscovic and other economists who would help Prebisch to create the Latin American Institute for Economic and Social Planning (ILPES) within ECLAC in the early 1960s. These economists would play a key role in that entity’s influential track record of training technical experts for governments throughout Latin America.¹⁵

Viewed from today’s standpoint, the guidance contained in the document on programming techniques seems trivial. It firstly indicates how to perform macroeconomic consistency exercises as a starting point for programming; in other words, how to define the growth rates that were possible given the foreseeable saving and balance-of-payments constraints. It also gives indications for making sector-level demand projections based on income elasticity, which only later texts would recommend doing through the input-output matrix. Once in possession of the future consumption map, the programmer had to select sectors and projects for import substitution according to the “social marginal productivity of capital” criterion.

Nonetheless, in the Latin American context of the 1950s, this was by no means trivial. Basic economic statistics were sparse; there were not even minimal systems of national accounts; and governments operated the economies largely ignorant of their basic trends. The orientation given by ECLAC programming techniques raised awareness of the shortcomings and of the importance of affording a minimum level of predictability to the macroeconomic context on which the desired growth process would be based.

Since then, throughout their history ECLAC and ILPES would produce numerous texts containing economic policy recommendations; and they would undertake numerous technical assistance missions to Latin American countries, in the broadest range of fields of economic activity and on the widest variety of topics within the development problem.

¹³ An initial incursion into this topic, which already outlines the bases of planning, consists of the cited text *Theoretical and practical problems of economic growth* (Prebisch, 1952).

¹⁴ In the Brazilian case, Celso Furtado did the work in 1953-1954 in collaboration with Regino Botti, at the premises of the recently created National Economic Development Bank (BNDE) in Rio de Janeiro. On that occasion, the joint CEPAL-BNDE Group was formed for that purpose.

¹⁵ In the ILPES bibliography on planning, see the volumes *Discusiones sobre planificación*, (ILPES, 1966) and *Experiencias y problemas de la planificación en América Latina* (ILPES, 1974), among others. The main bibliographical reference on Jorge Ahumada is his *Obras Escogidas* (Ahumada, 1986).

V. THE 1960S: REDISTRIBUTE TO GROW

1. The historical context

The history of Latin America in the second half of the 1950s included three elements that had a radical effect on the development of ECLAC thinking, and that of Latin America in general, in the 1960s.

Firstly, growth in most countries, although persistent (5.7% per year between 1955 and 1959) occurred in the midst of increasing macroeconomic instability, caused mainly by restrictions on imports, which only grew by 2.1% per year in the same period and by 0.3% per year between 1960 and 1964. In that context of tight external constraint, several countries faced heightened inflationary pressures.

Secondly, the industrialization process continued to impose itself as a historical trend, but the consequent urbanization led to growing impoverishment of the population and the development of slums in the cities —symptomatic of the inability of modern production activities to absorb the labour force arriving from rural zones, which very clearly extended rural poverty into urban areas. At the same time, democracy consolidated, and growing discontent fuelled social pressures expressed through daily political and labour-union activity.

Thirdly, the Cuban Revolution of 1959 would have a profound effect on the attitude of the United States to such pressures, and towards the political movement that was propagating throughout Latin America. In the diplomatic domain, the reaction to Cuba departed completely from the suspicious attitude of the McCarthyism period, and was expressed in the Alliance for Progress programme, directed by the Organization of American States (OAS). As expounded in the famous Punta del Este Charter (OAS, 1961), signed by the United States and by the vast majority of the region's countries, the political tone of the new North American stance had a clear "social-democratic" orientation".

The scenario required ECLAC to reorient itself to include contributions of a sociological nature in its studies. It was prepared for this thanks to the privilege of having had José Medina Echavarría among its senior staff since the 1950s. The most complete expression of that author's theoretical work in the 1950s, among other things because of its influence on ECLAC, is contained in the volume *Aspectos sociales del desarrollo económico* (Medina Echavarría, 1973).¹⁶ In the 1960s, the author would disseminate the sociology of development in ECLAC, the most inspired moment of which is possibly represented by the work *Economic development in Latin America sociological considerations* (ECLAC, 1963, text 11).

Drawing on that inspiration, many official ECLAC texts of that time analyse the evolution of Latin American society; and in general, they were optimistic in those early years of the 1960s. This was evidenced by the official document presented at the Mar del Plata session (ECLAC, 1963a):

"The political leaders and social science experts of the zone had never been in such agreement on the general policy needed for sustained development. The meetings of regional organizations had established principles, often very detailed and coherent, to guide action (...), and many countries had increased their technical capacity to plan development. Agrarian reform, diversified industrialization, the reduction of external inequalities in the income distribution; the destination of a larger part of income to production investment; the control of inflation; expansion and reorientation of educational activities; measures aimed at allowing low-income, poor and marginalized groups to act as responsible citizens, producers and consumers (...),

¹⁶ With regard to the author, see the anthology compiled by Adolfo Gurrieri (1980).

were thenceforth accepted as essential elements of a coordinated national policy, by sectors of public opinion that previously had not considered them at all or had placed their hope in one or two of them at best" (p. 3).

Considering the 1960s as a whole, the text proved to be overly optimistic. What occurred in the region from the mid-1960s onwards was a growing political and ideological polarization, which in some countries reached the extreme of confrontation between right-wing dictatorships and revolutionary left-wing organizations.

Throughout that decade, ECLAC would maintain dialogue with moderate political positions, even those situated on the right of the political spectrum, and also with the world of international diplomacy. This covered several areas: the mobilization of the Alliance for Progress, the issue of regional integration and LAFTA, the creation of UNCTAD, and the expansion of technical assistance to the region's governments on indicative planning. The modernization of the Latin American techno-bureaucracies benefited greatly from the work done by ECLAC and ILPES in that period.

However, the ECLAC of the 1960s would essentially serve as a forum for discussing ideas that were critical of the ongoing development process. The Commission's mobilizing power attracted intellectuals to a debate that gravitated increasingly towards three points that defined the political- ideological divide: firstly, the view that industrialization had followed a course that failed to include the majority of the population in the fruits of modernity and technical progress; secondly, the interpretation that industrialization had not eliminated external vulnerability and dependency, but had only altered its nature; and thirdly, the idea that both of these processes obstructed development. Their main interlocutors would be found among the nationalist centre-left concerned for social reforms. Points of contact would thus tend to be more firmly established between its analysis and the theorizing of the left than with conservative analyses.

2. Reforms to invigorate the economy, dependency theory and the structural heterogeneity thesis

In ECLAC, the most important invitation to the new discussion agenda governed by real history was once again formulated by Prebisch. While his text *Towards a dynamic development policy for Latin America*, published in 1963 (text 12) restates his arguments on the difficulties faced by the periphery in growing and absorbing the labour force, it also focuses on a new argument: the need to change the social structure and redistribute income, particularly through agrarian reform. Otherwise, he claimed, it would be impossible to overcome the "dynamic insufficiency" of the region's economies.

In other words, the model explaining the incapacity to absorb the labour force that was set out in the 1950s texts —insufficient saving and the use of capital-intensive technologies— is now harnessed to analyse the social use of the potential surplus. The 1950s idea that consumption by the wealthy classes needed to be restricted in favour of investment and technical progress now reappears focused on the agrarian issue. In the countryside, large landowners would obstruct technical progress, such that peasant access to land, if duly supported by the State, would pave the way to higher levels of agricultural productivity and improve the use of the surplus. It would also help to keep people working the land, and thus avoid urban marginalization.

Note that the idea of "dynamic insufficiency", on which the text is based, is not identical to the "tendency to stagnation" thesis later to be expounded by Celso Furtado (1969), particularly in connection with Brazil. Nor does Prebisch's text contain the very common argument of that period, that agrarian reform helps industrialization by expanding the domestic market

for industrial goods. All of his emphasis is placed on the availability of potential saving for production investment purposes.

In addition to defending agrarian reform, Furtado's "tendency to stagnation" argument shares the idea of "technological dependency" with that of Prebisch on "dynamic insufficiency". The periphery would use the technology generated exogenously in the centre, under completely different resource endowment conditions; and its employment would mean the overuse of a scarce resource, capital, to the detriment of the abundant resource, labour. The difference is that Furtado will use this to derive a thesis of dynamic demand insufficiency.

Furtado starts from the idea that the bad distribution of income is probably responsible for directing the production structure towards a pattern of industrialization that makes little use of labour and aggravates the income distribution further. As industrialization proceeded towards more advanced stages, the new sectors were not only more capital intensive, but also required increasingly large scales. In other words, they used less and less labour and required an ever larger consumer market. The result would be simultaneous trends of falling interest rates, declining income shares for wages, and an insufficient consumer market for the new products, with the consequent loss of growth momentum and a tendency towards stagnation. Only agrarian reform and its consequent beneficial effects on employment and the income distribution would make it possible to expand the consumption base for industrial products that were less demanding in terms of capital and scale, and could induce a realignment of the specifics of industrial investments and dynamism.

The clear evidence that growth was reviving in Brazil and throughout Latin America in the second half of the 1960s, would then invalidate the stagnation argument. We shall return to this later.

In the history of ECLAC ideas of the 1960s, there are two analytical vectors that are less ephemeral than "stagnation" and, for that reason, more representative of the institution's intellectual output: the theses on "dependency" and the thesis of "structural heterogeneity".

Dependency theory has two facets, one predominantly involving political analysis, and the other eminently economic.

Stimulated by the ECLAC sociology of development propounded by José Medina Echavarría, in 1966-1967 Fernando Henrique Cardoso and Enzo Faletto came together in ECLAC/ILPES to write their *Dependency and development in Latin America* (1969, text 13). The book was written as a theoretical reaction to the theses, current in that period, that the region was developing a nationalist bourgeoisie potentially committed to a development pattern that justified an alliance with the working class and could gain political hegemony.

Their study relates the growth processes of the different countries to the behaviour of social classes and power structures. Its great innovation is methodological, stemming from the requirement that the relation in question be identified by considering the relations that exist between those domestic structures and economic and political power in the rest of the world. The authors argue that the history of underdevelopment status stems from the relation between peripheral and central societies. So it is necessary to analyse how underdeveloped economies related to the world market in the past, and how the domestic social groups that defined the international relations intrinsic to underdevelopment were formed.

The "economic" analysis of dependency had different political nuances. In its Marxian formulation it was originally associated with André Gunder Frank, an author who spent a period as a visiting scholar at ECLAC in the 1960s. The basic idea, which attracted followers among

Latin American intellectuals, was that the industrialization that occurred in Latin America was just a new form of secular exploitation that imperialism was imposing on the workers of the underdeveloped region in alliance with the local elite.

According to this view, the accumulation process was inseparable from international capitalist expansion and imperialism, and formed part of a process that only enriched the developed countries and the small dominant elite that represented them. The global capitalist system functions by forming and exploiting a set of satellites and sub-satellites, which are reproduced within each country, to form domestic exploitation subsystems linked to the world system (Frank, 1976).

The idea of “dependency” (trade, financial and technological), had been present in ECLAC since its inception, although the expression as such was not used. In the 1960s, there were significant differences in the way the concept of dependency was used, not only in the analytical function performed in its interpretation, but also in relation to its political-ideological meaning. In ECLAC, “peripheral status” was interpreted as a determinant of problems that needed to be overcome through economic and social policies that were well orchestrated at the national and international levels; in other words it did not mean a source of insuperable exploitation that would require a break with capitalism.

Among economists of the ECLAC school, the most important and politically most compelling analysis of dependency was that developed by Osvaldo Sunkel (1970, text 14). His central argument was based on the postulate that there was just one capitalist economy in the world, which was totally integrated in terms of technological and consumption patterns, above all through the global expansion of transnational firms. The problem of underdevelopment stemmed from the fact that while in the “centre” the majority of workers were integrated into the modern world, in the “periphery” this would occur only with a small fraction of the population. Worse still, the spread of that global model of accumulation, had divisive social effects, since it tended to marginalize even economic agents with the greatest productive potentials.

At the same time (and with many analytical coincidences with the dependency interpretations of the ECLAC type) Aníbal Pinto formulated his thesis of “structural heterogeneity” in the region. This was based on the finding that the fruits of technical progress tended to be concentrated, in terms of the distribution of income both between the classes and between sectors (strata) and between regions of a given country (Pinto, 1965). Later, he would finesse that analysis with the argument that the growth process in Latin America tended to reproduce and renew the old structural heterogeneity that had prevailed in the agrarian-export period (Pinto, 1970, text 15).

In other words, just as for the dependency theorists industrialization had not eliminated dependency but only changed it, for Aníbal Pinto industrialization was not eliminating structural heterogeneity, but only altering its format. Both interpretations of underdevelopment envisaged a process that showed signs of perpetuating itself despite economic growth.

The ECLAC diagnostics of “dynamic insufficiency”, “dependency” and “structural heterogeneity” proposed similar policy agendas, namely reforms within capitalism; in other words the idea that the pattern or style of economic development would have to be changed through a better distribution of income and far-reaching reforms —agrarian, capital, financial, taxation, educational, and technological. They also understood that to achieve all of that, a far-reaching political transformation was needed, that would be centred on the restoration of democracy in countries in which military dictatorships had taken power.

While the far left predicted revolution as the only way out,¹⁷ ECLAC fine-tuned its conceptual framework to advocate fairer “styles” of economic growth within the context of the current system. That would prove to be the central issue of the following decade.

3. Industrialization and industrial exports

The thematic work that was to gain currency in the 1970s and also has its origins in the 1960s involved redirecting industrialization to promote exports. Already in the early 1960s, Prebisch (1961) would emphatically recognize the distortions and inefficiencies of the industrialization process and of insufficient export orientation:

“Industrialization, ring-fenced by excessive protectionism and excessive tariffs on certain important agricultural products, had created a cost structure that made it extremely difficult to export manufactures to the rest of the world” (p. 198)

Contrary to what the critics say, from an early stage, the stimulus to export expansion through a reorientation of trade and industrial policies would form part of the policy programme recommended by ECLAC. The idea of reorienting industrial trade policies towards greater international engagement can already be seen in the ECLAC discourse of the 1960s, for example, in various editions of the annual *Economic Survey*.

True to the ECLAC tradition, the key motivation for reiterating the warning in the 1960s and 1970s arose from worries about external vulnerability. It is true that there was also some concern for the issue of “efficiency” in resource allocation, but the key problem at that time was the shortage of foreign exchange. We shall return to this point below.

VI. THE 1970S: ADVOCACY OF A “STYLE” OF GROWTH WITH SOCIAL HOMOGENEITY AND INTENSIFICATION OF INDUSTRIAL EXPORTS

1. The historical context

From the mid-1960s until the end of the global economic boom in 1973/1974, Latin America enjoyed rapid growth (averaging 6.7% per year), accompanied by an excellent export performance (a 7.1% annual expansion). It also enjoyed abundant international liquidity which contributed foreign exchange over and above export earnings and enabled the region to expand its imports by 13.5% per year on average, in support of the industrialization process.

The Latin American reaction to the global recession that followed the 1973 “oil crisis” was to borrow to maintain growth (accentuating its initial indebtedness) or, in some cases, borrowing to stabilize the economy. For that purpose, the available petrodollars were recycled on a massive basis for anyone who wanted to receive them. It is unnecessary to review that process here, since it has already been documented and analysed to excess in numerous texts.

¹⁷ Communist parties of Soviet orientation took the view that it was necessary to strengthen a “bourgeois democratic alliance”, between a supposedly nationalist bourgeoisie and the workers, to break with production relations (latifundism and imperialism) that would impede the progress of productive forces, in other words industrialization. Those who dissented from that position adopted the idea of the Marxian dependency theorists that an alliance of that type would be historically unviable, because the local bourgeoisie depended on and was associated with imperialism. From several analysts of the agrarian reality, they received the idea that the countryside was already behaving in a capitalist way, so there was no sense in the interpretation of having to overcome a supposedly “feudal” stage. The conclusion was that those who proposed a “bourgeois democratic” stage as a strategy were wrong, and that the correct strategy would be to move directly to socialism.

Considering the circumstances of the global economy, Latin American growth rates remained relatively high between 1974 and 1980 at an average of 5.1%.

Despite the widespread choice of borrowing, the countries of Latin America pursued very different strategies in that period. On the one hand, Brazil and Mexico, for example, continued the strategy of industrialization with export diversification, through protection and heavy State participation; in contrast, the Southern Cone countries (Argentina, Chile and Uruguay) abandoned that strategy and fully liberalized their foreign trade and finances to free movement of goods and services. This process meant an avalanche of imported consumer goods that had been made cheaper by the sharp exchange rate revaluation fuelled by the heavy borrowing.¹⁸

The novelty that the international crisis introduced to ECLAC thinking was to assign greater importance than previously to macroeconomic analyses and a stronger emphasis on analysis of the debt and requirements for diversifying exports. Even so, in terms of the content of the ideas, the 1970s form a relatively homogeneous whole in the history of ECLAC, since the central interest in medium- and long-term analyses was maintained, and with it, the discussion of “styles”.

However, in terms of the production and dissemination of ideas, the institution entered a new stage as from 1973/1974, in historical circumstances that detracted somewhat from its previous capacity to influence economic thinking in Latin America. That partly reflected a positive process —the fact that in many countries, State technocracy had been strengthened and excellent academic centres had been set up. Nonetheless, essentially other very important historical determinants operated. Fundamental changes occurred simultaneously in the political domain (the installation of dictatorships, particularly in the host country, Chile, which restricted the Commission’s power to convene regional intellectuals), in the local and global economic domain (global crisis and recession) and, related to this, in the sphere of the history of economic ideas.

In the opinion of Enrique Iglesias, ECLAC Executive Secretary between 1972 and 1985, this phase was a matter of “surviving” those circumstances.

In the political sphere, it is unnecessary to explain the difficulties arising from the interruption of Chilean democracy. Between 1973 and 1989, ECLAC headquarters in Chile lost what had hitherto been one of its chief assets, namely its power to convene Latin American intellectuals. Economists, sociologists, technocrats, and democratic and progressive politicians simply were now unable to circulate in Chile, or no longer wished to do so. Apart from the Chilean problem, ECLAC was facing overt antipathy from other dictatorships, particularly in neighbouring Argentina, which was ideologically opposed to ECLAC, not least in the foundations of the “extreme” economic liberalization model that it was applying, as also were Chile and Uruguay.

In the economic domain, the end of the global expansionary cycle meant the start of a completely new phase in the region’s history. The two novelties would be: firstly, growing macroeconomic instability, which would last for much longer than a decade; and secondly, and more permanently, the increasing presence of the financial sector at the heart of economic events.

Obviously, long-term analyses, which are an area of excellence of ECLAC, would be increasingly pushed back by short-term anxieties. Partial exceptions were Brazil, with the Second National Development Plan, and Mexico, with the oil boom, but only during the 1970s, because these countries became protagonists of the crisis in the 1980s. The historical and long-term approach would only resist as the central plank of ECLAC thought until that crisis, and would then be marginalized for almost a decade, until it recovered in the 1990s.

¹⁸ The initial ECLAC criticisms of that model arose as early as 1975 (ECLAC, 1975a). The unsustainability of medium- and long-term borrowing was pointed out, along with the illusions that exports would continue to expand as in earlier years and that interest rates would stay low forever.

The lack of political space and changes in the economy coincided with a third element. In the wake of the decline of Keynesianism, development theory gradually faded throughout the world¹⁹ and a new orthodoxy for analysing developing economies rapidly emerged. In that ideological context, the unreserved adoption of that orthodoxy by some of the Southern Cone countries had far from negligible effects.

2. The interpretation of growth “styles” and pro-export industrialization

The elements of ECLAC analysis that have accumulated in earlier decades were integrated in the 1970s through the idea of growth “styles” or “modalities”. The debate around “styles” took place in ECLAC, stimulated by four basic influences. Firstly, the region’s economic recovery during the 1965-1973 global boom led to a recognition that, while agrarian reform and income redistribution would form the basis for a socially more homogeneous and fairer growth, it was not the only viable growth style. Secondly, the United Nations was promoting an intensive international debate on those same issues. Thirdly, ECLAC thinkers formulated strong methodological criticisms of the way the debate was unfolding; and, fourthly, the international crisis of 1973/1974, and the subsequent surge in borrowing, strengthened the emphasis on the need to refocus the “modality” or “style” of industrialization so as to combine domestic market stimulus with the virtues of the industrial-goods-export orientation.

This new stage in ECLAC thought corresponds to a third phase of the interpretive cycle that began in 1949, both with respect to the sphere of “domestic” analysis and in terms of the analysis of the region in the international economy.

The “domestic domain”, in the first decade contained elements that made it possible to identify a permanent trend towards underemployment, and thus a tendency to perpetuate underdevelopment, even with industrialization. In the second decade, the argument was made that only with agrarian reform and income redistribution could the economy be invigorated in the medium and long terms. In the third decade, there was a recognition that different growth modalities were possible, although not always desirable.

In terms of international engagement, industrialization was considered the long-term solution to the problem of external vulnerability in the 1950s, which would nonetheless be one of the intrinsic characteristics of the peripheral industrialization process. Regional integration was proposed as an initial formula for easing the problem. In the 1960s, criticisms would be made of the distortions inherent in the industrialization process and of its anti-export bias, and the belief that export reorientation would have the twin role of allocating resources to the industrialization process more efficiently, while at the same time reducing external constraints. The international crisis and borrowing of the 1970s would strengthen that interpretation, particularly in terms of combating external constraints.

As for the chances of that new modality of industrialization being successful, ECLAC work maintained a somewhat optimistic “tone”, based on the fact that some of the region’s countries, such as Brazil and Colombia, were adopting the strategy successfully. Nonetheless, in terms of the relation between growth styles and economic-social formation, the stage evolved towards a deep “perplexity” among ECLAC intellectuals, who were unable to conceal their worry as to the feasibility of reorienting development towards greater social homogeneity.²⁰

¹⁹ On this subject, see the articles by Hirschman (1980) and Streeten (1979), for example.

²⁰ Following spells as the head of UNCTAD in Geneva and ILPES in Santiago, in 1970 Prebisch would continue to maintain a moderately optimistic tone in his book *Transformación y Desarrollo, la gran tarea* (1970), although this did not prevent him from highlighting the gigantic scale and complexity of the “task” at hand. This was a two-volume work, the first of which is written by him, in which he restates his previous theses and updates them with accumulated historical evidence; the second is a compilation inspired by his ideas, which would mobilize a body of ECLAC thinkers at the time. From then

The diagnostics being made were enhanced by the analysis of the political structures and arecognition that the actual transformation processes under way in Latin America were socially unjust. Nonetheless, there was a clear perception of the difficulties of reversing the course that history had taken. The spread of dictatorial regimes throughout the region corroborated the climate of despair, and the Commission's intellectual honour did not admit of illusions: the end of the dictatorships would be a necessary but insufficient step. Given the historical roots of ownership and power structures, and their consequences for production structures and the distribution of income, the political-social struggle that was foreseen for the phase of recovery of democracy would be an arduous task.

In terms of analytical capacity, that perplexity could only have positive effects on the Commission's intellectual contribution, because it had the enhancing role of disarming the analyses of political-ideological conveniences of the moment, and returning them to the sphere in which they had most to contribute, namely the diagnostic of the history of peripheral capitalism as it occurred.²¹

(a) *Styles*. One of the most categorical recognitions of the fact that the Latin American economies could be dynamic despite containing grave social injustices was made in 1971, in the article *Beyond stagnation: a discussion on the nature of recent development in Brazil*, by Maria da Conceição Tavares and José Serra (text 16). It was written at ECLAC headquarters under the direct influence of their mentor, Aníbal Pinto, who encouraged acceptance of that idea in his influential thesis of structural heterogeneity. If industrialization had not abolished the differences, but, on the contrary, had only changed their format and expanded their visibility, what would prevent future economic growth from continuing to reinforce the ongoing historical process? Furthermore, was the concentration of income proving dysfunctional to vigorous growth?

The work of Tavares and Serra (1973) focused on the Brazilian experience (which explains why it starts with a critique of Furtado's interpretation based on stagnation); but the general conclusion can be considered one of the foundations stones of the new ECLAC line of analysis on "styles":

"The capitalist process in Brazil, in particular, although it was developing in an increasingly unequal way, incorporating and excluding population sectors and economic strata, deepening a series of differences related to consumption and productivity, had nonetheless succeeded in establishing a scheme that enabled it to self-generate sources of stimulus and expansion, that gave it dynamism. It could thus be said that while Brazilian capitalism developed satisfactorily, the nation, the majority of the population, remained in conditions of great economic deprivation; and that was largely due to the dynamism of the system, or even the type of dynamism that drove it" (p.158).

until the early 1980s, Prebisch's perception of structural phenomena in the Latin American periphery would evolve towards serious scepticism of development possibilities without radical changes in the prevailing ownership regime. In his book on the crisis of peripheral capitalism *Capitalismo periférico. Crisis y Transformación* (1981), he proposes a synthesis between liberalism and socialism and argues for the autonomous management of large firms by workers within a market regime, but in which the State regulates conditions relating to the social use of the surplus.

²¹ In truth, that positioning was conscious, according to ECLAC staffers who lived through the intellectual climate of the 1970s. In Latin America, the 1970s had been a time of great volunteerism, in which bold policy decisions were taken on the basis of precipitously stated theses, which were insufficiently formulated and tested. The installation of military dictatorships poured cold water on many simplistic aspirations for change, and forced a deeper analysis of the historical complexities of the region's countries.

According to the authors, the concentration of income would be functional to Brazilian growth and would invigorate it, since it realigned the structure of demand towards the existing production structure, expanding consumption among middle and high income groups, and raising the surplus to finance accumulation. This growth style was viewed as “malign”—the expression was first used by I. Sachs in a lecture given at ECLAC in 1968— or “perverse”, which is how the authors referred to the supposed “Brazilian miracle” proclaimed by the dictatorship of the time, and based on the rapid growth rates of that period.

Another of the initial texts in the discussion of styles was produced by a group headed by the Argentine Oscar Varsavsky, at the Centre for Development Studies (CENDES, 1969) in Venezuela. The work in question draws on a mathematical model (using statistics from Venezuela) to compare the effects of the different development “styles” on development problems, in other words the effects on those problems of the different ways of changing the existing structure of output and demand, considering the behaviour of the other economic variables related to each style. The formal rigour of the mathematical model applied by Varsavsky enthused a number of ECLAC staff members in the early 1970s. That was a time when the argument on growth styles or modalities was being harnessed to deepen the diagnostic of the problems that were arising with the predominant development modalities, and identify “viable” alternatives within the framework of the capitalist system.

Among studies that interpret the concept of development “styles”, the main reference from the 1970s was possibly that of Aníbal Pinto’s *Styles of development in Latin America* (1976, text 17). The author begins his article with a definition suggested by Graciarena, according to which a style is the “specific and dynamic modality adopted by a system within a particular context and at a particular moment in its history” (Graciarena 1976, p. 102). He then supplements this with the idea that “from a strictly economic angle, the term ‘style of development’ may be taken to be the way in which human 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” (Graciarena, 1976, p. 104).

On that basis, he develops a whole argument, supported by Latin American statistics, on the relation between the three “questions”, particularly the interaction between the first and the last —“what?” and “for whom?”. In Pinto’s view, the dynamic of the style had to be sought in interactions between the production structure and the income distribution. The author laments the “circle of cumulative causality” in the prevailing style, in which the bias in the income distribution strengthens or entrenches the existing production structure, and vice versa. Lastly, he performs a series of exercises on the desirable redistribution of income and reorientation of the production structure.

The climate of the debates in the United Nations was another source of stimulus for analysing styles. The Declaration on Social Progress and Development, approved in 1969 by the United Nations General Assembly, was prepared so as to highlight social development as the grand objective of humanity, and to establish a universal philosophical consensus on the social norms of development. Despite that merit, it also had the disadvantage of separating economic development from social progress. The attempt to make up for that failing then appeared in a 1970 document, also approved by the United Nations General Assembly, on the international development strategy, which proposed a “unified approach” on economic and social development.²² For many years, the topic of integrated development held centre stage in the different United Nations agencies, and was the subject of hundreds of articles, documents, seminars and congresses.

²² See also *Report on a unified approach to development analysis and planning* (United Nations, 1973).

The Commission's active participation in that intellectual output had two focuses. The first was "official", as an agency of the United Nations. As a continuation of a line of work that took off vigorously in the early 1960s, the 1970s saw a proliferation of studies on employment and income distribution.²³ In addition, ECLAC would respond officially to the mandate conferred by the General Assembly to evaluate the integrated development strategy in Latin American conditions. The most important document of that type was *The Quito Appraisal* (ECLAC, 1975b, text 18), coordinated by Manuel Balboa and Marshall Wolfe. The work defines a series of criteria for "integrated development" or "human development", which include, much to the delight of the reformist agenda of the 1960s, the need to change the land ownership regime and the control and sovereign use of natural resources. A flexible stance was adopted on strategies for change, arguing that these needed to be adapted to the different structural arrangements that exist in the region, and highlighting the fact that the model or style adopted should be guided by State planning and necessarily involve participation by all strata of the population.

The second, analytically deeper, approach was that produced by ECLAC thinkers when they were not involved in preparing official texts. Several moments of great inspiration by the institution's economists have already been mentioned. But the discussion on "styles" was necessarily interdisciplinary and kept alive the possibility that the sociologists' contribution, which began in the 1960s, could continue in full. Thus, it is not surprising that, apart from the aforementioned article by Aníbal Pinto, the inaugural edition of the CEPAL Review, in the first half of 1976, contained two essays that are essential reading for understanding the approach to "styles" at that time.

The author of one of these was the sociologist Jorge Graciarena (1976, text 19). Its central concerns are to clarify the confused conceptual theoretical treatment that the topic of styles was receiving, based on the "unified approach"; and to provide an integrated definition of the concept that was capable of methodologically indicating a multidisciplinary historical orientation.

The complicated nature of the issues on the agenda meant going way beyond mere identification of the different dimensions of each historical arrangement in the different countries —political, economic, social, cultural, and so forth— and set criteria for integrating all of those dimensions into a consistent analysis. As a task that diverted the analyst from optimistic messages, it was necessary to analytically recognize the existence of structures of power and domination and their remote relations with the viability of socially just strategies, and to incorporate the notion of "conflicts" as a central factor in the generation of existing styles and desirable ones.

The other text was written by the sociologist Marshall Wolfe (1976, text 20), at that time director of the Commission's Social Development Division. The article *Approaches to development: who is approaching what?* is a refined conceptual outline of the historical difficulties of making viable socially desirable strategies such as those defined in many international statements of that period.

It brings together the central elements of the "international consensus" on development based on values of freedom and equal rights: a rapid capital accumulation process, industrialization, agricultural modernization, inclusion of all in modern consumption, development of entrepreneurial capacity, technological and scientific dissemination, universal education, provision of services and social security, growing participation in world trade, and an increase in financial flows to developing countries.

²³ On these issues, see the following for example: in the 1960s ECLAC (1963b and 1965), and in the 1970s ECLAC (1970 and 1975a).

It then outlines the characteristics of the global and Latin American economic order, to reveal the huge difficulties involved in achieving those objectives. Lastly, it argues that there are three current criteria for dealing with development problems: “utopian-normative”, “technocratic-rationalistic” and “socio-political”, with the basic aim of formulating methodological warnings. According to the author, the first two can “escape from the blind alley of verbalism and ritual action only to the extent that their proponents relate them to sociopolitical approaches that identify certain agents and propose strategies consonant with the values, interests, and capabilities of these agents” (Wolfe, 1976, p. 162). Moreover, a consideration of the sociopolitical criterion shows that there is “no *a priori* reason to assume that the agents ‘needed’ for an acceptable and viable style of development will emerge in any given society”.

Despite all the warnings and the pessimism prevailing among economists and sociologists for the real chances of social change in Latin American societies, the discussion centred on the multidisciplinary notion of “styles” were analytically stimulating. ECLAC maintained its successful tradition of historical-structuralist analysis, now enhanced with the virtues of multidisciplinary diagnostics of specific experiences in the Latin American countries. Unfortunately, that promising orientation became increasingly fragile, largely owing to the debt crisis which would understandably crowd out discussion of long-term strategies throughout the region.

(b) *New modality of industrialization: combining the domestic market and exports.* It should be remembered that the Commission’s stance on distortions in the industrialization process and on the advisability of re-targeting it on export diversification, originated in the 1960s.

In the Economic Surveys of that decade, ECLAC continually drew attention to problems of allocative efficiency in Latin American economic systems, stemming from errors in the conduct of trade and industrial policy. Criticisms are made of the excessive protection given to projects of unviable scale and insufficient specialization, low productivity, high costs, and capital squandering.

Alongside the concern for efficient allocation, there was the classical worry about external constraints on growth, namely the foreign exchange shortage.²⁴ The 1971 *Economic Survey of Latin America* analysed prospects for the 1970s and identified two ways to deal with the problem of external dependency or vulnerability. One of these was the expansion of industrial exports and the other was a warning on the risks of precarious, costly and uncertain financing and borrowing (p. 8).

In the 1975 Economic Survey, ECLAC recognized the 1973/1974 crisis as the moment when the region’s economies began a new phase of their long trajectory of difficulties in the external sector. The “internationalization” of the economies —a higher import coefficient and an increase in their external liabilities— compounded by difficulties in exporting and borrowing adequately, suggested a long period of external barriers to growth. Throughout the second half of the 1970s, the diagnostic on the trends converged with ECLAC policy proposals to strengthen industrialization and exports as a mechanism for combating the difficulties of international engagement, in continuous warnings on the risks of generalized borrowing in the region and those associated with the full-blown trade and financial liberalization that was occurring in the Southern Cone countries.

It was argued that there was no conflict between making the most of the domestic market and export liberalization: on the contrary, they would be complementary processes in a good industrialization strategy. An exercise coordinated by Manuel Balboa produced medium- and long-term projections that warned of the remote chance of sustaining economic growth owing to the burden of debt commitments and the other prospects of international trade, with which

²⁴ Norberto González (1972), ECLAC Executive Secretary in the 1980s, made a study in the early 1970s that contains medium- and long-term projections on the saving and foreign exchange gap.

ECLAC (1978) refuted the ideological euphoria created artificially in the full-blown liberationist models of the Southern Cone.

VII. THE 1980S: ADVOCACY OF “ADJUSTMENT WITH GROWTH”

1. The historical context

As is widely known, the first three years of the 1980s saw a succession of foreign exchange crises in much of Latin America. With very rare exceptions, in the fragile macroeconomic circumstances prevailing in most of the region's economies the raising of United States interest rates would trigger a process that forced them to implement deep recessionary adjustments, as capital inflows dried up. Strengthening the option of recessionary adjustment, “conditionality” clauses proliferated in the loan negotiations held with the IMF and the World Bank.

There is an abundant literature discussing the numbers of the crisis and the history of the adjustment, so extensive comment here is unnecessary. Suffice it to note that the average annual rate of growth in 1981-1990 was 1.2%, which meant a fall in the region's per capita income. The recessionary adjustment would generate a large volume of foreign exchange to pay debt service, while exports expanded at 7% per year and imports virtually stagnated. The inflationary shocks caused by the exchange rate devaluation pushed a number of economies into hyperinflation; and, in conjunction with the recession, this had devastating effects on public sector finances, which were borrowed in dollars, partly owing to the “socialization” of the private sector's external debt.

The international ideological environment was increasingly dominated by liberal orthodoxy. The path of the ideological struggle is well known, and there is not space in this article to reproduce it. It culminates in the recipe dubbed by Williamson as the “Washington Consensus”, owing to its sponsorship by the IMF, the World Bank, and the U.S. State Department.

The adjustment promoted by the IMF and the creditors of the debt following the Mexican crisis was accompanied by the argument that in a couple of years time Latin America would be overcoming its difficulties and returning to growth. The actions of Executive Secretary Enrique Iglesias during the Commission's session in Lima symbolizes the Commission's stance in that period. Iglesias refuted that argument with projections that were both sombre and correct, forecasting a “lost decade” for the region — an expression that ECLAC would later coin to describe the period.

2. Expansionary adjustment and trials for the post-adjustment phase

In the second half of the 1970s the prevailing climate was one of potential crisis —and ECLAC warnings on the dangers of excessive borrowing— but several countries continued to grow, so the Commission's interest in development issues remained alive. This was the period when orthodoxy, which was to impose its hegemony in the 1980s, was gathering strength. This motivated an attitude of reaffirmation and refinement of ECLAC development and reformist thinking, which appeared as elements of “resistance” in an international ideological struggle, the shape of which could be clearly discerned.

The 1980s crisis finally pushed development-oriented output into the background, and the main intellectual effort moved to the historically imposed sphere of opposition to the

modality of adjustment required by the creditor banks and the IMF. As is obvious, in conditions of unviable growth, the space for and interest in long-term discussions were limited. Priority was given to immediate issues relating to the debt, adjustment, and stabilization.

Perhaps the most representative text of that phase was *Adjustment policies and renegotiation of the external debt in Latin America* (ECLAC 1984, text 21). This study contains a contribution on adjustment policies and others on stabilization policies. Both reveal the proximity that existed between the position of ECLAC and the cream of Latin American heterodoxy that was debating these issues at the time.

In relation to the adjustment policies, the text proposed replacing the recessionary balance-of-payments adjustment with an expansionary one. The only satisfactory solution from the social point of view would be that the external deficit was resolved in a context of economic growth that stimulated investments in tradable goods sectors, particularly the growth and diversification of exports.

For that solution to be feasible, a debt renegotiation agreement was required between debtors and bankers that would alleviate the external strangulation and give the countries time to react positively to the relative price changes resulting from the exchange rate devaluation. On a complementary basis, a less protectionist attitude by the central countries would be relevant for the adjustment. Lastly, the adjustment would have to include more flexible and pragmatic use of economic policy instruments, so that the relatively rigid production structures prevailing in Latin American countries could include the necessary reallocation of resources towards exports.

With regard to the stabilization policies, the text echoes the Brazilian and Argentine authors who in that precise period were conceptualizing the thesis of “inertial” inflation ahead of the counter-inflationary shock policies implemented shortly afterwards. As is well known, the inertialist interpretation belongs to the structuralist tradition, because it places the blame for inflation at least partly on the distributive struggle — “propagation mechanisms”, according to the expressions used originally by Noyola Vásquez and later by Sunkel. The concept of “inertia” is not actually mentioned, but the argument advocates the implementation of income policies that make it possible to address the downward rigidity of wages and basic prices, thus avoiding prolonged and socially harsh contractionary monetary and fiscal policies.

It also defends shock treatment in circumstances of very high inflation and low credibility, which are incompatible with the fundamental tenet of gradualism, namely the desire for time to favourably accommodate agents’ expectations.

The emphasis on the adjustment would shift the historical perspective to a backseat in ECLAC output of the 1980s, but would not discard it. In 1985, for example, an interesting innovation was published on “styles”, which added a historical integration between economic evolution and political-social evolution to the ECLAC tradition that began in the 1960s. That document (ECLAC, 1985, text 22) highlights, in terms of economic evolution, an interpretation of recent history that until then had not received sufficient critical analysis, namely the growing subordination of the production process to the interests of the financial system:

“As these financial changes became more extreme the productive system lost an appreciable part of its economic and political power. A new pivot for the organization of the national economies was introduced. Taken to extremes, it might be said that the mechanisms of control of the national economy tended to be reduced since the composition of certain norms for the functioning of the international economic system restricted the sphere and capacity of the local groups for autonomous decision.

The dominant groups set themselves to reorganize the domestic system so as to facilitate the introduction of a new mode of dependence. To ensure their participation in power, as already said, they found it necessary on occasion to change their centre of activity from the productive system to the financial system.

As growth declined and demand was concentrated in the high-income groups it became impossible to satisfy the demands of the masses. The policy of wage restraint, which was frequently applied, often led to repressive practices against the union organizations.” (p. 1).

As from the mid-1980s, articles began to appear heralding the renewal of the ECLAC debate on the long-term growth process, which would occur in the 1990s, starting with the document *Changing productive patterns with social equity: the prime task of Latin American and Caribbean development in the 1990s* (ECLAC, 1990). The most important were the two texts by Fernando Fajnzylber: *La industrialización trunca de América Latina* (1983); and *Industrialization in Latin America: from the “blackbox” to the “empty box”* (1990, text 23), the initial version of which dates from 1987).²⁵

The first of these texts makes an exhaustive analysis of Latin America’s “truncated” industrialization process, identifying shortcomings, failures and distortions, and proposing a “new industrialization”. This would be based on the concept of efficiency, understood as the obtaining of ‘growth and creativity’, founded on the creation of an endogenous core of technical progress, which is seen as a necessary condition for penetrating and maintaining a position in the international market (p. 358).

The “empty box” complemented the “truncated industrialization” by formulating the conceptual bases for “changing productive structures with social equity”. This study compares the patterns of growth in Latin American countries with those seen in both developed and other developing economies. The scheme that structures the comparison is ingenious. Fajnzylber takes the two central objectives of social economic development, namely growth and income distribution, and shows on the basis of their behaviour between 1970 and 1984, that the Latin American countries were divided into three groups: those that had grown rapidly but had a concentrated income distribution; those that had a relatively well-distributed income but grew little; and those that were in the worst of both worlds, namely they had a concentrated income and were not growing. Unlike countries such as the Republic of Korea and Spain, for example, no Latin American country was in the ideal group, that of countries that are growing and at the same time promoting a minimum level of distributive justice. In the table in which the four groups are distributed —which is a matrix with growth and distribution axes— in Latin America the group displaying growth with good income distribution is vacant, it is the “empty box”.

These two texts —especially the second one— are the key pieces of the transition of ECLAC production to the stage that would begin in the 1990s. On the one hand, they contain a good number of elements that are dear to the Prebischian ECLAC tradition. Secondly they introduced the conceptualizations that would serve as a reference for the stage organized around the idea of “changing productive patterns with social equity”.

In addition to their historical perspective, the texts bear the ECLAC stamp in several of their key dimensions: technical progress is the focus of the analysis, since it is the path through which the region’s poverty and external vulnerability can be overcome. The agrarian structure conditions the income distribution which, in turn, defines the consumption pattern; this then conditions the capacity to save and invest. Thus, according to the text, greater equity

²⁵ With the suggestive title *Development from the inside — a neo-structuralist approach for Latin America*, in 1991 Osvaldo Sunkel published a compilation of texts he had commissioned from various authors in the late 1980s and early 1990s, which represented a structuralist renewal effort parallel to that of Fajnzylber.

corresponds to more austere patterns that are better able to boost the economy; and greater austerity can have a favourable effect on the capital-output ratio, and on the intensity of the use of foreign exchange —although on this point the author believes that further research is needed to verify the hypothesis empirically.

The main conceptual innovation in the texts is the space they open up for reconsidering the growth strategy. They recognize the shortcomings of the industrialization model of the past, which was seen as unreceptive to technical progress, and frequently paralysed by the rent-seeking attitudes of the local business classes. The new strategy would help Latin America to enter the “empty box” through the “black box of technical progress”. In the ECLAC texts of the 1990s, inspired in Fajnzylber, the strategy would include a trade liberalization policy that is not previously found in ECLAC. The basic aim was to avoid technological isolation in the era of production globalization and electronic and biotechnological revolution, and to boost technological catch-up through an expansion strategy that involved increasing the export coefficient. The latter would be based on continuously adding intellectual value to exports, through the reprocessing of commodity exports and industrial market niches.

Several issues would remain pending, of which two were highlighted. Firstly, there was a need to specify the real processes needed to implement the strategies of international engagement through technical progress. Among other shortcomings, insufficient distinction was made in the strategies between countries that displayed potential capacity to expand through exports and those whose larger domestic market and higher level of industrialization advocated continued pursuit of growth strategies based on increasing exports as a result of economic growth. Secondly, the relation between technical progress, employment and income distribution received insufficient treatment, in contrast to the huge theoretical challenge posed by underemployment and technological unemployment for immediately linking productivity growth to equity improvements.

The great virtues of the volumes in question included a revival of discourse on long-term issues, however, opening up space for ECLAC to take a renewed stance in the debate on technical production and income distribution. It would also inaugurate a whole new discussion agenda, on how the State intervention strategy should be redefined in the new regulatory frameworks, which, regardless of the Commission’s wishes, were starting to be introduced in Latin America. Once again, ECLAC would reorganize its thinking in line with historical events. The title of the organizing message would be “changing production patterns with social equity”; and the new approach would be suggestively titled “neo-structuralism”.

VIII. BY WAY OF CONCLUSION: THE 1990S AND THE AGENDA OF “CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY”

1. The historical context

The events of the 1990s are fresh in the reader’s memory and do not require further description. As is well known, 1985-1990 was a period of increasing relief for the two Latin American countries that had faced the greatest crisis at the start of the decade, Chile and Mexico; but the vast majority of the region’s countries would only exit the crisis following the debt renegotiation under the Brady Plan in 1989/1990 and, above all, with the new international financing context that followed the radical reduction in interest rates as from 1991. In the 1990s the region’s countries again received large foreign capital inflows, radically changing the previous external strangulation.

In the economic performance and policy domain, there were two more or less generalized processes in the recent period. First, there was a moderate economic recovery accompanied by significant price stabilization. GDP grew by 3.5% on average between 1990 and 1997, but the growth process left a lot to be desired in terms of the recovery of investment rates, particularly in current terms. Stabilization was almost always favourably accompanied by control of the fiscal deficit and caution in managing credit; and it was nearly always adversely accompanied by a widening of the balance-of-payments current account deficit, largely as a result of the generalized appreciation of the exchange rate. The latter reflected pressure from abundant inflows of foreign financing, used by most countries of the region as a key element in controlling inflation —and strengthened by the substantial inflow of foreign direct capital, partly targeting privatization. With this, the problem of the region's external vulnerability would still threaten to destabilize the macroeconomy, as it always had. The Mexican and Argentine crises of 1994-1995 confirmed concerns about the problem, and the Asian crisis of 1997-1998, strengthened them.

There has also been a rapid process of reforms, which include trade and financial liberalization, privatization, and greater labour market flexibility. Although the effects of those reforms on the economy's performance are being gradually evaluated, they form a new model of the behaviour of production agents and the relation between them and the State.

The implementation of the reforms engenders both enthusiasm and apprehension, which are expressed in a heated and often polarized ideological debate. In the 1990s, ECLAC skillfully positioned itself between the two extremes. It did not oppose the tide of reforms; on the contrary, in theory it tended to support them; but it made its appreciation conditional on the existence of a "reformist strategy" that could maximize its benefits and minimize its deficiencies in the medium and long term.

ECLAC "neo-structuralism" regains the development analysis and policy agenda, by adapting it to the new era of openness and globalization. It takes the view that many countries in the past were unduly complacent over inflation, and that the new era requires changes in the way the State intervenes in the economy, in an attempt to improve efficiency. These are times of "compromise" between admitting the advisability of expanding market functions while defending the practice of more selective government intervention. The "compromise" allows analysis and policy proposals to be targeted on the issues prioritized by ECLAC, namely technical progress and the income distribution, and opening up dialogue to the right and left of the international theoretical and ideological spectrum.

2. Technical progress with distributive improvements, and the hazards of financial globalization

The 1990s began with a proposal by ECLAC for changing production patterns with social equity, as early as the April 1990 session (ECLAC, 1990, text 24) of which Fernando Fajnzylber was the lead author. Gert Rosenthal, Executive Secretary between 1988 and 1997, welcomed and promoted Fajnzylber's proposal that ECLAC should adopt a stance on the reform process, because everything seemed to indicate that this would propagate throughout the region. He proposed a message regarding a new form of State action, different from what had prevailed in the past, but not for that reason unable to significantly influence the future of the region's countries.

The inaugural document of the session founded the ECLAC strategy on attaining greater "authentic" international competitiveness, based on the deliberate and systematic incorporation of technical progress into the production process.²⁶ It highlights the

²⁶ In ECLAC usage, "authentic competitiveness" is contrasted with "spurious competitiveness" — an expression coined by Fajnzylber to denote the capacity to compete on the basis of exchange-rate devaluation and low wages, and by abusing and depleting natural resources.

systemic nature of competitiveness, which includes an entire network of linkages between production agents and the physical and educational infrastructure. It stresses the formation of human resources as a key way to achieve changing production patterns in the long run, together with active technological policies that allow for technological upgrading. Industry remains the hub of production change, but its articulations with primary and service activity are highlighted. It also draws attention to the importance of providing a healthy macroeconomic environment.

It proposes to change the style of State intervention —not necessarily increasing or reducing the role of the State, but rather enhancing its positive impact on the efficiency and efficacy of the economic system as a whole (ECLAC, 1990, p. 78). It also proposes greater openness of the economy, on a gradual and selective basis, as a way to introduce technical progress and increase productivity. The proposal contains important suggestions. Openness should allow for a simultaneous expansion of imports and exports, which means graduating openness on the basis of the availability of foreign exchange and harmonizing foreign exchange policy with tariff-protection and export-promotion policies, to create a neutrality of incentives between production for the domestic market and for export.

Without doubt the most difficult dimensions of the analysis of the thesis of changing production patterns with social equity are the relations between growth, employment and equity —an issue that remains a permanent challenge for ECLAC. The most detailed incursion into the topic thus far can be found in the document *Social equity and changing production patterns: an integrated approach* (ECLAC, 1992). This seeks to identify complementarities between growth with a large technical progress component and equity. However, in the 1990s, high levels of underemployment, together with evidence of the perverse effects of technical progress on the volume of formal employment and on wage inequalities, are elements that generate genuine fears and perplexities.

These are widely expressed by ECLAC itself in the 1990s in several documents. Since 1992, the institution has been tracking the region's social indicators, which it disseminates through the *Social Panorama* series, a publication that provides a wealth of empirical data on the trend of the problems faced by the region. The document presented at the 1996 session, *Strengthening development: the interplay of macro- and microeconomics* (ECLAC, 1996), fully recognizes the need for a much faster pace of growth, if the goal of equity through a simultaneous increase in productivity and wages is to be achieved.

Otherwise it becomes difficult to move towards reducing the “equity gap” —a suggestive expression used as the title of one of the most recent documents (ECLAC, 1997a, text 26). That study makes a comprehensive and scrupulously detailed survey of the trend of the Latin American social panorama in terms of poverty, employment and social integration; and it describes and evaluates the trend of social policies.

In the domain of those policies, since the early 1990s special attention has been given to education. The document *Education and knowledge* (ECLAC/UNESCO, 1992, text 25), which was coordinated by Fajnzylber supported by a team of specialists from ECLAC and UNESCO, is subtitled “basic pillars of changing production patterns with social equity”. This is an appropriate introduction to the central message: “Reform of the system of production and dissemination of knowledge is [...] a crucial instrument for tackling both the internal challenge, which is that of building citizenship, and the external challenge, namely competitiveness” (p. 17).²⁷

²⁷ The many other documents produced during the 1990s on the social issue include, for example, *Population, social equity and changing production patterns*, which links the demographic dynamic to the topic of changing production patterns with equity (ECLAC, 1993a), and the third part of *The fiscal covenant* (ECLAC, 1998a).

There is no space here, nor is it necessary, to cover all of the documents published in the tone of changing production patterns with social equity. To finalize this text, suffice it to mention two of them because of their originality. The first is *Open regionalism in Latin America and the Caribbean: economic integration as a contribution to changing production patterns* coordinated by Gert Rosenthal (ECLAC, 1994a, text 27). Its main innovation is the way it addresses the issue of the intense regional integration process currently unfolding in Latin America. The text positions itself on this issue by highlighting the virtues of simultaneity between the liberalization of Latin America's trade with the rest of the world and the intensification of intra-regional trade through the current integration schemes.

The other is the third part of *Policies to improve linkages with the global economy* (ECLAC, 1995a, text 28), which stands out in the intellectual output of the 1990s for its prescient vision of the processes that led to the Mexican crisis of 1994 and the Asian crisis of 1998. At the time of its publication, the document was confronted by a liberalizing orthodoxy that maintained relative hegemony even after the Mexican disaster. The trauma of the Asian crisis finally broke that hegemony and brought specialized international opinion closer to the recommendations that ECLAC had been making since then.

The study does more than simply issue warnings about capital volatility. In keeping with the ECLAC tradition, it draws attention to the potential perverse effects of capital inflows that are not matched by the corresponding increase in production investment and competitiveness to export. In particular, it stresses the danger of using capital inflows as a tool for stabilizing prices, when they fuel exchange rate appreciations that are incompatible with keeping the trade account in balance, which is necessary for medium- and long-term equilibrium in the external accounts. It also warns of the need to implement prudential bank regulation policies, particularly in stages of financial liberalization.

3. Final comments

In conclusion, two comments on recent ECLAC output can be made.

Firstly, the considerations of the 1990s still retain much of their original relevance. In the 1990s, the issues of technical progress and the income distribution under Latin American conditions were revived as central pillars of ECLAC thought, following the interregnum of the 1980s crisis. The analysis thus regains its focus on the trends of production and distribution patterns, in an updated version of the 1949-1980 research programme.

The aim now is to understand the demands imposed by the new model of interaction with the world economy, in terms of modernizing the worn-out production apparatus and restructuring the inadequate specialization of the region's economies, with a view to constructing "systemic competitiveness". While the context is new, the structuralist worries about external vulnerability remain valid, including financial vulnerability in particular.

ECLAC discourse also includes a diagnostic of solidarity or the conflict that the new model of international positioning has in its economic and social relations. In principle, relations between technical progress and production restructuring, on the one hand, and employment and the income distribution on the other, form the same research agenda as that of 50 years earlier. The context is new, but it reappears in the analyses of the traditional structuralist concerns about underemployment and the inadequacy of sustainable growth. Nonetheless, it should be remembered that the intention expressed in the proposal of changing production patterns with social equity has not yet elicited sufficient progress in ECLAC thought on the question of equity.

Secondly, there is an interesting historical analogy between what was happening at the time of the initial ECLAC studies and what is occurring today. ECLAC staffers of the 1950s studied the economic and social transformations that were occurring in the early stages of the change in the region's pattern of accumulation —from the commodity export model to the industrial urban model. This generated a programme of policies, including direct State intervention, to correct the structural problems of an underdeveloped "periphery" which the market would be unable to achieve spontaneously.

The ECLAC research programme of the 1990s is focused on the transformations caused by another change in the region's accumulation model, namely the reorientation of regulatory frameworks through market liberalization and reform of the State, particularly through privatizations. This program starts by recognizing that the set of liberalizing reforms could have a positive effect on the growth process, provided they were well directed. However, current ECLAC research shows that a set of public policies to support development is still justified in Latin America, based on the specifics of production structures, the organization of markets and, no less importantly, the make-up of societies in the region's countries

In that public policy domain, there is still much scope for ECLAC to enhance its contributions. The discussion agenda followed since the publication of *Changing production patterns with social equity* in 1990, had an essentially "normative" orientation, and greater knowledge is needed of the transformation processes that are under way to adequately support those policies. To some extent, the orientation adopted represented a limited use of the Commission's chief intellectual asset, namely the structuralist historical method. The laboratory of innovative experiences which Latin America became following the widespread reforms of the 1990s, together with the new global scenario, offers fertile ground for research using that methodological approach. ECLAC is better prepared than any other institution to identify and analyse the complexities of the Latin American economies and societies at this change of millennium. The historical opportunity must be seized once again.

BIBLIOGRAPHY

Ahumada, Jorge (1986), *Obras escogidas*, Caracas, Banco Central de Venezuela.

Assael, H. (1984), "El pensamiento de la CEPAL: un intento de evaluar algunas críticas a sus ideas principales", *El trimestre económico*, vol. 51(3), N° 203, México, D.F., Fondo de Cultura Económica, julio-septiembre.

Cardoso, F.H. (1977), "La originalidad de la copia: la CEPAL y la idea de desarrollo", *Revista de la CEPAL*, N° 4, Santiago de Chile, Comisión Económica para América Latina (CEPAL), segundo semestre. Publicación de las Naciones Unidas, N° de venta: S.77.II.G.6.

Cardoso, F.H. y Enzo Faletto (1969), *Dependencia y desarrollo en América Latina*, México, D.F., Siglo Veintiuno Editores.

Castro, A.B. y C. Lessa (1967), *Introdução à economia: uma abordagem estruturalista*, Rio de Janeiro, Forense.

CENDES (Centro de Estudios del Desarrollo) (1969), "Estilos de desarrollo", *El trimestre económico*, vol. 36(4), N° 144, México, D.F., Fondo de Cultura Económica, octubre-diciembre.

CEPAL (Comisión Económica para América Latina y el Caribe) (1998a), *El pacto fiscal. Fortalezas, debilidades y desafíos* (LC/G.1997 /Rev.I), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.98.II.G.5.

_____(1998b), *Panorama social de América Latina. Edición 1997* (LC/G.1982-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.98.II.G.3.

_____(1997a), *La brecha de la equidad. América Latina, el Caribe y la Cumbre Social* (LC/G.1954/Rev.1-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.97.II.G.11.

_____(1997b), *Panorama social de América Latina. Edición 1996* (LC/G.1946-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.97.II.G.4.

_____(1996), *Fortalecer el desarrollo. Interacciones entre macro y microeconomía* (LC/G.1898/Rev.1-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.96.II.G.2.

_____(1995a), *América Latina y el Caribe: políticas para mejorar la inserción en la economía mundial* (LC/G.1800/Rev.1-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.95.II.G.6. [Segunda edición revisada y actualizada, Santiago de Chile, Fondo de Cultura Económica, 1998].

_____(1995b), *Panorama social de América Latina. Edición 1995* (LC/G.1886-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.95.II.G.17.

_____(1994a), *El regionalismo abierto en América Latina y el Caribe. La integración económica al servicio de la transformación productiva con equidad* (LC/G.1801/Rev.1-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.94.II.G.3.

_____(1994b), *Panorama social de América Latina. Edición 1994* (LC/G.1844), Santiago de Chile.

_____(1993a), *Población, equidad y transformación productiva* (LC/G.1758/Rev.1-P; LC/DEM/G.131/Rev.1), Santiago de Chile, septiembre. Publicación de las Naciones Unidas, N° de venta: S.93.II.G.8.

_____(1993b), *Panorama social de América Latina. Edición 1993* (LC/G.1768), Santiago de Chile.

_____(1992), *Equidad y transformación productiva: un enfoque integrado* (LC/G.1701/Rev.1-P), Santiago de Chile, abril. Publicación de las Naciones Unidas, N° de venta: S.92.II.G.6.

_____(1991), *Panorama social de América Latina. Edición 1991* (LC/G.1982-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.98.II.G.3.

____(1990), *Transformación productiva con equidad. La tarea prioritaria del desarrollo de América Latina y el Caribe en los años noventa* (LC/G.1601-P), Santiago de Chile, marzo. Publicación de las Naciones Unidas, N° de venta: S.90.II.G.6.

____(1985), "Transformación y crisis: América Latina y el Caribe 1950-1984", Crisis y desarrollo: presente y futuro de América Latina y el Caribe (LC/L.332(Sem.22/3)), vol.1, Santiago de Chile, abril.

____(1984), *Políticas de ajuste y renegociación de la deuda externa en América Latina*, serie Cuadernos de la CEPAL, N° 48 (LC/G.1332), Santiago de Chile, diciembre. Publicación de las Naciones Unidas, N° de venta: S.84.II.G.18.

____(1978), "Tendencias y proyecciones a largo plazo del desarrollo económico de América Latina", serie Cuadernos de la CEPAL, N° 20 (E/CEPAL/1027/Rev.I), Santiago de Chile.

____(1975a), "El problema del empleo en América Latina", *El desarrollo latinoamericano y la coyuntura económica internacional* (E/CEPAL/981/Add.4), anexo, Santiago de Chile.

____(1975b), "Evaluación de Quito", *Las evaluaciones regionales de la estrategia internacional de desarrollo*, serie Cuadernos de la CEPAL, N° 2, Santiago de Chile.

____(1975c), *Estudio económico de América Latina, 1975* (E/CEPAL/1014/Rev.I), Santiago de Chile.

____(1970), *La distribución del ingreso en América Latina* (E/CN.12/863), Nueva York, Naciones Unidas.

____(1971), *Estudio económico de América Latina, 1971* (E/CN.12/935/Rev.1), Santiago de Chile.

____(1969), *El pensamiento de la CEPAL*, Santiago de Chile, Editorial Universitaria.

____(1965), "Los cambios estructurales del empleo en el desarrollo económico de América Latina", *Boletín económico de América Latina*, vol.10, N° 2, Santiago de Chile, octubre. Publicación de las Naciones Unidas, N° de venta: 65.II.G.6.

____(1963a), *Programas y tendencias sociales en América Latina* (E/CN.12/ 645), Santiago de Chile, marzo.

____(1963b), "Etapas actuales del desarrollo económico y social de América Latina", *El desarrollo económico de América Latina en la postguerra* (E/CN.12/659 /Rev.I), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: 64.II.G.6.

____(1959), *El Mercado Común Latinoamericano* (E/CN.12/531), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: 59.II.G.4.

____(1955), *Introducción a la técnica de programación* (E/CN.12.363), México, D.F. Publicación de las Naciones Unidas, N° de venta: 55.II.G.2.

____(1954), *La cooperación internacional en la política de desarrollo latinoamericano* (E/CN.12/359), Nueva York, Naciones Unidas. Publicación de las Naciones Unidas, N° de venta: 54.II.G.2.

____(1951a), *Estudio económico de América Latina, 1949* (E/CN.12/164/Rev.I), Nueva York, Naciones Unidas. Publicación de las Naciones Unidas, N° de venta: 1951.II.G.1.

____(1951b), *Estudio económico de América Latina, 1950* (E/CN.12/217 /Rev.1), México, D.F.

CEPAL/UNESCO (Comisión Económica para América Latina y el Caribe/Organización de las Naciones Unidas para la Educación, la Ciencia y la Cultura) (1992), *Educación y conocimiento: eje de la transformación productiva con equidad* (LC/G.1702/Rev.2-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: S.92.II.G.6.

Fajnzylber, Fernando (1990), *Industrialización en América latina: de la 'caja negra al casillero vacío'*, serie Cuadernos de la CEPAL, N° 60 (LC/G.1534-P/Rev.1-P), Santiago de Chile. Publicación de las Naciones Unidas, N° de venta: 89.II.G.5.

____(1983), *La industrialización trunca de América Latina*, México, D.F., Editorial Nueva Imagen.

Ferrer, Aldo (1979), *La economía argentina: las etapas de su desarrollo y problemas actuales*, Buenos Aires, Fondo de Cultura Económica.

Frank, Andre Gunder (1976), *Capitalismo y subdesarrollo en América Latina*, México, D.F., Siglo Veintiuno Editores.

Furtado, Celso (1985), *Fantasia organizada*, Rio de Janeiro, Paz e Terra.

_____(1984), "Underdevelopment: to conform or reform", *Pioneers in development*, G.M. Meier y D. Seers (eds.), Washington, D.C., Nueva York, Oxford University Press.

_____(1971), *Desarrollo y subdesarrollo*, séptima edición, Buenos Aires, Editorial Universitaria de Buenos Aires (EUDEBA). [Título de la obra original: *Desenvolvimento e subdesenvolvimento*, Rio de Janeiro, Editôra Fundo de Cultura, 1961].

_____(1970), *Formação econômica da América Latina*, Rio de Janeiro, Nacional.

_____(1969), "Desarrollo y estancamiento en América Latina: un enfoque estructuralista", *Investigación económica*, vol. 29, N° 113, México, D.F., Universidad Nacional Autónoma de México (UNAM), enero-marzo.

_____(1959), *Formação econômica do Brasil*, Rio de Janeiro, Fundo de Cultura.

González, Norberto (1972), "El estrangulamiento externo y la escasez de ahorro en el desarrollo de América Latina", *Transformación y desarrollo: la gran tarea de América Latina*, R. Prebisch (comp.), México, D.F., Fondo de Cultura Económica.

Graciarena, Jorge (1976), "Poder y estilos de desarrollo: una perspectiva heterodoxa", *Revista de la CEPAL*, N° 1, Santiago de Chile, Comisión Económica para América Latina (CEPAL), primer semestre. Publicación de las Naciones Unidas, N° de venta: S.76.II.G.2.

Gurrieri, Adolfo (comp.) (1982), *La obra de Prebisch en la CEPAL*, México, D.F., Fondo de Cultura Económica.

_____(1980), *La obra de José Medina Echavarría*, Madrid, Ediciones Cultura Hispánica del Instituto de Cooperación Iberoamericana.

Hirschman, A. (1980), "Auge y ocaso de la teoría económica del desarrollo", *El trimestre económico*, vol. 47(4), N° 188, México, D.F., Fondo de Cultura Económica, octubre-diciembre.

_____(1963), "Ideologías de desarrollo económico en América Latina", *Controversia sobre Latinoamérica*, A. Hirschman (comp.), Buenos Aires, Editorial del Instituto.

Hodara, J. (1987), *Prebisch y la CEPAL: sustancia, trayectoria y contexto institucional*, México, D.F., El Colegio de México.

ILPES (Instituto Latinoamericano y del Caribe de Planificación Económica y Social)

_____(1974), *Experiencias y problemas de la planificación en América Latina*, México, D.F., Siglo Veintiuno Editores.

_____(1966), *Discusiones sobre planificación*, México, D.F., Siglo Veintiuno Editores.

Lewis, W.A. (1960), "Desarrollo económico con oferta ilimitada de mano de obra", *El trimestre económico*, vol. 27(4), N° 108, México, D.F., Fondo de Cultura Económica.

Love, J. (1980), "Raúl Prebisch and the origins of the doctrine of unequal exchange", *Latin American Research Review*, vol. 15, N° 3, Chapel Hill, Asociación de Estudios Latinoamericanos.

Medina Echavarría, J. (1963), *Consideraciones sociológicas sobre el desarrollo económico de América Latina* (E/CN.12/646), Santiago de Chile, Comisión Económica para América Latina (CEPAL).

_____(1961), "Las relaciones entre las instituciones sociales y económicas: un modelo teórico para América Latina", *Boletín económico de América Latina*, vol. 6, N° 2, Santiago de Chile, Comisión Económica para América Latina (CEPAL), marzo.

Naciones Unidas (1973), "Informe sobre un criterio unificado para el análisis y la planificación del desarrollo", *Informe preliminar del Secretario General de las Naciones Unidas*, Nueva York.

Noyola Vásquez, J. (1957), "Inflación y desarrollo económico en Chile y México", *Panorama económico*, año 11, N° 170, Santiago de Chile, Editorial Universitaria, julio.

OEA (Organización de los Estados Americanos) (1961), "Carta de Punta del Este", *Alianza para el Progreso*, Washington, D.C.

Pazos, F. (1983), "Cincuenta años de pensamiento económico en América Latina", *El trimestre económico*, vol. 50(4), N° 200, México, D.F., Fondo de Cultura Económica, octubre-diciembre.

Pinto, Aníbal (1976), "Notas sobre los estilos de desarrollo en América Latina", *Revista de la CEPAL*, N° 1, Santiago de Chile, Comisión Económica para América Latina (CEPAL), primer semestre. Publicación de las Naciones Unidas, N° de venta: S.76.II.G.2.

____(1970), "Naturaleza e implicaciones de la 'heterogeneidad estructural' de la América Latina", *El trimestre económico*, vol. 37(1), N° 145, México, D.F., Fondo de Cultura Económica, enero-marzo.

____(1965), "Concentración del progreso técnico y de sus frutos en el desarrollo latinoamericano", *El trimestre económico*, N° 125, México, D.F., Fondo de Cultura Económica, enero-marzo.

____(1960), "Estabilidad y desarrollo: ¿metas incompatibles o complementarias?", *El trimestre económico*, vol. 27, N° 2, México, D.F., Fondo de Cultura Económica, abril-junio.

____(1956), *Chile: un caso de desarrollo frustrado*, Santiago de Chile, Editorial Universitaria.

Pollock, D.H. (1978), "La actitud de los Estados Unidos hacia la CEPAL: algunos cambios durante los últimos 30 años", *Revista de la CEPAL*, N° 6, Santiago de Chile, Comisión Económica para América Latina (CEPAL), segundo semestre. Publicación de las Naciones Unidas, N° de venta: S.78.II.G.4.

Prebisch, Raúl (1982), "Desarrollo económico, planeación y cooperación internacional, *La obra de Prebisch en la CEPAL*, A. Gurrieri (comp.), México, D.F., Fondo de Cultura Económica.

____(1981), *Capitalismo periférico, crisis y transformación*, México, D.F., Fondo de Cultura Económica.

____(1970), *Transformación y desarrollo: la gran tarea de América Latina*, México, D.F., Fondo de Cultura Económica.

____(1964), *Hacia una nueva política comercial para el desarrollo. Informe del Secretario General de la Conferencia de las Naciones Unidas sobre Comercio y Desarrollo (E/CONF.46/3)*, Nueva York, Naciones Unidas.

____(1963), *Hacia una dinámica del desarrollo latinoamericano (E/CN.12/680)*, México, D.F., Fondo de Cultura Económica.

____(1961), "El falso dilema entre el desarrollo y estabilidad monetaria", *Boletín económico de América Latina*, vol. 6, N° 3, Santiago de Chile, Comisión Económica para América Latina (CEPAL), octubre.

____(1959), "Commercial policy in the underdeveloped countries", *The American Economic Review*, vol. 49, N° 2, Menasha, American Economic Association, mayo.

____(1952), *Problemas teóricos y prácticos del crecimiento económico (E/CN.12/221)*, México, D.F., Comisión Económica para América Latina (CEPAL). [Segunda edición, serie conmemorativa del veinticinco aniversario de la CEPAL, Santiago de Chile, febrero de 1973].

____(1949), *El desarrollo económico de la América Latina y algunos de sus principales problemas (E/CN.12/89)*, Santiago de Chile, Comisión Económica para América Latina (CEPAL). [Publicado posteriormente en CEPAL, *Boletín económico de América Latina*, vol. 7, N° 1, Santiago de Chile, 1962].

Rodríguez, Octavio (1981), *La teoría del subdesarrollo de la CEPAL*, México, D.F., Siglo Veintiuno Editores.

Rostow, W.W. (1956), "The take-off into self-sustained growth", *The Economic Journal*, vol. 66, N° 261, Cambridge, Royal Economic Society.

Schumpeter, J. (1954), *History of economic analysis*, Londres, George Allen & Unwin.

Singer, H.W. (1950), "The distribution of gains between investing and borrowing countries", *The American Economic Review*, vol. 40, N° 2, Menasha, American Economic Association, mayo.

Streeter, Paul (1979), "Development ideas in historical perspective", *Towards a new strategy for development*, Nueva York, Pergamon Press.

Sunkel, O. (comp.) (1991), *El desarrollo desde dentro, un enfoque neoestructuralista para la América Latina*, México, D.F., Fondo de Cultura Económica.

_____(1970), "Desarrollo, subdesarrollo, dependencia, marginación y desigualdades espaciales: hacia un enfoque totalizante", *EURE. Revista Latinoamericana de Estudios Urbanos Regionales*, vol. 1, N° 1, Santiago de Chile, Centro Interdisciplinario de Desarrollo Urbano y Regional/Consejo Latinoamericano de Ciencias Sociales (CIDU/CLACSO), octubre.

_____(1959), "Un esquema general para el análisis de la inflación", *Economía*, año 18, N° 62, Santiago de Chile, primer trimestre.

_____(1958), "La inflación chilena: un enfoque heterodoxo", *El trimestre económico*, vol. 25(4), N° 100, México, D.F., Fondo de Cultura Económica, octubre-diciembre.

Tavares, M.C. (1964), "Auge y declinación del proceso de sustitución de importaciones en el Brasil", *Boletín económico de América Latina*, vol. 9, N° 1, Nueva York, Naciones Unidas. Publicación de las Naciones Unidas, N° de venta: 64.II.G.8.

Tavares, M.C. y J. Serra (1971), "Más allá del estancamiento: una discusión sobre el estilo de desarrollo reciente en Brasil", *El trimestre económico*, vol. 33(4), N° 152, México, D.F., Fondo de Cultura Económica, octubre-diciembre.

Wolfe, Marshall (1976), "Enfoques del desarrollo: ¿de quién y hacia qué?", *Revista de la CEPAL*, N° 1, Santiago de Chile, Comisión Económica para América Latina (CEPAL), primer semestre. Publicación de las Naciones Unidas, N° de venta: S.76.II.G.2.

THE ECONOMIC DEVELOPMENT OF LATIN AMERICA*

Raúl Prebisch

* Written in 1949 as an introduction to *Economic survey of Latin America 1948* (E/CN.12/89) and later published in *Economic Bulletin for Latin America*, vol. VII, No. 1, Santiago, 1962. United Nations publication, Sales No. 62.II.G.1 and 62.II.G.4.

I. INTRODUCTION

1. In Latin America, reality is undermining the out-dated schema of the international division of labour, which achieved great importance in the nineteenth century and, as a theoretical concept, continued to exert considerable influence until very recently.

Under that schema, the specific task that fell to Latin America, as part of the periphery of the world economic system, was that of producing food and raw materials for the great industrial centres.

There was no place within it for the industrialization of the new countries. It is nevertheless being forced upon them by events. Two world wars in a single generation and a great economic crisis between them have shown the Latin American countries their opportunities, clearly pointing the way to industrial activity.

The academic discussion, however, is far from ended. In economics, ideologies usually tend either to lag behind events or to outlive them. It is true that the reasoning on the economic advantages of the international division of labour is theoretically sound, but it is usually forgotten that it is based upon an assumption which has been conclusively proved false by facts. According to this assumption, the benefits of technical progress tend to be distributed alike over the whole community, either by the lowering of prices or the corresponding raising of incomes. The countries producing raw materials obtain their share of these benefits through international exchange, and therefore have no need to industrialize. If they were to do so, their lesser efficiency would result in their losing the conventional advantages of such exchange.

The flaw in this assumption is that of generalizing from the particular. If by “the community” only the great industrial countries are meant, it is indeed true that the benefits of technical progress are gradually distributed among all social groups and classes. If, however, the concept of the community is extended to include the periphery of the world economy, a serious error is implicit in the generalization. The enormous benefits that derive from increased productivity have not reached the periphery in a measure comparable to that obtained by the peoples of the great industrial countries. Hence, the outstanding differences between the standards of living of the masses of the former and the latter and the manifest discrepancies between their respective abilities to accumulate capital, since the margin of saving depends primarily on increased productivity.

Thus there exists an obvious disequilibrium, a fact which, whatever its explanation or justification, destroys the basic premise underlying the schema of the international division of labour.

Hence, the fundamental significance of the industrialization of the new countries. Industrialization is not an end in itself, but the principal means at the disposal of those countries of obtaining a share of the benefits of technical progress and of progressively raising the standard of living of the masses.

2. The Latin American countries are thus faced with an immense general problem, embracing a series of minor ones which must be defined before embarking on the long task of research and practical measures which will be necessary if there is a firm intention to solve the problems.

It would be premature, in this initial report, to draw conclusions that would have only the doubtful value of an improvisation. Admittedly much remains to be done in the Latin American countries, both in learning the facts and in their proper theoretical interpretation. Though many of the problems of these countries are similar, no common effort has ever been made

even to examine and elucidate them. It is not surprising, therefore, that the studies published on the economy of Latin American countries often reflect the points of view or the experience of the great centres of world economy. Those studies cannot be expected to solve problems of direct concern to Latin America. The case of the Latin American countries must therefore be presented clearly, so that their interests, aspirations and opportunities, bearing in mind, of course, the individual differences and characteristics, may be adequately integrated within the general framework of international economic co-operation.

The task ahead is thus considerable and the responsibility heavy. To deal with it methodically, it would be necessary to begin with a preliminary examination of the principal problems as a whole, at the same time bringing out certain general considerations suggested by direct contact with the economic life of Latin America. Such is the purpose of this report.

3. The industrialization of Latin America is not incompatible with the efficient development of primary production. On the contrary, the availability of the best capital equipment and the prompt adoption of new techniques are essential if the development of industry is to fulfil the social objective of raising the standard of living. The same is true of the mechanization of agriculture. Primary products must be exported to allow for the importation of the considerable quantity of capital goods needed.

The more active Latin America's foreign trade, the greater the possibility of increasing productivity by means of intensive capital formation. The solution does not lie in growth at the expense of foreign trade, but in knowing how to extract, from continually growing foreign trade, the elements that will promote economic development.

If reasoning does not suffice to convince us of the close tie between economic development and foreign trade, a few facts relating to the situation today will make it evident. The economic activity and level of employment in the majority of the Latin American countries are considerably higher than before the war. This high level of employment entails increased imports of consumer goods, both non-durable and durable, besides those of raw materials and capital goods, and very often exports are insufficient to provide for them.

This is evident in the case of imports and other items payable in dollars. There are already well-known cases of scarcity of that currency in certain countries, despite the fact that the amount of dollars supplied by the United States to the rest of the world in payment of its own imports was considerable. In relation to its national income, however, the import coefficient of the United States has, after a persistent decline, arrived at a very low level (not over 3 per cent). It is, therefore, not surprising that, notwithstanding the high income level of the United States, the dollar resources thus made available to the Latin American countries seem insufficient to pay for the imports needed for their intensive development.

It is true that as European economy recovers, trade with that continent can profitably be increased, but Europe will not supply Latin America with more dollars unless the United States increases its import coefficient for European goods.

This, then, is the core of the problem. It is obvious that if the above-mentioned coefficient is not raised, Latin America will be compelled to divert its purchases from the United States to those countries which provide the exchange to pay for them. Such a solution is certainly very dubious, since it often means the purchase of more expensive or unsuitable goods.

It would be deplorable to fall back on measures of that kind when a basic solution might be found. It is sometimes thought that, by reason of the enormous productive capacity of the United States, that country could not increase its import coefficient for the purpose of providing the basic solution to this world problem. Such a conclusion cannot be substantiated without

a prior analysis of the factors that have caused the United States steadily to reduce its import coefficient. These factors are aggravated by unemployment, but can be overcome when it does not exist. One can understand that it is of vital importance, both to Latin America and the rest of the world, that the United States achieve its aim of maintaining a high level of employment.

4. It cannot be denied that the economic development of certain Latin American countries and their rapid assimilation of modern technology, in so far as they can utilize it, depend to a very large extent upon foreign investment. The implications involved render the problem far from simple. The negative factors include the failure to meet foreign financial commitments during the great depression of the nineteen thirties, a failure which, it is generally agreed, must not be allowed to happen again. Fundamentally the problem is the same as that referred to in the preceding paragraph. The servicing of these foreign investments, unless new investments are made, must be paid for by means of exports in the same currency and, if these do not show a corresponding increase, in time the same difficulties will arise again. They will be the greater if exports fall violently. The question thus arises whether, pending that basic solution, it would not be wiser to direct investments toward such productive activities as would, through direct or indirect reduction of dollar imports, permit the regular servicing of foreign obligations.

5. Here one must beware of dogmatic generalizations. To assume that the meeting of foreign commitments and the proper functioning of the monetary system depend upon nothing more than a decision to obey certain rules of the game is to fall into an error involving serious consequences. Even when the gold standard was in operation in the great centres, the countries of the Latin American periphery had great difficulty in maintaining it, and their monetary troubles frequently provoked condemnation from abroad. The more recent experiences of the large countries have brought a better understanding of some aspects of the situation. Great Britain, between the two wars, encountered difficulties somewhat similar to those which arose and continue to arise in the Latin American countries, which have never taken kindly to the rigidity of the gold standard. That experience doubtless helps to bring about a better understanding of the phenomena of the periphery.

The gold standard has ceased to function, as in the past, and the management of currency has become even more complex in the periphery. Can all these complications be overcome by a strict application of sound rules of monetary behaviour? Sound rules for these countries are still in the making. Here there arises another vital problem; that of utilizing individual and collective experience to find a means of harmoniously fitting monetary action into a policy of regular and intensive economic development.

6. Let this not be interpreted as meaning that the classic teachings are of no value. If they do not provide positive rules, they at least show what cannot be done without impairing the stability of the currency. The extremes to which inflation has gone in Latin America show that monetary policy was not based upon these teachings, since some of the larger Latin American countries increased circulation to a greater extent than did those countries which had to meet enormous war expenditure.

There is yet another aspect of the problem of dollar shortage. It is true that, as already stated, a high level of employment increases imports. But it is also a fact that an excessive monetary expansion has often unduly increased the pressure on the balance of payments, thus leading to the use of foreign exchange for purposes not always compatible with economic development.

These facts must be taken into account in an objective analysis of the effects of the inflationary increase on the process of capitalization. It must, however, be admitted

that, in most of the Latin American countries, voluntary savings are not sufficient to cover the most urgent capital needs. In any case, monetary expansion does not bring about an increase in the foreign exchange reserves necessary for the importation of capital goods; it merely redistributes income. It must now be determined whether it has led to a more active capital formation.

7. The point is a decisive one. The raising of the standard of living of the masses ultimately depends on the existence of a considerable amount of capital per man employed in industry, transport and primary production, and on the ability to use it well.

Consequently, the Latin American countries need to accumulate an enormous amount of capital. Several have already shown their capacity to save to the extent of being able to finance a large part of their industrial investments through their own efforts. Even in this case, which is exceptional, capital formation has to overcome a strong tendency towards certain types of consumption which are often incompatible with intensive capitalization.

8. Nevertheless, it does not appear essential to restrict the individual consumption of the bulk of the population, which, on the whole, is too low, in order to accumulate the capital required for industrialization and for the technical improvement of agriculture. An immediate increase in productivity per man could be brought about by well-directed foreign investments added to present savings. Once this initial improvement has been accomplished, a considerable part of the increased production can be devoted to capital formation rather than to inopportune consumption.

How are sufficient increases in productivity to be achieved? The experience of recent years is instructive. With some exceptions, the rise in employment necessitated by industrial development was made possible by the use of men whom technical progress had displaced from primary production and other occupations, especially certain comparatively poorly paid types of personal services, and by the employment of women. The industrial employment of the unemployed, or ill-employed, has thus meant a considerable improvement in productivity and, consequently, where other factors have not brought about a general lowering of productive efficiency, a net increase in national income.

The great scope for technical progress in the field of primary production, even in those countries where it has already been considerable, together with the perfecting of existing industries, could contribute, to national income, a net increase that would provide an ever-increasing margin of saving.

All this, however, especially in so far as it is desired to reduce the need for foreign investments, presupposes a far greater initial capitalization than is usually possible with the type of consumption of certain sectors of the community, or the high proportion of national income absorbed, in some countries, by fiscal expenditure, which makes no direct or indirect contribution to national productivity.

It is, in fact, a demonstration of the latent conflict existing in these countries between the desire to assimilate, quickly, ways of life which the technically more advanced countries adopted step by step as their productivity increased, and the need for capitalization without which this increase in productivity could not be achieved.

9. For the very reason that capital is scarce, and the need for it great, its use should be subjected to a strict standard of efficacy which has not been easy to maintain, especially where industries have developed to meet an emergency. There is, however, still time to correct certain deviations and, above all, to avoid them in the future.

In order to achieve this, the purpose of industrialization must be clearly defined. If industrialization is considered to be the means of attaining an autarchic ideal in which economic considerations are of secondary importance, any industry that can produce substitutes for imports is justifiable. If, however, the aim is to increase the measurable well-being of the masses, the limits beyond which more intensive industrialization might mean a decrease in productivity must be borne in mind.

Formerly, before the great depression, development in the Latin American countries was stimulated from abroad by the constant increase of exports. There is no reason to suppose, at least at present, that this will again occur to the same extent, except under very exceptional circumstances. These countries no longer have an alternative between vigorous growth along those lines and internal expansion through industrialization. Industrialization has become the most important means of expansion.

This does not mean, however, that primary exports must be sacrificed to further industrial development. Exports not only provide the foreign exchange with which to buy the imports necessary for economic development, but their value usually includes a high proportion of land rent, which does not involve any collective cost. If productivity in agriculture can be increased by technical progress and if, at the same time, real wages can be raised by industrialization and adequate social legislation, the disequilibrium between incomes at the centres and the periphery can gradually be corrected without detriment to that essential economic activity.

10. This is one of the limits of industrialization which must be carefully considered in plans of development. Another concerns the optimum size of industrial enterprises. It is generally found in Latin American countries that the same industries are being attempted on both sides of the same frontier. This tends to diminish productive efficiency and so militates against fulfilling the social task to be accomplished. The defect is a serious one, which the nineteenth century was able to attenuate considerably. When Great Britain proved, with facts, the advantages of industry, other countries followed suit. Industrial development, however, spurred by active competition, tended towards certain characteristic types of specialization which encouraged profitable trade between the various countries. Specialization furthered technical progress and the latter made possible higher incomes. Here, unlike the case of industrial countries by comparison with those producing primary products, the classic advantages of the division of labour between countries that are equal, or nearly so, followed.

The possibility of losing a considerable proportion of the benefits of technical progress through an excessive division of markets thus constitutes another factor limiting the industrial expansion of these countries. Far from being insurmountable, however, it is a factor which could be removed with mutual benefit by a wise policy of economic interdependence.

11. Anti-cyclical policies must be included in any programmes of economic development if there is to be an attempt, from a social point of view, to raise real income. The spread of the cyclical fluctuations of the large centres to the Latin American periphery means a considerable loss of income to these countries. If this could be avoided, it would simplify the problem of capital formation. Attempts have been made to evolve an anti-cyclical policy, but it must be admitted that, as yet, little light has been thrown on this subject. Furthermore, the present dwindling of metallic reserves of several countries means that, in the event of a recession originating abroad, they would not only be without a plan of defence but would lack means of their own to carry out the measures demanded by the circumstances.

The principal problems having been set forth in this first part of the report, the following sections will be devoted to some of their outstanding aspects, which must be discussed both on account of their intrinsic importance and of the need for carrying out systematic research on them.¹

II. THE ADVANTAGE OF TECHNICAL PROGRESS AND THE COUNTRIES OF THE PERIPHERY

1. It was stated in the preceding section that the advantages of technical progress have been mainly concentrated in the industrial centres and have not directly extended to the countries making up the periphery of the world's economic system. The increased productivity of the industrial countries certainly stimulated the demand for primary products and thus constituted a dynamic factor of the utmost importance in the development of Latin America. That, however, is distinct from the question discussed below.

Speaking generally, technical progress seems to have been greater in industry than in the primary production of peripheral countries, as was pointed out in a recent study on price relations.² Consequently, if prices had been reduced in proportion to increasing productivity, the reduction should have been less in the case of primary products than in that of manufactures, so that as the disparity between productivities increased, the price relationship between the two should have shown a steady improvement in favour of the countries of the periphery.

Had this happened, the phenomenon would have been of profound significance. The countries of the periphery would have benefited from the fall in price of finished industrial products to the same extent as the countries of the centre. The benefits of technical progress would thus have been distributed alike throughout the world, in accordance with the implicit premise of the schema of the international division of labour, and Latin America would have had no economic advantage in industrializing. On the contrary, the region would have suffered a definite loss, until it had achieved the same productive efficiency as the industrial countries.

The above supposition is not borne out by the facts. As can be seen in the indexes of table 1, the price relation turned steadily against primary production from the 1870's until the Second World War. It is regrettable that the price indexes do not reflect the differences in quality of finished products. For this reason, it was not possible to take them into account in these considerations. With the same amount of primary products, only 63 per cent of the finished manufactures which could be bought in the 1860's were to be had in the 1930's; in other words, an average of 58.6 per cent more primary products was needed to buy the same amount of finished manufactures.³ The price relation, therefore, moved against the periphery,

¹ The obstacles in the way of carrying out such a task in Latin America are well known. The greatest difficulty is perhaps the small number of economists capable of an original approach to the specific problems of these countries. For various reasons, it has not been possible to supply the lack by training an adequate number of young men of high intellectual calibre. Considerable progress has been made by sending them to the great European and American universities, but this is not sufficient. One of the most conspicuous deficiencies of general economic theory, from the point of view of the periphery, is its false sense of universality.

It could hardly be expected that the economists of the great countries, absorbed by serious problems of their own, should devote preferential attention to a study of those of Latin America. The study of Latin America's economic life is primarily the concern of its own economists. Only if this regional economy can be explained rationally and with scientific objectivity, can effective proposals for practical action be achieved.

It must not be thought, however, that this desire springs from an exclusive individualism. On the contrary, Latin American economists can only accomplish it on the basis of a sound knowledge of the theories expounded in the great countries with their wealth of universal truths. An intelligent knowledge of the ideas of others must not be confused with that mental subjection to them from which we are slowly learning to free ourselves.

² "Post-War Price Relations in Trade between Under-developed and Industrialized Countries", document E/CN.1/Sub.3/W.5, pp. 115-116.

³ According to the report already quoted. The figures for the thirties go only as far as 1938 inclusive. The data given are the Board of Trade's average price indexes for British imports and exports representative of world prices for raw materials and manufactured goods, respectively

contrary to what should have happened had prices fallen as costs decreased as a result of higher productivity.

During the expansion of the last war, as in the case of all cyclical expansions, the relation moved in favour of primary products. Now, however, although there has not been a recession, a typical readjustment is taking place, with the result that prices of primary products are losing their former advantage.

The pointing out of this disparity between prices does not imply passing judgement regarding its significance from other points of view. It could be argued, on grounds of equity, that the countries which strove to achieve a high degree of technical efficiency were in no way obliged to share its fruits with the rest of the world. Had they done so, they would not have reached their enormous capacity to save, without which it might well be asked whether technical progress would have achieved the intense rhythm which characterizes capitalist development. In any case the productive technique exists and is at the disposal of those with the capacity and perseverance to assimilate it and increase their own productivity. All that, however, is outside the scope of this report. The purpose is to emphasize a fact which, despite its many implications, is not usually given the importance it deserves when the significance of the industrialization of the peripheral countries is discussed.

■ **Table 1**

RATIO OF PRICES OF PRIMARY COMMODITIES TO THOSE OF MANUFACTURED GOODS
(AVERAGE IMPORT AND EXPORT PRICES, ACCORDING TO DATA OF THE BOARD OF TRADE)
(Base: 1876-80=100)

Periods	Amount of finished products obtainable for a given quantity of primary commodities
1876-80	100.0
1881-85	102.4
1886-90	96.3
1891-95	90.1
1896-1900	87.1
1901-05	84.6
1906-10	85.8
1911-13	85.8
1921-25	67.3
1926-30	73.3
1931-35	62.0
1936-38	64.1
1946-47	68.7

Source: "Post-War Price Relations in Trade Between Under-developed and Industrialized Countries", document E/CN.I/Sub.3/W.5, 23 February 1949.

2. Simple reasoning on the phenomenon in question brings us to the following considerations:

First: Prices have not fallen concomitantly with technical progress, since, while on the one hand, costs tended to decrease as a result of higher productivity, on the other, the income of entrepreneurs and productive factors increased. When income increased more than productivity, prices rose instead of falling.

Second: Had the rise in income, in the industrial centres and the periphery, been proportionate to the increase in their respective productivity, the price relation between primary and manufactured products would have been the same as if prices had fallen in strict proportion to productivity. Given the higher productivity of industry, the price relation would have moved in favour of the primary products.

Third: Since, as we have seen, the ratio actually moved against primary products in the period between the 1870's and the 1930's, it is evident that in the centre the income of entrepreneurs and of productive factors increased relatively more than productivity, whereas in the periphery the increase in income was less than that in productivity.

In other words, while the centres kept the whole benefit of the technical development of their industries, the peripheral countries transferred to them a share of the fruits of their own technical progress.⁴

3. Before explaining the reason for this phenomenon, which is so important to Latin America, it would be well to consider how the effects of increased productivity are transmitted.

For this purpose, an illustrative example is presented in table 2, in which it is assumed that the indexes of productivity, per man, are greater in industry than in primary production. For the sake of simplification, both are supposed to make an equal contribution to the finished product.

⁴ "Post-War Price Relations in Trade between Under-developed and Industrialized Countries", document E/CN.1/Sub.3/W.5, pp. 115-116: "A long-term deterioration in terms of trade", de, such as has been found to obtain for primary producers over a long period, may be an effect of differences in the rate of increase in productivity in the production of primary commodities and manufactured articles, respectively. If we can assume that the deteriorating terms of trade for under-developed countries reflect a more rapid increase of productivity in primary commodities than of manufactured goods, the effect of worsened terms of trade would, of course, be less serious. It would merely mean that, to the extent that primary commodities are being exported, the effects of increased productivity are being passed on to the buyers of primary articles in the more industrialized countries. Although statistical data on differential rates of increase in productivity of primary production in under-developed countries, and production of manufactured articles in industrialized countries, are almost entirely lacking, this explanation of the long-term changes in terms of trade which were observed in this study may be dismissed. There is little doubt that productivity increased faster in the industrialized countries than primary production in under-developed countries. This is evidenced by the more rapid rise in standards of living in industrialized countries during the long period covered, from 1870 to the present day. Hence, the changes observed in terms of trade do not mean that increased productivity in primary production was passed on to industrialized countries; on the contrary, they mean that the under-developed countries maintained, in the prices which they paid for their imported manufactures relative to those which they obtained for their own primary products, a rising standard of living in the industrialized countries, without receiving, in the price of their own products, a corresponding equivalent contribution towards their own standards of living."

■ Table 2

ILLUSTRATION OF THE DISTRIBUTION OF THE BENEFITS OF TECHNICAL PROGRESS BETWEEN THE CENTRE AND THE PERIPHERY

Primary production (1)	Industrial production (2)	Total production ^a (3)	Ratio	
			1/3 x 100	2/3 x100
Assumption: Productivity increases in accordance with the creases as follows:				
100	100	100	-	-
120	160	-	140	-
First case: Costs decrease as productivity rises and prices decrease with costs, without any income increase				
100	100 ^b	100	100	100
83.3	62.5 ^b	71.4	116.7	87.5
Second case: Costs decrease as in the first case but income increases as follows:				
100	100	100	100	100
120	180	150	80	120
Changes in prices following the increase in income:				
100	100 ^b	100	100	100
99.9	112.5 ^b	107.1	93.3	105

^a Figures relate to the finished products.^b Part of the price representing value added by the manufacturing process.

It has been assumed in the first case that, with an increase in productivity, from 100 to 120 in agriculture and from 100 to 160 in industry, incomes of entrepreneurs and productive factors do not rise, but costs fall. If prices are reduced *pari passu* with costs, the decline in the price of primary products is less than that in the case of manufactured goods, as is shown by the corresponding indexes. Consequently, the ratio between the two moves, in favour of the primary products, from 100 to 116.7.

This is precisely the ratio that would have allowed the increase in final production to be shared equally by the primary producers and the industrial centres. In fact, if there is an increase in primary productivity from 100 to 120, and if, as has just been seen, 100 primary products can now be exchanged for 116.7 manufactured articles, it means that primary producers can now obtain 140 instead of 100 of those products, or, in other words, that the increase has been the same as in the case of final production, an increase obviously obtained by the industrial producers also.

There is a marked difference in these results when, in the second case, incomes are altered. It is assumed that, in industry, the increase in income is greater than the increase in productivity and that, in primary production, both increases are equal. As a result, the price ratio moves against primary production, from 100 to 93.3, so that primary products, despite the increase in productivity from 100 to 120, can buy only 112.0 final products, as against 100 previously. On the other hand, a similar calculation shows that industrial producers can now obtain 168 final products, as compared with the 100 they bought before.

It should be noted that, whereas the primary producers can increase their acquisitions of final products less than they increase productivity, industrial producers benefit more than they should in relation to the increase in their productivity.

It follows, logically, that if the increase in income in primary production had been assumed to be less than, instead of equal to, the increase in productivity, the price ratio would have dropped still further against the primary producers.

The deterioration of 36.5 per cent in the price ratio between the eighteen seventies and the nineteen thirties suggests the possibility of a phenomenon of that kind.

4. In short, if, in spite of greater technical progress in industry than in primary production, the price relation has moved against the latter instead of in its favour, it would seem that the average income, *per capita*, has risen more in industrial centres than in the producer countries of the periphery.

The existence of this phenomenon cannot be understood, except in relation to trade cycles and the way in which they occur in the centres and at the periphery, since the cycle is the characteristic form of growth of capitalist economy, and increased productivity is one of the main factors of that growth.

In the cyclical process of the centres, there is a continuous inequality between the aggregate demand and supply of finished consumer goods. The former is greater than the latter in the upswing and lower in the downswing.

The magnitude of profits and their variations are closely bound up with this disparity. Profits rise during the upswing, thus tending to curtail excess demand by raising prices; they fall during the downswing, tending, in that case, to counteract the effect of excess supply by lowering prices.

As prices rise, profits are transferred from the entrepreneurs at the centre to the primary producers of the periphery. The greater the competition and the longer the time required to increase primary production in relation to the time needed for the other stages of production, and the smaller the stocks, the greater the proportion of profits transferred to the periphery. Hence follows a typical characteristic of the cyclical upswing: prices of primary products tend to rise more sharply than those of finished goods, by reason of the high proportion of profits transferred to the periphery.

If this be so, what is the explanation of the fact that, with the passage of time and throughout the cycles, income has increased more at the centre than at the periphery?

There is no contradiction whatsoever between the two phenomena. The prices of primary products rise more rapidly than industrial prices in the upswing, but also they fall more in the downswing, so that in the course of the cycles the gap between prices of the two is progressively widened.

Let us now look at the explanations of this inequality in the cyclical movement of prices. It was seen that profits rise in the upswing and decrease in the downswing, thus tending to offset the disparity between demand and supply. If profits could fall in the same way in which they rose, there would be no reason whatsoever for this unequal movement. It occurs precisely because they cannot fall in that way.

The reason is very simple. During the upswing, part of the profits are absorbed by an increase in wages, occasioned by competition between entrepreneurs and by the pressure of trade unions. When profits have to be reduced during the downswing, the part that had been absorbed by wage increases loses its fluidity, at the centre, by reason of the well-known resistance to a lowering of wages. The pressure then moves toward the periphery, with greater force than would be the case if, by reason of the limitations of competition, wages and profits in the centre were not rigid. The less that income can contract at the centre, the more it must do so at the periphery.

The characteristic lack of organization among the workers employed in primary production prevents them from obtaining wage increases comparable to those of the industrial countries

and from maintaining the increases to the same extent. The reduction of income —whether profits or wages— is therefore less difficult at the periphery.

Even if there existed as great a rigidity at the periphery as at the centre, it would merely increase the pressure of the latter on the former, since, when profits in the periphery did not decrease sufficiently to offset the inequality between supply and demand in the cyclical centres, stocks would accumulate in the latter, industrial production contract, and with it the demand for primary products. Demand would then fall to the extent required to achieve the necessary reduction in income in the primary producing sector. The forced readjustment of costs of primary production during the world crisis illustrates the intensity that this movement can attain.

The greater ability of the masses in the cyclical centres to obtain rises in wages during the upswing and to maintain the higher level during the downswing and the ability of these centres, by virtue of the role they play in production, to divert cyclical pressure to the periphery (causing a greater reduction of income of the latter than in that of the centres) explain why income at the centres persistently tends to rise more than in the countries of the periphery, as happened in the case of Latin America.

That is the clue to the phenomenon whereby the great industrial centres not only keep for themselves the benefit of the use of new techniques in their own economy, but are in a favourable position to obtain a share of that deriving from the technical progress of the periphery.

III. LATIN AMERICA AND THE HIGH PRODUCTIVITY OF THE UNITED STATES

1. The United States is now the principal cyclical centre of the world, as was formerly Great Britain. Its economic influence over other countries is obvious, and in that influence; its enormous increase in productivity has played a vital part. It has profoundly affected foreign trade and, through its variations, the rate of economic development of the rest of the world and the international distribution of gold.

The Latin American countries, with their high coefficient of foreign trade, are extremely sensitive to such economic repercussions. An examination of the implications of the phenomenon and the problems it presents is therefore opportune.

2. It is a well-known fact that, in the United States, prices have not fallen in proportion to the increase in productivity as the recent research of Mr. Fabricant has clearly shown. During the period covered by that research —the forty years preceding the Second World War— manufacturing production costs declined regularly and persistently. The movement of prices did not follow this pattern at all. The increase in productivity was not reflected in prices but in income. Wages and salaries rose as real costs fell. This did not account, however, for all the benefits of productivity, as an appreciable part of it was passed on in the form of a shorter working day.

The increase in income arising out of higher productivity sooner or later extends to all phases of economic life through the well-known process, which need not be recalled here. By virtue of that same process, income has also increased in activities in which technical progress has been insignificant or non-existent, as in certain types of services. In some social groups the increase was very slow; meanwhile the rest of the community enjoyed advantages which, as the necessary adjustment took place, had to be yielded to the former. This transfer, however, was usually offset by new increases in wages resulting from still higher productivity.

This fact is pointed out as a good example of the type of adjustment to which the gradual industrialization of Latin America will necessarily give rise. As productivity increases with industrialization, wages will rise, thus causing a comparative increase in the prices of primary products. In this way, as its income rises, primary production will gradually obtain that share of the benefits of technical progress which it would have enjoyed had prices declined. As in the case of the lagging social groups mentioned above, it is evident that such adjustment will mean a loss of real income in the industrial sectors, which will, however, be limited by the import coefficient; but in the long run, that loss can be well compensated by the benefit of subsequent technical developments.

3. As mentioned before, since prices do not keep pace with productivity, industrialization is the only means by which the Latin American countries may fully obtain the advantages of technical progress.

Another solution had, nevertheless, been found by the classical theory. If the advantages of technique were not passed on through prices, they would be extended to the same degree by the raising of income. We have just seen that this is precisely what happened in the United States, as well as in the other great industrial centres. It did not, however, occur in the rest of the world. It would have required, throughout the world, the same mobility of factors of production as that which characterized the broad field of the internal economy of the United States. That mobility is one of the essential assumptions of the theory. In fact, however, a series of obstacles hampered the easy movement of productive factors. Doubtless the high wages paid in the United States, as compared with those in the rest of the world, would have attracted large masses to that country, with a very adverse effect upon wages, tending to reduce the difference between them and those in the rest of the world.

Thus the observance of one of the essential rules of the classic game would have resulted in a considerable lowering of the standard of living of the United States, as compared with the levels actually achieved.

It is easily understandable that the protection of this standard of living, attained by great effort, should have prevailed over the uncertain advantages of an academic concept. But the classic rules of the game form an indivisible whole and, if one is eliminated, the others cannot logically serve as absolute standards governing relations between the centres and the periphery.

4. This point is the more worthy of consideration, in that one of the consequences of the technical progress of the United States, so much greater than that of the rest of the world, has been another important departure from the rules.

As previously stated, the import coefficient of the United States has become extremely low, not more than 3 per cent. In 1929 it was 5 per cent. The decline is not new, but one of long standing. During the last hundred years, national income increased about two and a half times more than imports.

This phenomenon is largely explained by technical progress. Paradoxical as it may seem, increased productivity contributed to the strengthening of the United States' protective tariff policy, after that country had reached the stage of economic maturity. The explanation is simple. Over a given period of time, technical progress does not affect all industries equally. When higher wages resulting from the increased productivity of the more advanced industries are extended to the less advanced, the latter lose the advantage which had enabled them to compete with foreign industries paying lower wages. The significance of this factor will be appreciated from the fact that wages are twice or two and a half times as high in the United States as in Great Britain. Thus, tariff protection has been necessary for industries more efficient

than their foreign competitors, but whose level of productivity is lower than the average for their own country. For instance, despite the great improvement of agricultural technique, some of the important branches of agriculture needed protection as a result of their relatively high incomes as compared with those of foreign competitors.

England, when it was the economic dynamic centre, followed a diametrically opposed policy. If, however, the clock could be put back, it is by no means certain that it would abide by the same policy and disrupt its economy. The United States is a powerful and well-integrated economic entity and has become so largely through its own deliberate effort, the great significance of which is recognized. One cannot overlook, however, the fact that this brought about, for the rest of the world, conditions incompatible with the functioning of international economy in the same way as before the First World War, when the British centre strictly observed the rules of the game in the fields of monetary policy and foreign trade.

5. It is under these new conditions of international economy, that the process of industrialization has begun to develop in Latin America. The fundamental problem lies in adaptation to these conditions—in so far as they cannot be altered— while seeking new rules in keeping with the new circumstances.

Until that happens, and possibly with slight intervals, a persistent tendency toward disequilibrium will prevail. It is due, fundamentally, to the following fact: while, as we have seen, the import coefficient of the United States has been declining, the dollar imports of the Latin American countries are tending to increase, thus compelling them to take defensive measures to lessen the effects. There are several reasons for this:

First: Since technical progress has been greater in the United States than anywhere else, the demand for the capital goods necessary for industrialization is preferentially made upon that country.

Second: Technical development continuously manifests itself in the form of new products which, by modifying existing ways of life, assume the character of new necessities, of new ways of spending the income of Latin America, generally substituting them for the previous forms of domestic expenditure.

Third: In addition to those products which have undeniable technical advantages, there are others toward which demand is diverted by the considerable persuasive power of advertising. New tastes are created which must be satisfied by imports, to the prejudice of those which could be satisfied locally.

That it is not possible to reduce the import coefficient at the centre, on the one hand, and to allow it to increase freely in the periphery on the other, under the influence of the above factors, was fully proved by the serious events of the nineteen thirties. We now have sufficient perspective to understand their significance and to learn the lesson that they teach. One other fact must first be mentioned.

It has already been stated that the industrialization of Latin America, if wisely carried out, will open the way to a considerable increase in national income, by giving more productive employment to vast numbers of the population at present engaged in occupations of low productivity.

It can now be seen that the rise in income, so far achieved, has accentuated the influence of those factors on the demand for dollar imports. The greater the rise in income in these countries, therefore, the greater their need to import. This brings us once again to the problem of dollar shortage, which demands special attention.

IV. THE PROBLEM OF THE DOLLAR SHORTAGE AND ITS REPERCUSSIONS IN LATIN AMERICA

1. As soon as the symptoms of a dollar shortage begin to appear, the natural reaction is to look back at the not very distant past when, as shown in charts 1 and 2, increasingly large quantities of gold were being concentrated in the vaults of the United States. Before the First World War, that country held 26.5 per cent of the world reserves; by the beginning of the Second World War, this figure had increased to 50.9 per cent; and though at the end of hostilities it had fallen to 36.5 per cent, the United States again increased its share, which in 1948 comprised about half the world reserves.

The dollar shortage means that the United States does not purchase merchandise and services, or lend money, in an amount sufficient to cover the needs, justified or not, of other countries. This entails recourse to monetary reserves: dollars must be sold or gold sent to the United States.

Though this dwindling of reserves is not slow to give rise to monetary disturbances, the attraction of gold toward the main cyclical centre, if persistent, is not simply a monetary problem; it is the manifestation of a much deeper dynamic phenomenon, related to the rhythm of economic growth of the various countries and the way in which it occurs.

Depending on the type of its own growth, the action of the principal centre may, through cyclical fluctuations, take the form either of a persistent tendency to expel gold that flows to it, and thus stimulate the economic development of the rest of the world, or that of a tenacious retention of gold, to the detriment of the dynamic forces of the rest of the world.

The British cyclical centre was of the first type. So was the new principal cyclical centre before 1929. In the nineteen thirties, however, the second type prevailed, and the countries of the rest of the world were obliged to adjust their relationship with that centre in order that they might be able to continue developing, in spite of the unfavourable influence of the centre and its great absorption of metal.

The Latin American countries shared, with the others, the hardships of the nineteen thirties. It is understandable, therefore, that, faced with the symptoms of another dollar shortage, they should examine the past, as they can now do in clearer perspective, to discover whether the same factors which were at work then are again coming into force.

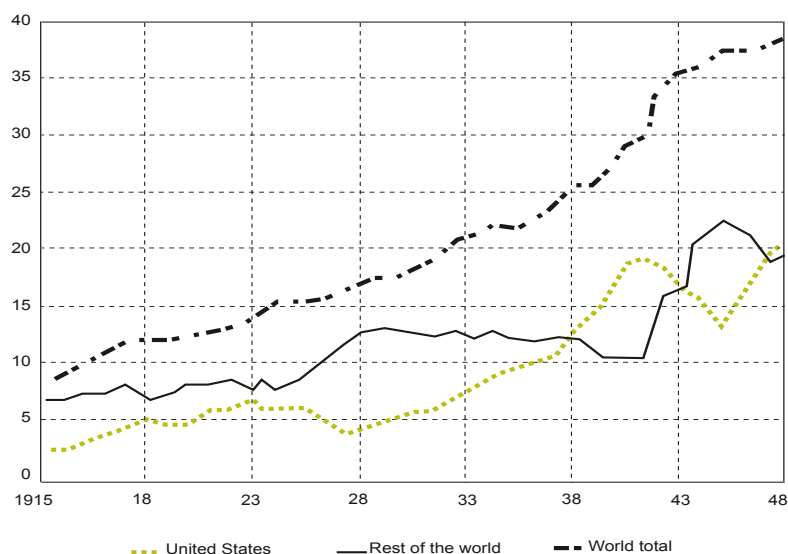
2. Those factors relate, on the one hand, to the repercussions on the rest of the world of the contraction and expansion of the principal cyclical centre and, on the other, to the marked reduction of its import coefficient and other foreign payments.

When income falls in the principal centre during the cyclical downswing, the fall tends to spread to the rest of the world. If the latter's income does not fall simultaneously and correspondingly, but with a certain lag a disequilibrium arises in the balance of payments. Since the fall in income is more rapid at the centre, the decrease in imports and other foreign payments is sharper there than in the rest of the world, with the result that the latter is forced to send gold to the centre. If equilibrium were possible — in the presence of cycles it is not — balance would be achieved when the respective incomes fell at the same rate.

■ Chart 1

GOLD RESERVES OF THE UNITED STATES AND THE REST OF THE WORLD

(Billions of dollars)



Note: The amounts representing net short-term dollar assets belonging to the countries of the rest of the world have been deducted from the gold holdings of the United States, since they represent monetary assets belonging to these countries and not to the United States. In view of the size of these assets at certain times, the effects of the adjustment are considerable. In 1947, for instance, the United States would have held 60 per cent of the world's gold, had not the exclusion of the above-mentioned dollar assets reduced the figure to 48.6 per cent.

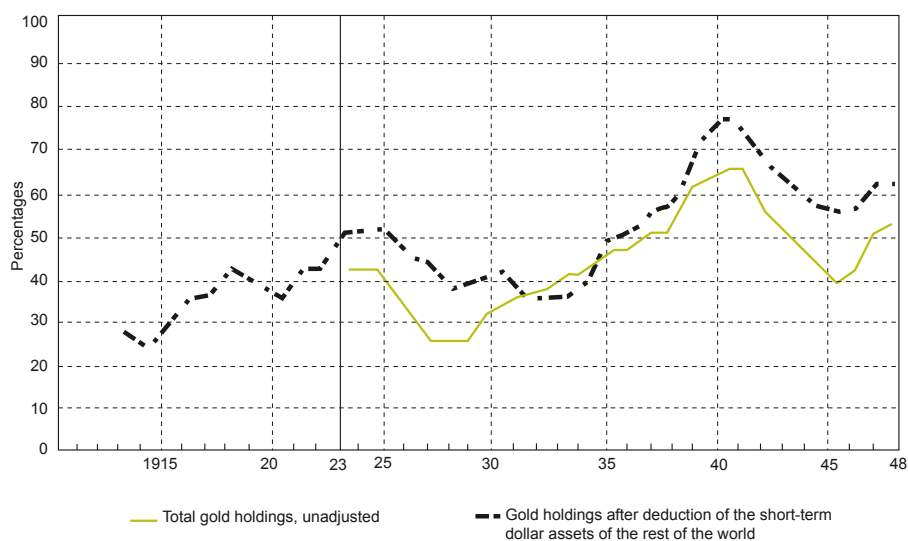
The following procedure has been adopted in making this adjustment: (a) Data for the years 1931-1936, both inclusive, have been taken from *Banking and Monetary Statistics* (Washington, 1943, pages 574-589), and after 1937 from the *International Financial Statistics* of the International Monetary Fund (Washington, January 1949, page 130); (b) The figures for the years before 1931 have been calculated by taking the net balances of the short-term capital movement according to the data for the United States balance of payments published in *The United States in the World Economy*, United States Department of Commerce, Bureau of Foreign and Domestic Commerce, *Economic Series No. 23*. In charts 1 and 2 parts of the curve have not been adjusted, owing to lack of data. The world total has been obtained from the *Federal Reserve Bulletin* for the years before 1940, and from the *Annual Reports* of the Bank for International Settlements, Basle, for the later years.

Data for 1948 are preliminary. All calculations have been made at a rate of 35 dollars per fine ounce.

The cyclical contraction that occurred in the United States, after 1929, would have been sufficient to attract a great part of the gold it had lost during the previous expansion, as usually happened in the cycles of the old principal centre. In this case, however, there appeared a new factor which had not been an element of the British influence, namely, the decline of the import coefficient. This decline was chiefly the result of two events: the raising of tariffs in 1929, on the one hand, and, on the other, a greater decline in the prices of imported primary products, than in those of finished products (which have the most influence on national income). Chart 3 illustrates the intensity of this phenomenon.

■ Chart 2

UNITED STATES' SHARE OF THE WORLD'S GOLD RESERVES (Percentages)



Source: See chart 1.

■ Chart 3

IMPORT COEFFICIENT OF THE UNITED STATES (Imports in relation to income, percentages)



Source: The data for income have been obtained from *National Income and its Composition*, by S. Kuznets, New York, 1941, for the years 1919-1928; from the *Statistical Abstract of the United States*, 1948 for the years 1929-1947, and from *Economic Indicators*, February 1949 (U.S. Government Printing Office, Washington, D.C., 1948). The data on imports were obtained from the *Statistical Abstract of the United States* and *Economic Indicators*.

The decline of the import coefficient in the principal cyclical centre strengthens the tendency to accumulate gold, resulting from the contraction of income. In fact, imports in the centre fall even more sharply than in the rest of the world and the disequilibrium turns still further against the latter. To restore the balance, it would not only be necessary, as in the previous case, for the income of the rest of the world to contract as sharply as that of the principal cyclical centre, but much more sharply. The greater the decline in the import coefficient and in other external payments of the principal cyclical centre, the more must the income of the rest of the world fall below the level of that centre. It must be remembered that, in addition to imports, these other external payments were also considerably reduced, by the cessation of the foreign loans made by the United States.

After the trough of the depression had been reached, in 1933, another expansion took place. According to British cyclical experience, the principal cyclical centre should have lost gold, as in fact it did during the expansion of the nineteen twenties. In the thirties, however, the opposite occurred; the monetary reserves of the United States attained extraordinary proportions, even discounting, as has been done in all the charts, the large quantity of foreign funds which, for other reasons, were deposited in dollars in the United States.

The decline of the import coefficient played a part in this. The income of the centre would have had to increase much more than that of the rest of the world for the former to cease attracting gold after the contraction and subsequently to begin losing it. The increase would have had to be great enough, first to compensate the effects of the decline in the coefficient, and then to surpass them. For instance, if the coefficient is halved, the income of the principal centre must increase to twice as much as that of the rest of the world, barely to offset the effects of such reduction.

The income of the United States, far from achieving this relatively high increase, took longer than that of the rest of the world to reach the level it had attained in 1929, judging from what took place in an important group of countries (see chart 4).

It is thus not surprising that gold should have been steadily accumulating in the principal cyclical centre. The concentration of metal in the United States was, in fact, enormous. Practically all the new production of monetary gold in the world, which was certainly considerable after 1933, collected in that country. The reserves of the rest of the world fell slightly, as may be seen in table 1.⁵

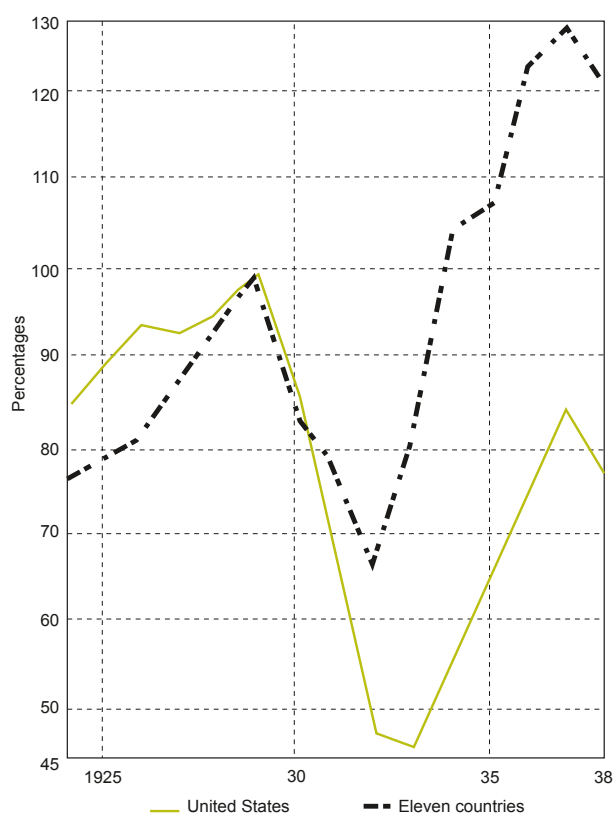
3. If, in the nineteen thirties, the rest of the world had relied for its economic development solely upon the stimulus deriving from imports and other payments made by the United States, the increase of its income would have been much less than that country's. As already pointed out, this is due to the depressive effect of the decline of the import coefficient of the United States. However, this did not actually happen since, in the countries shown in chart 4, income increased to a greater extent than in the United States.

⁵ An examination has been made in the text of the factors which caused the United States to attract gold in the nineteen thirties. There were also factors operating in the rest of the world which caused the expulsion of gold. Outstanding among them were those which appeared during the two world wars. The United States acquired large quantities of gold in return for supplies furnished to the Allies. It could only have lost this gold through a much greater inflationary expansion of income than that which actually took place, a possibility which need not, therefore, be considered. This was not the only phenomenon in the redistribution of gold brought about by the two wars. Part of the gold received by the United States was transferred to neutral countries or non-belligerents, to cover their favourable balance of payments. This is a normal phenomenon in the expansion of a cyclical centre, which was reflected in Latin America by a large increase in its metallic reserves. But it is also natural that a large part of the gold should return to the cyclical centre. This is what happened during the recession which took place in the United States after the First World War, and the cyclical movements of the British centre were also marked by fluctuations of gold. The present return of gold from the Latin American countries to the United States, however, is different, in that the movement has begun before a contraction in that country has taken place. This is due, as already stated, to the rise in imports, occasioned by the high level of employment and accentuated by inflationary phenomena.

If these countries, like the rest of the world, had increased their income without changing their import coefficient, it can be safely assumed that they would not have been able to do so for long without seriously impairing their monetary reserves. If this did not happen, it was simply because they had already reduced their coefficient of imports and other payments, especially of imports from the United States, which fell more than those from other sources, in order to attenuate the contraction originating in the United States.⁶ This enabled the rest of the world not only to develop in the way already described, but in several instances, to use part of its dollar exports to reduce its debt to the United States.

■ Chart 4

NATIONAL INCOME OF THE UNITED STATES AND OF ELEVEN OTHER COUNTRIES (AUSTRALIA, CANADA, DENMARK, FRANCE, GERMANY, HOLLAND, JAPAN, NEW ZEALAND, NORWAY, SWEDEN AND UNITED KINGDOM)
(Index numbers; Basis: 1929=100)



Source: Data for the national income of the United States have been obtained from *National Income and its Composition*, by S. Kuznets, New York, 1945, pages 310-311, for the years 1924-1928, both inclusive; and from the *Statistical Abstract of the United States, 1948*, for the years 1929-1938. Those for the income of the eleven countries were obtained from *World Economic Development: Effects on Advanced Industrial Countries*, by Eugene Staley, Montreal, 1945, page 144, chart 13.

Why was the coefficient of imports from the United States reduced more sharply in the rest of the world than the latter's total coefficient? Obviously because the deficit in the balance of payments was more acute in terms of dollars. Had imports in other currencies been reduced to the same extent as those in dollars, the damage suffered by international trade in the nineteen thirties would have been even more severe, with consequent additional loss of its classical advantages.

⁶ See charts published for various countries in *The United States in the World Economy*, United States Department of Commerce, Bureau of Foreign and Domestic Commerce, Economic Series No. 23, pages 67, 68 and 69.

4. What were the reactions of Latin America when faced with the phenomena occurring in those years in the principal cyclical centres? It is needless to repeat the story of the well-known way in which such events were reflected in this part of the continent, but they should serve to clarify and define the best interests of Latin America.

The reaction in Latin America was similar to that of other countries in the rest of the world, namely, a reduction of the import coefficient through depreciation of the currency, higher tariffs, import quotas and exchange controls.

Such measures had never been applied as widely as in those days, since there had never been a shortage of pounds sterling under the monetary hegemony of London.

The rapid extension of exchange controls is explained by the pressing need to reduce imports immediately and to stem the flight of capital. However, exchange controls were a means not only of reducing the volume of imports, but also of diverting to other countries, mainly those of Europe, demand for imports which, because of their low cost and suitability to Latin America's needs, it had formerly been preferable to bring from the United States. Notwithstanding its implications, it would be difficult to deny the obvious fact that exchange control has, in many instances, been used as an instrument of discrimination in international trade, contrary to the sound practices established with great effort through the general application of the most-favoured-nation clause. It must, nevertheless, be recognized that, when a country lacked the dollars necessary to pay for its essential imports, the only way out of so critical a situation seemed to be to import goods payable in currencies received in payment of exports.

Had these other currencies been convertible into dollars, the situation would have been very different. However, the dollar shortage affected all the rest of the world, and multilateral compensation could not be achieved when the total balance due in dollars exceeded available supplies.

Exchange control was not the result of a theory but was imposed by circumstances. None who had first-hand knowledge of the complications of every kind that it involved, would have adopted such a measure, had there been other alternatives available or had it been within the power of the Latin American countries to eliminate the fundamental causes of the evil.

5. Unfortunately these causes persisted too long. The abandonment of exchange control might have been considered when the worst of the world crisis was past and economic recovery in full swing, but the way in which the principal cyclical centre functioned made such a possibility remote.

Chart 5, showing the monetary reserves of Latin America, reveal the nature of the difficulties. Imports and other payments usually absorbed all the dollars newly added to the reserves and even a part of the reserves themselves. Exchange control, as already stated, served the purpose of diverting the demand for imports that could not be so financed. Even so, in the nineteen thirties it could not prevent total monetary reserves from remaining at a level considerably lower than that maintained in the nineteen twenties.

Such was the significance of exchange control in those days. Whether handled well or badly, it was the means of mitigating the serious repercussions of events abroad on the internal activity of the Latin American countries. Later, however, its functions changed considerably. Exchange control has been, and still is, used to check the effects of internal inflationary expansion on imports and other liability items in the balance of payments. It is evident that, in this instance, exchange control instead of counteracting the effects of inflation, diverts the inflationary pressure toward internal activity, thus accentuating the rise in prices.

The same considerations thus do not apply in both cases. Latin American countries had no influence over the external factors that imposed exchange control in the nineteen thirties.

On the other hand, the factors operating today are dependent upon their own decisions, as Latin American governments, concerned as they are at the gravity of this problem, have more than once admitted.

6. It is difficult, if not impossible, to determine to what extent the scarcity of dollars, which once more faces several Latin American countries, is the result of the low import coefficient of the United States and to what extent it is the result or the inflationary pressure referred to above.

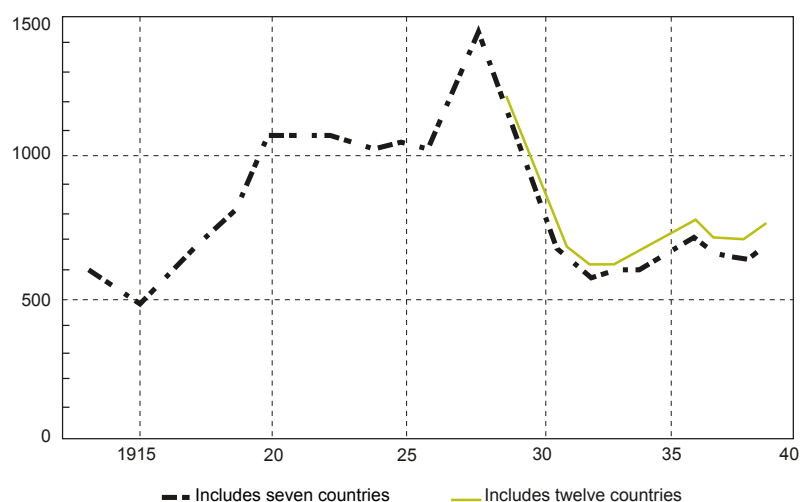
It has already been explained that the high level of employment attained in Latin America entails a considerable volume of dollar imports. Meanwhile, as its national income had reached an extremely high level, the United States also increased its imports from Latin America and other countries of the world. In 1948, its total imports amounted to 6,900 million dollars, with a coefficient of only 3 per cent. Had the coefficient been 5 per cent, as in 1929, imports would have totalled 11,500 million. These figures show the magnitude of the effects produced by the decline of the import coefficient.

It is still too early to say whether or not the Latin American countries' share of these imports will provide them with sufficient means of covering their import needs in addition to the other payments they have to make to the United States. A considered opinion cannot yet be given. Information is still very inadequate and does not permit an examination of the composition of imports for the purpose of determining with sufficient accuracy how much of the increase has been due to the redistribution of income typical of inflation. There are instances of considerable dollar payments for imports wholly unrelated to industrialization or the mechanization of agriculture, but it is difficult to say to what extent such cases can be considered general.

7. In any case, very special attention should be paid to the events now taking place. For instance, the recommendations recently made by the Joint Brazil-United States Technical Commission in its interesting report on Brazil are decidedly symptomatic.

There is great similarity between the measures envisaged by the Commission in connexion with imports and those which, as recalled above, several Latin American countries were compelled to take in the nineteen thirties.

■ Chart 5

GOLD RESERVES OF LATIN AMERICA
(Millions of dollars)

Note: As data for the earlier years of this period, from 1913 were available for only seven countries (Argentina, Bolivia, Brazil, Chile, Peru, Uruguay and Venezuela) the appropriate curve including them is shown until 1939. Five additional countries (Colombia, Ecuador, El Salvador, Guatemala and Mexico) are included in the second curve covering the years 1929-1939. These figures refer only to gold reserves and were calculated at the rate of 35 dollars per fine ounce.

Source: *Monetary and Banking Statistics*, Washington, 1943, for the years 1913-1936; and *International Financial Statistics*, Washington, 1949, for the years 1937-1939.

Despite the great increase in Brazil's dollar exports, the Commission has shown that they are not sufficient to cover its imports in that currency. It therefore approves the restriction of non-essential imports through a more effective application of the system of exchange control and recognized that "it would be necessary for Brazil to obtain its essential imports, as far as possible, from soft-currency countries with which it has had a favourable balance of trade in recent years", and adds that "one measure which might assist in reducing the total of hard currency imports, would be to require a review by the control authorities of all purchases in the dollar area proposed to be made by Brazilian government departments and 'autarquías'.⁷

It is remarkable that a report of this nature should envisage not only the restriction of imports through exchange control, but also the application of discriminatory measures.

The case would be of no great significance if it were merely a recognition of the temporary need for relieving pressure on the balance of payments. If, however, it is the expression of something more fundamental and persistent, the Latin American countries would have serious cause for concern.

8. Experience has shown that multilateral trade is the best suited to the economic development of Latin America. The ideal would be to be able to buy and sell in the best, though perhaps different, markets, without dividing foreign trade into water-tight compartments. The situation in which sales to Europe must be strictly counterbalanced by purchases from that continent, or even from each European country, with no possibility of using the balances for purchasing from the United States the goods which best satisfy the needs of Latin American economic development, is not a solution that offers the undeniable advantages of multilateral trade.

⁷ Report of the Joint Brazil-United States Technical Commission, Rio de Janeiro, 1949, pages 32-33.

It is essential, if multilateral compensation is to be practicable, that Europe have a dollar surplus with which to pay for its excess purchases from Latin America, after having satisfied its own import requirements from the United States.

This is, without doubt, the difficulty encountered by the Joint Brazil-United States Technical Commission. In the face of it, the Commission had only two alternative courses of action: either to propose the measures it actually recommended to Brazil or to suggest application of restrictions to all the countries equally, to the detriment not only of the exports of those countries with which Brazil has a favourable balance, but also to the rate of its economic growth.

9. The events of the nineteen thirties seem to have left the conviction that no fundamental solution can be expected from trade with the United States. Indeed, if the present extremely low import coefficient is maintained, its imports might be insufficient to solve the latent problem of a dollar shortage, even on the favourable assumption that maximum employment in that country would last. If, with maximum employment, income were to rise in the future at a rate unlikely to prove much more than 3 per cent a year, a corresponding increase in imports from the rest of the world would not do much to relieve the dollar pressure.

Is there, however, no possibility of an increase in the import coefficient of that country, whereby its imports would increase more rapidly than national income?

The possibility does exist. The persistent attraction of gold toward a principal cyclical centre is only conceivable theoretically when there is a considerable margin of unemployed factors of production.

There could be no repetition of the phenomena of the nineteen thirties if the United States were able to maintain maximum employment and if the rest of the world, thus stimulated by the principal centre, were able to carry out a similar policy of full utilization of its growing productive factors.

As explained in connexion with the adverse experience of those years, since there was unemployment in the United States, the rest of the world could not maintain its import coefficient with respect to that country without adjusting it to that of the United States with respect to the rest of the world, as no country can carry a permanent deficit in its balance of payments. Maximum employment, however, can alter the situation very much, as a brief reasoning will show.

Let us assume that a relatively high coefficient of the rest of the world, or better still a coefficient increased by the industrialization of Latin America, causes a sharp rise in the demand for exports from the United States. Let us further assume that, through the growth of productive factors, income increases annually by, say, 6,000, of which 4,000 represents factors employed in the export industry to satisfy the great demand and the remaining 2,000, industries supplying domestic needs, with an equivalent volume of production.

It is obvious that this volume of 2,000 will be insufficient to satisfy the internal demand created by the expenditure of the 6,000 income. Demand will then exceed supply, and since internal factors are fully employed, the deficit of production for internal requirements will have to be covered by imports.

If the productive factors were not fully employed, the excess of demand over supply would tend rather to stimulate internal production, and imports, far from rising in proportion to excess demand, would show only a slight increase, representing that part of the excess which is barely reflected in a demand for foreign goods, owing to the low import coefficient.

The nature of this report precludes more detailed development of the argument. It should be pointed out, however, that for such machinery to function, it is essential that the rest of the world be able to satisfy the United States' increased demand for imports, since the process would otherwise be inflationary. At the same time, the countries increasing their coefficient or their real income should be assured of sufficient resources to face a temporary disequilibrium in their balance of payments, pending the reaction of the principal cyclical centre.

10. In short, with full employment at the cyclical centre, any increase in its exports to the rest of the world, brought about by the action of the latter, would tend to be accompanied by a corresponding increase in imports (or other payments abroad) and gold would not tend to concentrate at the centre, to the detriment of the other countries.

It is clear that if this is to be achieved, the centre must not lower its import coefficient. In any case, what purpose would be served by such a measure if all productive factors are already fully employed? It is understandable that internal production should be substituted for imports in order to increase employment when there are unemployed factors. It is also understandable that, even when there is full employment, a country should avoid the sacrifice, through foreign competition, of industries supplying domestic consumption to favour those producing for export, as happened in the case of the British cyclical centre during the nineteenth century. Where full employment exists, however, it would show a lack of economic sense to lower the import coefficient generally while at the same time encouraging the development of certain industries producing for domestic consumption, at the expense of international trade.

Consequently, if nothing should hamper the natural play of economic forces, where there is full and growing employment at the principal cyclical centre, the way should be clear for the solution of that fundamental problem which is of such concern to the countries of Latin America and the rest of the world. The import coefficient of the United States would certainly increase, even if existing tariffs were left unaltered, and its interdependence with the rest of the world would be strengthened. Thus it could be demonstrated that, in addition to full employment, the United States could achieve two other fundamental objectives of its economic policy: the active promotion of foreign trade and the furthering of Latin American industrialization.

11. Another theoretical consideration closely related to the foregoing questions should be noted before closing this section. As yet nothing positive has been achieved in the attempt to explain, with the help of the classical theory, the fluctuations of the balances of payments and the international movements of gold in the nineteen thirties. Such an attempt could hardly have been successful, since, as is well known, the classical theory is based on the assumption of full employment. If this assumption were to take place in reality, the essential soundness of the classical reasoning regarding gold movements could be proved, allowing, of course, for the partial modifications which the theory demands. As Lord Keynes pointed out in his *General Theory*, with full employment we are safely ensconced in a Ricardian world. The opinion expressed on this, in his posthumous article published in the *Economic Journal*, is, therefore, not surprising: "I find myself moved, not for the first time, to remind contemporary economists that the classical teaching embodied some permanent truths of great significance, which we are liable today to overlook because we associate them with other doctrines which we cannot now accept without much qualification. There are in these matters deep undercurrents at work, natural forces, one can call them, or even the invisible hand, which are operating towards equilibrium..."⁸ Admittedly, if the classical medicine is to work, it is essential that import tariffs and export subsidies should not progressively offset its influence. It is for this reason that one is entitled to draw some provisional comfort from the present mood of the American Administration and, as I judge it, of the American people also, as embodied in the proposals for

⁸ Lord Keynes, "The Balance of Payments of the United States", *The Economic Journal*, June 1946, pages 185 and 186.

consideration by an International Conference on Trade and Employment. We have here sincere and thoroughgoing proposals, advanced on behalf of the United States, expressly directed towards creating a system which allows the classical medicine to do its work”.

V. CAPITAL FORMATION IN LATIN AMERICA AND THE INFLATIONARY PROCESS

1. The margin of savings depends ultimately upon the progressive increase of labour productivity. Though the level of productivity achieved by some Latin American countries is such that, by means of a judicious policy, they would be able to reduce the amount of foreign capital needed to supplement national savings to moderate proportions, in the majority of them this capital is admittedly indispensable.

In actual fact, productivity in these countries is very low owing to lack of capital; and the lack of capital is due to the narrow margin of savings resulting from this low productivity. The temporary help of foreign capital is necessary if this vicious circle is to be broken without unduly restricting the present consumption of the masses, which, generally speaking, is very low. If this capital is effectively used, the increase in productivity will, in time, allow savings to accumulate which could be substituted for foreign capital in the new investments necessitated by new technical processes and the growth of the population.

2. Throughout most of Latin America, the characteristic lack of savings is the result, not only of this narrow margin, but, in many cases, of its improper use. Saving means refraining from consumption and is thus incompatible with certain types of consumption peculiar to relatively high income groups.

Great disparities in the distribution of income may be, as they have been in the past, a factor favourable to the accumulation of capital and technical progress. Although the influences of that factor in the Latin American countries should not be overlooked, there are many well-known examples of how such distributive inequalities have fostered types of consumption peculiar to countries of high productivity. Considerable opportunities for saving and effectively employing monetary reserves for productive imports are thus frequently lost.

It is the increase in productivity that has enabled the United States, and to a lesser degree other industrial countries, to shorten the working day, raise the real income and standard of living of the masses, and considerably increase public expenditure, without impeding a huge accumulation of capital.

It is a well-known fact that fiscal expenditure, which, in the middle of the last century, formed a relatively small part of national income in the great industrial countries, today represents a large portion of it. This has become possible only as a result of increased productivity.

The Latin American countries have also followed this general tendency. If, where productivity is high and the accumulation of capital considerable, the increase in the proportions of public expenditure is cause for concern, it must be even more so in countries where a considerable part of the national income must be devoted to saving, since saving is necessary to attain that increase in productivity without which the aim of raising the standard of living of the masses would be a mere illusion.

The problem is essentially one of estimating needs. The resources available to satisfy the enormous individual and collective needs of the Latin American countries are relatively small, and the possible contribution of foreign capital is also limited. Those needs must therefore be

evaluated from the standpoint of the aim in view, in order that the limited resources may be most advantageously distributed. If the aim is to increase the measurable well-being of the community, the increase of capital per man must take very high priority. There are various types of public and private investment which are indisputably useful for this purpose, but since they do not increase productivity, they cannot bring about the increase in saving necessary for new investments. On the other hand, those same investments, if put into efficient capital goods, will immediately increase productivity and so develop a margin of saving which, transformed into new investments, will give rise to yet further increases in productivity.

For these and many other reasons, the problem of capital formation is of the utmost importance.

3. The considerable pressure of those individual and collective needs on comparatively scanty resources usually provokes inflationary processes such as those with which the governments are now so rightly preoccupied. At the same time there has grown up a belief, not only among the privileged, but also among those whose only concern is the general welfare, that inflation is an unavoidable means of forced capitalization where voluntary saving is evidently insufficient.

It is a thesis worthy of careful examination. Since the process is widespread, there is a wealth of data available for fruitful investigation which will later permit an appreciation of its value and range. Meanwhile, some comments may contribute to define this problem.

One indisputable fact stands out: the stimulus of monetary expansion has led to a high level of employment and thereby to a real increase in income. It appears, however, that a large part of that effect had already been achieved during a phase of moderate credit expansion, which preceded the acute inflationary process. As that process developed, the increase in employment and real income became less and less marked, and that of prices more so, with consequent disturbances in the distribution of total income.

This experience provides both positive and negative lessons.⁹ The positive lesson is pertinent to the subject since the growth of employment brought about an increase in the potential margin of savings. The negative lesson is also concerned with it. The exaggeration of the stimulus necessary for the achievement of maximum employment led internally to excessive inflationary pressure, which, with the rise in imports consequent upon the resumption of foreign trade after war-time restrictions, absorbed a large part of the gold and dollars which had been accumulated.

4. The fragmentary information available raises more than one doubt, as to whether those reserves have been used in strict accordance with the needs of the economic development of Latin America. In order to throw light upon those doubts, it would be interesting to discover to what extent the aforesaid reserves have been used to import the most essential capital equipment, how far they have been spent on non-essential articles or those related only to the mode of living of high-income groups, and to what extent they have served to cover the capital outflow caused by the process of inflation.¹⁰

These different uses of foreign exchange are closely linked with the internal effects of inflation. The rise in prices, by creating exceptional profits, places in the hands of a comparatively small group great opportunities for saving, as always happens when income distribution is altered in such a way. It would be extremely interesting to ascertain to what extent these

⁹ The possibility of a rational policy of employment of idle or ill-employed resources has been shown by experience. At one time exports had constituted the chief dynamic factor. After the world crisis, however, they proved insufficient to fulfil adequately their rate of stimulating development. In the nineteen thirties, the weakness of the external dynamic factor had already been counteracted in some of the Latin American countries by a policy of internal stimulation. In order to do so, as was explained elsewhere, it was necessary to reduce the import coefficient. The events of the Second World War showed how much further this policy could be carried. The war brought about a drastic reduction of the coefficient, while at the same time increasing the force of the external stimulus.

¹⁰ It is interesting to note that Latin American private deposits in the United States amounted to 729 million dollars, on 30 June 1947.

opportunities have been translated into collective savings and whether those savings have been put to the most productive use from the standpoint of the community.

If a large part of the profits arising out of inflation had actually been saved and efficiently invested, those who expound the foregoing thesis would have a strong point in their favour. Unfortunately isolated figures do not provide sufficient reliable evidence to justify any generalization. None the less, the information on Brazil presented by the Joint Brazil-United States Technical Commission is illuminating. In 1946 the large corporations reinvested 30 to 40 per cent of their profits and distributed the rest among the shareholders. The amount distributed by all the corporations is believed to have amounted to 12,000 million cruzeiros, of which one fourth, or barely 3,000 million, represented various forms of saving.¹¹ Taking the figures as a whole, only about 50 per cent of total profits would represent direct or indirect investments.

That being so, the proportion consumed would have been considerable. Since, moreover, the high-income groups have a high import coefficient, it is not surprising that a large part of the foreign exchange accumulated should have been spent on products not essential to economic development, as may be inferred from other information from the same source.

There is yet another aspect of the question to be clarified. Assuming that under given circumstances a certain amount of inflationary expansion is considered the most practical expedient, in view of the scarcity of savings, there would be ways of best achieving that purpose, at the same time mitigating the serious consequences of the inflation. The State has means of stimulating the investment of a large portion of profits and inflationary incomes through progressive taxation of the part spent and consumed, while lowering the tax or granting exemption on the part invested; furthermore, through exchange control or taxation, it can divert the part which tends to be used for imports incompatible with strong economic growth. Such means may, of course, also serve to increase unproductive public expenditure instead of savings, to the detriment of an increase in national productivity.

5. Logically, if some groups have benefited considerably from inflation, others must have suffered. Conclusive studies have not yet been made, but it would seem that there is no essential difference between inflation today and in the past. The middle class and the fixed-income groups have generally been those to bear the brunt of the transference of real income to entrepreneurs and other beneficiaries. The better organized labour unions have through wage increases managed to overtake, and at times surpass, the price rise, although usually with a lag. There are not enough reliable data, however, to ascertain to what extent the whole group has benefited and not merely certain sectors. Nevertheless, it should not be forgotten that the increase in employment during the first stage of the expansionary process has usually meant an increase in the real income of the working class family, even when wages have not been adjusted to rising prices.

All this redistribution of income brought about by inflation, creates in the sectors that benefit the illusion that the total wealth of the community is increasing, even though real income ceased to rise to any extent, once the initial stage of moderate expansion was passed. It is an illusion peculiar to the stage of euphoria and prodigality; during that time capital equipment is not renewed, as in the case of transport and other public and private investments, and a large part of the previous increase in monetary reserves is spent in a short while. This means the consumption of accumulated capital and so must not be mistaken for a real increase in income. The illusion begins to fade during the second phase —that of increasing tension— and finally disappears during the third —that of painful readjustment.

The first stage seems to be over in Latin America, and as the second develops, acute social antagonisms are appearing, which threaten the efficacy of the existing economic system.

¹¹ Report of the Joint Brazil-United States Technical Commission, part III.

An atmosphere unfavourable to the smooth development of that system is being created, and with it certain kinds of governmental intervention and fiscal measures prejudicial to private initiative and undermining the sense of individual responsibility. Thus the inflation that has greatly increased the remuneration of the entrepreneur ends by impairing his efficiency – a factor of vital importance for the growth of the Latin American countries.

6. The State soon takes a substantial share of the entrepreneur's inflationary gains in the form of taxes. The increase in public expenditure resulting from that participation will present a problem no less serious than the others, when inflationary profits disappear and it becomes necessary to bring State wages and salaries into line with the cost of living, with the obvious risk that the proportion of national income represented by public expenditure will again rise, to the detriment of capital formation.

7. Sound conclusions regarding the value of inflation as an instrument for collective saving can be drawn only after an objective analysis of the above facts and of others arising out of it. Whatever the final figures, it will have to be admitted that inflation has tended to discourage typical forms of voluntary saving which had acquired growing importance in some Latin American countries. Here may be found the source of future savings for industrialization, when monetary stability can be restored in accordance with the new rules of the game imposed by new conditions. In short, if the forced savings which accumulate through inflation are furnished by many sectors of the community whereas the benefits thereof are passed on to favoured groups only, the question arises whether it is not possible to devise other forms of saving (either voluntary or collective) by which resources could be better devoted to productive ends, without the serious social disadvantages of forced saving.

8. Meanwhile an appeal to foreign savings appears inevitable. Unfortunately, in this connexion the problem inherited from the disastrous experience of the nineteen thirties is still far from solution.

While the default of the debtor is still fresh in the memory of the creditor countries, there is a tendency both to forget the circumstances in which default occurred and to spread the mistaken belief that a recurrence of past events could be avoided by the observance of certain rules of procedure. At the root of this we find the same fundamental problem as was mentioned in connexion with foreign trade trends. This was pointed out by the United States Department of Commerce in a study published some years ago.¹²

In 1929 the United States supplied the rest of the world with 7,400 million dollars in payment of imports, investments and other items; hence the rest of the world could easily pay the 900 million due in fixed financial services on capital invested by the United States, apart from remittances of profits. In 1932, however, the supply of dollars was reduced to 2,400 million, while the services, had they been paid, would still have amounted to 900 million. The rest of the world would thus have had barely 1,500 million to cover its imports and other payments to the United States, as against 6,500 million in 1929.

In the light of these figures, it is not surprising that default was more or less general throughout Latin America. The few countries that continued to meet their obligations did so at great sacrifice, at the cost of a severe contraction of their internal economy and to the detriment of their monetary reserves. It is only natural that, after such an experience, they should be reluctant to find themselves once more in a position in which they must either fail to meet their obligations or sacrifice their economy.

Until a solution to the fundamental problem of foreign trade is found, care must be taken that dollar investments, where they cannot be used to further dollar exports, shall contribute,

¹² *The United States in the World Economy, Economic Series No. 23*, Washington, D.C., 1943, page 6.

directly or indirectly, to the reduction of imports in that currency, in order to facilitate future payment of services.

9. From this and other points of view, it would seem imprudent to renew the active flow of investments of the nineteen twenties without adopting a plan to deal with the series of concrete problems which arise in this connexion. The existence of international credit institutions could be a very effective factor in the drafting of such a plan, in which the types of investment best suited to the development of Latin American economy through their contribution to productivity and to the development of the necessary capacity for repayment may be considered in co-operation with the individual countries concerned.

There seems no reason why this plan should not include the field of private investment. Much is heard about the need for establishing a system of guarantees or regulations in order to promote it. All this is worthy of further consideration. New measures must, however, be developed in the light of past experience. There were many other difficulties besides the fundamental ones of the nineteen thirties, and the abuses on both sides should be fully admitted in order to prevent a repetition of the evil. In this way, and with effective technical assistance, it should be possible to develop an investment policy that would be welcomed by all concerned because of its reciprocal advantages.

VI. THE LIMITS OF INDUSTRIALIZATION

1. It is obvious that the economic growth of Latin America depends on the increase of the average income per inhabitant (which in most countries is extremely low) and on an increase in population.

An increase in the average income per inhabitant could be achieved in only two ways: first, through an increase in productivity, and second, assuming a certain level of productivity, through an increase in income per man engaged in primary production, in relation to the income of the industrial countries which import part of that production. This readjustment, as already explained, tends to correct the disparity in income brought about by the way in which the benefits of technical progress are distributed between the centres and the periphery.

2. We shall now consider the increase in productivity in relation to the existing population. There are two aspects of the question. On the one hand, the adoption of modern technique will allow production per man to increase, making labour available to increase production in the same activities in which it was already employed, or directing it to others. On the other, the index of productivity will also be raised by the diversion of persons ill-employed in activities where the very low productivity cannot be increased to any notable extent, to others where technical progress makes such improvement possible.

Agriculture offers a typical example of the influence of technical progress. In some of its important branches, technical development has made possible a steady increase in production with a proportionally lower increase in employment. In other words, agriculture absorbs a decreasing proportion of the increase in the population of working age, with the result that industry and other activities have been able to increase their employment more. This is not a case of diverting, to other work, people already employed, but of offering a different form of employment to people reaching working age. There have, however, been instances in which the rapid growth of industry during recent years has brought about an actual transference of workers, with unfavourable consequences for agriculture.

Furthermore, the increase in foreign demand for agricultural products after the great depression was, in general, relatively slow, by comparison with the rate in previous years. Taking this fact in conjunction with the consequences mentioned above, it would be difficult to say what productive activities, other than industry, could have absorbed the increase in population of the Latin American countries which export such products.

It is quite possible that technical progress in other activities will bring consequences similar to those just pointed out. That, too, will mean an important source of manpower for industrial development.

This is not the only possible source. The low level of productivity in industry itself represents a wastage of manpower which, given the proper use of modern technique, can be employed to great general advantage in expanding existing industries or in developing new ones.

Finally, there is another possibility which the recent experience of some countries has shown to be worthy of consideration. The low income level prevailing among the masses has made it possible for the higher income- groups to enjoy hand-made goods and certain types of personal services at comparatively low prices. This is due to what we have termed ill-employed manpower. As productivity in industry increases and real income, *per capita*, rises, there is a natural tendency for the ill-employed to move towards industry. However disturbing this trend may be to some sectors of society, it is the usual way in which the benefits of technical progress are passed on to all social groups within a country, as the experience of the great industrial countries has shown. The solution does not lie wholly in an increase in productivity, however. The social aim of industrialization might well be jeopardized if too large a part of the increase were to be devoted to increasing consumption or to a premature slackening of productive effort.

3. It has been emphasized that, to achieve this increase in productivity, capital, *per capita*, must be considerably increased and the technique for its effective use acquired. The need is progressive. In fact, a general increase in wages resulting from greater productivity in industry gradually spreads to other activities, which are thereby obliged to use more capital, *per capita*, in order to achieve the increase in productivity without which they would be unable to pay higher wages. Thus many activities in which human labour is now more profitable, because it is cheaper, will tend to become mechanized; the same will happen to a certain degree in household economy.

It is not possible to estimate, even approximately, the extent of these potential capital requirements and thus of the resources that will be needed to satisfy them, since even present capital, *per capita*, employed in the principal Latin American countries cannot be determined with any satisfactory degree of accuracy. However, to judge from the needs which have already arisen during the initial stage of the industrialization process, the resources made available by exports—at least by dollar exports—do not appear adequate to meet those requirements after other imports and foreign payments have been met.

As already explained, the possibility must be faced that a reduction in the import coefficient may be necessary. This may apply to either the general coefficient or the dollar coefficient and may be brought about by decreasing or eliminating non-essential goods, in order to allow increased imports of capital goods. A change in the composition of imports would in any case appear essential to the development of industrialization.

It should be clearly understood what this means. It is merely the adaptation of imports to the resources made available by exports. If the latter were to rise sufficiently, it would not be necessary to restrict imports, except as a further means of intensifying industrialization.

Exports from Latin America, however, are largely dependent on fluctuations in income in the United States and Europe and on their respective import coefficients for Latin American products. Consequently they cannot be controlled directly by Latin America, and the situation can be changed only by the decision of the other countries.

4. It would be a different matter if Latin America intended to carry industrialization to the point of directing certain factors away from primary production to industry in order to increase the output of the latter to the detriment of the former. In other words, if Latin America, being in a position to maintain exports and imports at a specified level, were deliberately to lower it, sacrificing part of its exports in order to increase industrial production as a substitute for imports.

Would there in that case be an increase in productivity? At this point the question would be defined in classical terms. It would be a matter of discovering whether the increase in industrial production brought about by the factors diverted from primary production was or was not greater than the amount of goods formerly obtained in exchange for the exports. Only if it were greater, could it be said that there was an increase in productivity, from the standpoint of the community: if it were not, there would be a loss of real income.

This then is one of the most important limits of industrialization, one of a dynamic nature which might become less restrictive as the economy developed but which should be constantly borne in mind, however, if the primary objective is to increase the real welfare of the masses.

There is no sign that Latin America is approaching this limit. It is in the initial stage of the industrialization process and in most cases the manpower available as a result of increased productivity is still amply sufficient for industrial growth. Moreover, it does not seem that the countries in which this process of industrialization has reached a more advanced stage have yet been driven to choose between an actual increase in exports and industrial development.

5. Nevertheless, exports can be sacrificed to an illusory increase in real income long before the possibilities of intensifying productivity or of utilizing all the manpower available have been exhausted.

An increase in productivity requires a considerable increase in capital, and before this can be achieved, a long time will elapse and new techniques will appear which may call for further increases in capital, in addition to that necessitated by the growth of population. At the same time, savings are scarce. It is necessary, therefore, to use them in such a way as to obtain the maximum increase in output. However, a mistaken policy could cause deficient use of these savings, as can be easily demonstrated.

It has been said that technical progress in agriculture and the comparatively slow foreign demand for its products have, in many cases, allowed industry to absorb a larger part of the increase in population of working age than agriculture. Let us assume that year after year this increase in hands is required in agriculture in order to meet rising foreign demands in addition to the increase in domestic consumption, but that, as a result of various measures, industrial development is expanded to such an extent that agriculture is deprived of the hands it needs in order to continue increasing exports.

The reasons why the substitution of industrial production for exports may represent a loss of real income have already been explained. There would, however, be also another loss. Land is a very valuable factor of production, which costs nothing.

By comparison with industry, the amount of capital that must be added to it is relatively small. Consequently, the men who could have worked efficiently in agriculture occasion a demand for more capital when employed in industry. That increased capital could, however,

have been put to more productive use if, instead of being diluted in the total annual increase in population, it had been confined to a part of that increase: the higher capital per man would have resulted in greater productivity. Hence, the dilution of capital would not have allowed the increase in productivity that otherwise might have been obtained. Thus to the direct loss would be added another, which, although less tangible, would be nonetheless real.

Furthermore, if productivity did not increase, there would be less incentive for ill-employed persons to go into industry, with the result that, instead of manpower being used to the best advantage, it would be disadvantageously diverted away from highly productive occupations.

This is not a remote possibility, but a danger to which Latin America is continually exposed and into which it may sometimes have fallen for lack of economic development programmes with specific aims and clearly defined means to achieve them. Capital is scarce and it would indeed be deplorable to invest it where it would lessen total productivity rather than where it could increase it.

It should therefore not be forgotten that the greater the exports from Latin America the greater may be the rate of its economic development. We should not, however, lose sight of the possibility that a recrudescence of protectionist policy in countries that import from Latin America might lead to the replacement of those imports with goods produced locally.

Such a turn of events would be highly regrettable, but should it occur, the only solution would appear to lie in limiting the growth of imports or even reducing them in absolute terms, in order to adjust them to exports. In such a contingency, the increase in real *per capita* income would be less than it might have been, and it is conceivable that it might decline if the phenomenon became acute.

6. In this connexion it is necessary to take into consideration one elementary fact. Europe has lost a large part of its investments in other parts of the world and, from the point of view of the availability of dollars, cannot be expected, even when the process of reconstruction is complete, to be in a position to supply dollars to Latin America. On the contrary, it will need to take great care to balance its own trade. Consequently, even if one individual country were able for a time to reduce its imports to Europe without perceptible loss in its exports to that area, it is obvious that Latin America as a whole could not do so.

7. In discussing the increase in capital, *per capita*, we have implicitly assumed that industrial establishments would be able to attain a satisfactory size, for which a minimum of production is required. What is this size in the Latin American countries? The variety of conditions obtaining in the different countries makes it difficult to generalize in this case, as in others. Moreover, no systematic study of productivity and its relation to the optimum size of the establishment and the industry has yet been made in these countries. Depressive examples are quoted, however, of the subdivision of industry into an excessive number of inefficient undertakings within one country or of the multiplication of comparatively small enterprises in countries which, by combining their markets for a number of products, could reach a higher degree of productivity. The present division of markets, with its consequent inefficiency, constitutes another limitation of industrial growth, in this case one which could be overcome by the combined efforts of countries which, by reason of their geographical position and economic features, would be able to undertake it to their general advantage.

8. It was pointed out at the beginning of this section that there are two ways of increasing real income. One is through an increase in productivity and the other through a readjustment of income from primary production, so as to lessen the disparity between it and income of the great industrial countries.

The second result can be achieved only in so far as the first is accomplished. As productivity and the average real income from industry increase in the Latin American countries, wages in agriculture and primary production in general will have to rise, as they have in other countries.

The effect will be gradual and if there is not some relationship between all the respective increases in average income of the principal countries exporting primary products, unavoidable difficulties may arise in readjustments of the kind just mentioned, whether they be internal or international.

The possibility of gaining ground in this sphere depends also on the ability of Latin America to maintain the prices of primary products in the cyclical downswing, the point at which it has frequently lost all or a part of the share of the benefits of technical progress that the periphery usually receives in the upswing. There is room here for international economic co-operation.

VII. BASES FOR THE DISCUSSION OF AN ANTI-CYCLICAL POLICY IN LATIN AMERICA

1. The cycle is the typical form of economic growth under our present system, and, although it is a general phenomenon which must be explained by a single theory, it manifests itself in a different way at the cyclical centres and at the periphery.

Notwithstanding these differences, much has been written about the cycle at the centres, but very little regarding the periphery. The brief comments which follow are not an attempt to fill the gap, but an outline of some ideas on anti-cyclical policy which, if accepted in principle, could constitute a suitable basis for the discussion of the problem. If the discussion is not to take place on an abstract plane, the particular case of each country must be examined in order to determine whether its economic structure and existing conditions make those ideas practicable or whether other ways of dealing with the cycle must be found.

2. The firm intention of the United States Government to follow an anti-cyclical policy is well known. It does not seem advisable, however, to rely exclusively upon measures taken by the principal cyclical centre, since in the case of a contraction in that country, firm action on the part of the peripheral countries could be very opportune. The Latin American countries should, therefore, prepare to play their part in the common task.

At the centres the policy resulting from this aim attempts to influence the volume of investments, which are considered the dynamic factor in economic fluctuations. This is not the case at the periphery. There exports are the dynamic factor, which is not surprising, since their fluctuations reflect those in income at the centres, which in turn are closely linked with investment.

It is not, of course, within the power of the periphery to regulate exports in the same way that the centres propose to regulate investments.¹³

Other means must therefore be sought of averting the more serious consequences of cycles on the internal activity of the Latin American countries. In the first place, the idea that industrial development will in itself make them less vulnerable to these phenomena should be dismissed. For this to happen, exports would have to become a very small proportion of national income. In that case, a country would have already left the periphery and become a

¹³ This refers to the impossibility of the Latin American countries changing the pattern of export fluctuations by their own actions, and not to the results that could be achieved through regulating export surpluses, to which reference is made at the end of this chapter.

cyclical centre, and though it might thus have lessened its vulnerability to external influences, it would have developed those inherent characteristics of the system which give rise to the cyclical fluctuations of the centres.

We are rather of the opinion that industrial development will bring out the consequences of the cycle more clearly, by accentuating fluctuations in urban employment. In a country that is essentially agricultural, depressions manifest themselves more in the fall of rural income than in unemployment; indeed in many Latin American countries during the great world depression, people who had previously gone to the cities to find work returned to the land. Unemployment was, so to speak, diluted. This cannot be expected when relatively large industrial masses are concentrated in the cities: in that case the cyclical unemployment problem would assume serious social complications.

Does this lead to the conclusion that, from the cyclical point of view, industrialization has this disadvantage? It might be so if economic activity were left free to operate under its own forces. If it is not, however, industrial development could be one of the most effective elements of an anti-cyclical policy.

3. Let us briefly examine the various possibilities: in one of them, perhaps the most wide spread, an attempt is made to lessen or counteract the effects of export fluctuations on internal activity by means of a compensatory policy in which investments, chiefly in public works, are made to vary in adverse ratio to the fluctuation in exports. This policy demands certain conditions. During the cyclical upswing, tax revenue increases and the market is favourable to the sale of public bonds. Nevertheless, the State should not only abstain from using these additional resources to increase public investments, but should restrict them in proportion to the increase in private employment. Thus, during the upswing, resources would be accumulated in anticipation of bad times or used to repay bank credit extended during the preceding contraction. At the mere mention of these requirements the difficulty of fulfilling them is apparent. For the very reason that the Latin American countries are in full process of development, their investment projects are always larger than can be carried out with the limited means available. To maintain that, when those means increase and the opportunity of carrying out such projects presents itself, the authorities instead of seizing it should accumulate resources for the future, which may be enjoyed by their successors, would mean making the success of anti-cyclical action depend on attitudes not always compatible with sound political interest.

There are yet other difficulties, among them the flexibility of plans. Investments must be alternately increased and restricted according to the cycle, and that is not an easy thing to do. Moreover, there would have to be a rapid transfer of people from the activities most affected by the depression to those created by the new public investments. All this, if it does not lead to the exclusion of the possibility of anti-cyclical action, at least suggests the exploration of other means more suited to Latin America's individual characteristics.

4. It is important that internal activity should develop at a high level of employment, despite the cyclical movement of exports. The way in which that movement causes internal activity to rise and fall is well known. When exports increase, so does internal demand, and with it employment and income; the rise in income brings about in turn a rise in imports, which thus tend, although with some lag, to adjust themselves to exports. This is the way the cyclical upswing develops in Latin America. The opposite occurs in the downswing: the fall of exports brings about a drop in income and employment, with a consequent reduction of imports.

Let us now assume that in the course of these phenomena, internal activity has reached its lowest point. Employment has fallen with a corresponding reduction of income from a maximum of, let us say, 10,000 to a minimum of 7,500. Of this 7,500, twenty per cent, or 1,500,

is spent on imports required in addition to local production to satisfy the current needs of the population, and the very low level to which exports were reduced barely suffices to pay for these imports.

If, in order to increase employment and income to a maximum, a policy of expansion similar to that recommended in the great centres were followed, there would be an immediate increase in imports, providing the coefficient had not changed. Thus when income reached 10,000, imports would be at least 2,000, and if exports were maintained at a level close to 1,500, there would ensue a disequilibrium which would reduce monetary reserves to a very small amount in a relatively short time.

It should be pointed out incidentally that similar difficulties are not likely to occur at the centre during the downswing, since that is precisely when they receive the inflow of gold from the peripheral countries.

Without exceptional resources, it would not seem possible, therefore, to develop in these countries a policy of expansion tending to increase employment, and at the same time not reduce the import coefficient.

The possibility of doing so is limited by obstacles which vary in importance from one country to another. Let us assume, for the sake of simplifying the argument, that they have been overcome and that the coefficient has gradually been reduced from 20 to 15 per cent through tariff changes. This has enabled employment and income to expand without an increase in imports above the minimum of 1,500, the level at which exports are also maintained; in other words maximum employment has been achieved without disturbing the equilibrium of the balance of payments.

Thus, owing to the reduction of the coefficient, the current needs of the population at this maximum level of employment can now be satisfied with 500 less in imports. The problem has therefore been that of producing the difference internally, whether they were finished consumer goods or the raw materials essential to their manufacture.

Not all consumption, however, can be satisfied by articles of immediate consumption or of comparatively short duration. As pointed out elsewhere, technical progress in the great industrial countries has steadily created new needs for durable consumer goods which must be imported. These goods become indispensable as the standard of living rises. This does not mean, however, that the importation of such articles cannot be drastically reduced when the fall in exports hardly allows payment for essential imports. For the very reason that the goods are durable, it would seem possible to restrict importation of them to the extent required by the intensity of the downswing, if they have been freely imported in the preceding upswing.

The same applies to capital goods. If it has been possible to meet requirements during the upswing, it will be possible to restrict temporarily their import during the downswing. In this connexion, it should be taken into account that with the reduction of the coefficient for articles and materials intended directly or indirectly to satisfy current needs, there will be a greater margin than before for the importation of both durable capital goods and durable consumer goods.

Finally, there are non-essential goods satisfying current needs, which are imported in comparatively large quantities in times of prosperity; it is obvious that when foreign exchange is scarce importation of these can be reduced without serious consequences.

In short, for the purposes of this policy, imports are divided into two categories. One covers those that cannot be deferred, and includes the articles and materials indispensable for

achieving maximum employment with a minimum of exports and at the same time ensuring the satisfaction of current needs. The other includes imports of durable consumer or capital goods which are by nature deferrable, as well as unessential goods for current consumption.

Let us now continue with our example. The policy adopted had succeeded in bringing about maximum employment, but meanwhile exports had again increased under the influence of a new upswing. At the same time, the demand of primary products which had also fallen to its cyclical minimum, rose again in proportion to the rise in income caused by the increase in the value of exports. It is evident that where there is maximum employment, this increase in demand will inevitably cause a corresponding increase in imports. Prices will also rise, with a consequent increase in the profits of entrepreneurs, which in turn increases their demand and, through it, imports.

Consequently the increase in income that ordinarily results from a rise in exports above the cyclical minimum will soon be transformed, in one way or another, into an increase in imports, without affecting the level of internal employment.

5. It must be remembered that the readjustment of the coefficient does not mean a reduction in imports. They will be of the same magnitude whether or not this anti-cyclical policy is followed, since they depend ultimately on exports and foreign investments. To reach the goal desired, it is only necessary to alter their composition.

In other words, this change is as follows. When exports are at the cyclical minimum, a peripheral country can pay for only a comparatively small quantity of imports. That quantity is not sufficient to cover the imports required to maintain maximum employment. Hence it is necessary to change the composition of imports and, with it, the structure and volume of internal production, in order to satisfy the current needs of the population while maintaining maximum employment.

While exports remain at their minimum level, only goods essential for maintaining employment and current consumption can be imported. When, however, exports again increase with the upswing, the time will have come for the importation of the additional goods necessitated by the increase in demand.

Thus, while the imports essential to the satisfaction of the current needs of the population will follow the relatively slow rate of the organic growth of the country, deferrable imports will remain subject to the fluctuation in exports.

6. When it was explained above that a reduction in the coefficient of imports for current consumption was indispensable for the carrying out of an anti-cyclical policy, reference was made to the obstacles which would have to be overcome. These obstacles are of various types.

In the first place, the substitution of internal production for imports usually requires the raising of tariffs, owing to the higher cost of internal production. From this point of view, there would be a loss in real income, but on the other hand, the loss in income resulting from cyclical fluctuations in employment is usually very great. It is very probable that in most cases the collective gain from employment stability is much greater than the loss resulting from the higher cost of internal production. It is conceivable, however, that the precariousness of natural resources and the inefficiency of workers or management might be such that the loss through increased costs would absorb an excessively large part of the increase in real income gained through greater employment. The seriousness of this difficulty cannot be denied.

At the same time, the substitution of internal production for imports requires the importation of capital goods, and consequently the necessity of saving during the process of reducing the coefficient. Even if saving could be achieved internally, to import the capital goods

it would be necessary to reduce still further the coefficient of imports for current consumption, thus bringing about a further rise in the cost of living. Therein lies the second obstacle, one which could doubtless be partly removed with the co-operation of international financial institutions, which would thus be able to show that their anti-cyclical measures, while aiding the peripheral countries, also help to maintain the demand for capital goods at the centres. Finally, an anti-cyclical policy of this kind might require transfers of productive factors that are not always easily carried out. However, as explained in another chapter, these difficulties could be lessened to a large extent by the increase of the population of working age and by the better utilization of the ill-employed.

7. In Latin America, the lowest point on the curve of exports and foreign investments has been rising in succeeding cycles. This does not mean, however, that they may not fall to a level lower than in the preceding cycle; the phenomenon is unusual, but has been known to occur, as, for instance, during the great world depression. If it should happen again, a high level of employment could be maintained only to the extent to which monetary reserves were sufficient to cover the excess of essential import over minimum exports or in so far as the international lending agencies were able to achieve their anti-cyclical purpose.¹⁴

8. The need for reducing imports of durable goods during the cyclical downswing has already been pointed out. Is exchange control indispensable to achieve this? As has been seen, the increase in demand for such goods is chiefly the result of new income from increased exports; hence if there is no undue increase in that demand as a result of credit expansion, there will be no need for restrictions, unless there should be a sharp drop in export prices in the cyclical downswing. Restrictive measures would be necessary only if the expansion were very great, or if minimum exports fell below the level of essential imports and there were no extraordinary resources to pay for them.

In such a case, the alternatives are clear: either to reduce even more the coefficient for essential imports, the increase in protective tariffs implied placing an additional burden on the consumers, or deliberately to restrict imports of deferrable articles by means of exchange control.

It is easy to picture a country where a marked propensity to import non-essential articles might be incompatible with the high level of imports of capital goods needed for intensive economic development. Exchange control could then be an effective instrument of selection, without precluding other measures.

For such special cases, one can envisage simple measures of control by which the distribution of import permits would be left to the free play of supply and demand, within the limits of the amount of exchange to be made available for such imports.

On the other hand, it is obvious that if a country were to embark on a very easy credit policy, it would be compelled to choose between devaluation or a system of exchange control which, while masking that devaluation, diverts it with an inflationary influence towards internal activity. An effective instrument of anti-cyclical policy would then become an instrument of inflationary policy. Actually, all measures of monetary policy may equally well be put to good or bad use. There would not even be the excuse of unemployment since, as maximum employment would have been already achieved, there would be no valid reason to continue the credit expansion.

9. Mention has already been made of the extreme case in which the cyclical minimum of exports is insufficient to cover essential imports. This is where monetary reserves can fulfil their specific function. It is therefore an appropriate point at which to examine the matter.

¹⁴ In this connexion, see the remarks of Dr. Hermann Max in *Significado de un Plan Marshall para América Latina*.

Reserves increase in the upswing and, in the downswing, lose a large part of that increase; the greater the previous credit expansion, the greater the loss incurred. This is easily comprehensible if it is remembered that in the peripheral countries imports generally lag behind exports. This, and the similar movement of other items in the balance of payments, causes receipts to exceed payments during the upswing, with a consequent inflow of gold and foreign exchange, while, in the downswing, the opposite occurs.

The theoretical explanation of this interesting process can be briefly recalled. The gold and foreign exchange that flowed in during the upswing tend to flow out again through the circulatory movement of the corresponding income. The foreign exchange that flows in as a result of an increase in exports, for instance, is closely related to an equivalent increase in income; this increase in income circulates internally and is transformed into other increases in income; but in each stage of this circulatory process part of the increase becomes an additional demand for imports, so that the original amount is progressively reduced. Thus the inflowing foreign exchange tends to flow out again. The time lag before it flows out depends, among other things, on the magnitude of the import coefficient and other liability items.

Other things being equal, the higher this coefficient, the sooner will exchange flow out.

It should not be surprising that the outflow of foreign exchange from the Latin American countries is imperceptible during the cyclical upswings, since the new exchange then flowing in exceeds, in the international accounts of a country, the exchange that flows out, and there is a net gold balance in favour of the country. In the downswing, when exports and other asset items decrease, the outflowing foreign exchange exceeds the inflowing, and monetary reserves thus lose part of the gold gained before.

At the end of each cycle there is thus a net increase in gold which represents the share of the country in the world distribution of new monetary metal production. The net increase is comparatively small and depends in the long run on the rate of economic growth of the country and on its coefficient of imports and other liability items in relation to the rest of the world.

If the coefficients do not change, the country which has a higher rate of increase than most will tend to lose a part of the net increase in gold which it would otherwise have had; the more marked the difference in the rates of growth throughout cyclical fluctuations, the greater will be the loss in the net increase of gold.

It could well happen that the gold added, in course of time, to the monetary reserves of a country would not be sufficient to offset the consequences of a reduction in exports during an unusually deep depression. Clearly a reduction in the total import coefficient would help to retain a greater amount of gold in periods of prosperity, and the country would be better able to face such an eventuality.

Additional monetary reserves could also be built up by means of savings; in so far as savings are not invested, a part of income in circulation is not transformed into imports and consequently does not give rise to an outflow of gold. The quantity of gold retained is equal to that of savings. This could be achieved, for instance, if the central bank were to issue bonds during the upswing and cancel the corresponding amount of money, which would again be put into circulation in the downswing; there would be an additional reserve equivalent to the money cancelled which, together with the existing reserves and the share in the world distribution of gold, could relieve monetary pressure if minimum exports should not be sufficient to cover essential imports.

We realize that the building up of additional reserves by means of savings is not a very attractive solution to countries that need to import large quantities of capital goods. It is clear, however, that if a country were able to obtain international credit during a period of

acute depression, it could use more gold during the upswing to import capital goods instead of retaining it as envisaged above. Such a possibility is, in fact, conceivable if a general anti-cyclical programme could be drawn up for the periphery whereby a country which had followed a sound policy could rely upon sufficient co-operation on the part of international institutions during the downswing.

It is very understandable that while an inflationary process was developing at the principal centre, it was not considered advisable to aggravate it by granting international credit in excess of that required for the urgent needs of Europe. If, however, there were to be a contraction, the case would be different, and it would be the right moment to adopt a general anti-cyclical policy without the contradictions that would result from unilateral action by each one of the Latin American countries.

10. International action need not be limited to the field of credit. There are other effective ways of combating depression in the peripheral countries. There has been much discussion of the possibility of purchasing the surpluses of primary production. It is well known that in the downswing agricultural production falls far less than that of industry. It is in the interest of both the centres and the periphery that it should not decline very much, since that would delay the recovery of the centres. It follows that a judicious policy of purchasing surpluses could be highly beneficial; the reduction in imports of primary producer countries would be less, in so far as the cyclical fall in exports could be checked and, consequently, the reduction of demand in the industrial countries would also be smaller.

This regulatory measure would have another advantage. The prevention of an unduly large drop in the prices of primary products through such purchases would help to keep the relation between those of primary and finished products from continually turning against the peripheral countries in the way described earlier.

11. The aforementioned tendency of agricultural production to decline far less than that of industry, or to decline hardly at all, was taken into consideration earlier, when the bases for a discussion of an anti-cyclical policy were outlined. It was then assumed that the reduction of exports would cause a decline in income in primary production, but no reference was made to the possibility of rural unemployment. The downswing is reflected in a drop in prices rather than in a contraction of production, but as rural profits fall with the prices, so likewise do investments in agriculture, thus causing a certain amount of unemployment.

Though, for the reasons given at the beginning of this chapter, a general compensatory policy is not deemed practicable, this does not mean that there is no need for partial compensatory measures. Even with the effective application of an anti-cyclical policy fluctuation in some types of investments is inevitable. In fact, we have seen that an increase in the profits of entrepreneurs causes an increase in their imports of capital goods. The new equipment, however, calls for the construction of buildings and other improvements that absorb manpower during the upswing and releases it in the downswing, just as happens in the case of rural investments.

This is not an insurmountable obstacle. One of the specific advantages of not being obliged to follow a compensatory policy of public works and general investment is that of being able to plan steady development in accordance with the growing needs of the country and the amount of savings that can be used to satisfy them. The total amount of construction can thus increase from year to year without the acute fluctuations entailed by a compensatory policy. Partial readjustments would fit into this progressive development very well. For instance, mortgage loans for private construction could be reduced during the upswing, in order to make available manpower for industrial construction, and during the downswing additional loans could be granted for construction and rural investments in general.

12. The ideas expressed in this chapter are far from constituting a programme of anti-cyclical policy. They are intended only to present the main aspects of the problem and to arouse discussion, while at the same time pointing out certain differences between cyclical behaviour at the centres and at the periphery which oblige the Latin American countries to work out their own programme.

Moreover, the exposition of the principal problems relating to the economic development of Latin America would not have been complete without a consideration of anti-cyclical policy. It is an indispensable complement of a long-term economic development policy. As mentioned before, industry will bring out the vulnerability of the periphery to the fluctuations of the centre. It is not enough to increase productivity and thus absorb unemployed or ill-employed factors. Once productive employment has been achieved, steps must be taken to prevent a return of unemployment as a result of cyclical fluctuations.

The two policies are compatible, however, not only as regards their ultimate aim, but also the means of achieving them. Both require a readjustment of the import coefficient. The anti-cyclical policy calls for it so that a country may continue to satisfy its current needs and to maintain maximum employment in spite of fluctuating exports. The industries and activities which satisfy those needs are precisely those which the Latin American countries can establish with least difficulty, thanks to a market which expands as the rise in productivity increases consumption. If a country could achieve this objective, it would be in a position to endure bad times without detriment to current consumption and employment. It is not necessary for this purpose to force the creation of capital goods industries. If it could be accomplished by a high level of industrial development, technical skill and the accumulation of savings, it would certainly be an encouraging proof of maturity. There is no sound economic reason for setting up capital goods industries, however, since there is still ample room for increasing the productivity of those producing for current consumption.

From the standpoint of economic development, the maximum rise in the standard of living depends on productivity and this in turn depends to a great extent on the most efficient machines. At the same time, it is in durable consumer goods that technical progress continually offers new or improved articles. It would seem advisable, therefore, to import such articles as can be paid for by means of exports or, in the case of capital goods, by foreign investments, within a general programme of economic development.

Moreover, from the anti-cyclical viewpoint, the consequences of export fluctuations could be diverted to fall entirely upon the importation of these imports.

All these are general considerations, which, by their very nature, cannot be applied to particular cases. A country might undertake the establishment of durable goods industries during the initial stage of its industrial development for special reasons, which would have to be carefully analysed.

Here, as in many other cases, our knowledge of the economic structure of the Latin American countries, their cyclical form of growth and their possibilities is limited. If a scientifically impartial investigation of such questions could be carried out and the training encouraged of economists capable of grasping new economic phenomena, foreseeing the problems involved and co-operating in the search for solutions, a service of incalculable value would be rendered to the economic development of Latin America.

ECONOMIC SURVEY OF LATIN AMERICA 1949 *

ECLAC

* Chapter I, numeral 1 (pages 3-5) and chapters III and IV (pages 46-73), in Economic Survey of Latin America 1949 (E/CN.12/164/Rev.1), New York, 1951. United Nations publication, Sales No. 1951.II.G.1. Prepared by Raúl Prebisch.

I. A NEW STAGE IN THE SPREAD OF TECHNICAL PROGRESS

The spread of technical progress from the countries where it had its source to the rest of the world has, from the point of view of each generation, been relatively slow and irregular. During the long period which elapsed between the industrial revolution and the First World War, the new methods of production in which technique has constantly found its expression have reached only a small proportion of the world's population.

The movement began in the United Kingdom, continued in varying degrees of intensity in Europe, received an extraordinary impulse in the United States and finally reached Japan, which strove to rapidly assimilate Western methods of production. Thus the great industrial centres of the world grew up, while the vast and heterogeneous peripheral areas of the new system shared only to a slight extent in the improvement of productivity.

In these peripheral areas, technical progress only affected small sectors of the vast population, as it usually only penetrated where it was needed to produce foodstuffs and raw materials at low cost for delivery to the great industrial centres.

If this economic pattern which the world had developed before the First World War could have been considered the ideal system of the division of labour, any departure from its principles would, of course, have had to be considered as a deviation from the economy's normal way of functioning. However, there could be no sound, scientific reason for believing that this was a final pattern. All that happened in that period was that the world economy passed through a singularly important stage in its growth, but in spite of the significance of its effects, it could hardly be called a final stage since, to a certain extent, it had left untouched the vast peripheral area with its enormous potential capacity for assimilating technical progress so as to raise the very inadequate standard of living of the great masses of its population.

Carefully considered, 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. A few early signs of this new stage had already appeared in the primary producer countries before the First World War. But it was the war, with the consequent difficulties of maintaining imports, which revealed the industrial possibilities of those countries, while the great economic depression of the 1930's strengthened 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; this conviction was confirmed during the Second World War, when Latin American industry, with all its improvisations and difficulties, nevertheless became a source of employment and of consumption for a large and increasing part of the population.

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, as explained above, new production 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. In the performance of this function as a primary producer which is actually the function of Latin America, there was from the beginning a strict selection of aptitudes. Vast regions were coupled to the world economic system while others, no less large and generally more densely populated ones, up to the present time, remained outside the system. Hence development was very uneven. New and fertile lands, which became accessible during the second half of the last century through the development of transport, acquired human material, technique and capital with which to undertake agricultural and mineral production to satisfy the ever-growing European demand, whereas the impressive process of the extension of capitalist

technique and economy by-passed other lands which had been cultivated for ages and which had supported their populations for centuries but which suffered from a low level of productivity or difficulties of access. Thus in Latin America there remain extensive regions, with relatively large populations, in which the methods of working the land, and consequently the standard of living of the people, are essentially pre-capitalist. Accordingly, economic development in these countries requires first and foremost technical progress in agriculture and other related activities, including means of communication.

Experience has repeatedly shown, however, that as modern technique increases productivity, a surplus of labour, no longer needed by agriculture, is created. It then becomes the task of industry and other activities to absorb this labour productively. Hence agricultural improvement and industrial development are two aspects of the problem of economic development. One need only consider the large number of people engaged in agriculture in Latin America, with the exception of a few countries, to realize the magnitude of this problem and the vast effort which will be necessary to solve it.

Through the force of circumstances, with the spread of technical progress an increasing proportion of the economically active population of Latin America, as part of the peripheral area, will be diverted from agriculture towards industry and other urban occupations. Yet, that would not constitute a full solution unless certain pre-capitalist or semi-capitalist methods of production (still used by a large part of the population) were to evolve towards methods characterized by a high level of capitalization per man and high productivity. Though this is indeed very important, the problem of the economic development of Latin America cannot be limited to these terms, for to do so would be to ignore other fundamental aspects. This is not surprising, for though there are certain common denominators in the appearance of the problem in the different countries, there are also specific differences which must be considered lest unwarranted generalizations are arrived at.

II. THE SPREAD OF TECHNICAL PROGRESS AND THE TERMS OF TRADE

1. Dynamic significance of the deterioration of the terms of trade

In the preceding chapter, we sought to show that the improvement in the terms of trade of the great industrial countries, with the corresponding deterioration in the periphery, has been one of the principal factors responsible for the decrease of the import coefficient of the former. We have also pointed out the adverse influence of this phenomenon on the import capacity of Latin America, which had just reached a point in its economic development where imports tended to increase constantly.

This relationship between the import coefficients of the great industrial countries and the terms of trade is no more than the statement of a fact, whatever interpretation one may wish to place on it. It is, however, a fact which is of the greatest importance to Latin America. One is therefore justified in devoting the present chapter to a theoretical examination of that fact, with a view not only to a better understanding of its nature but also in order to clear away some common doubts and confusion.

This is all the more necessary since we are dealing with a phenomenon which is closely related to the way in which technical progress is spread throughout the world. From the outset, we have stated that it is not possible to understand the problems connected with Latin America's economic development without first investigating this process and its consequences. One of these consequences, without a doubt, is the constant tendency of the terms of trade

to deteriorate. This phenomenon is purely dynamic and we hope to prove that, ultimately, it can be explained by the relative slowness of the world's industrial development to absorb the real or potential surplus of population gainfully employed in primary occupations. Technical progress, as we have seen, tends to decrease the amount of labour engaged in primary production. However, this decrease has been extremely slight over the years. In the meantime, new productive techniques are evolved which make further readjustments necessary in the distribution of employed population.

Thus there is a relative abundance of potential labour in primary occupations, tending constantly to exert pressure upon wages and the prices of primary products and preventing the periphery from sharing with the industrial centres the advantages of the technical progress attained by the latter. Furthermore, the periphery is unable to retain a part of the benefits of its own technical progress.

2. Significance of the price relations between primary and industrial goods

From the outset one must be careful not to attribute to this statement implications which can only be understood later. Therefore, a short explanatory note will be useful before going more deeply into the subject. If prices reflected only decreasing costs resulting from technical progress, then prices of manufactured goods should fall more than those of primary goods, since as is generally recognized, the increment of productivity is greater in the former than in the latter. The price relation would thus seem to swing in favour of primary production, and its index or that of its equivalent, that is, the index of the terms of trade, would consequently rise from say 100 to 150, if the terms of trade fell, thus indicating that the same amount of primary products as before could purchase 50 per cent more manufactured goods. Primary producers would then be able to share equally with the manufacturers the profits derived from technical progress, as they would be able to purchase larger amounts of higher quality goods. If despite the greater decline in the cost of manufactured goods, the index of the price relation were to remain at 100, it would mean that producers of manufactured goods would have retained for themselves the advantages of greater quantity and higher quality of manufactured goods. Should the index fall below 100, then not only would primary producers not have received any share from increased industrial productivity but they would have been unable to retain for themselves the full profits of their own technical progress, since they would have surrendered a part of it to the manufacturers. This does not mean that primary producers are worse off than they were before. Everything depends on the degree of increased productivity reached and the extent to which it is transferred to industrial manufacturers. If the index falls to 80, for instance, primary producers will be able to obtain 20 per cent less manufactured goods than they did before, for the same amount of primary goods. However, if to obtain that same amount they need work only half as long as before, one hour's labour would now allow them to purchase 60 per cent more manufactured goods, instead of 100 per cent more, as would have been the case had they received the full benefits of their own technical progress; or an even greater quantity had they been able to share in the benefits of technical progress achieved in the industrial sector, should such progress be greater than that achieved in the field of primary production.¹

The indices given in the preceding chapter seem to indicate that in the past seventy-five years something of this sort has occurred; that is to say, if, as is likely, technical progress in primary production at the periphery had been less than that of industry at the centre, then the

¹ For a fuller analysis of this phenomenon, see "The economic development of Latin America and its principal problems" (E/CN.12/89), page 2.

periphery will have transferred to the centre part of the benefits of its own technical progress. Unfortunately, due to the lack of data concerning the increment of productivity in primary production it is not possible to ascertain the extent of such benefits and what part of them has remained in the primary producer countries. We will return to this aspect of the question later. Meanwhile, we shall try to explain the causes of this phenomenon which is so vital in the economic development of Latin America.

3. The real or potential surplus of gainfully employed population and the terms of trade

We have already stated that a surplus of labour generally exists in primary production and that this excess exerts an unfavourable pressure on primary wages and costs. This tendency derives, on the one hand, from the relatively large increase of population in the regions of primary production and on the other, from technical progress, which reduces the number of persons required to obtain the same quantity of products. The absorption of such a surplus in fact becomes the task of industry and the occupations directly or indirectly depending on the development of industry.

The surplus may either be real or potential, that is to say, it may already have become a reality through the application of new techniques in primary production or occur when new methods are introduced either spontaneously or as a consequence of industry's labour requirements which, by drawing labour from primary production, cause wages to rise and forces an improvement in methods of production. This latter case seems to have occurred frequently in the United States, where industrial areas attract population from the peripheral zones of primary production in the country. A real surplus of gainfully employed population could also occur if technical progress in primary production was not accompanied by either prior or simultaneous development of industry and its related occupations, in which case neither would then be capable of absorbing the excess labour as it arises.

In either case, if the gainfully employed population were perfectly mobile and did not show reluctance or deliberate opposition to migration, and if the rapid development of industry and its related occupations could immediately absorb the aforesaid real or potential excess of gainfully employed, then there would be a marked tendency towards a levelling of primary and industrial wages, even making allowance for differences in skill. Both would benefit from the general increment to productivity if instead of wages rising with the increase of productivity, prices fell together with costs.

However, an examination of the situation in the world as a whole shows that both industry and its related occupations have developed relatively slowly, so that absorption of the real or potential surplus of gainfully employed population in primary production has been considerable in the great industrial countries; but the process is only just beginning in Latin America and the rest of the periphery.

The large countries, given the present structure of the world's economy, limit the process to their own population. Within their frontiers, industry and its associated activities do not develop in such a manner as to absorb the population of the periphery, so that the peripheral countries have no means of absorbing the surplus of their gainfully employed population except by developing their own industrial activity. It is not possible for them to employ this surplus in expanding primary production since the distribution of the population is not arbitrary but depends on productive technique, as has been pointed out in chapter I.

Consequently, the relatively slow spread of technical progress has weighed more heavily than the factors which tend to distribute its benefits over the world, and the periphery not

only has been generally unable to share with the industrial centres in the advantages derived from the technical progress in these centres but has even been compelled to cede to them a part of the benefits deriving from its own progress, due to the insistent pressure of the real or potential surplus of gainfully employed population.

4. Degree to which benefits of technical progress are transferred

The magnitude of this cession by the periphery to the centre of a part of the benefits derived from technical progress in primary production is not uniform. On the contrary, the intensity of the movement varies in proportion to the strength of two opposing forces. On the one hand, we have the growth of primary production and, on the other, the demand for primary goods in the industrial centres. Should the latter increase more than the former, the amount ceded decreases; and the centres might even transfer to the periphery a part of the benefits of their technical progress, a phenomenon which would become manifest in the improvement, for the periphery, of the terms of reciprocal trade. However, if demand in the industrial centres increases relatively less than primary production, or is slow to recuperate its powers after an acute depression, the price relation will deteriorate for the periphery, and the degree of its transfer to the centre will increase in inverse ratio to the proportional or absolute weakening of the dynamic industrial factor.

There is, in fact, a dynamic element in industry which is not found to a comparable extent in primary production. The latter, as its name would imply, covers the initial phases of the productive process, while industry accounts for subsequent stages. Because of this relative position of the two activities, the increase in industrial activity stimulates primary production, but the latter has not the power to generate industrial production. When industrial entrepreneurs, stimulated by the normal economic forces, or by extraordinary factors in times of a war, undertake to increase production, demand for primary products increases; as profits are consequently greater, entrepreneurs in the periphery seek to increase primary production. The spontaneous increase of the latter, on the other hand, does not cause a similar rise in industrial demand which would be capable of absorbing that increase, as can easily be seen from the following example. Let us assume, exaggerating the proportions to simplify matters, that in a total selling price of 1,000 units for a finished product, 500 correspond to the periphery and the rest represents values added during the various stages of the productive process corresponding to industrial sectors. Let it further be assumed that the periphery of its own initiative intends to increase its production by 10 per cent, giving its productive factors an added income of 50. To simplify even further, let it be assumed that this increase of income is entirely absorbed by the consumption of finished goods from the centre. It is clear that the demand for such goods will only increase by 5 per cent at most, whereas primary production will have increased by 10 per cent. There would, therefore, be no increase of industrial demand sufficient to absorb the increased primary production and the latter's terms of trade would deteriorate. In actual fact, the share of primary production in the value of finished goods is less than that given in our example and the increase in income is not absorbed entirely and immediately by the consumption of finished goods. In reality, the periphery's influence on the centre would be weaker and the consequent disequilibrium would be correspondingly greater.

The foregoing affords us a better understanding of the effects of increased production in the periphery deriving from either increased population or from improved technical progress, and shows that if such an increase of production is not accompanied by an equivalent increase in the demand for primary goods in the industrial centres, the position of the periphery is weakened and it cannot resist the pressure of factors which tend to take from it the benefits of its own productivity.

5. Dynamic importance of industrial growth

From our remarks concerning the dynamic significance of industrial development, it may be seen that this development affects manufacturing in two ways: first, by what we have called demand from the centre —this covers both raw materials for industry and foodstuffs required by the centre— and secondly, by the absorption of surplus manpower from primary production. Let us now look at this second point.

It has been shown that the centres absorb their own surpluses but not that of the periphery. However, they may have an indirect influence on the number of the gainfully employed in the periphery, through the demand for primary products. If industry and other activities at the centre develop to such an extent that they not only absorb the surplus manpower of their own primary production, but also the population which that production requires in order to meet the increased industrial demand, then the centres would tend to import from the periphery a greater proportion of primary goods to meet the increase of their own requirements. In this way the periphery would obtain relief from the pressure of its surplus population and at the same time the tendency of the price relation to worsen would be checked.

Phenomena of this nature must have occurred in the development of those countries which have now become great industrial centres. But there are other, better known and perhaps more important ways in which industrial development has functioned as a dynamic factor, absorbing surplus population from primary production. It is a well known fact that when the Industrial Revolution was in full swing in the nineteenth century, the European population increased considerably. An increasingly large part of this population was absorbed by industry and other related occupations developing at the time, and the rest was engaged in primary production not only at the centre, but also in the new overseas countries which technical progress in transport had thrown open to international economy, especially in the latter half of the century. Large numbers began to emigrate from the older regions of primary production in Europe (which were gradually becoming more and more industrialized) to the newer areas which had become either complements or substitutes in the production of primary goods. If we look at the phenomenon as a whole, however, we perceive that the proportion of persons gainfully employed in primary production tended to decrease whereas that in industry and related economic activities tended to increase. Nevertheless, the decrease was not sufficient to avoid a relative drop in primary prices.

Productivity in the new lands was higher *per capita* than in the older regions, and progress in transport enabled goods from the former to reach the European markets easily and cheaply. It is possible that this increase in production, probably greater than that of demand at the centre, greatly influenced the deterioration of the terms of trade which occurred after the seventies of the last century and continued until the First World War.

Then, as now, the growth of industry probably did not have sufficient impetus to prevent the terms of trade from turning against the periphery. If industry and related occupations at the centres had absorbed the population employed in primary production more efficiently, emigration toward new countries would have been less and consequently they would have had fewer people available to increase primary production; thus primary production would have been in a more favourable position *vis-à-vis* demand from the centre.

A good deal of this will remain conjectural until further research has been undertaken. Nor should we forget that, in the case of some primary goods at least, the increase of productivity indirectly attained when the new countries were opened to world trade by technical progress in transport, may possibly have been greater than that attained by certain industrial sectors.

This would not, of course, invalidate the analysis contained in this chapter since, if a part of the benefits of technical progress in primary production in the periphery is transferred to the industrial centres, both when the increase of productivity in primary occupations is greater than in industry and when the increase is less, the reason is probably that the real or potential surplus of gainfully employed population engaged in primary production exerts a persistent pressure on wages and prices.

Not all the countries then opened up to the international economy were predominantly exploited by immigrant labour from the older regions of Europe. In the Latin American countries with old settled populations that had come to live there before or after the Spanish Conquest, there is more than ample potential labour to work the land, whether in agriculture or mining. For this and other reasons, these countries do not attract immigrants from Europe, or at least not to the same extent as other countries. This fact cannot be overlooked in a study of the variations in the terms of trade of the various primary products, according to the latter's peculiar nature, the type of production and the degree of technical progress. Yet we must disregard it in this summary explanation, which for the moment has no other purpose than to clarify certain fundamental ideas for a better understanding of the problem of terms of trade.

The period during which the new lands were opened up on a large scale in Latin America may be taken as ending somewhere between the First World War and the Great Depression. There are remarkable contrasts between this period and those following. During the latter the deterioration of the terms of trade was much more pronounced than before, since the marked deterioration during the First World War was followed by that caused by the depression. There is not only a transfer to the centre of the benefits accruing from technical progress in transport and other activities which made possible the better utilization of the increased productivity of the new lands, but also a transfer of part of the increase in productivity directly obtained from improved technical methods of exploitation, or perhaps the whole of the increase and more, as may even have occurred in some cases.

Exports, which in the previous period had generally increased more than the population, continued increasing but at a slower rate than the population; the serious consequences of this fact in conjunction with the adverse trend in the terms of trade have been pointed out in the preceding chapter. In addition, income from land, expressed in a constant monetary term, decreased instead of increasing. All these circumstances combine to place an entirely different complexion on the economic development of Latin America compared with the earlier development of other countries.

The dynamic element of the large centres no longer functions as it did during the decade of the Great Depression and, in primary production the surplus population is distinctly noticeable; an imperative need is felt to supply the deficiency of that traditional dynamic factor by means of a new one springing from the growth of domestic industry. The extension of technical progress in Latin America thus enters a new stage.

6. Land rent and wages in the development of the periphery

In this first analysis of the terms of trade, it can be stated that in Latin America the export industries to which these terms relate have, as a general rule, kept wages at a fairly low level compared with wages at the centres, even in cases where there has been an appreciable increase of productivity. We should not forget, however, that there have always been marked differences from country to country and that in recent times, increases have been achieved where the organization of labour and other favourable factors made them possible, as will be shown in another chapter. A number of factors account for such differences between the

wage levels, among these the extent to which the industrial development of each country has progressively absorbed the surplus population and tended to raise wages relatively when competitive conditions in the international sphere allowed.

The fact that wages have remained at comparatively low levels during the primary development of the Latin American periphery, does not mean that technical progress has not been able to increase other sources of income considerably. In those areas which are opened up to agricultural or mining exploitation, a sharp increase has occurred in land rent, whereby the value of the land itself, previously worth little or practically nothing, was greatly enhanced. The rent of the economically new lands is, in the last analysis, the expression of their greater productivity as compared with the older lands. Technical progress in transport is largely responsible for this increase of land rent. A part of the benefits derived from this progress remains in the hands of the landowners, whilst another part flows into the industrial centres, by means of a relative lowering of prices.

The social and economic repercussions of this fact are indeed vast, as increasing returns from the soil impart a very special form to the penetration of capitalist technique in the export industries of the peripheral countries.

The relatively low level of wages in primary production was therefore compatible with the high increase in land rent, to the advantage of certain social classes.

Thus we find considerable sources of income springing up during the primary development of certain countries in which more advanced forms of economic development may later thrive, whereas in other countries, even though land rent also greatly increases, an appreciable part of the increase flows into the industrial centres, especially in the development of certain mining enterprises.

7. Terms of trade in this new stage of extension of technical progress

It was shown in the first chapter that technical progress had been predominant in Latin America's primary export activities, though with varying intensity. There is still much room for technical improvement in these occupations. But if present economic conditions continue, it is possible that these improvements would not guarantee the permanent raising of the wage levels. On the contrary, wages might even be lowered and a large part of the profits derived from technical progress lost, if the surplus population created by these very improvements cannot simultaneously be absorbed into industry and its associated occupations.

Still, the periphery is immense and the population which will have to be absorbed by its industry and associated occupations as modern technique expands is also large. If a country determined to raise its wage levels by increasing the productivity of its export occupations and absorbing into industry the surplus of gainfully employed population accruing there from, it might be seriously hindered by other countries, also engaged in improving their techniques, but making no effort to raise the very low level of their wages.

This might be the case for areas which are at present engaged in a process of primary development similar to that which occurred about the middle of the last century in the Latin American periphery. In these areas there is no industrial development to absorb the surplus population and this lack may contribute to the maintenance of low wage levels. This is one of Latin America's most serious problems, especially owing to its influence on the phenomenon described above, which occurs in the terms of trade of certain outstanding products.

The same thing does not occur in the case of primary production for domestic consumption in these same countries where, in general, little technical progress has been introduced, as compared with export industries. It is obvious that if the surplus of gainfully employed cannot be absorbed there, prices will drop as productivity rises, to the advantage of other social groups. But in this case the phenomenon can be counteracted by the development of industry and its related occupations, ensuring that primary producers obtain all the benefits deriving from technical progress without interference from competitor countries.

Nevertheless, even in the case where the benefits of technical progress in export industries flow abroad, a net increase of income would be possible by employing in industry and its associated occupations the surplus of labour created by technical progress in primary production. In other words, despite the possible deterioration of the terms of trade, the peripheral countries can obtain for themselves the full benefits accruing from technical progress in primary production for the domestic market, as well as from technical progress in industry, as applied to the surplus gainfully employed population. But it is obvious that the net increase in income will be proportionately greater in accordance with the country's ability to counteract the tendency of the terms of trade to worsen.

8. Another form of transfer of benefits of technical progress

At the beginning of the present chapter we cautioned against any indication, without further study, to attribute to the terms of trade any implication other than a mere statement of fact. The preceding analysis now permits us to study such implications, beginning with those which seem unacceptable.

In the first place, let us take the ethical implications. The fact that the centres tend to retain the benefits derived from their own technical progress does not mean that they are taking possession of something that does not rightfully belong to them. From the ethical standpoint, there might be more than one justification for this procedure. However, this point is irrelevant to this report. Our purpose is rather to point out that this method of taking possession of those benefits was not envisaged in doctrines of great influence on certain currents of economic thought. According to them the benefits accruing from technical progress should flow equally to the whole community in the form of lower prices or increased incomes. This is what has, in point of fact, generally taken place; but only in the industrial centres where the benefits of their technical progress remained. The same theories furthermore assumed absolute mobility of factors and products, and the abstract world of this assumption is substantially different from the one in which we live. It would, therefore, be necessary to revise the theory *ab initio* before applying it to the study of problems of economic development in the periphery. If the world division of labour had been effected according to this theory the distribution of economic activities throughout the world would perhaps have been very different from what it is today and the problems presented by the differences in the rate of increase of productivity and income, which so profoundly affect the world economy would not have assumed their present proportions. The difficulties would have been of another kind, perhaps far more serious than those with which we are now faced.

This same difference between the abstract world of absolute mobility and of levelling tendencies, on the one hand, and the complex reality of the present economic organization, on the other, makes easy comparison impossible between results which, in given circumstances, would correspond to that theory and those which are, in fact, observed.

It might be argued that, if the centres did not retain the benefits of their own technical progress, every peripheral country would be able to attain far higher terms of trade than at

present and its income level would approach that of the centres. But it might similarly be contended that the peripheral countries derive a lower income than that of the centres from their export industries, because their productivity is lower. According to the above-mentioned theory no country, region or industry could maintain itself in a state of absolute mobility of the factors of production if its technique were inferior to that of other countries, regions or industries, since it would no longer be able to export and its factors of production would be transferred to other countries, or else to other regions or industries in that same country.

Furthermore, according to the same theory, if the benefits derived from technical progress flow from one party to another, similarly benefits derived from great productivity in the latter must flow towards the former. There is reciprocity in this movement and in no case could the transfer be a premium on inefficiency in production.

Since the theory must not be applied only in part, we will do no more than keep it in mind as an aid to understanding the differences between the facts and its assumptions, in order to acquire wider knowledge of actual conditions.

9. Conclusions drawn from the preceding analysis

The foregoing leads to a first conclusion. The theory as outlined above assumes reciprocity of transfer whereas, in fact, such reciprocity does not appear to exist. Given the dynamic changes which are constantly taking place in the world economy, the slight mobility of the factors of production and the slow development of such occupations as can absorb the surplus of gainfully employed persons, the periphery tends to transfer a part of the benefits accruing from its technical progress to the centres whilst these latter retain their own benefits for themselves. The more the periphery seeks to increase its productivity, thus aggravating the surplus of its gainfully employed persons, the more intense will be the transfer, other things remaining equal. Therefore, in order to raise the income level in primary production in Latin America it is not sufficient merely to increase productivity; it is also necessary to absorb the surplus of gainfully employed persons in expanding industry and allied occupations.

There is also a second conclusion to be drawn in relation to the economies of developing industry. The argument demonstrates, with unimpeachable logic, the economic advantages to be derived from a natural division of international labour, given perfect mobility of the factors of production. It is evident that, if a country obtains all the advantages of technical progress achieved by other countries and in return affords them the advantages of its own productivity, it will not obtain any additional advantage if, by means of protective measures, it engages in the production of goods already produced by others. On the contrary, it can be proved decisively that economic losses will follow. However, if there is not absolute mobility of the factors of production from country to country, the development of industry may contribute to bring incomes in the primary producer countries up to the level of industrial countries. In so far as this occurs there will be a net profit for the primary producer.

Nevertheless, in order that this levelling may take place, it would be necessary for other competitor countries in primary production not to force competition in their own favour by lowering wages. That is precisely the great difficulty facing the periphery, as has been indicated elsewhere in this chapter. But there is another source of net profit which is less problematic, since industry and its allied occupations add a net increase to incomes previously earned when employing the surplus population formerly gainfully employed in primary production and dislodged there from by technical progress. This increase will be proportionately greater as the productivity of the new industries reaches that of those industries in the countries which are more advanced technically and it represents a net profit even though productivity be inferior.

Consequently, owing to the lack of international mobility of the factors of production we have to measure economic advantage in development of the periphery, by standards different from those possibly suggested by the above theory.

The third conclusion relates to the way of extending technical progress. In the theoretical argument we have been examining, the fact that a group of occupations increases productivity presupposes that the resultant lowering of prices will immediately benefit all other activities, creating an additional margin of income available to increase demand or savings. But in fact, if prices do not fall in the large centres as productivity increases and income rises, then greater demand and savings capacity will be developed only in the centres. This would mean that the peripheral countries have, on the one hand, remained unaffected by such advantages while, on the other, they are faced with the problem of assimilating an advanced industrial technique which requires extensive development of both demand and savings. But this point will be dealt with in another chapter.

To sum up, the discrepancy between the theoretic argument based upon absolute mobility of productive factors and the realities of economic experience is so significant for the theory of economic development in Latin America in particular, and the periphery in general, that we shall have to overhaul our theories thoroughly. A revision of this nature, being based upon premises closer to reality, will help us to state, on sound premises, the essential lines of a policy of economic development.

10. The economic cycle and fluctuation of terms of trade

In reviewing the theory, from the point of view of the development of the periphery, the study of the economic cycle must be given special consideration. Even though the low mobility of the factors of production as technical progress spreads suffices to explain the great differences between incomes at the centre and those of the periphery, these differences are created precisely during the cyclical movement. In other words, the cycle has, in fact, been the mode of growth of the capitalist economy. These phenomena are of great interest to the Latin American countries, and hence we shall consider some of them in concluding this chapter.

It is a well-known fact that, during the cycle, prices move in favour of primary products during the upswing but, during the downswing, generally tend to fall more than they had previously risen. Thus, as the price level falls during each depression more than it had risen during the preceding period of prosperity, we find that over a number of cycles, there is a continuous tendency for the terms of trade to worsen, as has been shown above.

These periodic falls in the price relations are the result of the way in which, in cyclical downswings, the benefits of technical progress are transferred from entrepreneurs to their social groups. During the upswing, despite increased productivity, prices rise and the profits of the entrepreneurs rise concurrently. If increased productivity brought immediate improvements to wages and salaries, these would have to rise more than prices. This does not usually occur during the upswing, when prices frequently rise more than wages so that the benefits accruing from technical progress remain in the hands of the entrepreneurs. It is during the cyclical downswing that these benefits are transferred to wages, which decrease less than prices, thus establishing a more favourable relation for wages; and greater advantage is taken of this as a new phase of prosperity absorbs the unemployment which marks the cyclical downswing.

In other words, during the depression, wages lose only a part of the benefits obtained during the period of prosperity and thus can reap the benefits of technical progress. Naturally,

the whole of the benefits does not go into wages. The State has been taking an increasing proportion of the benefits derived from technical progress and so has been able to widen the scope of its activities. Other social classes also take their share, to a greater or lesser extent, and, furthermore, as competition between entrepreneurs is limited, these are left with a greater share than they would otherwise have had. However, we are not concerned with the distribution of benefits in the centres but rather in the sum of the respective increments of productivity which remains there, as compared with that remaining in the periphery.

Let us assume that after a period of depression, the net increment to income at the centres is equivalent to the increase of production obtained by greater productivity. It is evident that if the full benefits remain in the centres, the periphery will obtain no share at all. Now let us assume that the net increase in income at the centre is greater than the increase of production there; this would mean that the periphery must have transferred part of its increased productivity to the centre and even part of the real income which it formerly enjoyed.

The question now arises: What are the forces which allow the industrial centres to exert such pressure on the periphery, retaining the profits of their own technical progress or even taking possession of part of the benefits accruing to the periphery?

To answer this question, let us recall some observations made in a previous document regarding certain manifestations of cyclical phenomena at the centres and in the periphery.² During the cyclical upswing, demand for finished goods in the centres is greater than supply. There exists, therefore, an excess demand increasing profits for the entrepreneurs and giving rise to other phenomena; these phenomena in which the periphery plays an important part, eventually transform this excess into shortage and so lead to the cyclical downswing, wherein demand becomes less than the aggregate supply price of finished production. As the value of the aggregate supply, swollen by the higher profits of earlier stages in the productive process, cannot be easily reduced by lowering prices, stocks of finished goods temporarily unsaleable at those various stages are accumulated.

Then a series of reactions follows which tend to lower the aggregate supply price until demand once again begins to absorb current production.

This way of decreasing the aggregate supply price of finished goods is of great importance to the periphery. In fact, this price, as mentioned before, was augmented at the centres by the addition of profits. However, some of these were converted into increases in wages and other forms of income. For the sake of brevity, and to avoid entering upon any unnecessary complexities, we will refer merely to the increase of wages, this being the more significant phenomenon.

If the aforesaid decrease in the supply price were affected in proportion to increases of profits and wages, which had previously raised that price, one would simply return to the point of departure, and both the centres and the periphery would share equally in the benefits of technical progress, whatever their amount in either place.

However, this is not the case, owing to the mechanism of the cyclical downswing and the nature of the forces affecting it. The accumulation of surplus stocks causes the sellers of finished goods to scale down their demand for the goods of their immediate suppliers; these in turn scale down their requirements of the goods of their suppliers, and so on to the stage of the entrepreneurs of primary production in the periphery. In each of these stages, through which the cyclical downswing is transmitted, employment and profits decrease.

It is a recognized fact, however, that at the centres there is great resistance to any lowering of wages, despite unemployment, and in some sectors to the reduction of profits.

² "The economic development of Latin America and its principal problems", *op. cit.*

This constitutes an obstacle to the lowering of the part of the aggregate supply price accounted for by the centres and when it cannot take place to the extent necessary to bring it nearer into line with aggregate demand, surplus stocks will continue to accumulate. It then follows that the greater the volume of these surplus stocks, the greater the need to curtail production and therefore, the demand for primary products, and the greater the fall in the price of these primary products.

In the periphery, lower prices for primary goods naturally mean lower profits and adverse pressure on wages in communities in which labour organizations, where they exist, are far less powerful than in the cyclical centres.

The greater part of production costs corresponding to the stages completed in the industrial centres is made up of the wages paid at those stages. Therefore, the fact that wages suffer a relatively small decrease means inevitably that it is for the periphery to reduce the aggregate supply price, so that the greater the wage increase during the cyclical upswing and the more rigid wages become during the downswing, the greater will be the pressure exerted by the centres on the periphery, through the reduction of their demand for primary goods and the consequent lowering of the price of these goods.

This occurs, other factors which influence the intensity and duration of the cyclical downswing remaining equal. For instance, if during the upswing, only a relatively small part of the profits has flowed into wages, the fact that during the downswing profits may become inelastic would have even more serious consequences than the rigidity of wages, since the former, during the depression, are the most important source of hoarding, to the detriment of demand.

Having made this qualification, let us continue the analysis. If, on the one hand, at the centres we have this relationship between the net increase in wages and their resistance to decline, and, on the other hand, we have the intensity of the pressure exerted by the centre on the periphery, it is not difficult to understand that if the net increase of wages is greater than that of productivity, in accordance with a previous assumption, then pressure on the periphery will be so great that the lowering of prices will take from the periphery an ever-increasing share of the benefits of its own technical progress, or even more, as has been shown above.

How far does experience show that the periphery can resist this pressure? There have been cases in which large stocks of primary products have been accumulated in the periphery in preference to selling at prices considered too low. But when the periphery resists the constriction of its own supply price, the total supply price of finished goods at the centre does not fall sufficiently to eliminate the difference between it and demand. Hence stocks of finished goods as well as of those being manufactured continue to accumulate and there is a steeper decline in the demand for primary products.

Though this explanation is fairly general and each individual case would have to be examined separately, the Great Depression of the 1930's showed clearly that the pressure on the primary producer countries can be so great as to compel them to devalue their currency in order to be able to adapt themselves to the fall in prices imposed by the decrease in demand at the cyclical centres. In this way, the whole population is affected by the consequences of a readjustment which would otherwise be catastrophic for those who derive their income from primary production.

It would not be admissible to generalize this inference and argue that the chronic tendency towards monetary depreciation, recorded in the annals of some of the Latin American countries, can be attributed to the peculiar manner in which this reduction in selling prices occurs during the cyclical depressions. But neither would it be reasonable to suggest that financial upheaval and the resulting inflation are exclusively to blame for that phenomenon, without admitting

the influence of the pressure which is automatically brought to bear on the periphery during the cyclical downswing. The whole problem offers a most interesting field for study.

It is evident that if there had been notable increases of productivity in the periphery, this area would have been better prepared to withstand the effects of such pressure by surrendering to the centres the benefits recently acquired through increased productivity. But if there were no such advantages, the periphery would find itself compelled to surrender a part of the benefits acquired in the previous phase of development. This is precisely one of the reasons why the world economic crisis affected Latin America and other peripheral countries so seriously. Depressions prior to the First World War had been shorter and far less intense. One must go back to the seventies of the last century to find as long a depression, though less intense. However, the downswing of the seventies coincided with a period during which Latin America was rapidly increasing its indirect productivity, by incorporating new areas into international productive activity, as we said earlier. There was, therefore, a wider margin of benefits derived from technical progress in the periphery to be shared with the centres.

Here we have another case where the course of events subsequent to the world economic crisis, when contrasted with those leading up to it, offers us a better vantage point from which to analyse the problem of economic development in Latin America. Yet this is not the only important comparison, as was shown in the preceding chapter.

III. CONTRASTS AND DIFFERENCES IN THE PROCESS OF ECONOMIC DEVELOPMENT

1. High degree of capitalization and low level of income

We have defined the economic development of Latin America as a new stage in the world-wide extension of the capitalist technique of production. To a certain extent, we are now witnessing a process similar to that which took place in the nineteenth century, when countries which today are great centres began their industrial development. The phenomena are not, however, identical, for conditions of the international economy which now prevail are, as has already been shown, very different from those which obtained then; the later phenomena present unique characteristics which had no cause to develop in the earlier centres, at least not in so manifest a form. We shall consider this aspect of the problem in the present chapter.

These peculiar characteristics are, in fact, the expression of the contrast between the very advanced stage of capitalist development in the great centres and the pre- or semi-capitalist state of a considerable part of Latin America.³

Contrasts of this type are due to the long time which has elapsed since the Industrial Revolution. They could not have arisen at the beginning of the process, since conditions in the countries which followed the example of industrialization set by Great Britain were very similar to conditions obtaining in the latter country. At that time, capitalist technique was only beginning to develop and the British national income had hardly increased. Furthermore, all these countries founded their new-born industry on the solid historic base of an artisan class.

³ Of course, many intermediary stages occur in Latin America in the industrial sectors which, so far as productivity is concerned, are closer to the great centres than to other Latin American sectors where production is primary and productivity extremely low. Therefore, in examining the concrete facts we must keep in mind the different stages of evolution in Latin America.

Industrial progress since then has been very great and consequently has widened the gap between the highly developed centres and the peripheral countries, in which modern technique generally has only been introduced into export activities. In the more highly developed countries, productive technique requires a high capital investment per man employed. However, the gradual increase in productivity brought about by this technique enabled these countries to attain a high level of *per capita* income, so that they could affect the savings required to create the needed capital. On the other hand, savings are low in the majority of the Latin American countries because of the low income level. When the great modern industrial centres were in a position comparable to that of present-day peripheral areas, and the *per capita* income in these centres was relatively low, productive technique also required only a relatively small capital investment per man. Careful study shows that savings are neither great nor small of themselves, but only in relation to the density of capital, determined by technical progress. In this sense, savings in Latin America are, on the whole, very small in comparison with the requirements of modern technique. Certainly in the early stages of the Industrial Revolution of the great centres, voluntary savings were not very great either, but neither did technique at that time require the large capital coefficient per man needed nowadays. Technical improvements were only brought into use as increases in productivity, income and savings made them economically possible and practical. In other words, one must go back several decades, if not a whole century, to find *per capita* incomes equivalent to those generally obtaining in Latin American countries nowadays.

In that period capitalist technique was still in the first stages of its development, whereas now it manifests itself in a high degree of capitalization, not easily within the reach of the scanty savings that can be put aside out of the low incomes prevalent in Latin America. It follows, therefore, that the later modern technique is introduced into a peripheral country, the sharper will be the contrast between its low total income and the large amount of capital necessary to increase this income rapidly; so that, had similar contrasts appeared in the development of the great centres, they would have been less sharp than those observed now.⁴

Consequently, countries which have recently begun their industrial development have, on the one hand, the advantage of finding a degree of technique in the great centres which required time and sacrifice to acquire; but on the other hand, they encounter all the disadvantages inherent in lagging behind in the course of evolution.

2. Low incomes and insufficient demand

Another important consequence of the disparity between the degree of growth of income and that of productive technique is the low level of demand which generally characterizes the greater part of the Latin American populations, despite their numerical size. Not only does lack of capital or of skill in managing it stand in the way of the adoption of advanced methods of technique but, in addition, low demand makes it impossible to reap the benefits of mass production. Industrial development in the great centres cannot have been hindered by limitations of this kind. There, the originally low income coincided with production on a correspondingly small scale. This scale grew in time, as greater productivity raised incomes and, with them, demand, which in turn absorbed the larger, better and more varied production.

The situation is very different in the countries which are now adopting modern industrial technique. Here demand is low because productivity is low; this is so because weak demand in its turn impedes, along with other factors, the utilization of more advanced technique.

⁴ Situations similar in this and other respects may have occurred in the economic history of Japan; it would be very interesting to compare them with conditions in Latin America.

Nevertheless, in large industrial countries, such as the United States for instance, there are regions which began to industrialize at a comparatively late stage in their development. One may ask if they, too, faced the problem of low demand, as does the Latin American periphery. The answer is not without interest since it shows us another of the consequences of the distribution of the benefits of technical progress. It is a known fact that the great mobility of labour in the United States tends to make all income rise as productivity increases, so that income rises not only in those occupations where technical progress is greatest, but also in those where it is low or non-existent. The increase of income is, therefore, a general phenomenon which occurs in all sectors of the country, as envisaged by the classical theorists. When productivity is increased in the industrial areas, for instance, the resultant increase of income is extended to others and, therefore, the capacity to increase demand develops not only in those areas but spreads throughout the whole country and the whole economy. The same may be said of the capacity to save, and as both these capacities are essential elements of industrial development, it is not surprising that industry has not remained within the limits of its original areas but rather has gradually extended in different directions. If the original areas had been able to retain all the benefits of technical progress, there would have arisen a growing disparity between the income and consuming and saving capacity of those areas and the corresponding factors of the periphery; and the latter would probably have been faced with problems similar to those arising today in the international periphery.

3. Technical progress and unemployment

It is also a well-known fact that one of the greatest spurs to technical progress in agriculture and other forms of primary production in the United States has been the increase in wages deriving from constantly increasing industrial productivity. The development of manufacturing and other similar activities, as has been said before, absorbed a growing portion of the increasing population, compelling primary production constantly to improve its technical methods. Thus technical progress in agriculture was to a great extent the consequence of industrial development. Agriculture in Latin America also requires considerable technical progress if it is to raise the standard of living of the masses. But if this meant that industry was going to suffer, we would be faced with another phenomenon which did not occur in the development of the great industrial centres. There, industry furnished the stimulus for technical progress in agriculture, as has just been indicated, whereas in Latin America progress would spring from agriculture itself. It is not difficult to foresee the consequences of this in the hypothesis under consideration if the unemployed workers from the land are not absorbed by industry and other occupations, as they are in the centres. The unemployment caused by technical progress would prevent the raising of wages, and might even lower them, and the benefits of such progress would be lost in a fall in agriculture relatively to other prices, for reasons which we need not repeat in view of the explanations contained in chapter III.

These unfavourable influences on employment and wages have often led to reactions adverse to technical progress in the development of the great industrial countries. Nevertheless, this same technical progress, by requiring increasing capital investments, develops in these countries a powerful factor of absorption of unemployed workers through development of capital goods industries. Thus we see that technical progress creates unemployment but at the same time tends to reabsorb the displaced workers by means of increased investments. Such was the function spontaneously discharged by investments in the development of the industrial centres, at least until the world crisis.

The element of expansion, the effects of which are felt in all sectors of the economic activity of the great centres, is lacking in the peripheral countries; consequently their exports are not sufficiently great to offer gainful employment to those unemployed as a result of

technical improvements. It is not surprising, therefore, that the fear of unemployment is ever present, and that it sometimes takes the form of stubborn hostility to the use of more advanced capital equipment, the immediate consequence of which is to reduce the labour requirements of primary and industrial production. The absence of this spontaneous element of development does, in fact, lead to extraordinary conditions. In the periphery, technical progress is accompanied by unemployment as in the great centres, but the demand for capital goods inherent in such progress does not operate, in the former as in the latter countries, since there are no capital industries. Consequently, this demand, instead of being reflected in the economy of the developing country, transfers its effects to the industrial centres where such goods are produced. If these centres do not compensate for this demand for their products by means of a corresponding increase of their imports from the Latin American countries, the unemployment caused by technical progress will persist unless it can be countered by a policy of economic development. This is another of the fundamental differences in the various ways in which economic development affects the centres and the periphery.

4. Available capital and the extent of its utilization

The problem is more involved than would at first appear and certainly deserves more careful study. In nearly all the Latin American countries there are frequent examples of production employing antiquated machinery, already obsolete in other countries where it has been replaced by other and more productive machinery. If this modern machinery could be introduced into important sections of primary and industrial production and transport in Latin America, increased productivity would cause the formation of an additional surplus of labour. The employment of this surplus would require a capital investment per man equal to that obtaining in the modernized sections, making allowances of course, for the difference in the nature of the occupation. The same requirements would prevail if technical progress were similarly to be extended to all the economic sectors. At this point a very serious problem arises. Would there be sufficient capital for the thorough equipment of all the sectors? If there were not, and the capital available were only sufficient to allow of an investment per man much smaller than the desired figure, how could the existing capital best be applied in order to obtain the greatest net increase of production, that is to say, of the real total income?

A problem of this nature could not have arisen in identical terms in the great industrial countries by reason of the continuity of their development, as we shall now try to show. It is recognized that modern equipment which requires a greater capital outlay per man is only economical when the total amount paid in interest and amortization is less than the amount whereby the new equipment reduces other costs. For brevity's sake, let us say the amount whereby it reduces labour costs. The progressive rise in wages was perhaps the most important factor in establishing the economic advantage of increasing the capital investment per man by successive technical improvements. Once the new capital outlay had been absorbed, and because of the new level of wages, it would not have been economic for a new undertaking to make lower capital outlays since these would have resulted in a lower wage level.

On the other hand, as the mobility of the factors of production extends wage increases to other occupations, it seems inconceivable that, in the long run, certain industries should raise the capital investment per man considerably by making use of increasingly modernized equipment, whilst others continue to operate with a relatively lower capital outlay. The greater the mobility of the factors of production, the more closely will the development of the different types of economic activity be correlated with capital outlay per man employed.

5. Optimum use of capital in the periphery

When we look at the relative development of an industrial centre and of a peripheral country we find that the same does not hold true. The fact that, at the centre, new capital outlay is more economical because the additional saving in labour more than compensates for the corresponding cost of amortization and interest does not mean that the same would occur in a peripheral country where wages are lower and where equipment must be imported from the centre. In the centre, the cost of the machinery is determined by wage levels similar to those of the labour saved, while in a country where wages are lower than those at the centre, the total saving will be proportionately less. In other words, the peripheral country imports capital equipment manufactured at high wage rates in order to obtain a lowering of costs computed in low wage rates.

Furthermore, the relative abundance of savings at the centres enables them to obtain the amounts necessary to achieve a high density of capital per man without putting too great a strain on the interest rate. In countries where savings are scarce, an increase in the density of capital would cause a considerable rise in the interest rates. Thus in the peripheral countries, the cost of capital rises more than at the centres, as the density of capital per man increases, while at the same time the reduction in the cost of labour is less, on account of the lower wage level.⁵ Therefore it appears that the optimum combination of labour and capital equipment in the less developed countries requires a lower density of capital per man than in the highly developed industrial countries; the greater the differences between the respective wage and interest levels, the lower should be the degree of capital density, other factors remaining equal. We will not consider these here in order not to complicate the problem further.

The foregoing analysis enables us to answer our earlier queries. Let us take a country where the average optimum density of capital is half that of a developed industrial centre; this average is obtained by the combination of the optimum densities in the various industries and occupations, densities which differ more or less from their counterparts in the centre according to their individual characteristics.

According to common theoretical beliefs, in each of the optimum densities the last increase of capital in any investment should lead to a marginal increase of production equivalent to that of outlays in other economic sectors and also equal to the cost of the amortization and interest corresponding to the capital increase. If the density of capital is increased further and goes beyond the optimum, its cost will be higher than the new increases of production and hence would not be economical. Thus, to go beyond the optimum degree in a given industry, in order to reach the optimum level obtaining in the centres, would not be to the good of the general economy, since there would be an excess of capital in industry and a shortage of it in other occupations; consequently, the total production would be lower than could be obtained by means of an optimum distribution of capital. These then, are more of the characteristic differences between economic development in the periphery and at the centres which, though of considerable influence, have not yet been studied with the attention they deserve.

6. Distortion in the optimum combinations

This simple theoretical presentation does not by itself throw enough light on the realities of the Latin American problem. The factors affecting the optimum arrangement are hidden or distorted by others, among which inflation is perhaps the most important.

⁵ When inflation occurs, the collective cost to the people rises in proportion to the amount of forced savings imposed upon the population.

In order to understand this aspect of the situation, let us analyse a very simple example. Let us assume the case of an industry in which new capital investments are required in order to meet growing demand. Our entrepreneur is faced with two alternatives, both of which would enable him to obtain the same additional increment of production. One solution requires him to employ 3,000 labourers and invest a capital of 6 million units. The other means employing only 2,400 labourers but requires the investment of 18 million units. In either case he must have recourse to the market to obtain his capital. The annual wage per labourer amounts to 2,000 units and amortization and interest amount to 10 per cent. The second solution means the utilization of an extra 12 million units of capital, which exactly equals the saving on labour. Therefore, both alternatives represent equal production costs and, consequently, equal profits. However, since the entrepreneur must obtain his capital from the market, in the favourable event that he can obtain the larger amount required at the same rate of interest, he will nevertheless prefer the first alternative, since with a debt which is only one-third of the other he can obtain the same production and identical profits.

The situation would be very different if the same entrepreneur had previously obtained high profits through inflation or if imports of the goods he manufactured had been restricted either on account of currency shortages or for some other reason. If the profits accruing to the entrepreneur were sufficient to cover the amount required by the second solution, he might well adopt it, since besides obtaining profits equivalent to those deriving from the first alternative, it would represent a profitable investment for his surplus capital and he could retain for himself the interest and amortization which otherwise he would have to pay to a third party.

It is true that in this case the entrepreneur could combine it with the first alternative, using the surplus profits in making interest-bearing loans, but he would hardly wish to be a creditor at the height of an inflation and would therefore probably adopt the second alternative.

If there are other industries equally accessible and yielding greater profits, it is obvious that the entrepreneur will prefer to invest his capital in them. However, he will probably be faced with situations similar to the one described above; and in this eventuality he would probably again be inclined to an over-investment of capital.

Could there, however, be over-investment of capital if this phenomenon occurred, not just in certain industries, but generally in the whole range of economic activity? Could not a general increase of productivity be obtained in this way, approaching that of the great industrial countries, which would make it possible to raise the wage level and so justify a greater density of capital investment per man? It is precisely this which it is difficult to foresee in Latin America for the following reasons.

In the first place, inflation and import restrictions do not affect all occupations equally. Profits are therefore not strictly proportionate to the real increase of productivity obtained by the latest capital investments, but to the extent to which this and other factors affect each occupation, so that investments do not correspond to a rigid concept of productivity essential to the optimum distribution of available capital. Thus investments are made which yield greater profits and for which *ipso facto* greater amounts of capital become available. This undoubtedly creates a propitious field for over-investment, with an artificially high density of capital. On the other hand, there are occupations which, because they were not protected by restrictions on imports or inflationary deviations of demand, yield much lower profits and, though a larger investment in these might lead to greater productivity, the incentive and the resources available are, in this case, much smaller than in the preceding example. In the same way, there are very important activities, such as transport, for instance, which because they do not share in the high profits accruing from inflation, so far from attracting new capital, actually lost capital.

Hence the increase in the density of capital in certain occupations does not necessarily mean a general increase in all of them approaching the optimum density of capital of the larger countries. It signifies rather a definite distortion in the series of optimum combinations suitable for a developing country.

7. Over-capitalization and the terms of trade

On the other hand, most of the Latin American countries, as mentioned before, are contending with the serious problem of supplying an adequate density of capital to the mass of the population which is still in a pre- or semi-capitalistic state. This is an essential factor and hence we are inclined to ask if productivity would not be stepped up more by a national distribution of capital among the sectors where productivity could be considerably increased, rather than by concentrating the density of capital in certain activities which are over-stimulated by inflation and restrictions.

Again, in the extreme supposition that it were socially possible and advisable to create the necessary savings by means of inflation, the enormous amount of capital needed in these countries to increase its density rapidly would create insoluble problems of foreign transfer.

Most of the capital goods must be imported, and no matter how much domestic consumption is restricted and the population compelled to save, the foreign exchange deriving from exports would soon be insufficient to cover the demand for capital goods, as well as other essential imports. The monetary aspect of the problem of expansion and capitalization need not concern us here. It will suffice to note other characteristics which occur in the development of the Latin American countries. This should serve as another reminder not to examine these problems as if they were similar to those which occur in different types of development.

There are two obstacles in the way of the formation of capital, which have just been indicated: the domestic accumulation of sufficient savings, and the limited capacity of exports to pay, to the necessary extent, for imports of capital goods. If this limitation were to be abolished and exports forced by monetary devaluation or other means, in order to import more capital goods, the terms of trade would inevitably deteriorate because of the factors analysed in the preceding chapter.

Capital formation in the countries which are now great industrial centres does not seem to have encountered obstacles of this nature. On the one hand, a considerable part of their capital goods are manufactured in their own economy, so that even forcing the process by means of inflation did not imply the same external consequences as in the Latin American countries. On the other hand, when the centres were compelled to expand their exports in order to cover shortage in the domestic production of capital goods, they exported manufactured goods under far more advantageous conditions than those obtaining in countries of primary production, since by exporting manufactured goods they were able to retain the benefits of technical progress more easily in the form of higher income. The goods manufactured as a result of the investment of this high income were exchanged for capital goods, also deriving from the investment of equally high incomes. This is the opposite of what occurs in the periphery. Furthermore, in exporting these goods the countries of the centre generally met with a very elastic demand, since the increase of real income in the various industrial countries was accompanied by a corresponding increase in reciprocal demand for these goods, as can be seen from the statistics showing the growing industrial trade of these countries before the First World War. Consequently when one of the countries of the centre exported in order to be able to import capital goods, there was no adverse effect on its terms of trade.

The position of the Latin American countries as exporters of primary products, raises the problem of partial over-capitalization, or of the rapid increase in the density of capital, which will repay careful study as regards both fact and theory. The forcing of exports in order to capitalize to an extraordinary degree, in the absence of foreign investment, might lead a country to sacrifice its real income unnecessarily precisely when it had intended to increase it. In fact, if the process is carried to excess, the additional labour employed in order to increase exports at lower prices might be less productive than if it had been employed in producing for domestic consumption, with a lower density of capital than that proposed to be attained by force. In other words, an uneconomic increase of density of capital might result owing to the deterioration in the terms of trade caused by the additional exports.

All these differentiations which mark Latin American development are, in the final analysis, the result of the distribution of the benefits of technical progress and of the differences between the degree of evolution of these countries and that of the great industrial centres.

8. Other aspects of technical progress and productivity

So far, we have limited ourselves to the study of these characteristic differences in relation to capitalization. To increase the capital per man is an essential but not the only condition for increasing productivity. The ability to organize, manage and administer on the one hand, and the technical skill of labour on the other, are also of great importance. One of the most significant conclusions drawn from a study of Latin America's textile industry being carried out by the Commission's experts, relates to this question. In important countries where industry generally is using antiquated equipment, productivity could be considerably increased even with the same equipment but with better organization and administration and a more rational utilization of their manpower. In the majority of the cases examined, the higher productivity attainable in this way would exceed that obtainable by a modernization of machinery and plant.

It is, of course, very important to have adequate equipment but knowing how to make the best use of it is equally important. For example, cases have occurred in which the equipment used was comparable to that in use in countries with very advanced textile industries; yet even with this equipment productivity was extremely low precisely on account of defective organization and administration.

An inflation may suddenly produce the necessary resources for the purchase of modern equipment, but it could hardly offer as swiftly the required skilled labour, which naturally takes time to develop.

Here we find another of the contrasts which are the consequence of a very uneven degree of development. In the large industrial countries, this skill, as well as the efficiency of labour, developed progressively, at the same rate as productive technique. Skill, efficiency and technique were, in fact, forms of the same general phenomenon which, though it emerged with the industrial revolution, had been evolving throughout centuries of artisan work and the growth of trade experience.

On the other hand, in the peripheral countries, where the technique and the organization of the great centres usually only penetrated superficially and where the population was in a pre-capitalist phase or merely in a rudimentary state of capitalism, the sudden awakening to the complex processes involved by such technique and organization was bound to cause reaction and consequences which had not marked the industrial development of the great countries.

Accordingly, productivity involves two closely connected factors: first, the investment of savings in capital goods, and second, the investment of savings in the training of men who can make the best use of these goods at the various stages of production. One of the points requiring most attention in the development of the Latin American countries is the judicious apportionment between the two forms of investment of the scanty increase in savings in order to obtain the maximum increase in productivity.

9. Differences in the capacity to consume

Differences of the nature described occur not only in production but also in the capacity to consume; and this in turn affects production. Technical progress has enabled the population of the great industrial centres to diversify their consumption remarkably, constantly offering these communities new articles or improving existing ones, making daily life easier, or creating new tastes to replace those already satisfied by means of the constant increase in income. These are types of consumption corresponding to the more advanced stages of economic development, but which in themselves develop an extraordinary power of diffusion and tend to spread to the populations of countries which, being less advanced, have a lower level of productivity and therefore smaller incomes with which to acquire these goods.

In other words, countries where *per capita* income is comparable to that long before enjoyed by the great industrial centres tend to imitate types of consumption prevailing at the centres today. At the same time they are trying to assimilate the productive technique of the industrial centres, which requires considerable *per capita* savings. As income is relatively low in the peripheral countries, it is not surprising to find them torn between the greater propensity to consume and the imperative necessity to capitalize. The result frequently is inflation, which is further aggravated if these advanced forms of direct consumption coincide with the increase of services of the State, for the State is equally susceptible by force of circumstances to the example of new forms of expenditure in the high-income countries, though not so ready to adopt modern defence measures. The latter makes it even more necessary to increase the general productivity of these countries which are thus striving to assume central types of consumption.

10. Characteristic features and common elements of the problem of economic development

We have tried in this chapter to explain briefly the causes of some of the characteristic features of the expansion of technical progress to Latin America. Ultimately, though the primary design of raising productivity has the great advantage of being able to make use of the experience of the great industrial nations, avoiding their trials and errors, it also meets with difficulties arising from the fact that those countries which developed first are more advanced as regards income, productivity and capitalization. Thus, though it seems paradoxical, it may be said that the high productivity of the great industrial countries is one of the greatest obstacles which the peripheral countries must overcome in order to attain a similar degree of productivity.

When other countries followed the example of Great Britain's industrial development, they met similar obstacles, but much less serious than those nowadays encountered by newly developing countries. Despite these obstacles, the United Kingdom, in being first to possess modern technique, had obvious advantages over those countries which strove to attain it later, so much so that, without any exception, all the countries that developed subsequently to the United Kingdom were compelled to adopt measures to stimulate and protect the industries they wished to establish.

Despite the above comparisons and contrasts, this last factor provides an element common to the problem of the economic development of Latin America and the initial and successive stages of that same development in those countries which are now great centres, with the exception that the differences of productivity between the most and the least advanced of these countries were in earlier times less than those existing today between the centre and the periphery.

There is a further common element. The assimilation of modern productive technique with its increasing complexity was not spontaneous but deliberate, and required considerable effort and persistence. This is all of great importance to the development of Latin America, since the differences in the standard of living between the developed and the developing countries does not only depend on the differences between their respective natural resources but to a great extent on the effective capacity to assimilate technique, build up the necessary savings and make the best use of both. The development of this capacity will therefore be a predominating factor in the economic evolution of the countries which are now in the growing stage.

THEORETICAL AND PRACTICAL PROBLEMS OF ECONOMIC GROWTH *

Raúl Prebisch

* Chapter II (pages 28-43) and part of chapter III (pages 46-49 and 54-67) of *Theoretical and practical problems of economic growth*, Santiago, ECLAC, 1973. Originally published in 1952 as ECLA document E/CN.12/221.

CHAPTER II, TECHNICAL PROGRESS, INDUSTRIALIZATION AND DISEQUILIBRIUM

Technical progress in the industrial centres and demand for primary products

1. In the interpretation of the process of growth contained in the Economic Survey¹ of last year, several theoretical propositions were put forward which, because of their effects on the policy of development, must now be more fully discussed.

One of these propositions asserts that technical progress compels the Latin American countries (which make up a part of the world periphery) to resort to industrialization as a means of development. Another proposition holds that in this form of economic development there are certain inherent and persistent tendencies to external disequilibrium.

The origin of these tendencies to disequilibrium lies in the changes brought about by technical progress itself. These consist, on the one hand, in alterations of the productive methods and in demand and, on the other, in the distribution of the gainfully-employed population in order to meet such demand within each country and within the sphere of world economy as a whole.

The elimination of external disequilibrium is essential to the achieving of a regular and orderly form of economic development. Thus far, the Latin American countries have sought to correct disequilibrium once it occurs, at a considerable cost, as may be deduced from the experience of the past twenty-five years. However, this experience provides valuable lessons in the means of avoiding the phenomenon, or, alternatively, of attenuating it, if it cannot be circumvented.

Before considering these practical aims, it is necessary to analyse the nature of the phenomenon of disequilibrium, which must be sought in certain aspects of the technique of production that are of great importance to primary producing countries. In a broad sense, technical progress has been reducing the share which the value of primary products represents in the value of finished goods. In other words, the share of primary products in the real income of the population has been declining, especially in the great industrial centres. There are various reasons for this tendency, among which the following should be cited:

- (a) Technical changes, by constantly creating new products, bring about a progressively more complex or refined elaboration of the raw materials required in the productive process, thus diminishing their contribution to the value of the finished article. In relation to the total value, the proportion of primary materials employed in the manufacture of an aeroplane is therefore lower than in a locomotive, which is again lower than in a horse-drawn vehicle;
- (b) Technical progress facilitates a better utilization of raw materials, sub-products and by-products, so that the same amount of primary products is now equivalent to a proportionately greater value of finished goods than heretofore. Though there is no reason to assume that cotton piece goods contain a smaller quantity of cotton than one hundred years ago, generally speaking in our times the same amount of raw material provides industrial by-products or sub-products which make the total value of the finished products considerably greater than previously, and

¹ *Economic Survey of Latin America 1949*, Economic Commission for Latin America, United Nations (E/CN. 12/164/Rev 1).

- (c) The materials made by synthetic processes, such as synthetic nitrates, artificial fibres and plastics, replace a number of natural products in spheres of industrial activity which are becoming increasingly important.²

New forms of production and certain alterations which technical progress brings about in the structure of consumption, thus contribute to lowering the intensity of the utilization of primary products. Technical inventions are undoubtedly the dynamic factor which has brought about the greatest changes in demand. Moreover, the increment in productivity and per capita income which these inventions entail, has enabled demand to seek new forms of satisfying human needs. Thus it is a well-known fact: a) that when the level of income rises, demand is diversified, and whilst there is only a relatively small increment of the demand for ordinary foodstuffs, the demand for various articles created by modern technical inventions rises sharply after a certain point. Furthermore, these inventions imply an increasing industrialization of foodstuffs, in order to obtain higher standards of hygiene, preservation or convenience, thus widening still more the gap between the rate of increase of the primary product and real income; and b) that within the tendency of total demand to diversify, the demand for personal services increases, therefore lowering the proportion of primary products in the supply of concerted demand of the population.

The combination of all these factors, arising from the evolution of the technique of production, has an effect of utmost importance to the periphery, since it causes imports of primary products in the industrial centres to expand at a lower rate than real income. Thus the income-inelasticity of primary imports in the centres tends to be lower than unity.

Other facts must also be mentioned which are partly the result of technical progress. In the industrial centres the increase of productivity may also be perceived in primary production, and it often enables them to compete satisfactorily with the periphery on foreign markets, despite the low salaries prevailing in the under-developed countries. In other cases, where this does not occur, the industrial centres resort to the application of customs tariffs in order to maintain or stimulate their primary production, thus protecting the domestic market against competition by the periphery. This is another of the consequences of the unequal distribution of the increase of productivity in the various domestic activities and in the various countries, and it also springs from a low international mobility of labour, as was pointed out in last year's Survey.³

As a result of the protection of primary production in the great industrial centres, the proportion of the population gainfully employed in these activities has not decreased to the extent it might otherwise have done, and consequently the increase of the population gainfully employed in industry, services and other activities has not been as great as it might otherwise have been. Likewise, in the periphery there would not be such a pressing need for labour to obtain employment in secondary and tertiary occupations when it is unavailable in primary activities. The protective tendencies of the industrial centres merely accentuate the compulsory migration of the peripheral population from primary into secondary production and services, since ultimately this displacement is occasioned by the extension of technical progress.

Imports of primary goods in the centres tend to increase proportionately less than real income. Hence, if the Latin American countries could only expand by means of primary exports, as was usual before the world economic crisis, their rate of economic development would be considerably lower than in the industrial centres.

However, these countries appear to expand at the same rate, if not more rapidly, than the centres, as a whole, owing to the stage of development which most of them have reached.

² After the completion of this Report, we learned of similar conclusions arrived at by Dr. H.W. Singer, and contained in lectures delivered in Brazil. See *Revista Brasileira de Economia* (September 1950) and *Estudos Economicos* (September-December 1950).

³ *Op. cit.*, pages 84-97.

The rate of growth of the population is much greater, and productivity, because it is relatively lower, has therefore a wider margin to rise.

A study of the twenty years preceding the world economic crisis shows unquestionably that the export activities of the Latin American countries, even allowing for their exceptional development in Venezuela, have been insufficient to offer full employment to the vegetative increment of the gainfully employed population and to the excess population created by the extension of technical progress in primary production.⁴

Hence the dynamic need for industrialization, in order that economic development may take place at a higher rate than the expansion of primary exports. Industrialization absorbs a part of the available population, enabling another part to be absorbed by associated activities such as transport and trade, which expand together with it. The increment of average productivity springing from the process of industrialization, together with the increase of productivity caused by technical improvements in primary production, raise per capita income and lead to a growing demand for services, thus creating new sources of employment. Industrialization is linked with various phenomena inherent in economic development, and if reference is only made to this aspect, it is for reasons of brevity and not because the importance of other phenomena has been overlooked.

Technical progress in the periphery and the demand for imports

2. During the course of development, when the new methods of production established in the more advanced countries were being progressively assimilated by the under-developed countries, similar changes took place in the structure of demand in both areas. As real per capita income surpasses certain minimum levels, the demand for industrial products tends to grow more than that for foodstuffs and other primary products. However, the position of the under-developed countries is very different from that of the more advanced countries, since the latter import primary products from the former, the income-elasticity of which is much lower than that of the industrial products which the periphery imports from the centres. In order to increase their real income, the peripheral countries must import capital goods, the demand for which increases at least as much as real income, whilst the raising of the standard of living is reflected in the intense demand for highly elastic imports, which tend to rise more than income.

The dynamic difference between demand in the centres and in the periphery is of such importance that it would be advisable to analyze it more carefully.

It is well known that industrialization causes the Latin American countries to develop at a much greater rate than their exports. Since the capacity to import depends fundamentally on such exports,⁵ it is evident that real income in these countries generally tends to rise at a greater rate than the capacity to import. The substantial volume of imports, which expands at the same or a higher rate than real income, could not be obtained if other imports were not limited, so as to prevent total imports from persistently exceeding the capacity to import, except when the gap can be covered by foreign investments.

Little foreign capital has been invested in Latin America since the world economic crisis. The Latin American countries have only been able to develop in a measure corresponding to the essential changes which have taken place in the structure of their imports.

⁴ *Op. cit.*, pages 15 to 45.

⁵ It would be redundant to review the problem of the terms of trade, which was dealt with at length in the *Economic Survey for Latin America 1949*.

When income rises more sharply than the capacity to import, the need to modify the composition of imports springs from three different causes which, in fact, are closely related to one another.

- (a) Let it be assumed that income increases in relation to the population, whilst the level of per capita income remains constant and no alteration occurs in the structure of demand.

Assuming an initial income of 100, of which 40 are applied to imports, and are compensated by an equivalent amount of exports, this initial income increases from 100 to 150, i.e., 50 per cent, whereas the capacity to import rises from 40 to 50, that is, only 25 per cent.

Even when the composition of demand has not altered with the increase of income, the structure of imports will have to be modified. In fact, when income has been increased to 150, 40 per cent of this, that is 60, will be spent on goods which were formerly imported. However, the capacity to import continues at 50, and therefore the difference of 10 must be produced by domestic industry. It is evident that if domestic production is not developed, income could not increase to this extent, since the corresponding increment of demand could not be supplied by imports, which would have permanently surpassed the capacity to import. Once monetary reserves had been exhausted, the situation would have become untenable.

It is hardly likely that this increase of 10 in domestic production, with a view to replacing imports, will occur proportionately in all these goods. Generally, the goods which can be most easily produced, or the production of which can be most easily increased, will be selected. Thus, imports of certain goods will be suspended or reduced and domestic production of these correspondingly developed, whereas imports of other articles will continue in a measure corresponding with the increment to demand, but there will be no expansion whatever of domestic production of such goods. An alteration in the structure of imports will thus have been effected. The distribution of the 50 now imported will differ from the 40 formerly imported.

- (b) Let it be assumed that per capita income increases and that at the same time the structure of demand is altered.

The foregoing example will be used, but instead of seeking to increase income in a measure with the growth of the population, it is increased as a result of a 50 per cent improvement in the level of productivity, and therefore in real per capita income.

In this case, the changes in the structure of demand, giving rise to a modification of the structure of imports, differ from those of the preceding example. These changes occur in a measure corresponding to the varying degrees of income-elasticity of demand for imported goods. Whereas in some cases there will be no increase, or only a very slight one, in others the increase of 50 per cent in income will cause a much greater increment of demand. To the extent that the increased demand will have to be satisfied with imports, it will be necessary to reduce or suspend other imports. Thus the new structure of imports and of domestic production will differ from the previous example.

- (c) Let it be assumed that total or per capita income does not increase but that the structure of demand is altered.

An income of 100 will again be assumed, of which 40 are used for imports as in the foregoing examples. The remaining 60 will be employed in acquiring domestic products. Income does not increase but the structure of demand is modified; demand for certain imported goods grows at the expense of domestic production. Imports increase, say to 45, whilst demand for domestic goods falls to 55. A double disequilibrium of the same magnitude thus occurs, of which one part is external, resulting from the excess of 5 in imports, and the other is domestic, and is caused by an equivalent deficiency of 5 in the demand for domestic products.

This position of disequilibrium cannot be maintained; income must either be reduced permanently, to a level where imports may be adjusted to the capacity to import, or the level of income is maintained by substituting imports with domestic products. It is necessary to reduce 5 from former imports and to replace them with domestic production, in order to allow for the new imports, as a result of the changes brought about in the structure of demand.

This may occur either because of a change in imports of consumer goods or because savings are increased, so that a greater volume of capital goods is imported. But it cannot take place without affecting the level of income, unless a change is made in the composition of imports.

As was pointed out, these three causes are closely bound to one another. The population grows, per capita income increases, and the structure of demand is altered not only because of these increases but also because of the persistent efforts of entrepreneurs, within a country and abroad, to modify the pattern of expenditure of the population in answer to continual innovations in productive technique.

The need to modify the structure of imports thus arises from essentially dynamic factors which are inherent to the process of development. Unless substitutions and changes take place, there can be no development.

The maximum real income. Exports and industrialization

3. It will thus be seen that besides absorbing those sectors of the population which increase and migrate from other activities, industry also supplies a developing country with the manufactured articles that it cannot obtain abroad, owing to its limited capacity to import.

The ultimate objective is the attainment of the maximum real income, that is, the goods and services which the population requires, according to its pattern of demand.

Two problems arise in the obtaining of this maximum. They both involve the best method of utilizing the productive factors. The first consists in determining to what extent the available factors in a growing economy should be employed in increasing exports, with a view to expanding imports, and to what extent agricultural and industrial production for the domestic market should be expanded. The second problem lies in ascertaining which goods can most advantageously be imported and which should be produced internally (given optimum quantities of imports and domestic production), in order to maximize real income.

The first problem will be examined in the light of total primary production in the Latin American countries.

The total volume of primary products depends mainly on the level of income in the industrial centres, on the state of productive technique, on the structure of demand, and on the degree of protection. Export prices in relation to those of manufactured goods generally appear to exercise only a secondary influence on the volume of exports;⁶ they seem to influence, though, the proportion of income which the industrial centres must allocate to the acquisition of primary products.

Thus the volume of exports is not determined arbitrarily. Because of its low price-elasticity, the concerted effort of the primary producing countries to increase the volume of exports substantially, without regard to the rise in income in the industrial centres, would be attended by so great a price decline that the value of exports would not increase and might even be lower than previously.

⁶ *Op. cit.*, pages 25 -27.

This would not prevent a relatively small and isolated primary producing country from increasing its exports to the detriment of other competing countries, by means of slight price sacrifices. It is nevertheless evident that if one considers the extensive problem of peripheral development, this is no solution for the area as a whole.⁷

Primary producing countries as a group are faced with the very limited option of either employing the increment of their productive factors in increasing exports so as to acquire supplementary imports, or alternatively, of increasing production for domestic consumption.

A brief explanation would help to elucidate the problem. Let it be assumed that countries producing a specific article obtain 100 dollars annually per worker employed in exportable production, and that they employ this amount to obtain an equivalent volume of imports. Another assumption is that one million workers are employed, in other words, that the value of total product is 100 million dollars, and that there are a further 100,000 workers and capital available, which can be employed either in increasing exports and obtaining additional imports, or in the production of these goods domestically.

Let it be further assumed that the productivity of these 100,000 labourers in domestic production is merely 70 dollars per capita,⁸ which is lower than the value accruing from export activities. It is evident that if exports could be increased 10 per cent by making use of these 100,000 workers, without allowing per capita yield to be lowered by the fall of prices, then it would be more profitable to employ the labour force in export activities rather than domestic production. On the whole, however, this is hardly likely to occur, if the increase of production exceeds the increment to consumption in the importer countries, in terms of the expansion of income and other factors, which determine the volume of demand. It would be sufficient for prices to fall 9.1 per cent, thus reducing the yield per man to 90.9 dollars, for the total value in dollars to be decreased to the 100 million prevailing earlier, despite the increase in the volume of goods.

It is evident that instead of increasing production for export it would be more convenient for primary producing countries to employ these 100,000 labourers in production for domestic consumption, despite the fact that the yield per worker (90.9 dollars in export activities) is greater than that accruing from domestic production (70 dollars).

This simple conclusion is of interest, since the current contradictory theory might be cited, namely, that the optimum solution lies in a distribution of productive effort whereby the marginal yield per worker in export activities is equal to the marginal yield per worker in activities supplying the domestic market, taking into account the differences in skill required by these activities.

If the industrial centres and the periphery are viewed as a whole, this latter theory would be correct since it would thus be possible to obtain the maximum volume of goods or of real income. However, because of the price-inelasticity of demand in the industrial centres, the latter would have been favoured in the distribution of these goods, to the detriment of primary producing countries.

Undoubtedly, in the case of absolute mobility of the factors of production, income or the remuneration of these factors would tend to be uniform in a given country and as between several countries. Thus, provided uniform skill throughout, the same wage level would obtain. Consequently, if in the foregoing example the yield of export activities declines, together with the wage level, there would be a displacement of the productive factors from these to other activities. Since these factors could not be employed in additional production for domestic

⁷ All generalizations of this nature should take into account certain individual cases. Given the stage of its technical utilization, there are many characteristic features of petroleum which place it in a very different position to any other primary products.

⁸ Computed according to the value of imports of identical goods of foreign origin.

consumption, where, because of the lower yield, wages would similarly be lower, excess labour would migrate to other countries, until wages were equalized.

It is therefore evident that an example such as the above could not occur, if the assumption of absolute mobility of the factors of production obtain. But it is unrealistic, whereas the example reflects conditions which are very similar to those found in a country in an active phase of development.

Let us consider the example again for a moment. In order that the increment of exports should be advantageous to the periphery, export prices should not fall below a per capita yield of 97.3 dollars. Thus, the increment to the value of exports and, therefore, to additional imports, would amount to 7 million dollars, which is the same increase in value to be derived from production of these goods for domestic consumption. Beyond this neutral point, it would be advantageous to utilize the productive effort in domestic activities.

It should be noted, however, that the cost of production for domestic consumption would be considerably higher than that of the imported article. If at the neutral point a worker engaged in export activities could obtain 97.3 dollars worth of imported products through trade, in domestic activities, he would obtain only 70 dollars worth of the same products, that is to say, the cost of the latter would be 28 per cent higher. Domestic production could not be fostered unless it were protected against foreign competition.⁹

The concept of the economic advantage of industries where the level of productivity is lower than in the centres

4. It has been shown that in view of the factors which influence the demand for primary products in the industrial centres and the very small margin of international mobility of the factors of production, it might be expedient for a peripheral country to employ the increments of the labour force in domestic production, even when the cost of such production is higher than that of competitive imported articles.

If complete mobility existed, this proposition would be inadmissible. Given the tendency for wages to equalize, the economic impossibility of increasing exports beyond a certain limit would cause the gainfully employed population to seek higher incomes in other countries. It could therefore be shown that it logically follows that the total volume of production and of real income for the whole world would be an optimum if certain other conditions obtained which need not be mentioned here. However, actual conditions differ from this theoretical model, and they are influenced by other more important factors than the purely economic. The economic development of the periphery is therefore not compatible with this theory.

The costs in a great number of Latin American industries and in large sectors of agricultural production are, in fact, higher than those of imports. The prevailing low incomes cannot offset the relatively low productivity in these activities. This does not imply that such activities are necessarily uneconomic. It simply means that goods which cannot be imported because of the limited capacity to export and to import must be produced by domestic industry, at a higher cost than if exports could be easily increased in order to provide the means of obtaining the necessary imports.

⁹ It is necessary to realize that the free interplay of economic forces might give rise to another solution which would render protection unnecessary. It would be sufficient for the excess population to exert pressure freely on the wage level, until it was lowered to such an extent that the cost of domestic production would equal that of foreign production. However, this would involve a serious deterioration of the terms of trade, and it would be greatly detrimental to total production, further to involving other considerations which are alien to the main thesis of this work. There is considerable theoretical interest in this particular example of the free interplay of factors in the peripheral countries, associated with their low mobility as between these countries and the industrial centres.

The concept of economic advantage should be based on the total available supply of goods for the population. It has been shown that a greater volume of goods is obtained despite higher costs. But it is evident that this volume could be increased proportionately with the raising of Latin American productivity to a level approximate to that obtaining in the great industrial centres.

This general proposition is not incompatible with individual solutions. In a given country and in given circumstances, it might be possible to expand the exports constantly and markedly, out of proportion with the rate of increase of income in the industrial centres. The Mission sent under the auspices of the International Bank for Reconstruction and Development to study problems of economic development in Colombia,¹⁰ investigated the advisability of increasing exports before undertaking an iron and steel industry, making use of the substantial mineral deposits in that country. The discussion of this concrete problem would be out of place here, but attention should be drawn to the fact that the reason given for considering it inadvisable to establish such an industry was that its cost of production would be greater than that of imported products, c.i.f. in Colombian ports. On this basis, it would be practically impossible for industrialization to develop in Latin America in its present stage of economic growth. Hence, the evident necessity of drawing up a theory of development in order to establish clearly defined principles for practical action.

Optimum distribution of the factors in different sectors of domestic production

5. Attention should now be given to the second problem presented. In view of the optimum volume of imports on which a country may rely under given circumstances, and the increased capital it could muster, it is necessary to ascertain in what sectors of production investments should be made so as to maximize real income.

The principle of marginal productivity would appear to meet this requirement fully. The increment of capital should be utilized so as to maximize production, which is only possible when the marginal productivity of the different investments is equalized, production being calculated at import prices, in order to avoid the illusion created by customs tariffs, exchange controls, or producer combines in regard to such estimates.

This criterion offers a basis on which to determine the best means of utilizing the limited capacity to import, that is, which products that were formerly imported should be replaced by domestic production, and which it is more advisable to continue importing. The advantage of developing an iron and steel industry instead of a heavy chemical industry, or of developing domestic production of all the footwear required by the population, or of the cultivation of all the wheat at present imported will depend on the comparative increases of production which can be obtained in the different activities, according to the diverse alternatives open to the investment of the available capital besides other conditions influencing productive efficiency. If the same amount of capital as is required by an iron and steel industry gives rise to higher productivity in that industry than that in other activities replacing imports, its development will be economic, despite the fact that its cost may be higher than that of the imported product. It may be higher, but not so high as in other cases, given the average level of productivity in the country.

These considerations are also applicable to agricultural production, which, in some Latin American countries, may be relatively easy to increase. In other countries, however, the

¹⁰ *Bases de un programa de fomento para Colombia* (Basis of the Development Programme for Colombia), report of the Mission headed by Lauchlin Currie. It should be remembered that though the International Bank gave its support to the Lauchlin Currie Mission, it does not necessarily support the views expressed in the Report. The Bank has, in fact, also provided funds, with a view to substituting imports by domestic production, without strict regard for this concept of costs.

increase in agricultural output involves extensive irrigation works or other improvements. If it is expedient to replace certain imports by agricultural production, or by the development of industrial production, how the two may best be combined, can only be determined by comparing the levels of productivity.

However, the maximization of productivity in the form described previously does not always imply that a satisfactory means of maximizing income has been found. Certain productive activities, in which the level of productivity is lower than in others, may nevertheless be eminently advantageous, owing to the fact that they diminish a country's vulnerability to foreign fluctuations and contingencies. The experience of the Latin American countries is very instructive at this point, and it is easily understandable that this type of considerations may prevail in certain concrete examples. More will be said later in this connexion.

The fact that the theory of marginal productivity may assist in solving the practical problem set forth above leads one to enquire whether, in view of the possibility of obtaining the optimum level of production by means of free competition, it would not be better to permit the uncontrolled play of economic forces, in order to obtain the best solution. This might be the case, were it not necessary to raise protective barriers in order to substitute domestic production for imports, and if, in certain cases where future demand must be estimated long beforehand and large investments made, private enterprise alone were not incapable of solving certain vital problems of economic growth. This being so, it is necessary to adopt certain principles, on the basis of which the selection of the various forms of investment can be made.

Growth, disequilibrium and inflation

6. In its bare outline the thesis of economic development set forth herein is the following: export activities in the Latin American countries are incapable of absorbing the additions of the labour force arising from technical progress in primary activities and the vegetative growth, of the population. Industrialization plays essentially the dynamic role of absorbing directly the redundant labour force and of stimulating other activities including agricultural production for domestic consumption, which contribute to the process of absorption. Thus, total income increases, and per capita income improves, as a result of technical progress and industrialization. As income rises and the structure of demand changes it becomes essential to modify the composition of imports and develop domestic production of substitute goods, so as to enable other imports to expand intensively.

If imports are not adequately readjusted, the expansion of income gives rise to external disequilibrium: imports rise faster than the capacity to import.

No instrument exists in the economic system of the periphery which might provoke the spontaneous readjustment of imports, in order to prevent such disequilibria. Hence, as income increases more rapidly than exports and than the capacity to import, a persistent tendency to external disequilibrium develops, as was pointed out above.

Inflation likewise causes external disequilibria. Since, in the Latin American countries, the process of growth is usually linked closely to phenomena of an inflationary nature, it may be assumed that this persistent tendency to disequilibrium in the process of development is merely the result of inflation.

Disequilibrium may nevertheless arise in the absence of inflation. The lack of this spontaneous instrument of readjustment in imports is sufficient for an excess of imports to occur at a given moment, due to deficient development in the production of substitute articles. It should

be remembered that if the structure of income expenditure is modified and a larger proportion thereof is applied to imports, disequilibrium must inevitably follow, as was shown above.

The characteristic form of generating disequilibrium in the case of non-inflationary development has been encountered in the cyclical upswing of some of the Latin American countries. Real income increases, industry and other domestic activities expand and no obstacles are placed in the way of expansion of imports, because of the cyclical expansion of exports. However, when exports and income diminish, it is found that the pattern of income expenditure is not compatible with the structure of imports, especially when an attempt is made to maintain the earlier level of income by resorting to credit expansion.

Development cannot continue for long, under a non-inflationary situation if disequilibrium prevails, since it would drain monetary reserves and, at the same time, there would be no stimulus to continue growth, because external disequilibrium is attended by an insufficiency of domestic demand, as will be shown in the following chapter.

The difference between this type of limited development and that of an inflationary order does not exactly lie in the fact that inflation enables the process of development to continue, despite the prevalence of disequilibrium, but in that it corrects the insufficiency of domestic demand and gives rise to certain reactions; which modify the composition of imports, enabling their continued growth, provided other conditions (which will be discussed later) prevail. These then are the results of monetary depreciation or direct import restriction to which inflation gives rise.

Inflation thus plays a dynamic role in the Latin American countries. If, on the one hand, it emphasizes the disequilibrium inherent in the process of development, it also tends to correct it, but at a substantial social cost. In certain cases, this cost is disproportionate to the limited dynamic effects of inflationary measures. One of the fundamental problems of economic development in these countries is the stimulating of expansion without provoking inflation, and the preventing of disequilibrium by changing the composition of imports.

CHAPTER III, THE PROBLEM OF PRODUCTIVITY AND THE RELATIVE SHORTAGE OF FACTORS OF PRODUCTION

The two aims of technical progress and the density of capital

1. In the preceding chapter, the validity of the principle of the yield or marginal productivity of capital was acknowledged in connexion with the planning of an investment policy for the Latin American countries. Accordingly, if the distribution of savings is carried out so that the productivity of the marginal increment of capital per gainfully employed person is the same in all branches of economic activity, production will be maximized. The optimum degree of capital density per gainfully employed person in each branch will thus have been attained, that is, the exact amount required in order that total economic activity shall yield the maximum production possible.

The mere statement of this principle does not suffice for the analysis of the concrete problems of investment encountered in the economic development of the Latin American countries. Outstanding amongst such problems is the determination of the most suitable density of capital per gainfully employed person, in relation to the amount of capital available.

As a result of technical progress, the optimum density of capital per gainfully employed person has tended to rise continuously in the great industrial centres. Thus, a constant increase in productivity has been achieved which, by raising per capita income and expanding the margin of savings, has facilitated the introduction of new technical methods, thus increasing further the density of capital, the process being repeated successively.

This process has different aspects in the under-developed countries. Technical improvements do not appear gradually, as they did throughout the course of development of the great centres, nor do they evolve through the successive stages of evolution as did their capital goods. In carrying out their investment programmes, these countries find that they must import the same equipment as is used in countries which have developed over a long period. Thus, equipment which represents a high density of capital per gainfully employed person and which is compatible with the high level of per capita income in the industrial centres, is equally available to the under-developed countries, in which per capita income, and therefore the capacity to save, are evidently lower.

In other words it is theoretically possible for the Latin American countries, considering their relative scarcity of capital and abundance of human labour to have a density of capital lower than that of the more advanced countries, but in view of the nature of the technical process, and its irreversible character, the under-developed countries have a very limited possibility of attaining in fact their optimum density of capital. It is a fact that in some cases they are in a position to use less complex equipment, whereas in others they may adopt backward methods which involve low capital investments. However, if they seek to modernize the equipment, due to the very low productive efficiency of the methods in use, they are often faced with the necessity of acquiring machinery with a high capital density, since given the nature of the productive technique utilized, each unit of equipment is generally indivisible, and therefore its density cannot be reduced, to bring it in line with the density which is compatible with a relatively small volume of available capital.

Were sufficient capital available for investment in all the branches of economy, no such problem would arise. It would only be necessary to assimilate the technical methods of the more advanced countries in order to obtain approximate, if not equivalent, levels of productivity. This, however, is not the case. The problem of capital density arises precisely because there is a shortage of capital, though its terms vary considerably from one Latin American country to another. In some of these countries, 60 per cent of the gainfully employed population is working under conditions of very low productivity and meager capital, whereas in others, capital availabilities and productivity resemble those of the more advanced countries. Hence it becomes necessary to qualify the following generalizations, in observing the varied range of concrete facts.¹¹

2. The diffusion of modern productive technique thus gives rise to a paradox. Countries having an abundant labour force and a scarcity of capital, are faced with a form of productive technique of which one of its predominant traits, especially in the United States, is the savings of as much labour as possible, by means of increasing the capital outlay per worker. Undoubtedly technical progress also seeks to increase the volume of production per unit of capital, whilst reducing the amount of labour required. However, though these two aims call for increasing capital investments per gainfully employed person, and though in the abstract they may be considered separately, technical development has linked them in such a way that, as a rule, it would be impossible to break down investments into the part which is aimed at increasing

¹¹ Another aspect of this problem lies in the possibility of intensive utilization of the equipment available, assigning two or even three shifts to its operation. The average capital investment per gainfully employed person would then be reduced, and capital requirements thus lessened. However, a study of this aspect in the course of this brief analysis would cause us to deviate considerably from the purpose of this report.

production per unit of capital and that which is directed toward saving labour. Undoubtedly sufficient capital has been available in the great industrial centres to realize both of these aims progressively. In other words, these objectives have been combined in a manner and measure compatible with the accumulation of capital. Thus, with the exception of brief intervals, investments to reduce labour consumption have tended to be made in accordance with the availability of the capital necessary for this purpose and, at the same time, for the absorption of the labour thus displaced.

In view of the fact that these aims have been achieved simultaneously and considering the indivisibility of equipment, in which technical progress is embodied, the combinations adopted in the economy of a highly industrialized country, with a high per capita capital density, cannot be undone arbitrarily, and transformed into other combinations which conform more closely to prevailing conditions in a less developed country, where per capita capital density is much lower. It is logical that if the combinations prevalent in the former were to be transplanted to the latter, there would not be sufficient capital to absorb the amount of labour saved. In order to avoid this self-defeating consequence, it would be necessary to obtain a type of equipment in which investment is made with a view to increasing production rather than to reducing labour consumption per unit of capital.

This, then, is the problem which faces countries in which there is a relative scarcity of capital since, as a rule, the characteristic indivisibility of equipment prevents the adoption of any combinations other than those resulting from the evolution of the great industrial centres.

Technical unemployment and the role of capital industry

3. Turning again to the saving of labour, which is generally entailed by equipment of high capital density, it should be noted that this problem is typical of the under-developed countries. This does not imply that, in the large centres, the introduction of such equipment has not occasionally given rise to a surplus of labour. However, the problem is not the same. The form of technical unemployment which generally occurs in these centres, especially during the cyclical downswing, is not super-imposed on a structural problem of large labour force, with little capital and a low productivity, as occurs in the under-developed countries. It is a transient phenomenon, which will occur as long as new investments do not reabsorb the unemployed. If this process of absorption does not take place rapidly, it is not due to a deficient capacity to save, but to flaws in the operating of the system. On the other hand, in the under-developed countries where capital is inadequate for the intensive absorption of low productivity labour, the excessive reduction of labour, by means of new capital investments or the replacement of equipment, intensifies the structural problem.

In the growth of the industrial centres, equipment of high capital density had been incorporated into productive activity because savings were sufficient to introduce it to all branches of the economy in which the entrepreneurs found it advantageous. The equipment, therefore, corresponds to a high income and a high capacity to save. On the other hand, in the under-developed countries, these equipments are out of line with the relatively low income and low capacity to save which characterize them. The fact that certain entrepreneurs may be in a position to acquire such equipments does not by any means imply that there is sufficient capital available to generalize their use. It is necessary to distinguish between the interest of the entrepreneur and the general interest of the economy. The entrepreneur is only concerned with the minimization of his costs of production and the increase of his profits. As a rule, the manner of combining the increase of production and the reduction of labour consumption per unit of capital in order to achieve his objective is merely a secondary, and at times unimportant

consideration for the entrepreneur. If his action causes technological unemployment and the unemployed cannot be absorbed because of the scarcity of capital, the entrepreneur will nevertheless have increased his profits even when the capital invested in saving labour instead of increasing production involves a misuse of capital from the standpoint of the country's economy, apart from the social repercussions of the phenomenon.

This phenomenon is not so evident when the reduction of labour consumption entailed by the introduction of this equipment, instead of causing technological unemployment, prevents the absorption of labour displaced from occupations with a lower productivity. This absorption might have taken place if the part of the capital required to save labour had been utilized in increasing production.

However, in the cases in which there are no better alternatives from an economic viewpoint in the under-developed countries, the latter, as was pointed out, are compelled to employ this equipment or they have to fall back on technical methods which imply a misuse of capital by reason of their very low yield. In other words, even though equipment with high capital density does not offer the best solution to the problems of development, in countries where there is surplus labour, they may constitute the least harmful amongst all practical means of increasing productivity within the reach of entrepreneurs.

4. There are still other differences between the under-developed and the more advanced countries. In the latter, technological unemployment tends to disappear as a result of new investments. The development of capital goods industries must have provided the strongest element of absorption, since employment in these industries has expanded more intensely than in consumer goods industries. Moreover, the increased profits accruing to entrepreneurs as a result of the reduction in costs, which stem from the introduction of these technical innovations, are to a large extent used for new investments thus stimulating demand for capital goods. It was pointed out in the last Economic Survey that the under-developed countries, lacking capital goods industries, except in their initial stages, find themselves in a very unfavourable position from the point of view of their internal development, because the profits accruing from the cost reductions mentioned above, when employed in acquiring capital equipment, are transferred to the great industrial centres producing the equipment, thus stimulating employment there and not at home. Consequently, in countries where no capital industries exist, the investment of profits does not tend to reabsorb unemployment as in the great centres, but only in a measure in which it is invested in building, and in the small amount of equipment manufactured in these countries.

It might be argued that these countries have vast possibilities for absorbing technological unemployment in existing consumer goods industries or in those which might be established with a view to substituting imports. That is a fact. This, however, brings us back to the initial point of capital scarcity. If the investment of profits in capital equipment purchased abroad offered a means of absorbing all the surplus labour technologically unemployed from which these profits arise, the problem would be relatively simple. But this is not the case. There is a considerable difference between the profits accruing from the displacement of a single worker and the capital required in order to re-employ that worker. Profits accumulated during the course of several years would be required for his reabsorption. In this as in other aspects of economics, the influence of the time factor is of the greatest importance. Substantial capital investments are necessary if time is not to be wasted. Undoubtedly the existence of profits with which to amortize investments over a period is a favourable factor in stimulating the latter. However, in order to absorb unemployed workers, an immediate increment of capital, several times greater than the wages saved, would be necessary.

The foregoing considerations show that the problem of investment in the present stage of Latin American development has several distinctive features which make it impossible to generalize the conclusions drawn from the experience of the great industrial centres. We do not propose to examine these characteristics individually, but merely to draw attention to the more important of them, the first of which is the density of capital analyzed above, and its obsolescence, which will now be considered.

Obsolete equipment and the shortage of capital

5. The persistent utilization of certain forms of obsolete equipment in combination with other highly efficient materials, is often encountered in Latin America. This is generally accounted for by the habits of the entrepreneurs, and in many cases this explanation might be acceptable, if it had not been frequently observed that the same entrepreneur uses concurrently and at the same factory obsolete and modern equipment, or that he seeks, which is even more significant, new investments in other fields of productive activity and acquires the most advanced equipment obtainable instead of investing his profits in dismantling his old machinery. There is undoubtedly an explanation for each concrete example. At the root of the whole problem, however, the common denominator was found to be the shortage of capital; not that any individual entrepreneur lacked capital, but a general shortage in the country in which he pursues his activities.

From the economic standpoint of an under-developed country, if despite its obsolescence, capital equipment is in a sufficiently good condition to continue operating, the solution of the problem lies in an analysis of the alternatives. Evidently, the introduction of modern equipment to replace obsolete forms will cause an appreciable increment to total production, disregarding momentarily its labour saving effects. However, it could well be the case that the same amount of capital invested in other sectors of economic activity in which capital resources are limited and productivity is low, would lead to an even greater rise in production. It is ultimately a question of ascertaining in what manner a greater increment to total production in the economy as a whole may be procured by the investment of a given amount of available capital; whether this may be achieved by replacing equipment which, though old, is still productive, or whether this capital should be invested in order to absorb the real virtual surplus of the gainfully occupied population. In many cases, it would possibly be preferable to retain the antiquated equipment in production, since its elimination would involve the destruction of existing capital, when capital for new investments is scarce. This possibility is nevertheless limited, since the productivity of obsolete equipment might be reduced to such an extent, in the course of time, that by substituting new equipment for it the net increment in total production would be greater, in which case this increase would exceed that which might be obtained in other branches of the economy.

In other words, in countries where the scarcity of capital gives rise to the employment in primary position of a sizable part of the labour force with little capital and low productivity, as well as to concealed unemployment in other occupations, there is no reason to destroy existing capital, if despite its obsolescence, it is more productive there than in other activities, and if the increase of productivity which new investments would bring about in the latter activities is greater than that which might result from the replacement of obsolete equipments. If, in addition to the increase of production, the labour saving effect is also taken into account, the problem becomes more complex. Even though there may be more suitable fields for investment from the general economic standpoint, the entrepreneur may find it advantageous to discard the obsolete equipment, replacing it by modern equipment simply because he will thus be able to obtain a substantial saving in labour costs.

Problems of this nature will continue to arise in the under-developed countries, whilst there are still substantial internal differences in the density of capital and in the productivity of different sectors of the economy. Therefore, a policy of investment should make a clear distinction between the interests of the entrepreneur and the general economic interest.

In the more advanced countries, where technology and productivity have developed gradually and have been extended to all branches of economic activity, the problem does not arise in the same way. There are no vast sectors in which the scarcity of capital offers a wide field for investments, the rate of growth of the population is lower than in the under-developed countries and the high level of income determines an appreciable margin for savings. Consequently, there is sufficient capital to replace equipment normally; secondly to shorten its normal span of usefulness in order to introduce technical innovations that increase productivity and thirdly to absorb at the same time the labour thus saved. This does not imply that this phenomenon never occurs in the more advanced countries since, in the great centres, there are familiar cases in which obsolete equipment has been retained in certain sectors which, for specific reasons, such as the recession of exports, have not progressed commensurately with technical improvements.

The special case of export activities

6. Since it is not our purpose to make a complete analysis of the problem of productivity and the consequence of a shortage of capital, but rather to stimulate discussion of these topics, there are important aspects and specific situations which cannot be included in this brief outline. However, the question of export activities must be considered separately. The introduction of labour saving equipment in these activities may be essential in order to enable them to compete favourably on the international market and in order to expand exports themselves. There is, of course, no need to stress the fundamental importance of exports in economic development. The reduction of labour consumption in primary export activities most certainly intensifies the problem of the real or virtual surplus of the labour force which should be absorbed by industry and other activities, therefore increasing the amount of capital required for economic development. On the other hand, exports may procure a wider margin of savings and better means of transferring such savings in order to facilitate imports of capital goods. The measure in which this may be done depends on the extent to which both the effects of a reduction in labour consumption and of the increase in production per unit of capital can be retained within the country, in the form of increased income, rather than be transferred abroad, to the detriment of the terms of trade.

The problem of investment in agriculture

7. The duality of the aims of technical progress, mentioned earlier in this chapter, is clearly perceptible in the case of agricultural investments, but, in practice, it is simple to distinguish the purpose for which investments in agriculture are made. Some investments are designed to increase the volume of production per unit of land, whilst others are aimed at reducing labour consumption per unit of land and per unit of production, by introducing technical methods in the different stages of the work, ranging from the utilization of the best implements to that of the most advanced mechanical equipment. Despite this division, there are certain relationships between both objectives which, for reasons of brevity, will not be taken into account in the following general observations.

The increase in the yield of land is a general necessity in the Latin American countries in which, with a few notable exceptions, foodstuffs production is relatively low. There is also a general need for mechanization, since, in the course of economic development, it offers a means of obtaining a labour surplus which must be productively absorbed by industry and other activities.

From the general economic standpoint, both aims have a very different significance though for the agricultural entrepreneur, both the reduction of labour consumption and increased yield per hectare achieve the same results, namely, the reduction of costs and the increase of the profits accruing to him.

From the same standpoint, and independently of the individual advantage of the entrepreneur, the degree of agricultural mechanization which it is desirable to attain depends as it was stated before not only on the capital available to purchase equipment and thus to free labour, but also on the capital available to absorb the surplus labour in industry and other activities. If mechanization is extended beyond the capacity to absorb this surplus labour, a problem of technological unemployment is created similar to that set forth in the section dealing with the example about equipment. Moreover, in agriculture it is easier to avoid this problem, since the investments are divisible and in order to increase production the self-defeating reductions in labour consumption need not be made.

This is a very important aspect of the extension of technical progress in Latin America and one which has not yet been given due consideration. It is likely that, in view of the scarcity of capital with which to absorb the labour freed by the mechanization of agriculture, the reduction of labour consumption in some cases may have given rise to concealed agricultural unemployment or in the dense concentrations of population in the urban area..

There are nevertheless examples in which the absorption of surplus labour by industry has been very intense whilst mechanization has lagged behind. In other cases, the opening up of new cultivated areas in scarcely populated regions has led to intensive mechanization, since the latter has proved to be more economic than the transfer and settling of large groups of the population which would otherwise have been required. There are also cases in which mechanization has become necessary in order to cultivate foodstuffs on what was formerly pasture land, rather than with a view to eliminating human labour, or to shorten the period of cultivation and thus reduce meteorological risks.

However, given the abundance of human labour on the land and the scarcity of capital, mechanization should be very carefully studied in programmes of economic development, especially because the scanty capital available might perhaps be far more advantageously employed in increasing production, particularly when a limit is reached beyond which surplus labour might not be absorbed.

8. Investments to increase production must also be considered from the general economic viewpoint. The land which can be utilized at once to expand the volume of production is likewise scarce throughout most of Latin America, with several notable exceptions; this factor, together with the scarcity of capital, constitutes one of the most serious drawbacks to economic development.

It is therefore necessary to use the scarce capital available so as to obtain the maximum increase of production from the land. Investments for this purpose may be divided into two main groups: those which tend to increase the yield per hectare, by technical improvement of the methods of cultivation, including seed selection and the utilization of pesticides, and other investments, designed to increase the arable area by irrigation, drainage, deforestation and

recovery of areas wasted by erosion, or which provide the means of preventing erosion from reducing the arable area and from diminishing the actual volume of production.

The relatively slow growth of agricultural production in these countries, together with the general low levels of nutrition, emphasize the need to stimulate the former type of investment, especially in cases where this represents the more economic of the two methods, given immediate possibilities of increasing the yield. In all cases where a persistent effort had been made, substantial results have been obtained, compared with the relatively small amount of capital per hectare needed by such investments. Undoubtedly little has been done in comparison with the magnitude of the task which the experts maintain must be carried out, as may be seen from the small amounts spent by most of the Latin American countries on agricultural research and experiments and on agricultural extension, in relation to their total public expenditures.

Nevertheless, the improvement of the methods of cultivation may also involve the opening up of new land, in order to achieve satisfactory results. In many countries, land with sparse rainfall and which has been exhausted by secular methods of cultivation, or impoverished by the type of culture, or by erosion prevails. However, where it is possible, large amounts of capital are required, not only to open up new land but also in order to introduce mechanization there, for the above-mentioned reasons.

It will be seen that here, as elsewhere, generalizations must be prudently made. Each country, and even the different regions within a country, have individual problems which must be considered separately in order to understand the concrete problems of economic development.

Not infrequently, there are cases in which the increase of agricultural production depends largely on improved utilization of existing available resources rather than on new capital investments. There are regions where the land is used uneconomically, not in relation to the improved methods of cultivation which might be adopted, but to the prevailing technique in that region or country. Thus, among others, there are cases in which, before undertaking costly programmes of irrigation, which might be justified at a later date, it is necessary to make better use of the water in lands which are inadequately irrigated; in other instances, land is wasted in areas of abundant rainfall, and in still other cases, natural pasture is used in land appropriate for artificial pasture of higher yield.

9. Thus, increased investment is not a panacea; the rational utilization of actual resources must also be considered. The solution encounters in many Latin American countries a serious obstacle in the system of land tenure. In some parts, there are vast stretches of well-cultivated land, whereas in others a poor or average utilization of a fraction of his land allows the large landowner to derive a substantial income from it. This problem is too familiar to require further consideration. There would be no reason for the industrial entrepreneur to allow a part of his capital to remain unproductive, except in periods of reduced demand. But, as a rule, the productive value of land does not deteriorate if it is not worked; in some cases, on the contrary, it may even improve, and its value is enhanced, in the course of time, commensurately with that of cultivated land, especially when inflation helps accelerate the normal process of increase of the income derived therefrom.

In many Latin American countries, this feature, together with other social factors, causes a considerable portion of arable land to remain in the hands of a relatively small number of

persons. This system of land tenure and the high value of the land, in relation to its present return (because of the advanced capitalization of future increments of its value), makes land almost inaccessible to the landless farmer. He is thus compelled to invest his limited resources in excessively small plots of land, in order to attain a higher standard of living than the very low which the agricultural workers have in most of these countries. Hence the unusual phenomenon of the minute subdivision of the land into numerous small uneconomic holdings that constitute a small part of the total area, whilst an insignificant number of landowners holds the greater part of available land.

There is little doubt that this problem may be solved as industrial development continues to absorb agricultural labour, but the process is slow and can only be speeded up by a sharp acceleration in the rate of the development of industry and other activities. Ultimately, it is a problem of investment, aside from other considerations, to be mentioned shortly. Substantial investments which will increase the demand for labour in activities of considerably higher productivity will compel the large landholders to mechanize and to increase the yield of the land and it will lead the small holder to abandon his parcel in order to obtain a higher return for his efforts.

It will readily be seen that the solution to the problem of land tenure is only a part of the general problem of economic development, if the considerable proportion of persons gainfully employed in Latin American agriculture is taken into account. Whatever the solution, little progress can be made in raising the standard of living of the agricultural population, especially in areas where the soil is poor and where secular methods of agriculture prevail, unless the surplus population can be displaced by technical progress, and unless that portion not required for work in the new areas opened up to cultivation can be reabsorbed into activities where productivity is high.

This does not imply that the problem of land tenure in the Latin American countries can be postponed. On the contrary, it should form an integral part of programmes of economic development, once an objective and impartial consideration of the different aspects of the vital problem of increasing agricultural production has been carried out. In regions where the land tenure system itself is not at fault in retarding progress, but rather the lack of investments and of technical action on the part of the Government, a different solution will be required from that applicable where the land tenure system constitutes the major obstacle. It is surprising that so little investigation in these concrete terms has been undertaken in this field, in contrast with all that has been written and planned with regard to the problem of land tenure. In other words, when there is a possibility of assimilating modern productive technique, extensive holdings may offer the most economical means of raising the level of productivity. Attention should be drawn to the recommendation of the Currie Mission¹² as regards the better utilization of land in Colombia. It was proposed that land should be taxed in proportion to its productive capacity, so that landowners using their property uneconomically should not be in so favourable a position as those who cultivate their land economically. Evidently such a system would entail an adequate classification of the soil, which is not a simple task. This suggestion is of interest in that it indicates possible measures which, in addition to dividing up large tracts of land or preventing their subdivision into minute holdings, especially when the form of land tenure is an obstacle to the improvement of productivity, should be seriously considered in a programme of economic development.

¹² *Op. cit.*, Part II, page 46.

Immigration and the surplus of human labour

10. In this brief outline of some of the aspects of the problem of productivity in Latin America, reference has been made to the real or virtual abundance of human labour, in relation to the shortage of capital and of arable land. It would now be of interest to ascertain if, in these circumstances, there is any point in discussing the possibilities of immigration, especially in countries where the disequilibrium of these factors is greatest. It is evident that if the productive capacity of these immigrants were comparable to that of the population which economic progress tends to displace from primary to secondary production within the country, then there would be no call for such immigration, since it would affect the process of migration within the country, intensifying unnecessarily the problem of the relative shortage of capital. However, if the productive skill of these immigrants is higher, then the case is different. In countries which must assimilate better methods of agricultural or industrial technique, immigrants with such skill would be of considerable usefulness, as has been shown by past experience. This experience has also shown that within the mass of immigrants not only are there efficient labourers who tend to raise the average level of productivity, but that many of these labourers have since become entrepreneurs, exercising considerable influence in the orientation and the rhythm of economic development. However, immigration likewise essentially involves a problem of increasing capital, as do all problems of economic development. The employment of every worker generally calls for an increment in capital and, if the present capital availabilities are inadequate to effect a satisfactory rate of absorption of the surplus labour in primary production, this same capital could hardly absorb immigrants. Immigration therefore depends on a greater prior increase of available capital if self-defeating results are to be avoided. It should be remembered, at the same time, that the capital requirements for foreign immigration is lower than that generally needed for internal migration, since in the latter case capital is required not only to free labour from primary occupations, but also to re-employ it in the secondary activities.

The cost of freeing labour does not arise in regard to foreign immigrants. Moreover, if the productivity of the immigrant is higher than that of the domestic worker and contributes to raising the general level of productivity, the resulting increase to real income will exercise a favourable influence on the formation of a greater volume of capital, in the future, to the evident advantage of economic development.¹³

¹³ The problem will be dealt with at greater length in the Report on Immigration and Economic Development, which is being prepared by the Committee for Economic Development and Immigration of ECLA, United Nations.

THE GROWTH AND DECLINE OF IMPORT SUBSTITUTION IN BRAZIL *

María da Conceicao Tavares

* Part of chapter I (pages 1-7) "The import substitution process viewed as a model of recent development in Latin America", in ECLAC, *Economic Bulletin for Latin America*, vol. IX, No. 1, New York, March 1964. United Nations publication, Sales No. 64.II.G.8.

I. THE IMPORT SUBSTITUTION PROCESS VIEWED AS A MODEL OF RECENT DEVELOPMENT IN LATIN AMERICA

A. Changes in the Latin American development model

1. Features of the export model

A cursory review of the salient features of the traditional externally oriented Latin American development model will make clear how it differs from the more recent development model described below.

It is usual to stress the strong influence of the external sector in the primary commodity exporting countries, with particular reference to the part played by the two basic variables: exports, as an exogenous factor responsible for the generation of a substantial share of the national income, and for its growth; and imports, as the flexible source of supply of the various types of goods and services needed to satisfy an appreciable part of domestic demand. However, this synthetic description does not bring out the special significance of these two components in the under-developed countries. Hence, if the external sector's role in those countries is to be fully grasped, it must be compared with the role played by that sector in the economies of the "centre". This will reveal some of the main features of the model to be analysed.

In the European development process the external sector generally predominated, and essentially performed both the above-described functions. Nevertheless, even from a fairly abstract standpoint, it can be seen that there were substantial qualitative differences in the behaviour of the external sector in the two types of economy.

Let us first examine the part played by exports in both cases. In the case of the industrial "central" economies, although exports were an important and dynamic factor in generating the national income, and essential to its expansion, the growth of the economy did not depend wholly or even primarily on exports. In fact, that external factor was combined with a highly important internal factor, namely, autonomous investment coupled with technological innovations. The combination of those two internal and external factors made it possible at the same time both to take advantage of the opportunities offered by the external market and to diversify and integrate domestic production capacity.

In the Latin American countries, on the other hand, not only were exports virtually the only autonomous source of income growth, but the export sector was the dynamic centre of the whole economy. Admittedly its effect in diversifying production capacity was necessarily limited, since the external sector rested on the narrow basis of only one or two primary commodities; in addition its influence on the rest of the system depended in practice on a series of factors, in particular the type of production process adopted, and whether or not the sector constituted an enclave of foreign ownership. In short, the degree to which export activities influenced the general economy of each country depended on the nature of the production process of these primary commodities, and the extent to which it multiplied and distributed income.

Generally speaking, the development of the export sector gave rise to a fairly intensive urbanization process, during which what are known as the "residential" industries (textiles, footwear, clothing, furniture, etc.) were established. These are, of course, traditional, low-productivity industries that are found in nearly all the Latin American countries, and arose out of the primary-export model itself.

The pertinent fact, however, is that this small-scale industrial activity, combined with a subsistence agriculture, was insufficient to impart to the domestic economy a vigorous growth of its own. Thus, economic growth remained essentially harnessed to the behaviour of external demand for primary commodities, and this is what has given the Latin American economies their pre-eminently dependent and vulnerable character.

Moreover imports, as well as being different in structure, played a different part in the economy. In the open economies at the centre of the system, the function of imports was primarily to supply food and materials that could not, on the basis of the country's natural resources, easily be produced domestically. In the Latin American economies, on the other hand, imports were required, in addition to meeting much the same needs, to supply whole ranges of finished consumer goods and practically all the capital goods required for the investment process induced by the exogenous growth of the national income. Thus the role of the external sector, as a means of filling the gap between demand and domestic production, is of a very different nature, which is largely responsible for the subsequent change in the development model.

Essentially, the problems of the outwardly directed growth that is typical of the Latin American economies are clearly linked to the pattern of international division of labour that arose out of the development process in the advanced economies, and which for the peripheral countries led to a social division of labour entirely different from that prevailing in the centre countries.

In the more advanced countries there is not, and never has been, any clear dividing-line between two sorts of production capacity, one to meet domestic and another to meet external market needs. There is no export sector as such: manufactured goods are both exported and consumed in large quantities within the country, and any specialization for the external market that exists is in terms of specific products rather than of different sectors of production.

In most Latin American countries, on the other hand, there is a clear social division of labour between the external and internal sectors of the economy. The export sector was, and still is, a well-defined sector of the economy, usually with a high level of productivity, specializing in one or two commodities of which only a small proportion is consumed within the country.¹ The internal sector, on the contrary, with its low productivity level, was primarily a subsistence sector, and met only part of the food, clothing and housing needs of that section of the population whose consumption was within the monetary economy.

Moreover, the high concentration of ownership of natural resources, especially capital, in the more productive export sector gave rise to an extremely unequal distribution of income. Thus while the income of the bulk of the population was so low as virtually to exclude them from the monetary economy, the high-income groups maintained levels and patterns of consumption similar to those prevailing in the large European centres, based largely on imports.

The combination of this dual pattern of division of labour with a marked inequality in personal income distribution was therefore responsible for the great difference between the structure of production and the composition of internal demand, which was made good by foreign trade. This, in the last analysis, is the most important feature of the primary-export model for an understanding of the post-Depression change.

¹ One of the few exceptions is Argentina, where this division is not so clear and a substantial part of the output of its two chief export commodities is consumed in the country. However, the basic character of the export sector is the same, as regards specialization, and the remarks that follow also apply.

2. Collapse of the traditional model and transition to a new one

From 1914 to 1945 the Latin American economies underwent successive foreign-trade crises as a result of twenty years of war and/or depression. The long Depression of the thirties, however, may be taken as the critical point at which the primary-export model broke down. The sharp decline in export receipts caused an immediate drop of 50 per cent in the importing capacity of most of the Latin American countries, and broadly speaking this capacity never, even after its recovery, regained its pre-crisis levels.²

Despite the severe impact of the Depression on the external sector of the Latin American economies, they did not remain in a prolonged state of depression like the more developed economies. The extent of the external imbalance impelled most Latin American Governments to take measures to protect internal income, thus anticipating the economic policy of compensation that was only later advocated by the “centre” countries. These measures consisted primarily in import restrictions and controls, the raising of exchange rates and the purchase of financing of surplus output, and were aimed more at protecting the country against external disequilibrium than at stimulating internal activity. Nevertheless, the industrialization which then began was undoubtedly buttressed by the maintenance of internal income resulting from that policy.

Let us now consider briefly, and in general terms, how the new internally oriented development model came into being.

Since the existing level of demand remained at virtually the same level, while the capacity to import was sharply reduced, it was no longer possible to make an *ex ante* adjustment between the structures of production and of domestic demand by means of foreign trade. An *ex post* adjustment was made through a substantial increase in the relative prices of imports, which provided a sharp stimulus to domestic import-substitution production. By making full or even excessive use of the existing production capacity, it was possible to replace a proportion of the goods formerly imported. Later on, by a reallocation of factors, especially the foreign exchange that was in such short supply, the available capacity to import was used for external purchases of the capital goods and raw materials needed to establish new production units and thus continue the import substitution process.

A lengthy description of the dynamics of this process is unnecessary, since it is dealt with in detail below. But the important fact is that it represents the emergence of a new development model.

The first point to be noted is the change in the economy’s growth factors. There was a decline in the external sector’s contribution to the national income and an increase in the contribution of domestic production, and in its growth rate.

The external growth factor, exports, yielded first place to the internal factor, investment, and the amount and composition of investment were what determined the continuation of the development process.

This does not mean that the external sector no longer played a major part in the Latin American countries, but merely that its function changed: instead of being directly responsible for income growth, through increased exports, it became the decisive factor in diversifying the structure of production, through imports of equipment and intermediate goods.

This explains how it is possible to achieve a reasonable rate of investment, and consequently of growth, despite a temporary stagnation or decline of the purchasing power

² See the many ECLA studies on this subject, in particular the *Economic Survey of Latin America 1949* (E/CN.12/164/Rev.I). United Nations publication, Sales No. 51.II.G.1.

of exports, provided that the composition of imports can be altered by reducing non-essential imports in favour of capital and intermediate goods.

There are other points that need to be made clear, for a better understanding of Latin America's new development model.

In the first place, the changes in the structure of production were virtually confined to the industrial sector and to allied activities, and had little or no effect on the situation of the primary sector —including, of course, the traditional export lines.

Hence two circumstances to which there will be occasion to refer later. One is the persistence of a precarious and undynamic export base, which is one of the causes of the chronic external bottleneck; the other is the incomplete nature of the transformation of the economic system, and the consequent emergence of a new type of dual economy.

Secondly, there is the well-known fact that the new dynamic sectors are established and expand within the narrow framework of the domestic market, which imposes a "closed" character on the new model.

If these characteristics are examined from a broad standpoint, it can be asserted that the change in the division of labour (or resources) in a country resulting from the industrialization process typical of the region was not accompanied by any corresponding change in the international division of labour, which remained basically the same, at least as regard the special functions of the industrial and the under-developed economies in world trade. In fact, the only appreciable changes that took place were in the trade within the group of "central" nations.

In essence, many current aspirations and movements, such as those relating to the regional integration of Latin America or the United Nations Conference on Trade and Development, are based on or imply new patterns for the international division of labour (or resources), in line with internal changes and with the need to accelerate the growth rate of developing countries by expanding their foreign trade.

To sum up, the import substitution process may be interpreted as an incomplete and "closed" development process which represented an attempt, in response to foreign trade restrictions, to reproduce in an accelerated form the industrialization carried out in the past by the more developed countries, but in entirely different conditions.

3. Nature and evolution of the external bottlenecks³

Since a decline in the dynamism of the external sector is one of the dominant features of the import substitution model, and is actually found in nearly all the Latin American economies, it deserves to be examined in some detail.

First, a distinction can usefully be drawn between the two main types of external bottleneck, namely, the "absolute" form, representing a stationary or declining capacity to import, and the "relative" form, representing a capacity to import that increases more slowly than the product. The first type of bottleneck is usually related to contractions of international trade in primary commodities, and the second to long-term trends in primary commodity exports.

Although there is no shortage of material on the vicissitudes and behaviour of the Latin American external sector, for the purpose of subsequent analysis it is useful to recapitulate briefly the main features.

³ The data used in this section were obtained from the following sources: ECLA's *Economic Survey of Latin America 1949*; "Inflation and growth: a summary of experience in *Latin America*", in *the Economic Bulletin for Latin America*, Vol. VII (1962), pp. 23, *et seq.*, and *Towards a dynamic development policy for Latin America* (E/CN.12/680).

Up to the end of the Second World War neither the volume nor the purchasing power of exports had regained their pre-Depression levels. After the war the purchasing power of exports rose in absolute terms, because of the increased volume exported and a temporary improvement in the terms of trade between 1949 and 1954. Since 1954 the purchasing power of exports from all the Latin American countries (except Venezuela) has remained at a standstill, and in recent years has even tended to decline because of the deterioration of the terms of trade.

A comparison of the evolution of per capita income and the per capita purchasing power of exports, sheds some light on the external sector's failure to recover in relative terms. From 1928-29 to 1960, while the region's average per capita income rose by over 60 per cent, the per capita purchasing power of exports fell by over 50 per cent. Even in 1950-51, the most favourable post-war years for Latin American exports, their per capita purchasing power remained 23 per cent below the pre-Depression level.

This external bottleneck and the consequent fairly intensive import substitution process were reflected in a reduction in the coefficient of the Latin American economies. The proportion of Latin America's total income absorbed by imports, which before the Depression was 28 per cent, has in recent years fallen to the relatively low level of 12 per cent, and as early as 1945-49 it was only in the region of 15 per cent.

In establishing the relation between these changes in the external sector and the various forms of import substitution, it is helpful to consider three separate periods that represent changes in the nature of this relation.

In the first period, extending from the Depression to the end of the Second World War, there were sharp reductions in the capacity to import, either overall or specific, according to the individual situation. Consequently, this was a period when restrictions in the external sector were "absolute", and called for vigorous import substitution in nearly all the Latin American countries, which was reflected in a substantial decline in the general import coefficient. This first phase was characterized above all by substitution in respect of non-durable final consumer goods. In some of the larger countries —including Brazil, as we shall see later— the process was extended to intermediate and capital goods as well.

In the second period, or the first decade after the war, the capacity to import was less restricted. The increased purchasing power of exports, though insufficient to restore the external sector to its former relative level, nevertheless permitted a considerable acceleration of the growth rate of the economy, through the expansion of domestic production combined with improved conditions in the export sector.

During this period, most of the Latin American countries reverted in practice to an externally rather than an internally oriented growth, based on a higher purchasing power of exports rather than on import substitution. In a few countries, however, such as Brazil, full advantage was taken of this relatively favourable situation in the external sector to expand the industrialization process. Thus import substitution made considerable progress, and some categories of durable consumer goods, were embarked upon, while production of other lines, including capital goods, continued.

Of the three decades under consideration this was the period of greatest growth for Latin America as a whole.⁴ Broadly speaking, it was made possible solely by a rapid increase in the purchasing power of exports, although this increase was slower than that of the product. (This means that the limitations deriving from the external sector were only of a relative nature.)

⁴ See *The economic development of Latin America in the post-war period* (E/CN.12/659/Rev.1). United Nations publication, Sales No. 64.II.G.6.

From 1954 on, external conditions were once more wholly restrictive (except in the petroleum producing countries) and the region's capacity to import again approached stagnation. Most of the countries were unable to maintain their rate of development by means of import substitution. Mexico and Brazil were practically the only countries able to proceed with industrial expansion at a rapid pace. Brazil even succeeded in increasing its growth rate through a number of circumstances dealt with in the section on Brazil below, but only at the cost of considerably increasing its balance-of-payments deficit.

B. The various meanings given to the term "import substitution"

The term "import substitution" is often used in a simple and literal way to denote the reduction or elimination of certain imports and their replacement by domestic products. This interpretation obscures the real nature of the import substitution process described above, and even gives rise to a false notion of its dynamics.

In actual fact, the term "import substitution", which has been adopted to denote the new process of development taking place in the under-developed countries, is unsatisfactory because it gives the impression that this process consists simply and solely in the removal or diminution of components of the import structure and their replacement by national products. It might be assumed by extension that the natural goal would be to eliminate imports altogether, in other words, to achieve self-sufficiency.⁵

Nothing, however, could be further from the truth. In the first place, the substitution process is not intended to reduce the overall import quantum. Such a reduction, when it occurs, is the outcome of restrictions in the external sector rather than an aim in itself. It is these restrictions, whether absolute or relative, that make it necessary to produce in the country goods formerly imported. But the place of the ousted goods is taken by others, and as the process gathers momentum it generates an increase in derived demand for imports of intermediate and capital goods which may lead to greater dependence on the external sector than during the earlier stages of the substitution process.

Now that attention has been drawn to this possible misapprehension, the next step is a more detailed examination of the analytical problems that may arise when import substitution is understood in its restricted sense, that is, as an absolute or relative decrease in certain groups of products in the import structure. For this purpose, some examples are given below in which no such decrease occurs, or, if it does, its real nature is masked by the "apparent" substitution taking place.

The first example that might be considered is the extreme case where no change takes place in the composition of imports in absolute or relative terms, that is, neither the quantum nor the respective proportions of the principal commodity groups in the import structure undergo any modification. In such an event there would be no "apparent" or "visible" substitution, even though a vigorous and effective process of substitution might actually be taking place through an increase in domestic industry's contribution to an expanding domestic supply, which would be reflected in a reduction of the economy's import coefficient.

Another kind of problem is posed by the emergence of new products on the world market, which makes it difficult to undertake a comparative analysis of the pattern of imports in different periods. For instance, after the Second World War, new durable consumer goods made their appearance which bore no resemblance to the type of product imported previously.

⁵ Incidentally, this point of view has been advanced by some theoretists, such as Professor Rottenberg of Chicago, to emphasize the "dangers" inherent in a policy of import substitution. See Simón Rottenberg, *Reflexiones sobre la industrialización y el desarrollo económico*, Catholic University, Santiago, 1957.

Consequently, the development of a domestic industry producing such goods cannot be described, strictly speaking, as “substitution” in terms of pre-war imports. It is obviously a continuation of the general process described above; that is, it involves a realignment of the factors of production corresponding to a change in the pattern for the division of labour in the economy.

Another common occurrence in Latin America, particularly during the last decade, is a decline in imports of non-essential goods (certain kinds of durables and non-durables) as the result of discriminatory exchange policies aimed at reconciling the overall level of imports with the real capacity to import.

The effect of these restrictions has been to stimulate domestic production. Obviously, in these circumstances the “real” substitution takes place after the “apparent” substitution discernible in the pattern of imports. But it may well be that some products are not actually replaced (because the market is not large enough, and/or the resources for producing them locally are lacking), and that their reduced share in the import structure is entirely attributable to import controls. Once these have eased, imports of such goods will automatically begin to climb again, possibly in company with those of other goods that cannot be produced locally on a competitive basis without the protection afforded by very high tariffs or other discriminatory measures.

Lastly, there is a point which, while obvious enough, is not always clearly grasped; “real” substitution is usually much less than the “apparent” substitution manifested in the reduction of certain imports. For instance, when import substitution takes place in end goods, there is a rise in demand for basic inputs and materials (not all necessarily produced locally), payments have to be made in respect of technical services and capital, and so forth. In reality, the production of a particular article replaces only part of the value added which used to be generated outside the economy. As previously indicated, the result may be an increase in the derived demand for imports that exceeds the saving in foreign exchange achieved by domestic production.

These brief remarks are not intended solely to indicate the risks inherent in a narrow interpretation of the term “import substitution” but to draw attention to some features of the process itself that are masked by that designation and sometimes even appear to be in conflict with it.

An analysis follows of the dynamics of what will continue to be called “the import substitution process”, since this is the accepted term in the literature of economic development in Latin America, and in ECLA studies in particular. Nevertheless it should be understood that in the rest of this study this term will be used in a broad sense, to designate an internal development process that arises out of and takes its direction from external restrictions, and is evidenced mainly in the expansion and diversification of industrial production capacity.

C. The dynamics of the import substitution process

The object of this section is to make a highly theoretical analysis of the main features of the dynamics of what is meant by “import substitution”, in the broad sense, and of the external and internal problems that arise as this process develops.

The dynamics of the process of development through import substitution may be regarded, to put it shortly, as a series of responses to the successive challenges presented by the restrictions in the external sector, as a result of which the economy gradually becomes less quantitatively dependent on external sources, and also effects a transformation in the nature of this dependence. Throughout this process, which gives rise to a number of structural modifications in the economy, the basic contradiction between development requirements and the barrier represented by the capacity to import manifests itself in a series of different forms.

The aim here is to show how some of the difficulties can be surmounted, but the conclusion reached is that external and internal problems tend to accumulate to the point where they act as a brake on the dynamism of the process.

1. Responses to the challenge of external disequilibrium

The beginning of the import substitution process is historically linked with the world Depression of the thirties, but for analytical purposes the starting-point chosen may be any lasting external disequilibrium that disrupts the balance between demand and production, as described above in dealing with the traditional export model.

Thus, during its first phase the aim is to satisfy current domestic demand which is not affected by the crisis in the export sector, and may or may not be maintained by government action.

There are three possible ways of expanding domestic supply, namely: better utilization of existing installed production capacity; the production of goods and services relatively independent of the external sector (e.g., government services); and the establishment of production units to replace former imports.

The first alternative comes to an end when the utilization of idle capacity existing in the economy reaches saturation point. Part of the second alternative is closely bound up with the third, and together they form the backbone of the inward-oriented development process known as import substitution.

Substitution usually begins in the easiest area, the production of finished consumer goods, partly because the technology is generally less complicated and less capital-intensive, but mainly because there is a larger untapped market for goods of this kind, either already existing, or brought into being as a result of the foreign trade policy adopted as a defensive measure.

There now follows an explanation of how the very expansion of internal production that characterizes the first phase imposes the need to press on with the development process.

In the first place, the establishment of industrial plants to produce internally final consumer goods formerly imported tends to enlarge the home market for such goods, not only because of the higher income that results from the investment process,⁶ but also because of the absence of internal restrictions of the kind imposed on equivalent imports. Secondly, domestic production, as we have seen, replaces only a part of the value added that was previously generated outside the economy. Consequently, derived demand for imports of raw materials and other inputs climbs rapidly and tends to outstrip the supply of foreign exchange.

This, then, is the first manifestation of one phase of the above-mentioned internal contradiction between the aim of the process, which is to expand the product (and, consequently, imports, at least to some extent), and the limitations of the capacity to import.

The response to this challenge is a fresh wave of substitutions, which means that some of the less essential imports have to be cut to release the foreign exchange required for the establishment and operation of new production units. Once more there is an increase in the product and in income, and the phenomenon described above then repeats itself, to a greater or lesser extent.

The mainspring of the import substitution process is the constant struggle to resolve these contradictions. Theoretically, the process could continue, though a rigorously selective

⁶ How far consumption expands in relation to the growth of income is essentially a question of the income-elasticity of the products in question.

use of foreign exchange, to that point in the international division of labour where utilization of existing domestic resources reaches its maximum.⁷

But in practice, as the substitution process solves the problems successively posed by the “external barrier”, its progress becomes increasingly difficult and costly, not simply for internal reasons, such as market size, technology, etc., but also because, as a result of the limitations of the capacity to import, the import structure tends to become extremely rigid before the development process has acquired sufficient independence in terms of diversification of production.

The internal factors are analysed in the next section, which deals in more detail with the ways in which the dynamics of substitution affect the structure of imports, and what the implications are for the continuity of the process.

2. Changes in the structure of imports and the substitution mechanism

In the first phase of the substitution process the choice of new lines of production is based on the existing domestic demand for those items in the import structure that were easiest to manufacture, to wit, as already indicated, finished consumer goods.

This change in the orientation of domestic activity is reflected in the import structure by a reduction in the proportion of finished consumer goods and an increase in the proportion of intermediate products.

However, once the initial stage of industrialization is completed, the persistence of a structure of imports largely unchanged as regards the relative position of the three main groups (consumer goods, intermediate products and capital goods) may mean that substitution is being effected in several categories at the same time, although the emphasis on particular groups of products will vary according to the individual circumstances of each country and the stage of development it has attained.

Clearly, this does not mean that there is no alteration in the structure of imports; on the contrary, it will undergo changes within each group, at a speed determined by the pace of the substitution process. However, if the process is to continue, substitution activities must be so coordinated as to prevent any coincidence of peaks of demand for imports that might give rise to a persistent internal bottleneck. The behaviour of the various historical series for imports could therefore be expected to appear in a graph as a series of dephased parabolas that represent the alternate appearance and disappearance of new products in the import structure.

The possibility of maintaining some degree of flexibility in the structure of imports, when the capacity of import is limited, depends on forging as soon as possible certain links in the chain of production which are of strategic importance for furthering the process. In other words, the possibility of proceeding with substitution depends upon the types of substitution already effected.

If, for example, substitution were confined to final consumer goods, the import schedule might be virtually limited to the imports needed to maintain current production, with no margin left for the entry of new products and, in particular, of the capital goods essential for the expansion of production capacity. To prevent this happening, it is imperative to embark promptly on substitution in respect of additional categories, especially of intermediate products and capital goods, before an excessively rigid import structure jeopardizes the very continuation of the process.

⁷ The lack of some of the natural resources required rules out even the academic possibility of progressing towards self-sufficiency.

A notable advantage of substitution in respect of semi-processed materials and other intermediate products, from the standpoint of internal restrictions, is that imports needed to maintain existing output are relatively modest. There are two main reasons for this. The first is that some of the raw materials needed for the manufacture of such goods can be found within the country itself, and the proportion imported consists of raw or simply processed materials of a low unit value. The second is that their domestic market, unlike the internal market for consumer goods, does not tend to expand sharply merely because production within the country is undertaken. In all probability the main outlay of foreign exchange made once and for all will be on the purchase of the equipment needed for the installation of production units.

In this intermediate production sector, however, there is a considerable time lag between the decision to invest in a given branch of activity and entry into operation. Consequently, if import substitution is not envisaged until these products have already become important items in the import structure, almost certainly the rise in derived demand, combined with the time lag in the domestic supply, will result in a substantial increase in such imports which may exceed the country's foreign exchange resources.

What has been said above, especially in the preceding paragraph, about the production of intermediate goods also applies to some extent to certain types of capital goods. In addition the earliest possible start on their production has the strategic advantage of giving the domestic development process some degree of independence in relation to external restrictions.

To sum up, it can be asserted that, given the conditions of the import substitution model, it is practically impossible for the industrialization process to proceed from the base to the apex of the production pyramid, that is, to start with the more simply processed consumer goods and progress gradually until it includes capital goods. The substitution process might be regarded as a building of which every storey must be erected simultaneously, although the degree of concentration on each varies from one period to another.

It is plain that this undertaking gives rise to a series of problems of all kinds whose solution requires a conjunction of favourable conditions. Two such problems, one internal and the other external, merit special attention.

The first relates to the choice of product categories for substitution purposes. Clearly, in view of what has been said above, such a choice cannot be made in the light of a static conception either of the domestic market, or of the import structure at a given moment, or of both. In the first place, this means that not all investment can be induced only by existing demand, and secondly, it calls for a degree of foresight and ability to make autonomous decisions that can be looked for only from the State, or occasionally from the very few entrepreneurs of the "innovating" type.⁸

It will be difficult for what are termed the basic investments, for example, to be effected soon enough except through government decisions, either to undertake direct promotion of private enterprise or to stimulate and protect it by financial and other measures.

Of the market-induced investments themselves, many are in no way "spontaneous",⁹ since they are due largely to economic policy decisions, especially on foreign trade (exchange and tariff policy), which by causing changes (sometimes very abrupt) in relative prices, deliberately or otherwise determine changes in production capacity.

⁸ The term is used in the Schumpeterian sense. Thus, although it is recognized that in some of the Latin American economies there is a considerable body of able entrepreneurs capable of responding adequately to market stimuli or decisions of government economic policy, or both, the "innovating" and far-sighted type of entrepreneur, capable of seeking out the opportunities implicit in the opening-up of new lines of productive activity, may fairly be considered a rarity.

⁹ In the sense of resulting from the free play of market forces.

The second type of problem that arises with import substitution relates to the nature of the limitations of the external sector. Naturally, if there is an "absolute" stagnation of the capacity to import, it is hardly possible for industry to expand sufficiently to maintain a rapid growth rate. If the high rates of capital formation and the composition of investment needed for the rapid diversification and integration of the production mechanism are to be achieved, the limitations of the external sector must at worst be relative, i.e., there must be some import expansion, even if it takes place at a lower rate than the growth of the product. This can be achieved by an increase in the purchasing power of exports, with or without an autonomous or compensatory inflow of foreign capital.

As explained below in the section on Brazil, in recent times fairly satisfactory solutions have been found for the two problems referred to.

DEVELOPMENT AND UNDERDEVELOPMENT *

Celso Furtado

* Chapter 4 (pages 115-140), *Development and Underdevelopment*, Oakland, USA, University of California Press, 1971.

THE UNDERDEVELOPED STRUCTURES

The advent of an industrial nucleus in eighteenth century Europe disrupted the world economy of the time and eventually conditioned later economic development in almost every region in the world. The action of that powerful dynamic nucleus proceeded to operate in three directions. The first marks the line of development in Western Europe, within the structure of the political divisions which had crystallized in the preceding mercantile period. This development, as we have seen, was characterized by disorganization of the pre-capitalistic artisan economy and progressive absorption at a higher level of productivity of the factors released. Two phases can be identified in this process: in the first, the release of labour faster than it was absorbed made the supply of this factor wholly elastic; in the second, the tendency towards exhaustion of the labour supply resulting from the disjointing of the pre-capitalistic economy called for reorientation of technology in order to maintain the flexibility of the system, so that the factors could be combined in proportions compatible with their respective supplies. Thus, the development of technology —the transformations of the capital goods industries— became more and more conditioned by the relative availability of factors in the industrial centers.

The second line of development of the European industrial economy consisted of displacement of frontiers, wherever there was still unoccupied land with characteristics similar to those in Europe itself. A number of factors were involved in that expansion. In the case of Australia and the American West, gold played a basic role. The revolution in maritime transportation, making it possible to bring grain great distances to compete in the European market, was decisive in other cases. It must be remembered, however, that this displacement of the frontier was not basically different from the process of development of Europe itself, of which it formed a part; the Australian, Canadian, and American economies in that phase were mere extensions, so to speak, of the European industrial economy. The populations which emigrated to those areas took with them European techniques and consumption habits, and on encountering a greater abundance of natural resources they rapidly achieved rather high levels of productivity and income. If we consider that these “colonies” were established only where exceptionally favourable economic potentials existed, we see why their populations achieved right from the start high standards of living relative to those of the European countries.

The third line of expansion of the European industrial economy was towards already inhabited regions, some of which were densely populated, whose old economic systems were of various, but invariably pre-capitalistic types. The contacts between the vigorous capitalistic economies and these regions of long-standing habitation did not occur in a uniform manner. In some cases interest was limited to the opening up of lines of trade. In others there prevailed right from the start a desire to encourage the production of raw materials for which demand was increasing in the industrial centers. The effect of the impact of capitalist expansion on the archaic structures varied from region to region, being conditioned by local circumstances, the type of capitalistic penetration, and the intensity of the penetration. The result, however, was almost always to create hybrid structures, part tending to behave as a capitalistic system, part perpetuating the features of the previously existing system. The phenomenon of underdevelopment today is precisely a matter of this type of dualistic economy.

Underdevelopment is, then, discrete historical process through which economies that have already achieved a high level of development have not necessarily passed. To grasp the essence of the problem of contemporary underdeveloped economies this peculiarity must be taken into consideration. Let us, for example, view the typical instance of an economy into which a capitalistic “wedge” is introduced —let us say productive activities intended for export, a mining undertaking controlled by a capitalistic enterprise which organizes not only

production but also marketing of the product. The intensity of the impact of this nucleus on the old structure will depend basically on the relative importance of the income to which it gives rise and which remains available within the community. Thus the impact depends on the volume of labour the enterprise absorbs, the level of the average real wages it offers, and the total amount of taxes it pays. This last item is typically of minor importance during the initial stages of capitalistic expansion, when stimuli of all kinds, including complete tax exemption, are created to attract capital from outside. The level of real wages is determined by living conditions prevailing in the region in which the new enterprises are set up, without any precise connection with the productivity of labour in the new economic activity. Creation of a highly elastic supply of labour requires only that wages in the capitalistic enterprise be somewhat higher than the average for the region. Hence the decisive factor is the volume of labour absorbed by the capitalistic nucleus. But experience shows that this volume of labour did not usually reach large proportions. In the case of the economies specialized in mining, it hardly amounted to 5 per cent of the working age population. Furthermore, the new enterprises tended to encourage and assist local authorities to carry out sanitation and other health measures resulting in a decline in the death rate and a corresponding increase in the rate of growth of the population. After a certain period, the population had increased enough to reestablish the ratio of population to resources prevailing in the stage prior to the penetration of the capitalistic enterprise.

The economic structure of the region into which the capitalistic enterprise has penetrated —as in the example above— does not necessarily become modified as a result of that penetration. Only a small fraction of the available labour is absorbed by the alien enterprise; the wages paid to that labour are not determined by the level of productivity of the enterprise but by the living conditions prevailing in the region. And the increase in the rate of growth of the population is quite significant. But, all in all, as the capitalist enterprise's connection with the region in which it has been established is almost exclusively as a wage-generating agency, the payroll must attain a relatively substantial level before modifications occur in the economic structure. The phenomenon seems to resemble that observed in the first phase of development of a capitalist economy, when the previously existing artisan scheme is destroyed and absorbed. The similarity is only apparent, however; the capitalistic enterprise penetrating into a previously inhabited region with an archaic economic structure does not become dynamically linked with the latter, for the mass of profit it generates does not become integrated into the local economy.

The dynamism of the capitalist economy results, in the ultimate analysis, from the role the entrepreneurial class plays in it, especially in its having to utilize reproductively a substantial part of its constantly accruing income. We have already mentioned that the consumption of the capitalist class is determined by institutional factors and is largely independent of short-term fluctuations in the level of aggregate income. Its consumption is unquestionably the most stable factor in the aggregate expenditure of the community. But consumption by wage earners is determined by the aggregate employment level, a circumstance which tends to minimize the role it plays in the process of development. What ensures the dynamism of the capitalist economy is the manner of utilization of the mass of income that reverts to the entrepreneurs and which they put aside as savings. This portion does not become tied in with the region in which the enterprise is located; its utilization depends almost exclusively on conditions prevailing in the economy to which the owners of the capital belong. Let us consider the case of British capital invested in South East Asia in companies producing tea, rubber, or metals. The income those enterprises generate becomes integrated partly into the local economy and partly into the British economy. The part involved in the local economy probably tends to be the larger. However, it is the portion connected with the British economy that establishes the dynamic characteristics of the capitalistic system. As a matter of fact, the mass of savings required by

the British economy every year for transformation into productive capacity is derived largely from income of firms located all over the world.

It is because of the circumstances just described that the expansion in international trade in the nineteenth century —an expansion resulting from the industrial development of Europe— did not lead to a spreading of the capitalistic system of production on the same scale. The displacement of the European economic frontier almost always resulted in the formation of hybrid economies in which a capitalistic nucleus, so to speak, existed in a state of “peaceful coexistence” with an archaic structure; the capitalistic nucleus rarely modified the preexisting structural conditions, but was linked with the local economy merely as a formative element creating a mass of wages. Only when the type of enterprise called for the absorption of a large number of wage earners —as on the tea plantations in Ceylon and the rubber plantations in Burma— did the effect of the capitalistic organization on the local economy become of major importance. If the local labour supply was relatively scarce, as in those two countries, the possibility of an increase in real wages arose early (that tendency could be partially annulled, however —as in the two cases in question— by imports of labour from countries with low living standards). Even so, despite an improvement in living standards, there was no structural modification in the economic system —the basic step required for the creation of a typical capitalistic economy was not taken. When external conditions ceased to permit expansion in the output of tea or rubber in those countries, the situation became one of equilibrium at a level of permanent under-employment of factors, a circumstance inconceivable in a typical capitalistic economy.

As wages are determined by the conditions of subsistence —and the profit margin is therefore high— the typical company becomes able to absorb substantial price falls and for that reason the level of employment fluctuates little. Price falls, affecting mainly the profit margin, concentrate their effects on the British income itself, into which the profits of the company are integrated. *Mutatis mutandis*, the recovery in prices and the period of abundance pass almost unnoticed in the country in which the enterprise is located, unless factors of another kind make it advisable to utilize the larger profits for expansion of the business in the region in which they are obtained. The decision in regard to a possible expansion in the business is taken in London; it is made from the British, not the economic, point of view. Thus, despite the relative strength of the capitalistic nuclei in economies such as that of Ceylon or the Central American countries, these regions have remained essentially pre-capitalistic structures.

But it would be incorrect to conclude that the hybrid economies we have been discussing have behaved in all circumstances as if they were pre-capitalistic structures. In many cases —Brazil is a good example of this— the mass of wages in the sector connected with the international market has been sufficiently large to give a monetary character to an important sector of the economic system. The growth of the monetary sector has prompted substantial modifications in consumption habits, spurred by and spurring the introduction and spread of innumerable articles manufactured abroad. Diversification in consumption habits has had important consequences on the subsequent development of the economy. We have already seen that the level of employment in an economy of this type tends to be relatively stable, even though the value of exports fluctuates in line with the oscillations in international prices for raw materials. Stability in the internal monetary income, by comparison with the instability of importing capacity, creates strong pressure against the balance of payments in phases of declining international prices, and makes it hard to adopt the rules of the gold standard. To the extent that the relative importance of money income within the Brazilian economy grew because of expansion of the sector connected with the international market, there was a tendency towards increased pressure against the balance of payments during phases of falling international prices. Thus conditions arose favourable to the establishment

of activities connected with the domestic market itself, for during phases of strong decline in export prices, the profitability of business connected with the domestic market tends to increase in relative terms, inasmuch as the prices of imported commodities rise while the level of money income remains steady.

When exporting activity was partially controlled by national capital —as was the case in Brazil during the period of coffee expansion— the problem presented other important aspects. The mere existence of a large mass of profit formed in activities connected with the external market, both opened up new possibilities and created new problems. It must be borne in mind that those profits did not play the same role in the coffee economy that profit plays in an industrial economy. The dynamic factor of the Brazilian coffee economy was external demand, not volume of investment within the coffee sector. If such investments were found to be excessive, the ultimate effect might be a loss of real income through declines in the coffee prices. In the Central American republics two phenomena may be observed side by side, namely: the effect of “incrustation” of foreign companies, as in the banana plantations; and the effects of an expansion partially controlled by national capital, as in the coffee plantations. The results were not much different, although coffee gave rise to a flow of profit over and above that of wages. The profit flow from coffee was reinvested in the coffee economy itself to the extent that land and labour availabilities permitted. Once possibilities of expansion of the coffee sector had been exhausted, however, the new capital formed therein tended to emigrate rather than look for new fields of application within the system itself.

Brazil's experience, in view of its considerable magnitude, constitutes a special case. Actually, in view of the great abundance of land suitable for coffee planting and the elasticity of labour supply,¹ investments in coffee growing were not limited by factor availability. This explains why ever since the end of the nineteenth century the situation has been one of chronic over-supply while at the same time it was possible to control supply artificially. During phases of prosperity, the profit in the coffee sector tended to concentrate in that same sector without playing any basic role in altering the structure of the system. The only difference from the situation in Central America lay in the fact that, since there was an elastic factor supply, profit was invested in the same sector that generated it. Voluminous investments in the coffee sector —even when their real profitability was relatively low— led to the absorption of the previously existing subsistence economy and financed European immigration, thus promoting expansion of the monetary sector within the economy. As the requirements for manufactured goods within this sector were fairly high, a market for manufactured products arose which was later to justify the creation of an industrial nucleus which eventually induced a structural transformation in the economy.

The dynamic element in the first stage of European industrial development acted, as we have seen, on the side of supply. Entrepreneurial action —through the introduction of new combinations of factors— created its own demand as it became possible to offer a cheaper and more abundant product. In the case of development induced from without —as in Brazil— the first consequence was a demand for manufactured goods. At first this was met by imports; but the dynamic factor began to act internally, here on the side of demand, from the moment demand could not be met by external supply. On the one hand, the stability in the level of money income, and on the other, instability in importing

¹ The first phase of great coffee expansion in Brazil (in the third quarter of the nineteenth century) was based on labour which had remained semi-utilized in the mining region after the gold economy entered into a state of decadence; in the second stage of expansion (last quarter of the past century) the problem of labour was solved by European immigration; the expansion in the twenties, forties, and fifties of this century was based on the absorption of excess labour coming from Minas Gerais and the states in the Northeast.

capacity, acted cumulatively to guarantee attractive conditions for investments linked with the domestic market.²

The industrial nucleus based on demand for manufactured goods formerly met out of imports commenced with light industries producing general consumption articles such as textiles and processed foodstuffs. Thus, three sectors came to coexist within the economy: one was the “remnant” economy with a predominance of subsistence activities and a minor money flow; the second comprised activities directly connected with foreign trade; the third consisted of activities connected with the domestic market for general consumption manufactured products. The total constituted an economic structure a good deal more complex than that of mere coexistence of foreign firms along with the vestiges of a pre-capitalistic system.

In the more simple underdeveloped structures, the mass of wages generated in the exporting sector is the only dynamic element; expansion of the exporting sector engenders a greater flow of money income permitting absorption of factors previously engaged in the subsistence sector; if the exporting sector remains stationary, growth in population brings an enforced reduction in the average real wage level and a decline in the income per inhabitant. In the more complex underdeveloped structures, in which there is an industrial nucleus linked with the domestic market, cumulative reactions may arise tending to cause structural transformations in the system. The basic dynamic factor continues to be external demand; but an important difference lies in its impact: its action is multiplied internally. As external induction increases monetary income, the profit of the industrial nucleus linked with the domestic market also grows; increased investment within that nucleus follows, increasing further the level of money income. All in all, the relative importance of the subsistence sector shrinks, even though the expansion of the external sector is accompanied by an improvement in importing capacity and the competitive power of imports in these phases, reducing the real magnitude of the domestic income multiplier.

The greatest difference occurs, however, in the following stage of contraction of importing capacity, with the decline in the prices of exported products. As money income remains at a relatively high level, the decline in importing capacity causes substantial exchange devaluation. The nucleus thus enters into a boom, precisely during the phase of decline in profitability of the export sector. Although the level of money income declines, exchange devaluation spurs an increase in the demand for domestically produced manufactured goods, and the sector connected with the domestic market shows an improved profit picture. The effective possibilities of growth are partially frustrated, however, by the reduction in importing capacity. High profitability in the industries connected with the domestic market is partly illusory, inasmuch as the cost of replacement of imported equipment increases with exchange devaluation. The existence during a period of relative increase in prices of industrial equipment of a substantial mass of profit due to activities connected with the domestic market gives rise to a tendency to invest capital in activities less dependent on imports, such as the building industry. As these investments do not cause permanent changes in the employment structure of the community, the relative increase tends in the last resort to put a brake on the process of growth itself.

The higher stage in underdevelopment is reached when the industrial nucleus becomes diversified and able to produce part of the equipment needed for expansion of productive capacity. Reaching this stage does not imply that the industrial nucleus connected with the domestic market automatically becomes the main dynamic element. The normal process of development of the industrial nucleus remains a matter mostly of replacement of imports;

² The policy of artificial control of the supply of coffee introduced in the first decade of this century gave greater stability to importing capacity and very probably had a negative effect on the development of the industrial nucleus already in course of formation. Paradoxically, however, even the “negative” effects of this policy were in at least one situation structurally important: by intensifying and extending the coffee crisis which commenced in 1929 the policy precipitated notable structural transformations.

the dynamic element continues to reside in previously existing demand created mainly by external induction, and not, as in the fully developed industrial economies, in the innovations introduced into the productive processes. But with the system capable of producing a part of the capital goods required for expansion of productive capacity, the process of growth may continue for a far longer time, even if importing capacity is choked off. Under such conditions, for a series of reasons to be commented on at greater length in the next chapter, development takes place with strong inflationary pressure.

We see, then, that underdevelopment is not a necessary stage in the process of formation of the modern capitalistic economies. It is a special process due to the penetration of modern capitalistic enterprises into archaic structures. The phenomenon of underdevelopment occurs in a number of forms and in various stages. The simplest case is that of coexistence of foreign companies producing export commodities alongside a wide range of subsistence activities. This coexistence may continue in a state of static equilibrium for long periods. The most complex situation, as in the Brazilian economy at the present time, is that in which there are three sectors in the economy: a subsistence structure, a structure oriented mainly towards export, and an industrial nucleus connected with the domestic market and sufficiently diversified to produce a part of the capital goods it needs for its own growth. The industrial nucleus linked with the domestic market develops through a process of displacing importation of manufactured goods, that is, under permanent competitive conditions with external producers. The greatest concern of the local industrialist is therefore to provide an article similar to the one imported and, consequently, to adopt production methods which make it possible to compete with the foreign producer. In other words, the price structure in the industrial sector connected with the domestic market tends to be similar to that prevailing in highly industrialized countries exporting manufactured goods. Thus the technological innovations which appear most advantageous are those making it possible to approach the cost and price structure of the countries exporting manufactured goods, and not those permitting faster transformation in the economic structure through absorption of the subsistence sector. The practical result of this (even if the industrial sector connected with the domestic market grows and increases its participation in the product and even if the per capita income of the population as a whole rises) is that the occupational structure of the country changes only slowly. The part of the population affected by development remains minor, and there is a very slow decline in the relative importance of the sector whose main activity is production for subsistence. This explains why an economy in which industrial production has already achieved a high degree of diversification —with the share of the industrial sector in the product hardly distinguishable from that in more highly developed countries— may present a rather pre-capitalistic occupational structure and have a large portion of its population cut off from the benefits of development.

Again we see that underdevelopment, specific phenomenon that it is, calls for an effort at autonomous theorization. Lack of such an effort has led many economists to explain by analogy with the experience in developed economies problems which can be properly expressed only through full understanding of the phenomenon of underdevelopment. The tendency in countries with an underdeveloped economy, such as Brazil, towards disequilibrium in the balance of payments is one of those which, for lack of a proper theoretical basis, has most commonly been incorrectly presented and misinterpreted.

AN INTRODUCTION TO THE TECHNIQUE OF PROGRAMMING *

ECLAC

* Chapter III (pages 18 to 26) "Nature and Methodology of the Aggregate Projections", in *An Introduction to the Technique of Programming* (E/CN.12/363), Mexico City, July 1955. United Nations publication, Sales No. 1955.II.G.2. Drafted by Celso Furtado.

I. SCOPE OF THE AGGREGATE PROJECTIONS

In the two previous chapters, it was maintained that programming should start from aggregate projections of the economy, proceed with an analysis of the different sectors and, finally, compare the aggregate projections with the results obtained from the individual study of the different branches, so that any necessary corrections and adjustments can be made. The adoption of the aggregate projections as a starting point constitutes a fundamental aspect of the technique which is being examined here, since it would also be possible to begin the preparation of a programme by studying the various sectors, and to combine the individual projections by branches in an aggregate programme at a later stage. Consequently, the time has come to explain the reasons for preferring the first method.

The preparation of a general development programme means that basic data must be available in anticipation. In the first place, the rate of growth which the economy must reach during the period in which the programme is in force, as well as the volume of investment necessary to achieve that rate, must be determined beforehand. Only by starting from this basic data will it be possible to follow the subsequent stages of the programming. Thus, the initial object of a programme is to establish the investment which must be made in each sector of the economy and to fix the order of priority for the different investments. This requires a prior estimate both of the future demand for exports and of the internal demand for consumer, intermediate, and capital goods. But this estimate —particularly as regards the internal demand— must be based on the probable growth of income and on its distribution, for which it is necessary to have previous knowledge of the rate of growth of the economy. A programme also has to establish what share of the demand will be supplied with imported goods and what share with domestic commodities. From another angle, a programme must determine the investment required to produce both commodities for export and those for the domestic market. This will also need previous knowledge of the total volume of investment on the one hand and, on the other, of export prospects and the capacity to import. In calculating investments, it will be necessary in addition to know how these will be financed, that is, to what extent domestic saving can supply the capital required to attain the desired level and, if necessary, what would be the share of foreign capital. To reach a solution —starting from the probable increase in income— the trends of domestic consumption and saving, as well as the anticipated role of foreign capital, must be estimated.

Each of these aspects provides different possibilities. The rate of development may be more or less rapid, according to foreign trade prospects or to the degree of domestic effort represented by the level of saving. Production may advance with greater or lesser intensity towards the realization of a programme of import replacement, according to the hypotheses on foreign trade. The contribution of foreign capital may vary in magnitude, given the estimate made for the rate of growth and for the possibility of curtailing the future expansion of consumption.

These various possibilities also presuppose different ways in which economic policy is used. A slow rate of development or a large inflow of foreign capital will require measures which differ from those applied to an accelerated growth or a high rate of saving. The decision as to the objectives of the programme, and its more detailed application to the various sectors of the economy, will depend on a study of the different alternatives.

The aggregate projections are calculated with the basic data previously mentioned. With this information, it is possible to proceed, in the first place, with an evaluation of the different alternatives which arise from the initial stages of programming an economy and the degree of effort required by each alternative. Once the objective has been established, it can

be used as the basis for drawing up the partial programmes, which in conjunction will permit the accomplishment of the overall programme.

The procedure of starting from plans or programmes for the various sectors and then combining them in a general plan, which is sometimes adopted because sufficient information is lacking, differs substantially from the method used for aggregate projections. In that case, the targets for each sector would not be fixed as a result of the estimate forecast for the probable gross income and for the distribution of expenditure, but a series of heterogeneous criteria would be applied to establish an estimate of the needs or possible growth of each sector. Neither would capital requirements be the result of the distribution of a volume of investment which had been previously established in terms of a rate of growth, in accordance with an order of priority applied to the economy as a whole; rather, the required investment would be fixed in each isolated case and the total capital to be invested would represent an aggregate of the individual investments, which would certainly have to be adjusted later if the available capital proved insufficient to cover the estimated total. Lastly, in the aggregate projection method, the rate of growth is the fundamental criterion upon which is based the volume of investment and the required levels of domestic saving or of foreign capital. In contrast, under the system of individual programming, the future rate of growth is unknown beforehand and can be assessed only after the individual sector programmes have been established; as a consequence it is very probable that the result will not coincide with the highest rate of growth which the country might reach.

II. THE ANALYSIS OF THE PROCESS OF DEVELOPMENT

The drawing up of the aggregate projections must be based upon as complete an examination as possible of the economic situation of the country and of the evolution of its economic development, over a sufficiently long period of time, to enable its main characteristics and the determining influences of the process to be appreciated. This analysis of historical trends is indispensable if both the projections and the possible subsequent decisions derived from them are to be founded upon reality and are to reveal the strategic points upon which economic policy should be brought to bear, if the desired results are to be obtained from programming.

This analysis should, above all, clearly reveal the rate of growth experienced by the economy concerned during the immediate past. It might happen that there was no growth, or that the expansion hardly existed, in other words, that a state of economic stagnation had been reached, the causes of which it would be necessary to determine; but in the event that the economy had experienced a period of satisfactory development it would have to be established how and to what extent development had affected the different branches of production of goods and services, the occupational distribution of the population and the income from the various productive factors.

The evolution of production and gross income is influenced by both internal and external factors. The action of each of these agents should be studied with the greatest care.

Among the external factors, the volume of foreign trade, the terms of trade and the inflow and outflow of capital are of particular interest. The importance in the overall economy of foreign trade —the export and import of goods and services— will indicate the degree to which the national economy is integrated with world trade in marketing production and in the domestic availability of goods and services, as well as recent movements in the principal sectors of this trade. The terms of trade will measure the way in which the prices of products

sold in foreign markets and the prices of those purchased abroad for domestic consumption and investment have evolved; they will also show the influence of price variations on the volume of gross income. The movement of capital and the capital services account will indicate the magnitude of the contribution of foreign capital to investment and development, and the resources which the country must remit for interest and profits on such capital, or for its amortization.

A study of the internal factors in the development process covers a wide variety of aspects. Particularly important are the evaluation and evolution of the country's resources: the active population and the labour force by sectors; productive capacity or installed capital; natural resources of which use is or could be made; and productivity per worker and per unit of capital in the different activities. Data are likewise needed on the share of each social group in the gross product and on the distribution of income and expenditure, so that the proportion of income used for consumption, and its movements, the percentage that has been saved and the distribution of investment may all be established. The ratio, by factors of production, between the income received and the proportion saved, is of vital importance if the share of each in capital formation is to be assessed.

The manifold part played by the public sector in the process of growth deserves special mention. As the recipient of taxes and the source of public services, the State simultaneously acts as a producer receiving a remuneration, as a purchaser of goods and services in competition with the private sector and as an agent for the redistribution of the population's aggregate income. In its character as the executor of all kinds of public works the State is an investor contributing to capital formation. The extent to which the State participates in creating income, the use and influence of its redistributive function in the development process, the volume of public investment and the form it assumes, are all indispensable data for a study of a national economy and an evaluation of its tendencies.

The purpose of the analysis made on the basis of this information is intended to give an idea of the forms and characteristics of the development of the economy concerned, identifying its dynamic centres and strategic points and assessing the evolution of all these factors in the final period. An effort can thus be made to prepare what might be termed the diagnosis of the economy, on the basis of which the aggregate projections can later be established.

This list of essential data by no means covers all the information required. It has been used merely to attempt an outline of those facts which are indispensable for one part of the task of programming, and even so it must be considered as deficient. The lack of statistics and basic economic data represents one of the most serious problems which under-developed countries must face in carrying out an effective economic policy. One of the first positive results of a policy aimed at programming would in fact be to encourage an improvement in the data which might be available. A first step would be to prepare what is nowadays called "a system of national accounts". The United Nations has been carrying out a campaign in favour of the application of universal standards in such matters¹ and it is to be hoped that these under-developed countries which have not already done so will make a serious effort to apply these standards in practice as soon as possible. But this is not all. The task of programming in addition calls for other data and analyses which will be described in the course of this report, especially as regards consumption statistics and inter-industrial relations.

In the specific applications of the technique of programming which the secretariat has already commenced in the cases of Brazil, Chile and Colombia, and which form part of this

¹ See United Nations, *A System of National Accounts and Supporting Tables (Studies in Methods, No. 2; ST/STAT/SER.F/2)*. United Nations publication, Sales No.: 1952.XVU.4; *Concepts and Definitions of Capital Formation (Statistical Papers; ST/STAT/SER.F/3)*. United Nations publication, Sales No. 1953.XVIL6.

series, the use of statistics and economic information for accomplishing the analysis of growth, can be illustrated in practice. The material and methods are similar in these studies, varying, of course, according to the amount of data available and to the differences in the examples analysed. They demonstrate better than any formal description the methodology of this sector of the technique of programming,

III. THE ANALYTICAL INSTRUMENTS FOR THE CALCULATION OF THE AGGREGATE PROJECTIONS

The technique of programming which is presented here —and in consequence the calculation of the aggregate projections— is based on the supposition that the economic development of a community can be measured by the increase in *per capita* income and production. This simplification does not overlook the other economic and sociological elements which characterize the process —the population structure, the distribution of property and income, utilization of technology, social mobility, spirit of enterprise, etc.— but tends to seek, within these heterogeneous elements, a quantitative instrument which would make it possible to decide, in a preliminary analysis, whether there was a case for development, and, if so, to determine its extent. The increase in *per capita* income and product is a prerequisite of development. However, it is not in itself sufficient, since such expansion can occur without other conditions being present that assure the economy as a whole greater welfare, or which allow the process to continue satisfactorily. Thus, during the course of the present study the premise which rests on the growth of *per capita* income will be used as a starting-point, but an attempt will also be made to take into account the other elements which integrate the phenomenon of development. It must be acknowledged that this is an aspect which has hitherto been somewhat neglected, and which will call for further attention in the preliminary technique of programming.

The first step in the analysis consists in defining the factors that determine the growth of income and product. It is known that the fundamental elements of this process are capital formation or investment rate, and the average productivity of capital, also known as the product-capital ratio.² Thus, if it is assumed that, in a given period, a community had attained a net rate of capital formation —after depreciation is deducted— equivalent to 15 per cent of income, and that the product-capital ratio was 0.4, net income would increase by 6 per cent. If, during the same period, the population had increased by 2 per cent, *per capita* income would have grown by approximately 4 per cent.

This equation also involves a high degree of simplification. In the first place, the analysis of the production process has been focused upon one single factor —that of capital— and no specific mention is made of other elements, of which the most important are natural resources and labour productivity. A more careful examination reveals that these factors have, in fact, been taken into consideration. Natural resources influence the increment of income through the product-capital ratio. Thus, the same investment, when applied to very rich natural resources, will yield more than when applied to poorer ones. In the first case the product-capital ratio will be high and in the second, the effect will be the opposite. Something similar occurs with the labour factor. Technical skills and human productive capacity usually

² Use is also made of the reciprocal of the product-capital ratio; the capital-product ratio, known as the capital coefficient. For recent works on this subject, see *inter alia*, R. Harrod, *Toward a Dynamic Economy*, MacMillan, London, 1949; E. D. Domar, "Expansion and Employment", *The American Economic Review*, 1947; "The Problem of Capital Accumulation", *The American Economic Review*, 1949; "Economic Growth: An Econometric Approach", *The American Economic Review*, May 1952.

mean a greater investment yield, or —what amounts to the same thing— an increase in the average productivity of capital.³

These facts are of great importance, and it will be possible to appreciate their practical application both in the present work and in the specific studies on Brazil and Colombia. On the other hand, the formula given undoubtedly represents a most valuable instrument for the analysis and programming of development. For this reason, more attention should be paid to its parameters, namely, the investment rate and the product-capital ratio.

IV. THE INVESTMENT RATE

No attempt is being made here to formulate a theoretical analysis of capital formation, which would be outside the scope of this study. It is merely proposed to examine certain aspects of the methodology in so far as they are related to the preliminary technique of programming.

For this purpose, capital is defined as those goods resulting from economic activity which are used for the future production of other goods. In the first place, this concept is expressed in real terms as opposed to the monetary concept —even though monetary units are employed to measure it— and in the second, it is of a limited nature. Thus, durable consumer goods, which are sometimes included in capital, are excluded. Also discounted are minted precious metals, as well as those natural resources, such as land, which do not result from economic activity, although any improvements which man may make to the latter for productive ends are considered to be included. In turn, investment would consist of all additions to capital of goods of the same kind, or, in other words, the process whereby part of the goods available to a community in a given period is withdrawn from final consumption and incorporated into the productive capacity. The investment may be considered in relation to the stock of capital or to income. Thus, if at a given moment a country's capital amounts to 100, and the investment or accumulation of new capital stands at 10, it may be said that the capital or productive capacity has increased by 10 per cent. Or, again, if out of an income of 10,000 million dollars, 1,300 millions is invested, then the investment rate, in relation to income, will be 13 per cent.

In considering the investment rate, it should be taken into account that part of it does not consist in additions, strictly speaking, to the stock of capital, but rather serves to replace that capital which, for one reason or another, has been depleted, or has been consumed in the process of production. This leads to the concept of depreciation, which has been defined as the difference between the value of productive equipment at the end of a period, and the value which had been assigned to it at the outset. From the point of view of economics —as opposed to that of accounting, in which somewhat rough methods of approximation are permissible— capital depreciation is one of the most difficult estimates to compute, on account of the varying duration of its different components, if the criterion of depreciation is applied, net capital or the stock of capital might be defined as the depreciated replacement value of reproducible, tangible and durable capital goods, and the net investment as equivalent to the gross investment less depreciation.

To apply the equation given in the foregoing section, use must be made of net investment, that is, total investment less depreciation. The net rate of investment would be the ratio between net investment and national income.

³ When labour productivity, instead of capital productivity, is used as a measure the other factors will have to be taken into consideration through their effect on the yield of the labour factor.

It has already been pointed out that the inadequacy of Latin American statistics constitutes a serious obstacle hampering the application, to specific cases, of the analyses and methods necessary to the study of economic development and programming. However, the Economic Commission for Latin America has made every effort to utilize the unreliable material available, improving it wherever possible, and always endeavouring, in each case, to reach useful, common-sense conclusions. For this reason the fact must be acknowledged that the calculations, rather than leading to exact and definite conclusions, give only a preliminary understanding of the phenomena, and an idea of their extent. Apart from the contribution it may make to improving statistics, the use of present material is considered as representing an advance on vague generalizations, or merely qualitative concepts as to economic development. However, it should be observed that in some Latin American countries considerable progress has already been made, and valuable, though generally incomplete, information is available; moreover, everywhere in the region there is a growing interest in perfecting economic statistics.

It would now be as well to give an idea of the scope and sources of the figures on Latin American capital and investment which are utilized by ECLA. The figures on the stock of capital which appear in the Commission's studies, include reproducible, tangible and durable capital goods, and exclude land, durable consumer goods, minted precious metals and, in most cases, inventories. The reason for excluding the last-named item is the lack of data as to their volume and fluctuations. For estimating purposes, complete or partial inventories of the stock of capital have been used, as well as chronological series for the formation of gross and net capital. As has already been stated in another document,⁴ it should be noted that the character, quality and amplitude of available data vary from one country to another, and have presented problems of interpretation and adjustment. In the absence of complete data for a precise calculation of depreciation, a useful life for capital goods, longer than that in the United States, has been used as a working hypothesis, taking into consideration the dissimilar capital structure, disparity in the economic nature of obsolescence, owing to the difference between the relative costs of labour and capital, and the influence of the rate of growth on the rate of depreciation. The figures on investment have been based, as a rule, on series formulated in the countries themselves, with some adjustments and corrections wherever necessary; they include the import value of imported capital goods, plus a provision corresponding to the cost of installation, the valuation of public and private construction at market prices, the cost of the domestic production of unexported capital goods, and estimates of the increment of livestock inventories, and agricultural improvements.

In the countries where studies have been made for the application of the preliminary technique of programming, available statistics were better than the average. In the studies on Brazil and Colombia reference has been made to the sources used for drawing up the series, and it can be stated that in these cases there is a greater degree of accuracy in the estimates and corresponding conclusions. As will be appreciated in these studies, the investment rate has varied for clearly defined reasons. In Brazil the net investment rate—which was 8.0 per cent at the beginning of the Second World War—began to decrease, until in 1945 it dropped suddenly to 4.8 per cent, owing chiefly to the difficulty in importing equipment. It recovered during the post-war period, and in 1952 reached 13.6 per cent of net income, but in 1953 and 1954 declined again to 10.4 and 9.4 per cent respectively.

In Colombia—which had a high investment rate during the period 1925-30 (an annual average of 12.5 per cent)—the depression of the thirties and the Second World War provoked a decline, the average for the whole period being 6.3 per cent. In 1945-54 investment recovered again and the annual average reached 11.4 per cent.

⁴ See *Economic Survey of Latin America, 1951-1952*, p. 34.

V. THE PRODUCT-CAPITAL RATIO

The term “product-capital ratio” is comparatively new in economic science. However, its meaning is closely related to the classic concepts of “organic structure of capital”, “turn-over of capital”, “average cycle of production”, which refer to the connexion existing between the volume of productive equipment and the other factors, or the real production of goods and services, and show that the more a country increases its capital, the longer the production process takes to mature. The re-emergence, during recent years, of the concept and of interest in problems of this kind is the result of the renewed importance which macro-economic studies in the scientific field have achieved, thanks to the impact of cyclical phenomena and expansion in the under-developed countries.

The product-capital ratio, or the productivity of capital, is the relation which exists over a given period between the net national product, or national income, and the capital which has participated in production. Naturally, a distinction must be made between the average and the marginal product-capital ratio. The average ratio is that of product to capital employed; by marginal is understood the relation between net investment in a given period, an increase of net product during a succeeding period.

In the latter case, some authorities advocate a longer period —two to three years— for the evaluation of the direct and indirect results of the investment, which generally become effective only after such a lapse.

It is easy to understand that the factors which have an effect on capital and on the product have a more marked incidence on the marginal than on the average ratio. Consequently the latter usually has a certain amount of stability, while the former is subject to continual fluctuation. Therefore, to calculate it correctly, an average of marginal product-capital ratios must be examined over a long period, for example, ten years. If a sufficiently lengthy period is taken it is inevitable that this average of marginal ratios would differ but slightly from the average ratio.

Apart from the terms of trade, the principal factors which influence the product-capital ratio are inventories, the degree of capital utilization, capital structure and the time the investments take to mature.

If inventories have been included in the calculation of the stock of capital or their variations taken into account when net investment is computed, any fluctuations they may register will augment this term of the ratio, and consequently an increase in inventories will tend to reduce the product-capital ratio, and vice versa.

The degree of capital utilization is another variable. If, during a given period, inadequate demand, or other elements, diminish the intensity with which productive capacity is utilized, the product-capital ratio will clearly be lower. Conversely, the ratio rises in those periods when there are difficulties in the supply of capital goods and when equipment is used to full capacity.

Lastly, capital structure and the time taken by investments to mature are other important elements. If the stock of capital consists mainly of items of lesser productivity, such as agricultural investment and build-ups, the ratio will be lower than when the larger volume is represented by highly productive investments, such as industrial equipment. Similarly, a lapse of time must obviously occur between the initiation of the investment and the moment when its product reaches the market. The length of this period is dependent upon the nature of the investment, but as a rule it amounts to several years in the case of large-scale investments in electricity, transport and other services, as well as big irrigation projects. In calculating the product-capital ratio, those investments still in process of maturing are included. Furthermore, a proportion of the new production results from investments made wholly or in part during

previous years. It is evident that in periods of greater investment —or when investment is of such a nature that it takes a long time to mature or has great capital intensity— the ratio will be lower than in periods in which investment has fully matured, especially if at such times it is not adequately balanced by new investments of the same type.

So far, reference has been made to the overall product- capital ratio, that is, as applied to the economy as a whole. This overall ratio is evidently the result of individual and different relationships between investment and product, which exist in the diverse sectors of the economy and in the very varied and numerous enterprises within each sector. The question now arises as to whether the overall ratio has any significance, and what is its use in economic analysis and the technique of programming.

Its value lies primarily in the fact that it is an element in estimating the social productivity of capital. Only by comparing the product generated in the economy as a whole with the investment made can an approximate idea be obtained of the effects deriving from that investment. Apart from its intrinsic theoretical interest, it is of practical importance in that it provides grounds for allotting priority to investments. The product-capital ratio by sectors or by enterprises could not be used for this purpose, since its productivity is strongly affected by relative domestic prices, and by the possible effect of new investment in production in other sectors. Low relative prices in the public services may mean that industrial activity is subsidized. In consequence, the average productivity of an investment in electricity or transport could not be measured merely by the product of the respective sector, for its effect on other sectors would have to be taken into account; and the opposite would occur in the case of enterprises and branches of production which benefit from the low relative prices. On the other hand, it may happen that new investment puts other enterprises out of the market, and, in this case, in measuring its social productivity, the reduced production caused in other sectors would have to be taken into consideration.

The other point of interest in using the overall product-capital ratio is more closely allied to the calculation of the aggregate projections. Its use enables a preliminary estimate to be made of the investment required to obtain a given income, indispensable if some notion is to be formed of the possibilities of putting the various alternatives into practice. When one of these has been decided upon, the anticipated volume of investment will be the starting point for a preliminary estimate of the respective contributions of domestic savings, and supplementary foreign capital. It is true that these calculations are merely preliminary approximations, and that in those referring to projections by sectors or to specific projects, the individual capital coefficients concerned must of course be utilized. These individual projections will then serve to correct and adjust the preliminary figures deriving from the aggregate projections. But this does not deprive the product-capital ratio of its fundamental role in the first stage of programming as a basic means of judging the feasibility of a programme and its consequences.

The ECLA secretariat has calculated the average product-capital ratios for a group of countries, which represent more than 90 per cent of the stock of capital in the region. The statistics used for the calculation are those of the gross product; the estimates used were, in the majority of cases, those computed by the countries themselves, and in other instances, those prepared by the secretariat. These differ in their degree of accuracy, but no greater precision could be obtained with the statistical material available. In the figures for capital, inventories and durable consumer goods are excluded, contrary to common practice in United States calculations.⁵

⁵ See William J. Fellner, "Long-Term Projections of Private Capital Formation: The Rate of Growth and Capital Coefficients", National Bureau of Economic Research, *Conference on Research in Income and Wealth*, May 1951, and Raymond Goldsmith, "The Growth of Reproducible Wealth of the United States from 1805 to 1950", International Association for Research in Income and Wealth, *Income and Wealth Series*, Vol. II. In the latter work, however, Goldsmith calculates two series of product-capital ratios, in one of which buildings and installations are not taken into account, a procedure more in line with that of ECLA.

The result has been a product-capital ratio which varies from 0.43 to 0.46, for the period 1945-54. The difference between this and the figure of 0.30 for the United States, given by the studies mentioned in footnote 5, is partly attributable to the statistical methods used. If inventories and durable consumer goods had been added to capital in the ratio found for Latin America—which would mean an increase of perhaps 20 per cent—and if depreciation had been deducted from production—approximately 7 per cent—the average value would have been about 0.35. It should be observed that the most conservative calculation used by Goldsmith, gives a ratio of 0.40 for the United States.

In the application of the method to Brazil, a product-capital ratio for that country has been calculated. The estimate of the stock of capital was based on the figures of the Industrial Census of 1940, and on data on net investment over the period 1939-53. The figures for the product are those of the Instituto Brasileiro de Economia, Fundação Getúlio Vargas (Brazilian Institute of Economy of the Getúlio Vargas Foundation). The average ratio of the overall period 1939-53 stands at 0.52, having risen from 0.49 in 1939 to 0.57 in 1947 and 1948, and reaching 0.53 in 1953. The marginal ratio has been calculated for the years 1947-53. The two extremes are 0.73 in 1950 and 0.34 in 1952, while the average is 0.514.

The preliminary research carried out by ECLA in the study on economic development and programming in Colombia has revealed some unusual facts. One of the most significant aspects of this country's economic development, has been the continuous long-term increase of the product-capital ratio since 1925. In this year the average ratio of 0.22 was the outcome of an economic structure characterized by an accumulation of capital employed principally in agriculture and building, and by a low technical level. As a result of changes in capital structure—in the direction of greater investment in industry and in transport and electricity—and in consequence of the overall process of development of the national economy, the ratio rose until it reached 0.31 in 1938, 0.32 in 1945, and 0.40 in 1954.

The product-capital ratio for Latin America might appear very high. Apart from the differences from calculations made in other countries with respect to the elements included in the terms of the ratio, the inadequacy of the statistics themselves undoubtedly may give rise to a certain margin of error. However, it is not beyond the bounds of possibility that the figure arrived at—in the more approximate calculations for the majority of the countries, as well as in the more precise ones for Brazil and Colombia—is very near to the truth. It must be taken into account that, during the period analysed, exceptionally favourable factors have been present in Latin America and have made possible a more efficient utilization of capital, labour, and natural resources.

Studies of capital productivity in the under-developed countries, and its evolution as investment progresses, are still in their initial phase. The results of research carried out in the most highly developed areas have hitherto shed little light on the case of the under-developed countries. One of the most interesting aspects of the studies made in the United States is the absence of any indication that the average product-capital ratio shows a marked tendency to fluctuate. In fact it seems characterized by a certain stability.⁶

Some economists hold that the accumulation of capital tends to provoke a decrease in the ratio over a certain period, and that this is due to many causes. Among these may be mentioned the need for basic installations of relatively low productivity, the costs which arise from import replacement, and losses and difficulties caused by inexperience. Another very important factor is the need to maintain heavy stocks both of materials required for the production process proper, and of consumer goods to satisfy a growing demand generated by investments which have not yet matured.

⁶ See, Goldsmith, *op.cit.*

No premature conclusions should be drawn on this topic, but its theoretical and practical importance is obvious. It is therefore indispensable that the studies begun should be followed up with greater thoroughness, particularly in regard to their application to Latin America. At all events, the results obtained demonstrate the importance of this theoretical instrument in the technique of programming.

VI. FOREIGN AND DOMESTIC DEMAND

Once the analytical instruments have been agreed upon, the method of calculation of the aggregate projections can be described. One indispensable element in the preparation of the projections is the estimate of future demand for goods and services both for export and for domestic consumption. There is some variation in the methodology applicable to each of these sectors. The preparation of the aggregate projections calls for as full as possible a calculation of the demand for exports, so that the probable extent of the effect of external factors on production and income can be assessed. In contrast, only aggregate figures indicating the probable volume of domestic demand are needed, since the detailed analysis of its composition will be made when the time comes to undertake the calculation of the projections by sectors.

There is another difference which must be taken into account. Exports depend on external economic conditions on which the domestic economy can exert only slight or limited influence. Conversely, internal demand results from the process of national development, and from decisions taken in connexion with its intensity and character.

The estimate of demand for exports is based on the probable trends of factors affecting the goods and services which the country exports, or could export. These factors are the future income level in the export markets, the income-elasticity of demand for such goods and services, their probable price trends, and the situation regarding competitive commodities whether these are identical or potential substitutes. A similar analysis must be made for each separate product, taking into consideration all the peculiarities of its market. Projections of the demand for exports should also take into account, in appropriate circumstances, the country's possible ability to influence foreign markets by measures of trade or exchange policy. This will depend on the country's relative position in regard to the world supply of the commodity concerned. For example, it might happen that, in the event of a price-elasticity of demand exceeding unity, it was considered possible and advisable to increase exports through price reduction, so as to augment the supply of foreign exchange. Such cases may affect the projections of future production for export which would have to be appraised in the light of other alternatives, in terms of their effect on the economy as a whole.

The degree of accuracy in the calculations of the demand for exports is limited on account of the unreliability of the statistics used. Generally speaking, price data and forecasts are the least exact. There is a greater probability of accuracy in short-term estimates of income trends in foreign markets. In contrast, this probability diminishes in long-term forecasts, and it is precisely these which are the most important for programming. For this reason, projections of the demand for exports — more than any others — indicate merely reasonable hypotheses, and must be revised and adjusted periodically so as to embrace any possible market variations.

It is more difficult to anticipate the evolution of the terms of trade. If information as to prices is the weakest part of export analysis, the difficulties will be multiplied when an attempt is made to forecast import prices. A solution might be found by studying the historical trend of trade factors and by establishing one or more hypotheses based on this trend, on the

understanding that any variation in the terms of trade, by affecting the volume of gross income, will modify the basic data of the programme and necessitate its revision and adjustment.

Overall domestic demand is calculated as a function of income, after domestic saving has been deducted. It is advisable to examine each of these factors. Income depends on domestic production and the terms of trade. One or more hypotheses on the latter having been established, income will be determined by the rate of growth of the gross product. Here a crucial point is reached in the technique of programming. Defining the desired rate of growth means fixing a target for the programme and at the same time establishing a constant, on which all the other variables of the problem will depend. On the other hand, this rate is subject to the economy's capacity to achieve it—in particular to the degree of effort signified by domestic saving—and to supplementary foreign investment. Analysis of past records and of the probable future trend of those factors which have influenced the rate of growth will serve as a basis for judging future possibilities. But other circumstances will have to be taken into account. For example, it might be that the previous rate of growth was very low, and an accelerated rate of development is desired; or, as has happened in the study of Brazil, that it may be considered unlikely that a set of favourable conditions, which gave rise to a rapid growth in the past years, would persist in the future. In the preliminary technique, the starting point was the selection of various rates of growth which, although hypothetical, were based as far as possible on reality and on the future possibilities of the economy. The selection of several alternative rates of growth is designed to reduce to the minimum the arbitrary element which undoubtedly exists in this part of the technique. The methodology used in the study of programming in Brazil contains some variants which will be dealt with later.⁷ An effort has been made to eliminate this arbitrary element by different means.

Once a given hypothesis as to growth of income has been adopted, the distribution of this income between consumption and saving will have to be estimated. Here judgment must be primarily based on past experience. Studies made in various countries seem to indicate that the population tends to earmark a fairly stable percentage of its income for consumption, or, from another standpoint, the rate of saving is usually confined within certain limits. Kuznets has found a gross rate of capital formation in the United States which varies from an average of 22.8 per cent for the period 1869-98, to 22.0 per cent for 1894-1923, and 18.2 per cent in 1919-48. The net rate would have a more marked downward trend, averages of 15.2, 13.2 and 6.8 per cent being recorded for the above periods.⁸ In Canada, the gross rate of capital formation, excluding foreign investment, has fluctuated during the last fifty years between 15.3 per cent (1931-40) and 19.3 per cent (1926-30), reaching 18.7 per cent over the period 1941-50; the net rate which during the period that began with the world depression (1931-40) was 5.9 per cent, rose again to 11.9 per cent in the ten succeeding years, a figure more in line with the recorded trend. In Sweden the gross average rate over the years 1891-1930 was 18.0 per cent, and the net 11.1. The statistics mentioned and studies carried out in other countries seem to indicate that the gross savings of any capitalist economy tend to be around 20 per cent of the income, and the net savings to attain a figure that seldom exceeds 10 or 12 per cent. This of course does not mean that these averages may not vary, as a reflection of community effort to accelerate investment.

In the study of economic development in Brazil, it has been estimated that the net rate of saving has varied in the last sixteen years from 6.8 per cent in 1940 to 13.1 per cent in 1950, the highest frequencies being between 8 and 9 per cent, which occurred in five separate years, mainly in the period prior to 1948, and between 10 and 11 per cent, also occurring on five occasions. With the exception of 1952, the savings rate remains above 10 per cent from 1948 onwards.

⁷ See the appendix at the end of this chapter.

⁸ See Simon Kuznets, "Long-Term Changes in the National Income of the United States of America since 1870", in *Income and Wealth of the United States*, International Association for Research in Income and Wealth, *Income and Wealth Series*, Vol. II.

The study of the historical rate of saving indicates the limits within which economic effort tends to be exerted. An analysis of the circumstances which may have determined the rise or fall of the rate, and an estimate of the behaviour of the factors affecting it, will provide grounds for a short-term projection. It might be considered that future saving should be increased to achieve a higher degree of investment, within reasonable limits that will not endanger the process of development. Here also there are possible alternatives. The increase in the savings rate should be considered in relation to its effect on the required level of consumption, and to the possibility of restricting the latter's expansion; and a study must be made of those measures of economic policy which would have to be adopted to attain this end. An example of such an analysis may be seen in the study of programming in Brazil. The technique of programming will have to present anew, if necessary, the alternatives which may be required to furnish more complete information as to the effect on the economy of different saving and consumption levels.

The difference between the income arrived at by a given rate of growth —plus the effects of the terms of trade— and the volume of savings, gives the volume of domestic demand for consumer goods and services. No mention has hitherto been made of demand for capital goods. In principle, the volume of domestic saving is equivalent to the demand for producer goods and services on the part of domestic investors. However, this domestic saving may represent only a part of the capital formation. It is not yet known whether the estimated saving is adequate to meet the anticipated rate of growth, and if so, in consequence, how large an inflow of foreign capital, if any, may be necessary. Therefore the demand for producer goods and services can be assessed only when the overall investment necessary to attain the established target has been calculated. This topic is discussed in the following section.

VII. THE PROJECTION OF INVESTMENT

An outline has been given of the methodology of estimating a rate, or alternative rates, of growth of income which is expected to bring about a programme, and the probable or desirable volume of domestic saving corresponding to those income levels. On these bases, and with the help of the product-capital ratio, it will now be possible to calculate two fundamental elements, namely, the investment required to attain the income envisaged and the proportion of such investment to be contributed by foreign capital.

The calculation of overall investment is a simple operation. For each volume of income the capital required will equal the income divided by the product-capital ratio. On the assumption that in the current year the income is 100, the stock of capital 200, and the product-capital ratio 0.50, to secure a 5.0 per cent expansion of income in the following period, new investment will have to amount to 10 per cent. If the population has increased 2.0 per cent in the same period, the *per capita* rise in income will have been 3.0 per cent. If such a calculation is made year by year during the course of the programme, it will be possible to assess the amount of capital required.

It seems unnecessary to stress the nature and limitations of so simple a calculation. Its usefulness lies in the provision of a rough, overall conception of the volume of investment necessary to achieve a given rate of growth, and in the fact that it thus furnishes a basic criterion as to the applicability of a programme. As has often been stated, when the projections by sectors are calculated, more exact methods will be used, and later compared with the preliminary result obtained in the aggregate projections, so that the latter can be adjusted.

When the estimate of investment has been made, it must be compared with the domestic saving forecast. The difference between investment and domestic saving will give the amount of foreign capital required, year by year, and in its entirety.

The apparent simplicity of this procedure conceals a series of decisions, in which an essential part is played by economic and political considerations. The variables of the functions used should be taken into consideration, namely, rate of growth, product-capital ratio, rate of domestic saving, foreign investment. Developments in any one of these have an immediate effect on the overall system. If it is assumed that, as is probable, the domestic saving is not capable of attaining the required volume of investment, and that foreign capital must be called upon, several different situations must be considered. For example, is it likely that the foreign capital inflow will continue indefinitely, and will be large enough to cover requirements? And if the answer is negative, will it be preferable to maintain a more moderate rate of savings and extend the period of foreign investment, or is it worthwhile to make a greater effort to increase the rate of savings in the initial years, and thus curtail the term or volume of the foreign capital inflow? What will consumer levels be in either case over the total period? What measures of policy will be necessary to attract this capital, or to attain a given rate of savings, and how will these measures react on the overall economy? And if it is unlikely that foreign capital and domestic savings will be available in the required amount, or that the measures of policy which would make them possible will be accepted, then should not the original target be reduced and a less ambitious programme formulated?

All these considerations must be taken into account in preparing the aggregate projections. It is now easier to assess the presentation of various alternatives, a theme on which so much stress has already been laid. The economist who prepares a programme on the basis of the aggregate projections, can make a forecast of the results of given hypotheses of growth, and carry out a preliminary selection of those which are feasible. Or, if he so prefers, he can point out, wherever possible, the effects of these alternatives on the economy, and the measures of policy which each situation may dictate.

VIII. THE CAPACITY TO IMPORT AND THE REPLACEMENT OF IMPORTS

The next step in the formulation of the aggregate projections is the calculation of the capacity to import, and of the imports which will have to be replaced if this capacity is to be utilized to the maximum advantage of economic development.

The imports which a country can make in a given period depend on two factors: the exports of goods and services, and the balance of the flow of capital. When the projections of the demand for exports were discussed, reference was made to the method used in calculating its volume and the terms of trade. The hypotheses established in this connexion constitute the basic factor in the calculation of the capacity to import.

In computing the flow of capital, the most important components are the external public debt, the servicing of the past and future inflow of capital, the volume of fresh investment, and the flow of short-term capital. Obligations arising from the public debt are generally easy to estimate, and all countries have information on this subject. The servicing of foreign capital—that is the remittance abroad of profits and interest, whether for loans or returns on direct investment—create greater difficulties. Apart from the complete information which has to be collected on this subject, the future movement of such servicing may be affected by the exchange situation, and by future investments and their behaviour as regards interest rates, amortization terms, etc. Despite this it is possible to make a relatively accurate forecast of the item. Fresh foreign investment would be calculated in accordance with the projections for

investment previously examined.⁹ The flow of short-term capital is a more difficult element to assess, but also of lesser importance to programming. It may even cause disturbances, by provoking temporary trends and alterations in international transactions which do not correspond to the economy's normal evolution. This factor may be ignored in most cases, on the assumption that the application of a programme implies the establishment of a policy to avert the undesirable consequences of the short-term flow of capital, or in general to tackle unstable external factors.

The algebraic sum of exports and of the probable balance of the capital account during operation of the programme will give an estimate of the capacity to import.

And now another aspect of the problem must be examined, namely, the projection of imports. Here, the distinction must be made between the import of consumer goods, intermediate goods (including fuels) and capital goods.

It has already been pointed out in previous chapters, that these categories of goods are likely to follow dissimilar trends, as development progresses. Even should the import of consumer goods diminish, overall imports do not tend to decrease because the import coefficient in investment is higher than the import coefficient in consumption. On the other hand, in the process of expansion which has taken place in Latin America so far, the import coefficient of raw materials has shown a tendency to remain stable, and that of fuels to increase.

For the projection of imports and their replacement, in this initial stage, a provisional hypothesis may serve as a point of departure. For this purpose, it may be assumed that the coefficient of imports will not vary in any of the categories of goods, or, in other words, that imports will continue to maintain their present share in consumption and investment.

From the calculations of consumption and investment already made, it will be possible to formulate a projection of the future imports of these goods. The computation is more complicated in the case of intermediate commodities and fuels, since for a fairly accurate calculation, information on their share in the production process would be required. However, as a preliminary approximation, current import coefficients for these goods in relation to consumption could be applied. To the results thus obtained will have to be added an estimate of the services paid for abroad, for which it may be assumed —provisionally— they will maintain their present proportion in regard to income.¹⁰

The comparison of the projections of the capacity to import with those of imports will reveal a difference, except when export prospects are highly favourable, or, to be more exact, when the rate of increase in the capacity to import is at least equal to the rate of increase in the demand for imports.

If this is not so, the disparity between the capacity to import and the volume of imports will denote the extent to which domestic production must replace imports if the programme is to be implemented. As has often happened in Latin America, since imports have tended to increase more rapidly than the capacity to import, the problem of substitution is one of the most important in programming.

⁹ See section 7 of this chapter.

¹⁰ Or as regards foreign trade, in the case of services connected with it.

IX. THE RESULTS OF THE AGGREGATE PROJECTIONS

A summary can now be made of the results obtained from the calculation of the aggregate projections, and the projections themselves allotted their proper context in the formulation of a programme.

In the first place, the probable targets of economic growth have been established, and the future trend of production calculated, as well as the income corresponding to each of the rates of growth selected. Secondly, targets have been fixed in regard to future distribution of income in consumer goods and savings, and therefore with respect to the community's degree of effort to achieve greater investment. The amount of investment necessary to implement each hypothesis has been calculated, and, through a comparison of the volume of this investment with that of domestic saving, the foreign capital inflow has been estimated. Similarly, the growth of the capacity to import has been postulated, and, by a comparison of this latter with the probable demand for imports, the amount of substitution required to carry out the programme has been established.

Hitherto, overall figures have been employed. In the final issue the object of a programme is to establish the distribution of future investment, so as to attain the targets envisaged. This means that from the overall analysis, it is necessary to pass to the analysis of each sector of the economy. It must first be determined how future demand will be distributed among the different consumer goods, and what effect will this structure of consumption produce on the demand for intermediate and capital goods. Once the future requirements in goods and services are known in detail, a study must be made as to what part of these requirements will have to be covered by imports, and where replacement is most feasible. The volume of demand in each sector, less the part satisfied by imports, will give the production targets which will have to be attained in each branch of domestic activity. To this must be added the targets set for export activities. The first step will be to determine the measures which must be applied if these targets are to be reached. This will require a detailed analysis of the situation in each sector, with the object of achieving the greatest possible utilization of existing resources, as well as of establishing the extent and nature of the investments required. Among existing resources, labour is especially important. The raising of *per capita* productivity is one of the essential objectives of a programme. A study of each sector must indicate the level of the productivity of labour, and what are the possibilities of improving it. Coupled with this problem is the necessity of shifting the labour force from less productive to more productive sectors of the economy, thus modifying the occupational structure of the population.

Thus, the projections by sectors constitute the second phase of the programming technique. Once the results have been obtained, their comparison with the aggregate projections is the final step in the elaboration of this phase of programming, but not in the formulation of a programme. When the given objectives have been set, on the basis of the projections, two extensive fields still remain to be covered: the establishment of an economic policy, and a suitable administrative organization for the execution of the programme. The present work does not cover these latter aspects, but rather stops at the level of the projections.

INFLATION AND ECONOMIC DEVELOPMENT IN CHILE AND MEXICO *

Juan F. Noyola Vásquez

* *Panorama económico*, Year 11, N° 170, Santiago, Chile, Editorial Universitaria, July 1957.

Inflation is not a monetary phenomenon; it is the result of real imbalances that manifest themselves in the form of a general increase in prices. The true nature of the inflationary process is much more evident in underdeveloped countries than in industrialized ones.

However, it is not enough to say that inflation is a consequence of real imbalances in the economic system. A proper understanding of the phenomenon calls for a theory or a set of theoretical categories or tools, but the analysis must go beyond the mechanical application of these categories, particularly those derived from very simplified theories, such as Keynesianism or the Stockholm school, which explain inflation in terms of overinvestment or ex ante demand exceeding supply.

Much light has been shed on the true nature of inflation by more precise approaches, such as the work of Kalecki, which stresses the importance of supply rigidity and the degree of monopoly in the economic system, and, more particularly, that of Henri Aujac, which examines the behaviour of various social classes and their bargaining power. The latter approach shows very clearly that inflation is one particular aspect of the more general phenomenon of class struggle.

However, even these approaches do not get us very far in our understanding of inflationary patterns in Latin America without incorporating a series of factors derived from observing the structure and functioning of the region's national economies into the analysis. Including these factors makes it clear that each Latin American country has its own particular inflation problem, even if they do share a number of common features. What factors should be included in the analysis? Strictly speaking, all those that can produce imbalances in the economic system, including structural factors, such as population distribution by occupation and productivity differences among various economic sectors.

There are also dynamic factors, including differences in the growth rate for the economy as a whole and for some specific sectors, such as exports and agriculture.

Lastly, there are institutional factors, such as the productive organization of the private sector, the degree of monopoly, pricing methods, the extent of trade union organization, or the organization and functioning of the State, and the scope and bent of government involvement in economic life.

How can we combine all these elements into one easy-to-use theoretical framework? I would like to suggest a very simple model, which focuses on two fundamental categories, namely basic inflationary pressures and propagation mechanisms. Basic inflationary pressures usually originate in localized growth imbalances, almost always in two sectors: foreign trade and agriculture. There is a great variety of propagation mechanisms, but they can generally be grouped into three categories: the fiscal mechanism (which includes social security and exchange-rate systems), the credit mechanism, and the price and income adjustment mechanism.

The intensity of inflation depends primarily on the magnitude of basic inflationary pressures, and then on the existence of propagation mechanisms and the roles they play. Therefore, to analyse inflation in various Latin American countries, the first step is to identify basic inflationary pressures and their intensity in those countries, before proceeding to ascertain whether the conditions are favourable for propagation mechanisms, what those are and the effects they have.

Having outlined the theoretical tools, I will analyse two cases of what could be considered extreme inflation in Chile and Mexico, from the mid-1930s to the present day.

I will begin by highlighting the differences between the two situations, which were considerable over that period, but were even more marked during the Second World War. Between 1939 and 1947, prices rose by a factor of 3.6 in Chile, compared with just 2.6 in Mexico.

Conversely, while income distribution was, to a certain extent, uneven in Chile, to the detriment of wage workers, it was nothing compared with the radical transformation that took place in Mexico. Data from the Mexican Joint Commission indicate that the wage share of national income fell from 30% to less than 22% over this period, while the profits share rose from 26% to 45%. In Chile, considerable new fortunes were undoubtedly made during the war, but not to the same extent as in Mexico, where a truly inverted social revolution took place, which accounts for many of Mexico's current social and political traits.

I have made this comparison to show how hard it is to answer the question of whether the inflation was more intense in Chile or Mexico. If intensity were measured in terms of price hikes, Chile would be the clear winner; but if it is accepted that inflation is a result of the struggle among diverse social groups to improve or maintain their share of national income, then inflation in Mexico had much deeper distributive consequences. Without trying to answer the question of which was the more intense, I shall describe the main features of both types of inflation, in order to explain why there were such marked differences between them.

First, let us examine the case of Chile. Applying the analytical method outlined above, we shall begin by identifying the basic inflationary pressures and then pinpoint the propagation mechanisms.

Over the last 25 years, two basic inflationary pressures have acted on the Chilean economy, one external and one internal. The external pressure came essentially from stagnating exports that coincided with population growth and increasing demand for imports. This long-term stagnation was also accompanied by extreme, short-term fluctuations in the volume of exports and the terms of trade and, therefore, import capacity. The biggest fluctuation coincided, of course, with the Great Depression, from 1929 to 1932. In those three years, Chile's import capacity fell by 84%, as a result of the catastrophic drop in production and international prices for saltpetre, which was the main source of foreign currency revenues at the time. Even in more recent times, when the cyclical fluctuations of the world economy have been much smaller, there have been dramatic variations in import capacity. For example, from 1952 to 1953, foreign currency income from copper fell from US\$ 250 million to US\$ 150 million, or by more than 40%, as a result of lower prices and a drop in demand for the metal in the world markets.

These two examples illustrate the extent to which import capacity in Chile varied. Over the long-term, it should be noted that Chile's import capacity per capita in 1953 remained below the level of 1929. This stagnation in exports is a phenomenon that has occurred, albeit to a lesser extent, in other Latin American countries. However, in Chile, it had particular characteristics, which are outlined below.

External imbalances do not only affect demand, they also influence domestic costs in two ways. One is chronic currency devaluation caused by the imbalance in the balance of payments. Chile is particularly sensitive to this impact on costs because of the importance of imported raw materials (cotton, for example) for industries making mass market products. The other effect of external imbalances on costs stems from the difficulty of finding substitutes for imports in Chile. This is the result of the combination of three factors: the limited natural resources base for industry and consumer goods, market constraints on industry and capital goods, and much lower productivity in industry and the mining export sector. Thus, replacing imports with domestic products leads to higher average real costs in the long term.

The second basic inflationary pressure in Chile arises from the fact that agricultural production has been unable to meet the increasing demand for food. This agricultural stagnation is of an entirely different nature to the stagnation of mining exports. Despite the monopolistic structures at play and underutilized production capacity in both cases, the reasons for the

stagnation are very different. While very rapid technical progress has been made in the mining sector, it has been very slow in the agricultural sector, and producers' decisions are influenced by the semi-feudal system that still exists today in the Chilean agricultural sector.

Having described the basic inflationary pressures, I will show how they are transmitted through the economy; but before identifying the propagation mechanisms, I will examine the reasons why the Chilean economy is conducive to the emergence of these mechanisms, unlike other Latin American countries. The reasons for this are both economic and institutional, and the latter are not independent of the former. Among the purely economic reasons is the occupational structure of the population, which is characterized by (a) a relatively low proportion of agricultural workers compared with other Latin American countries (barely 32% of the workforce); (b) relatively small differences in wages and productivity among the various sectors; (c) very slow productivity gains, except in the export sector, where they have been neutralized by sluggish demand and a persistent decline in prices; and (d), as a result of all of the above, labour transfers from more productive sectors to less productive ones, contrary to the theory of economic development, or rather, the requirements of economic development.

All these characteristics make the labour supply very rigid, which has facilitated trade union organization and the defence of real wages. At the same time and a little paradoxically, these same characteristics accentuate the risk of unemployment in better paid activities. This has led employees to view deflation as a far more serious threat than inflation.

Furthermore, there are also other characteristics that tend to create rigidity in other factors of production, including the monopolistic nature of mining exports and the prevailing structure of agriculture, which allows producers to organize to fix prices, avoid taxes and control the banking system. In addition to these economic factors, the political situation in Chile has created a balance of power in which no social group can make all the basic inflationary pressures fall on other groups.

Against this backdrop, it is easy to understand how the propagation mechanisms work. First, let us briefly examine the fiscal mechanism, starting with revenue. The fiscal system in Chile is largely independent of foreign trade. Adjusting official revenue statistics in order to be able to compare taxes paid at various exchange rates, we can see that, from 1929 to 1953, taxes on foreign trade accounted for between 45% and 60% of tax revenue; but the share of export taxes expanded considerably over that period, while that of customs duties fell, owing mainly to the higher taxation on copper mining. With regard to domestic taxes, the Chilean fiscal system was increasingly regressive: direct taxes increased 2.3 times in real terms between 1929 and 1953, while indirect taxes increased 6.3 times. Thus, the fiscal mechanism raised taxes on mining exports, relieving inflationary pressures on the economy resulting from low growth. In contrast, among other taxpayers, the tax burden shifted from high-income groups to wage workers.

With regard to expenditure, the fiscal mechanism largely offset the regressive effect of domestic taxation. One way this was achieved was by increasing current expenditure, although this played a minor role, as its share of global supply rose from 7% in 1929 to barely 10% in recent years. Transfers, including social security costs and exchange-rate subsidies, were a much more important form of redistribution. Transfers increased 4.6 times in real terms between 1929 and 1953, of which exchange-rate subsidies (which did not appear until 1932) increased the most, until they accounted for more than a quarter of public spending in 1953. These subsidies protected, to a certain extent, the purchasing power of the working classes against the effects of chronic devaluation, keeping the prices of imported basic goods (such as sugar, wheat, cotton and kerosene) relatively low. However, as current expenditure and transfers increased much more quickly than fiscal revenues, investment costs, even in recent years, are still below the level reached in 1929.

Contrary to popular opinion, the most passive propagation mechanism has been the expansion of credit, whose function has been to provide the economy with enough liquidity in real terms to keep pace with rising prices. Of course, this expansion was made possible by the institutional conditions that gave business owners almost complete control of the financial system, including the central bank.

The price and income adjustment mechanism is the simplest of the propagation mechanisms. It has taken three main forms: price adjustments, in the strictest sense, wage adjustments and rentier income adjustments. Price adjustments, in the strictest sense, have relied primarily on the degree of monopoly in the market and shortages of various products. Price controls for supplies and subsidies have, however, limited the ability of industrialists and business owners to make these adjustments, even when the effectiveness of these instruments has been limited. Wage adjustments in Chile, thanks to the efforts of trade unions, managed to protect wage workers' share of the national income, to a certain extent, until 1953. A surge in inflation from then until the end of 1955 and recent stabilization measures seriously undermined these efforts to protect wages.

Inflation accelerated after the copper crisis in 1953, leading to price hikes of between 75% and 80% in 1954 and 1955 and the collapse of the multiple exchange-rate system. In the last six or seven months, a combination of factors have started to have an effect, specifically on copper prices and, to a lesser extent, on production, which have recovered, alleviating the basic inflationary pressure considerably. At the same time, the authorities have pursued a frankly deflationary credit policy, temporarily breaking the political balance, forcibly disrupting trade union structures, and thus driving down real wages. After years of high inflation, supply improvements and efforts to protect wages have, in recent months, brought inflation in Chile practically to a standstill.

Turning now to the case of Mexico, basic inflationary pressures have also been generated by the inability of exports to grow at the same rate as the domestic economy. This has created balance-of-payments imbalances and given rise to a series of successive devaluations, whose effects on domestic price levels have not been mitigated by exchange-rate subsidies, as the current foreign exchange system does not have preferential rates.

However, Mexico's exports have increased at a higher rate than Chile's, due in large part to the increasing diversification of exports, which means that international demand and the prices of some goods can vary and in some cases these fluctuations cancel each other out. This also explains why fluctuations in the terms of trade in Mexico are not as extreme and, therefore, not as serious as those in Chile.

A fundamental difference between inflation in Chile and inflation in Mexico is the influence of the food supply. In Mexico, inflationary pressure has hardly ever been caused by rigidity in agricultural production. On this point, Mexico differs not only from Chile, but from almost all Latin American countries and with practically all underdeveloped countries. Why? I believe that the explanation for this exceptional situation lies in the major agricultural reform undertaken between 1934 and 1940, and in the official agricultural development policy that has been pursued relentlessly for more than 30 years.

Nevertheless, although rigidity in agricultural supply has not been a long-term source of inflationary pressure, in the short-term it has had this effect and sometimes it has exerted a great amount of pressure. For example, the surge in inflation in 1952 was not only the result of high levels of public investment and exports. In addition to that increased demand, the food supply contracted, due to bad harvests caused by inclement weather that year.

On the whole, therefore, basic inflationary pressures have been less intense in Mexico than in Chile. Nonetheless, the difference between the two situations, particularly the effects of inflation on income distribution, seems to be rooted in how the propagation mechanisms work. We will outline below how the effects of those mechanisms have, in general, been weaker; but what should be noted in particular is how this weakness has a profound impact on the defence mechanisms of lower-income social groups.

Following the same order used to examine the case of Chile, we will look at the workings of the Mexican fiscal system. First of all, the system appears to have become more regressive. This statement might seem strange, or even unacceptable, given that all available statistical information indicates that direct taxes are responsible for a growing share of federal revenues; however, this does not contradict my affirmation for two reasons. The first is that income tax tends to become less progressive as the general price level rises. When this happens, the minimum tax threshold decreases in real terms and social groups that were previously exempt because of their economic weakness become liable for tax. At the other end of the scale, the most progressive rates lag behind the gains in the fortunes of the wealthiest.

The second and most important reason why a relative increase in direct taxation does not make the system more progressive, is that export taxes are direct taxes.

Revenue from ad valorem tax —the most important of these taxes— increased considerably after each devaluation between 1938 and 1954. Moreover, the very purpose of ad valorem tax is to levy exporters' windfall profits. However, it can be argued that devaluations are simply real income transfers from importers to exporters. Such income transfers are clearly regressive, given that exporters are a small minority, while the majority of the population are direct or indirect consumers of imported goods. An ad valorem tax therefore appears to be a way for the Treasury to take a part of these income transfers. In other words, the combination of currency devaluation and an ad valorem tax is actually an import tax, part of which is used to subsidize exporters. Furthermore, the currency system in Mexico does not include preferential exchange rates to subsidize imports of consumer goods as it does in Chile.

The first thing that becomes apparent when examining the fiscal mechanism from the point of view of spending is that current expenditure has played a very minor role in redistributing national income. The fact that current expenditure has not kept pace with domestic product has had two significant consequences. The first is that the services that citizens receive from the State and that make up part of their real income have not increased on a par with other components of domestic production. The second is that the real wages of the vast majority of civil servants have fallen by more than those of workers in any other sector.

The scope of the social security system in Mexico is much narrower than in Chile. However, it is only fair to point out that Mexico has had a very high level of public investment, which has not only neutralized the redistributive failure of current expenditure, but, as stated above, has also contained sources of basic inflationary pressures by increasing supply elasticity.

Contrary to what one might think, there are great similarities between the credit mechanisms in Mexico and Chile. Credit has also been the most passive inflation propagation mechanism in Mexico, and has even, on occasion, played a negative role, as it did in 1947, when monetary policy restricted private liquidity to such an extent that investments tumbled in many sectors, producing a curious state of affairs where a housing construction crisis coincided with a public works boom. This, incidentally, neatly confirmed the well-known maxim that monetary policy is only really effective when it reduces economic activity, increases unemployment and holds back development.

We will now look at how price and income adjustment mechanisms have worked. With regard to price adjustments, in the strictest sense, the degree of monopoly is perhaps as large in Mexico as in Chile; but on the other hand, prices and supplies have been controlled to a lesser extent, for shorter periods and perhaps less effectively in Mexico, with a partial exception: the freeze on house sales. In this case, and only for cheap housing, controls succeeded in preventing the spread of inflationary pressures, unlike in Chile. With regard to prices for nearly all other goods and services, it has been very easy for business owners to shift inflationary pressures elsewhere, but this has not been the case for wage workers. This is perhaps the fundamental difference between Chilean and Mexican inflation. The weakness of wage adjustments in Mexico is due, in part, to the structure of the economy itself and, in part, to institutional and political factors.

The structural issues include a huge reserve army of agricultural workers whose productivity is very low. In 1950, nearly 60% of Mexico's labour force was still employed in agriculture, but they received only 20% of the national income. Another issue is strong population growth, at nearly 3%, which is double the rate in Chile. This abundance of cheap labour tends to depress real wages and weaken trade unions. In addition to these far-reaching economic factors, there are other extra-economic ones, which can be explained by the history of the Mexican labour movement, by the structure of its leadership and by the sui generis relationship it has had with public authorities since the end of the 1920s. As a result, Mexican trade unions have had a weak base; their general approach has been influenced to a greater or lesser extent by a certain official paternalism, and there have been numerous cases of corruption involving their leaders. All of these factors have caused real wages to lag far behind the huge productivity gains, even though average wages have increased slightly in the last 20 years. The fruits of this growth have therefore been easily absorbed by the corporate sector.

The subject that was assigned to me in this series of round tables was "Inflation and economic development in Mexico and other Latin American countries". I have reduced the other countries to one, partly because of the short time available, but mainly because of the magnitude of the task of examining even the most significant examples.

I would have liked to discuss the case of Brazil, which I had the opportunity to study once and is very intriguing; but it was too daunting to do so in front of experts on the subject.

It would also have been interesting to analyse the case of Cuba, where there has been neither inflation nor economic development.

Strictly speaking, we cannot draw conclusions from the discussion, but I would like put forward three statements as the basis for our debate. The first is that if the alternative to inflation is economic stagnation and unemployment, inflation is the lesser evil. The second is that the worst aspect of inflation is not the price rises themselves, but their impact on income distribution and the resulting distortions between production structures and demand structures. The third is that it is possible to mitigate, although not contain, inflationary pressures through a very progressive fiscal policy, price controls and wage adjustments. Controlling prices and supply and similar economic policy instruments are an infinitely preferable alternative to monetary policy, which only begins to be effective when it stifles economic development.

INFLATION IN CHILE: AN UNORTHODOX APPROACH *

Oswaldo Sunkel

Errors and exaggerations matter not. The courage to voice one's thoughts, to express things as they are felt at the time they are said —that is what counts. To make so bold as to proclaim what one considers to be the truth... If one waited until one possessed the absolute truth, one would either be a fool or remain silent forever.

José Clemente Orozco ¹

* This version has been prepared for the anniversary issue of *El Trimestre Económico*. The original was submitted to the First Seminar on Economic Development organized by the Asociación de Ingenieros Comerciales and the Círculo de Economía under the auspices of the Departamento de Extensión Cultural and the Instituto de Economía of the Universidad de Chile. The seminar was held in Santiago, Chile, in July 1958.

The opinions expressed in this paper are purely personal and should not under any circumstances be ascribed to the institution with which the author is connected. The author wishes to express his thanks to Licenciado Juan F. Noyola for the privilege of submitting the ideas expressed in the paper to his criticism and for the encouragement afforded over the years by Noyola's own studies and thoughts on the subject of this essay. Nevertheless, anything in this article to which exception may be taken should be attributed entirely to the author.

¹ Excerpt from a letter by Orozco, quoted in Justino Fernández, *Orozco, forma e idea*, Ed. Porrúa, second edition, Mexico, 1959.

I. INTRODUCTION

The prolonged inflationary process experienced by the Chilean economy has consistently been the object of international curiosity and interest. These have been aroused even more of late by the quickening of the pace of inflation to an unsuspected level and by the subsequent stabilization policy introduced during the first few months of 1956.

International observers have unfortunately nearly always had to make do with sporadic and partial information which, since the beginning of the stabilization programme, has even become biased. This has certainly not helped the foreign observer to form a valid opinion of the problem confronting the Chilean economy. Perhaps for the same reason, the views now being expressed with ever greater insistence are intolerably simplified and superficial. There can be no justification for this, even if the same sort of opinion is voiced more often than it should be within the country itself. Even a superficial knowledge of the characteristics of inflation in Chile —and surely this is not too much to expect of anyone who intends to express an opinion— would protect one from such pitfalls. In fact, it should be borne in mind that inflation in Chile has been a secular phenomenon, that the rate of price increase has been very high, especially during the post-war years, and that in spite of this the situation has not developed into a “runaway” inflation accompanied by a collapse of the productive system —as frequently happens in such cases. It should also be remembered that we have only recently experienced some of the effects traditionally produced by inflation: redistribution of income at the expense of fixed income groups, money no longer being used as a means of exchange, undue stock-piling of goods, etc.

These few basic features of the inflationary process in Chile clearly suggest the somewhat peculiar character of the phenomenon. It would therefore seem logical that neither the diagnosis nor the remedy lie in the analysis and policy traditionally followed. The simple truth —none the less ignored because it is simple— is that inflation does not occur *in vacuo*, but as part of a country’s historical, social, political and institutional evolution. It therefore does not seem out of place to assume that inflation in Chile —as in the case of other countries at the same stage of development, with a similar economic structure and comparable historical evolution— should be analysed in the light of a distinctive interpretation conditioned by the reality to which it purports to apply.

Such an interpretation of the inflationary phenomenon rests on a fact that is beginning to gain wider acceptance: the underlying causes of inflation in underdeveloped countries are to be found in basic economic development problems and in the structural characteristics of the system of production in these countries.²

It seems necessary, therefore, to replace the traditional short-term approach normally used to analyse inflation in our countries, which mainly consists of pointing an accusing finger at conventional monetary statistics and referring to the government, the central bank and the trade unions respectively as “spendthrift”, “weak” and “irresponsible”. This type of “analysis”, which at best barely makes it possible to trace the path of inflation in the financial sphere, has never provided an explanation of the causes of inflation or of its continuing character, much less of the local characteristics it adopts in different countries.

On the other hand, once the principle of the interdependence of the growth process and the inflation phenomenon is accepted, an analytical model can be outlined in which the primary and derived factors of inflation, as well as its characteristic mechanism, can be arranged

² United Nations, *World Economic Survey*, 1956, New York, 1957, pp. 7-8; *Economic Survey of Latin America*, 1957, Santiago, 1958, Part II, Chapter VI.

coherently within the framework of the country's structural conditions. This, no less, is what the present paper, perhaps over-ambitiously, attempts to do.

In recent years, as serious and objective research into the many factors of inflation gradually replaced *a priori* interpretations of the Chilean phenomenon, the extremely complex nature of the various elements and components of inflation have become apparent. The interrelationship between growth and inflation phenomena have also been recognized, as have the links between purely economic circumstances on the one hand, and political, institutional and social conditions on the other.³ Hence, what is needed is an analytical model in which the primary causes of inflation may be separated from the secondary, and subsequently all of them so arranged as to permit a thorough understanding of the "working" or "functioning" of inflation. The remarks which follow should be taken as a modest first step in that direction. The outline of a simple analytical model specifically adapted to Chile and perhaps to other countries with similar characteristics is all that has been attempted. A somewhat brief but sufficient formal account of that model will be found in the first part of the paper.

The analytical framework is then used in the second part in order to explain the inflationary process during the period ranging approximately from the late thirties until 1955. The same approach is used later to analyse the stabilization experiment carried out during 1956 and 1957. Lastly, it is used as a frame of reference in setting out, in very general terms, the objectives which an appropriate stabilization policy should seek to achieve.

The exposition that follows has had to be brief because, while it seeks to present a comprehensive approach to the phenomenon of inflation in Chile, care had to be taken to keep it within reasonable proportions. In the hope that a more extensive and fuller study, duly developed and documented, may be presented later on, the present article is offered at this time for the purpose of putting forward a thesis and of demonstrating the feasibility and possibilities of the suggested approach. All that has been attempted is the setting out of a working hypothesis. Although it is as yet unproven, its relevance seems to be supported by the facts mentioned, the statistics quoted and the earlier research on which it is based.

The author of this paper hopes that abler and more experienced economists will be prepared, at this crucial hour for our country, to "voice their thoughts". There is a growing need for an unbiased, candid appraisal of Chile's economic situation and prospects. The disastrous stabilization policy recently instituted has not only seriously curtailed short-term economic activity but has also jeopardized long-term development prospects. Hence, the formulation of policies properly adapted to the realities of the situation in Chile is essential.

II. THE APPROACH

Analysis of inflation may be reduced to two basic aspects: (a) the identification and classification of the various elements and categories involved in the process of inflation, and (b) analysis of their interrelationships. The first step might therefore be to distinguish between the different inflationary pressures, to be followed by an analysis of the mechanisms by which inflation spreads (propagation mechanisms).⁴ This is a fundamental distinction, because the two types of factors constitute separate logical categories; the propagation mechanisms do not constitute causes of inflation, but may well keep it alive and even contribute to its cumulative character.

³ A fairly complete synthesis on the many studies of Chilean inflation published during the past few years, classified by type of approach or analysis, has been made by Gonzalo Martner, "La inflación chilena en el pensamiento y en la acción", *Panorama Económico*, No. 192, July 1958, Santiago.

⁴ Juan F. Noyola, "El desarrollo económico y la inflación en México y otros países latinoamericanos", *Investigación Económica*, Vol. XVI, No. 4, fourth quarter, 1956, Mexico, pp. 604-605.

Moreover, these mechanisms, as will be seen, are usually the most obvious features of the inflationary process. This situation is largely responsible for the current confusion which consists of taking them as the real causes of inflation.

Inflationary pressures may be logically classified into at least three separate categories: (a) basic or structural inflationary pressures; (b) exogenous inflationary pressures, and (c) cumulative inflationary pressures induced by the inflationary process itself

A. Basic inflationary pressures

These are fundamentally governed by the structural limitations, rigidity or inflexibility of the economic system. In fact, the inability of some productive sectors to adjust to changes in demand —or, in short, the lack of mobility of productive resources and the defective functioning of the price system— are chiefly responsible for structural inflationary disequilibria.⁵ As will be seen below, the main structural pressures in Chile consist essentially of: (a) the stagnation of food supply in the face of expanding demand; (b) the inability of the Chilean economy to diversify exports and to increase the purchasing power of exports; (c) an inadequate rate of capital formation; (d) structural deficiencies in the tax system.

In these phenomena —and others which will be referred to later— rest what might be called the “underlying causes” of inflation. Accordingly, stability cannot be restored unless they are eliminated.

B. Exogenous inflationary pressures

These would include, for instance, upward movements of the prices of imported goods and services and major increases in public expenditure arising out of a national calamity or political measures. This type of inflationary pressure is, of course, always latent. All that economic policy can hope to do is to provide a cushion against these pressures and prevent them from spreading.

C. Cumulative inflationary pressures

These are inflationary pressures induced by inflation itself. Their effect is an increase in the intensity of the very phenomenon which has created them. In view of their character, they are an increasing function of the extent and of the rate of inflation itself. These pressures and the propagation mechanisms have in recent years played a predominant role in Chilean inflation.

There is virtually no need for examples of this type of pressure since not a single study of Chilean inflation fails to underscore —among other factors— the deplorable distortions of the price system, the maldistribution of capital investments, the harmful effects of price control and the twisting of economic expectations.⁶

⁵ United Nations, *World Economic Survey*, 1956, pp. 7-8, New York, 1957; M. Kalecki, “El problema del financiamiento del desarrollo económico”, *El Trimestre Económico*, Vol. XXI, No. 4, October-December, Mexico City, 1955; Samuel Lurié, *Estabilidad y desarrollo económico*, CEMLA, Mexico City, 1955, pp. 139 et seq.; Horacio Flores de la Peña, *Los obstáculos al desarrollo económico*, Escuela de Economía, UNAM, Mexico City, 1955; Osvaldo Sunkel, “Cuál es la utilidad práctica de la teoría del multiplicador?”, *El Trimestre Económico*, Vol. XXIV, No. 3, July-September, Mexico City, 1957, pp. 271-274.

⁶ The analysis of the effects of “repressed inflation” may be found in Bent Hansen, *The Theory of Inflation*, London, 1951, chapters IV-VI, and in H.K. Charlesworth, *The Economics of Repressed Inflation*, London, 1956.

D. The propagation mechanisms

Were it not for the presence of an “effective” propagation mechanism, not all the types of inflationary pressures referred to above would manifest themselves in a violent and continuing process of monetary expansion and increase in the general price level. This mechanism is essentially the result of the political inability of Chilean society to solve in some final way two major struggles of economic interests.

The first struggle concerns income distribution among the different social groups involved in the economic process. The second is related to the distribution of the productive resources of the community between the public and private sectors of the economy. The income-struggle is a paradoxical situation in which each specific group in the community seeks to derive benefits at the expense of the other groups, but fails to achieve a permanent advantage. The resource-struggle arises out of the government’s intention to increase or at least to maintain its actual share in national expenditure in spite of its inability to enforce the corresponding transfer of real income (resources) from the private sector.

In short, the propagation mechanism may be defined as the ability of the different economic sectors and social groups continually to readjust their real relative income or expenditure: the wage-earning group through readjustment of salaries, wages and other benefits; private enterprise through price increases and the public sector through an increase in nominal fiscal expenditure.⁷

III. DIAGNOSIS OF THE CHILEAN CASE

A. Inflation in Chile before 1956

1. Structural inflationary pressures

(a) *Inflexibility of supply.* An essential element generating structural inflationary pressures in underdeveloped economies is the lack of mobility of productive resources which characterizes these economies. This circumstance prevents the structure of production from adjusting as rapidly as it should to changes in the demand pattern and, in view of the limitation on imports imposed by the purchasing power of exports, permits the generation of basic inflationary pressures. In the case of Chile, these pressures may be grouped as follows:

- (i) *Rigidity of food supply.* As may be seen in table 1, between 1940 and 1952 the level of employment, total and *per capita* real income, and consumer expenditures on food increased substantially, while agricultural production remained virtually unchanged and exports increased very slightly. If the agricultural production figures are divided by population growth, they show a reduction of about 16 per cent. This development necessarily created pressure on food prices; notwithstanding subsidized food imports and price controls, this always had its effect in the end.⁸

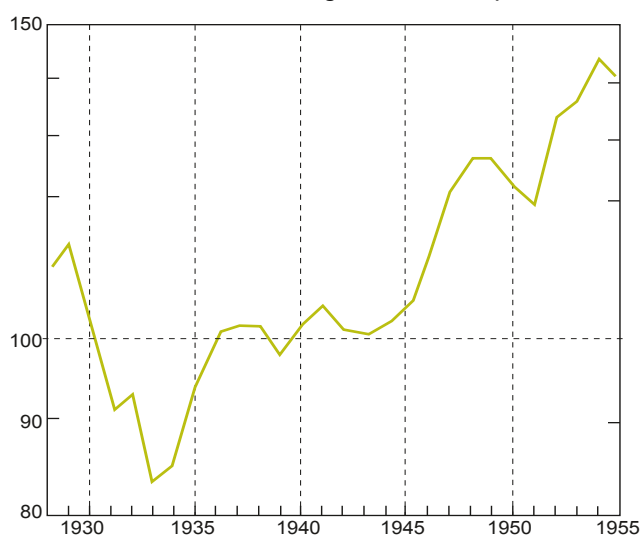
⁷ Henri Aujac, “Inflation as the Monetary Consequence of the Behaviour of Social Groups”, translated from French by A.C.L. Day, *International Economic Papers*, No. 4, London, 1954. For a historical analysis of the “political deadlock” in Chile and its inflationary consequences, see Aníbal Pinto Santa Cruz, “Perspectivas del proceso inflacionario en Chile”, *Comercio Exterior*, Vol. VI, Nos. 11 and 12, Mexico City, 1956.

⁸ United Nations, *World Economic Survey*, 1955, New York, 1956, pp. 94-107; Nicholas Kaldor, “Informe sobre la inflación chilena”, *Panorama Económico*, No. 180, Santiago, 1957; David Félix, *Desequilibrios estructurales y crecimiento industrial: el caso chileno*, Instituto de Economía de la Universidad de Chile, Santiago, 1958 (paper presented at the First Seminar on Economic Development).

■ **Table 1****AGRICULTURAL PRODUCTION, EXPORTS, EMPLOYMENT AND NATIONAL INCOME, 1940-1952**
(1940=100)

	1952
Agricultural production	104
Wage-earning population	127
Population not engaged in agriculture	151
Real national income	167
Real national income per wage-earner	132
Real consumer expenditure on food	157
Purchasing power of exports	115

Source: United Nations, *World Economic Survey*, 1955, New York, 1956, p. 97; Corporación de Fomento de la Producción, Departamento de Planificación y Estudios, *Cuentas nacionales de Chile, 1940-1954*, Santiago, 1957; Instituto de Economía de la Universidad de Chile, *Desarrollo económico de Chile, 1940-1956*, Santiago, 1956.

■ **Figure 1****THE RATIO OF THE INDEX OF AGRICULTURAL WHOLESALE PRICES
TO THE INDEX OF GENERAL WHOLESALE PRICES**
(Base 1934-1938=100, semi-logarithmic scale)

Source: Ministerio de Agricultura, *La agricultura chilena en el quinquenio 1951-1955*, Santiago, 1957, table 123.

Given the limited scope of this paper, it would not be appropriate to dwell at length on the factors that have restrained the growth of agricultural activity. Nevertheless, as it has often been claimed that the question is merely one of unfavourable agricultural prices, these factors will be dealt with briefly in order to show that such assertions are unsound and that the problem is of a structural nature. What has happened to the relative prices of agricultural production, both in terms of finished goods acquired by farmers and of agricultural inputs is quite obvious. Figure 1 leaves no doubt on the first comparison.

Since 1937, following the recovery from the harmful effects of the depression, the ratio of the agricultural wholesale price index to the general wholesale price index has shown a persistent trend in favour of agricultural products. In 1946 the relatively high level of the years 1928-1929 was again reached, and the price ratio continued to improve until in 1955 it exceeded the 1946 figure by about 24 per cent.

The post-war development of relative agricultural prices in terms of inputs has been even more favourable. In fact, table 2 shows that the price relationship between agricultural products and inputs improved by no less than 45 per cent between the annual averages of the 1946-1950 and 1951-1955 periods.

■ **Table 2**

THE PRICES OF AGRICULTURAL INPUTS AND OUTPUTS
(Base 1951-1955=100)

	Price index of agricultural inputs (A)	Price index of agricultural products (B)	Index of relative Prices [(A) / (B)] x 100
1946	24.3	18.1	74.5
1947	29.6	23.9	80.7
1948	34.4	27.4	79.6
1949	37.4	31.3	83.7
1950	40.8	37.2	91.2
1951	50.3	47.7	94.8
1952	65.5	63.3	96.6
1953	89.8	76.2	84.2
1954	113.9	117.6	103.2
1955	180.6	195.2	108.1

Source: Ministerio de Agricultura, *La agricultura chilena en el quinquenio 1951-1955*, Santiago, 1957.

A wealth of readily available statistics proves that agriculture in Chile is not as bad a business as some allege. Table 3 indicates the extraordinary increase in the importation of agricultural capital goods and inputs since the war. A barely profitable economic sector could hardly have increased its purchases of tractors and other machinery, fertilizers, seeds, etc., from an annual average of 5.5 million dollars in the five-year period 1946-1950 to 14 million dollars in the five-year period 1951-1955. Finally, if all this evidence is not convincing, one need only look at what has happened to the production of wheat, said to be the commodity most affected by the adverse price policy.

■ Table 3

AGRICULTURAL INPUTS

	Five-year averages	
	1946-1950	1951-1955
A. Imported machinery and equipment		(units)
Tractors	890	2 274
Ploughs and harrows	940	2 983
Self-propelled combines	110	230
Baling presses	103	177
Threshers	84	44
Combines	146	78
Seeding-machines	305	838
Mowers	670	548
Fertilizer distributors	108	234
		(dollars)
Miscellaneous equipment and spare parts	818 388	1 604 970
Total A.	4 644 287	11 599 897
B. Domestic and imported fertilizers		(metric tons)
Phosphate fertilizers ^a	20 779	29 169
Nitrogenous fertilizers ^a	7 450	13 108
Potassic fertilizers ^a	4 969	6 841
		(dollars)
Value of imports	456 561	1 879 409
C. Seed imports		
Value of imports	346 826	491 922
D. Total	5 447 674	13 971 228

Source: Ministerio de Agricultura, *La agricultura chilena en el quinquenio 1951-1955*, Santiago, 1957, tables 59, 60 and 61.

^a Units of P₂O₅, of N and of K₂O, respectively.

According to table 4, in the part of the country comprising the provinces of Valdivia, Osorno and Llanquihue a rapid absolute and relative expansion of the area under seed took place, while wheat production increased even faster, which means a rise in yields. By the five-year period 1945-1949 the region represented more than one-fourth of domestic production, and this figure has come closer to one-third in recent years. This region, which is one of the least favoured from the climatic and transportation points of view, with difficult access to credit and rural development institutions, nevertheless developed very quickly during the last few decades within the frame of the same domestic market as the rest of Chilean agriculture. Hence, the stagnation of global agricultural production cannot be attributed to market, demand and/or price conditions, but must be due to factors inherent in the institutional and economic structure of the main part of the agricultural sector itself.

- (ii) *Inelasticity and instability of the purchasing power of exports.* The slow development of Chilean exports (expressed in terms of external purchasing power) in face of population and real income growth (see table 1 again) has created a persistent pressure of import demand on the available foreign exchange. This long-term phenomenon has been accentuated from time to time by violent short-term foreign trade contractions, to which the country is becoming increasingly vulnerable. Both factors exercise constant pressure on the exchange rate and are responsible for the repeated devaluations of

the peso. Devaluations, in turn, cause readjustments of the country's cost and income levels. The latter reaction is particularly marked in Chile because of the following factors: (a) industrial production depends largely on imported inputs; (b) until recently all the fuel and lubricants consumed in the country were imported; (c) the substantial volume of food imports (about 60 million dollars annually in 1955 and 1956).⁹

■ Table 4

WHEAT CULTIVATED IN THE PROVINCES OF VALDIVIA, OSORNO AND LLANQUIHUE

Five-year averages	Area sown	Production		
	(Thousand hectares)	(Percentage of country total)	(Thousand metric tons)	(Percentage of country total)
1915-1919	42.4	8.5	630.1	11.0
1925-1929	78.8	12.2	1 156.7	15.8
1935-1939	103.8	13.0	1 391.0	16.4
1945-1949	146.0	18.4	2 526.6	25.8

Source: ECLA, *Economic Survey of Latin America*, 1949, New York, 1951, chapter VIII.

- (iii) *Specific bottlenecks in the supply of goods and services.* Apart from the general cases of supply rigidity mentioned in the preceding paragraphs, the growth process of the Chilean economy has also been characterized by many instances of specific bottlenecks in the availability of such basic services as transportation and power, of some types of skilled labour and of certain raw materials or intermediate products; generally speaking, there have been many cases of rigid supply combined with inelastic demand.

Particular reference should be made to supply rigidity resulting from monopolistic conditions. As is generally known, underdevelopment tends to breed monopolistic conditions in foreign trade —both export and import— and in domestic industry. Chile is unfortunately becoming more and more a case in point.¹⁰

(b) *The low rate of capital formation.* The creation of employment opportunities in underdeveloped countries depends essentially upon the expansion of productive capacity. In Chile the creation of enough new employment opportunities to absorb not only the growth of the active population but also the shift of manpower from agriculture and the mining industry to urban activities would certainly require a substantial increase in the rate of gross capital formation. (During the last decade it has not reached an annual average of 10 per cent, net investment being almost negligible.) This notorious dynamic inability of the Chilean economy to absorb its growing manpower in the production of goods resulted in an absorption of the "excess" labour force in the production of services and so contributed substantially to the expansion of the demand for goods while the production, and supply of goods only showed marginal increases (see table 5).¹¹

⁹ The structural problems of Chilean foreign trade have been dealt with in many publications. Only the following need be mentioned here: ECLA, *Economic Survey of Latin America*, 1949, chapter VIII; *Economic Survey of Latin America*, 1954, p. 28 et seq.; Juan F. Noyola, op. cit., pp. 606-608; Albán Lataste, "Tendencias del desarrollo económico chileno desde 1930", *Panorama Económico*, No. 148, Santiago, 1956; Jorge Ahumada, *Una tesis sobre el estancamiento de la economía chilena*, Santiago, 1958; Jaime Barrios, *La inflación chilena como consecuencia de la agudización de la lucha de clases derivada de desequilibrios estructurales*, Santiago, 1958. (The last two studies were presented at the First Seminar on Economic Development.)

¹⁰ Some quantitative and qualitative data on the points mentioned in this paragraph may be found in Instituto de Economía de la Universidad de Chile, *Desarrollo económico de Chile, 1940-1956*, Santiago, 1956, especially chapters V, VII, IX and X.

¹¹ See chiefly Nicholas Kaldor, op. cit.

■ Table 5

WAGE-EARNING POPULATION BY SECTORS
(Percentages)

	1940	1948	1953
"Productive" sectors			
Agriculture, forestry and fisheries	51.8	44.6	40.6
Mining	4.2	3.5	2.9
Industry and building	15.1	19.0	20.5
Electricity, gas, water, transport and Communications	4.2	4.7	4.7
Sub-total	75.3	71.8	68.7
"Services" sectors			
Trade, finance and insurance	6.9	7.3	7.7
Government	5.1	5.8	6.7
Personal services	12.8	15.1	16.9
Sub-total	24.8	28.2	31.3
Total	100.0	100.0	100.0

Source: Corporación de Fomento de la Producción, Departamento de Planificación y Estudios, *Cuentas nacionales de Chile*, 1940-1954, Santiago, Chile, 1957.

(c) *The tendency of real costs to increase.* The Chilean economy is characterized by the existence of an export sector —large-scale copper mining— where the average productivity per active worker is more than ten times that of the economy as a whole (see table 6). The wage-earning population in this particular sector fell from 86,000 in 1929 to 42,000 in 1940; subsequently, as may be seen from table 5, it continued to decline fairly rapidly. As a result, there has been a strong shift of manpower from an extraordinarily productive activity to others of much lower average productivity levels, a situation which tends to slow down the increase in the general level of productivity. As this phenomenon is combined with a relative rigidity in the wages of the labour force shifted to other sectors —i.e., productivity declines faster than wages rates— an increase in the real cost of production also ensues.¹²

(d) *Instability, inflexibility and regressivity of the tax system.* The Chilean tax system has traditionally been incapable of adjusting its revenues to the requirements of public expenditure policy. The relative importance of revenue derived from the external sector —which in the period 1950-1954 still constituted about 52 per cent of the total—¹³ has declined over the years as a result of the following factors: (a) the stagnation of exports; (b) the decline in the share of imports in gross domestic product; (c) the reduction in the fiscal income obtained by purchasing foreign exchange from the large mining companies at highly overvalued rates and selling it to importers at more normal rates, because the margin between purchasing and selling rates narrowed; (d) the change in the structure of imports in favour of essential goods subject to relatively lower duties.

¹² This problem has been carefully studied in an unpublished work of Juan F. Noyola. See also ECLA, "Some aspects of the acceleration of the inflationary process in Chile", *Economic Bulletin for Latin America*, Vol. 1, No. 1, Santiago, Chile, 1956.

¹³ Including an estimate of the tax on copper mining that was implicit in the overvalued exchange rate applied to copper-mining export proceeds. See Instituto de Economía, op. cit., p. 180, table 153.

■ Table 6

GROSS DOMESTIC PRODUCT PER ACTIVE PERSON, TOTAL AND BY SECTOR*(Thousands of 1950 pesos)*

Year	Economy as a whole	Large-scale copper mining	Industry	Agriculture
1950	69	771	60	40
1951	70	826	60	40
1952	71	853	63	40
1953	67	692	66	43
1954	67	837	—	—

Source: ECLA, "Some aspects of the acceleration of the inflationary process in Chile", *Economic Bulletin for Latin America*, Vol. 1, No. 1, table 1.

The long-term stagnation of tax revenue from the external sector is aggravated by the instability of this revenue, which fluctuates violently with the vicissitudes of foreign trade and, more particularly, of copper mining.

The structural contraction of external tax revenue has not been counterbalanced —either on a long-term or a short-term basis— by an increase in internal tax revenue. The chief elements responsible for the inefficiency of the tax system are: (a) its inflexibility, which precludes an increase in tax revenue commensurate with the increase in nominal national income; (b) its regressivity, which, owing to the large proportion of indirect taxes, leads to two consequences: a direct impact on prices as indirect taxes are shifted to the consumer, and inability of the Government to benefit from potentially higher revenues as a result of the regressive redistribution of income; (c) its legal and administrative complexity which has transformed it into "a tax system virtually impossible to operate".¹⁴

2. Exogenous inflationary pressures

(a) *General increase in salaries and wages.* In 1939 the Popular Front Government decreed a general wage increase of 20 per cent. This is not mentioned here in order to imply that it was a chief cause of inflation. In the years immediately preceding that decision prices had risen substantially and therefore the 1939 wage increase was merely intended to bring wages into line with higher prices. However, it has to be mentioned because it marked the beginning of a new stage in Chilean inflation: official acceptance of the policy of wage and salary readjustments.¹⁵

(b) *National calamities.* The violent earthquake which devastated two major provinces in the central zone in 1939 led to the establishment of two semi- governmental institutions —the *Corporación de Fomento de la Producción* and the *Corporación de Reconstrucción y Auxilio*— financed by loans from the Central Bank representing about 20 per cent of the total money supply.¹⁶

(c) *Increases in import prices.* The index of the unit value of imports rose year after year between 1940 and 1949, during which period it virtually tripled. There was another substantial increase later, between 1951 and 1953. The extraordinary parallelism between the relative annual

¹⁴ Herrick K. Lidstone, *Legislación y administración de impuestos en Chile*, Technical Assistance Administration, United Nations, New York, 1956, p. 3. Two excellent accounts of Chile's tax problems are: Instituto de Economía, op. cit., chapter XI, and A. Pinto S.C., C. Matus R. and G. Martner G., *Política fiscal y desarrollo económico*, Santiago, 1958 (paper presented at the First Seminar on Economic Development). See also various studies published by the Departamento de Estudios Financieros and the Oficina de Estudios Tributarios of the Ministerio de Hacienda.

¹⁵ An explanation of the political and social background of this fact of major importance may be found in A. Pinto S.C., "Perspectivas del proceso inflacionario en Chile", *Comercio Exterior*, Vol. VI, Nos. 11 and 12, Mexico City, 1956.

¹⁶ Banco Central de Chile, *Memoria Anual de 1955*, Santiago, 1956, p. 48.

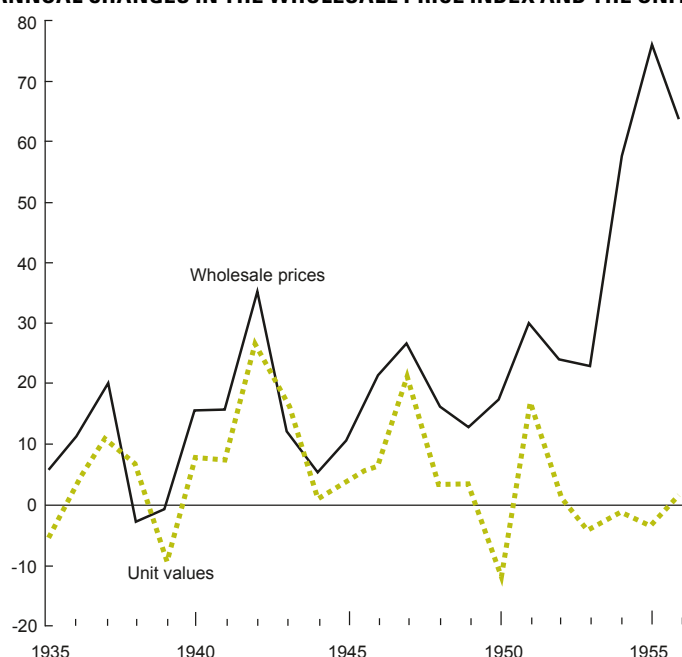
variations of import prices and the wholesale price index clearly indicates the strategic role played by this exogenous factor in the Chilean inflationary process (see figure 2).

(d) *The war period.* This period was characterized in the monetary sphere by a considerable expansion corresponding to the accumulation of substantial international monetary reserves. While national income (in current values) expanded, the supply of imported goods was severely limited and the shortage of fuel, raw materials and capital goods aggravated the problems arising out of the existing bottlenecks in the flow of production.¹⁷

(e) *International instability.* Once the problems arising out of the second World War had been overcome, the external sector of the Chilean economy was faced with three foreign trade crises within a single decade (1949, 1953 and 1957) which created severe pressure for the extremely sensitive mechanism of financing both government expenditure and imports.¹⁸

■ Figure 2

ANNUAL CHANGES IN THE WHOLESALE PRICE INDEX AND THE UNIT VALUE INDEX OF IMPORTS



Source: ECLA, *Economic Survey of Latin America*, 1949 and 1954, and Banco Central de Chile, *Boletín Mensual*, No. 356.

3. Cumulative inflationary pressures

(a) *The orientation of investment.* The prolonged inflationary process has by and by produced marked abnormalities in the price system, particularly as regards some price-controlled items, certain subsidized imports, the rates for some essential public services, rents and real estate prices. The resulting distortions in the system of investment incentives have had two kinds of result: on the one hand, investment funds have often found their way into financial transactions, and, on the other hand, real capital formation was often diverted from the production of basic goods and the expansion of many essential services —whose prices and rates were controlled—

¹⁷ *Ibid.*, pp. 50-54.

¹⁸ The effects of the 1949 and 1953 crises, particularly of the latter, are fully analysed in ECLA, *Economic Survey of Latin America*, 1957, *op. cit.*

to activities which make hardly any contribution to the country's productive capacity, such as residential buildings.¹⁹ As a result, by distorting entrepreneurial incentives, inflation itself has tended to reduce real capital accumulation and the productivity of investment. Both trends have contributed to a restriction in the supply of essential goods and services — particularly where net investment has been negative— thus strengthening structural inflationary pressures.

■ **Table 7**

LEGAL AND ILLEGAL STRIKES

Annual average	Number of strikes	Workers affected	Man-days lost
1947-1950	121	44 603	1 194 885
1951-1954	231	109 539	1 427 726
1955	274	127 626	^a

Source: Instituto de Economía de la Universidad de Chile, *El desarrollo económico de Chile*, 1940-1956, Santiago, 1956, table 4.

^a Not available.

(b) *Expectations.* As a result of persistent inflation, the expectation of higher prices and increased incomes is something which the different economic units have come to include in their forecasts and plans. This has created a tendency among consumers to spend as much money as possible as quickly as they can, thus incurring huge debts. These conditions tend to reduce savings, increase the liquidity of the financial system and expand non-banking credit margins.

In the public sector, the expectations of wage and price increases are reflected in the expansion of the expenditure budget, if only for the purpose of maintaining the relative share of the public sector in gross national expenditure. Since fiscal revenue does not increase correspondingly, for the reasons mentioned above, and public investment is the least rigid part of public expenditure, there is a strong pressure to cut public capital expenditure. The effect of such a cut —as in the case of reduced private investment— is to help to aggravate the bottlenecks in the basic social capital sectors, and thus to accentuate structural inflationary pressures.

(c) *Productivity.* Inflation had negative effects on productivity, including the following:

- (i) The continuing struggle to maintain the real income of the different sectors caused in the wage-earning sector a growing number of strikes and work stoppages (see table 7); in the entrepreneurial sector much loss of executive and technical ability through time absorbed by administrative and financial red tape, and, in the public sector, the distortion of the remuneration and incentive systems of the civil service and the continuous postponement of basic long-term decisions, because attention was concentrated on day-to-day problems requiring immediate solution. All this resulted in widespread disorganization of public and private economic activity.
- (ii) Inflation made it possible for numerous economically objectionable and inefficient enterprises and activities to exist and to multiply.
- (iii) Inflation gave rise to various schemes for the direct control of its monetary manifestations. Price control produced a series of distortions in the price system, as previously indicated, and, by its very mechanism, protected marginal enterprises on the one hand and perpetuated idle capacity in efficient enterprises of the same branch of industrial activity on the other. Moreover, it led to the circumvention of price control by means of a deterioration in the quality of goods produced.

¹⁹ In 1954 and 1955 buildings constituted 45 per cent of gross investment. See ECLA, *Economic Survey of Latin America*, 1957, op. cit.

- (iv) Inflation seriously disorganized the operation of the social security system, leading to the inefficient use of the capital (including human capital) invested in this sector and to inadequate social care of the members of the community.

(b) *Lack of export incentives (excluding the large-scale copper and nitrate mining industry).* The continuing increase in domestic production costs as a result of rigid export exchange rates made it necessary from time to time to readjust such rates. To obtain privileged export exchange rates gradually became the main concern of many exporters who, instead of furthering their export markets, started to concentrate on importing profitable luxury items thanks to the favourable conditions in which exports proceeds were made available to them.²⁰ Under the circumstances the level of exports could hardly be increased or even maintained; thus, diversification of the export sector was even more difficult.

4. The propagation mechanisms of inflationary pressures

(a) *Public sector deficit.* One of the chief means by which inflationary pressures of all kinds are propagated is a budget deficit, as it inevitably leads to the issuing of money. The problem arises essentially as a result of the downward rigidity of public expenditure in the face of the aforementioned structural deficiencies of the revenue system, namely its inflexibility, regressivity and major instability.

Downward rigidity of public expenditure is determined chiefly by the following factors: (a) inadequate creation of new job opportunities in the goods production sector; this compels the public sector and other service sectors to absorb the excess labour supply arising out of growth and sectoral shifts of the active population (see table 5 again); (b) since 1939 public expenditure policy has had to be expansionist because it has constituted the main stimulus for the economic development of the country; (c) the increasing insufficiency of the public sector to cope with the basic needs of general administration, education, health, public works, housing, etc., which the community expects the Government to provide; (d) the inability of the public sector, for reasons of employment, politics or tradition, to limit the heavy outlay represented by transfer payments, subsidies and the armed forces (see table 8).

In view of the downward rigidity of public expenditure and the structural problems previously mentioned, which prevent a corresponding readjustment of tax revenue, the public sector shows a structural trend towards deficit, aggravated whenever government financing is disrupted by foreign trade contractions.

Hence, the public sector deficit reflects the existence of a number of structural problems which preclude the realization of a balanced-budget policy. The propagation mechanism of the inflationary pressures to which the public sector is subjected consists, on the one hand, of the financing of the deficit by loans from the banking system, issuing bonds to the social security institutions, revaluation of monetary reserves and other measures related to the money supply and, on the other hand, increases in the rates charged by public enterprises, tax-rate increases, higher social security contributions and other measures to increase fiscal revenue —all of them directly affecting prices.

²⁰ In the new exchange system introduced in 1956 the pressures to import luxury items found expression in the granting of "free port status" to Arica and other Chilean ports.

■ Table 8

PUBLIC EXPENDITURE ON TRANSFER PAYMENTS AND NATIONAL DEFENCE*(Percentages of total public expenditure)*

	Transfer payments	National Defence ^a
1940	34.3	14.1
1947	27.8	19.7
1954	30.2	15.9

Source: Instituto de Economía, Universidad de Chile, Desarrollo económico de Chile, 1940-1956, Santiago, Chile, 1956, table 158.

^a Excluding expenditure in foreign currency.

(b) *Salary and wage readjustments.* As stated earlier, the real income of the wage-earning sector suffers from various downward pressures. Mention should be made chiefly of the limited food supply which generates a corresponding rise in prices. But higher food prices necessarily entail a reduction in the real income of wage-earners, who usually spend a large share of their income on food supplies.

Exchange rate devaluations also contributed to the pressure to which real labour income was subjected, not only because of their direct effect on the price of imported foodstuffs, but also because of the subsequent readjustment in the cost structure of industry and of transportation, sectors that are very sensitive to changes in import prices.

The tax system worked in the same direction. Regressivity of the tax structure is another form of pressure exercised on the real income of wage-earners. In fact, much of the fiscal revenue is produced by indirect taxes, which, as is well known, are largely paid by the consumer. Moreover, under the prevailing inflationary conditions, this also applies to a good portion of the direct taxes.

In order to compensate its losses in real income arising out of these and other inflationary pressures, the wage-earning sector makes effective use of its bargaining power and, by means of the automatic wage readjustments which it receives or of special readjustments and indemnities, manages to maintain its relative income position or at least to protect it from deteriorating seriously.

(c) *Price readjustments.* The business sector feels the impact of inflationary pressure in the form of higher costs. These may be caused by: (a) higher salaries and wages; (b) higher prices for raw materials, energy, fuel and capital goods; (c) higher taxes; (d) higher interest rates; (e) lower productivity.

The business sector is compelled to readjust the sales price of its products in order to counteract the effect of higher costs on its net income. However, cost increases materialize immediately whereas the increased income deriving from higher prices is not received for some time. This produces a drain on the working capital which enterprises need for their normal operations, and they are therefore compelled to resort to bank credit. Hence, price increases supported by passive reaction of the monetary and credit system constitute the propagation mechanism of the inflationary pressures to which the business sector is subjected.

(d) *The import subsidy system.* The import subsidy system is a major propagation mechanism of inflationary pressures and very characteristic of the Chilean economy. The system was established, among other reasons, for the purpose of subsidizing —and thus keeping low and stable— the prices of imported foodstuffs, capital goods, fuel and a few strategic raw materials. In fact, it did alleviate the effects of inflationary pressures as long as foreign trade expanded, the Government increased its share of the foreign exchange brought in by the large-scale

mining industry, and the rate of domestic inflation did not become too fast. However, the public sector's dollar commitments increased (*i.e.*, less foreign exchange was left over for import subsidies), the volume of subsidized imports expanded (as in the case of foodstuffs), external import prices rose and the purchasing power of exports became stagnant; as a result, the funds available for exchange subsidies were gradually curtailed and a continuing process of devaluation became necessary. The situation came to a crisis in 1953 when, after a very good export year during which subsidies were substantially increased, a critical year followed which led to so sharp a devaluation as to constitute the chief cause of the acceleration of the rate of inflation that has taken place after 1953.²¹

In short, the system of import subsidies, while it lasted, made it possible to absorb inflationary pressures on the exchange rate as long as basic foreign trade conditions were satisfactory. But when conditions worsened, these pressures—which had been accumulated over time by the import subsidy policy—showed their full force in sharp devaluations. The sensitivity of price levels and domestic costs to this influence has already been mentioned. It is clear that these cost and price increases seriously affected in various ways and at different times the real income of the wage-earning sector, the real expenditure of the business sector and even of the public sector. The import subsidy system therefore actively contributed to stimulating the reaction of these sectors, which try to use the readjustment mechanism in order to maintain their relative real incomes.

B. The economic stabilization experiment of 1956 and 1957

1. Main stabilization measures

The Chilean inflationary process became so acute from the second half of 1953 onward that the Government thought it necessary to introduce a drastic stabilization policy. In 1956 and 1957 a number of economic measures were adopted to check the rise in the overall level of prices. Of these the following were the most important: (a) a restrictive monetary policy; (b) wage and salary readjustment in smaller proportion than the rise in the cost of living; (c) some check on the increase in public expenditure, particularly government investment; (d) a reform of the foreign exchange system involving heavy devaluation and a new system of import control; (e) a big increase in public utility rates in order to eliminate State-enterprise deficits, and (f) the granting of rather favourable prices for agricultural commodities.²²

2. Results of the stabilization measures (see table 9)

If the measures specified in the previous paragraph are classified in accordance with the scheme of analysis outlined in this paper, it may be seen that the stabilization policy adopted was inadequate to deal with the Chilean inflation. While credit controls were intended to reduce the propagation of the inflationary pressures which are transmitted through higher prices, the partial readjustment of wages and salaries was intended to reduce the pressure of increases in factor remunerations on production costs. Moreover, the brake applied to increases in public expenditure and the measures designed to avoid State enterprise deficits were intended to eliminate or reduce the fiscal deficit and thereby to impede the propagation of inflationary pressures through this sector. As may be seen, it was a direct attack on what has been termed

²¹ This case is fully analysed in ECLA, *Economic Bulletin for Latin America*, *op. cit.*

²² ECLA, *Economic Survey for Latin America*, 1957, *op. cit.*

the mechanisms of propagation, the partial readjustment of wages and salaries being particularly effective in dealing with higher living costs.

As a result of the application of measures to limit the ability of the different sectors to defend themselves, particularly of the wage-earning sector, there was a severe contraction in the latter's real income (table 9, items 2 and 3). As was only to be expected, the monetary manifestations of inflation also became less marked. But the structural, exogenous and cumulative inflationary pressures remained latent, since the other stabilization measures —devaluation and exchange reform, improvement of agricultural prices and the rise in utility rates— did not actually counteract these pressures but rather allowed them free influence on the price system.

As the stabilization programme did not eliminate the various inflationary pressures, inflation continued. The only difference was that under the new conditions, deprived of the free action of the propagation mechanisms, inflation brought along a substantial regressive shift in income distribution (table 9, items 2, 3 and 14) and a limitation of real public expenditure, on top of a general rise in prices.²³ It might be argued that these effects are not too high a price to pay for stability. But whoever thinks along those lines will be falling into an error of logic because those are not the real alternatives. In an underdeveloped country, the objective is, almost by definition, to achieve economic development, and the methods that are being used to stabilize the Chilean economy are jeopardizing the country's possibilities of long-term economic progress.

■ **Table 9**

THE ECONOMIC SITUATION IN 1957 IN RELATION TO THE AVERAGE OF THE PERIOD 1953-1955
(Percentage variations, original values at constant prices)

1. Gross product <i>per capita</i>	-8.8
2. Real income per wage-earner	- 19.8
3. Share of wage-earning sector in total consumer expenditure	-10.5
4. Gross investment ^a	-24.2
5. Building ^b	-55.2
6. Production index for clothing manufacture ^b	- 9.4
7. Production index for refined sugar ^b	- 23.8
8. Production index for "various" industries ^b	- 4.1
9. Freight transported by rail	-13.5
10. Coastal shipping (freight) ^a	-8.1
11. Number of unemployment benefits authorized by social insurance	+ 427.9
12. Protested cheques	+ 169.1
13. Protested promissory notes	+ 5.8
14. Share of entrepreneurial sector in consumer expenditure	+10.0

Source: Banco Central de Chile, *Boletín Mensual*, No. 362, Santiago, Chile, April 1958; United Nations, *Monthly Bulletin of Statistics*, Vol. XII, No. 8, New York, 1958; ECLA, *Economic Survey of Latin America*, 1957, mimeo, Santiago, Chile, 1958.

^a The base for comparison is the annual average 1954-1955.

^b These four partial indices represent two-thirds of the general index of manufacturing production.

In fact, given the dynamic role which the public sector plays in the development process and the inability of underdeveloped countries to redirect their incipient industrial production towards the external market, the policy of regressive income redistribution and reduced public expenditure necessarily leads to a contraction of economic activity (see again table 9). So much so that in 1956, when external conditions were extremely favourable, domestic economic

²³ The cost-of-living index still rose 56 per cent in 1956 and 33 per cent in 1957; the increments in the foodstuffs sub-index were 56 and 41 per cent, respectively. See Banco Central de Chile, *Boletín Mensual*, No. 362, Santiago, Chile, April 1958.

activity declined more than 2 per cent; an “achievement” as spectacular and unprecedented as it would be to obtain an increase in gross domestic product (in real terms) during a foreign trade crisis.

There was no question, as might be imagined, of a period of “consolidation” after which the development process would once more be reinitiated, this time with monetary stability. Naturally enough, no such “consolidation” took place, since the various types of inflationary pressures remained alive.

Quite to the contrary, the redistribution of income has considerably aggravated the maladjustments between the structure of production and the composition of demand. It is true that a regressive redistribution of income, if sufficiently intensive, will succeed in adapting the demand for foodstuffs to available supplies, but it will simultaneously lead to a disequilibrium between demand and productive capacity in other sectors —industry, transport, energy, construction, trade and services— in accordance with the respective income elasticities of demand. This situation leads to the creation of a structural labour surplus, which would increase with the growth of the active population and with the fall in the rate of capital formation brought about by the recession and by the policy of restricting public expenditure (table 9, items 11 and 14). Furthermore, the contraction in public investment is particularly serious in the circumstances. The deterioration of the community’s basic social capital in some sectors is leading to the creation of bottlenecks which, in the future, will hamper the implementation of any programme for economic development with stability, while the cumulative deficits in educational and housing requirements will make it increasingly difficult to find a solution.²⁴

3. The main policy choices

In the last few years, Chile has followed two of the three possible courses that can be adopted by a country which is not prepared to eliminate the structural problems that hamper its economic development and give rise to basic inflationary pressures. From 1953, or even as far back as 1947, up to 1955, Chile experienced one of those possibilities: inflation without economic development. The continuation of the policy introduced in 1956 may bring the country to the second possibility: relative monetary stability, depressed economic activity and stagnation.

Under present structural conditions, there is a third possibility: an abundant and steady flow of long-term foreign capital.²⁵ Only in this case would “economic development with stability” be feasible, although future problems might become overwhelming. But there is no need to ask whether this possibility merely implies postponement of existing problems and what it entails in the way of debts for the country. The external resources required would be so big and would have to be made available for so long that it would be absurd to consider this alternative as feasible in any way.

Hence, if the large majority of the community demands more and better food, more and better clothes, longer life expectancy and better health, decent housing, a good education, opportunities for the coming generations and leisure for cultural and spiritual development, and all this as well as monetary stability, it should be self-evident that only one choice remains: the removal of the structural obstacles to economic development or, what amounts to the same, the elimination of basic inflationary pressures.

²⁴ Instituto de Economía, *op. cit.*, p. 193 (educational deficit) and p. 196 (housing deficit).

²⁵ This refers to a growing inflow of capital which would have to be substantially more abundant, more continuous and of longer duration than that which accompanied the stabilization experiment of 1956-1957. The latter involved a large increase in the external debt without helping to solve any basic or structural problem of the Chilean economy.

C. Outline of a stabilization programme

If the approach suggested in this paper is correct and if the inflationary phenomenon and the stabilization experiment are adequately interpreted, the same approach might be used as a basis for outlining a more appropriate stabilization programme. This is clearly not the most suitable place for a task of such scope. On the other hand, it might be useful, at this juncture, to give a very general picture of the main objectives and strategy of a stabilization programme. This might serve to assess the usefulness of the approach for the formulation and orientation of an anti-inflationary policy.

1. The structural problems

According to the analysis of the factors that generate basic inflationary pressures, a realistic stabilization programme should concentrate on two main fronts: the rigidity of the supply of goods and the inflexibility and regressive nature of the tax system. The other two structural problems —the negative pressure on average economic productivity and the low rate of capital formation— will be included in the discussion of the aspects mentioned above.

(a) *The rigidity of the supply of goods.* The fundamental problem of a stabilization programme is how to obtain in a short time a substantial increment in the supply of foodstuffs, domestic and imported. In order to do this, it would be necessary to draw up emergency programmes for increasing the output of foodstuffs for the home market and for an overall expansion of exports. The programmes would obviously require an increase and rechanneling of public investment together with monetary, fiscal, institutional and other measures pursuing similar aims in the private sector.

The higher level of employment created by expanded investment would in itself produce additional demand for food —adding to the existing deficit— and would also mean an increase in the demand for imports. That is why the initial investment effort should be concentrated in the agricultural and export sectors. This would not only help to solve the basic problems of supply rigidity but would make it possible to cope with most of the demand generated by the additional investment itself.

An increase in exports is of particular importance for still other reasons: (a) because it helps to overcome some current bottlenecks as well as some of those that will arise as economic activity recovers; (b) it will help to alleviate the problems caused by the instability and external vulnerability of the public sector, the balance of payments and the industrial sector, because an increase in exports will mean more diversified exports.

The average productivity of the Chilean economy will tend to increase as investment grows and is reorientated, especially if the effort to increase agricultural production is accompanied —as it must be— by a substantial increase in agricultural productivity. This would lead, furthermore, to an extensive shift of rural manpower to the export and industrial sectors, which would become the most dynamic. Hence, in addition to an increase in agricultural productivity itself, there would be a shift of labour from a low-productivity sector to others of higher productivity. This would tend to counteract the adverse pressure on productivity caused by the shifting of manpower from the country's most productive sector (large-scale copper mining) to the rest of the economy.

(b) *Problems of the tax system.* A drastic reform, which would do away with the inflexibility and regressivity of the tax system and cause it to be applied and administered expeditiously and

firmly, is a prerequisite of the stabilization programme. The reform should take into account the need for reorientation of private investment by reducing the incentives to invest in real estate and luxury buildings, for example, and channelling capital formation into agriculture, export and other sectors essential to the programme. Obviously the system of exchange controls will also have to be used to achieve these objectives.

2. Cumulative problems

At the same time as measures are applied to eliminate the structural pressures of inflation, action must be taken with respect to cumulative pressures, particularly those which aggravate the basic problems of inflation and development.

(a) *Distortions of the price system.* The abnormalities of relative prices are one of the most harmful cumulative consequences of inflation, because they affect the orientation of investment. It is often a matter of the effects of price controls and of other systems of direct control over the monetary symptoms of inflation. A stabilization programme which attacks basic inflationary pressures and, at the same time, purports to establish a policy of economic development must do away with direct controls as problems of supply rigidity are gradually eliminated. Direct controls are admissible only as part of a positive policy of reorientation of productive resources. Even so, preference should be given to indirect methods of incentives and disincentives, such as tax, foreign exchange, monetary and credit measures, specific subsidies or direct public investment.

The policy of eliminating direct controls should be accompanied by strict supervision of the competitive operation of the market. An attempt should be made to solve forthwith the problems of supply rigidity created by the variability and seasonal character of agricultural production and by transport and market conditions, as well as to exercise close control over monopolistic situations.

(b) *Productivity.* Elimination of direct controls under the above-mentioned conditions should help to restore the price system to normal. This should help to bring about a better allocation of private productive resources —obviously within the framework of the objectives of the development programme— and also help to do away with marginal activities, poor quality of products and other results of inflation and direct controls. This aspect of the question should be borne in mind in view of a possible Latin American common market.

The greater confidence created in the community by a stabilization programme of this kind and the increase in employment and *per capita* real income would probably reduce strikes and work stoppages among wage-earners to a minimum.

At the same time measures should be taken to stimulate the reorganization of private firms on a more rational and efficient basis and, above all, to effect a drastic reorganization and modernization of the public sector. The basic objective would be to convert the State administration into an efficient servant of the public by facilitating rather than hampering its activities. A civil service should be built up in which the only criteria for appointment, tenure and promotion would be ability, merit and seniority. Lastly, the entire activity of the public sector should be geared to a vigorous programme for the economic, social and political development of the country, in accordance with the aspirations of the community and its available productive resources.

(c) *Other cumulative problems.* Of particular importance here are price expectations and the lack of export incentives. The feeling that prices will inevitably go up will disappear gradually if the stabilization programme produces results. Thus, its negative effects on saving, excessive indebtedness, etc., would be eliminated. Much the same would happen to the lack of export incentives caused by inflation and a defective system of exchange control, primarily because exports would be one of the sectors on which development efforts would be concentrated.

3. The propagation mechanism

(a) *Budget deficit.* This problem would be virtually eliminated if the tax reform included a flexible, progressive revenue system. On the other hand, public expenditure rigidity would be eased by the greater absorption of labour into the goods production sector and a firm attitude with respect to superfluous expenditure. This would also make it possible for the State to increase its investment.

The problem of external instability would still remain and this can only be solved if the domestic tax base is widened, if exports are diversified, if a more adequate taxation system is negotiated with the large mining companies and if the policy of the underdeveloped countries in general to bring about an expansion and stabilization of the raw materials market has some effect.

(b) *Salary and wage readjustments.* The increases of prices and utility rates resulting from the abolition of controls and from the self-financing policy of certain public enterprises would not seriously affect the real income of the wage-earning sector if these pressures on real income are compensated by an adequate increase in the availability of food and other essential goods and services. This should be the case particularly if the tax reform proves to be effective and if the economic development process is stepped up and is accompanied by a substantial increase in productivity.

In any case, since the price system can never achieve absolute stability in an economy as vulnerable as that of Chile and, moreover, in view of the fact that this economy is characterized by a tendency towards concentration of income, the system of automatic salary and wage readjustments must continue to exist even though its application may be modified in order to alleviate its effect as a propagation mechanism. The best course might be to effect readjustments only when the price level rises above certain limits which will gradually decrease as inflation is controlled. Moreover, when a readjustment becomes necessary it should not be granted all at once but should be spread out over a period of several months in order to allow some adjustment of supply to take place.

(c) *Price readjustments.* As stated earlier, inflation produces a plethora of inefficient enterprises, particularly in the trade and services sectors. As a result of the present restrictive policy, these enterprises are disappearing and their resources remain idle, while the more efficient enterprises are having serious trouble in readjusting their financial structure. Something similar will happen under the stabilization programme described here, but since the economy will not be stagnant but expanding, the resources used in the inefficient enterprises will be reabsorbed into the country's economic activity. The monetary and banking system will play an important part in the reorientation of domestic activity, by encouraging saving and the development of a capital market, mobilizing idle financial resources and controlling the real estate market and luxury building.

4. Exogenous pressures

The only defence the country has against exogenous inflationary pressures is the knowledge that such phenomena may occur at any time. In other words, defence against these pressures consists basically of the existence, at the highest level, of an economic policy agency which closely follows the stabilization and development programmes and analyses current domestic and international economic conditions which might affect the country. Only thus will it be possible to reduce the creation of exogenous domestic inflationary pressures to a minimum and to provide a cushion against the effects of those created by external forces. In any case, control of propagation mechanisms will lessen the possibility of exogenous inflationary pressure becoming a cumulative phenomenon.

5. Requirements of a stabilization and economic development policy

The author is fully aware to the fact that a programme of the kind set out above will require various types of conditions in order to be applied in practice. These conditions may be summed up as follows:

- (a) The existence of a political basis for the implementation of the programme (in the same way as the recent stabilization policy was based on a specific government coalition);
- (b) The existence of a large group of experts to undertake research leading to the diagnosis of the concrete problems to be faced and to the immediate formulation of a programme of specific measures to deal with them;
- (c) The willingness of large sectors of the community to make a positive contribution to the reorganization of the economy;
- (d) The existence of more or less normal external conditions or, failing that, an external contribution within the framework of the objectives and requirements of the programme.

THE LATIN AMERICAN COMMON MARKET *

ECLAC

* Chapter I “Significance of the common market for the economic development of Latin America” from the first part of “The Latin American common market and the multilateral payments system”, in *The Latin American common market* (E/CN.12/531), Santiago, 1959. United Nations publication, Sales No. 59.II.G.4. Prepared by Raúl Prebisch.

THE LATIN AMERICAN COMMON MARKET AND THE MULTILATERAL PAYMENTS SYSTEM

REPORT BY THE SECRETARIAT

Significance of the common market for the economic development of Latin America

1. Dynamic concept of the common market

The object of the following pages is to approach the question of the common market from the standpoint of the economic development of Latin America. 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,¹ subsequently reasserting itself² until it was given definite expression in the recommendations on the structure of the common market and the bases for its operation which were prepared by the Working Group on the Latin American Regional Market, in close co-operation with the secretariat.³

The Working Group has made every effort to devise realistic proposals. The common market must emerge from a policy rather than a formula. It is, of course, possible to visualize a comprehensive and far-reaching formula according to which goods and services, human beings and capital circulate freely, without hindrances of any kind, in one huge Latin American common market. This final objective must be constantly borne in mind, even though it can be reached only by gradual stages. In the first of these, aspirations would have to be confined to partial but attainable targets; and would necessarily have to be the patiently-nurtured issue of a policy conceived on realistic lines and implemented with firmness of purpose.

Such a policy must inevitably go through an experimental phase. This is the keynote of the recommendations formulated. There would be a preliminary ten-year period by the end of which the average level of inter-Latin American customs duties would have to be substantially lowered. And the decision as to how this policy might best be pursued in a future second stage would be left for later negotiation.

The reductions whereby duties would be brought down to the desired average level would not be uniform, but would be differentially established for specific groups of countries and categories of goods, not so much for the mere purpose of classification, as in obedience to the fundamental concept that allowance should be made for the varying stages of economic development reached by the Latin American countries, and for the practical difficulties attendant upon application of the reductions.

The common market should offer each and all of the Latin American countries equal opportunities of expediting their economic growth. But the disparities in their relative situations consequent upon the varying stages of development referred to necessitate differential treatment if such equality of opportunity in respect of the common market is to be ensured so far as possible.

¹ See *Economic Survey of Latin America, 1949* (E/CN.12/164/Rev.I). United Nations publication, Sales No. 1951.II.G.1.

² See the report "Payments and the regional market in inter-Latin American trade. Analysis and recommendations" (E/CN.12/C.1/4), prepared by the consultants Mr. Eusebio Campos and Mr. José Garrido Torres, in collaboration with the secretariat. (This document was afterwards incorporated in *Inter-Latin American trade: current problems* (E/CN.12/423)). United Nations publication, Sales No. 1957.II.G.5, pp. 93 *et seq.*

³ The text of the reports of the first and second sessions of the Group is given in Part Two, pp. 28 *et seq.*

However great the pains taken to devise suitable formulae, only when these are put into practice can their true efficacy be assessed. Hence, too, the desirability of adopting highly flexible procedures and establishing far-sighted escape clauses during this experimental phase. Once the first ten years are over, the lessons of experience will enable a truer course to be steered towards the final goal.

All this is a matter of understandable caution. The idea of the common market has been gaining a great deal of ground in Latin America. But it is easy to see why concern still exists as to the safeguarding of existing production —whether primary or industrial— against competition that might bring in its train serious distortions which are not inherent in the common market. The market is based upon an essentially dynamic concept, and looks towards the future —not just the immediate future, but also that of a Latin America whose 193 million inhabitants will have grown to nearly 300 million by 1975, and will probably exceed 450 million by the turn of the century.

For countries handicapped by a shortage of capital and with a growth capacity that has proved to be insufficient as yet for the efficient absorption of large volumes of manpower, a great deal of whose effort is wasted in rudimentary forms of production, no solution entailing persistent unemployment of the factors of production would be acceptable. Similar considerations underlie the anxiety frequently felt as to the possible consequences of too abrupt a discontinuance of protectionism among the Latin American countries. A major proportion of the region's existing activities is carried on under the aegis of the present protectionist policy. But a common market on the lines conceived would not affect these activities so much as the industries which will henceforth have to be developed in response to the demands of economic growth.

The magnitude of these demands will be considerable. To take only a relatively short period into account, if Latin America re-establishes and up to 1975 steadily maintains the annual rate of growth of the average *per capita* product registered during 1945-55, which was then 2.7 per cent, but since that period has declined, demand for industrial products will be quadrupled. About 90 per cent of this industrial demand will have to be satisfied with the region's own production, and only the remaining 10 per cent with imports.

Such an expansion of industrial production will afford ample opportunity for specialization and reciprocal trade, particularly in connexion with the new industries that are bound to be promoted in the field of capital goods, motor vehicles and other durable consumer goods, as well as in that of intermediate products. 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 necessitated by the march of industrialization, and the results obtained in the great industrial centres with broader markets at their disposal.

The more complex industries in question have not yet been established, or are still in the early stages of development, and it is in their case that the reduction or abolition of customs duties implied by the common market can be effected with relative ease. With respect to existing industries, on the contrary, great care will have to be taken to prevent the distortions referred to above. But even there the growth of demand may gradually create conditions favourable to specialization and reciprocal trade, as over-all economic development gains enough momentum to enable readjustments to be made in activities which might be adversely affected.

Consequently, the more thriving the development of the region, the more smoothly and efficiently can the common market be brought into being. But the vigorous growth required

cannot be achieved without that intensification of inter-Latin American trade which is one of the aims of the common market. Thus there is dose interdependence between this latter and the acceleration of economic development.

In reality, the common market is an expression of the effort to create a new pattern for an intra-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. So long as these countries' economies were principally directed towards supplying the large industrial centres with primary commodities, they had no major incentives to reciprocal trade. Except as regards some degree of primary complementarity, they were linked by no close economic relations, nor was there any reason why such relations should exist. The trouble is that this same economic regime still persists at the present stage of industrial development. The progressive establishment of the common market would mean that it could undergo a gradual transformation, with the great ensuing benefits that might be derived from a more rationally organized system of production, under which the potentialities of the land would be more efficiently utilized, and industry, thrusting beyond the narrow bounds of each country's individual market, would acquire more economic dimensions and, by virtue of improved productivity, would be able to increase its already considerable contribution to the standard of living in Latin America.

Moreover, the common market could play a leading part in mitigating the Latin American countries' vulnerability to external contingencies and fluctuations, which, notwithstanding their industrialization, is still acute, precisely because of the arbitrary fragmentation of the latter process.

2. The common market and the acceleration of development

These preliminary concepts must now give way to discussion of the main topic of this section. The contention here is that Latin America's basic economic problem consists in the achievement of a rate of economic growth satisfactory enough for the gap between its income levels and those of the great industrial centres to be progressively narrowed. Attention has just been called to the interdependence of the common market and the acceleration of development. During the post-war years, Latin America's economic growth seemed to gain new momentum; but the impetus did not last, because its most important generating factors were of an exceptional nature. The cumulative average annual rates of increase of the *per capita* product and of *per capita* income reached 2.7 per cent and 3.3 per cent, respectively, in 1945-1955.⁴ Such rates were relatively high for Latin America, but they could not be maintained, and in 1955-1958 the corresponding figures fell to 1.1 and 0.5 per cent, respectively.

The terms of trade played a very important part in determining this movement; their improvement in the earlier period was conducive to the higher rate, and their subsequent deterioration was largely responsible for the latter decline.

So long as they show no unmistakable signs of a recovery —and none is in sight for the moment— the task of re-establishing the former rate of growth of the *per capita* product (2.7 per cent) will be more difficult than in the past; nor will this be due to the above-mentioned factor alone.

What is more, a rate of 2.7 per cent does not fully meet the social demands of development, nor is it comparable with the recent experience of other countries in process of rapid industrialization. Yet to regain and maintain it will mean overcoming considerable

⁴ The difference between the two rates is given by the terms- of-trade effect.

obstacles. Among these, there are two of external origin which are highly important and closely inter-related. These are (a) the relatively slow growth trend of exports of goods and services and (b) the limitations imposed by this very circumstance on the capacity to absorb foreign capital. The question of exports may conveniently be dealt with first, and the problem of foreign capital discussed later.

A rate of increase of 2.7 per cent for the *per capita* product would imply an annual increment of approximately 5.4 per cent in the aggregate product, given the rate of growth of the population of Latin America. Everything suggests that a less intensive upward trend will be shown by primary exports than by the product. On the basis of existing prospects, it would be over-optimistic to estimate that they will expand at an average annual rate of more than 3 per cent, as against 2 per cent in 1945-1955.⁵

A marked disparity is observable between this situation and the probable expansion of demand for imports. While the tendency of exports is to lag behind the growth of the product, that of imports, of course, is to outstrip it. Unquestionably, therefore, Latin America will be compelled to pursue its import substitution policy as intensively as possible in order to achieve the rate of aggregate growth just mentioned.

Consideration must also be given to the possibility that exports might develop more intensively. Would this lessen the need for import substitution? Herein might lie one of the alternative solutions. The other might be to take advantage of this more intensive expansion of exports to raise the rate of increase of the *per capita* product above 2.7 per cent. There would be no reason why this should make any perceptible difference to the conclusions reached or to the magnitudes involved.

3. Excessive decline in the import coefficient

How far would the foregoing suggestion be practicable, given the present pattern of trade? This question springs to mind when the decrease that would necessarily take place in the import coefficient is estimated. If the substitution policy referred to is adequately implemented, imports, which at present constitute 16 per cent of Latin America's aggregate product, will correspond to barely 7.7 per cent by 1975, a figure consistent with the purchasing power deriving from the region's traditional exports.

This coefficient represents an average for Latin America as a whole. For the countries of Western Europe, the corresponding average coefficient is at present 18.5 per cent; a considerable proportion is attributable to their reciprocal trade, which, in fact, accounts for approximately 9 per cent of the aggregate gross income of the countries in question, while trade with the rest of the world is responsible for the other 9.5 per cent that brings the aggregate coefficient up to the figure mentioned (18.5 per cent).

In the case of Latin America, on the other hand, out of the projected average coefficient of 7.7 per cent barely 1.2 per cent would be represented by intra-regional trade, unless radical changes were introduced in trade policy. The contrast between the two situations is patent. In Western Europe, the relatively low income-elasticity of demand for imports of primary commodities and the protectionist policy adopted in respect of agriculture have played a noteworthy part in reducing the coefficient of imports from the rest of the world. But, on the other hand, the development of trade among the countries forming this economic group has fostered the process of industrial specialization which is sure to be considerably encouraged by the common market.

⁵ These and other projections mentioned here are formulated in the study "Influence of the common market on Latin American economic development" (E/CN.12/C.1/13), included in part B of the present volume, pp. 53 *et seq.*

The United States, by virtue of the same factors that have operated in Western Europe, registers a still lower coefficient with respect to the rest of the world, but its internal trade coefficient is far higher in every way than that of Western Europe, since a true common market exists among the fifty States forming this vast area of economic integration. The same is true of the USSR, whose external coefficient would seem to be barely 2 per cent and which also has at its disposal an extremely broad common market and is developing with great vigour.

At this juncture it is worth while pausing a moment to consider the coefficient for Latin America. The intensity of the downward movement postulated in the projections cited is a measure of the ever greater difficulties that would be encountered by import substitution policy in its inevitable advance towards types of industry which require a broad market if they are to be run on economically sound lines. Some of the consumer industries in those of the Latin American countries which have the largest populations have been successfully built up to an economically satisfactory size, but in many cases the internal market is still too narrow to allow of rational specialization whereby costs can be reduced. And as progress is made in the industries producing capital goods, motor vehicles and certain durable consumer goods, the need to expand the domestic market becomes increasingly evident. If the common market is not organized, however, each individual country will find itself compelled by the imperative necessity for import substitution to carry the development of these industries farther and farther, and will have to do so at exceedingly high costs. This is a point of vital importance, since industrialization is not an end in itself, but an efficient means of increasing average productivity and consequently raising the standard of living of the population. And if the heavy investment required for the industries under discussion yields an average product much smaller than in the industrial centres with broad markets, the beneficial effects of this new phase of industrialization in the more advanced Latin American countries will have been largely thrown away.

The countries in question —Argentina, Brazil, Chile and Mexico— currently account for about 70 per cent of the industrial output of Latin America as a whole, while their share in its population is 65.1 per cent. The other countries are still in the initial stages of industrialization. Will they follow in the footsteps of the former group and try to produce within their own frontiers all the current consumer manufactures they require? Will they also undertake the more complex type of production in which progress is being made by the countries at a more advanced stage of development?

If so, the attendant circumstances will not be the same, but, in general, less advantageous, owing to the smaller population of the countries concerned, their lower income levels and, consequently, the more limited volume of demand. These countries' need for industrialization admits of no discussion, but it is equally unquestionable that an attempt to carry out the process within the confines of each watertight compartment will deprive them —and to a much greater extent than has been the case with the bigger countries— of the opportunities for specialization and low costs which can materialize only within a common market so organized as to provide positive incentives for the industrial expansion of Latin American countries in the initial stages of development.

The gradual establishment of the common market would mean that the decrease in the coefficient of imports from the rest of the world which resulted from the relatively slow growth of primary exports could be offset little by little, at least in part, by an increase in the coefficient of intra-regional imports. It is, of course, impossible to make a reliable estimate of what this coefficient might be by 1975, but it can be approximately computed. If the figure at present is 1.5 per cent, it would be idle to suppose that it could rise to 9.5 per cent, and totally compensate the fall in the coefficient of imports from the rest of the world. The implication

of such a development would be that inter-Latin American trade, the figure for which is at present 765 million dollars,⁶ would increase more than seventeen times over. If it were to be multiplied eleven times, the coefficient would be 5.9 per cent and the approximate amount of trade 8,300 million dollars. This could perhaps constitute a reasonable common market target, so that the proposed task of regaining and steadily keeping up the aforementioned annual average rate of growth of the *per capita* product —2.7 per cent— might not be rendered extremely difficult, if not impossible, to accomplish.

4. Expansion of exports to the rest of the world

This, however, is not the only possible way of offsetting the decline in the coefficient with the rest of the world. There are two other alternatives, dependent mainly upon the trade policy of the great industrial⁷ centres *vis-à-vis* Latin America. These are (a) lower tariff protection for primary commodities and (b) encouragement of the region's industrial export trade.

As regards the first, very clear recommendations were formulated by the group of experts which the General Agreement on Tariffs and Trade (GATT) convened a short time ago to pronounce upon this and other allied problems.⁷ In so far as the Latin American countries are able to expand their primary exports, their industrial imports will also increase. It has already been pointed out in other reports that in all this an element of reciprocity is implicit; and experience demonstrates conclusively that in Latin America an increment in exports is followed very shortly afterwards by an upswing in imports. But these imports will not be of the same nature as before. A concomitant of economic development is the imperative need for their composition to be brought into line with the changes introduced in the internal structure of the economy.

This is a significant consideration from the standpoint of trade policy. The demands of economic development would not permit the customs tariff as between the Latin American countries and the rest of the world to be set in a specific and rigid mould. As progress is made in import substitution, modifications will have to be gradually introduced, because of the need to give protection to new substitution industries, although this will not affect whatever reductions of duties it may be possible to establish in respect of industries already in existence.

The other possible way of checking the downward movement of the import coefficient would be by exporting manufactures from Latin American countries to other parts of the world. It would seem somewhat paradoxical that these countries, which still need customs protection, should be able to compete industrially on the great centres' home ground. But this is exactly what is happening with respect to the countries of Western Europe in the United States market. What is more, there are even some Asian countries which are now developing their exports of textiles to countries in Europe. The development of this type of industrial trade depends upon the following two factors: on the one hand, Latin America's capacity to export, and, on the other, the willingness of the large centres to facilitate the corresponding imports by means of suitable tariff treatment.

As regards the first of these factors, the common market, by helping to lower costs, might boost certain lines of industrial exports. It must be acknowledged that hitherto the domestic market facilities created by import substitution policy have not given rise to any very impressive undertakings in the field of industrial exports to the rest of the world. Moreover,

⁶ Average for 1954-1956, in terms of dollars at 1950 prices. In this report monetary values are invariably expressed in dollars at 1950 prices; aggregate production and income figures can be converted into dollars at 1959 prices by raising them about 20 per cent. Figures for foreign trade, on the other hand, and for individual goods, have their own special deflators.

⁷ See GATT, *Trends in International Trade. A Report by a Panel of Experts*, Geneva, October 1958.

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. The return to the customs tariff as an instrument of protection, the lowering of intra-regional duties in some cases 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.

Clearly, the success of this policy would also depend upon a receptive attitude on the part of other countries, especially to advanced industrial centres. In some of these there are already signs of a trend towards employment of manpower in industries characterized by their high technical quality and relatively rapid growth, at the expense of others which could not stand up to competition on equal terms from similar industries in countries that have comparatively recently entered the field of industry. If the more advanced industrial centres in the rest of the world were to succeed in steadily maintaining a satisfactory rate of economic growth, and the momentum of technical progress continued carrying them on to increasingly complex and elaborate types of industry which would absorb manpower displaced from other activities, hitherto unsuspected prospects might be opened up for Latin America's industrial export trade.

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.

Clearly, then, Latin America common market policy, in the form in which it is conceived, far from inhibiting international trade, might actively promote it. It has been repeatedly shown that the tendency of industrialization in the past has been to increase trade among the countries that become industrialized rather than to restrict it, except when the process has developed in watertight compartments, as in the case of Latin America. But such encouragement of international trade is dependent not only upon the common market patterns contemplated here, and upon their favourable influence on production costs, but also upon a receptive attitude on the part of the industrial centres and upon the degree of efficacy with which commercial policy exploits these new trade possibilities as between the two groups.

In other words, 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. If Latin America's exports to these were still to consist mainly of traditional commodities, and these were to remain subject to the same restrictions that exist at present, the volume of imports from the great centres in question would be the same with or without a common market, and only their composition would be altered. But if a readjustment of trade policy were to improve the trend registered by these exports of primary commodities and at the same time open up the new prospects for industrial exports alluded to above, the trade expansion potentialities of the Latin American common market could materialize.

5. Import substitution and industrial growth

Given a specific rate of economic growth in Latin America, the development of such industrial exports would reduce the scale on which import substitution had to be promoted. Latin America would be using its own manufactures to pay for industrial imports which in other circumstances it would have to replace by domestic production in order to attain the rate of development in question. The possibility under discussion would in no way imply a slackening of the rate of industrial growth that would otherwise have to be attained.

This is an important point upon which it is worth while dwelling for a moment. First and foremost, it should be recalled that, from the standpoint of the labour force, industry, like other urban activities, has the dynamic function of absorbing the manpower which technical progress releases from agriculture and other primary activities, from artisan industries and from precapitalistic occupations with very low productivity. The more intensive is the technical progress achieved, the higher will have to be the rate of growth of employment in industry, if the effects of improved techniques are not to be frittered away through unemployment, or through under-employment, of such manpower as primary production and the other activities mentioned no longer require.

Consequently, the scale on which industry must fulfil this dynamic role of absorbing manpower is by no means an arbitrary matter, if a given rate of development of primary exports is assumed. Should trade continue to follow its traditional patterns and industrial exports fail to develop, a larger proportion of manpower would have to be employed in import substitution industries than would be the case if exports of this other type were promoted.

The proportions concerned are of decisive importance for the rate of increase of a country's availabilities of industrial goods for consumption and capital formation. The employment of a very high proportion of the labour force in substitution activities—that is, a low import coefficient—implies that a country is setting up all sorts of industries regardless of the advantages of specialization; so that the productivity of its manpower will be lower than might be the case if industry were rationally organized and could depend upon broader markets. For this reason, industrial employment itself may result in a larger or smaller output of goods, according to the degree of industrial specialization achieved.

6. The essential principle of reciprocity in inter-Latin American trade

The development of industrial exports to the rest of the world might be one of the derived consequences of the common market, although not its primary, direct and immediate objective, which is twofold, embracing: (a) the intensive development of industrial exports from each of the Latin American countries to all the rest, and (b) the provision of powerful incentives to traditional trade in primary commodities, so that national import substitution policy may be kept within reasonably economic bounds. If a country aspires to a rate of development more rapid than the slow pace imposed by the expansion of its exports, it has at present no choice but to substitute domestic production for everything that it cannot feasibly import. The common market would offer it another alternative: i.e., that of developing industrial exports to the other countries of the region so as to obtain from them goods which otherwise it would have been compelled to produce at home. Thus, instead of trying to establish all kinds of substitution industries, each country could specialize in those it deemed best suited to its natural resources, the aptitudes of its population and the possibilities of its own market; and it would resort to imports of industrial goods from the rest of the Latin American countries in order to meet other requirements which could not have been satisfied on the basis of purchases from outside the region.

All this raises problems of great importance for the operation of the common market. As has just been pointed out, the market offers an alternative to import substitution policy—that of buying from other Latin American countries industrial products which were formerly imported from the rest of the world, and increasing its exports to pay for them. This last point is of supreme significance. Substitution policy is not arbitrary, although in practice it may be arbitrarily applied; imports are replaced by domestic production for want of sufficient exports to finance them. The advantage of the common market lies in the opportunity that it would

afford for sales to other Latin American countries, from which the imports that could no longer be obtained from the rest of the world could then be purchased without difficulty.

If a country were unable to effect such exports to other Latin American countries on a sufficiently large scale, it would not reap the benefit of the alternative offered by the common market; and its situation might prove less favourable than would have been the case had the market not existed. A concrete example may be given as an illustration, to facilitate later discussion of the corrective measures that would have to be applied in order to ensure the satisfactory operation of the common market.

Let it be assumed that a particular country, given a certain trend in its export trade, needs to achieve import substitution to a value of 200 million dollars within a specific period. In default of a common market, the country in question would be compelled to establish all the industries necessary for the attainment of this purpose, whatever their degree of productivity. The common market would offer it an opportunity of diverting some of the import trade concerned towards other Latin American countries, and so limiting the amount it had to replace by domestic production. It may be further assumed that the figure for the import trade thus diverted would reach 150 million dollars, and that domestic production would be substituted for the remaining 50 million dollars' worth. This does not mean that the country in question would develop only the new substitution industries needed to produce those 50 million dollars' worth of goods; it would also have to be in a position to expand existing production, or establish other industries manufacturing exportable products to a value of 150 million dollars. In other words, apart from the growth of its current activities, the country's additional production would amount to 200 million dollars, with the consequent increase in employment of the factors of production. The economy would thus achieve a higher rate of growth than would have been the case had this alternative not existed owing to the greater productivity consequent upon industrial specialization.

What would happen if, instead, the country merely switched its import trade with the rest of the world to other Latin American countries? Simply this: its imports from within the region would total 150 million dollars more, and those from outside it 150 million dollars less, and the new industries established would be confined to those required for achievement of the import substitution figure (50 million dollars) mentioned above. No export industries would have been developed, nor would existing production have been expanded with a view to external sales, and consequently the economy would not have attained the rate of development at which it was aiming.

The reasons why a country might find itself in such a position will not be analysed here. If the result were that factors of production remained idle, import substitution amounting to the whole 200 million dollars would have been preferable to the unilateral diversion of its import trade towards other Latin American countries.

Thus there is an essential element of reciprocity in the common market, the absence of which might place some countries in a difficult situation; this topic will be reverted to later, since at the moment another aspect of the problem claims attention. The common market would permit the diversification not only of exports —inasmuch as exports of manufactured goods would be added to those of primary commodities— but also of imports. All this would help to lessen the external vulnerability of the Latin American countries.

7. External vulnerability

One of the paradoxes of Latin America's economic development is that countries that tried to reduce their vulnerability by means of industrialization have once again found themselves in a highly vulnerable position. This is attributable precisely to the fact that substitution policy has been implemented in sealed compartments. In the most advanced countries of Latin America the substitution process has been carried so far that imports have been cut down to such goods as are essential for the maintenance of economic activity. Thus, when the vicissitudes of the export trade lead to a contraction of the capacity to import, as there are no longer current consumer goods to which restrictions can be applied, these latter must inevitably be imposed on essential items themselves.

Hence the reduction of the import coefficient to very small proportions has involved a new kind of external vulnerability, formerly unknown. In the past, when exports and, therefore, imports accounted for a high proportion of income, there was always a wide reducible margin of imports when unfavourable foreign trade movements made this necessary; but, on the other hand, export fluctuations exerted a considerable influence on internal demand, which has been greatly weakened by the decline of the coefficient in question. In other words, the economy used to be vulnerable mainly on the demand side; now the principal source of its vulnerability is to be found at the other extreme, in the supply of essential imports, the curtailment of which is prejudicial to employment levels.

Comparison of this situation with that of the countries of Western Europe, whose import coefficient is higher, will reveal a very significant contrast. There, too, a change has taken place in the composition of imports, but, apart from their trade with the rest of the world, their intra-regional trade covers a very wide range of consumer goods, as well as essential raw materials and capital goods. The countries concerned have not been compelled to resort to arbitrary selection as have those of Latin America; and while it is true that in certain periods dollar shortages have necessitated severe restrictions, successful efforts have been made to prevent the group's reciprocal trade from being affected, at any rate to an equal extent, and this has enabled the same wide range of imports to be maintained. Thus, a country whose payments situation is persistently critical has a freedom of movement that the more advanced countries of Latin America have lost or are tending to lose.

The establishment of the common market would mean that the trade distortion described could gradually be remedied, and prevented from occurring in countries where it had not taken place. By virtue of progressive specialization, the common market would enable the member countries to supply one another's needs in respect of an increasing proportion of those goods which they had been obliged to refrain from importing, and this would allow them once again to diversify their external purchases from outside the region. No backward step is involved; technical progress and changes in habits and tastes are continually introducing new consumer goods, or new varieties or features in those which already exist, and, as inter-Latin American trade developed, room could gradually be made for these new imports. In addition, the promotion of industrial export to the rest of the world would give an increasing impetus to this salutary process of rediversification of imports.

Furthermore, intra-regional trade in consumer manufactures could be developed within the common market. It is true that stress has been laid here on those goods in respect of which import substitution would have to be promoted in the more advanced countries —raw and intermediate materials, capital goods, motor vehicles and other durable goods— but this would not preclude the additional undertaking of a specialization effort in certain consumer industries which already exist, particularly in cases where the growth of demand facilitated

this course. Moreover, it would often be through the development of consumer industries that the industrial exports of countries in the initial stages of development could participate in the common market.

In this way the composition of imports would gradually acquire the element of flexibility which it has been losing little by little as a result of the special form assumed by substitution policy in Latin America. External vulnerability would then be considerably lessened, since a judicious margin for import restriction would have been re-established.

However, so far as their intra-regional trade is concerned, it may be hoped that, if a satisfactory payments and credits system were instituted along with the common market, the Latin American countries would be able to withstand trade fluctuations without having to make use of the margin for restriction in any but extreme cases.

8. Absolute necessity for the intensive development of capital goods industries

There are two closely interrelated factors that hinder the acceleration of Latin America's economic development: the relatively slow growth of exports of goods and services and the limitations of the capacity to absorb foreign capital. The organization of the common market would offer a means of tackling the serious problem created by this state of affairs. As was shown in the preceding section, the existence of the market would mean that import substitution policy, in respect of goods from the rest of the world, could be rationally implemented through suitable forms of inter-Latin American specialization, with a view to countering the effects of the slow development of primary exports. But, in addition, thanks to the common market, it would be possible to combat the serious difficulties deriving from the above-mentioned limitation in the capacity to absorb foreign capital.

In reality, this limitation is one of the effects of which the slow growth of exports is the cause. As the stock of foreign capital increases, the burden of financial services also becomes heavier, and gradually claims an increasing proportion of export earnings; and the larger the share of these services, the narrower will be the margin for utilizing such resources to import capital goods. At the present time, about 15 per cent of the total value of Latin America's exports to the rest of the world is absorbed by services payments, including amortization. Experience would seem to suggest that 30 per cent of exports ought to be the maximum for financial services.

The next step is to estimate the quantity of capital goods that might be imported by 1975 if this maximum were reached, on the basis of reasonable assumptions as to the possible change in the composition of imports by major categories of goods, as indicated by the following data:

■ **Table 1**

PROJECTION OF RELATIVE COMPOSITION OF IMPORTS^a (Percentages)

	1955	1975
Consumer goods	25.0	58.5
Intermediate goods	40.0	
Capital goods	35.0	41.5
	100.0	100.0

^a These data refer to imports from outside the region.

The assumption here is that the proportion jointly absorbed by consumer and intermediate goods would contract in order to leave more room for imports of capital goods, which would thus increase from 35 to 42 per cent of the total. This would mean that the figure for imports of machinery

and equipment could rise from 2,000 million to 3,700 million dollars. But as the expansion of demand for such goods would be much greater, these lines of production would have to develop in Latin America at a very rapid rate, as can be seen from the following supplementary table:

■ **Table 2**

PROJECTIONS AND SATISFACTION OF DEMAND FOR MACHINERY AND EQUIPMENT

(Millions of dollars)

	1955	1975
Imports	2000	3700
Production in Latin America	200	5400
Demand	2200	9100

The region's output of machinery and equipment is at present relatively small. According to approximate estimates, its value amounts to some 200 million dollars for the whole of Latin America, excluding the manufacture of spare parts and repair work, which attain considerable figures. To satisfy the increment in demand, production would have to expand at an annual rate of 18 per cent and reach about 5,400 million dollars by 1975, which would mean its increasing 27 times over, whereas aggregate industrial output would be quadrupled.

If these projections were fulfilled, production of such capital goods in Latin America, which at present satisfies about 10 per cent of demand, would cover some 60 per cent by 1975.

These estimates are not, of course, forecasts, but are formulated merely for illustrative purposes, and give an approximate idea of the magnitude of the production effort required in the field of machinery and equipment, on the hypothesis that up to 1975 the region's capacity for absorption of foreign capital will be utilized to the maximum.

In any event, even if the assumption adopted is the most moderate as regards absorption of foreign capital and the most optimistic as to the possibilities of importing machinery and equipment, it is obvious that the substantial development of Latin America's production of these goods is an indispensable prerequisite for the attainment of an economic growth target such as is postulated in this report.

Machinery and equipment industries, therefore, will have to be given high priority as regards foreign capital investment, so that the region's own resources may suffice for the maintenance of a high rate of capital formation. Thus, the supremely important role incumbent upon foreign capital during the next few years will be that of helping to create such conditions as will permit the intensive growth of the Latin American economy on the basis of its own resources.

From another point of view, the fact that the structural changes which must be introduced into industrial production open up a promising field for foreign investment does not imply that Latin American enterprise and capital will cease to be keenly interested in the promotion of such industries. On the contrary, one of the essential points in common market policy ought to be the provision of both technical and financial assistance whereby the Latin American entrepreneur may be encouraged to forge resolutely ahead in these new lines of production. In this and other connexions a statement made some years ago in a report presented to the Rio de Janeiro conference is still of topical interest.⁸ It was said at that time that the situation of Latin American entrepreneurs "is unquestionably inferior to that of their foreign counterparts, and any effort to decrease this difference will have marked effects upon economic development, and the functioning of the free enterprise system".⁹

⁸ Meeting of Ministers of Finance or Economy, at the IVth Extraordinary Meeting of the Inter-American Economic and Social Council of the Organization of American States, held in November 1954. See *International co-operation in a Latin American development policy* (E/CN.12/359), United Nations publication, Sales No. 1954.II.G.2.

⁹ *Ibid.*, p. 31.

9. Special situation of agriculture

Attention has already been called to the dynamic role incumbent upon industry from the standpoint of the distribution of manpower: that of absorbing the manpower which the progressive introduction of improved techniques releases from primary production, as well as from artisan industry and other pre-capitalistic activities where productivity is unsatisfactory.

If industrial production were to be quadrupled by 1975, in accordance with the projection postulating an annual increment of 2.7 per cent in *per capita* income, the proportion of the active population employed in agriculture, which is at present about 50 per cent, would fall to approximately 36 per cent. (This figure relates to Latin America as a whole. There are countries in which the corresponding proportion is and will continue to be very high.)

This leads to the consideration of another very important aspect of the question. The agricultural population falls into two broad categories: (a) those working in agriculture for export; and (b) those engaged in supplying the needs of the domestic market. In agriculture for domestic consumption, out-of-date methods of farming and a very low level of productivity usually prevail, while in addition the soil is often impoverished by long periods of unremitting cultivation during which nothing is done to review its productive potential. These are some, though not all, of the reasons why in certain cases protectionist measures have to be adopted to enable agriculture for domestic consumption to withstand foreign competition.

The sudden impact of such competition as a result of the creation of the common market would unquestionably have a far-reaching effect upon these protected activities. Where would the manpower displaced from them turn for employment? What would be done with the land that would thus be left unused?

The above-mentioned estimate of the percentage decrease in the manpower employed in agriculture is based on existing activities and on the assumption that production will continue to expand by virtue of the progressive introduction of improved techniques. The development of industry would have to be on a still larger scale than in the projections formulated, with the consequent increase in the rate of growth of the *per capita* product, if manufacturing activities had also to absorb a substantial volume of manpower displaced from agriculture by external competition.

Industrial development on such a scale, however, would imply a very considerable effort, and it would be unwise to base common market policy on the assumption that higher rates of growth will be achieved, although the existence of such a possibility should be recognized. Hence a special criterion must be adopted in tackling the problem of agricultural production, as in the case of the Western European common market and the Scandinavian project. It would be ill-advised to contemplate the reduction or abolition of existing customs protection, without a readjustment of production in accordance with a carefully devised programme for agricultural development and the improvement of farm techniques. This does not imply that the common market would not influence the situation as it stands at all. Certainly it might. In fact, it would open up a possibility which is almost non-existent at present —that of importing an agricultural commodity at a cost lower than that of the domestically produced item— in exchange for exports either of other primary commodities or of industrial products. In other words, the common market would afford an opportunity, in the first place, of gradually readjusting current production with a view to more efficient land use in combination with imports; and, secondly, of at least controlling the advance of customs protection in the face of competition from other Latin American countries, when the problem of internal supplies could be more satisfactorily solved by means of intra-regional trade.

The caution alluded to earlier is not in reality incompatible with the extensive development of inter-Latin American trade in agricultural commodities. Such trade at present amounts to about 400 million dollars, of which 300 million are accounted for by eleven specific items. In the projections presented in the report mentioned above,¹⁰ it is estimated that trade in these eleven items might increase to about 1,100 million dollars by 1975, without detriment to those lines of production which currently enjoy customs protection; it would be enough if the future growth of consumption allowed a sufficient margin for expansion of imports from other countries, in accordance with the alternative just referred to.

From another point of view, as progress is made in the introduction of more advanced techniques and the productivity of land and labour increases, substantial changes may take place in present cost relationships, and certain lines of production now requiring protection may thereby be placed in a position to compete.

¹⁰ See footnote 5.

TOWARDS A NEW TRADE POLICY FOR DEVELOPMENT *

Raúl Prebisch

* Selected pages (43 - 52, 55 - 58, 65 - 75 and 79 - 89), in United Nations, Towards a new trade policy for development. Report by the Secretary-General of the United Nations Conference on Trade and Development (E/Conf.46/3), New York, United Nations, 1964.

I. PRIMARY COMMODITY EXPORTS

A. The question of price

1. The redistribution of income in international trade

There are at present three major problems relating to international trade in primary commodities: the question of prices; access to the markets of the industrial countries; and agricultural surpluses and their utilization in development policy.

The phenomenon of the deterioration in the terms of trade affecting primary commodity exports is understood better today than it was a few years ago. The difficulties of other countries are usually better appreciated when they arise in one's own country.

As explained in part One, primary production tends to increase beyond the limits of what is required by the relatively slow increase in demand. As a result, there is a tendency towards deterioration in the terms of trade; this tendency is aggravated by the effects of technological progress on the volume of production.

The industrial countries have been able to observe that, if market forces were allowed free play, shifts in the terms of trade between agriculture and industry would have distinctly regressive effects on the internal distribution of income. The primary producers would be deprived of part of their real income because of the drop in relative prices and this loss of income would, in general, be all the greater as productivity increased as a result of technological progress. In order to avoid that situation, steps have been taken to support prices of, or income from, agricultural products. Such measures of support are also necessary at the international level with respect to primary commodity exports.

This better understanding out of the problem is no doubt one reason for the recent more favourable attitude of great industrial nations towards commodity agreements. The conclusion of the International Coffee Agreement is an example of this, even though it is still early to pass judgement on its implementation. Similarly, whatever may be thought of particular features of the French plan for the organization of markets,¹ the plan seems to be based on the conviction that it is necessary to intervene at the international level in order to avoid, or at least attenuate, the consequences of the regressive redistribution of income which has been taking place between developed and developing countries. These new attitudes are not, however, established as yet on a completely firm basis. To create such a basis is one of the primary objectives of the Conference.

The achievement of this objective requires that the industrial countries which import primary commodities should be prepared to consider an extremely important policy decision, namely, to take such measures as would prevent this regressive redistribution of income in the international field. It is to a consideration of the factors on which such measures must be based that we now turn.

¹ See document E/CONF.46/P/5.

2. Prices, market forces and demand

It is necessary, in the first place, to face up squarely to the fact that the international prices of primary commodities would, in general, have to be supported at levels higher than those which would prevail in the absence of international regulation.

The price mechanism cannot fulfil its traditional functions when most transactions in particular commodities are subject to government regulation at the national level, so that world prices are determined in a very narrow residual market that cannot be regarded as representative of the real market forces. Speaking generally, the smaller the share of the total supply of a particular commodity that is exported, the larger the spread that is apt to develop between prices in the various national markets subject to regulation and the greater the difference that arises between national prices and world market price. The small proportion traded is not, of course, in itself a cause of these disparities: rather it reflects the protection and mutual isolation of national markets which make it impossible for international trade and competition to perform their normal equilibrating functions.

Thus the prices realized on the world market reflect the existence of temporary imbalances between supply and demand outside the main regulated markets: such prices cannot therefore offer a sound basis for determining the level of commodity prices to be included in inter-governmental agreements.

This situation prevails particularly in the case of temperate-zone agricultural products grown by the industrial countries largely for their own consumption and insulated from the world market by various types of price-support measures. In 1959-61, less than 20 per cent of world production of these goods was traded internationally. This proportion stands in contrast with ratios characteristic of tropical products, where the proportion of production traded internationally is high.

Although world market prices are more meaningful for the tropical and mineral exports of developing countries than temperate products, they none the less do not provide valid guidance for decisions by producers or by the Governments concerned, though for a different reason from that mentioned in connexion with temperate-zone products. For instance, in situations in which resources devoted to agriculture or mining have little or no alternative employment and in which the response of producers to a decline in prices may, in some circumstances, be an expansion rather than a contraction of output, the price mechanism is as incapable of operating in the normal manner as it is in the case of the residual markets discussed above.

It is for these reasons that it is no longer possible to take the view that commodity agreements should not interfere with the long-term operation of underlying market forces through the price mechanism. Where prices are determined in the context of abnormal restrictions on trade, in fact they no longer reflect the operation of market forces. Under such conditions, it becomes necessary to bring about, on a permanent basis, a confrontation of the production policy and the trade policies of the various countries in order to arrive at solutions satisfactory to all.

It is recognized, of course, that prices cannot be set at any level in a completely arbitrary manner. A number of considerations have to be taken into account, notably the effect on consumption. When domestic prices in the importing countries are higher than world market prices, it would be possible to raise the latter through international agreements without affecting the prices paid by the consumer. It is clear that, where import taxes or internal levies exist with respect to imported primary products, the reduction or elimination of such charges would be necessary if prices to the consumer were not to be raised.

In the case of some tropical products, prices to consumers could be increased reasonably, without appreciable reductions in the quantities consumed. Moreover, in most cases in which such products are subject to heavy domestic taxes, world prices could be raised without any increase in the price to the consumer, provided that the internal taxes were reduced accordingly. Indeed, in some cases, these internal taxes are so high that, if they were eliminated, it would be possible not only to raise export prices but also to effect a significant reduction in prices paid by consumers, which would naturally have a very beneficial effect on consumption.

In particular, where commodities exported by developing countries compete with output of the same commodities in developed countries, or with similar natural, synthetic or substitute products, it will be evident that the ability to raise or maintain prices depends on the co-operation of the developed countries. Even where developing countries are sole producers of a given commodity, lack of agreement among these countries themselves, or differences of interest between members of various preferential systems —as well as between them and non-members— may make concerted action to raise or maintain prices difficult to achieve.

Particularly difficult problems arise in relation to synthetics. It has been estimated that more than one third of the increase in the consumption of industrial raw materials in the developed countries between 1953 and 1961 consisted of synthetics and aluminium,² and the relative displacement of exports of developing countries was almost certainly even greater than this would imply.

How is that competition to be faced? In no circumstances could we seriously entertain the thought of restraining technological advances. That does not mean, however, that it is advisable to encourage certain types of research which should not, for the time being, enjoy any priority whatsoever, as, for instance, research into substitutes for coffee. Moreover, in some cases, the transition might be made easier for the producing countries if minimum proportions were established in the use of the natural product, just as minimums are fixed in some cases in the use of certain national primary products in relation to imported commodities.

On the other hand, it is argued that the competition of synthetics or substitutes should be countered by technological improvement in the production of the natural product. For example, there appear to be encouraging prospects for developing certain properties of wool which, in addition to the natural qualities of the product, might enable it to compete favourably with artificial fibres. It is also pointed out that there are possibilities of increasing productivity and reducing prices in order to come out ahead in competition, and natural rubber is mentioned as one of the products in which that objective could be attained. It is evident that we should then be confronted by a case in which the benefits of technological progress would be transferred abroad in the form of lower prices corresponding to lower costs, which would only be acceptable if it was accompanied by a substantial increase in export volume.

Problems also arise when natural products exported from developing countries compete with identical or similar commodities produced in the industrial countries. Efforts to raise the prices of cane sugar and of tropical oils and fats, for example, would be faced with the difficulty that these products compete with beet sugar and oils and fats produced by industrial countries.

Each particular case will need special consideration. Here we may note, however, that wherever it is found impossible or inadvisable to raise or maintain prices to the extent required to avoid deterioration in the terms of trade, as in the case just mentioned of competition between certain natural products and synthetics, it will be necessary to resort to compensatory financing, as will be explained in the relevant chapter below. In other words, it will be necessary to achieve indirectly whatever cannot be secured through direct action on prices.

² Based on data communicated by Mr. A. Maizels, National Institute of Economic and Social Research, London.

The means employed for maintaining or raising prices will generally have to include the regulation of supply, involving export quotas and possibly import quotas as well.

This would appear to be inevitable, if the measures for raising prices restricted consumption to any appreciable extent. This could happen if the countries importing a primary commodity imposed import duties in order to transfer the corresponding income to the producing countries, so as to compensate them for losses resulting from the deterioration in the terms of trade. If consumption were to fall because of the rise in internal prices and exports were not regulated, international prices would decline; and thus the exporting countries themselves, instead of benefiting, would pay the duty in whole or in part. The same would happen if, instead of import duties, export taxes were levied in the producer countries.

Lastly, it should be recognized that an international commodity agreement that sets reasonable prices for primary exporters should also contain provisions involving appropriate action to be taken when and as shortages occur by setting ceiling prices in the latter eventuality. This would not only provide protection to consumers but would also be of long-run benefit to producers since unreasonably high prices would stimulate excessive production which, in turn, could lead to low prices for producers.

3. The effect of higher prices on production

One of the most cogent arguments against raising the prices of primary commodities is that such increases would stimulate production. If a deterioration in the terms of trade results from the difficulty of adjusting the volume of production to the slow expansion in demand, the difficulty would be even greater if the rise in prices provided additional incentives for increasing production.

Developing countries have acquired sufficient experience in fixing prices to producers at levels different from those prevailing on the world market. Where government trading agencies have been employed, prices received by producers have generally been different from those in force in the international market. In addition, wide-spread use has been made of export taxes and multiple exchange-rate systems. The motives for such policies have been various and have included such goals as the stabilization of producer prices; the protection of consumers from sharp changes in the cost of living; the expansion of government revenue; and the containment of inflationary forces.

If, therefore, it were decided in a particular case that the international price of some commodity might be raised above the current level through intergovernmental agreement, and that the additional proceeds should not accrue to individual agricultural producers, there is abundant experience for implementing such a decision.

The idea of not allowing price incentives to encourage over-production ought also to be applied to importing countries. As explained elsewhere, the policy of agricultural protectionism in many western European countries has resulted in very high prices, making it profitable to farm high-cost marginal land, to the detriment of imports. There is a danger that this process may be intensified during the negotiations pending within EEC. It has been estimated³ that, on alternative income assumptions, EEC grain imports would average between 8.4 million and 10 million tons by the end of the present decade, at unchanged producer prices. If, however, French grain prices rose by 20 per cent in the movement towards a common price level, EEC imports would fall, on the same income assumptions, to between 2.9 million and 4.5 million tons by that time.

³ *Agricultural Commodities and the European Economic Community*, prepared by the FAO secretariat (E/CONF.46/45, pp. 6-7).

Every country is entitled to redistribute its income internally as it deems most fitting from the economic and social point of view. That cannot be a subject of international discussion. But it is possible to discuss the means employed to that end. There are some methods which have purely internal effects and are unobjectionable, but there are others which resolve domestic difficulties by aggravating the problems of other countries. If instead of resorting to high prices, additional revenue were to be paid to the producer without being linked to the volume of his output, it might be possible to attain the social objective sought, namely, to effect a redistribution of income without stimulating production. EEC has itself been considering the idea of utilizing subsidies instead of high prices in supporting the agricultural economy.⁴

Domestic price policy, as pointed out above, is closely related to the demand for imports. Any commodity agreement or other international measure agreed upon in connexion with trade in primary products would have to prescribe minimum import quotas or commitments by the industrial countries. There would be no point in agreeing on higher prices for internationally traded primary commodities only to find that the volume of commodities demanded was declining and perhaps tending to disappear altogether owing to the growth of domestic production in the industrial countries.

This problem is reflected in the French plan for the organization of markets in the recognition that the development of agricultural production in EEC might tend to generate agricultural surpluses; and the plan recommends the sale of such surpluses on concessional terms as a form of aid to developing countries. A number of problems would arise as regards the financing of such sales. But, in any event, it should be understood that there would be a need for firm commitments guaranteeing access to imports from the developing countries, even if such imports had the effect of increasing the volume of surplus supplies to be disposed of on concessional terms. The whole matter should, moreover, be dealt with through concerted action at the international level.

B. Acces to markets

1. The restriction of imports

As stated earlier, the establishment of prices higher than world market prices, as well as measures for compensatory financing, must be linked with access to markets. The reason for this is not merely that imports might fall when prices rise, but the fact that this rise in prices would be borne mainly by countries that pursue a liberal import policy and which would therefore have to shoulder a heavier financial burden than countries applying a restrictive import policy.

The problem of access to markets must be viewed broadly; it is not merely a matter of the policies being pursued by members of EEC or of EFTA but of long-term trends which may be traced back to the inter-war period. Likewise, it is not merely a matter of the tendency of supported agriculture in western Europe to become more and more self-sufficient, but also of the tendency of supported agriculture in the United States to develop larger and larger excess supplies.

If we go back to the period preceding the great world depression, it will be seen that the subsequent increase in the imports of primary products by western Europe has been extraordinarily small. Between 1927-1929 and 1958-1961 imports (excluding petroleum) of the most important commodities increased by barely 13 per cent during the entire period, whereas consumption⁵ rose much more sharply: per capita imports of these products actually dropped by 2 per cent.

⁴ See European Economic Community, Commission document VI/COM(60) 105 (provisional edition), part II, para. 11.

⁵ Full data on meat consumption do not exist for the early years. Excluding meat and petroleum, consumption of the other primary commodities rose by 52 per cent and imports by 16 per cent during the period mentioned.

These developments can be explained mainly by the import trend in cereals, meat, fibres and sugar. Imports of cereals in 1958-61 amounted to 21 per cent less, and imports of meat to 24 per cent less, than in the years preceding the great depression. The falling-off in imports of those two groups of commodities is attributable to a combination of protectionism and the technological revolution. Imports of fibres dropped by 12 per cent as a result of competition from synthetics. Imports of sugar were 30 per cent higher, but consumption rose by 87 per cent in the western European countries taken as a whole.

The contrast between agricultural products, on the one hand, and minerals which western Europe does not produce for itself, on the other, is very striking and indicates the possibilities for increases in imports where protectionism is less significant. Western European imports of metals and ores rose by over 160 per cent from 1927-1929 to 1958-1961 and imports of petroleum have risen twenty-two-fold, as shown in the following table.

The same table shows the figures for the United States. Gross imports there increased much more than in western Europe, and also more rapidly than consumption. The table does not, however, provide a valid basis for overall comparison with western Europe because the United States is a major exporter of primary products and its exports have increased as well as its imports, and also because of differences in population growth.

2. Possibilities for effective action

Consideration should now be given to the action that might be taken regarding the facts outlined above. In view of the legitimate interests of both industrial and developing countries, the first minimum policy objective regarding grains might be a standstill agreement: importing countries might, under a contract similar to the International Wheat Agreement, undertake to maintain existing access to markets, and exporting countries might undertake not to increase pressure on world markets through surplus disposals and to reduce export subsidies.

In the case of western Europe, total grain production now represents about 90 per cent of consumption; it would therefore be desirable to ensure at least that the proportion of 10 per cent currently imported is maintained for cereals as a whole. This could not apply to wheat alone since, as income increases, per capita consumption of wheat tends to decrease. In the case of forage cereals used for feeding livestock, however, there could be a large increase in consumption, since meat consumption rises considerably as per capita income advances. It is clear the attainment of this objective of maintaining the ratio of imports to consumption depends, as we said earlier, on domestic policy regarding prices and surpluses.

For other products, the objective should be greater access to markets wherever possible. There are cases in which agricultural production in both western Europe and North America is high-cost and ought to be readjusted gradually so as to provide greater opportunities for exports from developing countries. Prominent among such commodities is sugar but there are many others, including fats and oils. New taxes or duties affecting imports of primary products from developing countries, such as that now put forward in EEC with respect to margarine, should certainly be avoided. At the same time, improved access should be provided for tropical products in western Europe and for minerals in the United States, involving the gradual removal of existing restrictions, including import or domestic levies of one kind or another.

It would scarcely be possible for the Conference to consider individual commodities in detail. It might, however, consider the advisability of:

■ Table 3

UNITED STATES AND WESTERN EUROPE: RELATIVE GROWTH OF CONSUMPTION AND IMPORT
(Indices, 1927-29=100)

Commodity or commodity groupings ^a	United States				Western Europe			
	Total consumption		Gross imports		Total consumption		Gross imports	
	1953-37	1938-61	1933-37	1938-61	1933-37	1938-61	1933-37	1938-61
I								
Cereals		96	120	89	138	151	74	79
Meats		217	136	1,077	—	—	78	76
Fibres	133	131	171	173	103	99	91	88
Copra and coconut oil		98	91	97	122	96	122	99
II								
Tobacco	181	204	166	216	131	162	99	108
Coffee, cocoa and tea	163	176	170	179	125	153	121	143
Sugar	133	149	100	113	159	187	142	130
Bananas	114	140	114	141	194	266	194	236
Metals and ores	222	220	172	156	214	260	208	263
Rubber, natural	139	114	126	106	356	255	343	264
Petroleum, crude	863	872	526	576	1,600	2,402	1,500	2,277
III								
Average (including petroleum) ^b	167	172	167	176	167'	179*	126	141
Average (excluding petroleum) ^b	131	136	145	151	149*	152'	108	113

Source: *United Nations, World Economic Survey, 1958, updated.*

^a The commodity groupings contain the following commodities: *cereals* (wheat, rice, barley and maize); *meats* (beef and veal, mutton and lamb); *fibres* (cotton, wool and jute); *metals and ores* (aluminium, copper, lead, tin and zinc).

^b Weighted throughout by 1962 average export unit values.

^c Excluding meats.

(a) Taking action to provide greater access to markets in industrialized countries, partly by means of import targets that increase as consumption rises, and partly by the removal of various barriers to trade in primary commodities, including consumption taxes, tariffs and import quotas;

(b) Setting certain quantitative import targets in the form of commitments to purchase entered into by importing countries and specifying quantities or prices. This provision could be tied to a guarantee given by exporting countries to provide the importing countries with adequate quantities, thus ensuring supplies of essential foodstuffs and raw materials for the latter countries in times of shortage.

All this would constitute one of the most important and urgent functions to be discharged within the new organizational scheme which is suggested later in this report. Once this policy of setting targets was approved in principle, it would be necessary to make specific proposals concerning these targets and the ways in which they could be put into effect.

The adequacy of such targets in relation to the export needs of developing countries depends, of course, on the willingness of the industrial countries to make significant modifications in their domestic policies. The case of Sweden provides a striking illustration of a country that has been able to raise the productivity and incomes of its agricultural population without being forced into a policy of self-sufficiency thereby. The Government has adopted as a deliberate objective of its policy the reduction of agricultural output to a level corresponding to 90 per cent of domestic consumption requirements. Swedish agricultural prices, though above world market levels, reflect changes in the pattern of world prices, and are set on the basis of the calculated revenues of well-managed farms. Small farmers receive additional cash payments, but the payments are limited to the current farmers' period of occupancy and do not devolve upon their successors.

A variety of other measures could be introduced to facilitate a scaling down of inefficient agricultural operations in the industrial countries, ranging from the withdrawal of high-cost marginal land from cultivation, to the retraining of agricultural manpower for new occupations. These matters have been the subject of recommendations by FAO and the Organization for European Economic Co-operation (OEEC).⁶

C. International commodity agreements

1. Recent experience

So far as commodity agreements are concerned, experience since the end of the Second World War reveals many positive elements and a progressive evolution towards a more favourable framework for international commodity trade. But even more vigorous action is required.

It is not so much a question of creating new machinery, as of adapting the existing machinery to the needs of a policy in which the objectives pursued are more clearly and more fully defined.

The Havana Charter recognizes that international commodity trade is subject to difficulties resulting from persistent disequilibrium between production and consumption. The Charter also refers to measures designed gradually to reduce any unwarranted disparity between world prices of primary commodities and those of manufactured products.

Nevertheless, the Charter gives a rather narrow definition of the circumstances in which commodity agreements may be applied. But nowadays these problems exist on a greater scale and, generally speaking, the view is held that commodity agreements should include suitable measures relating to the various aspects of international trade, especially the fixing of minimum prices, access to markets, and surplus disposal. Notwithstanding this progress, it has so far proved possible to establish international commodity agreements for only five products: wheat, tin, sugar, coffee and olive oil.

Among the difficulties facing countries seeking to formulate these agreements has been the fact that, when export prices are high, many of the exporting countries are less interested in reaching agreement and importers consider that their bargaining position would be better at another time. And, when prices are low, the opposite applies.

From another standpoint, the Havana Charter provides for equal representation of importing and exporting countries. This does not take into account the fact that, under normal

⁶ See, for example, FAO, *An Inquiry into the Problems of Agricultural Price Stabilization and Support Policies* (Rome, 1960), and "Agricultural Policies in Europe in the 1960s", *Monthly Bulletin of Agricultural Economics and Statistics* (Rome, January and February 1963); and OEEC, *Trends in Agricultural Policies since 1955*, Report by the Ministerial Committee for Agriculture and Food (Paris, 1961), chapter V.

conditions, exporting countries have a much larger stake than importing countries in the operation of an agreement because their total export incomes are usually largely dependent on trade in the commodity concerned.

The effort to conclude commodity agreements can hardly succeed so long as such agreements are regarded simply as a compromise between the interests of exporting and importing countries and if they are based mainly on the idea of dealing with market fluctuations. Apart from the understandable interest in having lower prices for the commodities they import, there are at least two aspects to be taken into account by the importing countries. The first involves recognition of the fact that, as the export incomes of the developing countries fall because of the drop in prices, their demand for exports from the industrial countries also declines. The second aspect to be taken into account is the unfavourable impact of low commodity prices upon the growth of the developing countries, and hence upon the general outlook for political and economic well-being throughout the world.

Part of the difficulty surrounding the negotiation of commodity agreements lies in the fact that these aspects of the problem are not always given the consideration they deserve. More of these agreements —and more comprehensive ones— could possibly be concluded if these aspects carried greater weight during the negotiations. But this obviously requires a clear statement of the policy to be followed in respect of primary commodities.

The sort of problem that is apt to arise may be illustrated from experience with attempts to negotiate commodity agreements for coffee and cocoa. It appears that for several years it was impossible to negotiate a commodity agreement for coffee because the point of view of the importing countries was largely influenced by commercial interests. However, as a result of the sharp declines in coffee prices during the latter part of the 1950's and the serious impact of these declines upon a large number of Latin American countries, the importing countries began to take a broader view of the problems relating to the regulation of world trade in coffee. This recognition of the issues made it possible for an agreement to be reached embodying the concept of supporting the price of coffee at the 1962 level.

The precedent set in the coffee negotiations aroused expectations that a similar outcome might be reached for cocoa. However, this favourable attitude towards commodity agreements does not appear to have extended to the case of cocoa. Fewer countries were seriously affected by the outlook for this product, and the cocoa problem therefore did not have the same impact in the higher governmental echelons of the importing countries as had the coffee problem. The result was that considerable difficulty was experienced in reaching a meeting of minds on prices. Under these conditions it was, perhaps, inevitable that the negotiations should fail. This breakdown is a great disappointment, and it is to be hoped that the outlook will improve in the future.

2. The broadening of commodity agreements

What is required is that Governments should formulate their policies in this matter and thus provide a frame of reference within which negotiations can be carried out; in other words, there must be a political will to reach these agreements and a desire to carry them out. There can be no doubt that the obstacle here is primarily political rather than technical.

In the first place, a major effort should be made to increase considerably the number of commodities regulated by inter-governmental agreements.

It is important, moreover, that the preparatory work for the formulation of new commodity agreements and the negotiation of such agreements should be vigorously pursued irrespective

of current market conditions. In the case of a number of commodities, steps are already under way. The United Nations Cocoa Conference will, it is hoped, be reconvened as soon as there is an indication of better prospects for agreement. Draft agreements on cotton and rubber were discussed some time ago. The International Lead and Zinc Study Group is also considering the drafting of an agreement. A study group on copper has been suggested and tungsten problems are now receiving inter-governmental consideration in a United Nations committee. Certain agricultural commodities are being considered by FAO groups.

From the technical point of view, considerable importance attaches to the study of the problem of standardisation and the development of a mechanism for setting up price differentials between various commodity grades, as has been done successfully in the case of wheat.

As was stated earlier, commodity agreements should also be more comprehensive and cover the various aspects of international trade in the commodities concerned. There is already a trend towards this broader approach. For example, the International Coffee Agreement contains an article concerning the removal of obstacles to trade; the International Tin Council has been undertaking negotiations regarding the disposal of non-commercial stockpiles; and the International Wheat Agreement provides for an annual review of international trade in wheat which could influence the determination and implementation of domestic production and price policies.

The latter development is particularly important since one of the main shortcomings of commodity agreements so far is that they have only dealt with international trade in the commodity concerned and, in some cases, with only part of this trade; thus other very important aspects, e.g., the policy of support prices, have been neglected and the consequences have not always been compatible with the interests of other exporting countries.

Under the Havana Charter, no agreement is to remain in force for longer than five years, and the principal objective has been to deal with short-term difficulties or special temporary problems rather than to create conditions for the long-term expansion of commodity trade at stable prices.

In short, there needs to be greater recognition of the role of commodity agreements in the production and trade policies of both exporting and importing countries; the possibility of increasing consumption of primary products and of thus improving long-term prospects should also be further explored. A movement in this direction has already begun with the setting up of a publicity fund under the Olive Oil Agreement, and with the various provisions for promoting consumption contained in the International Coffee Agreement. Reference was made earlier to the possibilities that research may open up new uses for wool; and similar research might well be undertaken for other commodities. This is a field in which international resources might well play an important role.

Some thought might also be given to those commodities for which no agreements are at present envisaged, particularly in cases where they are subject to regulatory measures at the national level. Inter-governmental consultations should be held on these measures, with a view to arriving at solutions in the common interest.

Much of the machinery necessary for a broader and more vigorous commodity policy already exists in embryo, in the form of study groups and similar bodies and commodity commissions of the United Nations and FAO, what is needed is a clearer sense of the objectives to be achieved and of the policy to be followed, and a simplification and unification of structure.

All this would have to be the subject of further study in the event that the Conference agreed in principle on the need for such a policy.

D. The question of preferences

1. Meaning of the problem

In order to stimulate exports of industrial products from developing countries, two types of measures are required. In the first place, channels to the markets of the great industrial centres should be opened through the elimination of obstacles to the flow of exports. Secondly, the active promotion of exports should be undertaken both in the developing countries themselves and on the international plane.

The existing obstacles to exports have just been examined. But it is necessary to go further and introduce a system of preferences.

The case for preferential treatment for exports of developing countries is that it would help the industries of developing countries to overcome the difficulties that they encounter in export markets because of their high initial costs. It is a temporary measure which, by opening up larger markets to the industries of developing countries, would enable them to lower their costs and thus compete on world markets without the need for continuing preference.

The case is thus a logical extension of the infant industry argument. It is not a matter of controversy among economists that national protection of infant industries is justifiable wherever such industries have a long-run prospect of reaching a high level of efficiency.

In order to be efficient, those industries must have access to wider markets; otherwise they may not be able to break out of the vicious circle of low output and high costs. Such markets must be sought in the developed countries as well as in other developing countries. But if infant industries need protection in the domestic market because of high costs, they obviously need even more protection in foreign markets, whether developed or developing, in the form of preferential treatment. It is for this reason that the following two suggestions have been made: (a) developing countries should give preference to imports from other developing countries in their own markets; (b) developed countries should give preference to imports from developing countries in their own markets.

The two suggestions raise somewhat different issues. The main features of the first have already been outlined, and the following discussion will concentrate on the second.

As was said earlier in this report, GATT sanctioned the continuation of preferential arrangements in force at the time the Agreement was signed, but prohibited new arrangements of this sort except where they represented a stage in the setting up of customs unions or free-trade areas.

The reason for the prohibition was, and still is, the belief that countries ought to treat one another equally in their foreign trade and not grant advantages to some countries that they are not prepared to extend to others. But however valid the most-favoured-nation principle may be in regulating trade relations among equals, it is not a suitable concept for trade involving countries of vastly unequal economic strength. The acceptance by the Meeting of Ministers of GATT in May 1963 of non-reciprocal tariff concessions to developing countries was a valuable first step in recognizing the need for special encouragement to the trade of these countries. Adoption of the principle of preferential treatment for the trade of developing countries is the logical next step.

It should be emphasized that the granting of preferences to developing countries would not conflict with the objective of the Kennedy round of tariff negotiations or indeed with any

other effort to bring down or remove the barriers to trade. Even if the Kennedy round were completely successful, it would mean the reduction but not the elimination of tariffs by the negotiating countries. The issue that arises, therefore, is whether the industrial countries would be ready to grant free entry at least to the developing countries if not to one another. The idea is not to create permanent margins of preference that could be maintained only through retention of existing tariffs by the developed countries. The suggestion is, rather, that pending the elimination of obstacles to trade by the developed countries, free access should be granted to the developing countries.

The introduction of a new system of preferences would involve the mutual adjustment of various conflicting interests among the developing countries on the one hand, and between the developing and the industrial countries, on the other. There may be a temptation to try and take account of any difficulties that arise in reaching such adjustment by introducing complicating devices and refinements into the scheme so as to cater to particular preoccupations. Certain of these devices and refinements could indeed prove to be indispensable, but the general proposition should be borne in mind that the greater the complication of the scheme, the less chance it has of being accepted or found workable.

The first question for consideration is: which countries should grant preferences? The hope and expectation, as already noted, is that all developed countries would agree to grant preferences to all developing countries. While it may be doubted whether the scheme could be effectively implemented unless all major developed countries agreed to participate, unanimity would not be essential. The scheme might enter into force when an important group of countries indicated their willingness to participate.

So far as the participation of the socialist countries in the concession of preferences is concerned, as indicated elsewhere, tariffs do not have the same meaning in these countries as in private-enterprise economies. Nevertheless, whenever tariffs are imposed, free entry should be assured to imports from developing countries. At the same time, the socialist countries should favour imports from developing countries in their foreign trade plans, and their State trading agencies should give effect to such preferences in their purchasing arrangements.

The implementation of all such measures could be evaluated in the light of actual performance, and would be one of the subjects for review within the new organizational scheme of trade and development that might be suggested by the Conference.

The selection of countries to benefit from preferences is somewhat more difficult. No single criterion has been found satisfactory in identifying those countries which should be regarded as qualifying for preferential treatment. Such factors as per capita income, the size of the country, the share of agriculture and industry in total employment and output, and the impact of the primary export sector on the growth of the economy should be considered. If these factors are taken into account, it is relatively easy to decide which are and which have ceased to be developing countries in most cases. There is, nevertheless, a small group of borderline cases at the top of the per capita income range and it is not an easy matter to establish the cut-off point among them.

The problem is, perhaps, not too important from the standpoint of the industrial countries, because imports of manufactures from the developing countries are not likely to be a matter of overwhelming consequence for them in any case, as we have seen. But they are for some developing countries which may fear that they will not be able to benefit from preferences if they have to compete with other more advanced members of the developing group. The problem of which developing countries should be included in the scheme is thus closely linked to the problem of gradation or differentiation of preferences which will be examined below.

2. Selection of general preferences and their duration

Most of the discussion of preferences thus far has proceeded on the assumption that they should be granted on a selective basis for particular products. The main consideration underlying this approach appears to be the desire to exclude products which would raise domestic problems for the developed countries, notably those produced in relatively weak or stagnant sectors of the economy of these countries. There may also be a desire to direct the efforts of developing countries towards industries offering substantial growth potential and the prospect of viability within a reasonable number of years, making it possible to discontinue the preferences.

These two considerations appear reasonable enough, but if they are examined more closely, serious disadvantages may be observed.

First and foremost, the experience of GATT and of other bodies has shown that a system of selective negotiations, product by product, raises great difficulties. Naturally enough, each industry which considers itself threatened by foreign competition is liable to adopt a severely defensive attitude and seek to maintain the *status quo*. This very understandable attitude does not find its logical counterbalance in the industries which may increase their exports to the developing countries as the foreign-exchange earnings of the latter advance, since these advantages are still problematical and therefore do not provide a tangible incentive for the adoption of preferences. Nor is it to be expected that an industry that felt itself affected by imports would examine this matter from the viewpoint of the economy as a whole and not for its own particular situation.

If, moreover, the preferences to be granted by all developed countries are to be standard in terms of commodity coverage, the ultimate list of products qualifying for preference is likely to be the lowest common denominator of all national lists; since any industry regarded as vulnerable in any one country is likely to have its way with the general list of all countries.

From the standpoint of the developing countries, moreover, it is difficult to imagine how a suitable selection of industries for preferential treatment could be made. It would surely be better to leave scope for the initiative of enterprises to seek out the best opportunities, subject, of course, to measures of guidance and assistance, in which Governments should have a very important role, as will be seen later. One wonders what degree of success might have attended efforts, in any of the countries that are now industrialized, to draw up a precise pattern of possible industrial exports in advance when they were at the earliest stage of development. It is hardly likely that an effective selection could now be made, from the whole range of industry, of all those particular branches which might prove to be successful in particular developing countries in the long run.

Thus, the danger is that a selective list of products qualifying for preference may turn out to be unduly restricted and drawn up much more with an eye to static considerations than to the dynamic possibilities of a new international division of labour. For this reason, a better and simpler approach would be for preferential treatment to be granted in principle to all imports from the developing countries, subject only to certain specified exclusions, as well as certain safeguards, as indicated below.

Much of the discussion that has taken place so far has been related to preferential treatment for semi-finished and finished manufactures only. Acceptance of this limitation would raise a number of difficulties in defining the scope of these products, calling for expert study and recommendation. Expert study would also be required of the problem of defining the origin of products manufactured or semi-manufactured from imported materials or components. Neither these nor any other difficulties seem to be of major consequence, and they should not prevent the

Conference from adopting a decision in principle in favour of preferences. Indeed, this decision in principle is necessary in order to provide, through common agreement of Governments, a framework within which the technicians will be required to work out practical details.

A small margin of preference is not likely to provide adequate incentives for establishing new export industries in developing countries. If a new system of preferences is worth introducing at all, the margins of preference should provide incentives that are clearly adequate in relation to the magnitude of the problem.

Since many or most of the tariffs applied to manufactures by the industrial countries are relatively low, and are expected to fall even further as a result of the Kennedy round, the optimum solution would be to grant free entry to imports from developing countries. For the members of EEC and EFTA this would simply mean granting to the developing countries treatment not less favourable than they are prepared to give one another.

Since the new preferential system is intended as an encouragement to infant industries, it will be evident that some provision must be made for the elimination of preferences once the industries are firmly established. In general, preferences should be introduced for a period of no less than ten years with respect to any given industry in any developing country. At the end of the ten-year period, preferences would be withdrawn unless it could be shown, to the satisfaction of an appropriate international authority, that special circumstances warranted their continuation. The ten-year period would be reckoned from the time of the initial granting of preferences to exports of a particular industry in a given country, even though this would mean that plants established subsequently in the same country would not benefit from the full period of preference.

The fact that preferential treatment for any one industry in a developing country would normally come to an end after ten years would have two advantages. For one thing, it would compel the entrepreneurs concerned to concentrate on making the industry fully competitive by the time the shelter of preferences was withdrawn. A second advantage would result from the fact that infant industries, established shortly after the inception of the scheme in countries that are still at an early stage of development, would count their ten-year period of preference from the time such preference was first applied to any industry subject to this regime. This means that such industries would enjoy preferential treatment not merely in relation to the industries of developed countries but also in relation to those of the more advanced developing countries, once the respective industries of the latter countries were no longer entitled to preferences.

The duration of preferences should probably not be fixed at less than ten years. Sufficient time must be allowed for their incentives to take effect and for significant results to be achieved in export markets. In the conditions pertaining in developing countries, a short-term scheme of preferences would scarcely be better than no scheme at all.

Thus the duration of preferences raises an issue similar to that involved in the margin of preference, namely, that there is a minimum scale and duration below which the incentive provided would be inadequate. It would not be worth facing all the political and other difficulties entailed in a new departure from the most-favoured-nation principle simply for the sake of token margins of preference on a few selected products for a very limited period, amounting to little more *in toto* than a gesture in the face of the immense problems of the trade gap.

3. Safeguards for developed countries

It would not be difficult to understand an initial hesitation on the part of the industrial countries in accepting a scheme that appears to promote competition from developing countries with the

output of certain of their own industries. In time, they would undoubtedly see the advantages of the scheme, since it would provide a means of increasing their sales to developing countries by the amount of the additional purchasing power accruing to the latter countries from the expansion of their own exports with the aid of preference. Thus, the industrial countries may see advantages in expanding rather than in contracting the volume of their preferential imports. Nevertheless, particularly at the outset of a programme of preferences, the developed countries would no doubt wish to have assurance as regards both the total volume of preferential imports and the volume of imports in any one category.

As we have seen, an expansion of exports of manufactures that would be very large in relation to the existing shipments by developing countries, would still be extremely small in relation to the actual and potential consumption of manufactures by the developed countries. If, therefore, the developed countries wished to set an overall limit to the volume of goods imported preferentially, that limit could be fixed at a level very high in relation to existing exports of developing countries, but still very small in relation to the size of their own domestic markets.

The question now arises as to how the aggregate quota of manufactures from the developing countries would be divided between the various industrial countries. One way of doing this would be to divide the total quota in proportion to the consumption of manufactures by each importing country. But this approach would make no allowance for the fact that large countries with highly diversified resources and productive facilities naturally tend to import less in relation to consumption than small countries whose economies are more highly specialized.

An alternative method would be to divide the import quota in proportion to each developed country's imports of manufactures. In this way imports from developing countries would increase, from year to year, in line with total world imports of manufactures. However, the disadvantage of this method is that the developed countries whose import coefficient is very low would have a relatively small quota of preferential imports. It may be possible to combine these two methods in order to find a formula acceptable to all developed countries.

As regards the impact of preferential imports on particular industries, it is necessary to keep in mind the fact that preferences are designed to help in offsetting the high costs of infant industries in developing countries. If, however, as a result of the preference, a country exerts undue pressure on the prices prevailing in the industrial countries, it thereby demonstrates either that it does not need the preference or that the preference is excessive.

Developed countries could hardly be expected to offer encouragement through preferences to those industries in developing countries that are already able to stand on their own feet in world markets, and still less to those industries whose costs are much lower than those of similar industries in developed countries.

In view of this, it may be considered desirable that, at the time the new preferential system is introduced, each developed country should be able to reserve its right to withhold preferential treatment from products accounting *in toto* for a reasonable percentage of its aggregate imports or consumption of manufactures. This percentage could include some articles, which it might be considered advisable to exclude from the preferences so as not to affect certain imports from other supplying countries, and certain articles that would be specially reserved for the less advanced developing countries, as will be seen below.

Once the system is in effect, developed countries might add new exceptions to the preferential regime, in accordance with clearly established criteria.

Another possible safeguard might be to provide that imports of particular products could cease to qualify for preferential treatment when they exceed a certain percentage, to be fixed in advance, of the domestic consumption of a particular importing country.

It should be emphasized that the withholding of preference from particular products, under provisions such as those discussed above, would simply imply that normal most-favoured-nation treatment would be applied. The withholding of preference could not in any case justify action to restrict normal imports of the products in question outside the provisions of GATT.

4. Differences between developing countries in relation to preferences

It is now necessary to examine the possibility that some of the more advanced of the developing countries might quickly pre-empt so large a proportion of the total preferential quota allocated by the industrial countries as to leave insufficient scope for countries at a much earlier stage of development. In general, the extent of any danger that the total quota might be used up would obviously depend on the size of the latter. As already noted, in the course of time, developed countries may see enough advantages in the preferential scheme to be prepared to enlarge the total quota.

If the quota were large in relation to existing exports from developing countries, there would be adequate room for all, and it would probably not be necessary to take any steps in the immediate future. Action would be required only if it became apparent, in the course of such an annual review, that there was an obvious danger that some countries might be excluded from the quota and that no possibility existed of enlarging it.

However, the total quota is established at a relatively low level, the case for exporting country quotas becomes stronger. The difficulty here is that such an approach is so complicated as to be, in all probability, unworkable. It is not simply that a dozen or so industrial countries would have to establish a quota for each of one hundred or more developing countries — or well over a thousand quotas in all. Difficult as such a sharing out of a small total quota might be, it would be simplicity itself compared with the problem of policing such quotas for each and every item on the import list.

Instead of establishing individual exporting country quotas, it might be better to set some limit to the share which any one country might take of the available total quota. Countries would be permitted to exceed this limit only where it could be shown that the unutilized portion of the total quota was so large in relation to the exports of other developing countries as to leave ample margin for the latter. At the same time, special measures should be adopted to encourage exports from the least developed countries, along the lines discussed below.

Among the most difficult of all problems connected with the introduction of a new system of preferences is whether to give different degrees or kinds of preference to countries according to their per capita income or stage of development.

The rationale for such a gradation of preferences is quite a simple one. The productivity differential between the least and most advanced of the developing countries is far greater than the corresponding differential between the latter and the industrially developed countries. Consequently, the very same considerations that would justify the granting of preferences to developing countries in general would call for substantially larger preferences to the least developed than to the most developed among them.

Differentiation of this sort among developing countries has already found a place in the Treaty of Montevideo establishing the LAFTA. Under the Treaty, the relatively less developed

of the Latin American members of LAFTA receive particularly favourable treatment as regards the mutual reduction of tariffs and in other respects.

There is no doubt that not all developing countries would be equally able to benefit from a preferential scheme drawn on a uniform basis. As already noted, the group of developing countries currently exporting manufactures on a significant scale to the industrial countries is relatively small, and the short-term gains from preferences would be limited to this small group. On the other hand, the objective of the preferences would be to provide incentives leading to a broader distribution of manufactured exports in terms of supplier countries as well as of types of products. The danger is that, if these incentives were uniform, the increment in exports might tend to be concentrated in those countries that have already taken the lead in this field.

Unfortunately, the scope for a gradation of preferences may not be very great, especially if the Kennedy round of tariff negotiations achieves significant successes.

When tariffs are relatively low, for example, of the order of 10 to 15 per cent, the gradation of preferences could be detrimental to the incentive to export in the most advanced developing countries without the less advanced having a meaningful advantage; indeed, this advantage could be smaller than would be necessary to overcome cost differences with the most advanced developing countries.

At the same time, it has to be stressed once again that, however well founded may be the reasons for introducing refinements into the scheme, the greater the administrative complications, the smaller the chances that anyone at all will benefit, since the scheme may prove unworkable.

It should also be noted that it is in the nature of the case that not all countries will benefit equally from any one proposal before the Conference, taken by itself. Thus the only countries in a position to benefit from the elimination of domestic charges on tropical commodities in certain industrial countries are those that can or do produce those commodities; and no gains from long-term compensatory financing will accrue to those whose terms of trade do not decline.

At the same time it should be recognized that the problem of the least developed countries as regards preferential arrangements is a very real one and that the issue must be faced squarely. These countries may not now be in a position in which they are likely to benefit to any great extent from preferences on industrial products, and may not be ready to do so spontaneously for some years. Immediate steps must be taken for the ultimate attainment of this objective.

It has already been suggested, as a partial response to the problems of these countries, that preferences should be terminated for any given industry in any given country at the end of ten years, so while the benefits accruing to the least developed countries will begin later, they will also end later. In this way they will enjoy preferences which no longer apply to other developing countries.

Furthermore, the possibility of granting preferences on a series of articles to the less advanced developing countries without extending them to the more advanced, can well be envisaged. For this purpose use could be made of the list of products with regard to which the industrial countries had reserved the right not to grant general preferences.

But this is not sufficient. It will be necessary to set special targets for national and international policy in relation to the least developed countries as well as the adoption of special measures to achieve these targets. Such measures should include exceptional efforts to analyse export market opportunities for such countries, to promote their exports accordingly, and to provide aid at a higher per capita level commensurate with the gap to be bridged between them

and the most advanced developing countries. In other words, it may be that the provision of a larger volume of per capita aid and of higher promotional effort is a better way of handling the problems of countries at the earliest stage of economic development.

This is not, however, a matter on which a dogmatic position can be taken; it is *par excellence*, one of the most important questions calling for further analysis and discussion.

5. The alternatives of subsidies or devaluation

As was said before, preferences are justified as a means of protecting infant industries in their attempt to gain export markets. The question may be raised whether this could not be achieved by readjustment of the exchange rate rather than by a preferential system.

It is a well-known fact that, generally speaking, the exchange rate appropriate for the traditional trade of developing countries tends to discourage the development of new types of exports. While, in the case of an industrially developed country, a single rate of exchange is sufficient to secure equilibrium between domestic costs of production and the prices in foreign markets, in the case of a developing country there may be no single rate of exchange capable of securing this result. It has to be borne in mind that the exchange rate of a developing country reflects the level of money costs of production in the primary sectors of the economy and not in the manufacturing sector. On the other hand, the less developed a country is, the higher are its manufacturing costs, in general, relative to money costs in the primary sectors of the economy. Thus, the exchange rate equating domestic costs and prices in the primary sector with those of the world market will cause manufacturing costs to be excessively high in terms of foreign currencies. It is therefore an overvalued exchange rate from the standpoint of exports of manufactures. On the other hand, the particular rate of exchange which would make it possible for a developing country to gain export markets for its manufacturing industries would mean a considerable undervaluation of the currency in terms of the primary commodities which form the great bulk of its exports.

Devaluation would be a possible solution in such cases, provided that it did not lead to further increases in costs. This might be difficult to ensure in countries where a rise in the price of imports has a direct and marked impact on the cost of living, thereby generating demands for higher wages. Moreover, devaluation would probably lead either to a fall in the external prices of traditional exports or to excess profits for primary producers.

It has been suggested that, in order to avoid these drawbacks, devaluation should be accompanied by two other measures: first, a tax on traditional exports equivalent to the amount of the devaluation; and, secondly, a cut in tariffs, also in proportion to the devaluation. Exports of new products would not, therefore, be subject to the export tax, but would benefit from the incentive provided by the lower exchange rate, while the rise in the cost of foreign exchange for imports would be offset in its effects on internal consumption by the cut in tariffs.

If, for political or other reasons, it proved impracticable to devalue, some method of subsidizing industrial exports could be studied. In this case it would be necessary to secure the agreement of the developed countries not to apply countervailing duties. Such agreement would no doubt be conditional on the construction of an acceptable framework providing for safeguards against abuse.

It goes without saying that, in so far as the above solutions require that the cost of promoting exports of manufactures would have to be borne by the developing countries themselves, neither of the solutions would be as satisfactory for these countries as preferential treatment for their exports.

II. THE PROVISION OF INTERNATIONAL RESOURCES FOR THE DEVELOPING COUNTRIES

A. Compensatory financing to counter the effects of deterioration in the terms of trade

1. The policy of financial co-operation

The great defects discernible in present financial co-operation policy towards the developing countries must not blind us to the substantial progress that has been made both in the scale and the results of financial co-operation since its beginning soon after the Second World War.

The funds supplied by the private enterprise economies in various forms (loans, private investment and assistance proper), which amounted to US\$ 1.8 billion in 1950, reached a total of US\$ 6.6 billion in 1962. Although the average rate of increase has been around 11 per cent *per annum*, a great deal remains to be done. In 1962, the funds supplied amounted to only 0.7 per cent of the combined income of these developed countries. On the other hand, although this is a great deal less than the 1 per cent approved by the United Nations General Assembly, it compares favourably with the figure of scarcely 0.3 per cent recorded in 1950.

There have been very positive advances in the conception of financial co-operation. While the importance of external private investment in the developing countries is recognized, the need for the provision of considerable amounts of public resources is no longer questioned. The liberalization of the terms on which these are made available, with respect to maturity, interest charges, and type of projects, is in itself a considerable advance. Regional institutions have been set up which usefully supplement the world finance agency, while the recent evolution in the policy of the latter has given a strong impetus to a process that had been developing over the years as a result of experience. Quantitative targets for the provision of international resources were established in the Punta del Este Charter and the amounts and allocation of those resources were linked not only to the viability of specific projects but also to development plans in which modifications in the economic and social structure are recognized as an indispensable requirement for development.

However, this progress in financial co-operation policy is not without its negative aspects. There are two which are of major concern to us here. First, the deterioration in the terms of trade has seriously impaired the developing countries' capacity to import capital goods, thereby offsetting the positive effects of the international resources made available. Secondly, the relatively early maturity dates for repayment of a considerable proportion of these resources, together with the kind of servicing some of the loans require, are a heavy burden on many developing countries and will become so for others if things continue as at present. These are matters which are obviously important and we shall proceed to examine them in view of their close connexion with the purposes of the Conference.

2. The need for compensatory financing

If the developing countries are to reach and surpass the goals of the Development Decade, they must be able to plan the necessary mobilization of internal and external resources to this end. Any acceleration in the rate of growth implies a stepping up of the rate of investment; and in so far as this in turn involves imported equipment, it can be programmed only on the assumption that the required volume of disposable foreign exchange will be available.

Most of the developing countries have little or nothing in the way of a safety margin for absorbing declines in foreign exchange availabilities. Their external reserves are low, and in many cases their imports of non-essential goods have already been cut to the minimum. Thus, any deterioration in the terms of trade seriously impairs their capacity to import the capital equipment required for growth. Such a deterioration thereby undermines the achievement of the very objectives for which international resources are supplied to them. Economic development is or should be a coherent process in which particular elements and projects mutually support and reinforce one another. The effectiveness of any project financed under a programme of co-operation is therefore bound to be diminished if other foreign exchange resources, which were counted upon for complementary investments, cease to be available because of an unforeseen decline in commodity export prices. In seeking reasons for the shortcomings in existing programmes of financial co-operation one cannot afford to overlook the damage caused by the deterioration in terms of trade.

The solution to this problem should be approached from two sides. We have already examined the case for commodity agreements. But such agreements cannot offer a complete solution for all commodities or for all situations. It is therefore important to provide supplementary resources to compensate developing countries for losses from declining terms of trade.

The fundamental aim of a compensatory scheme should be to maintain the total purchasing power of the external resources accruing to developing countries through their exports.

Much thought has been given to the short-term aspects of this problem. Proposals have been made for a development insurance fund designed to give full or partial compensation for a shortfall in export proceeds compared with some base period. While action on these proposals has been deferred, the International Monetary Fund has begun to apply a new scheme of lesser scope which provides certain accommodations to tide countries over a period of temporary balance-of-payments disequilibrium resulting from export shortfalls.

Useful as holding operations of this kind may be, they do not go to the heart of the longer-term problems associated with a downward trend in the terms of trade. As in the case of commodity agreements, a basic policy decision is required — a decision in principle that developing countries experiencing a deterioration in their terms of trade should have easy access to additional international resources in order to achieve the objective of maintaining their purchasing power. As will be explained, the satisfaction of such requirements must depend on certain conditions. Subject, however, to the fulfilment of acceptable criteria, the international community should recognize that it has a clear responsibility towards developing countries that have suffered a deterioration in their terms of trade in the same way as Governments recognize a similar responsibility towards their domestic primary producers.

However, the additional resources that would thus be provided are different from the usual resources made available in the form of loans. Loans represent resources which the countries making them take from the income they themselves generate, whereas the operations under discussion constitute transfers of resources derived from the income which accrues from countries exporting primary commodities as a result of the deterioration in the terms of trade in respect of those products.

What, then, should be the point of departure for measures of compensation? In relation to what point in time should losses be calculated? Would it suffice to assure the developing countries that they will not be subject to new losses in relation to present prices? Or should losses be calculated in relation to some past year, when the terms of trade were less unfavourable to developing countries than they have recently been? To compensate for new losses is important but it is not enough; something needs to be done to restore the purchasing power of the developing countries, and not simply prevent it from weakening further.

So far as the first aspect is concerned, the point of departure presents no major difficulty, since it would be possible to take the terms of trade prevailing in the last year and, in the light of any new decline that may have occurred, to calculate the resources to be transferred.

The second aspect, however, raises the problem of deciding from what year or years the deterioration ought to be calculated, since the results will obviously be very different depending upon the year chosen and there is no objective or automatic way of solving this problem. It will therefore be necessary to adopt a pragmatic approach to a solution.

Such an approach would have to be based on a study of the potential investment resources lost by each country as a result of actual past deterioration in the terms of trade, the impact of this deterioration on the balance of payments, the effects of both these phenomena on the rate of growth, and any other factors that it might be advisable to consider in each particular case. This study would be necessary in order to determine what additional international resources would have to be provided in order to compensate developing countries for the adverse effects of the terms of trade.

It is not for this report —and much less for the Conference— to deal with such questions of methodology nor with the statistical procedures that might be developed to determine what further deterioration there may be in the terms of trade or, as has just been explained, to compute the amount of additional resources that would have to be furnished in order to deal with the consequences of past deterioration. All this should be studied by experts, whose recommendations will have to be submitted to the Governments for consideration. However, in order to prevent the experts from proceeding along the wrong track, there must be a prior political decision regarding the transfer of resources and the two aspects that the transfer will involve. In other words, a clear distinction must be made between a political decision adopted in principle and the most appropriate technical methods of implementing it.

3. Compensatory financing and development plans

The pragmatic approach to which reference has just been made would be easier if the countries concerned had a development plan. A development plan is generally based on the assumption that the export and import prices currently prevailing will be maintained during the period of the plan. It is on this assumption that the possibilities of mobilizing domestic capital are quantified. If, however, the terms of trade subsequently worsen, not only will it be impossible to finance imports on the scale envisaged in the plan, but domestic resources may also fall short of the target because of the adverse effect on real income.

Nor is it usually possible, in such a situation, to have recourse to external borrowing to replace the lost resources, since the institutions providing long-term credit are apt to regard the deterioration in terms of trade as a factor which, because of the impairment of ability to repay, reduces a country's credit-worthiness. This reduction in borrowing capacity aggravates still further the consequences of the deterioration in terms of trade.

The need for compensatory financing to maintain the integrity of development programmes will therefore be apparent. Nevertheless, such *financing* cannot be purely mechanical. The mere transfer of compensatory funds will not suffice to restore the plan to its original course. It will be necessary —as was said before— to examine the new situation that has been created and to determine the impact of the deterioration in the terms of trade, the adjustments that should be made in the plan, and the manner in which the funds given in compensation should be applied. The important point is that the country should know in advance that, subject to the

fulfilment of certain conditions, it can count on the necessary funds to offset the consequences of the deterioration.

It should also know in advance that, if the plan has been based on a serious effort to mobilize domestic capital, a country will not be required to intensify that effort at a time when its ability to do so is clearly reduced. Any such additional effort would in any event reinforce, but not be a substitute for, compensatory financing, assuming there was sufficient margin for that purpose. Finally, the availability of compensatory funds would afford the international credit agencies the assurance they would need that the country's ability to pay would not suffer from the effect of the adverse terms of trade.

Any significant review of the development plan will obviously take time, and if a country had to wait until such a review was carried out, the deterioration of the situation might make the plan, as originally conceived, unworkable. It is in such conditions that the experiment in short-term compensation initiated by the International Monetary Fund might come into play: such compensation would provide a means of tiding a country over the period during which the necessary adjustments in the plan could be made, and a claim established for long-term compensatory financing.

In the light of this explanation of the close link between compensatory financing and development plans, it will be understood that the resources in question should not normally be allocated directly to individual producers. If that were done, not only would the basic objectives of the development programme be adversely affected, but the problem of deterioration in the terms of trade might be aggravated in the future as a result of the incentive which the higher return would offer to producers.

The relationship between compensatory financing and developing programming is linked to still another consideration. To ensure that such financing achieves its purpose, the additional resources mobilized should not be obtained at the expense of financial resources already being supplied to the developing countries. The percentage of national income which such resources now represent should not decrease but should go on increasing towards the accepted target of 1 per cent. Compensatory funds should constitute a net addition to that target, the amount of the addition depending, of course, on the terms of trade. Moreover, in view of the outright loss that a deterioration in terms of trade represents, the compensatory resources should not take the form of loans subject to amortization and interest payments.

4. Receipt and disbursement of resources

While the obvious differences between compensatory and other forms of financing would necessitate separate treatment of the former, including perhaps the creation of a separate fund, it does not follow that a new institution would be required. A fund of this type could be administered through existing international credit institutions, including regional credit institutions.

In order to fill this new role, these institutions could review claims for compensatory financing submitted to them under general rules approved by Governments. An alternative might be the creation of a body of independent experts of the highest standing which would be responsible for the review.

In this connexion, it may be noted that experience with development plans has shown the need to specify the investments required for the attainment of the plan's objectives, the internal resources to be mobilized for that purpose, and the international financial resources required for the same end. Much remains to be done in working out appropriate methods and procedures along these lines: particularly difficult for recipient countries is the practice

of financing individual projects without committing the total external funds required for the duration of the plan. It is to be hoped that procedures for allocating resources furnished as compensatory financing will help to give developing countries every reasonable assurance that they can rely on the global funds needed for the carrying out of their development plans.

Finally, as to the form in which the necessary resources should be raised, naturally it would be for each country to determine the form which suits it best. However, if use is made of a levy on imports of primary commodities the total external funds required for the duration of the plan, care would have to be taken to ensure that it does not have a very marked effect on consumption, and that the effective incidence of the levy is on importing and not on exporting countries, as we have already explained in our comments on such arrangements elsewhere in this report.

It would also be necessary to bear in mind what was said in these comments about the need for a link between such measures and access to markets, not only because of its importance as such but also for reasons of equity since, without it, the more primary commodities a country imported, the greater the effect would be on the receipt of resources.

B. The burden of servicing and other aspects of external financing

1. Critical situations in the matter of servicing

The problem of the burden of servicing is closely linked to the slow growth of exports and the deterioration in the terms of trade. It is also clear evidence of the need for a consistent policy of international economic co-operation. While on the one hand the flow of international financial resources to the developing countries has increased —and this is very laudable— on the other hand, the access of exports from these countries to markets of industrial countries has not been facilitated, nor been provided reasonable stability in the purchasing power of those exports.

In what way, other than by such exports, could the increasing financial burden of servicing be borne? Reducing imports for that purpose has its limits, and the greater the need for essential imports, the narrower those limits will be.

The results of this contradiction are apparent in a number of countries and have assumed critical proportions in some of them, as we have said before. This is due not only to the accumulation of external debts but also to the relative shortness of their repayment periods, the relatively high rates of interest on some obligations, and the high earnings of some investments. According to preliminary findings contained in a report that the International Bank is preparing for the Conference, the public and publicly guaranteed debt⁷ on the developing world rose from approximately US\$ 8-10 billion at the end of 1955 to some US\$ 24 billion at the end of 1962: i.e., increasing at an annual average rate of around 15 per cent. The increases, of course, varied markedly from country to country, as shown in the following table:

⁷ Excluding socialist countries. The public debt data exclude net obligations arising from transactions with the IMF, and outstanding short-term commercial arrears. If the latter were included, the 1962 figure has been estimated at approximately US\$ 28 billion.

■ **Table 4****EXTERNAL PUBLIC DEBT OF NINE MAJOR DEBTOR COUNTRIES***(In millions of United States dollars)*

Country	End 1955	End 1962	Average annual percentage increase	
Argentina		(600)*	2,067.1	19
India		309.8	2,925.9	38
Pakistan		147.4	829.2	28
Turkey		(600)*	931.5	7
Mexico			1,359.9	16
Yugoslavia		331.5	778.1	13
Colombia			638.8	12
Chile			741.9	11
Brazil			2,349.0	8
		Above total (4,475)	12,621.4	16

Source: IBRD, Economic Department.

* Estimates.

For all developing countries, servicing charges arising from interest and amortization⁸ on the public and publicly guaranteed debt rose from US\$ 900 million in 1956 to US\$ 3.1 billion during 1963: the growth rate for such service payments, therefore, averaged somewhat in excess of 19 per cent during this interval. Of course, the amount of these annual servicing payments depends not only upon the level of a country's existing debt, but also upon the repayment terms under which international public loans are extended. As can be seen below, a considerable number of developing countries currently face an important problem because of the relatively short period within which repayment of their public debt is due.

■ **Table 5****PERCENTAGE OF PUBLIC AND PUBLICLY GUARANTEED DEBT^a REPAYABLE OVER THE NEXT FIVE YEARS**

50% or more	40-49%	30-39%	20-29%
Argentina	Burma	Ecuador	Bolivia
Brazil	Ceylon	Ethiopia	Dominican Republic
Guatemala	Chile	Iran	India
Israel	Colombia	Nicaragua	Pakistan
Mexico	Costa Rica	Nigeria	Paraguay
Philippines	El Salvador	Peru	Sudan
Turkey	Spain	Thailand	Uruguay
Venezuela			
Yugoslavia			

Source: IBRD, Economic Department.^a Excluding short-term commercial arrears.

Loans and investments for the developing countries have not always been made in reference to their need for resources and in the light of their ability to pay but have often been motivated chiefly by the immediate convenience of the countries exporting capital goods. This has frequently resulted in the establishment of repayment periods which, while

⁸ Excluding socialist countries. In both periods, amortization represented over two thirds of the total.

possibly justified in individual transactions, were not compatible with a cautious estimate of the country's ability to pay.

Actually, the care with which some institutions have adjusted the repayment periods of loans to the special situation of each country was of little value in cases where similar transactions were taking place through other channels.

In any case, those are the facts and they have to be confronted without delay. The way in which that should be done is being studied by competent bodies and we will therefore limit ourselves here to some general comments, comments which we consider relevant to this Conference.

For the purposes of the Conference, there are two aspects to be examined: first, the critical problems confronting a number of countries; and, secondly, the need to prevent their repetition by measures affecting both the countries which provide international financial resources and those which receive them.

2. Consolidation of debts and extension of repayment periods

So far as the first of the above aspects is concerned, the consolidation of a number of short-term or medium-term debts and the average extension of the repayment period for the external debt as a whole, would appear to be unavoidable for some countries. Experience, both national and international, has shown, more than once, that some very critical situations of indebtedness have been successfully dealt with, and serious dangers avoided in this manner. However, meeting pressing obligations by assuming others which soon will become equally pressing simply postpones the hour of reckoning but is not a solution.

Obviously it is not merely a matter of calculating by mathematics how servicing could be reduced by stretching out the repayment periods. This is a problem which cannot be divorced from a country's economic development policy. It must therefore be part and parcel of a development programme which makes provision for using, together with other internal and external resources available for covering the investment programme, the resources released by the lightening of the servicing burden as a result of debt adjustments.

There is no doubt that compensatory financing is an important factor in this adjustment of the external debt. Compensating a country for the loss it suffers because of worsening terms of trade will provide a much sounder basis than at present for these adjustments of the external debt and for further operations in the future. What is more, such compensatory financing resources might be used by Governments for servicing the new debts deriving from the adjustment. There is no doubt that this additional safety factor would help considerably to make the operation more feasible, particularly the reduction in the interest burden.

The other problem —that of preventing a repetition of the events that led to the critical situations which cause so much concern— must also be related to the need for gearing international loan and investment operations to the requirements of each economic plan. The composition of a developing country's debt, so far as its type, repayment period and other characteristics are concerned, cannot be arbitrary; it must respond to the conditions and needs of each country.

3. Problems that will be solved more easily with development plans

There has been considerable progress in thinking in this field in recent years but not enough. Where a plan is considered sound by those who have to decide on the provision of supplementary international resources, it would be highly desirable for such resources to be

committed in principle for the duration of the plan and for their disbursement to be subject to fulfilment of the basic conditions of the plan and to the submission of specific projects. This overall approach to the plan and its financial requirements would give the Governments and institutions providing the resources an opportunity to co-ordinate the various operations so as to make them compatible with the plan and the capacity to pay all servicing charges, in the light of probable export growth, import requirements and other external payments.

Naturally, in the complex of reciprocal commitments involved in an operation of this kind, countries receiving resources will have to assume, *inter alia*, the obligation of prior consultation concerning any marginal operation not included in the overall financing of the development plan with those who have undertaken to provide the international resources. Otherwise they would run the risk of once again finding themselves in a critical situation.

Again, a plan is the only way of solving a problem which is closely linked to foreign trade in the developing countries. A start has been made in the right direction but the complete solution of this problem will depend on a plan's overall perspective. We are referring to the external financing of a part of internal investment.

There has been considerable reluctance to do so because it has been felt that external resources should be used exclusively for imports of capital goods. The result has been that a developing country which found it convenient to produce some capital goods domestically could not do so with international resources: it was compelled to use its own limited resources, not only for that purpose but also for the local expenditure related to investments effected with imported goods.

The fact is that external resources are needed to make up for the shortage of internal resources in programmes of investments and if they are effectively used for any of those investments and are not spent on consumption, it makes no difference, economically speaking, whether they are used to pay for imported capital goods or for internal investment.

That reluctance may be due mainly to a desire to promote the export of capital equipment in the major centres, but, while such desire is understandable, it may not necessarily coincide with the requirements of good development policy, since there is no reason for stimulating imports of certain types of capital goods when they can be economically produced in the developing countries. Moreover, if external resources are used internally, either in the production of such capital goods or for local costs of investment, that does not mean that they will be lost from the point of view of foreign trade. Actually, they will be used for other imports, since there is no perceptible tendency in the developing countries to accumulate unduly large monetary reserves.

It would therefore be advisable to avoid this water-tight separation of resources not only as regards the aspect just indicated but also as regards another important respect. In this report, emphasis has been laid on the advisability of forming groupings of developing countries in order to promote their reciprocal trade and thereby to reduce their potential trade deficit. Now, it is the desire of industrial countries to promote their own exports of capital goods which generally prevents financial resources obtained in such countries by a developing country from being used in other developing countries for procuring the same goods under competitive conditions. This is part of a general problem of multilateralism in the employment of international financial resources. However, pending a solution of that problem, it would be advisable to introduce this additional element of flexibility as an integral part of the policy of international co-operation for economic development.

If this were to happen, considerable impetus would be given to exports of capital goods from some developing countries to others, as well as to industrial countries, in the course of time.

Under present circumstances, the developing countries are at a disadvantage because they cannot compete with the more advanced countries with respect to the granting of export credits. In order to remedy this inequality, the Inter-American Development Bank has initiated a system of export credits for the Latin American countries and it is to be hoped that the necessary resources will be forthcoming to give these operations the impetus they require. Likewise, it would be desirable for a similar system, to be extended to the other developing countries, and for the possibility to be studied of setting up an insurance scheme for such credits.

This close link between the external resources granted to a developing country and specific projects geared to imports of capital goods is also based on the need for a thorough study of the projects. However, in the absence of a development plan in whose context such a study could be made, there is nothing to prevent internal resources from being used on low priority projects or on projects which are meaningless from the economic or social point of view.

All these considerations make the need for planning more imperative, a point that is duly stressed in this report. What is more, planning is the best way of making the policy of financial cooperation most effective.

In this connexion, it must be borne in mind that the extent to which international resources allocated to developing countries in recent years have been effectively utilized is being widely questioned in the developed countries.

Comparisons are being made with the European Recovery Programme —a programme of aid which was associated with the rapid post-war revival in western Europe in the space of a few years, and which it was possible to discontinue as country after country regained its economic strength.

There is no doubt that much remains to be done by the developing countries in taking the internal measures which would enable them to make more effective use of the external assistance available to them. We shall refer to some of these measures later.

But one cannot in any case make a valid comparison between the aid that was supplied to western Europe after the war and the resources now being placed at the disposal of the developing countries. For one thing, the average annual amount of economic aid given to western Europe from 1948 to 1951 was of the order of US\$ 12 per capita, while the corresponding assistance now being supplied to developing countries works out at about US\$ 4.

Above all, it is in the very nature of the problems of developing countries that they do not yield to rapid or sudden solutions. The task of making up for the economic lag of centuries cannot be compared with the problem of European economic recovery even after a destructive war.

ECONOMIC DEVELOPMENT IN LATIN AMERICA SOCIOLOGICAL CONSIDERATIONS *

José Medina Echavarría

* *Economic Development in Latin America Sociological Considerations* (E/CN.12/646), Santiago, Chile, Economic Commission for Latin America (ECLA) , April 1963.

I. DIAGNOSES

To obtain knowledge of a contemporary society (Latin America in this case) is perhaps the real purpose of sociology. And the form the acquirement of this knowledge takes is to find out principles of guidance, which in the best of cases cannot dispense with a diagnosis, or at least a prognosis based on a series of alternative hypotheses. A diagnosis as an interpretation of a situation can only be achieved if one has an idea of its structure and the dynamic tendencies that are manifest in it. But both structure and tendencies come from a previous situation and perhaps point towards a new one, the possible attainment of which depends, among other things, upon the external condition of a certain set of circumstances. The path through contemporary considerations leads us back towards history, towards its permanent elements of continuity and circumstance or, we might say, contingency. In view of the concern now manifest to understand the contemporary situation in Latin America (a concern awakened by the idea of its economic development), it is important not to overlook the essential facts of its history which, have exerted an influence up to the present time.

If these are not borne in mind irreparable misunderstandings will result. Two of them are of special interest to us here. The first —it has often been necessary to point out— is that for centuries past Latin America has constituted a fragment, however marginal, of so-called Western culture and not merely in a passive way, but by taking an active part in many sectors. It is true that, for better or for worse, Latin America is the product of a gigantic process of “transculturation” which because of its very vastness is still not completed. But it was also so advanced in the main centres that the destiny of the region very soon became linked with that of the West. Sociologically, this means that there is a continuity, or a logic if you prefer, in the evolution of internal situations, so that present-day problems (problems of development, for instance) are not the result of the juxtaposition now of a foreign and a non-traditional culture. Or, to put it another way, there is no break in the historical consciousness.

This is no reason for applying to the cultural situation in Latin America the concern of some thinkers¹ who —in the age of decolonization— are convinced that the “Europeanization” of other regions or countries, whether achieved or in process, is a European problem. It cannot be maintained with regard to Latin America that what carries it on towards its future has no continuity with what has made it historically what it is. The second fact to which attention should be drawn is the tremendous impact on the history of Latin America (indeed, on the Hispanic world in general) of events taking place outside it more than once with adverse effects. As we know, the independence of the whole region, whether achieved peaceably or through violence, was due to Napoleonic ambitions. On the other hand, the consequences of its immediate antecedent (the French Revolution) are more difficult to specify and to assess although they may have been of incalculable importance. The immediate reactions provoked by the Revolution prevented the maturing of the Enlightenment movement, so full of promise, and led to the breakdown of a decisive phase in the historical continuity of Spanish America. The case of the Enlightenment —and of its failure— stands out as a clear example of the effects of an external set of circumstances. From that time onwards however, other influential circumstances of greater or lesser importance can be seen without difficulty. The stages in the politico-social history of Latin America are found to coincide with specific moments in European history² (the only, universal history at that time) until we reach the period of the world wars. The significance of the two “Great Wars” in relation to Latin American economic development and especially to its planning is a matter of common knowledge.

¹ Joachim Ritter, „Europaisierung als europaisches problem“, *Europaisch-Asiatischen Dialog*. Dusseldorf, 1956. (ver español)

² As Latin America has been a creator of styles and has hitherto always kept to one style or another, it is significant that such phases could well be designated by artistic or literary names, sometimes representing whole ways of life; the baroque, the romantic, the modernist, the social novel. The dating of the periods, though not imprecise, would not of course be quite sharply defined. This is a subject (of enormous interest from the standpoint of the sociology of culture) that has not yet been developed.

A. The so-called revolutionary situation

The facts referred to above have a marked effect on the aspect of the contemporary situation in Latin America. Firstly, because her acutest problems arise from an internal evolution which puts to the test, above all, her capacity for building up a culture, her desire to go forward along her own particular lines. Secondly, because the need to find a solution has again become pressing on account of external circumstances and the almost unbelievable general speeding-up of the historical process; and (although this seems only to apply to Hispanic culture as a whole, and Latin American culture in particular on account of its slower rhythm and of reasons which it is not for us to examine here) the accumulation at one time of questions dealt with successively in other Western zones. Such problems could have been faced and solved at their own particular time, if it were not for the unavoidable fact of the acceleration of the historical process as a whole, an acceleration which is due not only, as it might seem at first, to technological change (the most obvious reason) but which is even more accentuated if that is possible in the sphere of awakened consciousness. Urgency —awareness of urgency— is therefore the essential characteristic of the Latin American scene today.

If we were asked to state in the briefest terms the decisive fact, in the present situation in Latin America, there would be only one possible answer: the profound revolution through which the whole region is passing. The term is, of course, used in the non-violent sense in which it is applied to the Industrial Revolution, as a prolonged process which brings about changes in all the basic elements of life: in ideas and systems of production, living standards and social mobility, range of occupations and power structures.

While the industrial societies properly so-called are already in the second stage of their development, Latin America, caught within two periods, is still subjected to the stress of the first without being able to escape the repercussions (favourable and unfavourable) of the second. That this radical transformation in depth should here and there give rise to revolutionary situations (in the other sense of the term) is something that is perhaps not necessarily determined by the process itself, but that cannot be denied or prevented. In any case, it is not a matter for consideration here.

1. Validity and limits of structural dualism

Recourse is often had nowadays to the idea of structural dualism³ for the purpose of providing an intelligible explanation of the situation described. But this interpretation, valid though it is, being highly evocative and descriptive, is none the less insufficient. According to this thesis, the structure of Latin America is in fact formed by the coexistence of two different societies, coetaneous but not contemporary, the modern and the traditional, the “progressive” and the “archaic”; and the distinction between these two areas of human activity (for the most part separate watertight compartments, or reciprocally influencing one another) explains by itself alone the sociological drama of the region.

The idea of dualism is very precise in the economic field, whence it may have originated and even drawn the terms used to describe it. It means the juxtaposition in a given country —especially as a result of colonization— of two technique-economic complexes infinitely remote from each other. But even in the economic field the theory is not clear or unanimously accepted, inasmuch as there are some who maintain that, in the “underdeveloped” countries, the mule will not be replaced in one generation by the aeroplane, but that both mule and aeroplane will continue, for a long time yet, to fulfil necessary economic functions. It would not be appropriate to embark here on a discussion of this highly technical and difficult question. Suffice it to quote the following opinion put forward by an economist: “...while dualism no doubt

³ The best book in this connexion: J. Lambert, *Le Brésil*, Paris, 1953.

brings with it many social and psychological stresses, it has some compensating advantages and represents in a way an attempt by the economy of the underdeveloped country to make the best of its resources during a transitional phase.”⁴

The concept of structural dualism is not sociologically inexact either if we base ourselves on an ideal image of the sociologically most advanced countries. These are characterized, in all their social aspects, by being free from abrupt breaks or sharp delineations, showing instead a continuous process of change and gradual transition. This continuum is found between town and country,⁵ between income levels, different classes or strata, degrees of education, etc. However, while there is in actual fact a continuum of the image, it appears that it is fully realized in only a few countries, so that all the rest are dualist to a greater or lesser extent.

It would then be inaccurate to identify the idea of structural dualism as a characteristic peculiar to Latin America, even if we ignore two points to which reference has already been made: first, that the distances between the traditional and the modern in Latin America are due to her own internal development process and not to the sudden introduction in a primitive society of the economic institutions of foreign powers; and second, that what is important is not so much the differences and tensions between two different ways of life, as the thread of their continuity—in other words—their interpenetration; the reactions of the backward sectors and the efforts towards expansion of the more advanced. Thus, in a good many Latin American countries, dualism is being weakened and dissolved to a considerable extent by the general spread of “modern” aspirations throughout all areas.

2. The threefold change

Without attempting to deny that something similar is happening in other parts of the world (although not, of course, in the same historical context), it may be said that the transformation in depth which Latin America is experiencing is the result of a threefold process of change supported by movements which in part coincide with it and in part are independent.

(a) Economic change

In the first place, the economic change itself. It is a fact that, from 1929 to 1959, the increase in Latin America’s total production followed an ascending curve, at a rate calculated by the economist to be 4 per cent per annum. It is true that the impression is less favourable when production is reckoned per inhabitant and that there are very marked differences between one country and another. But on the whole, during that period, Latin American development was sufficiently rapid to keep pace with population increase. It is true also that some dark patches begin to appear in the picture from 1953 onwards.

It is not our task here, without full competence in the matter, to set out the main features of the economic scene. Sociologically, the decisive fact is that this economic movement has existed and still exists, and has aroused a general consciousness sometimes confused, sometimes clear of the problems inherent in it. A further step forward would consist in finding out what form some of the components of this new consciousness have taken. And, although the economic indices appear to be obscure on the subject and do not of themselves indicate the social and cultural hypotheses of the phenomenon, a patient interpretation of some of them would disclose something of their sociological significance. Here are some indications by way of illustration. It appears that there is a change in the composition of demand, which implies, in

⁴ A.O. Hirschmann, *The Strategy of Economic Development*, New Haven (Conn.), Yale University Press, 1958; p. 132.

⁵ Herbert Kotter, *Landbevölkerung im sozialen Wandel*, 1958 (with relevant bibliography).

addition to the lesser proportion of exports therein, a change in the composition of the exports. The question is an economic one and can be challenged both as regards its interpretation and the policy it calls for. But there is no doubt that behind the phenomenon there are not only certain changes of circumstances but also variations in attitudes and decisions, which imply changes in the collective economic conscience and the advent of new leaders. An economic index such as that of the long-term increase in current State expenditure in a good many countries, in addition to its strictly economic significance, also has a wide social significance, to which we shall have occasion to refer later. And, lastly, there is no point in stressing, the social value of the indices, or the changes in the propensities to, or composition of, consumption as they belong indiscriminately to both the subjects under discussion. If the indices were more complete, they would enable us to penetrate, through the changes in consumption "habits", to the psychological stratum of personality, the variations in which are always closely (and sometimes fundamentally) connected with other variations of an institutional nature.

(b) National integration

The second factor in the threefold change which we are analysing is the conclusion of the process of national integration in the majority of countries. The fact that they can all count a century and a half of existence might make this statement appear incomprehensible or exaggerated. But if national integration is taken to mean that a considerable proportion of the citizens of a country are capable of taking part in some way in its collective activities, sharing, even to a small extent, in its common values and aspirations, it is obvious that some Latin American countries have not yet reached that stage, and for widely differing reasons; some because of the large numbers of their immigrants, others on account of that part of their original population which has resisted (or rather remained on the fringe of) the process of "transculturation" mentioned above.

For the latter type of countries it has been possible to speak of a cultural division into three sectors (the Indian sector, the sector in transition and the modern sector) and an attempt has been made to measure their significance in terms of volume and percentages. However, in the course of the last century, and especially within the last decades, the process of national integration has been very rapid and has sometimes been brought about through events promoted with other ends in view. One result of the Mexican Revolution was, unquestionably, to speed up the advance towards national homogeneity; according to the above-mentioned calculations, in 1940 the purely indigenous sector represented only about 15 per cent of the population. And, though the movement has been slower in other countries, the tendency is the same. In the not too distant future yearnings for the picturesque will be forced to seek satisfaction in literary descriptions, to this connexion other events and figures that are still highly controversial from other points of view — such as the name of Vargas or the phenomenon of "Peronism" — have made their permanent mark. And it must not be forgotten that this process as a whole is linked with the rate of economic progress, under conditions and with effects applicable to both.

(c) Supranational integration

The third stage in this continuous process of transformation in Latin America is that of its own supranational integration. It is a much less clear and less sustained movement than the previous ones, but it undeniably exists as a permanent aspiration vague perhaps, yet felt to be inevitable. It is due to complex reasons which we cannot examine here in detail, but which in their coalescence show very clearly that, at a certain moment, something which is the product of a heritage, a past, may unite with something which is an impulse towards a future determined by the stimulus of circumstance.

Nevertheless, the first point that must not be overlooked in considering this subject is the relative historical and cultural heterogeneity of the two great components of Latin America. Although the Portuguese sector does not stand entirely apart from this process, it is in the Hispanic sector that it has been most marked. The Hispanic nations are united in taking for granted their common bonds in the modern setting, though perhaps, they retain in their collective subconsciousness the painful scar of separation, and they still respond at every turn to the ideals of their heroes of the Independence, movement, epitomized above all in the lofty visions of Bolivar. But, with the passage of time, they have had to forge their own destiny as nations, in a sustained and as yet uncompleted effort, which at times led them into conflicts with one another, and more often than not made them act with their backs turned towards each other. Nevertheless, the idea of integration never entirely died out: it was taken up at varying time by this or that group of intellectuals, this or that group of national politicians and complicated in the latter case by aspirations, if not towards hegemony, at least towards leadership.

The details and vicissitudes of this whole movement are of course worthy of an attention which would be out of place here. Today, in view of the changing horizons opened up by the end of the Second World War and of the new dimensions taken on by world problems, the aspirations towards supranational integration in Latin America corresponds largely to the needs of the times. The shortening of distances due to the techniques of communication, the appearance of vast political configuration, the breaking-up of the nineteenth-century ideas of nationalism, the need (in a world tending towards uniformization) nevertheless to maintain the wealth and variety of the different cultural pattern, leads the Latin American countries to regard themselves once more as a unit, for the purpose of defending their interests, making their voice heard and asserting and showing the value of their own personality. However, in Latin America, as in other parts of the world, centuries of separation, together with certain deeply rooted ideas, place considerable difficulties in the way of political union. And any kind of integration would be impossible unless the idea of limited unions of a functional nature had already existed for some time. In one area or other of common problems (technical, cultural, economic, etc.) it has been found possible to enter into agreements which because of their technical nature do not arouse misgivings or offend long-standing emotional predispositions. A network of functional links of this kind is the efficient implement of integration, which would otherwise be impossible. In regard to what concerns us in this study, it is significant that it should have been problems of economic development which led to the setting in motion of this kind of integration machinery, making a viable instrument out of what had previously been mere pompous rhetoric. The quiet and lasting work for the economic integration of Central America and the creation, through the Montevideo Treaty, of the Free Trade Area (the first steps towards a Common Market) show the extent to which Latin America is passing from dreams to realities.

B. The decline of the old structure

This examination of the components of the threefold fundamental change which Latin America is now experiencing is obviously too rapid to be adequate, but it does throw into relief two points that seems to delight in facing us simultaneously with manifold problems that others have been able to solve at different times; and there is a vast task before us, calling for the use of exceptional resources. Where are these resources to be found? What kind of leaders are capable at the present time of controlling and directing them?

1. From the "hacienda" to commercial organization

Every social structure is wont to show, in its most diverse sectors and its most unexpected places, the trace and influence of one particular prototype. Present-day industrial societies

bear the stamp of the factory system in relationships and ways of life far removed from and without apparent connexion with the factory itself. For a long time every facet of the social structure of Latin America bore traces of the formative influence of one fundamental institutions the “*hacienda*” (large cultivated estate). All the economic, social and political history of Latin America is largely the history of the consolidation and transformation of that particular economic and social unit. And consequently the story of the gradual downfall of the traditional structure is interwoven with that of the slow decline of this ancient institution, We say “decline” rather than “disappearance” because it still exists and its influence is still felt.

The *hacienda*, needless to say, was not the only economic and social unit of any significance. In the economic field, it shared its importance with the silver-mining towns and the mercantile export centres, and from its earliest times (sixteenth century) it formed part, with them, of that peculiar economic set-up which continued for centuries without substantial change until a few decades ago. In the cultural and political sphere, it had to reckon with the activities of State and Church, and to accept or endure the growing influence of the towns. The differences between the Portuguese and Spanish parts of Latin America are to be found precisely in the different influence exerted in the course of their history by one or other of these elements. But neither their specific character nor their particular line of development are of concern to us here.

If it were possible, a more interesting exercise would be to trace, from the point of view of the *hacienda*, the evolution of property rights from the time when they were first consolidated in the seventeenth century, through the failure of the eighteenth-century reforms, down to the liberal-inspired disentailing trends in the nineteenth century which were fatal to the residues of indigenous communal property and established the concentration of property in the hands of the *latifundio* owners even more rigidly than before. And perhaps still more interesting, in the context of the present work, would be the economic history of the *haciendas*, that is to say, the history of the successive variations in their main products, from the indigo of early times, and the sugar cane, to which nowadays constitute the basis of Latin American exports. But these points of interest are in fact accessory to our main subject.

It suffices to recall the decisive fact: the complete emergence of the *hacienda*, with all the characteristics which it subsequently maintained, occurred in the seventeenth century. In other words, the vast geographical entity of Latin America, which up to that time had only been touched from without by an impulse confined to a few widely separated towns, began to take shape from within. An excellent historical account tells us: “...around the *hacienda*, rural life —previously little known— began to acquire form and vigour...”, and it adds in a paragraph highly significant for anyone desirous of understanding later history: “in opposition to the great city, the bastion of a State growing progressively weaker, the *hacienda* represented the power of the large landowners, whose authority in fact was measured by the number of workers and dependants they had around them, and the amount of land they possessed. At the end of the seventeenth century, the *hacienda* symbolized importance and extent of rural life to a degree which permits us to (compare it with the Roman *villa* during the decline of the Roman Empire”.⁶

From the economic point of view, therefore, it was the *hacienda* that formed Latin America, which is still predominantly agrarian. And it did so in what was perhaps the only possible way, having regard to the geographical situation confronting a movement of colonial expansion which did not move forward in successive compact advances but which, within a very short time, manifested itself in dispersed settlements such as have persisted down to the present day. It formed Latin America, too, on a deeper plane: that of its social or, if preferred, its human substance. In Brazil, the work of Freyre gives an account of this formative process

⁶ See G. Céspedes del Castillo, “La Sociedad Colonial Americana en los Siglos XVI y XVII”, in J. Vicens Vives Ed., *Historia Económica de España y América*, Vol. III, Barcelona, Teide, 1958.

—sometimes lost sight of among the rich detail of the *petite histoire*— an account which has been accepted or criticized, according to differences of temperament or point of view, but which nevertheless paves the way for a continued analysis of this great task. There is nothing comparable in Spanish America though there are scattered fragments awaiting someone who will use them to build up a comprehensive picture. In what follows we shall merely attempt to give a very brief sociological outline as an aid in understanding the situation as it is today.

What has, in fact, been the sociological significance of the *hacienda* in the whole of Latin American life? What follows, we need hardly say, is in no sense an apology. As we know, a methodological requirement in the building-up of a type is purity of characteristics, which unfortunately, is never met with in practice. To begin with, the very term *hacienda* is a composite abstraction used to denote a richly diverse reality, varying, according to regions, periods, and types of activity and known, moreover, by different names: *ingenio*, *rancho*, *fundo* (plantation, ranch, rural property), etc.

Having *made* the above point, we can go on to look at the sociological features of the *hacienda* that concern us here, listing them first, for purposes of clarity: (a) the *hacienda* was a centre of political and military power as well as of economic power; (b) it formed the nucleus of a widespread patriarchal system; (c) it was authority's epitome; (d) it gave rise to a particular human type or "character".

We can only touch very lightly on each of these features here. Since it first emerged in definite form, the *hacienda* has been something more than a unit of economic production. It was the means of establishing order in the vast empty tracts of agrarian land, and consequently became a nucleus of political power, tolerated, or used, according to circumstances, by the State authorities and sometimes granted or assuming on its own account a military significance. In frontier areas this military significance was inevitable, and in the Hispanic world the function in question was recognized from early times by various honorary titles: *capitanes*, *maestres de campo*, and the famous *adelantados*. This politico-military significance, which of course already, existed in the Kingdom of the Indies, persisted well into the Independence, Carranza, for instance, remained a powerful landowner. The debased forms which the phenomenon took at the time of *caudillismo* have received special attention, as does anything spectacular. But few people have analysed the significance of this politico-military nucleus as a factor making for stabilization and continuity when the governmental and bureaucratic machinery of the Empire collapsed and the social framework had to be kept together during long years of anarchy and of fluctuating political structure following the emergence of the new nations. For that reason it is worth mentioning here the pertinent "suggestions" of a foreign observer, Frank Tannenbaum, as yet awaiting systematic development —an undertaking which is doubtless rendered more difficult by the persistent academic traditions of political history.

The *hacienda* was also something more than a form of property. It was the support of a family and the symbol of a name. From his territorial redoubt, the head of the *hacienda* sought and concluded alliances with other heads of families, and these family federations, with their recognized chiefs, extended over whole regions and to some extent "organized" them. As we know, however, the owner of the *hacienda* did not remain all the time on his estate; both in the Portuguese and the Spanish zones he used to take up residence in a town which might be the nearest one or sometimes might be the distant capital. Family relations and federations by relationship were therefore not confined to rural domains but, through the towns, extended over the whole country.

The *hacienda* thus became the support of the kind of family structure which continues to exist in the Ibero-American countries in more or less attenuated form up to the present day and which so surprises and disconcerts the outside observer. This family structure, comprising not only close family relationships but also complex bonds of friendship could be studied in

terms of the functional theory so dear to modern times. It might perhaps also be maintained that, while nepotism was one of the disfunctional factors in such a situation, the network of "personal" relationships and bonds of friendship which it also involved was, on the other hand, a functional element or at least a latent structure which made possible on more than one occasion the suppression or attenuation of violence in politics that were nearly always passionate. This point could be made without introducing into the serious question of sociological consideration the aesthetic factor of the "charm" of this system of "personal" association.

But, if we admit that the *hacienda* was an economic unit, a political nucleus and the material support of a family and its circle, this means that it must be regarded as a closed social group, when account is also taken of the large number of servants which formed its base. And, like any other social group, it can resolve itself into a web of continuously repeated human relationships with a system of functions and duties involving in each case specific rights and obligations. To detail these functions and duties is a matter for historical description. What concerns us here is the supreme, the principal function; that of authority. "Over each and all, from his eldest son to the least of his slaves, the chief of the *hacienda* exercises his authority, at once tyrannical and protective, in degrees varying according to complex factors and circumstances."⁷ "At once protective and tyrannical" signifies authoritarian and paternal. And this image of the relationships of subordination —protection and obedience, arbitrariness and graciousness, faithfulness and resentment, violence and charity— which in its origin is a replica of the characteristics of the far-off monarchical domination was maintained intact for a long time after the king had been replaced by a President of the Republic. The model of authority created by the *hacienda* spread and penetrated through all the relationships, of command, embodying in the paternalistic employer the notion of authority persisting in the popular mind.

No one would claim that this manifestation is peculiar to Latin America. The practical forms of domination (to describe it in Weberian terms) have always been a mixture of the legal, the traditional and the charismatic. Legal domination is now beginning to be fully achieved within the combination of "secondary systems" of the advanced industrial societies. And complete adaptation to the sentimental vacuum left by the extinction of the paternal authority is a universal problem which each and all must face. In Europe —to leave aside the *exceptional* case of the United States— the transition has been slow and it was attenuated, among other things, by the gradual interposition of the machinery of government bureaucracies, which accustomed the people little by little to the existence of impersonal, objective regulations. The greater rapidity of the process in Latin America left widespread traces of nostalgia for the lost, father-figure, and it is not surprising to see it still in the aspect of some of her political movements. The change was sometimes so abrupt that, as in Bolivia, it seemed to take place from one moment to the next. And one of the most fascinating sociological enigmas still awaiting investigation is to discover what happened in the minds of the good Quechuas and Aymarás who passed overnight from deep-rooted obedience to their paternalistic employer to intelligent compliance with trade union rules.

Lastly, the *hacienda* as social unit (or social system in the language of today) has its particular character. But we must not make too much of this point if, as we should do here, we wish to avoid entering the boundless domains of cultural sociology and philosophical anthropology. The subject is obviously linked with that of the hierarchy of values in the traditional Latin American world, and it naturally fascinates foreign observers. The *hacienda* system is often spoken of as "feudal" which, technically, is absurd. It would be less so if the much wider term "seigneurial" were used. Then the figure which indicates the character type is the seigneur (seigneur of the *hacienda*, the livestock ranch, the plantation, etc.) and

⁷ G. Céspedes del Castillo, *op. cit.*

he is endued with the special characteristics everywhere attributed to this type of man: a sense of being of the elect, even among devout Catholics; magnanimity and a noble bearing; dilettantism in the rare cases when he is a cultivated man; personal fearlessness; contempt of death; and a capacity for staking his life impassably on a single card; all this to meet the demands of a duty held to be absolute. For the rest, compliance according to his status with the undefined requirements of *noblesse oblige*. The foregoing is, of course, an exemplary image; but when those qualities are deformed or debased, they serve to foment a vicious evil in Latin American society. Magnanimity becomes the ostentatious squandering of the *señorito* and virile indifference in the face of a noble death is transformed into an obsession for morally empty “masculinity”.

Even if we take the highest expressions, aesthetic, moral and religious, of this seigneurial existence, they are clearly not the best suited to the requirements of modern economy. But their influence on the pattern of the economic ethics of the Ibero-American should be looked into more closely. Similarly, little is known about the extension of the Weberian thesis of the Latin American scene; in other words, a duly objective, impartial and rigorous investigation into the influence of the Catholic Church, both in the formation of these fundamental economic attitudes and in the actual development of Latin American economy, has not yet been made. The seigneurial way of life has gone beyond recall and with it some of its virtues and qualities. There may be some who deplore its disappearance and think that with it a brilliant streak in the spectrum of life's colours has vanished. But this is not the case; for what they omit to say is that values which were at the origin of a form of life but do not serve to form the structure of a new one are not capable of handling on any originality of example. In Alfred Weber's words, a culture dies only when it is incapable of reacting creatively in continuity of style to the “aggregate of life” which the general advance of the historical process inexorably presents.

It is impossible to trace in detail here the history of the dissolution of the *hacienda* system, or to be more precise, its transformation into other types of economic operation and social relations. Passing over the details we can, however, state that the causes were economic and proceeded from the foreign market as well as from home markets. We could trace the thread of known economic indices, relating either to exports or to changes in total demand. But we must confine ourselves here to making one affirmation and giving a few significant examples.

It is generally asserted that the *hacienda* broke up in proportion as it became more and more “commercialized” or, in other words, as it took on the characteristics of a profit-making concern. From this distance in time we can see that the introduction of refrigeration in Argentina, in 1876, was the first modern impetus in the transformation of the *hacienda* of the pampas. A little later, the installation of freezing arrangements not only led to technical advances in stock-farming methods but also gave rise to a new social group which looked towards the towns and direct trade contacts with Europe and which rapidly acquired wealth and powerful political influence.

It would be out of place here to attempt to trace all the repercussions of this phenomenon. In another part of Latin America, far from the one mentioned above, and much later on, there was the appearance of cash-crop farming, arising out of a combination of economic and political circumstances, and its significance has been carefully analysed by R.N. Adams in his excellent study on Guatemala.⁸ In that instance, the main social effect was immediate: the uprooting from the *haciendas* of their permanent labour force, which became a part of the mobile proletariat, either rural or urban.

Lastly, among the studies of this kind in Brazil, a “type-study”, has been produced on the changes in the structure of the traditional sugar plantation.⁹ In careful and concise sociological

⁸ See “Social Change in Guatemala and U.S. Policy”, in Richard N. Adams et al., *Social Change in Latin America Today*, New York, Harper and Brothers, 1961.

⁹ H.W. Hutchinson, “The Transformation of Brazilian Plantation Society”, *Journal of Inter-American Studies*, April 1961.

terms it explains the circumstances in which the old family plantation, managed by the seigneur, has become the modern factory operated by a limited company. The climax came with a crisis in the classic cultivation of sugar cane for export and the protective measures introduced by the Government with the establishment of the Instituto del Azúcar y del Alcohol (Sugar and Alcohol Institute). The main point was that the new commercial concern no longer had the total freedom of the old plantation it had in future to reckon with Government regulations (concerning volume of production, relations with contractors, market prices, techniques, etc.) with labour laws and with trade union action. This represents a complete transition from one age to another. Many such cases might be quoted, all related to the question of foreign markets.

But the home market, too, contributed towards the transformation of the *hacienda* by revealing everywhere its inadequacy. In many areas agricultural production under the traditional system was not enough to meet the continually increasing food requirements. The structural reforms we have mentioned (though we have spoken only from the economic point of view) were above all due to an awareness of this problem. The time for easy-going ways had passed once and for all. To realize something of this, it is enough at times to take a look at the actual situation. We give below the observations of one who, without need of statistics, saw with the clear, kindly and penetrating eye of the philosopher, and set down his thoughts, in passing, in very characteristic style, at the end of a brilliant philosophical and literary essay: "For, Argentineans, we must make haste. Time is flying and, for America, there is little doubt that colonial life, even in its most progressive forms, is at an end. Colonial economy is on its death-bed and so, too, is the rest of that way of life. And the end of colonial life means the end of living *ex abundantia* — the wide open spaces are becoming peopled. The population is increasing; there is no longer plenty of good and free land and much of the free land has been found to be not good. So long as there was land enough and to spare history could not begin... But now the history of America, in the full force of the term, is about to begin..."¹⁰

II. TOWARDS THE NEW SOCIETY

A. The two fundamental questions

We are now witnessing the disappearance forever of Latin America's traditional "consistency". An attempt has been made in the foregoing pages to outline the main factors which have determined this momentous change — momentous, as is any turning-point, although we trust that in this case it is largely a matter of growing pains. It inevitably raises two fundamental questions. Firstly, what are the present-day foundations of the new system which is taking the place of the old and which was inherent in it from the earliest days of its decline? Secondly, what is the ultimate basis of the *prise de conscience* that will enable us to gauge the character of the immediate future ushered in by the new economic cycle?

It must not be thought that these questions are raised out of sheer intellectual curiosity. If appropriate answers can be found, it will then be possible to take effective action in one direction or another, not only by gearing all the energies of individual countries to the achievement of set goals, but also perhaps by marshalling outside forces as well, for, in these days of interdependence, the assistance they provide may be a decisive factor in success or failure.

Whenever history enters upon a new phase, the clearest thinkers are bound to wonder anxiously what groups of men will be called upon to shoulder the new responsibilities arising, and where those men are to be found. Any number of instances of this situation may be cited.

¹⁰ José Ortega and Gasset, *Meditación del pueblo joven*, Buenos Aires, Emece 1958, p. 80.

It will be enough to quote one example of special interest, not only on account of the man's calibre, but also because the problems he analysed, for all their apparent similarity to our own, are actually very different and remote, even though so short a time has elapsed. When the young Max Weber set out (about 1895) to elucidate the problems arising out of Bismarck's system, he concentrated on one decisive question: who were to be the political leaders of the new Germany which was then heading, through large-scale industrialization, for an unknown destiny in both the political and economic spheres? and on which of her main classes was it possible to depend? His thorough analysis, which cannot be discussed in detail here, is a model of its kind. He shows how the old Junker class, accustomed to command, nevertheless found their economic interests at variance with the *Wirtschaftspolitik* that came to be imposed on the new State. As for the new *bourgeoisie*, it had been tamed by the old Kaiser and at that time had no urge for power, nor was it remarkable for its political judgment. The brand-new proletarian class was felt to be immature and, as yet, inoffensive. In the impasse created by this situation Weber already foresaw the greatest danger for Germany's political power. Needless to say, the situation is not the same in any part of the world today, including the Latin America of 1961. But Weber's approach to these major issues can still provide useful guidance.

To what groups of men can we look, in present-day Latin America, to steer our continent successfully through the changes by which it is now assailed? On what classes can we depend? On the land-owning class which ruled Latin America's destinies with some success for a considerable period? On the newer *bourgeois* class brought into existence by exports and industry? Or on the newest, the proletarian class, barely organized and with but slight experience of power?

The second question formulated at the beginning of this chapter is equally important. What is to be the basis of the *prise de conscience* which is the inevitable prelude to the new era ushered in by the 1960's?

I have elsewhere attempted to give a scholarly answer to the question why, in all parts of the world, economic development has become the ever-recurring theme of discussion, at learned international meetings, in newspaper articles, among students or wherever people gather together".¹¹

One of the points brought out was the "necessary" character of economic development which, according to accepted theories, has nowadays become a worldwide movement forming part, alongside social and cultural development, of the general historical process of civilization. Economic development was defined in more precise terms as a trend stemming from the combined effects of technical power and scientific knowledge. Yet theory, sound as it may be, is perhaps not enough to explain mankind's present experiences. Were I not afraid of being upbraided for my incorrigible attachment to Ortega (though this is not discreditable), I would yield to the temptation to comment on his theory of wealth.¹²

For the philosopher, wealth is not something purely economic, for it relates to life as a whole; it means that man "has far greater opportunities in life than were open to him before. Enrichment can be equated with modernism; there can be no denying that every people reaches a stage when its established, traditional way of life is swept away by a current of modernism." My comments would bear more particularly on this idea of established custom. At a later point we shall discuss the significance of certain periods of social change.

However, in the present report, concerned as it is with economic development, it would be well to turn to the economist rather than to the philosopher. It was for this reason that I

¹¹ José Medina Echavarría, "El papel del sociólogo en las tareas del desarrollo económico", in *Aspectos sociales del desarrollo económico*, op. cit.

¹² See José Ortega and Gasset, *Una interpretación de la historia universal* (lessons VII and VIII).

chose to borrow an economist's phrase at the beginning of the present chapter, leaving it in French. As used by André Marchal,¹³ *prise de conscience* implies the introduction of a decisive, dynamic element in changes of structure. It is the basis of the distinction between short and long periods in the sense defined in the following paragraph.

It is far from my intention to enter into details of a —theory which could not but be controversial. But I have recourse to it here in order to express one of any convictions in economic terms. What was previously regarded as a far-reaching change, the decay of a social system, now assumes the more harmless shape of a change in the length of an economic period. To put the matter in a nutshell, a “periods longue” is now opening up for Latin America. Marchal's own words will justify this bold statement: «Alors que le processus de courte période était justiciable d'une analyse purement économique, en quelque sorte mécanique étant donné que, seules les réactions instinctives étaient retenues —le processus de longue période est justiciable d'une analyse psycho-sociologique, puisqu'il s'agit de rendre compte de réactions volontaires, conscientes, des individus et des groupes».¹⁴ Where do we find this “prise de conscience”, and what is its scope?

B. Politics as a driving force and a guide

1. Technology and politics

Where, as we have already asked, do we find the ultimate basis of the *prise de conscience* (in Marchal's sense of the word) which is now ushering in a new “long” period in Latin America's economic life or, in more general terms, a new era in its life as a whole? The theory of cultural backwardness that was in vogue for some time helped to spread a belief in the decisive importance of the “technological” factor and, through its over-simplified approach, exerted an influence on practical politics. It has rightly been asserted that no one can fully grasp the nature of modern industrial societies which halt giving serious consideration to two phenomena which may appear widely disparate —technology and painting. To technology,¹⁵ not so much because through its progress it surpasses other sectors of culture (a theory that is disproved by science) but because it leaves its mark on the manners, customs and language of the day, because it completely overthrows the nineteenth century concept of progress, and because its development affords an example of how to tackle problems in other fields, including the most recalcitrant branches of the social sciences. In the matter of painting, the situation is more delicate and complicated, but Arnold Gehlen¹⁶ may well be right in maintaining, along with other thinkers, that some of the secrets of the age are unlocked by Picasso or Miró, Klee, Max Ernst or Mattia Moram.

No attempt has so far been made to analyse the present day situation in Latin America by giving a sociological interpretation of the starkness of its modern paintings (those of Orozco, for instance, of Tamayo or Siqueiros, Portinari, Matta or even Jusep Torres Campalans). Yet almost excessive stress has been laid on the revolution in ways of thought and feeling that has been brought about by the latest technological advances. What may be termed a “technological interpretation” has been given of the *prise de conscience* in Latin America today. This interpretation obviously yields part of the truth, but by no means, the whole truth.

¹³ André Marchal, *Systèmes et structures économiques*, Paris, Presses Universitaires de France, 1959.

¹⁴ *Op. cit.*, p. 91.

¹⁵ Hans Freyer, „Gessllschaft und Kultur“, in *Propylaen Weltgeschichte*, chapter X, pages 532 et seq.

¹⁶ Arnold Gehlen, *Zeit Bilder*, Bonn, 1960.

In his study of Guatemala¹⁷ which can now suitably be quoted for a second time, Richard N. Adams had the intellectual and political courage to oppose the prevailing fashion for technological determinism. The people of Guatemala obviously do not spurn anything that can improve their lot through technological aid. Yet, as in the past, so doubtless in the present, their main hopes for the future are centred on a general reform of the traditional social structure; there is no cause for surprise that these hopes are cherished chiefly by the lower middle classes: by teachers and students, officials and office workers, small industrialists and landowners. Two paragraphs by Adams, deserve quoting in full: "When we examine the process of change in Guatemalan society as a whole, two striking features leap to the eye. In the first place, the nation is in the throes of changing over from a discontinuous set of regional cultures to a continuously evolving and nationally centred culture. In the second place, this change-over is being initiated by political and social innovations, rather than arising spontaneously out of changes in production and technology".¹⁸

Later on, he states categorically: "... we must realize that in a country like Guatemala people do not see their problems solely in terms of technological aid and economic development. They are intimately involved in the painful emergence of a new society with its new sources of power".¹⁹

Adams' discerning remarks concerning Guatemala are applicable *mutatis mutantis* to most, if not all, of the other countries in Latin America. This means, to borrow the terms used by another economist, that, although due importance should be attached to the problem of technology when considering the historic role of the region's "autonomous forces", equal account should be taken of population movements and particularly of the movement of ideas. In answer to our second basic question, this means that the *prise de conscience* ushering in the new era must be chiefly of a psychological and social character. To quote the words of Marchal: «C'est, en effet, la prise de conscience d'un désajustement dans les structures sociales qui peut conduire —au besoin en faisant intervenir la contrainte don't disposent l'État et les groupes— qui peut conduire a une modification des structures économiques et vice-versa".²⁰

Would it be possible, or rather, are we able at this stage to tackle a last, thorny question? Up to now, the conviction has prevailed that the democratic system is capable of promoting economic development, and in some sort not only because of value judgments but also for technical reasons. These reasons provide at once for the prerequisites of growth, i.e., a sustained and adequate rate of growth, and the equitable and human distribution of the fruits thereof. No one would deny in principle that the human intelligence is capable of determining the procedures required for democratic programming. It would, doubtless, be more difficult, though by no means impossible, to reconcile planning and democracy. Intellectuals may be provoked to great impatience at times by the delays and obstacles which their ideas encounter when applied to the complex situations of real life, though the experience of practical men may in due course contrive to damp down the intellectual's inherent intolerance. What may happen, however, is that a moment will come when the general conviction prevails that the democratic system is a failure, that Western ideas are exploded. The future is in the lap of the gods; and there is no point in our striving with Proteus now, to wrest his secret from him the —elusive sea-god will always escape us, so we had better give up any idea of prophecy. Although the future is unforeseeable, we can in any case bear in mind the causes that may lead us to some such gamble with fate —as rejecting democracy. In these last remarks on the viability of the democratic system, let us emphasize once more the significance of its two indispensable buttresses: legitimacy and efficiency. The democratic system can perish if it is wasted by inefficiency. But it can also perish if the vital force of its legitimacy is sapped by

¹⁷ "Social change in Guatemala and U.S. policy", in *Social change in Latin America today*, op. cit.

¹⁸ *Op. cit.*, p. 257.

¹⁹ *Ibid.*, p. 283.

²⁰ *Op. cit.*, p.103.

pernicious anaemia. It is important not to be mistaken about these two dangers; the second is much more serious and relentless than the first. There is always a hope that, even at the eleventh hour, men may arise who are able to turn inaptitude into efficiency, who are able, if need be, to perform a final, saving operation. On the other hand, the complete evaporation of beliefs, the moral collapse that may result from the dissolution of faith —the psychological disintegration of a whole society— can only lead to hopelessness and “extremism”. Men cannot live without the stimulus of a lofty example. And, sometimes, ruling groups through their corruption may poison democracy instead of affording an example of devotion and steadfastness. But there is perhaps no deeper form of such corruption —for the very reason that it slowly and inexorably undermines— than the power, Machiavellism of public men, whether of their own country or of a foreign dominating country. It has rightly been observed that the Machiavellian of the Prince corrupts, at most, his little Court; but the mass Machiavellian of the great modern leaders saps, equally and inevitably, the moral fibre of all individual citizens. And democracy is basically a question of ethics, as has been so clearly explained by the philosopher Jaspers. Psychological disintegration implies, at the most, mere selfish resignation, content, to gratify its most “human” and immediate interests, and, at the least, escape to an “ivory tower”, represented, perhaps, by one of the world religions. Let us, then, face this possibility —as is fitting for adult, mature beings— and at the same time let us hope, and, still more firmly determine, that it be not translated into fact. In one of the most fateful moments in the history of Spain, her greatest leader was in a position to say: Spain “*fará da sé*”. He did not, however, do so, and therefore did not shatter the mystery that history preserves throughout its long course by reason of its secrets. Why should not that same hope be repeated here? We have no doubt that, in the era which is now dawning, Latin America, too, *fará da sé*.

TOWARDS A DYNAMIC DEVELOPMENT POLICY FOR LATIN AMERICA *

Raúl Prebisch

* Selected pages (3 - 10 and 23 - 43), in *Towards a dynamic development policy for Latin America* (E/CN.12/680), Mexico City, Fondo de Cultura Económica, 1963.

1. Structural reforms to clear the way for development

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

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

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

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

Even so, average per capita income in Latin America is appreciably higher than in other peripheral regions, and thus affords an advantageous starting-point for the realization of what is no longer a utopian dream: the eradication of poverty and its inherent evils, by virtue of the tremendous potential of contemporary technology and the possibility of assimilating it much more quickly than was the case with the capitalistic evolution of the more advanced countries. However, this rapid penetration of technique demands and brings with it radical changes: changes both in the pattern of production and in the structure of the economy, which could not be effectively brought about without a basic reform of the social structure.

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

- (a) The structure in question considerably hampers social mobility, that is, the emergence and rise of the dynamic elements in society, men of drive and initiative, capable of taking risks and responsibilities, both in technical and economic matters, and in the other aspects of community life;
- (b) The social structure is largely characterized by a situation of privilege in the distribution of wealth and therefore of income; privilege weakens or destroys the incentive to economic activity, to the detriment of the efficient utilization of human resources, land and machinery;
- (c) This state of privilege in regard to distribution is not reflected in a rapid rate of net capital formation, but in extravagant patterns of consumption in the upper strata of society, in contrast with the unsatisfactory living conditions of the broad masses of the population.

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

² See the chapter on "Income distribution in Latin America", in *The Economic Development of Latin America in the Post-War Period* (e/cn.12/659/Add. 1).

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

2. Capital formation and income distribution

The test of a system's dynamic strength lies in its ability to accelerate the rate of development and progressively improve the distribution of income. If the annual rate of growth of average *per capita* income could be raised from the very low figure of 1 per cent registered of late to a minimum of 3 per cent in Latin America as a whole, a rational redistribution policy would enable the personal income of the under-privileged half of the population to be doubled in seventeen years, and the lot of the middle-income groups also to be improved, although at a less rapid rate.

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

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

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

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

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

The only available means of meeting them is by directly combating one of the anomalies that most affect the development of Latin America, namely, the marked failure of capital formation to reach the levels demanded by contemporary technology, as against the extravagant pattern of consumption of the high-income groups.

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

3. International co-operation and the structure of trade

This capacity might be seriously handicapped by the external bottleneck in development, which, in conjunction with the limitations of domestic production of capital goods, would mean that not all the additional saving obtained could be invested in such goods. Hence the vital need for international resources, until the structural reforms advocated here enable full advantage to be taken of the increase in savings.

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

The countries in which industrialization advances most rapidly tend to be affected more and more by the bottleneck in question. Their difficulties do not originate solely in the social structure, but also in the type of trade structure which characterized the epoch of externally-gearred development that preceded the world depression of the thirties. Here again, as in other aspects of our development problems, a whole series of out-of-date ideas survives. It is true that the peripheral industrialization of the regions has at last been accepted as an indispensable requisite for economic development. But what is still perpetuated is the anachronistic pattern inherent in the peculiar concept of the international division of labour which was prevalent up to a short time ago —the trading of primary commodities against manufactured goods. This is the framework within which the industrialization of our countries has been taking place. And the obstacle to economic development that it represents is now beginning to loom larger at every turn, for whereas the upward trend of demand for the manufactured goods we import is very sharp, primary exports are expanding relatively slowly, largely for reasons over which the Latin American countries have no control. Thus, there is a latent tendency towards disequilibrium which is aggravated as economic development gains speed.

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

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

Latin America's exports are of course affected by the universal slowness of the growth of demand for primary commodities, in contrast with the buoyancy of demand for manufactured goods as *per capita* income rises. But this circumstance is combined with other factors of considerable importance. In the first place, the moderate rate of economic development of

the United States, together with its import restrictions, has exerted an adverse influence on Latin America's export trade. And, secondly, the protection and discrimination practised by the European Common Market prevent us from taking full advantage of the steady expansion of demand for primary commodities in the vast economic area it represents.

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

While it is true that basically the solution of such problems depends upon the great industrial countries and the degree to which their trade policy favours liberalization, it is no less certain that the Latin American countries too must put forth a tremendous effort in the same direction. In this sense, the formation of a common market is an undertaking that brooks no delay. Its importance has been realized by the Central American countries, whose determination to establish such a market has been bold and resolute. The problem of the Latin American Free-Trade Association is more difficult, for the very reason that the development of industrialization in watertight compartments has created vested interests and prejudices which oppose reciprocal trade without taking account of the serious effects of such an attitude on economic development. This is not a merely technical matter, it is a question of important policy decisions which must follow up the Montevideo Treaty. The technical groundwork for these decisions is basically complete; all that remains to be done is to study and select the best ways of putting them into practice.

4. The closed type of development in Latin America

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

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

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

This is a point of considerable importance for Latin America, for unless such solutions are resolutely sought, our countries will be swept by the force of circumstances towards an increasingly closed type of development, and a steady contraction of their share of trade with the rest of the world, which will add further difficulties to those inherent in this process. In

default of sufficient international co-operation in overcoming these difficulties, both in the field of trade and in that of financing, all kinds of authoritarian measures might supervene, with grave consequences for the progressive development of democracy in Latin America.

5. Internal bottlenecks

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

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

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

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

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

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

No exhaustive examination has yet been made of all the repercussions of these factors on the drift from the countryside to the bigger Latin American towns, which is a disquieting and striking sign of economic and social disequilibrium. There is no doubt that immigration is bound to take place; nor is there any doubt that the increased technical progress of the rural

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

areas will tend to give it greater momentum. But is it necessary for the displaced population to congregate in the big towns?

Why should they not stay in the rural milieu, living in small and medium-sized communities and employed in industries and services that would satisfy some of the requirements of that milieu itself? Why have the bigger towns in Latin America grown, at the expense of the medium and small towns, to an extraordinary extent that is quite disproportionate to the trend of developments in more advanced countries?

These questions cannot be answered satisfactorily except on the basis of careful research. Perhaps the weakness of rural demand, or, to put it another way, the concentration of demand in the big towns as a result of the structural⁴ and adventitious factors mentioned above, may have played an important part in this phenomenon. And, as in the case of other social phenomena, there have been no countervailing reactions but a self-perpetuating spiral, since the agglomeration of people in big towns concentrates demand there even more, and leads to further population congestion. It may therefore be concluded that the geographical redistribution of income is also of great social importance.

I. THE DYNAMIC WEAKNESS OF LATIN AMERICA'S DEVELOPMENT

A. Productive absorption of manpower

1. Slow growth rate and surplus manpower

The very low annual growth rate of 1 per cent in *per capita* income for Latin America as a whole since the middle of the last decade is clear proof of the lack of dynamism in Latin America's development. Comparison of this rate with the 3.7 per cent in Western Europe for the last decade and 8.3 per cent in Japan, and the annual *per capita* rates of between 5.3 and 9.0 per cent in the socialist countries of Eastern Europe, brings home the full significance of this. At the rate of 1 per cent it would take seventy years to double the *per capita* income of Latin America as a whole —although there are marked differences between countries.⁵

This in itself is very serious. But there is another fact that is perhaps an even greater cause of social tension. An appreciable proportion of the increase in the active population is not properly absorbed in the productive process, and remains beyond the bounds of economic development. This is mainly true of the population that moves from the country areas to the towns. In the country demographic growth is possibly higher than the general average of 2.9 per cent per annum, but in the last decade those who have remained on the land represent only about 1.5 per cent. This is what must inevitably happen in the process of economic development, but what is not inevitable is the fate of such people. Far from being able to integrate themselves into the life of the towns, and to share in a better way of life, they put up their wretched shacks and live from hand to mouth in a variety of personal odd jobs extremely badly paid, with periods of complete unemployment.

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

⁵ See chapter II of the study *The Economic Development of Latin America in the Post-war Period* (E/CN.12/659).

Thus the country becomes a purveyor of poverty, frustration and resentment to the towns, where the symptoms of the concentration of income are already so conspicuous. This is *clear* proof of the explosive social polarization of development, due to its dynamic weakness and distributive shortcomings.

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

This fact alone is sufficient explanation of why the increase in the active population should drift to the towns on a larger scale. But this is not the only explanation, since as productivity increases in agriculture and in other primary occupations, the displacement must increase —other things being equal— and it will also increase in proportion to the higher natural growth of the rural population compared with that of the urban population.

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

But what are these activities that provide employment? Firstly, industry and activities related to the movement of goods (trade and transport), which all tend to grow more rapidly than income, and secondly, other activities that also tend to grow relatively fast as income increases thus helping to increase income growth; these are a large range of skilled personal services, that require varying degrees of vocational training, and Government services.

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

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

But there is yet another point to consider. The people engaged in these personal services, who are also trying to move into the manpower-absorbing activities, can only do so to a limited extent. The result is an uncontrolled mushroom growth of marginal activities in the medium-sized and small towns, with the serious consequences this entails. All this is

due to the dynamic-weakness of the system as it functions at present, and its lack of capacity to attain the minimum rate of development with a satisfactory rate of capital accumulation.⁶

2. Increased productivity and the need for new investment

The above considerations enable us to throw some light on a very important phenomenon: in view of the dominant role of industry and related activities in absorbing manpower, their growth rate must increase proportionately with the increase in average productivity in these activities; and the increase in productivity in agriculture and other primary activities imposes a similar responsibility on industry and related activities.

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

The annual growth rate of 1 per cent in *per capita* income is far below this minimum rate, and even the rate of 2.5 per cent referred to in the Charter of Punta del Este is insufficient from this standpoint. Consequently, it is hardly to be wondered at that the surplus active population are to be found not only in unskilled personal services, but also often in industry itself, and in trade and transport, or else move into the public services, needlessly swelling the ranks at the expense of efficiency. That is, when they do not stay in the rural areas as redundant labour.

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

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

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

In order to bring out the significance of this, a rough calculation has been made of the minimum growth rate of income that would have made it possible to employ this redundant manpower in production and transport activities. We start from the arbitrary though not unreasonable assumption that services in general did not require an increase in employment higher than the 2.6 per cent growth rate of the active population, or in other words, the 5 per cent growth rate that took place represented an excess annual growth of 2.4 per cent.

⁶ There are extreme cases in Latin America where capital accumulation must grow at a rate that will make it practically impossible to fulfil this manpower-absorbing function. This points to the need to take special measures to keep the superfluous rural population in the country areas, and avoid forms of mechanization that will aggravate the problem

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

It should be noted that this marked increase in the overall growth rate of the product would have been obtained with the same growth rates of productivity in these activities.⁷ This is of special significance from the dynamic standpoint, and it is explained by the transfer of manpower away from agriculture, where in 1962 the product was barely 530 dollars per unit of the active population, into those other activities the production and transport of goods, where the average was 1,840 dollars.

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

On this assumption, the *per capita* growth rate, which averaged 2.2 per cent per year between 1941 and 1962—a period that includes a fair proportion of favourable years as regards the terms of trade—would have had to be not less than 3.1 per cent to absorb the surplus population.

3. Main causes of dynamic weakness

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

Rightly considered, this disequilibrium, in the guise and degree in which it makes itself felt in developing countries, springs from the obvious contrast between the technique they have to assimilate and their present capacity for capital formation. The technique in question, perfected in the great industrial centres, is based mainly on the need to save labour by increasing the amount of capital per head. In the centres referred to, this presents no difficulties, thanks to their high income levels. The same cannot be said of developing countries. And as it is inexpedient to revert to out-of-date techniques, in an endeavour to adopt those compatible with the existing capacity for capital formation, the only alternative open to developing countries is to achieve an exceptional increase in the capacity in question, commensurate with the requirements of production technique. However, this disequilibrium or disparity is aggravated by a number of serious distortions in the production process in Latin America. Let us try to describe them briefly.

A regression in respect of production techniques is certainly not feasible, as has just been remarked, it is none the less true that there are possibilities of choosing between higher

⁷ That is, an annual rate of 2.6 per cent in agriculture and 2.9 per cent in industry, energy and transport.

and lower levels of employment of manpower, according to the ratio between the cost of labour and the cost of capital, as determined by factor prices and by rates of interest on investment resources.⁸ This is a problem that will not solve itself of its own accord, although such a possibility is conceivable in the abstract. The terms in which it presents itself were described earlier in this document, but from another standpoint. Capital formation is insufficient to absorb, at the relatively high level of productivity of the labour-absorbing activities, the manpower released by the labour-economizing industries whose productivity or income per worker is lower. In effecting their investment, entrepreneurs adopt the techniques that suit them best in the light of the cost of labour and of capital.

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

Strictly speaking, it is conceivable that in a very fluid market the ratio between the cost of labour and the cost of capital might be such as to ensure optimum employment of manpower—that is, a ratio permitting the maximum absorption of human resources compatible with the maximum increase in the product. This is what accounting prices signify in the evaluation of the economic soundness of investment. Not enough progress has yet been made in respect of the possibilities for the practical application of this concept, except as regards investment by the *State*, which can get away from the current fallacious notion of economic viability. If, for example, a higher rate of interest than is paid by the State on the resources it borrows is applied in the relevant calculations certain types of investment which result in a saving of manpower become anti-economic, and others involving the employment of more labour are found to be economically sound.

But this procedure is not, of course, applicable in private activities, except as a guide to the adoption of measures aimed at ensuring economic viability. The possible nature of these measures cannot be defined at present with any reliability, for as this important aspect of the question does not concern the great industrial centres, but the peripheral countries, it has not yet been explored as thoroughly as it deserves.⁹

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

⁸ These possibilities vary according to the branches of industry concerned, but are never negligible, except perhaps in the extreme case of continuous-process activities like the chemical industries. In the textile industry, for example, recent ECLA studies have shown that two technical alternatives, characterized by differing degrees of automatic control of equipment, represented a difference in the product-capital ratio of a little over 50 per cent (in an integrated cotton textile-mill). That is, the selection of the less highly mechanized (but nevertheless up-to-date) technique would enable the value added per unit of capital invested in equipment to be approximately doubled.

⁹ Nor has sufficient progress been made in the study of methods whereby a saving in construction materials might be achieved and more human labour employed in engineering works—bridges, roads, dams, buildings—which absorb a significant proportion of total investment in Latin America. The technical standards applied are generally brought from the industrial centres, where the wage-materials ratio is much higher than in Latin America. *Inter alia*, therefore, empirical research is needed to determine the technical standards best suited to the special conditions prevailing in the Latin American region.

The asymmetry of protectionist policy —explained in an earlier document—¹⁰ has also contributed to the development of labour-economizing industries, at the expense of others with a higher labour-absorbing capacity. Protection implies subsidizing import substitution industries but not export industries. This has militated against the economic soundness of the industrialization process, since activities have been developed to serve the domestic market whose costs, in relation to the world level, are higher than those of other activities that have had no chance to develop, either for the domestic market or for export. For example, from the economic standpoint there would seem to have been no good reason to encourage, by means of protection, substitution activities with costs 30 per cent above the international level, if by means of subsidies of one kind or another it would have been possible to promote export industries in which the differences in costs were less than this.

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

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

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

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

The serious dynamic weakness in the development of Latin America must be combated in several ways at once. Firstly, by more intensive capital formation and more efficient utilization of the existing stock of capital. Secondly, by the more rational use of capital in whatever ways are most advantageous from the standpoint of the absorption of human potential. In short, the more rational application of capital in relation to the different possibilities offered by technology, and the more efficient utilization of the existing stock of capital, would redound to the benefit of the product-capital ratio, and, in consequence, would reduce correlatively the proportion of capital required to secure a specific rate of development. This should be particularly borne in mind in relation to the following section.

It is not, of course, a question of arbitrarily increasing the size of the labour force employed with the available capital, but of devising applications which yield the maximum

¹⁰ See *Economic Development, Planning and International Co-operation* (E/CN.12/582/Rev.I), United Nations publication, Sales No. 61.II.G.6.

aggregate product, for only in this way will the maximum *per capita* product be achieved in the economy as a whole.

II. CAPITAL FORMATION

1. The possibility of reducing consumption

All these measures designed to curtail the use of capital and to increase manpower absorption necessarily involve a fairly considerable amount of time. Yet the problem of lack of dynamism in development brooks no further delay. Accordingly, attention must first be centred on measures aimed at a swift increase in capital formation, without prejudice to those designed to curtail its use.

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

As will be recalled, the upper strata consisting of about 5 per cent of the Latin American population account for nearly three-tenths of total personal consumption. At the opposite end of the social scale, 50 per cent of the population receive barely two-tenths of the total. Between these two extremes the middle income groups, consisting of about 45 per cent of the population, represent approximately the remaining 50 per cent of total personal consumption.¹¹

This impressive disproportion in the consumption of these groups and in the income transferred abroad for investment and hoarding, offers an ample savings potential which could lead to a sharp increase in the rate of development, provided other conditions, were met at the same time.

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

What this would mean for the upper income groups is illustrated roughly by the following figures. Annual average consumption by a family of five persons in these group is about 8,000 dollars. This would be reduced to 5,700 dollars (a reduction of 28 per cent), if the disparity dropped to eleven times the consumption of the lower strata, or to some 4,600 dollars if it dropped to nine times the consumption of the lower strata, as just indicated. This gives some idea of the difficulties which the problem involves.

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

The fact of the matter is that in these countries internal capacity to produce or capacity to import capital goods is inadequate. At present the coefficient of gross investment is about

¹¹ In advanced countries such as the United States and those of Western Europe, consumption by the high income groups is not more than nine to ten times that of the low income groups.

15.5 per cent (10 per cent net). To achieve a growth rate of 3 per cent this coefficient would have to be raised to 20.5 per cent, and to 23 per cent in order to obtain a growth rate of 4 per cent. This means that imports of capital goods would have to be increased forthwith by 32 per cent and 48 per cent, respectively, in the two instances given. These are targets beyond the reach of most —if not all— of the countries concerned, in view of the prevailing external bottleneck.¹² To this must be added the fact that the increase in the internal demand for capital goods, as well as for consumer goods as a result of the rise in income, could only partly be met by using idle production capacity. In addition it would be essential to increase the capacity in question, and this takes time. In the meantime, this aspect of demand too would have to be met through additional imports.

Thus, clearly, under present conditions, Latin America would be unable to accelerate its growth rate without external co-operation. A temporary inflow of international resources is required until such time as import substitution and increased exports permit internal and external use of the additional savings obtained through a contraction of consumption. Moreover, these international resources would have to be channelled, first and foremost, into investment aimed at achieving these objectives and eliminating the causes of the internal bottleneck.

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

2. Initial coercion and incentives to economic activity

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

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

Land tenure provides a good example of this distinction. Reform of the structure of land tenure is a major means of curtailing consumption, if land is not paid for at its commercial value, as will be explained later.¹³ And if payment is spread over a relatively long period, at a low rate of interest, incentives can obviously not operate. On the other hand, the new owners of the land will have to have incentives to induce them to increase and improve production, and these incentives will have to be essentially economic. To put it differently: contraction of consumption with a view to private or government savings, after the land tenure system has been reformed, will be the result of these incentives rather than of coercive measures.

This is a far-reaching problem and its solution is of decisive importance. Its significance will be better understood when we come to consider the question of social mobility.¹⁴ If the

¹² See in this connexion Part C, chapter I, of this document.

¹³ See section III of this chapter.

¹⁴ See Part B, chapter II, section I, item 1, of this study.

economic system is to operate effectively and to function democratically the emergence of the dynamic elements in all strata of society and their move up the economic and social scale must be promoted; and the operation of incentives is of major significance. From these dynamic elements will come the experts, administrators and leaders in all branches of economic activity; and their personal income must be commensurate with their effective contribution to the economic process. There will therefore be disparities in income distribution, although these will not be the result of a system of privilege. Moreover, these disparities will on the whole be much smaller than those prevailing at present.

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

Moreover, a more rapid rate of development and the income distribution policy will enable the normal effort to increase savings, as distinct from the extraordinary effort inherent in structural reforms and essential to the achievement of an increase in the rate of development, to be extended to all levels of society. In this case, however, it would no longer be a matter of curtailing present consumption but rather of increasing consumption among all levels of society. Popular saving would then have to be stimulated also by means of adequate incentives.¹⁵

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

In fact, all that the 3 per cent rate could achieve would be a relatively rapid improvement in consumption by the lower strata, i.e., the underprivileged half of the Latin American population. With the help of an adequate income redistribution policy, consumption by this sector could be increased at an annual rate of 4.2 per cent and thus doubled in seventeen years. The middle strata would improve somewhat more slowly and the upper strata at an extremely slow rate.¹⁶ On the other hand, a growth rate of 4 per cent or more would lead to more rapid improvement not only for the lower strata but for the middle and upper strata as well. This is very important, because the dynamic elements in the upper strata could overcome the initial curtailment of their consumption caused by structural reforms, and the new dynamic elements moving up from the bottom would have much stronger incentives to reach the top.

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

The Latin American countries regularly face a very serious problem of capital formation in their public services. The use of international assistance for the purchase of securities in these

¹⁵ In this connexion, the following was stated in another report: "The loan of investment resources as a means of promoting the eventual formation of capital does not have to be confined to enterprises. It may also be extended to workers. This may turn out to be one of the most effective means of achieving popular capital formation and a question arises in this connexion which should be given some consideration. The use of credit for the purchase of durable consumer goods has been rapidly gaining ground in the Latin American countries. This is clearly a way to afford the broad masses of the population access to goods which it would be difficult for them to obtain in any other way. But this, in common with inflation, is a grave threat to saving practices. Perhaps such practices could be encouraged by credits for the purchase of securities by the workers themselves, either in the enterprises in which they work or in others. These possibilities should be explored and the organizations that finance development might play a very important part in this respect.

¹⁶ Contraction of consumption by the 5 per cent of the population in the upper income groups would amount to about 14 per cent. Half the population would double its *per capita* consumption in the stated period of seventeen years, and the middle strata (45 per cent of the population) would do so in twenty-two years. The upper strata, once its consumption had been reduced, would increase it again at the very slow rate mentioned in the text.

services could have very important repercussions on the accumulation of capital and on the management of the enterprise. The participation of the producers and users of such services could provide a new way out of the common dilemma of choosing between foreign ownership and management by the State." (See *Economic Development Planning and International Co-operation*, *op. cit.*, page 11.)

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

3. The population problem

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

III. THE LAND: AN OBSTACLE TO DEVELOPMENT

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

An annual growth rate of 3 per cent for *per capita* income would call for a considerable effort from Latin American agricultural production, much greater than in the past. Hitherto, the effort made has been appreciable but not adequate. In the last twenty years agricultural production expanded by 80 per cent (2.6 per cent annually), that is, at a higher rate than in other regions of the world, as pointed out in another report.¹⁷

Nevertheless, if population growth is taken into account, the *per capita* increment in production barely amounted to 0.2 per cent annually, a negligible proportion exceeded by the other regions of the world where demographic growth is much slower than in Latin America.

Moreover, this annual rate of growth of 2.6 per cent for aggregate production has been well below that of consumption, which increased at the rate of 3.7 per cent. This deficiency in production has been made up mainly by reducing exports and stepping up agricultural imports from the rest of the world. These imports constitute a relatively small percentage of

¹⁷ See *Agriculture in Latin America: Problems and Prospects* (E/CN.12/686).

total consumption, nevertheless, they add up to a very considerable sum, i.e., about 450 million dollars worth of items which, given a rational production policy and reciprocal trade, could be largely obtained in Latin America itself.

Admittedly, this imbalance between production and consumption is mainly attributable to Argentina, where the substantial increase in domestic requirements had to be covered to the detriment of exports because of the scant technical progress made by agriculture.¹⁸ But, even if this country is excluded from the Latin American total, the deficiency in production is obvious, since it expanded by only 3.2 per cent while consumption rose by 4.2 per cent annually.

If a minimum annual development rate of 3 per cent rate *per capita* were achieved, and if, in addition, a resolute policy of income redistribution were put into force, the growth of production would have to be much faster than before, and faster still if it were hoped to slow down the rate at which agricultural imports are increasing and so contribute to the removal of the external bottleneck.

Given those circumstances, it has been estimated that overall consumption of agricultural commodities will have to increase at the rate of 4.6 per cent annually and production by 4.2 per cent. This means that production should expand slightly more than 130 per cent in the next twenty years, i.e., by considerably more than the increment of 80 per cent recorded over the previous twenty years. The point is that exports are expected to lag behind production in rate of growth (2.5 as against 4.2 per cent), thereby enabling consumption to increase more intensively than production (by 4.6 per cent).

Here, then, is the full scale of the problem that Latin America has to deal with if it hopes to achieve the objectives of development and income redistribution. Everything points to the fact that the achievement of an increase in production on this scale will have to be based mainly on an increase in the yield from land and not on an extension of the cultivated area as hitherto. Past trends will have to be reversed. A review of twenty-four staple agricultural commodities shows that the increment of 60 per cent in output during the last twenty years was obtained by enlarging the cultivated area by 38 per cent and yield by only 16 per cent, i.e., 0.7 per cent annually.¹⁹

2. The inescapable need to raise yield

It would not be easy to pursue the trend towards expansion, firstly, because the amount of land that is readily accessible has been gradually diminishing and, secondly, because of the vast investment entailed by the incorporation of new land and its preparation for productive use.

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

Putting the accent on improved yield also has social repercussions since this is the only way to raise the extremely low level of living of the rural population. Land reform is, of course, indispensable, but the redistribution of income that might be achieved thereby would

¹⁸ In the rest of Latin America there was an increase in exports, especially coffee, cotton, sugar and bananas.

¹⁹ These commodities covered approximately 50 per cent of the total cultivated area.

not be enough in itself to solve this particular problem satisfactorily, just as it would also fail to solve the problems of the economy as a whole.

Nonetheless, the social aim of higher yield cannot be attained without reference to the development rate, since agriculture and the other sectors of the economy are closely interdependent. It will be recalled that the annual rate of increase of 4.2 per cent in agricultural production was estimated in relation to an annual growth rate of 3 per cent for income and a level of demand for agricultural commodities that was in line with the relative intensity of growth of internal and external consumption.

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

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

This point is extremely important as far as the mechanization of agriculture is concerned. If capital is invested to mechanize farming and cut down on labour, and if the workers thus displaced are unable to find employment in the labour-absorbing activities, the investment will have been wasted, that is, the meagre capital of the community will have been thrown away. As has already been said, this adverse consequence is not incompatible with the personal interests of the entrepreneur who urges mechanization without any thought for the social implications of what he is doing.

Thus, the choice of the right method for increasing agricultural productivity should not be left solely to the whim of private interests when there is not enough capacity to absorb displaced labour, as is the case in Latin America. Preference should therefore be given to those methods of introducing modern techniques that raise productivity by increasing the yield from the land rather than by making investments designed to economize on manpower. The only difficulty is that this requires technological research beforehand, together with the dissemination of its findings, which would not be needed in the same way in the case of mechanization; in other words, preliminary groundwork by the State is called for.

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

3. Dynamic significance of agrarian reform

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

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

This should not in any way be taken to mean that these considerations counsel slow progress. The terms of the agrarian reform, which will not be the same in all countries or in every part of a country, must of course be accurately defined, and the appropriate solution decided upon in each case. Similarly, the key personnel will have to be trained. But once all this has been accomplished —and without unnecessary delay— reform will have to be swift and extensive, not only to alleviate the social tension in the rural areas but for other reasons as well. There must be a large-scale mobilization of forces, which cannot be brought about unless the reform is radical. Such mobilization is essential, since, although the role of the State is of decisive importance it is equally important to stimulate and make use of the community and co-operative spirit of the people, both in the rural areas and elsewhere, to ensure that State action is both prompt and effective. Reform calls for the enthusiastic support of the community which must be directed into constructive channels.

Only by launching the reform can we learn how to carry it out. It is impossible to foresee all the complications that will arise or to avert most of the mistakes that can be made. What is essential is to have a properly thought-out plan for reform and to turn experience to the best possible account for rectifying mistakes with flexibility.

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

4. Technical action by the State

There is no more serious symptom of the anachronistic outlook of the Latin American State and of its inability to meet the demands of economic development than its virtually complete neglect of agricultural research, of the dissemination of the findings obtained and of the basic education and technical training of the rural population, except in a few outstanding cases. These technical tasks could not have been accomplished by individual effort alone. The impressive technical progress of United States agriculture has been the product of an undeniably effective combination: (a) the "socialization" of technology and (b) the provision of incentives to individuals to apply it. Technology was "socialized" in the sense that it was not private enterprise activated by the profit motive that brought technical progress, but the action of the State and the universities inspired by the desire to help the community. To this were added incentives to individual initiative in the shape of technical facilities, investment resources and protection of prices. What made it possible to do all this with an eye to the needs of the community were two salient factors: a far sighted policy of land tenure and the constant absorption of rural labour into urban activities. Without these, all that technical progress could have done would have been simply to augment the income from the land but not the income of the farmer.

Once the problem of tenure has been resolved, the inevitable complement to technical action by the State is the provision of incentives for farmers. Under the present system of land

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

5. Incentive to agricultural production

Furthermore, it cannot be said that incentive to the agricultural producer has been a matter of general or lasting concern in our countries. This is a most important point in relation to the success of agrarian reform, and it is appropriate to dwell on it briefly.

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

A factor that has often tended to cause a deterioration in relative domestic prices is an increase in the prices of manufactured goods and services consumed by the rural population, due to import substitution and excessive protectionism. An additional factor is the cost of social welfare benefits and other State services not absorbed by an increase in urban productivity and therefore in part passed on to the cost of goods and services required in rural areas. These benefits and services are generally confined to urban activities, and have been extended to rural activities either not at all or to a smaller extent.

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

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

There may have been cases in which the effects of these factors detrimental to agriculture have been counteracted or even wholly overcome, when a vigorous increase in the demand for agricultural products has led to an increase in prices sufficient to produce favourable results for agricultural producers. There have apparently been cases in which the strength of demand has made it possible to transfer to the urban consumer the adverse effects of unfavourable relative prices, so that as demand increases these effects have been counteracted or even completely offset. Tariff protection of some agricultural products, and the relative shortage of land to increase production, must have facilitated this movement.

In other cases this transference in response to adverse effects has been prevented by imports or price control.²⁰ In these cases —by no means infrequent— there was a weakening or abolition of incentives to increasing, or even maintaining, the volume of production.

Monetary overvaluation has had similar effects by preventing agricultural prices from rising to keep up with domestic inflation or to counteract the adverse movement of domestic relative prices. Overvaluation is widely recognized as having affected not only products for domestic production, but also exports. In some cases this has resulted in serious discouragement of production, especially when deterioration in domestic relative prices has been combined with a deterioration in external relative prices.

6. Overvaluation of land and agrarian reform

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

When land is thus over-valued, to transfer it at the inflated values in the process of agrarian reform means a heavy burden for the individual or co-operative purchases, a burden more difficult to carry than in the case of large properties, because of the actual amount of income derived from it.

This indicates the desirability of fixing the value of the land on the basis of present yield and providing long payment terms and moderate rates of interest.²¹ Otherwise there may be an appreciable weakening of the new owners' incentive to greater productivity, which would endanger the success of the agrarian reform. This is a crucial point, for all the reasons previously given. And to stimulate technical progress it may be advisable to combine the purchase of land at a value representing its present yield with a tax on the potential value of the redistributed land. This potential value could be determined in relation to the improved productivity that could be achieved with relatively simple techniques, without prejudice to periodic readjustments to stimulate further improvement.

Without this vigorous introduction of technical improvements in agriculture the social purpose of agrarian reform, namely to provide a means of steadily improving the conditions of the rural population, would be a mirage, as would also be the notion that the purpose of this great structural transformation is to improve the level of living of the urban population, by providing them with cheaper food.

²⁰ In this connexion attention should be drawn to the unfavourable situation of certain essential agricultural products —milk, wheat, rice, etc.— which in many countries are subject to the fixing of ceiling prices of a political nature; the aim to favour the consumer is laudable; but the result is a serious disincentive for the producers.

²¹ Moreover, a low rate of interest is necessary for the harnessing of the potential savings, either by the State or by the new owners, as explained in section II of the present chapter.

TRANSNATIONAL CAPITALISM AND NATIONAL DISINTEGRATION IN LATIN AMERICA *

Oswaldo Sunkel

* Social and Economic Studies, Vol. 22, No. 1, *Dependence and underdevelopment in the new world and the old* (March 1973), pages 132-176.

THE TASK

Five important concepts, problems and processes have received overwhelming attention in the work of Latin American social scientists, especially during the last decade. A large proportion of the literature falls naturally under the headings of development, underdevelopment, dependence, marginality and spatial imbalances.

At the same time, these subjects are assuming great importance in the broader disciplines of economics, sociology, political science, social psychology, planning and regional studies. As a result, interdisciplinary approaches have become more frequent. As the phenomena under examination are highly complex and cover a wide spectrum of social reality, any attempt at a global interpretation necessarily transcends the limits of a given discipline. Consequently, the study of each of the subjects mentioned above has perforce to cross disciplinary frontiers, making a “holistic” as opposed to a specialized compartmentalized approach to social science imperative.

In order to develop such a general approach, a theory embracing the structure, functioning and transformation of society is needed. Without prejudice to the significance and usefulness of existing theories of social change including Marxism, and notwithstanding their usefulness to our concerns, I should like to follow a somewhat different approach. Instead of using one of the received theories of social change as our starting point and “applying” it to perceived reality, I shall initiate my explorations with certain empirically observed processes which have been repeatedly studied during the last several years as the most significant phenomena in the evolution of developing societies. The fact that the scientific community concentrates its attention on the above-mentioned five processes, that the intelligentsia in general is preoccupied with them, and that political controversy and the plans and policies of governments also view them as very important, would suggest that they represent a significant reflection of the reality which it is our object to analyse.

Moreover, the social reality which expresses itself in a set of coexisting and overlapping phenomena —development, underdevelopment, dependency, marginality and spatial imbalances— is a single whole conceptually differentiated but occurring in fact in an undifferentiated manner. In order to approach such a reality systematically, we should study the system embodying it, by isolating such sets of variables as are relevant and trying to define the structure of interrelationships between the variables within each set and between the variables of different sets by which the system is characterized. The conception of the system underlying our perception of reality is influenced by ideological, theoretical and empirical factors. This is not to imply that ideology, theory and reality are independent. Quite the contrary; for they condition each other in a dialectical process which, subject to the operation of certain rules, gives rise to scientific knowledge.

We have suggested somewhere else citing Schumpeter, that: ... Scientific elaboration takes the following forms... in order to state a problem, we will first have to appreciate a defined set of coherent phenomena as an objective which merits our analytic efforts. In other words, the analytical effort is necessarily preceded by a pre-analytic cognitive act which furnishes the raw material for the analytic effort. This pre-analytic cognitive act, which precedes scientific elaboration will be called *vision*. After this initial step,... the first task is the verbalization or conceptualization of the vision in such a way that its elements take their places, with names attached to each one, in order to facilitate their recognition and manipulation in a framework. But in doing this, two other tasks are simultaneously performed. On the one hand, additional facts to those already perceived

are incorporated, and one learns to mistrust some that were in the original vision; on the other hand, the construction of the framework or model will itself add new relationships and concepts to the original set, and will also eliminate others. The manipulation of data and facts, and the theoretical work, will eventually produce scientific models as the product of an interminable process of give and take, where empirical observation and theoretical work are mutually tested and challenged to new tasks. Therefore, scientific models are the provisional product of this interaction with the surviving elements of the original vision, to which progressively stricter standards of coherence will be applied. Notwithstanding the clarification to which thinking is subjected in such a process of successive approximations, it is clear that the starting point, the pre-analytic cognitive act or vision, will be decisively influenced by the social factors and processes in which the researcher is immersed.

The principal "factors and processes in which the Latin American social scientist is immersed" are precisely, development, underdevelopment, dependency, marginality and spatial imbalances; they constitute the "defined set of coherent phenomena" which we want to study in this essay with a view to formulating a global interpretation.

THE APPROACH OR "VISION"

We shall start with a pre-analytic cognitive act or vision which is not arbitrary, but is in turn the product of substantial experience as well as of ideological, theoretical and empirical conceptualization of the set of processes which have characterized our evolution. The essential elements of this approach have already been suggested by the author elsewhere, but it may be useful to repeat them here in a summary vein, since what follows is but a first attempt at an analytic elaboration of the overall approach referring especially to the evolution of Latin America during the last two decades.¹

The reality of our underdevelopment has been seen mainly from the vantage point of conventional theories of growth and modernization. The optimum functioning of the social system is therefore perceived in terms of the ideal theoretical framework of the mature capitalist economy, represented in practice by the developed countries; underdevelopment as an imperfect and earlier stage on the way towards the ideal prototype. However, the formative stages of development and the present structure of the underdeveloped countries are radically different from the assumptions implicit in such a theoretical logic.

It is necessary, therefore, to replace the idealized and mechanical vision implied by conventional theory with an approach which enables us to perceive in concrete terms the structure, functioning and the problem of transformation of underdeveloped societies. Given such a position, it is possible and logical to direct our research towards the development of an analytical approach based on a historical study of the process of development of our societies. In order to produce the scientific base needed for the elaboration of a more comprehensive interpretation, such an approach will obviously have to make critical use of existing analytical tools.

The approach proposed here takes the characteristics of underdevelopment as a set of normal features inherent in the functioning of a given system. In other words, the structure of the system defines the manner in which it functions, and, therefore, the results which it

¹ With slight modifications, the following paragraphs are taken from the Inaugural Lecture of the VII Interamerican Planning Congress, Lima, October 1968, and are part of a paper published under the title "La tarea política y teórica del planificador en América Latina" in *Revista de la Sociedad Interamericana de Planificación*, Vol. II, No. 8, December 1968, and in *Estudios Internacionales*, Year 2, No. 4, January-March 1969. The subject is further developed in Sunkel and Paz, especially Part I and III.

produces. These results are well known in the case of underdeveloped countries; low income and slow growth, regional disequilibria, instability, inequality, unemployment, dependence on foreign countries, specialization in the production of raw materials and primary crops, economic, social, political and cultural marginality, etc. The conventional student takes those symptoms of underdevelopment as deviations from the ideal, or the teething troubles of an infant economy which would be overcome with economic growth and modernization. He does not perceive that at the root of these characteristics there exists a system which normally produces and continues to produce those results as long as development policy continues to attack the symptoms of underdevelopment without dealing with the basic structural elements which give rise to underdevelopment.

Historical insight is essential for the identification of such structural elements, explanation of the functioning of a system with a given structure, and analysis of structural change itself. This seems to be the more decisive aspect of development analysis, because if the results of the process are seen as a function of the structure of the system, these results will change only if the structure of the system undergoes change.

If one were to apply this orientation to Latin American countries, it becomes quite clear that external links and relationships have exercised a fundamental influence on the shaping of the structure of our systems, and, therefore, on their functioning and outcome, as well as on the process of structural transformation. Nevertheless, the importance attached to these external links should not lead us to underestimate the existence of structures of underdevelopment internal to the system. Although external influences probably tend to prevail as main factors in the long-term process of transformation, structural transformation is the product of the interaction between external and internal variables.²

A realistic analysis of Latin American development should therefore be based on a conception which assumes our socioeconomic system to be formed by two groups of structural elements: internal and external. Among the internal factors are: the pattern of natural resources and population; political institutions, especially the State; sociopolitical groups and classes; the ideologies and attitudes of different groups and classes; the specific policies followed by the government; etc. The complex of internal and external structural elements, and the interrelations among them, define the structure of the system, and constitute, therefore, the framework within which the functioning of the national system and its processes of structural transformation take place.

The two different aspects of the dynamics of the system, already referred to above, are now clearly distinguishable. On the one hand, there is the functioning of the system with a given structure: the higher or lower intensity of the processes of capital accumulation, of mobilization and utilization of productive resources, of change in the location of economic activity, of changes in income distribution, etc. In conventional economic theory this is the subject of macroeconomic growth theory.

But what is far more interesting from the point of view of the long-term development process is the dynamics of the structural change of the system. The systematic study of the long-term development process of Latin American economics suggests that such transformation takes place in two main ways. Firstly, in so far as a system functions and grows during a certain period, and capital accumulates, economic activity expands, the composition of production and income changes, economic activity is redistributed spatially,

² The distinction between "internal" and "external" factors should be taken essentially as a preliminary simplifying classification. It will be seen later that the so-called "internal" structures are in turn the outcome of earlier historical processes of interaction between the external and the internal, and that "external" links have in fact very concrete and powerful internal manifestations.

etc., this will necessarily induce significant transformations in the internal structure, that is, in the pattern of natural resources and population, institutions and particularly the State, in socioeconomic groups and classes, in their ideologies and specific policies and also in the nature of external relations.

Secondly, the internal structure of the system suffers fundamental transformations as a consequence of exogenous changes in the nature of the external links of the country. These exogenous changes are the product of the evolution of the system of international relations within which the country operates, and particularly of the evolution of the hegemonic power of that system of international relations. On historical examination, in effect, it is quite clear that the great transformations experienced in the past by European society and by the United States are distinctly reflected in the various phases of structural change which the Latin American countries have undergone over time.

In sum, an adequate analytical framework for the study of underdevelopment and development must rest on the notions of process, structure and system. According to an approach of this kind, it is not possible to admit that underdevelopment is a moment in the evolution of a society which is economically, politically and culturally autonomous and isolated. On the contrary, it is postulated that underdevelopment is part and parcel of the historical process of global development of the international system, and therefore, that underdevelopment and development are simply the two faces of one single universal process. Furthermore, underdevelopment and development have been, historically, simultaneous processes which have been linked in a functional way, that is, which have interacted and conditioned themselves mutually.

The evolution of this global system of underdevelopment-development has, over a period of time, given rise to two great polarizations which have found their main expression in geographical terms. First, a polarization of the world between countries: with the developed, industrialized, advanced, "central northern" ones on one side, and the underdeveloped, poor, dependent, and "peripheral southern" ones on the other. Second, a polarization within countries, between advanced and modern groups, regions and activities and backward, primitive, marginal and dependent groups, regions and activities.

Development and underdevelopment should therefore be understood as partial but interdependent structures, which form part of a single whole. The main difference between the two structures is that the developed one, due basically to its endogenous growth capacity, is the dominant structure, while the underdeveloped structure, due largely to the induced character of its dynamism, is a dependent one. This applies both to whole countries and to regions, social groups and activities within a single country.

This approach focuses attention on two types of polarization processes, one at the level of international relations, the other at the domestic level. We shall now examine some of the more relevant aspects of both processes from the dominant viewpoint of this paper, viz., the interaction between the international and domestic levels of the dual process of polarization.

INTERNATIONAL POLARIZATION

The theories which relate the national development process to the system of international economic relations, and which underline the interpretation of past and present trends, may be classified in three main groups: the neoclassical theory of international trade, the Marxist theory of capitalistic-imperialist exploitation and the theories of the “backwash effect” of international trade.³

The liberal *laissez faire* approach is a rather inappropriate basis for analysis and recommendations, because of the highly unrealistic and restrictive assumptions upon which it is based, of which one is particularly damaging. I refer to the identification of the concepts of “economy” and “country” which means that countries are conceived as self-contained economic units which exchange products in the international market place, these then being their “international economic relations”. Quite apart from the very partial aspect of international economic relations implicit in this approach, such an approach fails to grasp one of the essential characteristics of the international economy, viz., that it is basically made up of transnational conglomerates,⁴ firms which operate simultaneously in various *national* markets, thus constituting an international economic system which penetrates and overlaps with the national economic system.

The Marxist theory of imperialism is based precisely on the recognition of this fact, since it suggests that international monopolies penetrate national economies in search of raw materials and market outlets in order to use and add to their increasing economic surplus. Nevertheless, until relatively recently, the Marxist approach had restricted itself mainly to the role of *international monopoly capitalism*, neglecting to some extent an element which seems most essential from our point of view: the “spread” and “back-wash” effects of the international extensions of some national economic systems into other national economic systems.

This analysis, which was associated originally with the names of Myrdal, Singer, Prebisch and others, and which has been a central concern in important Marxist and non-Marxist contributions in recent years, suggests that in the interaction of industrial economies with primary producing economies, the former tend to benefit relatively more than the latter, and that this gives rise to cumulatively divergent trends in the development of the two groups of countries. Although there are many different arguments advanced in favour of this hypothesis, they essentially boil down to the following: (a) the nature of foreign owned or controlled primary production for export, which tends to be an “enclave” with little relation to or influence over the local economy but with substantial promotional effects over the home economy where most procurement, financing, storing, processing, research, marketing and reinvestment take place; (b) the characteristics of the local economy, which lacks trained manpower, entrepreneurial talent, capital and physical as well as institutional infrastructure, and is therefore unable to respond positively to the potential opportunities of an expanding export activity; (c) the relative behaviour of the prices of raw material exports and manufactured imports —the worsening of the terms of trade of primary producers— as well as the instability of primary product prices; (d) the generally monopolistic nature of the primary export activity which, when the firm is foreign owned, implies an outflow of excess profits.

³ The expression “backwash effect” is used here in the Myrdalian sense, to represent the deforming, inhibiting and exploitative effects of specialization in primary exports on underdeveloped economies.

⁴ Later we shall examine more closely this new kind of world enterprise, also called multinational firm or international corporation.

This approach introduces a most important perspective since it focuses attention on the interaction between the external agents and the domestic economic, social and political structures. Nevertheless, it is still somewhat partial and requires further generalization and systematization.

Apart from other considerations, it is partial because it has concentrated its analysis of the differential effects of the interaction between developed and underdeveloped countries exclusively on the primary producing export activities of the latter. One of the results of this bias in the analysis was the conclusion that these countries had to industrialize because industrialization would result in a cumulative process of self-enforcing “spread” effects — Rostow’s “take-off into self-sustained growth”. To a large extent this seems to have been the consequence of applying the European model of the Industrial Revolution to the Latin America cases.

But the model of import substituting industrialization that has characterized Latin America seems to be something quite different. It is in fact very difficult to understand if, apart from the internal peculiarities of each country, reference is not made to the framework of external links conditioning factors and pressures that have influenced industrial development so decisively in our countries. In fact, its dynamics, its structure and the nature of the productive processes adopted, especially with reference to technology, have been induced to a large extent by external conditions.

When Latin American countries embarked on a deliberate policy of industrialization, they were confronted with the need for substantially expanding specialized manpower, skilled human resources, entrepreneurs, machinery and equipment, raw materials and inputs, financial resources, sales, marketing, credit and publicity organizations, as well as the technology and know-how necessary for all these tasks. When industrial development outgrows its initial stages, the scarcity and urgency of all these elements become more and more critical, particularly when industry enters the more complex fields of basic manufactures and consumer durables.

Under such conditions, the forces of industrialization have had to rely heavily and increasingly on external support, for know-how, technology, administrative capacity, equipment, financing, etc. These various international contributions to domestic industrial development, clearly indispensable in view of the precarious base from which such development started, have taken place in various forms manifesting different modalities. External financial contributions, for instance, have come as public or private loans, portfolio investments, immigration of foreign capitalists, foreign subsidiaries wholly or partially foreign-owned. Skilled human resources have also come in different ways: immigration of qualified people, hiring of foreign experts, training of personnel both at home and abroad. Technological transfers also conform to different modalities —through foreign subsidiaries which bring their own technology by means of licenses, patents, trademarks, technical assistance contracts, etc., and by adapting or developing technology locally. All these various ways of incorporating foreign inputs for industrial development have resulted in different costs and effects.

Until about the middle of the 50s, the nature of external contributions to industrial development was such that it contributed to the development of a *national* manufacturing sector in our economies. Since then, however, a period of denationalization and of “subsidiarization” of industrial development has ensued, coinciding with the end of the decades of crisis and coldwar (the accelerated expansion of the transnational conglomerate and a more advanced phase in the import substitution process in Latin America).

The change that has taken place in the ways in which foreign resources have been attracted and incorporated into domestic industrial development has probably been one of the most important factors determining the nature of the results of industrialization, contribution

to the growth of the economy, the level of employment, the distribution of income, institutional characteristics (concentration of property, vertical and horizontal integration, conglomeration, etc.,) structure of production, exports and imports, external financial flows, transfer of technology, etc.

It is therefore clear that the process of industrialization via import substitution, although stimulated and induced by the crisis in international relations and international crises in general and balance-of-payments problems in particular, and also by a deliberate policy of protection, has not taken place in isolation, as a spontaneous process. On the contrary, it has meant new and very important, though different, links with the international economy, and particularly with the United States. Industrialization did not reduce foreign dependence; a primary-exporting economy is fatally condemned, by its very structure, to depend almost entirely on its basic exports, unless and until industrialization changes that situation, which import substituting industrialization has not been able to do.

In other words, at a higher level of abstraction, the phase of import-substituting industrialization, just as the period of primary export expansion that preceded it, constitutes, in the final analysis, a new way of integration of the underdeveloped economy, at a different level of evolution and through different means, into a new type of international capitalist system. Although this new system is again organized in terms of developed and dominant economies on the one side, and underdeveloped and dependent economies on the other —ever more closely interrelated— it is necessary to take into account that this new model of international economic relations is based operationally on the transnational conglomerate, a new kind of business organization that has experienced an enormous growth during the last decades. This is particularly the case in the United States, mainly as a consequence of the enormous expansion of government expenditure —especially in armaments and space exploration— and of the resulting spectacular technological progress.⁵

In the factories, laboratories, design and publicity departments and in the centres of decision, planning and finance which constitute its super-structure and which is always situated in a developed country, the transnational corporation develops: (a) new products; (b) new ways of manufacturing these products; (c) the machines and tools necessary for manufacturing them; (d) the synthetic and natural raw materials and inputs needed for their production, and (e) the publicity needed for the creation and dynamization of the market for these goods.

On the other hand, the final stages of assembly and production of these goods take place in the underdeveloped economy through an industrialization process that proceeds by means of the importation of new equipment and inputs and the use of the corresponding marks, patents and licenses, both by public and private national firms, as well as by the wholly or partially owned foreign subsidiaries of the transnational conglomerate. This process is of course supported by public and private international finance as well as by international technical assistance, which constitute efficient aid for the expansion of the international markets of the American, European and Japanese transnational conglomerates.

In a world of protected markets, but helpless consumers, a new international division of labour appears with its new agent: the international manufacturing oligopoly. As in earlier stages, there is also a new international specialization in the generation of scientific and technological knowledge in the metropolitan countries, and of its routine “consumption” in the peripheral countries. If the above line of argument is valid, then we are now again in a period of organization of a centre-periphery model of a new kind, despite our prior belief that import substituting industrialization was leading us away from it.

⁵ *The Economist*, May 16-22, 1970, p. 81.

We should not be surprised by the consequences of such a process, with which we are only too familiar: (a) a persistence and even worsening of the primary exporting character of the economy; (b) exogenous source of the economy's dynamism; (c) exogenous character of most of the fundamental centres of decision in finance, economic policy, science and technology, access to foreign markets, etc.; (d) acute and persistent tendency to foreign indebtedness, denationalization and subsidiarization; (e) a great danger of Latin American integration efforts ending up in favour of transnational conglomerates: a definitive liquidation of the remaining local enterprise; (f) a growing income gap between developed and underdeveloped countries, etc.

THE INTERNAL POLARIZATION

Let us now return to the central theme of this essay —the hypothesis that we are in the midst of a simultaneous process of dual polarization, international and national. We have just described the first, we shall now turn to the second.

The internal process of polarization can be seen as a growing division between modern dominant and advanced economic activities, social groups and regions on the one hand, and backward, marginal and dependent activities, groups and regions on the other. In fact, the geographic, economic, social, political and cultural centres of modernity and development are closely associated with the rise and fall of the activities linked more closely —directly or indirectly— to the developed countries. This is the case of regions, cities or ports which are subject to the direct influence of the investments and expansion of the traditional export activities, and also of those other cities or regions which, either because they are administrative centres or areas producing inputs for the export sector are able to capture part of the income generated in the export sector and redistribute it to other regions and social groups.

In the import-substituting industrialization phase, the activities which concentrate a large part of the investments and which expand fastest are of course manufacturing, i.e., the activities which produce their inputs and the infrastructures most necessary for industrial development. As this industrialization is basically orientated towards consumer goods, it tends to concentrate around the larger population centres, thereby reinforcing the tendency of urban concentration so characteristic of Latin America. This tendency is frequently further accentuated by the stagnation and/or modernization of the traditional export sector and of domestic agriculture, a phenomenon which is usually accompanied by a growing concentration of ownership of the means of production in these activities. All three elements —stagnation, modernization, and concentration— accelerate the exodus of the population directly or indirectly related to export and agricultural activities.

When this polarization of population corresponds to the decline of economic activity in traditional export and/or agricultural activity, it leads to acute and growing spatial imbalances. We might in this respect, recall that some of the most underdeveloped areas of Latin America today are precisely zones which once were regions of exceptional wealth, social prestige, political importance and cultural splendour: the Northeast of Brazil; the areas of precious metals in Mexico, Peru, Bolivia, Brazil and Chile; the nitrate fields of Chile; *henequén* fields of Yucatán; the abandoned banana fields of Central America and Ecuador, and the old coffee and cocoa plantations of Brazil.

The great urban concentration in the two or three main cities of each country, which is the other side of the coin, poses a striking internal disequilibrium. The phenomenon of

the primacy of a few important gigantic cities in which practically the entire economic, social, administrative and cultural infrastructure is concentrated is of course well known. But a brief reference should be made to the process of urban polarization or segregation which occurs, particularly in those few great cities where the largest part of the population surplus is accumulating, and which has given rise to a large portion of the literature on the phenomenon of marginality. It is perhaps precisely in the ecological characterization of the main cities of Latin America that the phenomenon of internal polarization becomes most dramatic and explicit: the marginal population, which constitute a belt of infernal misery around the city and also infiltrating into it; the factory districts which coincide more or less with the residential areas of the proletariat; the administrative, financial and commercial centre, around which lower middle class residences are located; and the residential areas of suburbia of the middle and higher income groups which coincide with the physical area of most of the luxury spending, both in private and public goods and services, and where population density is probably lowest. This is in the end the spatial urban expression of the process of polarization and segregation which affects income distribution, the pattern of public and private expenditure — both in consumption and investment— social stratification and the distribution of power, prestige and culture.

Given the structural and institutional characteristics of Latin American underdevelopment —concentration of property and wealth in all its forms; acute inequality of incomes; discrimination in the access to education; great technological and productivity differentials between various activities; oligopolistic goods and factor market structure; etc.— and the characteristically unstable dynamism of dependent economies, with their recent historical periods of export growth and import substitution, it seems convenient to base the analysis of the causation of the process of internal polarization or segregation —normally called marginality— on the factors which determine personal incomes.

The various forms of racial, political, social and cultural discrimination which prevail in Latin America, though very important, are insufficient as an explanation of the situation of absolute marginality which characterizes a substantial and probably growing proportion of the population of the region. These forms of discrimination constitute, without doubt, substantial obstacles to the upward social mobility of important groups: they may even accentuate the marginal condition of a certain group over a longer period of time. Nevertheless, in order to be consigned to a situation of absolute marginality, it would be necessary for certain groups of the population to be deprived of all means of access to a source of income of reasonable level and stability. It is obvious that access to such a source of income does not guarantee that marginality in some of its many aspects —social, cultural, political, etc.— will disappear. But although a reasonable and stable income is not sufficient condition for overcoming marginality —as is clearly demonstrated by the existence of this phenomena even in developed countries— it is obviously the most important element in the case of our countries.

Consequently, the marginality which constitutes the most serious and urgent problem in Latin America is the one which is mainly conditioned by the lack or difficulty of access to a reasonable and stable income. Frequently, particularly in economic literature, the problem is simplistically reduced to the question of “the creation of employment opportunities”, which is assumed to result directly from capital formation. There are at least two criticisms to be made with respect to this approach. In the first place, salaried employment, which forms the implicit base of this approach clearly constitutes an important source of income, but by no means the only one, especially in underdeveloped countries. Other income sources are private property, entrepreneurial and artisanal activities, the independent exercise of professions and skills and public and private “transfer” (incomes which have no counterpart in services rendered or property used). Secondly, capital formation may have very different effects on

employment —even if the technological spectrum of the economy is assumed constant— according to which sectors, activities, regions or social groups (not only entrepreneurs) have access to it. Therefore, the study of the specific characteristics of the various possible sources of income and of the factors which condition the access of the population to them constitute a vital requirement for the understanding of marginality.

The study of marginality could thus be organized around its two main sources: (a) the limited availability of and the conditions limiting access to the means of production or the transfer of incomes necessary for obtaining a reasonable and stable level of income; (b) the different forms of racial, social, cultural, political, and other types of discrimination which may lead to a loss of accessibility to the means of production and transfer necessary for obtaining, maintaining or increasing a reasonable and stable income.

The foregoing analysis implies that the problem of marginality is not a phenomenon peculiar to underdeveloped countries, representing a necessary stage inevitably to be overcome in an ongoing process of evolution through a hypothetical *continuum* spanning underdevelopment-development or tradition-modernity. On the contrary, in order to grasp the phenomenon of marginality in all its complexity, it must be related to the process of underdevelopment, of which it is an essential part, as much as the phenomenon of dependency, with which, therefore, it must also be related.

It is suggested that underdevelopment, marginality and dependence are three aspects, manifestations and/or simultaneous and over-lapping consequences of the general evolution of the international capitalist system; to understand it in its essence and effects would require a total view of the structure of the system, of the way it functions, and of the process of transformation that both its structure and performance experience over time.

In a dependent underdeveloped economy, the dynamism of the system is basically derived from the expansion of primary export activities and import substituting industrialization. The question, therefore, is one of determining the effects of these forms of economic expansion on the availability of and access to the sources of a reasonable and stable income referred to above, i.e., employment opportunities, access to property, possibilities for the exercise of entrepreneurial, technical, artisanal and professional activities, and/or participation in income transfer systems.

The conventional approach, utilized normally in planning models and in employment projections, assumes that employment is a function of the availability of capital, assuming technology to be homogeneous and constant or improving at a fixed rate. In this way, the amount of capital needed to employ one person at an average level of productivity can be estimated and, therefore, also the rate of investment necessary to employ an active growing population. The problem appears then to be one of achievement of a rate of savings which will finance a level and expansion of investments sufficient to “absorb” the growing labour force; in other words, if the economy can be made to grow rapidly enough —and this is mainly a function of the rate of investment— there will be no unemployment. If internal savings are not adequate to reach such a rate of capital formation, a complement of foreign financing, assistance and investment may and probably will solve the problem.

This view is not only far too simple but also far too mechanical. To begin with, the crucial assumption of technological homogeneity, in the model, but rarely explicitly stated, is in total contradiction to the heterogeneity which characterizes precisely those economies where marginality prevails. If, to simplify the argument, we assume that there exist only two levels of technology —modern and primitive— the former, capital-intensive and the latter labour-intensive, and that the productive capacity of the modern sector grows faster than

that of the primitive sector, the rate of investment, as well as the average amount of capital per person employed will have to grow in order that a *constant* rate of employment may be maintained—at least until the weight of the sector of primitive technology becomes relatively insignificant. If the modern sector, apart from expanding relatively faster than the primitive sector, further replaces to some extent its output, technological modernization would result on the one hand, in the *creation* and on the other, in the *destruction* of employment opportunities. If demand remains constant during this process of technological substitution, an increase in investment in the modern sector would create idle capacity and unemployment, since the number of persons employed per unit of capital in the modern sector is less than in primitive activities. In this way, it is conceivable that an *increase in the rate of investment* could lead to an *increase in the rate of un- and underemployment*, and therefore, of marginality. In fact, I would suggest that this is not just an extreme hypothetical situation, but is perhaps the best working hypothesis to explain the growing problem of unemployment, underemployment and marginality in Latin America.

To justify this assertion it becomes essential, to begin with, to drop the highly restrictive and unrealistic assumption of the constancy of total demand made, for the sake of simplicity, in the foregoing argument. In fact, this assumption is not necessary; in order for the hypothesis to hold, it is sufficient if the increment in total demand induced by the increase in net investment produces an additional increment in employment that is smaller than the net employment (reduction of employment at the primitive level less creation of employment at the modern level) created by the initial new investment. This is very likely to happen if the distance between the modern and primitive levels of technology is very wide, if the proportion of employment in the primitive sector is very large, and if the employment multiplier of investments in the modern sector is very low.

These situations are quite frequent in most of our countries. It should be noted that this analysis has been conducted in terms of *levels* of technology and not, as is usually the case, of sectors of activity. In other words, we are thinking of a horizontal classification of the economy, separating the modern and primitive levels in all sectors of economic activity. In this way it becomes apparent that the technological innovations which are introduced at the upper margin of the modern level replace technological processes that are being abandoned at the lower margin of the primitive level. In plain words, computers, satellite communication, automated electric power plants, etc., are in effect replacing the accountant, the smith, the water mill, the coach, etc.

On the other hand, the income generated by additional investments in the modern sector mainly enlarges the incomes of middle and higher income groups, whose demand expands proportionally to a greater extent in consumer durables and modern services where highly capital-intensive technologies prevail. This fact, together with the high marginal import propensity of these groups considerably reduce the employment-creating effect of investments in the modern sector. In this way, the multiplier effects of employment creation at the modern level will probably be lower than the unemployment caused by the replacement of economic activities at the primitive level and its negative multiplier effects.

It is not possible here to systematically apply this general working hypothesis to the various types of economies found in Latin America, nor to the different stages of export growth and import substitution that most of them have experienced or are experiencing. Nor is it possible to examine how the suggested process influences the availability of and access to the main sources of income: employment, property, independent activities, and income transfer systems. But a few examples may contribute to a better understanding of our approach.

The effect on the labour market of the relatively fast growth of the modern activities and the consequent disruption of the more primitive activities is quite clear: the demand for skilled human resources grows very rapidly while the demand for unskilled manpower slackens. As a consequence, a tendency towards improvement of wages of qualified personnel (except under conditions of rapid expansion of higher and technical education) and a relative stagnation or decline in the wages of unskilled labour is observable. This phenomenon has been perceived clearly in the agricultural sector and in the traditional export sector. These activities react to the decline in demand with reduction of production and employment; the decline in demand is still followed by processes of technological modernization which substantially reduce the level of employment. This gives rise to an important outflow of unskilled manpower which adds to the ranks of the urban marginal groups.

The same phenomenon can be examined from the point of view of the different types of occupation which provide access to sources of income. The expansion of the modern sector normally implies the installation of relatively large enterprises, and this will increase the number of large firms. But given the oligopolistic conditions which generally prevail, this will also limit the possibilities of expansion of medium and small-sized firms, as well as of artisanal work. Frequently, the expansion of large firms in extractive, commercial, industrial or other activities will result from the penetration of foreign subsidiaries. This may have the effect of limiting or excluding medium and small, and even large, national entrepreneurs, particularly when this process involves an acute tendency of concentration of the ownership of markets or means of production: land, water, foreign exchange, credit, technology and know-how, etc. Furthermore, inequalities in the labour market and the concentration of property will tend to accentuate the unequal distribution of income, with the consequent reinforcement of a structure of demand which contributes to the dynamization of capital-intensive activities. This process involves an acceleration of obsolescence of existing products and processes, leading to unnecessary and premature replacements of installed capacity, generally with considerable savings of manpower. In this and many other ways, impolicy, or lack of policy, contributes to a restriction of the access of the population to sources of income.

If what has been suggested in the foregoing analysis is correct, the problem of marginality looks much more serious and unmanageable than is normally assumed, both because it probably will worsen in the near future and also because such partial policies as popular participation or integration as well as such global policies as population control or indiscriminate acceleration of economic growth do not reflect the true dimensions and nature of the problem. An adequate consideration of the question of marginality requires an approach that incorporates this phenomenon as one of the inherent processes of dependent underdevelopment, where appropriate consideration is given to those questions of technology, institutions, income distribution, concentration of property, structure of consumption and production, etc., which have a more pronounced and direct influence on the accessibility of the population to the sources of income.

THE RELATIONSHIPS BETWEEN THE PROCESSES OF INTERNATIONAL AND NATIONAL POLARIZATION

The examination of the internal and international processes of polarization clearly suggests a further step in the analysis. If we look at countries as composed of developed and underdeveloped functions, groups and regions, and remember the basic characteristics of the international economy —the penetration of the underdeveloped economies by the economies of the developed countries through the extractive, manufacturing, commercial and financial transnational conglomerates— it becomes apparent that there must be a close correlation and connection between the extension of the developed economies into the underdeveloped countries, and the developed, modern and advanced activities, social groups and regions of these countries.

From such a perspective of the global system, apart from the distinction between developed and underdeveloped countries, components of importance can be observed: (a) complex of activities, social groups and regions in different countries which conform to the developed part of the global system, and which are closely linked transnationally through many concrete interests as well as by similar styles, ways and levels of living and cultural affinities; (b) a national complement of activities, social groups and regions partially or totally excluded from the national developed part of the global system and without any links with similar activities, groups and regions of other countries.

In this conception of the phenomena associated with the development-underdevelopment *continuum* which implicitly claims to incorporate the aspects of domination-dependence and marginality which form an inherent part of it, the so-called developed countries would be those where the developed structure —economic, social and spatial— prevails, while the backward and marginal activities, social groups and regions would appear as exceptional, limited and secondary situations.

THE INTERNAL PRODUCTIVE STRUCTURE AND THE NATIONAL TRANSFER MECHANISMS

The analysis of the income differentials which allow local minorities in the underdeveloped countries to maintain international consumption patterns leads us to the question of how these incomes originate. From a logical point of view, only four sources of high incomes can exist in underdeveloped economies: (a) high productivity activities; (b) income transfers from sectors of high productivity to social groups not linked to these activities; (c) monopolistic exploitation of goods and/or factor markets in low productivity activities, and (d) income transfers from abroad.

These four sources of high incomes are obviously not mutually exclusive; on the contrary, they complement and reinforce each other. In fact, the social groups linked more closely to the high productivity activities have therefore the capacity to acquire a larger bargaining strength and to exercise greater pressure over the transfer mechanisms, and also the capacity to exercise a larger degree of monopoly power in their markets of inputs and outputs. On the other hand, the fact that a certain social group is closely linked to a high productivity activity does not mean that it cannot in turn be exploited by other internal or external groups.

The activities of relatively higher productivity in Latin American countries have traditionally been the primary export sectors, which have always enjoyed comparative advantage. The manufacturing industry has also shared this advantage by virtue of the policy of industrial

protection and the internal structure of incomes. This does not mean that the entire population linked in some way to these activities —as workers, employees, owners, buyers, providers, etc.— will necessarily enjoy high incomes. It merely means that these activities permit the generation of a large total income due to the high average productivity per person, which in turn results from a relatively high degree of capitalization per person and the relatively favourable prices of goods which they produce. The distribution of this income among groups which participate in its generation will depend on institutional conditions in respect of the nature of the property relationships of natural resources and capital, and the degree of their concentration. It will also depend upon the general characteristics of the labour, goods and capital markets.

In cases in which the volume of income generated is considerable and centred in very few establishments, with a small, strongly unionized, skilled labour force, the salary of workers would be substantially higher than average. In diametric opposition to this is the position of the large mass of unskilled workers —scattered throughout a large number of small establishments where traditional forms of ascription rather than a labour market prevent effective unionization— whose real income would tend to be kept at a low level, perhaps not much higher than in the more primitive rural activities.

Nevertheless, in all these cases there exist privileged groups which obtain incomes similar to those prevailing in developed countries.

Moreover, in countries where middle and working class groups have acquired some influence over the State, governments usually become important agencies of income redistribution, acquiring by means of taxation, foreign exchange policies or other mechanisms a part of the income generated in high productivity activities, and then redistributing it to middle and working class sectors in a variety of ways. Thus, sectors which are not associated in any way with the higher productivity activities are in a position to make use of the State apparatus as a transfer mechanism and thereby obtain access to higher incomes which will also allow them to adopt, at least partially, the life style and patterns of consumption of the international community.

There are yet other groups which, without in any way being associated with high productivity activities, are still able to secure high incomes, as happens, for example, when institutional conditions allow certain persons to capture a large proportion of the incomes of many other people with whom they have some kind of economic relationship as workers, buyers, sellers, etc. This happens generally where there is a high degree of concentration of ownership or control of the means of production or other sources of income, and/or oligopsonistic or oligopolistic situations in the market for goods and services. Even though these situations exist in high productivity sectors, they are more clearly observable in the more primitive and traditional activities, in rural areas, in handicraft and small industries, and many service activities: commerce, non-institutionalized financial markets, etc. These are generally economic activities which are highly labour-intensive and have a low *per capita* productivity, but where salaries can be kept low due to the abundant supply of unskilled labour, and where markets can be very imperfect due to institutional power arrangements. As can be appreciated, these situations represent the obverse of what we observed in relation to the process of marginalization.

Finally, small high-income groups which do not derive their incomes from any of the sources mentioned above can be found in every country. This is the case with persons who obtain their income from abroad because they are part of a foreign economic, administrative, cultural, religious, military or political structure, or of an international organization. This is normally a marginal group in most countries, but it becomes a significant element when any of these structures or organizations is present on a massive scale, or when certain local

social groups or organizations are amply financed from abroad, sometimes even through the apparatus of government. These are rather special cases where, for example, due to the decline of a high productivity activity or to war, the revenues of the State are maintained by means of income transfers from other economies of high productivity in order to preserve the privileged position of the high income groups of that country.

The four sources of high incomes described above do not appear in a pure form in any given country, but in unequal combination. According to the particular combinations occurring in various countries, it is possible to type Latin American countries. Only for illustrative purposes and on a purely preliminary basis, it might be suggested, for instance, that El Salvador represents a case in which the principal high income groups are limited to those more closely linked to high productivity activities, recognizing at the same time that a substantial part of these high incomes is the product of the low salaries paid to workers on the coffee plantations. The second case, where the main high income groups derive their *status* from the income transfers operated by the State, would correspond to some extent to the case of Venezuela. Examples of a combination of the first and second cases would probably be Argentina, Uruguay and Chile. Haiti would be a case of more or less pure exploitation —the third type of Latin American country in this context— where an absence of high productivity activity of any significance does not prevent the persistence of a small minority of high income groups. Peru and Colombia would perhaps correspond to a combination of the first and third situations since high income activities coexist with a large degree of exploitation. Brazil would be a combination of the above factors with important internal transfer mechanisms. Finally, Bolivia might represent a combination of the third and fourth, viz., exploitation and foreign transfer.

It should be stressed again that these are merely suggestions for further research aimed at clarifying the combination of factors that prevail in the different countries. But whatever the combinations, and the important consequences flowing from them, for our understanding of development, underdevelopment, dependence, marginality and spatial imbalances in each specific situation, one fundamental fact remains: the high income groups, with internationalized consumption patterns, obtain their incomes from a very heterogeneous productive structure which is not compartmentalized but is, on the contrary, closely integrated and institutionally interrelated. Only a relatively small part of this productive structure, which differs in nature and importance from country to country, has levels of productivity sufficiently high to allow certain groups to sustain these patterns of consumption; the low productivity of the larger part of the productive structure, on the contrary, must be organized on an exploitative basis in order to provide minority groups with high incomes. Moreover, strong transfer mechanisms must be present if a wider range of groups, including those not directly or indirectly associated with high productivity activities, are to achieve the internationalized pattern of consumption. In other words, the magnitude of the high income sector is a function, in the first place, of the economic magnitude of the high productivity activities, and secondly of its political capacity to obtain a larger share of the incomes generated by that sector. Thirdly, it is a function of the capacity of this group to extract a part of the income generated in the low productivity activities through the maintenance of an institutional structure in the factor and goods markets and in the income transfer mechanisms, which will restrict the access of large sectors of the population to the sources of reasonable and stable incomes. (See p. 140) If broad features of this analysis which need more detailed and careful scrutiny are correct, it could be inferred that the presence and expansion of the internationalized consumption sector of high incomes is not independent of the presence and expansion of a marginalized sector, nor of the capacity of the former to strongly influence the evolution of the productive structure, the nature of the productive structure, the nature of the transfer of technology, internal income transfers, and the pattern of consumption.

One final paragraph to suggest that it may also be worthwhile to explore the spatial manifestations of the four categories of productive structures and income transfer mechanisms suggested earlier, not only at the regional and urban-rural levels, but also at the inter-urban and intra-urban level. In general, as the productive structure and income transfer mechanisms imply a great heterogeneity of closely related modes of production and strong administrative mechanisms, and at the same time great income inequalities, the spatial distribution of economic activities (including consumption activities) will in general tend, on the one hand, towards strong urban concentration, and on the other towards intra-urban segregation. In the main cities especially, economic activities (except agriculture and mining), power structures (and their administrative and financial management), and the centre of consumption (conveniently discriminated between low and high income consumption areas), will tend to coincide.

The typology of internal productive structures and transfer mechanisms to which reference has been made is related, on the one hand, to the interaction of the different forms of external links of the internationalized sector with the dominant economy, and, on the other, to the interaction of that sector with the rest of the domestic economy and society. So far, the analysis has concentrated mainly on the internal relationships. However, it is essential to return to the international links in order to establish as firmly as possible that if the internal process of marginalization is the product of a certain combination of dynamics of productive structures and transfer mechanisms, the dependency relationships represented by the internationalized sector also correspond to an international productive structure and its superstructure, including the corresponding international transfer mechanisms.

THE STRUCTURE AND SUPERSTRUCTURE OF THE INTERNATIONAL ECONOMIC SYSTEM

One basic element of the approach developed in this essay is the hypothesis of the central role played by the external links in the structural formation and transformation of our economies. To understand the nature and consequences of those external links, it is essential to have a clear conception of the characteristics of the international economic system. To begin with, it is important to recognize that the international economic system, as any other social system, is simultaneously a system of power and a system of domination-dependence, that has systematically been biased in favour of the developed countries and against the underdeveloped countries. This system has evolved through various historical periods —mercantilism, liberalism, neo-mercantilism— with the type of hegemonic power and the instruments of domination which each has used.

The main agent of the neo-mercantilist system of domination is the new and powerful entity called transnational conglomerate (TRANCO).

For our purposes the salient feature of the TRANCO is the *integration* of its activities, involving segments of the economies of a large number of different countries, within the frontiers of a single decision-making machinery. The goal of the TRANCO is the maximization of profit in the long run, but this goal often resolves itself into a number of proximate objectives such as the maintenance of existing, and the capture of new, raw material sources and of markets; and a high rate of technological progress in the fields of process and product innovation.⁶

In other words, the main characteristic of the present and probably the future system of international economic relations is the penetration of the economy of the underdeveloped countries by the most powerful economic agent of the developed economy, in particular the

⁶ N. Girvan and O. Jefferson, "Corporate vs. Caribbean Integration", *New-World Quarterly*, Vol. IV, No. 2, 1968, Jamaica, pp. 51-52.

United States, the predominant centre of the contemporary capitalist world. In fact, since the end of the last century, the United States economy has been undergoing a significant change in the institutional character of its productive system which has resulted in the concentration of production in very big firms, first of national and subsequently of international scope. In this process, the firm has evolved through various stages of internal organization —i.e., from the typical family firm, where the owner performed and controlled all the functions of the enterprise— to the multi-divisional or conglomerate firm subject to horizontal and vertical integration throughout national and international markets, where productive specialization is achieved by means of the simultaneous control of numerous plants engaged in various lines of production, and where, moreover, a new specialization seems to hold between the productive functions proper and the planning and management of the conglomerate as a whole.⁷

This process of conglomeration is based on three basic principles: (a) the diversification of risk; (b) the maximization of the benefits to be obtained from participation in the most dynamic markets, and (c) the maximization of financial power, through the centralized control and allocation of the financial surplus of each of the conglomerate units. The first two principles imply that the conglomerate acts with respect to the plants it owns in a way similar to an insurance company with respect to its investment portfolio —buying the best stocks and selling the rest.

The impressive expansion being experienced by these conglomerates in the United States, and on a lower scale in Europe and Japan, flows over the national boundaries of these countries. These vast new enterprises spread throughout the international economy in various stages: export of their products, establishment of sales organizations abroad, concessions of licenses to foreign producers to use their patents, trademarks and know-how, and finally the stage of buying into the local producers in order to establish themselves locally through a partially or wholly owned subsidiary.

TRANSNATIONAL INTEGRATION AND NATIONAL DISINTEGRATION

In the previous sections, an effort has been made to interpret the five concepts, problems and processes that engage us in this essay —development, underdevelopment, dependence, marginality and spatial imbalances— in such a way as to render their interrelationships apparent. We believe that we have suggested that they are not only interrelated, but that in fact they are different manifestations of a single global process, which is simultaneously a process of transnational integration and national disintegration.

The main actor in this process is the transnational conglomerate, in the sense that this is the basic economic institution of the post-war capitalist world, an institution of tremendous dynamism, which is bringing about a fundamental transformation of the structure and functioning of that system, not only in the central countries but in the whole world, creating in the final analysis a new model of civilization represented by the superconsumption society exemplified by the U.S.

For our present purpose it is necessary to stress only two aspects viz.: (a) the TRANCOS do in fact constitute a new economic system —both national and international, and (b) this new system favours the development of local segments integrated into the internationalized nucleus of the capitalist system, in particular, those segments which are more directly connected with the TRANCOS, while at the same time tending to disrupt the rest of the economy and society, segregating and marginalizing significant sections of the population.

⁷ See Economic Concentration, Hearings before the Subcommittee on Antitrust and Monopoly of the Community on the judiciary, U.S. Senate, Eighty-Eighth Congress, second session, U.S. Government Printing Office, Washington, 1964.

That part of the American economy which is made up of “a few hundred technically dynamic, massively capitalized and highly organized big corporations” is termed the “Industrial System” by Professor J.K. Galbraith, who clearly perceives that a system dominated by a few very large corporations is qualitatively different from the classical conception of the capitalist system consisting of a large number of small and independent enterprises.

Galbraith’s argument is as follows: the tremendous development of modern technology requires an increase in the capital committed to production and in the time for which it is committed. The commitment of time and money tends to be more and more specialized in a great variety of different tasks. Therefore, requirements of specialized manpower increase greatly, and as specialization advances, efficient organization becomes essential. In order to maximize long-run profits and reduce uncertainty and risk, the corporation engages in planning.

...In addition to deciding what the consumer will want and is willing to pay, the firm must take every possible step to see that what it decides to produce is wanted by the consumer at a remunerative price. It must see that the labour, materials and equipment that it needs will be available at a cost consistent with the price it will receive. It must exercise control over what is supplied. It must replace the market with planning [emphasis supplied]... The market is superseded by what is commonly known as vertical integration.

The planning unit takes over the source of supply or the outlet. Where a firm is specially dependent in an important material or product (such as an oil company on crude petroleum, a steel company on ore, an aluminium company on bauxite), there is always the danger that the requisite supplies will be available only at inconvenient prices... From the point of view of the firm, the elimination of a market converts an external negotiation, and hence a partially or wholly uncontrollable decision, to a matter for purely internal decision. The size of General Motors is in the service not of monopoly, or the economies of scale but of planning. As for this planning —control of supply, and demand, provision of capital, minimization of risk— there is no clear upper limit to the desirable size. It could be that ‘the bigger the better’. The corporate form accommodates to this need. Quite clearly it allows the firm to be very, very large.⁸

The nucleus of the TRANCO is its headquarters, which is located in the metropolis, and which is the central planning bureau of the corporation. The headquarters is something quite distinct from its productive activities, which can be classified in three main types —extractive, industrial and marketing— and which are located also in the metropolitan country, but with subsidiaries, branches or affiliates in the peripheral countries. The headquarters consists essentially of a group of people who plan and decide what will be produced and sold, how, where, how much and over what period of time. In order to perform the decision-making process rationally, it has developed a highly efficient system of communications through which the necessary information, personnel, scientific and technological knowledge, finance and decisions flow.

Between the productive activities of the TRANCO there develops a flow of goods and services within an institutional framework of vertically and horizontally highly integrated oligopolistic enterprises —both nationally and internationally. In this manner, the TRANCO replaces to a large extent the market —again both national and international— since it takes over the sources of supply of its inputs and the outlets of its production. Moreover, it is able to influence significantly the demand for its goods and services through the pressure it is able to exercise over the individual consumer as well as over governments. As can be seen, the new industrial system also entails the disappearance of the classical entrepreneur, the suppliers of capital and capital markets, and their replacement by the top planners and managers who constitute the corporate techno-structure. These same technocrats who, according to Mr. Barber,⁹

⁸ Galbraith, John Kenneth, *The New Industrial State*, Boston, Houghton Mifflin, 1967.

⁹ *Op. cit.*

will rule the world in the near future, are in fact replacing the national entrepreneurial class in the underdeveloped countries, as we shall see presently.

For the reasons indicated above, and since the expenditures in research, design and technology have become a major item in the TRANCO fixed cost structure, it has every interest in spreading these costs over an ever increasing total output, including the output sold in the metropolitan markets and overseas markets. Therefore, the capturing of more and more consumers at home and abroad is absolutely central to the long-term profitability of the TRANCO. According to Galbraith, in underdeveloped countries the introduction of new consumer goods —cosmetics, motor scooters, transistor radios, canned foods, bicycles, phonograph records, movies, American cigarettes— is recognized as of the highest importance in the strategy of economic development. And he reminds us that, in the golden days, commodities such as tobacco, alcohol, and opium which involved a physical and progressive addiction were considered useful trade goods. It is clear then that this strategy of economic development is really a long-term strategy of maximization of the TRANCO's profits, involving the spreading of its subsidiaries and of a homogenized consumer culture throughout the world.

Nearly every country in the world has in the past made efforts to attract foreign private capital for everywhere experienced the acute need for the contributions that foreign capital was supposed to make (capital, technology, markets, entrepreneurship, etc.). But the nature of traditional enterprise based on foreign capital was different from the new international industrial system build around the TRANCO. It is now becoming increasingly clear that the claims traditionally made regarding the contributions of foreign private capital are not necessarily valid.

In fact, the contributions of new additional capital are rather small, as the subsidiaries finance themselves in large measure with local resources. Remittances abroad of profits, interest, royalties, payments for technical assistance, foreign inputs, etc., are normally several times larger than the net inflow of capital, with the consequence of a substantial net outflow of resources (this amount is generally under-estimated because of the possibility of overpricing in the case of each of the items of payments abroad, facilitated by the transnational integration of the firms).

Technological transfer also manifests some very special peculiarities. As it occurs within the framework of the TRANCO, it is not to be expected that any substantial effort will be made to adapt techniques to local conditions or to stimulate local scientific and technological activity; therefore, we learn to "consume" new techniques through this kind of transfer, but not to adapt or generate science and technology. Something similar occurs with the national entrepreneur —he is converted into an international technocrat or bureaucrat, or becomes marginalized. Finally, with respect to the opening of new foreign markets, experience, at least in the case of manufacturing, has been entirely negative.

On the other hand, multinational business through the proliferation of subsidiaries, has grown so large and influential that nation-States, through which its influence extends itself challenging national decision-making processes, are becoming increasingly restless.

To many countries, the multinational corporation is something of a new problem and there is much uncertainty about how to deal with it; general apprehension is found more often than articulated analysis. Its benefits are appreciated, but there is suspicion of its newness. In essence, the main concern is the locus of decision-making; countries fear that important decisions will be made outside their country or, if made inside their country, by foreigners. In particular, they are afraid of losing power to the United States. They fear that some decision "taken in Detroit" will shut down a factory in their country.

It is possible to identify a number of problems which keep recurring:

- (i) The multinational corporation is a medium for the intrusion of the laws, politics, foreign policy and culture of one country into another. This relationship is asymmetrical for the flow tends to be from the parent country to the subsidiary country rather than vice versa. The issue of extra-territoriality with regard to such things as anti-trust and trading with the enemy is one of the main focuses of debate and concern.
- (ii) Multinational corporations reduce the ability of the government to control the economy. Multinational corporations, because of their size and international connections, have a certain flexibility for escaping regulations imposed in one country. The nature and effectiveness of traditional policy instruments — monetary policy, anti-trust, taxation — change when important segments of the economy are foreign-owned.
- (iii) The multinational corporation tends to centralize research and entrepreneurial decision-making in the home country. Unless countermeasures are taken, the “backwash” effects may outweigh the “spread” effects, and the technology gap may be perpetuated rather than alleviated. Over-reliance on multinational corporations may cause the country to remain a margin rather than become a centre.
- (iv) Multinational corporations often occupy a dominant position in their industry. Countries are concerned that they will not get a fair share of production and exports. Decisions depend on the horizons and outlook of the head office management, which can be limited and biased. Each country is aware that other countries, including the United States, put pressures on the multinational corporation to produce, export, import or invest in a particular way. A country without the ability to make its presence effective in the decision-making process may end up with a smaller share than otherwise.
- (v) Natural resource industries are sometimes highly oligopolistic, and have only a relatively small number of firms. The price a country obtains for its raw materials is not set objectively in a free market, but is determined by bargaining and negotiation with the dominant corporations. Unless a country has the requisite knowledge and effectiveness, it may get a smaller than possible share of the benefits.¹⁰

The growing conflict between the TRANCO and the nation-State is also anticipated by observers who are favourably inclined to the trends that have been described earlier. Ball recognized three main conflicts: (a) between the TRANCO and the local business community; (b) between the TRANCO and local governments (the company’s decision may have been completely sound with reference to the world economy, but quite irrelevant to the economy of the country concerned), and (c) because of the enforcements of US... “domestic legislation or policies abroad by trying to extend its writ to the actions of foreign subsidiaries of American companies.” In the final analysis, according to Mr. Ball, there remains the question of the legitimacy of the power of the TRANCO.¹¹

Some of the effects of the process of transnational conglomeration on the developed and underdeveloped countries are the following:

- (a) The increasing capacity of the TRANCO to take the fullest possible advantages of size and diversification — economies of scale, large accumulations of capital, long range planning, market power, scientific and technological research, predominantly internal sources of finance, reduction of uncertainty and risk, choice of best opportunities over a very wide economic horizon, etc.— accrues mainly to the country where the basic

¹⁰ Stephen Hymer, *Transatlantic Reactions to Foreign Investment*; Economic Growth Center, Yale University, 1968 (unpublished Center Discussion Paper, No. 53).

¹¹ George W. Ball, “Making World Corporations into World Citizens”, War Peace Report, October, 1968.

functions of the TRANCO are located, constituting a kind of external economy which integrates, increases the degree of complexity and specialization, and dynamizes the rest of the economy of the metropolis. The subsidiaries and affiliates of the TRANCO located in the peripheral country —not only in the primary producing sectors but in all activities of the underdeveloped economy— do not create a similarly integrated industrial complex with the rest of the local economy, but on the contrary, remain integrated with the TRANCO. Moreover, they even have some disintegrating effects, among other factors, in view of the parallelism of productive activities which they tend to produce. This is due to the fact that TRANCOS never leave the market to competitors (which means excess capacity in small markets), and also to the massive introduction of highly capital-intensive technologies displacing local activities, including their entrepreneurs, workers, etc. Since the subsidiaries remain as closely tied to the TRANCO as possible in terms of inputs, technology, personnel, property, administration, product and process innovation, etc., the effects of the spread over the local economy tend to be less important than the backwash effects or the spread effects over the economy of the metropolitan country.

- (b) Since, for various reasons, the TRANCO needs permanently to expand its markets, underdeveloped countries are subject to a massive offensive of the consumerism characteristic of developed societies. There is of course a ready market for these goods among the small segment of higher income groups which are integrated into the developed part of the global system, but the demonstration effect also trickles down to the lower income groups. This introduces serious distortions and irrationalities into the structure of demand and in the allocation of private and public investment resources, while at the same time reduces savings.
- (c) The activities in which TRANCOS operate are frequently of a highly oligopolistic nature. A few primary exporters may buy from a large number of small agricultural or mining firms, while a few producers of consumer durables may sell to a large number of independent consumers. Under these conditions, the TRANCOS could well underpay local producers and overcharge local consumers, obtaining excess profits on both accounts and either sending them back to the headquarters or reinvesting them locally, initiating a process of cumulative accentuation.

The above analysis leads us to the following tentative conclusion: the capitalist system of world economy is in the process of being reorganized into a new international industrial system whose main institutional agents are the TRANCOS, increasingly backed by the governments of the developed countries; this is a new structure of domination sharing a large number of characteristics of the mercantilist system, which concentrates the planning of the deployment of natural, human and capital resources and the development of science and technology in the “brain” of the new industrial system (i.e., the technocrats of TRANCOS, international organizations and governments of developed countries), and which tends to reinforce the process of economic, social, political and cultural underdevelopment of the Third World, deepening foreign dependence and exacerbating internal disintegration.

The example of Canada may be illustrative:

“The following is a sketch of Canada’s slide into a relationship of economic, political and cultural dependence upon the U.S. It seeks to explain the process whereby national entrepreneurship and political unity have been eroded to a point beyond which lies the disintegration of the Canadian nation-State.

Canada was discovered, explored and developed as part of the French, and later, the British mercantile system. It grew to independence and nationhood in a brief historical era in which goods, capital and people moved in response to economic forces operating in relatively free, competitive international markets”.

“Present-day Canada has been described as the world’s richest underdeveloped country. Its regression into a state of extreme economic and political dependence cannot possibly be attributed, as is fashionable in some quarters, to an unfavourable endowment of resources. Nor can its present scarcity of independent dynamic be laid at the door of a traditional culture. Here we are forced to seek the explanation of underdevelopment and fragmentation in the institutions and processes of modern society. We suggest that such an explanation is to be found in the dynamics of the New Mercantilism of American corporate economy”.¹²

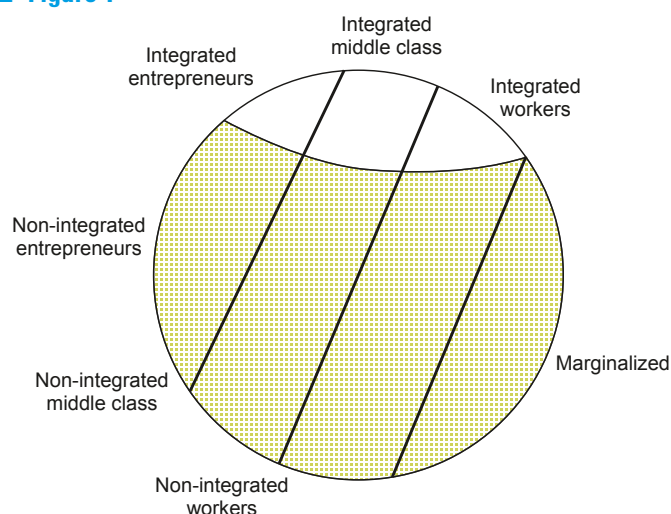
In relation to Latin America, the following quotation from Furtado suggests a similar process:

“The penetration of the TRANCO in Latin American industry started after the Great Depression. After the Second World War, this penetration becomes very intensive, particularly in countries which had already achieved some substantial industrial development (Argentina, Mexico and Brazil mainly). In this way, ... the process of formation of a national class of industrial entrepreneurs was interrupted. Given their strong financial position, TRANCOS progressively extended their control over the most dynamic sectors of industrial activity. The best talents that emerged from local industries were absorbed into the new managerial class... National independent entrepreneurship was, in the process, restricted to secondary activities or to pioneering ventures which, in the long run, simply open up new fields for the future expansion of the TRANCO... The elimination of the national entrepreneurial class necessarily excludes (therefore) the possibility of self-sustained national development, in the line of classical capitalist development”.

Furtado’s observation may be generalized to all groups and social classes in order to gain a clearer perception of the process of national disintegration. To do this, we must incorporate a class structure into the scheme presented in previous graphs, as in the following figure:

¹² Kari Levitt, “Canada: Economic Dependence and Political Disintegration”, *New-World Quarterly*, Vol. IV, No. 2, Jamaica, 1968.

■ Figure 1

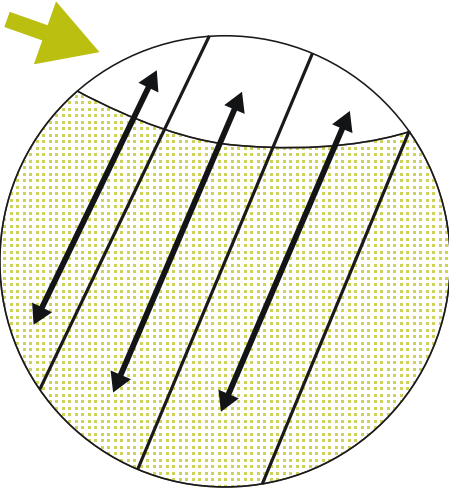


As can be seen, the classification of integrated and segregated groups now overlaps with a class structure, so that integrated and non-integrated groups appear among entrepreneurs, middle class and workers, as well as in a segment of “absolutely” marginalized population. It should be emphasized that the classification used here and the relative importance of the seven segments into which society has been divided are mainly of an illustrative nature. This compartmentalization of society will assume different forms, depending upon the actual situation prevailing in different countries.

The hypothesis that has been elaborated in this essay suggests that this social structure derives an important part of its dynamism from the influence that the internationalized or integrated sector receives from the central countries. At the level of the productive structure, this influence makes itself felt through the massive and extraordinarily dynamic penetration of the transnational conglomerate and its subsidiaries and affiliates; at the technological level, by the large scale introduction of highly capital intensive techniques; at the cultural and ideological level, by the overwhelming and systematic promotion and publicity of the super-consumption civilization, and at the concrete level of development policies and strategies, by the pressure of national and international public and private interests in favour of the production of higher income consumption goods and services and the process of transnational integration.

As was indicated in the section on the international process of polarization, modernization implies the gradual replacement of the traditional productive structure by another of much higher capital intensiveness. In the conditions that were specified then, this process appears to produce two opposed tendencies. On the one hand, the process of modernization incorporates into the new structures the individuals and groups that are apt to fit into the kind of rationality that prevails there; on the other hand, it expels the individuals and groups that have no place in the new productive structure or who lack the capacity to become adapted to it. It is important to emphasize that this process does not only prevent or limit the formation of a national entrepreneurial class, as indicated by Furtado, but also of national middle classes (including national intellectuals, scientists, technologists, etc.) and even a national working class. The advancement of modernization introduces, so to speak, a wedge along the area dividing the integrated from the segregated segments.

■ Figure 2



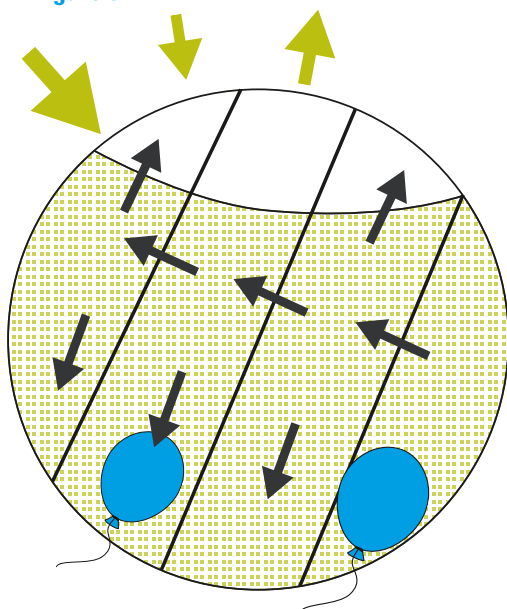
In this process, some national entrepreneurs are incorporated as executives into the new enterprises or those absorbed by the TRANCO, and others are marginalized; some professionals, forming part of the technical staff and the segment of employees are incorporated, and the rest are marginalized; part of the qualified labour supply and those that are considered fit to be upgraded are incorporated, while the remainder are marginalized.

The effects of the disintegration of each social class has important consequences for social mobility. The marginalized entrepreneur will probably add to the ranks of small or artisanal manufacture, or will abandon independent activity and become a middle class employee. The marginalized sectors of the middle class will probably form a group of frustrated lower middle class people trying to maintain middle class appearance without much possibility of upward mobility and terrorized by the danger of proletarianization. The marginalized workers will surely add to the ranks of absolute marginality, where, as in the lower middle class, growing pools of resentment and frustration of considerable demographic dimension will accumulate.

Corresponding to this downward mobility there will probably also be an upward mobility of a selective and discriminatory character. Some absolute marginals will be incorporated into the working class, some workers will rise to the lower ranks of the middle class and some sectors of the middle class may become medium or small entrepreneurs. This upward movement will probably tend to depress the wage level, at least of the unskilled workers, and will increase the anguish of the lower middle class.

Finally, it is very probable that an international mobility will correspond to the internal mobility, particularly between the internationalized sectors of developed and underdeveloped countries, which, as we have indicated before, constitute the nucleus of the international capitalist system, and, therefore, probably also constitutes an international market for skilled resources. Part of this international mobility is the so-called "brain drain", the counterpart of which is the reverse flow of experts and administrators sent to the underdeveloped countries in order to orientate and administer the process of development and modernization described in this paper. An attempt is made to illustrate this complex of internal and external social mobility process (see figure 3).

■ Figure 3



The process of social disintegration which has been outlined here probably also affects the social institutions which provide the bases of the different social groups and through which they express themselves. Similar tendencies to the ones described for the global society are, therefore, probably also to be found within the State, church, armed forces, political parties with a relatively wide popular base, the universities, etc. The crisis which each of these institutions is experiencing in Latin America will also have special characteristics according to the combination of social forces which they represent, and of which they are made up, but also according to the intensity with which they are affected in their structure and functioning by the process of transnational integration and national disintegration.

NATURE AND IMPLICATIONS OF THE “STRUCTURAL HETEROGENEITY” OF LATIN AMERICA *

Aníbal Pinto

* El trimestre económico, vol. 37(1), N° 145, México, D.F., Fondo de Cultura Económica, January-March 1970.

1. This article, which is related to and coordinated with others on the same general topic,¹ will discuss the following issues:

- (a) The nature of the structural heterogeneity of the Latin American economies and how this differs from the classical dualism approach; and
- (b) The implications of that heterogeneity for the Latin American development dynamic.

Although the analysis will be conducted at a very high level of abstraction, focusing on Latin America as a whole, the last part of the article will consider a number of specific national or regional situations.

2. The article firstly considers certain points in relation to the “dualist thesis”.

As an economic concept, dualism is clearly identified with an extreme and “abstract” case of the commodity-exporting economies, or “enclaves”. A distinction is made between the export “complex” and the “rest” of the economy, with the two areas being more or less completely separate. Recalling Singer, it might be said that, although the export complex was geographically and politically inside the country, in practical economic terms it was an “extension” or part of the “central” system. Nonetheless, the key point is not that it involved differentiated areas, but there was little or no “irradiation” from the export locus towards the “hinterland”. The former grew towards and from the outside, while the latter “vegetated” with nothing more than “endogenous” stimuli.²

3. The commodity-exporting countries of Latin America can be classified according to their proximity to, or distance from, the enclave archetype. Possibly the closest have been the “banana republics” of the past; and the most distant, those of the Southern Cone, including Brazil, given the special dispersion and time sequence of this country’s various export hubs. The differences can be attributed to factors of three main types.

Firstly, the nature of the resources underlying the exports was different. Where these were to a large degree “specialized” for the external market (plantation-type and mining products), the divorce tended to be greater than in the case of productions that were more widely shared between the domestic and external markets (the case of the basic food producers of the River Plate area). Aside from this, there was the political-institutional factor. Where a more or less independent “national state” was involved, the possibilities for transferring the dynamism of the export complex to other activities and regions were greater.

Lastly, there is the greater or lesser significance and impermeability of the traditional society or economy, as exemplified by the countries of the Inca Empire. These and other circumstances defined the dualist context of Latin America’s commodity-exporting economies, mainly in terms of radical disparities in productivity and the points of contact or “communication” between the export sector and the rest of the economy; and not, for example, the predominance or differences in terms of capitalist or “feudal” (more precisely “baronial”) relations, or their integration or otherwise into a “political-national system”. In some places, to repeat, the separation was almost total, whether from the standpoint of the populations involved in one or other sector, or else spatially, in terms of regions that were incorporated into external trade or excluded from it.

¹ See *Economic Survey of Latin America and the Caribbean*, 1968.

² On this point, see Yoichi Itagaki “A review of the concept of the ‘dual economy’”, *The Developing Economies*, vol. VI, No. 2, June 1968. This article contains very complete references to the key contributions on the subject.

4. The development of industrialization, understood in its broadest sense to include all complementary activities, significantly changes that relatively simple and pronounced framework of structural heterogeneity, and by several degrees. In substance, and to avoid repeating what are now familiar analyses, “inward” diversification leads to the appearance and emergence of a “modernized” and “capitalist” non-export sector, with productivity levels that are substantially above the system average and similar (at least in domestic-price terms) to those of the export complex. To some extent, this phenomenon has been taking shape in the leading countries in the “second stage” of the process, when they enter the domain of intermediate goods and “heavy” consumer durables, based on modern technologies and greater capital density. In contrast, in the previous phase, broadly speaking from the 1930s until the early 1950s, manufacturing growth was based mainly on the use of pre-installed capacity and the development of light industries. Another example could be the case of the later-industrializing countries, in which the initial industrial steps now involve the importation of modern technologies that immediately impose a “break” in terms of productivity levels.

5. In view of the changes wrought by industrialization, the productive structure of Latin America can usefully be divided into three broad strata, for certain analytical purposes to be mentioned below. Firstly, there is a “primitive” stratum, in which productivity and per capita income levels are probably similar (and sometimes below) those that prevailed in the colonial economy, and, in some cases, the pre-Colombian economy. At the other extreme, there is a “modern pole”, consisting of export, industrial and service activities that function with productivity levels similar to the averages of the developed economies; and, lastly, there is the “intermediate” stratum which, to some extent, corresponds more closely to the average productivity of the national system. Note the multisector nature of each of the strata, and how this framework differs from the more common urban-rural dichotomy.

Several problems arise when considering this classification. The first might concern the validity of the differentiation or “discontinuity” of the strata in question; while the second relates to the relations between them, or to their position on the “continuum” of the domestic economy.

6. On the issue of “discontinuity”, there are two crucial points: the magnitude of the contrasts between the classified segments and the size of the human contingents and productive activities related to each of them.

From the first standpoint, productivity per person in the “modern” sector is estimated at just over four times the economy average, whereas in the “primitive” sector, it would not attain one quarter of that level. In other words, productivity in the first case would be over 20 times that of the second. In absolute terms, this would mean productivities per person of about US\$ 4,000 and US\$ 190 per year, respectively. That of the “intermediate” strata would be almost equal to the economy average and equivalent to roughly US\$ 1,000 per person employed.³ An approximate benchmark can be obtained from the differences in productivity per person in the main economic activities in developed countries:

³ On this subject, see *La mano de obra y el desarrollo económico de América Latina en los últimos años*, ECLAC, E/CN.12/L.1, prepared by Zygmunt Slawinski and presented at the seminar organized by the International Labour Organization (ILO) in Rio de Janeiro, Brazil, in October 1964. See also A. Pinto, “Concentración del progreso técnico y de sus frutos en el desarrollo de América Latina”, *El Trimestre Económico*, No. 125, Mexico City, 1965.

■ Table 1

GROSS DOMESTIC PRODUCT PER PERSON EMPLOYED ^a IN THE UNITED STATES AND GREAT BRITAIN, 1960

Sector	United States	Great Britain
Total	100	100
A. Agriculture	47	93
B. Non-agriculture	105	100
I. Goods and basic services	128	102
(a) Mining	133	90
(b) Manufacturing	125	97
(c) Construction	120	99
(d) Basic services	147	128
II. Services	90	98

Source: Yearbook of National Accounts Statistics 1965; Statistical Abstract of the United States, 1964: and Annual Abstract of Statistics.

^a At factor cost.

The relative homogeneity of the various sectors is immediately evident. The differences would clearly be greater if the same approach as used in this article had been adopted; but, even from the strictly “sector-based” viewpoint, the Latin American contrasts are substantial. For example, productivity per person in agriculture is less than one tenth that of mining and less than a fifth of the level in manufacturing industry. There are also large disparities within sectors: globally in agriculture, for example, farming operations attached to the “modern” segment, would have a productivity about 14 times higher than that prevailing in the “primitive” segment. In manufacturing, establishments in the “modern” segment would achieve productivity levels almost 30 times higher than the small units operating in its “primitive” segment.⁴

It is therefore hard to deny that there really is a discontinuity, or a clear situation of structural heterogeneity, whatever the angle chosen for the comparison; and this also stands in contrast to the considerable homogeneity prevailing in the industrialized economies.⁵

7. Nonetheless, the above should be seen in conjunction with another aspect: namely the relative size of the different strata. In essence, the following could be posited. Whereas activities, populations and areas that are “backward” or “marginalized” (or however one wants to call them) represent small or insignificant fractions of the global structure of the “central” economies, the opposite is the case in Latin America (and in the underdeveloped world generally). Studies estimate that between 35% and 40% of the economically active population of Latin America is working in the “primitive” strata (although this generates less than 8% of GDP), and only around 13% are employed in the “modern” strata. One could speculate that these proportions would be reversed in an industrialized economy, and even then, the “backward” strata would certainly be less distant from average productivity and from the productivity levels prevailing in the most advanced area.

8. The foregoing considerations relate only to certain basic features of the global structure. It is now worth examining relations between the strata in the development dynamic. To avoid digressions, the issue will be cast in the light of the experience of the central economies. Firstly, there seems to be a clear long-term trend towards the “homogenization” of economic

⁴ Preliminary ECLAC estimates for 1960. Naturally, the proportions of the active population incorporated in the various strata vary considerably in each sector. Roughly speaking, the percentage held in the “primitive” strata of industry is relatively small but it is quite high in the agriculture sector.

⁵ As is understood, that substantial heterogeneity goes hand-in-hand with, and to a large extent is the cause of, the incomplete or very weak internal integration of the systems. The low productivity, and meagre tradable or exchangeable “surpluses” in some sectors, in practice hinder or restrict their relations with the others. Something similar also occurs at the international level: relations are stronger and more dynamic among industrialized economies (diversified and “homogenized” in terms of technical progress) than between them and the underdeveloped economies.

systems, which is reproduced at practically all levels. Secondly, although that development path obviously did not mean advancing on a uniform front, since focal points or “leading sectors” appeared, the key point is that these “dragged” the others up towards similar or even higher levels of productivity. This is not a totally spontaneous or “natural” trend therefore; but economic and social policies, particularly in the post-war years, played a key role in the process. Doubtless, the vision of that experience was in the minds of those who proposed the path of industrialization in Latin America (naturally without forgetting the effect of other events, thoroughly highlighted in the ECLAC approach). In short, it was based on the idea that the new “pole” established around industry and projected “outwards”, would fulfil a “homogenizing” mission similar to that seen in the “central” countries.

For a while, in the initial phases of “substitutive industrialization”, it was possible to believe that that prospect was showing signs of materializing. Now, however, the optimism has clearly faded or disappeared.⁶

9. What are the grounds for this change in expectations? A “heroic” summary might prioritize the following:

- (a) The pace of development has been far from accelerating, consolidating and becoming “self-sustained”;
- (b) Dependency on the exterior has changed in outward appearance, but in many cases it has become just as influential as in the past, or even more so (chronic borrowing, alienation of economic policy decisions; technological subordination, basic activities being transferred abroad, etc.);
- (c) Large segments of the population, the productive structure and the “economic space” have been totally or substantially excluded from the progress made in the “modern pole”. In other words, the fruits of technical progress have been concentrated in three ways: at the social level, in terms of the economic “strata”, and at the regional level.
- (d) Lastly —and most importantly— there is no real sign that the trend in question will correct itself spontaneously. On the contrary, it seems reasonable to assume —and there are arguments to support this hypothesis— that it could or ought to accentuate. To summarize, the capacity of the “modern sector” for irradiation or spillover has proven much less than expected, to say the least.

Thus, rather than the global structure becoming more homogeneous, it is actually becoming more heterogeneous.⁷

10. On this point, to ground the assumption, it is worth considering a number of background facts relating both to our own region and to economies that are more highly developed than those of Latin America, but where several similar characteristics are being or have been reproduced.

The first concerns what happened in a number of southern European economies such as Spain and Italy. A very important study by the Economic Commission for Europe⁸ found that:

⁶ This does not mean a “disillusion” with industrialization in general, as Hirschman has recently written, but a reconsideration of a particular type of substitutive industrialization. See “The political economy of import-substituting industrialization in Latin America”, *The Quarterly Journal of Economics*, vol. LXXXII, February 1968.

⁷ Note that (without being a deduction “by analogy”) this conclusion has its counterpart in what occurred internationally. Moreover, in this case, the optimistic nineteenth-century assumptions for the global dissemination and sharing of productivity improvements in the industrialized central countries were also not fulfilled. On the contrary, the initial inequalities have clearly become exaggerated.

⁸ See United Nations, *Economic Survey of Europe in 1953*.

...regional income disparities are much wider in the poor countries of Europe than in the rich ones. Large areas of southern European countries have per capita incomes of below two thirds of their national averages, unlike West Germany, Sweden or the Benelux countries. The differences between rich and poor countries in this respect are much more pronounced ... because most of the poor areas in rich countries are sparsely populated. In contrast, the poor regions of the south and east of Europe are very densely inhabited. Whereas the population in regions with per capita incomes below two thirds of the national average represent a very small percentage in Great Britain, Switzerland, Austria, and about 10% in Norway and France, it accounts for around one third of the population in Italy, Turkey and Spain. Regional disparities in the poorest European countries partly reflect the fact that these contain “islands of progress” —generally the capital and other large cities— in the midst of an ocean of relative backwardness, whether owing to differences in natural resources, the climate or topography, or because of land tenure systems and other institutional factors.

It should be stressed that a key element for the issue posed is the growth and/or retention of populations in backward areas. For example, the same source reports that between 1900 and 1950 in the poor regions of Spain and Italy, the number of inhabitants grew at more or less the same pace as those of the country as a whole. In some cases, such as Andalusia and Cerdeña, the population actually grew faster —and those areas represent quite a high proportion of the total.⁹

Another clear and largely overlooked illustration (which does not reject the long-term trend towards homogenization in the central countries) is the United States and, more specifically, the southern part of that country. Here it suffices to reproduce a few paragraphs from the well-known paper by Sydney Dell:¹⁰

... Perhaps it should be pointed out that history records numerous examples of the opposite trend, namely “economic polarization” as the wealthy areas of the community or country become richer and richer, and the poor areas become yet more impoverished ... the history of the United States suggests that the forces of economic integration in that country have not been as vigorous as is often claimed. Firstly, qualitative data suggest that for most of the nineteenth century the southern states were considerably backward compared to the rest of the country, with respect to both output and income growth.

... Even around 1954, after some 80 years of industrial development in the south, the southern states accounted for just 20% of the country’s total industrial employment, although they still represented 31% of the national population. Moreover, average income in the poorest southern states was still less than half that of the wealthier ones.

What is clearly remarkable about the gap (between the north and the south) is not that it occurred between 1880 and 1950, but that it has lasted so long, despite the dominant competitive forces in the most dynamic economy of the Western world.

11. In the case of Latin America, the first point to consider is that after so many decades of “outward” and “inward” growth, between 40% and 50% of the Latin American population are still excluded from the benefits of development, with average incomes similar to those of the Asian and African countries.

⁹ This problem has eased more recently, mainly owing to the massive emigration of labour to other European countries.

¹⁰ Sydney Dell, “Economic integration and the American example”, *The Economic Journal*, March 1959.

Unfortunately, no data are available to gauge the past and present pace at which population groups are integrating into the “modern” sector; although it has been shown that absorption rates in core elements of the strata, such as manufacturing industry and basic services, have declined in the 1960s compared to the previous decade.¹¹

Nonetheless, a rough idea can be gained by considering how some representative countries have evolved in terms of incorporating the economically active population into developed areas; and the obverse, the retention of that population in underdeveloped areas. The following tables display that information for Brazil, Peru and Ecuador. Possibly the key conclusion to be drawn from the data is that the (sometimes quite rapid) population growth of the most dynamic regions has not prevented the contingent trapped in the “internal periphery” from continuing to expand in absolute terms. It should also be noted (and this is another key point for the discussion) that the advanced regions have their own internal periphery, formed mainly by “urban marginality”.

To repeat, there are reasons to expect a trend of increasing structural heterogeneity, which in some cases may entail an absolute deterioration of the situation of the “excluded”, but will nearly always mean they fall further behind in relative terms.

■ **Table 2**

BRAZIL: DISTRIBUTION OF THE POPULATION BY DEVELOPMENT AREAS

	1940		1960		1970 ^a	
	No. of inhabitants (000)	%	No. of inhabitants (000)	%	No. of inhabitants (000)	%
Developed area ^b	8 944	22	16 282	23	22 600	24
Underdeveloped area ^c	15 862	38	30 007	43	38 291	40
Intermediate area ^d	16 430	40	24 678	34	34 371	36
Brazil	41 236	100	70 967	100	95 262	100

Source: 1960 Population Census.

^a IBGE projection.

^b States of Guanabara and São Paulo.

^c Includes the north and north-east regions and the states of Bahia, Sergipe, Espírito Santo and Rio de Janeiro,

^d Includes the states of the south — Panamá, Santa Catarina and Rio Grande do Sul; along with Minas Gerais and the new centre-west border region.

■ **Table 3**

ECUADOR: DISTRIBUTION OF THE POPULATION BY REGIONS

	No. of inhabitants (000)			Structure (percentages)		
	1938	1950	1962	1938	1950	1962
Sierra	14 52.3	18 96.1	2 461.0	61.3	58.0	52.1
Coast	759.1	13 26.2	2 178.6	32.0	40.5	46.1
East (and others) 158.4	48.8	81.5	6.7	1.5	1.8	
Total	2 369.8	3 271.1	4 721.1	100.0	100.0	100.0

Source: *Indicadores Económicos*, Junta de Planificación del Ecuador, July 1967.

Nota: 1938 —estimations according to the aforementioned source. 1950 and 1962— census data.

¹¹ See *Economic Survey of Latin America and the Caribbean*, 1968, Table 1-22.

■ Table 4

PERU: POPULATION RECORDED ON THE COAST AND IN THE OTHER REGIONS 1945 AND 1965*(Millions of inhabitants)*

	1945	% of total	1965	% of total
Coast	2.4	31.2	3.4	29.6
Other regions	5.3	68.8	8.1	70.4
Total	7.7	100.0	11.5	100.0

Source: Estimations based on the 1940 and 1961 censuses. Census data for smaller areas have been extrapolated in line with regional growth indices.

Note: The definition of the coastal region is not confined to the usual topographical demarcation (for example, the 1,500 m altitude contour). Some areas have been excluded or included according to their degree of integration into the non-mining export economy of the western slopes of the Andes. This procedure assigns a larger population to the coast than that resulting from applying the normal definitions. The difference is relatively small however (fewer than 250,000 inhabitants in 1965) and would not alter the growth trend of the "other regions" as a whole.

12. Clearly, the different strata and all components of the global structure, in general, are "set" in a common context. They are not static compartments or "systems"; so the nature of their relations needs to be analysed in greater depth, a subject that still requires a lot of thought and research. The key possibilities in this regard are discussed below on a merely exploratory basis. The first could be identified with "domestic colonialism".¹²

It is not hard to find cases and situations that display a sort of "exploitation" of the "internal periphery" by its "centre" (or modern sector), which could have occurred through any or all of these main mechanisms:

- (a) The terms of trade, which would reproduce the internationally observed phenomenon in which the "internal centre" does not distribute or share with the periphery the gains obtained from its growing productivity (mainly by trading commodities for manufactured goods).¹³
- (b) Exchange rate discrimination, since exports originating in the periphery were paid for in overvalued currency, which were then delivered undervalued to the importers of the "centre".
- (c) The transfer of financial surpluses created in the periphery to the activities of the "centre" (similar to capital flight from the periphery to external "centres").
- (d) The possible disproportionate distribution of public and private investments to the benefit of the modern sector, particularly in the large urban centres.

13. While it is difficult to assess and quantify those phenomena, it is also true that there are "compensatory" effects, such as those deriving from public expenditure, social investments, regional rebalancing policies, etc., which aim to alleviate "periphery" status and are necessarily financed largely from the surpluses of the modern sector. It might also be thought that this brings the goods that characterize the latter's consumption patterns within the reach of the marginalized, or at least within their sight or hearing. Nonetheless, apart from being very similar to the "Torment of Tantalus",¹⁴ this to some extent causes undesired or debatable effects (such as the lowering of food standards to purchase a transistor radio for example (observation by Pedro Vuskovic).

¹² I believe Wright Mills was one of the first to draw attention to this aspect in a colloquium on "Resistance to change", held in Brazil (1960). The article is contained in his anthology *Power, Politics, and People: The Collected Essays of C. Wright Mills*, Oxford University.

¹³ On the economic and social meaning of "real" and "nominal" increases in productivity (owing to economic policy, pressure groups and other factors) please see the author's article "Concentración del progreso técnico y de sus frutos en el desarrollo latinoamericano", *El Trimestre Económico*, No 125, January-March 1965.

¹⁴ Remember that 50% of the population has virtually no participation in the "industrial market" (See *El proceso de industrialización en la América Latina*).

Incidentally, these and other expedients are what make the periphery participate in global society (on a limited and “passive” basis), but without being able to “integrate into” it at the basic or economic level — in other words, through the dissemination of technical progress, productivity and income growth, the expansion and increase in employment opportunities and so forth. (Perhaps all of this is similar to the functions and scopes of “foreign aid” (particularly with social aims) and the “demonstration effect”?).

14. In the author’s view (and it is well known that there are clear differences of opinion on this)¹⁵ more important than the foregoing issue is the other alternative: that in current conditions modern sectors may have acquired a considerable degree (albeit always relative and conditional) of internal but not external autonomy. In other words, they tend to grow on the basis of their own effort, establishing specific expenditure-income, saving-investment circuits, etc. From another standpoint, this means that (aside from the “correctional” efforts of public policy) its “spontaneous” trend aims at less irradiation towards the internal periphery and greater concentration (or appropriation) of its productivity achievements.

The disadvantages of this tendency are patently obvious from a “national” point of view, and there is no need to go further into this issue. One could also raise doubts as to the general “economicity” of the process, an aspect which will also not be addressed here, since it has been widely discussed in documents on the regional distribution of economic activity.¹⁶ Instead, it is more interesting to speculate on the opportunities for prosperity offered by the scheme in question.

15. Prevented from properly analysing the issue, a “drastic” synthesis will again be made, to draw attention to what the author sees as the “model’s major contradiction”, namely that it is striving to reproduce the productive structure of the “opulent consumer society”, which is enabled by a broad and diversified base of production and average income levels above US\$1,500, in economies that obviously do not have the former and only generate US\$ 500 per person per year.¹⁷

It would be useful to contrast this basic contradiction with what emerged in the outward growth phase. As aptly noted by Jorge Ahumada, this rested on the disjunction between a “simple” productive structure, based on commodity-exporting activities, and the diversified demand and expenditure structure, determined by the level of income and, above all, its concentration. Imports had to resolve the contradiction. Given the contraction or suffocation of import capacity, countries took on the task of “adjusting” their domestic production structures to the pattern of demand. Nonetheless, for various well-known reasons, ranging from the income distribution to the “internalization” of the demonstration effect (with the domestic production of goods that were once banned or unknown), that production structure supported the essential reality of low average income, while endeavouring to reproduce that of much more developed economies.

This is probably the source of one of the underlying causes of the “exhaustion of easy industrialization”. Once the demands of the relatively small high-income population have been satisfied, the system falters or efforts are made to ease the pace (or both), thereby concentrating

¹⁵ For example, with those who believe that the modern sector emerged “at the expense” of the other sectors, and that “the exploitation” of the latter is indispensable for its functioning — an idea which basically we do not share.

¹⁶ See *Economic Survey of Latin America and the Caribbean*, 1968, Chapter II.

¹⁷ It could be claimed that income per person in the modern sector probably exceeds US\$ 2,000 per year, and that while the sector is relatively small in absolute terms, there are also small countries which are highly industrialized. This reasoning, among other things, ignores aspects such as the following: (a) the historical context and general domestic conditions in which the industrialization of the small European developed countries took place, for example; (b) the high proportion of manufacturing output that is exported (extension of the domestic market); and (c) the considerable homogenization (from all points of view) of domestic society.

incomes even further or “fictitiously” expanding the market by extending deadlines, granting facilities, encouraging “the second car”, etc, or both of these. All of this involves a tremendous drain on financial resources and “potential” saving; in other words, it leaks into financing consumption instead of fuelling real investment.

16. It is worth noting here, albeit in passing, two ideas on “conspicuous consumption”, the first relating to the concept as such. As is obvious, this is not related to the “nature” of the goods themselves, but to other characteristics such as the fact that such consumption is wholly restricted to a small minority and is thus divorced from the pattern of demand or expenditure of the majority, which is constrained by average income. This is the obvious reason why the automobile is not a “conspicuous” item in the United States or Germany, but it is in an underdeveloped economy that has a per capita income of one third or less. This does not mean that one should or could absolutely suppress the use of that or other conspicuous goods.

Secondly, and most importantly, few analysts have paid attention to the additional “social cost” attaching to the new forms of “opulent” consumption”. In short, the typical consumption of the “traditional” high-income groups were relatively “cheap” in terms of “opportunity cost”: in the main, it involved numerous servants, good food and drink and luxurious residences—all uses that require relatively abundant factors of production with few alternative uses. The present case is very different. Today’s “opulent” modes of consumption demand a lot of capital and labour force, and highly skilled business capacity (as exemplified by the automotive or electronics industries). Where these factors are abundant—in other words, in a developed economy—the problem is reduced (but by no means eliminated, as authors such as Galbraith Sweezy and others have repeatedly pointed out). In the Latin American economies, however, the problem acquires overriding importance, particularly when these types of productions also involve a large imported component, not only in terms of inputs and machinery, but also in payments abroad.

One should also not neglect the different financial implication of the two patterns of “conspicuous consumption”. In short: the new or modern patterns require massive resource mobilization, in addition to an extensive and costly institutional apparatus. These factors were not needed to produce and sell drinks, shoes, textiles or personal services; but they are indispensable in the case of automobiles, television sets, radios, central heating systems, and so on. The “financing of consumption” becomes at least as important (particularly in our countries) as the “financing of investment.”

17. Is there an alternative to the growth modality outlined above, and which has been labelled “growth by diversification”, thereby suggesting that it depends on the endless multiplication of products for a relative minority of high- and middle-income groups, while neglecting essential goods and services and the expansion of the productive base?¹⁸

Needless to say, the answer goes beyond the scope of these notes and their author’s possibilities. Nonetheless, a few basic guidelines for a different model and strategy can be sketched out.

The first would be based on a thorough shift of emphasis from precariously based growth, as described above, towards one in which the pivot and central objectives are the dissemination of technical progress, expansion of the domestic market, homogenization of the system—which are closely related aims and, in fact, different sides of the same coin—and, last but not least, the achievement of a higher degree of autonomy or capacity for self-sustainability of the process with respect to outside influences.

¹⁸ See Carlos Matus, “Algunas cuestiones básicas para la discusión de una estrategia del desarrollo latinoamericano”, ILPES, unpublished, 1968.

Without intending to develop the contents of this strategic recomposition, the background of which can be found in the foregoing observations, it is worth dispelling certain misunderstandings —in other words, what the new proposal being developed does *not* mean.

18. Firstly, it does not involve any “prejudice” against the modern sector or the stimulus to, and creation of, highly productive units; far from it. For one thing, it is based on the fact that its “material” existence is highly advantageous factor, both because that is where much of the “real potential of investment arises (basic intermediate and capital goods and even consumer durable industries which have alternative investment and consumption uses) and because of the “potential for saving”.¹⁹

Secondly, and in view of the above, this sector should be “restructured” so that, instead of mainly serving the interests and demands of a “caricature” of “opulent society”, its potential can be used to “transmit” its progress to the rest of the economy and to “lifting up” backward populations, areas or sectors. There are abundant simple but eloquent illustrations of this: steel can be used to build office skyscrapers or to make agricultural machinery or tools; the automotive industry can provide costly cars or trucks; cement can be used in large mansions and in irrigation or roadworks, etc. To repeat, it is not a question of “either one or the other”, but a substantial change in the proportions assigned to the different ends.²⁰

19. In the same context —and alluding to another misconception, there is clearly no opposition to “technological importation” *per se*— despite its well-known inconsistencies. The *quid* of the problem again exists in the criteria used to allocate the *limited* resources that are available for that purpose. Although elementary, this precept is seldom highlighted in the economic textbook. The resources that are spent on an intensive and continuous modernization and diversification of textile production, for example, are the same as could or should be channelled into key industries, such as exports. The extensive mechanization of the financial sector might be highly beneficial “in itself”, but it would use the same means of production that could contribute to establishing or expanding basic intermediate industries or chemical products for agriculture; and so on.

20. Lastly, it also seems clear that a perspective such as the one outlined has nothing in common with the old “redistributive” policies. On the contrary, its aim is to change some of the underlying conditions of extreme inequalities, such as those that establish productivity levels, employment situations, the breadth of opportunities for the masses who are largely “excluded” from the development process and change, etc.²¹

21. As noted above, the foregoing discussion has focused on the region as a whole, so now it is necessary to take account of the national differences that significantly affect the degree and way in which the global analysis is applied.

The issue can be presented through the data shown in the following table, based on highly conjectural estimates, but which are nonetheless useful for contextualization purposes. To simplify the analysis, only the “modern” and “primitive” strata have been taken, recording the percentages of the active population and contributions to domestic product in each case.

¹⁹ It seems obvious that a Soviet-style model is unimaginable in current Latin American conditions.

²⁰ For a very wide-ranging discussion of these issues see the ECLAC document presented at the 1969 Lima Conference, “Mobilization of internal resources” (E/CN. 12/827).

²¹ On this topic, see “Estudios sobre la distribución del ingreso en América Latina, E/CN.12/770/Add, Caracas, 2 - 13 May 1967.

■ Table 5

SITUATION OF SELECTED COUNTRIES IN TERMS OF PRODUCTIVE STRATA AROUND 1960
(Percentages)

	Modern sector employment	% GDP	Primitive sector employment	% GDP
Argentina	24	55	7	2
Venezuela	20	72	26	5
Chile	21	53	24	5
Mexico	16	51	35	8
Brazil	14	42	42	10
Peru	10	40	56	14
Central America	7	32	60	16

Note: Rough estimates based on the information contained in the document by Z. Slawinsky. See p. 4.

At first glance, what stands out is the contrast between the extreme cases. Whereas in Argentina, employment in the “primitive” sector is not significant, and about one quarter of the population was already working with productivity levels comparable to those of the developed economies, the reverse is true in the Central American group, where three quarters of employment is in “primitive” activities.

Taking account of those differences makes it possible to identify the central problems in each case. In Argentina, to a significant degree, the bulk of the active population is relatively “incorporated”, and the problems that need to be resolved are: (a) to speed up the growth of the system; (b) to extend “modernization” to “intermediate” activities; and (c) to achieve a fair distribution of the social product among the “incorporated”.²² In Central America, in contrast, the basic issue is precisely how to incorporate the population of the “primitive” sector into the development process by assimilating and disseminating technical progress.

Although it is impossible to analyse the different realities and national problems in this article, a number of key aspects can be highlighted. Firstly, in some countries, the nub of the issue seems to be the survival of “traditional” agriculture (in the broadest sense of the term), where a large proportion of the population still vegetates. Examples include several Andean countries, such as Peru, Ecuador or Bolivia. Elsewhere, such as in Chile or Venezuela, the issue of urban marginalism can be relatively more important. Another fact to be considered is that in some countries, such as Bolivia, part of Central America, and the north-east of Brazil or regions of Mexico, the problem is complicated by an unfavourable ratio between man and resources. In other parts however, such as Venezuela, Colombia, or even the Peruvian *sierra*, the situation is more advantageous in this regard, and institutional constraints such as the land tenure system weigh more heavily.²³

Nonetheless, although in different degrees, it could be said that all cases pose the question of whether the “concentrating” pattern of development analysed above is compatible with substantive progress in terms of “incorporation” and “homogenization” within an acceptable timeframe.

²² From this standpoint, it can be deduced that the Argentine concern with its “national integration” has more to do with “spatial incorporation”, that is with making more of its backward and underpopulated areas, than with the “social incorporation” of large excluded populations.

²³ In the case of Mexico, it would be interesting to evaluate the importance for this issue of one of its most dynamic activities, tourism, which is also relatively “modern” and an intensive user of low- or unskilled labour.

STYLES OF DEVELOPMENT IN LATIN AMERICA *

Aníbal Pinto

* Published in CEPAL Review, No. 1, Santiago, ECLAC, first semester 1976. United Nations publication, Sales No. E.76.II.G.2.

A. General concepts¹

In view of the growing interest in “styles of development” and the discussions that have arisen about them, there is some danger that old discussions and problems may be revived under new slogans, adding little of substance and perhaps even accentuating misunderstandings or serving as the basis for sterile exercises.

Accepting the foregoing and taking it as a useful warning should not be carried to the extreme of disparaging the whole subject and the efforts that have long been made to elucidate it, however. It is a well-known fact that important changes in meaning and approach usually begin with what seem to be or are considered as purely formal or semantic modifications. A case in point is the transition from the concept of growth to that of development, where the conceptual difference between them took time to crystallize. The concept of development has since been the subject of continual re-interpretations which have still not jelled into a new term that adequately expresses them. The only expressions which have so far come into general usage are an extension (“social” or “integrated” development) and a caricature (“developmentalism”) which give little more than the restricted or insufficient concept of growth, with some additional critical considerations on dependence and long-term prospects.²

Be that as it may, the fact is that the term “style” is used in very different ways and this leads to confusion.

Before attempting or recalling any definition, it would seem best to place the subject within a specific historical context.

Let us first of all investigate the origins —which, incidentally, are relatively recent— of the interest shown in this matter. It is common knowledge that the discussion stems from widely differing sources.

In the first place, it derives from the growing dissatisfaction with the quality of life and the deterioration of the environment in the industrialized or post-industrial societies. The extensive and varied literature existing on the subject renders any digression in this respect unnecessary.

Secondly, the same and other arguments are reproduced to a lesser but definitely growing degree in the semi-industrialized economies (in Latin America, for example), which are just becoming aware of the problems involved in continuing their progress towards the point reached by the advanced countries, and are beginning to suffer the effects of the process.³

Criticism is also prevalent in many countries (mainly in Asia and Africa) which have not reached the threshold of the industrial society and in some cases are still far from doing so. Here, the discontent is fed by a combination of fairly explicit and rationalized elements, such as the discouraging view of the Western industrialized model, the idea that this pattern threatens or is antagonistic to deep-rooted cultural values which are worth

¹ In writing this article the studies by Marshall Wolfe and Jorge Graciarena which appear in this same publication were also taken into account. While it is obviously necessary to integrate the various approaches and to forge ahead along those lines, it also seems certain that it would be useful to have some division of labour in this effort, at least at the present stage of the discussion. Accordingly, this article deals mainly with economic approaches, and there is therefore no room for disparaging references to economism (however broad) or to the sociology or politicization of other approaches. The information on which this article is based was prepared with painstaking care, but also with imagination, by the economist Santiago Jadue, of the Economic Development Division of ECLA.

² It is worth noting that although developmentalism became the facile and favourite target of many authors, few took the trouble to investigate and explain its meaning. A conspicuous exception is Luciano Martins in *Industrialização e Desenvolvimento*, Editora Saga, Rio de Janeiro, 1967.

³ The word “advanced” is not used in any ironic sense here, since the industrialized economies are undoubtedly advanced in terms of the development perspective guiding them and of the objective fact that they have achieved a high degree of “freedom from want” (actual or potential).

preserving, and the awareness that the reject scheme is neither feasible nor capable of solving their cardinal problems.

In other words, concern about the “style of development” is shown by those who are sick and tired of the “affluent society”, those who —while half way to reaching that state— criticize the presumed desirability of that goal and, lastly, those who have no desire to reproduce the rejected model or have little or no chance of doing so.

The first comment that may be made on this state of affairs is that it represents a complete change of view compared with past habits. Generally speaking, as an international economy and society was gradually coming into being, the prevailing criterion was that the patterns of evolution and progress for all nations should be those established by the more advanced and dominant communities, which, in the words of the Communist Manifesto, tended to transform the world in their own semblance and image.⁴

Now, however, the discouragement and pessimism of some is matched by the hostility and resentment of others, despite the irrefutable fact that the international economy and the economies of the industrialized capitalist countries, in particular, have lived through a quarter century of uninterrupted and exceptional material growth.

In other words, criticisms of the prevailing style are emerging and spreading in circumstances notably different from those existing at the time of the eclipse or decline of other great established orders —the Roman Empire, the feudal system, etc. This fact gives the present crisis a unique significance which has not been properly clarified. Nor, incidentally, is there any real basis for the parallels repeatedly drawn between the present situation and the depression of the 1930s.

A fact which is less often considered but is of prime importance in the discussion of these concerns is that they and the consequent criticisms and reservations are limited to a fairly restricted, although broadening, social context. That is to say, everywhere the broad masses are excluded from the discussion, be they in the central countries, the semi-industrialized countries, or those on the periphery. What is more, if their feelings on these points could be ascertained, it seems fairly obvious that the overwhelming majority would be inclined to “suffer” the ills of the affluent consumer society rather than remain in their present situation, or, in the case of the masses in the central countries, to risk all they have so recently and laboriously achieved for the sake of a different and uncertain style or mode of development.

Even though it may be open to misunderstanding, this point must be emphasized in order both to determine the nature and depth of the aforementioned concerns and to comprehend the vital importance of fully exploring alternative courses that would have the support and understanding of the broad masses.

Approaching the matter from a different angle, it is quite easy to agree with various writers —among them my colleagues Wolfe and Graciarena— about the confusion surrounding the terminology and concepts used in the discussion. Styles, models, systems, structures, patterns, profiles, etc. are either currently used as though they were synonymous terms, or else the differences between the words and their special meanings are not strictly defined. I

⁴ In the introduction to the document entitled “Technical progress and socio-economic development in Latin America: general analysis and recommendations for a technological policy” (ST/CEPAL/Conf.53/L.2, November 1974), this question was referred to in the following terms: “It is common knowledge that two main currents which appeared and prevailed in the nineteenth century and which still reflect rival views today —what we could call the liberal and the marxist currents— shared the conviction that industrial capitalism would spread *urbi et orbi*, replicating in outline the central economies. Naturally, both outlooks differed greatly with respect to the social costs of transformation and its later aims, but both and it is worth repeating, looked to the revolution of production forms and mean —in fact, technical progress— to open the way to finding solutions to the material, institutional, and cultural impediments which bog down the pre-capitalist communities, or were won over by the preliminary phases of the evolution of the system”.

myself, for example, must confess that in a preliminary version of this study I used the words “system” and “style” indiscriminately.⁵

I do not think it would be either feasible or appropriate to venture a series of tentative definitions of each of these and other terms used. Let us instead take a different course and endeavour to identify three basic concepts which are interlinked in the discussion.

The first is that of the *system*, which for our purposes and in very general terms we shall associate with the two main opposing forms of organization coexisting in the world today: capitalism and socialism.⁶

The basic features of the two models are well known. They differ above all in institutional organization and in socio-political structure, but from the standpoint which interests us here the basic contrast is 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.⁷

In line with this concept and the comments at the beginning of this study, it is well known that for some people dissatisfaction with and criticism of the existing style or situation are merely effects or necessary concomitants of the procedures and contradictions of the capitalist system. Obviously, this would seem to imply, in contrast, that the second system was immune from all the problems generated by the first.

Although the reservations and difficulties attributable to the two systems are clearly not identical,⁸ the number of those supporting such an extreme over-simplified view has decreased considerably. Conversely, there are more and more people who think that there are some questions which go beyond this dichotomy, e.g., problems of the environment, urban agglomeration, the dissatisfaction of youth, etc.

Following a different approach, a second important category derives from the classification into industrialized countries and under-developed or developing 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.

From this standpoint, it seems clear that the concern about styles is primarily linked with the implications of the industrialized community, both when fully arrived at industrialized status and when half way there, in both capitalist and socialist systems.

In the developing economies the problems are more in the nature of the elementary question of survival, once again in both the capitalist and socialist systems. In both these situations, however, there is also a common feature, as already indicated: the conviction held by some that the continuation or reproduction of the developed industrial model is undesirable or impracticable, or both.

⁵ A. Pinto, *Notas sobre estilos de desarrollo en América Latina* (ECLA/DE/DRAFT 103), draft for suggestions and comments, December 1973.

⁶ For the purposes of this study it is not really important that, as many contend, in terms of “pure” paradigms neither “capitalists” nor “socialists” are actually such.

⁷ In 1970, the Soviet Union spent 23 per cent of the national income on education, health and cultural activities of various kinds. See V. Komarov, “The service sphere and its structure”, *Problems of Economics*, Vol. XVI, No. 3, New York, July 1973.

⁸ For example, some questions such as unemployment, stability, the allocation of resources in accordance with elementary needs, etc., are features of the capitalist rather than the socialist system. Others, such as the degree of openness and political participation, dynamism and technological innovation, etc., are more typical of the socialist regimes.

These perspectives are both relevant for purposes of this study and should be combined. We thus have, from the outset, a difference of *system* and another of *structure*, enabling us to identify four types of basic situations:

- (a) industrialized capitalist,
- (b) developing capitalist,
- (c) industrialized socialist,
- (d) developing socialist.

As everyone knows and past experience has shown, there can be widely differing individual situations within these system-structure contexts.

As regards the first group, it is hardly necessary to refer to the contrasts in the development and present profile of the industrialized capitalist economies such as the United Kingdom, the United States, Canada, Denmark, France or Switzerland.

Nor is it necessary to describe the differences between the experiences of these countries and those of such developing capitalist communities as Greece, India, Egypt, Mexico or Nigeria, and between the features characterizing the latter countries and distinguishing them from one another.

This is also applicable to the socialist world. Although they belong to the same “system”, there are some notable distinctions, both between the more industrialized countries —the Soviet Union, Czechoslovakia, the German Democratic Republic— and between these countries and China or their sister countries in Europe (Bulgaria or Romania).

This is not the time or the place to go more deeply into the causes of these differences. Let us merely note that they are influenced by such important questions as the quantitative and qualitative endowment with material and human resources (compare the Soviet Union with China, the United States with Japan, India with Brazil, Argentina with Mexico, Rumania with Albania, etc.); historical and cultural background (old and new civilizations); external ties (dominating entities, subsidiaries such as the former British dominions and former colonies); degree and type of political and social organization and participation, etc.

Taking all this into account, and for the purposes of this study, the point here is that in 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 those broad groups. Later on we shall consider the economic meaning of the concept from the angle of the situation in Latin America.⁹

From this point of view, therefore, I agree to all intents and purposes with one of the definitions suggested by J. Graciarena,¹⁰ according to which a *style* is “the specific and dynamic modality adopted by a system within a particular context and at a particular moment in history”. On the other hand I disagree with his statement that “this proposition relates to a structure (or social formation) rather than a style”. To my mind, his reference to a “context” should be taken precisely to apply to the structural fact of the developed-developing complex referred to above.

Within this general meaning of the term, there are various possibilities regarding the scope and content of the propositions with respect to styles.

In the most restricted sense, these possibilities take the form of options *within* an existing system and structure, but involving more or less significant changes in different directions in the predominant style, depending on the prevailing values.

⁹ See the reasons for this “methodological reduction” in footnote 1.

¹⁰ This does not mean that I reject his other suggestions on the subject.

This, in my view, was the main line of the pioneering attempt made by the Venezuelan Centre for Development Studies (CENDES) under the guidance of Oscar Varsavsky, following up work initiated in the time of the well-known economist Jorge Ahumada.¹¹ The three styles discussed in the CENDES study ("consumer", "authoritarian" and "creative") were assumed to be compatible with the general framework of Venezuelan society. In the words of that study, "in the hypotheses used there is no discontinuity or sharp change of policy which could bring about revolutionary situations or revolts".

A second possibility is that criticism of the prevailing style and the search for possible alternatives involves or requires a change in the basic setting of the process. This could mean that it is considered essential to change the *system*, i.e., to replace a capitalist system by a socialist system, or vice versa.¹²

It seems fairly clear that this second possibility (and its different combinations) transcends the conceptual frontiers of the term "styles". On the other hand, the first or stricter meaning of the term considerably limits the substance and even the attractiveness of the word.

This reflection does not detract from the importance of this approach, and it does help to clarify its meaning and place *vis-à-vis* others relating primarily, as noted above, to the institutional or political context.

Continuing with this digression, it is useful to consider the possible relations between those categories or approximations.

Of course, it is possible to visualize a basic situation which hypothetically admits various options as regards styles, i.e., to return to Graciarena's definition, one that permits various "specific and dynamic modalities" within "a system in a particular context at a particular moment in history".

To illustrate this situation, let us take some developed capitalist economies such as the Scandinavian countries. It is conceivable that in those and other similar countries there may be a fairly broad margin for introducing appreciable changes in the prevailing style. In fact, several of them have been adopting long-term measures to combat serious problems of the industrial civilization, such as pollution and urban congestion. In others, such as the United States itself, there are also potential conditions for seemingly marginal changes which could, however, have a far-reaching impact on their mode of development. Suffice it to consider, for example, the projections of a radical change in the system of relative prices as a result of the rise in the cost of petroleum, the cheapness of which up to 1974 gave a special character to the use and allocation of production resources.

Much the same might be said about the situation of some developing economies which, either because of their production potential or because of the greater flexibility of their institutional and social frameworks, allow fairly significant changes in their style of growth.

The same speculations could be made in the light of the particular situations of various countries operating under the socialist system.

In other circumstances, however, the radius of action is far more limited or simply non-existent, so that the possibilities of modifying the prevailing style are very remote unless changes take place in the institutional and structural base.

¹¹ See CENDES, "Estilos de desarrollo", in *El trimestre económico*, No. 144, Fondo de Cultura Económica, Mexico City, October-December 1969.

¹² This calls to mind a widely-published article by P. Sweezy, "Transición pacífica del socialismo al capitalismo", on the experience of Yugoslavia.

From this point of view, China's experience is one of the most impressive. Few doubt that the change in the political system after the war was a key factor in overcoming many acute and long-standing problems. Moreover, China's rejection of the classic development scheme of the industrial economies has been another major factor in defining its unique style, in contrast to the capitalist system and the other socialist systems which basically follow the industrial community model, although they give it their own particular stamp.

Naturally, however, this does not mean that China's experience can be reproduced under other conditions, as is sometimes so ingenuously contended. From the operational standpoint and from that of the real or potential opportunities for change, it is imperative to take these different situations into account.

From a strictly economic angle, the term "style of development" may be taken to be the way in which human 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.

The reciprocal influences between "for whom" to produce and "what" to produce are fairly obvious, as also are the links between them and the question of "how" to produce. In any case, it may safely be assumed that the most important factor in the global response to these questions is "for whom" to produce. As will readily be understood, it is not a case of absolute options but rather of relative preferences as regards the social distribution of the main components of the product: an aspect which can be of considerable importance, as we shall see later. The tendencies of the production system to benefit the social groups in differing proportions should be evaluated from an angle which will take into account the dynamics of the process: i.e., the fact that it is a cumulative phenomenon which gradually strengthens the tendencies toward greater or lesser inequality.

From an economic point of view, a style may be classified according to two kinds of closely interrelated factors. The first are structural factors, which reveal the way in which the production apparatus has been organized from the standpoint of the economic resources and the structure of supply. It is a static perspective, but of fundamental importance since it represents the framework of the system at a given moment.

The other class of factors includes those which are vital for the operation or dynamics of the system: those which "drive" it. They are associated with the level and composition of demand and with its basic factor, the level and distribution of income.

At the risk of repetition, emphasis must be placed on the interrelationship of these factors. Those which "drive" or infuse dynamism into the production structure are obviously conditioned by the conformation of that structure, *whose relative rigidity in the short term has a significant effect on the operation of the motive forces*. These, in their turn, constantly influence the production structure and either favour change in it or further accentuate its features.

B. The structural base

The relevant data are presented for Latin America as a whole and for two contrasting cases of countries which represent variations of the "general style", *mainly on account of the stage of development reached*.

Table 1 shows the conformation of the structures of production and employment in the region in 1970.¹³ The distinctive features are well known and there is no need to dwell on them, except in two respects. The first is the still very high participation of agricultural employment

¹³ For further information on the subject, see "Trends and structures of the Latin American economy in the 1960s", *Economic Survey of Latin America, 1970* (United Nations Publication, Sales No. E.72.II.G.1).

—a generic sign that the development of the forces of production is still at an incipient stage— which is ultimately reflected in the per capita product or income.¹⁴

The prevailing style (and its alternatives) rests on this basic reality. The second important feature for our purposes is the disparity between the shares of the various sectors in the product and employment, which is another of the factors determining under-development and simultaneously influencing the conformation of the style of growth.

■ **Table 1**

STRUCTURE OF PRODUCT AND EMPLOYMENT, 1970

	Latin America		Argentina		Nicaragua	
	Employed population	Gross domestic product	Employed population	Gross domestic product	Employed population	Gross domestic product
Agriculture, forestry, hunting and fishing	43.7	16.4	15.3	14.8	46.4	29.0
Mining and quarrying	1.2	4.1	0.7	1.8	0.6	1.1
Manufacturing	12.7	24.6	22.1	35.7	12.0	15.9
Construction	6.0	3.5	6.6	5.2	3.7	4.1
Electricity, gas, water and sanitary services	0.5	2.0	{7.6	9.6{	0.6	2.4
Transport and communications	3.8	6.2			3.4	5.4
Trade and finance	9.0	22.0	15.5	18.7	10.9	19.0
Other services	23.1	21.2	32.2	14.2	22.4	23.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLA, on the basis of official statistics.

These data permit a first approach to the questions of “what” and “how” to produce. The composition of the product and the levels (and disparities) of sectoral productivity indicate the true situation in these respects.

Table 1 also includes the figures for two variations of the regional situation. The contrast between the profiles of Argentina and Nicaragua is all too eloquent, as regards both the sectoral proportions and the relationships between employment and product. The spectrum of Argentina is at once more “developed” and more “balanced”, this latter if consideration is given to the shares of the important agricultural sector. It does, however, show marked disparities under the headings of “other services” and “manufacturing” in both these respects. While employment is shown to be excessive in “other services”, the opposite is the case in “manufacturing”. In contrast, Nicaragua’s system is more “homogeneously under developed”.

The production structure can also be analysed from another standpoint, on the basis of technological strata, thus revealing the sharp disparities between the standards of productivity of economic activities. This, of course, represents the much-discussed problem of structural heterogeneity, which has a clear influence on the questions of “what” to produce, “how” and “for whom”.¹⁵

Table 2 contains the estimates on technological strata for Latin America as a whole, for Argentina and for Central America.

¹⁴ About 500 dollars in 1970, which is appreciably higher than in other developing regions.

¹⁵ As regards structural heterogeneity, see *Economic Survey of Latin America*, 1968 (United Nations publication, Sales No. E.70.II.G.1), and A. Pinto, “Naturaleza e implicaciones de la “heterogeneidad estructural” de la América Latina”, *El trimestre económico*, No. 145, Fondo de Cultura Económica, Mexico City, January-March 1970.

Beginning with the overall table for the region, it can be seen immediately that while only quite a small part of the population is employed in the modern sector (a little more than 12 per cent), this sector accounts for more than half of the goods produced.¹⁶ As we shall see later, certain goods (and services) which directly or indirectly satisfy certain types of demand are produced primarily or exclusively by this sector.

The mining and manufacturing sectors are those which occupy the most important place in the modern area, and particularly the former, because of the big exporting establishments so characteristic of it. In agriculture, in contrast, the poor absorption of labour in its modern sector is very marked and is responsible for the disparity among the variables chosen.

At the other end of the scale is the so-called primitive sector, which still accounts for more than a third of regional employment although its contribution to the material product is only 5 per cent.¹⁷

■ Table 2

LATIN AMERICA: CONJECTURAL BREAKDOWN OF EMPLOYMENT AND PRODUCT BY TECHNOLOGICAL STRATA AT THE END OF THE 1960s

	Latin America				Central America				Argentina			
	Modern	Intermediate	Primitive	Total	Modern	Intermediate	Primitive	Total	Modern	Intermediate	Primitive	Total
<i>Total product</i>												
Employment	12.4	47.7	34.3	100	8.1	33.6	55.0	100	21.3	65.8	5.3	100
Product	53.3	41.6	5.1	100	42.6	48.0	9.4	100	58.6	40.5	0.9	100
<i>Agriculture</i>												
Employment	6.8	27.7	65.5	100	5.0	15.0	80.0	100	25.0	57.0	18.0	100
Product	47.5	33.2	19.3	100	43.9	30.6	25.5	100	65.1	32.3	2.6	100
<i>Manufacturing</i>												
Employment	17.5	64.9	17.6	100	14.0	57.4	28.6	100	25.6	70.6	3.8	100
Product	62.5	36.0	1.5	100	63.6	30.4	3.3	100	62.1	37.5	0.4	100
<i>Mining</i>												
Employment	38.0	34.2	27.8	100	20.0	60.0	20.0	100	50.0	40.0	10.0	100
Product	91.5	7.5	1.0	100	57.2	40.0	2.8	100	77.8	21.6	0.6	100

Source: ECLA, *La mano de obra y el desarrollo económico de América Latina en los últimos años*, E/CN.12/L.1, 5 October 1964.

As another look at table 2 shows, a large share of agricultural employment (65.5 per cent), and no mean proportion of agricultural production (almost 20 per cent) are associated with the primitive sector. It seems clear that this is the source of a sizeable share of rural self-supply production. This is not so in the case of manufactures, for in this sector its share is only about 1.5 per cent of the product, although it accounts for almost 18 per cent of industrial employment.

The intermediate sector is the most "balanced" from the point of view of the employment/product ratio.¹⁸ This sector accounts for almost half of the jobs offered and a little more than 40 per cent of the product. It plays a particularly important part in manufacturing activities, since it employs 65 per cent of the industrial labour force and accounts for more than a third of the product. Its share in mining production is very small, even though more than a third of the

¹⁶ Services have not been included, owing to the limitations attached to the concept of productivity in this respect. However, activities in that sector show equal or even greater inequalities. Productivity in the modern sector would be equal to average productivity in the developed countries, and may be estimated at between 12,000 and 15,000 dollars per worker.

¹⁷ The primitive sector covers mainly subsistence agricultural activities and part of handicraft production. If services are included, of course, it accounts for a high proportion of unskilled workers. Its annual productivity per worker would probably be around 300 to 400 dollars.

¹⁸ Thus, of course, the activities in this sector show a level of productivity close to the national average: in absolute terms, about 2,500 dollars per worker employed.

workers employed in that activity work in this sector. Therefore, of all the sectors considered, this one has the worst employment/product ratio.

Study and comparison of the figures for Argentina and Central America show different situations and features.

Taking an overall view, it is easy to see the great importance of the modern sector in Argentina, particularly from the employment figures. The respective table for Central America shows a much higher degree of imbalance, for a significantly smaller part of the labour force (8 per cent compared with a little more than 21 per cent in Argentina) produces much of the overall product (42.6 per cent compared with 58.6 per cent in Argentina).

Taking the opposite approach, it can be seen that in Argentina the primitive sector is of very limited importance, whereas in Central America no less than 55 per cent of total employment and 80 per cent of agricultural employment are accounted for by this sector.

This is not the place to go into further detail on the structural features of the Latin American economy, but this part would be incomplete without reference to some aspects of Latin America's external position or its external "relationships", which are of great importance for the study of development styles.

Reference should be made in particular to the openness of the Latin American economies. This shows the extent to which they are part of the scheme of the international division of labour. As everyone is aware, the region's export and import coefficients are relatively low:¹⁹ a situation for which the bigger countries are largely responsible, since these coefficients range from approximately 10 per cent for Brazil, Mexico and Argentina, to more than 30 per cent for some Central American economies. The great majority of the countries increased these coefficients over the past decade, and the region became even more open during the first three years of the 1970s.

Other events have led to a sharpening of this trend and helped to create a different structural situation. During the 1960s, the importance of external financing in reducing the ever increasing deficit on the trade balance and current account increased.²⁰ At the same time, the external relationship was also strengthened through the constantly increasing importance of transnational enterprises in the economies of the region.²¹

The changes which occurred in the composition of exports and imports are yet another factor.

As regards exports, there was a small but noticeable decrease in the degree of concentration on the export of primary products in the 1960s,²² while the share of manufactured products rose.²³ It should be borne in mind that in 1970 approximately 36 per cent of the region's exports of manufactures were produced by transnational enterprises.

As regards imports, the most important change, although it was not a spectacular one, was the drop in the share of consumer goods (from 21 per cent in 1955 to 16 per cent in 1968) and the corresponding increase in capital goods.

¹⁹ For information on this subject see "Tendencias y estructuras de la economía latinoamericana", *op. cit.*

²⁰ Total external financing (excluding Venezuela, which is a special case) increased from 6,600 million dollars in 1950-1959 to 13,850 million in 1960-1969 (see "Tendencias y estructuras de la economía latinoamericana", *op. cit.*).

²¹ Overall figures are not available for the percentage of regional production or country production accounted for by transnational enterprises, but it is easy to show their predominance or even monopolistic position in many major lines of durable consumer goods (especially motor vehicles) and capital goods.

²² Between 1955 and 1968, the share of the main export product dropped from 62 to 50 per cent, while that of the three mean products dropped from 80 to 65 per cent (see "Tendencias y estructuras de la economía latinoamericana", *op. cit.*).

²³ These represented approximately 2.5 per cent of the total in 1955. By 1970 the figure was in the region of 10 per cent, and they increased in the second half of the 1960s at a rate of more than 20 per cent per year.

Of course, these overall changes for the region conceal many national variations. Such variations have been much more important in the larger economies (Mexico, Brazil and Argentina), but similar trends —and therefore the same structural adjustments— are to be found in almost all the Latin American countries.

Lastly, these countries are heading in several basic directions which are of key importance for the matter under study. In particular, there is a tendency towards the strengthening of what has come to be called the “internationalization” or dependent incorporation of the regional economies. This path has a few features which are different from those of the old model of “outward-looking growth”, since emphasis is placed on greater diversification of exports and, especially, on the “internalization” and transfer through transnational enterprises of production and demand patterns (or consumption patterns), forms of technical progress, marketing and financing, etc., prevailing in the developed capitalist centres.

It is scarcely necessary to stress the enormous significance of this process for the development style or, looked at from another point of view, for the vital questions of “what”, “how”, and “for whom” to produce.

C. The functioning of the style

The dynamics of the style —that is to say, the motivating or change-producing forces which accentuate or modify its basic profiles— are just as important as its structural base or even more so.

Although there is little information on the subject, some figures have been collected here on Latin America, and in some cases on specific national variants, from which certain major features can be seen.

Table 3 shows the growth rates of the principal industrial groupings. Subject to a few exceptions and reservations, they give us an idea of the global dynamics, since they reflect indirectly the performance of the primary and tertiary sectors.²⁴

A look at the data for the region for the period 1960-1971 immediately shows that the figures for each individual grouping fluctuate considerably with respect to the average growth rate of the industries as a whole (6.8 per cent). In general terms, the rate is lower for the so-called traditional activities, where non-durable consumer goods industries predominate; it is close to or exceeds the average in the case of intermediate activities, and it more or less easily exceeds it in the case of the basic metal industries, particularly those connected with heavy durable goods: appliances, motor vehicles, etc.

²⁴ The primary sector provides the necessary inputs, while the tertiary sector will follow to some extent the expansion of the industrial groupings. The inclusion of primary production for direct consumption (after deduction of exports and inputs) would strengthen rather than change the sense of the table in question, since its rate of growth was lower. On the other hand, the table is obviously of less importance for the less industrialized countries, where the composition of imports is of greater importance.

■ Table 3

LATIN AMERICA: GROWTH RATES OF THE MANUFACTURING SECTOR BY INDUSTRIAL GROUPINGS
(Cumulative annual average rate for the period 1960-1971)

	Average Latin America	Argentina	Brazil ^a	Mexico
Food, beverages and tobacco	4.8	3.7	7.6	5.8
Food products except beverages	4.6	3.1	7.9	5.7
Beverage industries	4.9	5.7	6.3	6.9
Tobacco industry	4.3	4.9	7.1	4.5
Textiles, wearing apparel and leather industry	4.1	2.0	7.1	7.2
Wood and wood products, including furniture	2.9	3.8		4.8
Paper and paper products; printing and publishing	7.4	5.9	7.5	8.2
and plastic products	9.0	7.9	13.1	9.2
Industrial chemicals	9.9	13.3	13.6	12.8
Other chemical products		6.6		7.8
Petroleum refineries	6.4	6.3	10.6	
Petroleum and coal products		15.4		
Rubber products	7.3	6.9	13.9	6.5
Non-metallic minerals, except petroleum and coal products	7.0	7.1	12.1	8.7
Basic metal industries	8.8	8.7		8.8
Metal products, machinery and equipment	9.5	6.9	13.2	11.9
Metal products, excluding machinery and equipment	8.3	8.4	18.4	9.0
Machinery except electrical		5.3	17.9	14.1
Electrical machinery, apparatus, appliances and supplies	10.4	5.8	12.7	11.5
Manufacture of transport equipment	10.2	7.4	23.5	13.1
Motor vehicles	13.5	10.4		15.4
Other manufacturing industries	8.2	3.0		7.7
Total manufacturing industries	6.8	5.6	12.2	7.8

Source: ECLA, on the basis of official figures.

^a 1967-1971.

The figures describing trends in Argentina, Brazil and Mexico confirm similar tendencies, which are less pronounced in the first of the countries mentioned but are particularly marked in Brazil. For this country the period 1967-1971 was chosen, both because the longer term covers highly dissimilar periods, and because these years of active and sustained growth at the end of the decade clearly bring out the sources of dynamism of the existing style. In the case of Brazil, as we can likewise see from table 3, the average overall rate of 12.2 per cent is made up of quite a high rate of expansion in "traditional" activities (around 7 per cent) — a feature which cannot be overlooked — but extraordinarily high rates in the basic metal industries, particularly as regards heavy durable goods.²⁵

The picture which emerges is not a surprising one and it was anticipated or implied by many analyses. The usual explanation of these trends is also very well known, namely, that they are due (almost tautologically) to the different income elasticities of the demands for goods and services.

The most important thing to do, however, is to ascertain the source of this income elasticity: i.e., to determine the groups in which demand originates and the size for demand for the different classes of products.

²⁵ It is essential to make a distinction between activities devoted to capital formation and those devoted to the production of durable consumer goods (despite all the difficulties that drawing such a distinction implies) if more light is to be thrown on the subject. The same could be said of a breakdown of the items of current consumption into mass consumer goods and other types of goods with more limited uses, such as certain food or textile products.

In other words, the unequal rates of growth of the industrial groupings provide an approximate indication of the tendencies of the system or style as regards what is to be produced. The next question is to find out to which groups these efforts are directed, since these are the economic mandants in this matter: in other words, "for whom" is the system producing (primarily or exclusively) the various goods.

In table 4 an attempt is made to provide an approximate answer to these questions, bearing in mind the participation of the different income strata in the total consumption of the main items, listed by type: foodstuffs, clothing, housing, services, durable goods.

Without going into details, it is nevertheless possible to bring out some principal relations.

■ **Table 4**

LATIN AMERICA: SHARE OF DIFFERENT POPULATION STRATA IN TOTAL CONSUMPTION, BY TYPE OF CONSUMPTION, AROUND 1970^a

Type of consumption	Population strata	Poorest 20%	Poorest 50%	20% below the richest 10%	Richest 10%
Food, beverages and tobacco		5	23	29	29
Meat		2	12	34	41
Cereals		8	32	24	19
Other foods		5	25	28	28
Beverages and tobacco		5	22	29	30
Wearing apparel		2	14	32	42
Clothing		2	13	32	44
Footwear		3	16	32	36
Housing ^b		2	15	29	44
Transport		1	5	25	64
Personal care ^c		2	15	31	41
Domestic service		-	1	16	82
Other personal services		1	4	25	67
Recreation and amusement ^d		-	3	20	75
Durable goods		1	6	26	61
Motor vehicles (purchase)		-	1	13	85
Houses and apartments (purchase)		2	9	29	54
Furniture		2	5	16	74
Electrical and mechanical appliances		1	5	37	50
Total		3	15	28	43

Source: ECLA, estimates based on national surveys.

^a Estimated average on the basis of data from Argentina, Brazil, Chile, Colombia, Honduras, Mexico, Paraguay, Peru and Venezuela.

^b Housing includes: rents, textile articles for the home, fuels, electricity, gas, water and household goods.

^c Personal care includes: toilet articles, drugs and medicines, medical services, hair dressing and suchlike.

^d Recreation and amusement includes: holidays and tourism, recreation, newspapers and magazines, dues to social clubs and suchlike.

Using the shares of the strata represented by the poorest 50 per cent of the population and the 10 per cent in the highest income bracket as benchmarks, it is immediately obvious that the share of the first group is invariably lower than that of the second, except in respect of the consumption of cereals, and it becomes progressively smaller in respect of dearer goods and more skilled and costly services. In contrast, the 10 per cent of the population in the highest income bracket account for a very large share of such goods as motor vehicles (85 per cent),

recreational activities (75 per cent), domestic services (82 per cent), appliances (50 per cent), clothing (44 per cent), meat (40 per cent), housing (44 per cent), etc.

If we add to the consumption of this bracket that of the 20 per cent of the population in the next lower income bracket, it will be seen that their joint consumption amounts to between 75 and almost 100 per cent of the total in a number of cases, particularly those of the higher-priced durable consumer goods.

The figures for Argentina and Honduras (see tables 5 and 6) show, as might be expected, less marked and more acute versions respectively, of the regional table. The share of the upper bracket is consistently lower in Argentina, and conversely that of the lower half is consistently higher. From the point of view of total consumption, the 30 per cent in the highest income bracket account for 56 per cent of consumption in Argentina as against 73 per cent in Honduras.

Furthermore, if we take some key items in modern consumption patterns, it will be seen that the expenditure of the poorest 50 per cent of the population on electrical and mechanical appliances hardly amounts to 3 per cent of the total in Honduras, whereas the corresponding figure for Argentina is 25 per cent. In the case of motor vehicles, however, the poorest half of the population is of little significance in Argentina, since the acquisition of such goods is concentrated in the highest bracket (60 per cent), although of course, the corresponding figure for Honduras is much higher: 94 per cent.

Although they are not strictly comparable, the tables on the rates of expansion of industrial activities and on the social distribution of various consumer goods are sufficiently clear and indicative to be used as a basis for a well-known assumption: that the more dynamic elements of the productive apparatus are interrelated and depend *mainly, and sometimes entirely*, on the demand of the groups situated at the peak of the distributive structure. In other words, *given the level of average income in the region and in the individual countries*, if the present style of development is to work and progress, then income and expenditure must be concentrated in those strata, so as to sustain and increase demand for the favoured goods and services. If this is done, then the productive apparatus will adjust itself primarily to the satisfaction of such demand.

■ Table 5

ARGENTINA: SHARE OF DIFFERENT POPULATION STRATA IN TOTAL CONSUMPTION, BY TYPE OF CONSUMPTION, AROUND 1970

Type of consumption	Population strata	Poorest 20%	Poorest 50%	20% below the richest 10%	Richest 10%
Food, beverages and tobacco		9	32	26	21
Meat		9	33	26	20
Cereals		11	37	25	18
Other foods		9	32	26	22
Beverages and tobacco		7	27	29	23
Wearing apparel		5	20	28	31
Clothing		4	18	29	34
Footwear		6	26	28	24
Housing ^a		8	28	27	26
Transport		3	15	32	40
Public		5	23	29	29
Private (operation)		1	7	34	51
Personal care ^b		8	30	27	27
Domestic service		2	6	26	61
Other personal services		2	13	28	40
Recreation and amusement ^c		3	14	28	44
Durable goods		2	12	27	47
Motor vehicles (purchase)		-	5	27	60
Houses and apartments (purchase)		1	7	29	53
Furniture		1	6	20	70
Electrical and mechanical appliances		5	25	26	24
Total		6	25	27	29

Source: ECLA, estimates based on national surveys.

^a Housing includes: rents, textile articles for the home, fuels, electricity, gas, water and household goods.

^b Personal care includes: toilet articles, drugs and medicines, medical services, hairdressing and suchlike.

^c Recreation and amusement includes: holidays and tourism, recreation, newspapers and magazines, dues to social clubs and suchlike.

■ Table 6

**HONDURAS: SHARE OF DIFFERENT POPULATION STRATA IN TOTAL CONSUMPTION;
BY TYPE OF CONSUMPTION, AROUND 1970**

Type of consumption	Population strata	Poorest 20%	Poorest 50%	20% below the richest 10%	Richest 10%
Food, beverages and tobacco		6	18	29	35
Meat		3	9	30	52
Cereals		9	25	25	25
Other foods		6	18	30	35
Beverages and tobacco		7	21	33	27
Wearing apparel		5	13	28	46
Clothing		5	13	27	47
Footwear		5	13	30	44
Housing ^a		4	12	30	46
Transport		2	6	28	60
Personal care ^b		4	12	30	45
Domestic service		-	-	17	82
Other personal services		2	5	23	67
Recreation and amusement ^c		1	3	14	81
Durable goods		3	8	23	61
Motor vehicles (purchase)		-	-	5	94
Houses and apartments (purchase)		4	12	26	49
Furniture		3	8	25	58
Electrical and mechanical appliances		1	3	28	66
Total		5	14	28	45

Source: ECLA, estimates based on national surveys.

^a Housing includes: rents, textile articles for the home, fuels, electricity, gas, water and household goods.

^b Personal care includes: toilet articles, drugs and medicines, medical services, hairdressing and suchlike.

^c Recreation and amusement includes: holidays and tourism, recreation, newspapers and magazines, dues to social clubs and suchlike.

D. Some questions and options

The situation described raises a few questions which can be put in the form of two alternatives:²⁶

- (a) the style persists and in time gradually brings other social strata into the acquisition of the new consumer goods, until their use is widespread;
- (b) the style persists, but without promoting a steady and substantial integration of sizeable groups, which continue to be marginal consumers of these goods and, furthermore, remain in conditions of poverty as regards the satisfaction of their vital needs.

The first option copies the process of the central capitalist economies. The differences in this respect have been brought out in many studies, and this is not the place to repeat them.²⁷ At all events, the “special case” of Argentina indicates that large-scale marginalizations in not an obligatory feature of the Latin American experience (the problem is dealt with

²⁶ A further obvious possibility which is particularly applicable to the relatively less developed countries, namely, that the style does not work, has not been left out through ignorance or underestimation, but because it is felt that for these countries the external variable is much more important.

²⁷ Among others, see another study by the present author: “Concentración del progreso técnico y de sus frutos en el desarrollo latinoamericano”, *El trimestre económico*, No. 125, Fondo de Cultura Económica, Mexico City, January-March, 1965.

later at the regional level). However, it is clear that a basic question of deadlines is involved. A gradual incorporation which might have taken a century or many decades in the past in the central economies does not seem viable in current circumstances unless politico-social restrictions are applied, although this latter possibility cannot be overlooked in the light of certain regional experiences.

Some of the remarks made above also hold good for evaluating the second option. In this option, the prevailing style leaves aside important sections of the population located in marginal rural areas and on the periphery of the cities, so that in absolute and even perhaps in relative terms, the number of non-participants remaining in a state of abject poverty increases.

Without going into the specific viability of this option in the short or long term, it is clear that it is not acceptable in terms of the professed values of the international community.²⁸

To probe deeper into the subject, some figures on income distribution in the region and on the changes which have taken place between 1960 and 1970 may be useful (see table 7). Although the documentation is admittedly unsatisfactory, the trends and relations which they reveal do seem to be close to the facts.

When the information on the participation of the various strata in total income is studied, several aspects stand out. On one hand, the share of the poorest 20 per cent dropped slightly and that of the poorest 50 per cent hardly varied. At the extreme —and in contrast to what is usually believed to be the case— the strata representing the 10 and 5 per cent in the highest income brackets showed a moderate drop. There was an increase, however, in the share of the stratum corresponding to the 20 per cent immediately below the richest 10 per cent from 24.6 to 28 per cent. In reality, this last-mentioned group and the group corresponding to the 30 per cent above the poorest 20 per cent are the only groups which improved their relative position.

From these points of view, therefore, it could be argued that there is a slight deconcentration of income from the social peak to the benefit of the groups in the middle and upper-middle brackets. On the other hand, there is the drop in the share of the poorest stratum.

The foregoing picture must be completed with a view of the absolute magnitudes, which clarifies and modifies some of the assumptions made in the previous paragraphs.

As may be seen from table 7, per capita income in the region is estimated to have increased by some 27 per cent between 1960 and 1970, which would represent 95 dollars at 1960 prices in absolute terms.²⁹

²⁸ See ECLA, "Report on a unified approach to development analysis and planning. Preliminary report by the Secretary-General". (Revised text of the Spanish version of document E/CN.5/477 of 25 October 1972, presented at the 23rd session of the United Nations Social Development Committee).

²⁹ Between these years the domestic depreciation of the dollar was almost 32 per cent.

■ Table 7

LATIN AMERICA: PER CAPITA INCOME IN 1960 DOLLARS AND CHANGES IN THE SHARES OF THE DIFFERENT SOCIO-ECONOMIC STRATA IN TOTAL INCOME OF THE REGION

Socio-economic strata	Share of each stratum in total income		Per capita income ^a (1960 dollars)		Rise in per capita income		Total rise by all strata	Rise of each stratum as percentage of total rise
	1960	1970	1960	1970	Percentage	1960 dollars	(millions of 1960 dollars)	
Poorest 20%	3.1	2.5	53	55	3.8	2	107.6	0.4
Next 30%	10.3	11.4	118	167	41.5	49	3 919	15.4
Poorest 50%	13.4	13.9	92	122	32.6	30	4 025	15.8
Next 20%	14.1	13.9	243	306	25.9	63	3 359	13.2
20% below the top 10%	24.6	28.0	424	616	45.3	192	10 237	40.3
Top 10%	47.9	44.2	1 643	1 945	17.7	292	7 785	30.7
Top 5%	33.4	29.9	2 305	2 630	14.1	325	4 332	17.1
Total	100.0	100.0	345	440	27.5	95	25 406	100.0

Source: ECLA, estimates based on national surveys.

Note: The average distribution for Latin America in 1970 was estimated on the basis of information from Argentina, Brazil, Chile, Colombia, Honduras, Mexico, Paraguay and Venezuela.

^a Per capita personal income.

This average or global change meant very different things for the different strata. Thus, the smaller percentage increases of the two groups in the highest income brackets represent absolute improvements of 325 dollars for the 5 per cent at the top of the income bracket structure and 292 dollars for the top 10 per cent. For the 20 per cent immediately below the top 10 per cent, the big relative increase of 45 per cent represents 192 dollars in absolute terms, which is double the overall gains of all strata taken together (95 dollars).

Taking a look at the other levels of the distribution pyramid, the first thing which strikes one is the stagnation, at a very low level of income, of the poorest 20 per cent. Even the poorest 50 per cent only increased their income in absolute terms by 30 dollars, thus reaching in 1970 a level of barely 122 dollars per year, and again in this case the increases of the group (30 per cent) above the poorest 20 per cent must be taken into account.

If these striking features are examined in the light of these notes, it is easy to see their influence in the forces behind the system or the style of development.

With this in view, calculation has been made of the increase in personal income which has taken place during this period and which amounts to the sum of 25,406 million dollars: an increase of 27 per cent with respect to 1960. From a limited point of view —namely, leaving aside other items such as retained profits and government savings— this sum represents the principal expansion factor of the market and of overall domestic demand.

How was this greater purchasing power distributed among the social strata under consideration?

As the last columns of table 7 show, almost a third of the increase (31 per cent) went to the top 10 per cent, and this share increases to 71 per cent if the following 20 per cent are included.

The poorest half, in contrast, only appears to have received a 16 per cent of the total, and almost the whole of the poorest 20 per cent at the base of the pyramid failed to benefit from this increase.

If the increase obtained by the next 20 per cent is added to that of the strata making up this bottom half, the 70 per cent of the population is estimated to have had a 29 per cent increase in income: a figure which is lower than that received by the richest 10 per cent (31 per cent).

From another point of view, considering the absolute figures, it may be said that the expansion of the market attributable to the highest 30 per cent amounted to some 18,000 million dollars and that of the remaining 70 per cent to only 7,400 million.

These figures clearly show in which strata the income increases in the period under study were concentrated, and it is obvious that this trend corresponds roughly to that which occurred in the allocation of resources translated, as we have seen, into different rates of expansion of the productive activities. It is worth repeating that "what to produce" has had to be brought in line with "for whom to produce".

An even clearer picture can be gained if we look again at the absolute figures for income and link them to the main items of consumption. In this respect, and in the light of the figures in table 7, some reasonable assumptions can be made.

First, it is clear that at the *regional level* approximately one-half of the population have an average per capita income of some 120 dollars per year and therefore, have great difficulties in satisfying their most elementary needs. Among them, the poorest 30 per cent are probably below any "poverty line" that could be drawn,³⁰ while the remaining 20 per cent, whose income approximates to 200 dollars per year, are probably situated only just above it.

The upper crust of this sector, together with the 20 per cent of the population situated immediately above it, whose average income is about 300 dollars, has surely already entered the market for basic low cost industrial products and a range of cheap urban services. On the other hand, this group can only gain access to durable goods and more skilled services at considerable sacrifice, or by reducing their consumption of essential goods. Neither the shares nor the absolute increases of these strata show significant changes at this stage.

As already stated, it is a very different matter when we look at the changes which took place in the position of the 20 per cent below the richest 10 per cent. Both their share and the absolute increase in per capita income (approximately 45 per cent over the decade, thus raising this stratum above the 600 dollar mark) are of obvious importance. In fact, this stratum absorbed 40 per cent of the overall increase in income, amounting to more than 10,000 million dollars (see table 7).

It seems reasonable to think that the members of this stratum have crossed the threshold of the market for durable goods. If we take another look at table 4 it will be seen that this group accounts for 37 per cent of the consumption of electrical and mechanical appliances, 30 per cent of the purchases of housing and related expenditure, 32 per cent of the consumption of footwear and clothing, etc. However, their access to more expensive durable goods such as motor vehicles (only 13 per cent) is still limited, although their participation in the used car market is probably increasing steadily.³¹

Without repeating what has been said about the highest strata in the system, some of the assumptions made may be reviewed.

On one hand, the concentrating bias of the prevailing style is beyond doubt and is clearly seen from the increases in per capita income, in absolute income, and in market potential. From this point of view it appears obvious that there is a circle of cumulative causality, in that this bias in income distribution influences the orientation of the productive system and strengthens

³⁰ The average income of this 30 per cent of the population probably hardly exceeds some 70 dollars. The Economic Development Division of ECLA is working on the identification, from different points of view, of "the poor of Latin America", by country, activities, rural/urban distribution, etc. It may be noted that in some studies the "poverty line" is set as low as 50 dollars per capita per year. See *Redistribution with growth: An approach to policy* by the Institute of Development Studies of the University of Sussex and the Development Research Centre, World Bank, Washington, D.C., August 1973.

³¹ In Argentina, their share in the purchase of motor vehicles is 27 per cent; in Honduras, it is only 5 per cent. See tables 5 and 6.

or entrenches a given supply structure. Such a structure, in its turn, calls for a corresponding distribution scheme. In view of the level of average income and the social destination of the most dynamic lines of production, this scheme will inevitably tend towards the concentration of income, thus completing the circle.

On the other hand, however, this style seems less exclusive than is sometimes argued. Available data suggest that it has succeeded in widening its supporting base in the upper-middle levels (the 20 per cent below the top 10 per cent) and that it has even brought about positive changes in the better-placed sectors of the poorest half of the population, although in absolute terms their incomes continue to be very low (see table 7).

The third aspect worthy of consideration is the obvious marginalization and deplorable living conditions of a fair part of the population—at least a third—which is undoubtedly situated below the abject poverty line. This gives rise to the basic question as to the value of the prevailing style, in other words, whether its functioning offers possibilities or not for raising substantially, within a reasonable period of time, the standard of living of those suffering from the highest degree of ethical, social, and political deprivation.

E. The meaning of critical poverty

Before going into the possibilities which the prevailing style offers for tackling the problem of abject poverty, an approximate idea of what the term means may be useful. In order to gain such an idea, a study has been made of the regional situation as regards some basic consumer goods—foodstuffs (meat, cereals and others) and clothing (including footwear)—and this situation has been compared with the average levels obtained in Argentina.

As may be seen from table 8, the standards of consumption of at least 70 per cent of the Latin American population differ greatly from the figures for Argentina, except in respect of cereals, where the figures reflect the unbalanced diet prevailing in large sectors of the region. In contrast, the consumption figures for the third stratum (the 20 per cent in the income bracket immediately below the top 10 per cent) are close to the Argentine average, and those of the group in the highest income bracket considerably surpass it.

Table 9 continues the exercise of appraising the magnitude of the increases which would be necessary to reach the levels of Argentina and of establishing in what proportion they should be distributed among the groups for each group to attain this objective.

The size of the increases needed is immediately obvious; except in the case of cereals, the consumption of the different items would have to double or nearly so. It goes without saying that the greatest increases would have to be concentrated in the poorest 20 per cent.

■ **Table 8**

PER CAPITA CONSUMPTION OF FOOD, CLOTHING AND FOOTWEAR IN ARGENTINA AND IN THE DIFFERENT POPULATION STRATA OF LATIN AMERICA, 1970
(1960 dollars per capita)

	Latin America				
	Argentina	Poorest 20%	Next 50%	20% below the richest 10%	Richest 10%
Food	317	42	133	251	515
Meat	81	4	19	71	172
Cereals	29	16	39	47	74
Other	207	22	74	133	269
Wearing apparel	93	6	25	85	221
Clothing	69	4	17	63	172
Footwear	24	2	8	22	49

Source: ECLA, estimates based on national surveys.

■ **Table 9**

LATIN AMERICA: INCREASES IN FOOD, CLOTHING AND FOOTWEAR NEEDED TO ACHIEVE PER CAPITA CONSUMPTION OF SUCH ARTICLES AT LEAST EQUAL TO AVERAGE CONSUMPTION OF THEM IN ARGENTINA IN 1970

	Share of total increase corresponding to the different population strata				
	Necessary percentage increases over present availability of each item	Poorest 20%	Next 50%	20% below the richest 10%	Richest 10%
Food	90.9	34.3	57.4	8.3	-
Meat	118.1	32.9	61.0	6.1	-
Cereals	-15.6	43.0	-85.0	-58.0	-
Other	125.4	31.2	56.4	12.5	-
Wearing apparel	99.0	32.9	64.1	3.0	-
Clothing	101.7	32.3	64.5	3.2	-
Footwear	91.1	34.7	62.5	2.8	-

Source: ECLA, estimates based on national surveys.

The next 50 per cent would also have to receive a somewhat higher share than that corresponding to their share of the population, however, particularly as regards clothing and footwear.

Lastly, table 10 shows the rates of growth which would have to be attained over different periods of time (five, ten and fifteen years) for the population of the region to reach the levels of consumption desired.

Undoubtedly the effort required is a big one. In order to attain the objective in question within a period of five years, expansion rates beyond the possibility of any system would be required, and even if this period were extended to ten years, considerable strain would be put on the productive system.³²

These growth requirements, which are far from encouraging any simplistic optimism, are associated with urgent needs in other fields of major importance to social welfare, such as health, education and other community services, which also call for huge resources if the situation of abject poverty is to be radically changed.

³² On this point, see table 3 and in particular the growth rates of traditional industries in Brazil. Even bearing in mind that these also include goods consumed above all by high-income groups, at existing expansion rates it would take more than 15 years to reach the levels indicated.

At the same time, to put things on a realistic plane, it should be realized that the average levels of consumption in Argentina are very high, both compared with those prevailing in the region and also compared with hypothetical subsistence consumption targets.

According to a recent study,³³ if these targets are to be achieved and abject poverty eliminated, the lowest income of the poorest 50 per cent of the Latin American population should be at least 238 dollars (at 1970 prices) per capita per year: a sum which would enable this stratum of the population to satisfy their minimum needs of clothing and food. Around 1970, actual income was 73 dollars per year for the poorest 30 per cent of the population and 122 dollars for the poorest 50 per cent.

■ **Table 10**

LATIN AMERICA: ANNUAL ACCUMULATIVE GROWTH RATES OF FOOD, CLOTHING AND FOOTWEAR PRODUCTION NECESSARY FOR THE REGION TO ACHIEVE WITHIN FIVE, TEN AND FIFTEEN YEARS A MINIMUM PER CAPITA CONSUMPTION OF SUCH ARTICLES EQUAL TO THE AVERAGE FOR ARGENTINA IN 1970

	5 years	10 years	15 years
Food	16.7	9.6	7.3
Meat	19.8	11.0	8.2
Cereals	-0.4	1.2	1.8
Other	20.5	11.4	8.5
Wearing apparel	17.6	10.0	7.6
Clothing	18.0	10.2	7.7
Footwear	16.7	9.6	7.3

Source: ECLA, estimates based on national surveys.

Note: These rates were calculated on the assumption of a 2.9 per cent annual increase in the population of Latin America.

In view of the foregoing, table 11 was prepared, which shows the per capita income of the different strata in 1970, with projections for 1980, the target being to raise minimum per capita income to at least 238 dollars per year. In order to make the outlooks clearer, two hypotheses were made. The first assumes a modification of the 1970 distribution structure, whereas the second assumes no change in the structure.

³³ See "La alimentación en América Latina dentro del contexto económico regional y mundial" (preliminary version), a document prepared by the ECLA/FAO Joint Agriculture Division for the thirteenth FAO Regional Conference for Latin America, August 1974.

■ Table 11

LATIN AMERICA: PER CAPITA INCOME BY STRATA IN 1970 AND PROJECTIONS FOR 1980 ON THE ASSUMPTION THAT MINIMUM PER CAPITA INCOME WILL REACH AT LEAST 238 DOLLARS PER YEAR, WHICH IS THE AVERAGE PER CAPITA SPENDING ON FOOD AND CLOTHING OF THE 30 PER CENT OF THE POPULATION WITH INCOMES HIGHER THAN THE MEAN
(1960 dollars and annual growth rates)

I Per capita income in 1970		II Hypothesis I 3% annual increase in the average per capita income of the region		III Hypothesis II Retaining the 1970 distribution structure		IV Percentage share of each stratum in total income	
		Per capita income	Annual rate 1970-1980	Per capita income	Annual rate 1970-1980	Hypothesis I	Hypothesis II
First 30%	73	238	12.5	238	12.5	12.0	8.3
First 50%	122	238	6.9	238	6.9	20.1	13.9
Next 20% 20% before	306	381	2.2	595	6.9	12.9	13.9
the top 10%	616	767	2.2	1 200	6.9	26.0	28.0
Top 10%	1 945	2 424	2.2	3 794	6.9	41.0	44.2
Top 5%	2 630	3 277	2.2	5 130	6.9	27.7	29.9
Total	440	591	3.0	860	6.9	100.0	100.0

Source: Column I ECLA, estimate on the basis of national surveys.

In the first case, in order to achieve the desired consumption with a rate of increase of average per capita income of 3 per cent per year —similar to the rate recorded in the 1960s— the income of the poorest 30 per cent of the region's population would have to increase at a rate of 12.5 per cent per year, while for the poorest 50 per cent the rate of increase would have to be 6.9 per cent. For this to be possible, the relative shares of each stratum in total income would have to be changed.³⁴ As may be seen from section IV of table 11, this would involve only quite modest changes in the shares of the sectors situated in the upper half of the distribution pyramid, and these would moreover be compatible with absolute increases in their income between 1970 and 1980. Thus, for example, although the share of the richest 10 per cent of the population would drop from a little more than 44 per cent to 41 per cent, their income would increase from 1,945 dollars in 1970 to 2,424 in 1980.

The situation is different if we assume that the 1970 distribution structure is to be maintained, as assumed in the second hypothesis. In this case, for the poorest 50 per cent to reach the minimum level established, per capita income would have to increase annually by almost 7 per cent —more than double the historical rate— which is of course beyond the realm of reasonable possibility.

In other words, if an objective more modest than that indicated in the previous exercise is fixed, the target aimed at would not be excessively ambitious if in one way or another an appreciable but not radical transformation could be made in the distribution structure. Although this is not the place to develop this subject, it should be noted that the foregoing clearly shows that, as far as average per capita income is concerned, the elimination or substantial reduction of abject poverty is not a utopian ideal. And it is even less so if the problem is looked at from a realistic point of view, i.e., bearing in mind the degree of development of the production potential and the different possibilities of using and allocating such potential.

At all events, however, the problem cannot be solved without a considerable mobilization and reallocation of human and material resources.

³⁴ It should be borne in mind that such changes would not necessarily mean monetary transfers from one group to another. They could also be brought about through material transfers financed, of course, through fiscal and monetary channels.

F. Options

The above statement is confirmed to some extent by the exercises which have been carried out using a numerical model in a joint project undertaken by the Economic Development Division and the Economic Projections Centre of ECLA.³⁵

On the basis of the prevailing growth style, a fairly dynamic rate of expansion (7 per cent per year), and a background typical of an economy similar to that of Brazil (and to some extent, therefore, of the region as a whole), an attempt has been made to show what would occur towards the end of the century as regards some basic features, among them employment and income distribution, which are closely interrelated.

As far as employment is concerned, the proportion of the labour force which is unemployed or employed in backward strata (the primitive stratum and the lower part of the intermediate stratum) would drop from 53 to about 45 per cent between 1970 and the end of the century, although its size in absolute terms would double. The composition of this group would undergo a marked change, becoming more urban than rural.

The consequent differences in productivity would become more pronounced, and by the end of the period productivity in agriculture and traditional services would only amount to a quarter of the national average and a much smaller fraction of the productivity of the modern stratum.

This concentration of technical progress (and its effect the absolute or substantial marginalization of a large sector of the system) is matched symmetrically as regards the distribution of its fruits.

As indicated in a study quoted earlier,³⁶ "the insight into the distribution of income which can be obtained from the model follows directly from the employment structure and its evolution... There is some improvement, but the basic imbalance remains. By the end of the century there has been some upward shift in the relative composition of the labour force: the low income group declines to less than half of the total, the middle group is marginally larger and the high income group is considerably larger, accounting for about one sixth of all income recipients".

Thus, the point raised previously crops up once again: namely that while the style admits of or involves a certain degree of "deconcentration" or "levelling up", it involves above all the absolute or considerable marginalization of an appreciable proportion of the "poorest half".

In order to define the foregoing aspects more clearly, a summary exercise was carried out which appears in table 12. Here, two hypotheses are put forward with respect to policies which might be proposed for reducing the degree of heterogeneity of production characteristic of the Latin American structure or, looked at from the opposite point of view, for promoting a definite movement towards the homogenization of that structure. For this purpose a long-term view is taken from 1970 to the year 2000.

The first hypothesis is the more radical. It involves the disappearance of the primitive or subsistence stratum and the reduction of the intermediate stratum. In this way, the share of the modern stratum in employment would increase from 15 to 70 per cent, while the proportion of the production of the product generated by this stratum would increase from 57 to almost

³⁵ See in particular ECLA, *Un modelo para comparar estilos de desarrollo o políticas económicas optativas*, E/CN.12/907, 1971 and "Different development models or styles", *Economic Bulletin for Latin America*, Vol. XIX, Nos. 1 and 2, 1974. United Nations publication, Sales No. E.75.II.G.2.

³⁶ "Different development models or styles", *op. cit.*, pages 45 and 46.

76 per cent. The economy in question would therefore show a very high level of homogeneity and modernization by about the year 2000. For this to be possible, the overall economy and the modern stratum would have to grow rapidly (at rates of 7 and 8 per cent, respectively) and the *average* productivity of the modern stratum would continue to be that of 1970, although the average productivity of the system as a whole would increase by 4.4 per cent per year.

Obviously, this picture is very different from the real possibilities. At the same time, it should be borne in mind that, even in this extreme or utopian version, it does not involve, as has sometimes been thought, any suggestion of a technological holdup or freeze, since the productivity of the economy as a whole increases, as we have seen, at the very high rate of 4.4 per cent. Moreover, as far as the modern stratum is concerned, the fact that its *average* productivity would be maintained does not exclude the possibility that *within this* unchanging global level there could be branches or enterprises which would increase their efficiency at much more rapid rates, even at rates more rapid than that of the growth of the overall economy.

■ Table 12

LATIN AMERICA: PROJECTION OF PRODUCTIVITY SECTORS TO THE YEAR 2000, ON THE BASIS OF A TREND TOWARDS GREATER HOMOGENEITY IN THE ECONOMY

	Percentage structure				Product per employed person (1960 dollars)		Annual average growth rates (1970-2000)		
	Employment		Product						
	1970	2000	1970	2000	1970	2000	Employment	Product	Product worker
Hypothesis A									
Primitive sector	35	-	4.7	-	210	-	-	-	-
Intermediate sector	50	30	38.1	24.3	1 200	4 400	1.0	5.4	4.4
Modern sector	15	70	57.2	75.7	6 000	6 000	8.0	8.0	0.0
Whole economy	100	100	100.0	100.0	1 500	5 500	2.6	7.0	4.4
Hypothesis B									
Primitive sector	35	9	4.7	1.5	210	900	-2.0	3.0	5.0
Intermediate sector	50	37	38.1	24.4	1 200	3 900	1.5	5.5	4.0
Modern sector	15	54	57.2	74.1	6 000	7 700	7.0	8.0	1.0
Whole economy	100	100	100.0	100.0	1 500	5 500	2.6	7.0	4.4

Note: In hypothesis A the primitive sector is absorbed by the modern sector, whose labour force increase by 8% annually while its product per person employed remains unchanged.

The second hypothesis postulates more moderate changes. It assumes that in the year 2000 the subsistence stratum will still contain almost 9 per cent of the active population, but thanks to the decrease in its size, its per capita product will have increased from some 200 to some 900 dollars per year. The intermediate stratum, for its part, would have a greater role to play in absorbing some of those displaced from the subsistence economy. Thus, as is evident, the modern stratum would become more important as a source of employment and would also have a greater possibility of increasing both its average productivity (1 per cent per year) and that of top priority branches or enterprises.

These exercises, it must be stressed, are neither prophecies nor programmes. Between them and the concrete reality of the near and more distant future stand the actions of society (on both the domestic and external levels) and, from a more specific point of view, the economic and social policies followed. In other words, they are and will be only as valid as the assumptions on which they are based, which are by definition changeable.

G. Some vital questions

In any event —going back to the initial theme— this discussion leads us inevitably to the essential question of the possibility of introducing the changes which are considered to be desirable, necessary and historically viable in the light of material circumstances and within a given period of time. Put in other words, closer to those used in the discussions we all know so well: Is it a question of changing the *style* of development or must the *system* also be changed.³⁷

It is clear that we cannot provide an answer to the question. Further, we do not believe that there can be any answer which is valid for all times and places and which does not specify the concrete terms in which it holds good. From this point of view it seems obvious that, while certain changes in a prevailing style may imply or require radical changes in institutional and political parameters —i.e., in the system— there are others which fit within an existing framework, although they will always call for some review and adjustment of it. The historical experience to which we referred in the first section provides many different examples of this.

Furthermore, the same experience also shows us that replacing one system by another does not mean the disappearance of all the problems of the former style, although it can indeed bring new ones with it, to the distress of “utopian ideology”. But this alone does not disprove the need for or advisability of such a change.

From a more specific point of view, and thinking of Latin America and its problems, I would make so bold as to argue, for example, that there are a number of countries which could eliminate or substantially mitigate abject poverty within a reasonable period of time, without a total transformation of the existing system being necessary, although it would of course have to undergo marked changes in its structure and operation.

The situation of other countries is different, but even in respect of these it should be borne in mind that in quite a few cases the problem is not just that of changing the system but also of dealing with aspects of major importance or complexity regarding such matters as resource endowment, economic size, native cultures which are difficult to “modernize” or activate in the context of traditional structures, etc.

In the final analysis, only by trial and error will it be possible to find the answers to each situation and to each desired change in the existing style.

³⁷ For a different approach, but one which is still relevant to these problems, see the author's study *Inflación: raíces estructurales*, and particularly the article “Heterogeneidad estructural y modelos de desarrollo reciente de la América Latina” (page 104 et seq.), Fondo de Cultura Económica, Mexico City, 1973. Study by A. Pinto and A. Di Filippo, “Nota sobre la estrategia de la distribución y la redistribución del ingreso en América Latina”, in *Distribución del ingreso* by Alejandro Foxley (compiler), Fondo de Cultura Económica, Mexico City, first edition, 1974.

THE QUITO APPRAISAL *

ECLAC

* United Nations-ECLA, 1973

A. The concept of integrated development

1. A central preoccupation in the review and appraisal of the International Development Strategy should be the concept of integrated development and the differences existing between the phenomenon of economic growth and actual development.
2. Integrated development cannot be achieved through partial efforts in particular sectors of the economy or the social system, but only through concerted progress in all aspects. It is exceedingly difficult to make an appraisal of the development process thus defined, since it is not sufficient to refer to one or more indicators, but it is necessary to observe to what extent concerted progress in all sectors is helping to promote a new type of society oriented towards rapid human development.
3. The growth of economic variables has frequently failed to bring with it qualitative changes of equal importance in human well-being and social justice. This is shown by the continued existence of serious problems such as mass poverty, the incapacity of the system of production to provide employment for the growing labour force, and the lack of economic and social participation of broad strata of the population. Clearly, however, these qualitative changes are more difficult to achieve when the economic variables do not grow at satisfactory rates. In line with this approach, achievement of the quantitative targets of the Strategy should constitute the complement necessary to achieve human development, which is the ultimate aim of the process.
4. The traditional structures, inasmuch as they put obstacles in the way of change, hinder social progress and economic development. Accordingly, even more strenuous efforts must be made to effect the qualitative and structural changes mentioned in the IDS, which are indispensable to establish the bases that will permit the achievement of the social and economic objectives of the Strategy. Failure to stress the vital importance of this aspect of development and to put these qualitative and structural changes into practice largely explains the unsatisfactory results achieved by many Latin American countries.
5. These structural changes, which are an essential condition for any integrated process of development, especially one set out in the broad human and social terms in which the IDS states this objective, include: the control and sovereign utilization of natural resources; the reform of land tenure systems as required in order to promote both social justice and agricultural efficiency; the establishment of such forms of public or mixed ownership of property as each country may consider appropriate in those activities which, in its view, require such measures in order to promote self-sustaining independent economic development; and any other type of substantive reform needed to secure that objective.
6. At the same time, accelerated, harmonious and independent growth is essential to the success of these qualitative and structural changes, and consequently, of the objectives of the Strategy, since accelerated growth of the economy as a whole makes it easier to obtain the resources necessary for the investments required for human development.
7. When, in its efforts to implement the Strategy, a country simultaneously tackles all aspects of development and promotes the structural reforms needed to achieve integrated development, experience indicates that imbalances occur in the initial stages which make it difficult to continue the process. The social injustices and tensions which have accumulated over the years manifest themselves in demands which domestic resources cannot meet. In order to correct these imbalances, the international co-operation received by such a country should not be

subject to restrictions, as has so often been the case. Some countries undertaking structural changes in conformity with the IDS sometimes have to face hostility and economic aggression from abroad. This is particularly serious since, in the light of the commitments undertaken in the Strategy, countries engaged in reforming their structures should receive international support for those reforms.

B. Economic growth

8. The Latin American countries display a high degree of heterogeneity in their economies and societies, for they have a wide variety of structures and situations and also present marked differences as regards the development strategies and policies they are pursuing. Thus, the per capita product ranges from 100 to 1 000 dollars and similar disparities exist, sometimes on an even larger scale, between different sectors or regions and between urban and rural areas. Furthermore, there are not only differences as regards economic circumstances but also different approaches to the development process, with each model having different options or methods of implementation. At present, medium- and long-term policies are being implemented whose basic principles, both political and economic, differ substantially. Hence, there is no single model to which the appraisal can refer. Nevertheless, there is a marked degree of Latin American solidarity which makes it possible to deal with common problems.

9. In the last two years, the growth rate of the product was generally insufficient. Although the region as a whole exceeded the growth target established in the IDS, most countries fell short of it. Similarly, while industry in the region as a whole achieved the sectoral growth target set in the IDS, this was the case in only a few countries; the situation was still worse in agriculture, which lagged not only behind the target set in the IDS but also behind population growth. As a result, the effectiveness of the development process, viewed as an integrated process, is still being undermined in some cases by the difficulty of achieving adequate growth rates.

10. The internal efforts made in the Latin American countries have not been accompanied, in most cases, by international co-operation or even by acceptable terms as regards prices and systems of marketing raw materials, trading practices for manufactures, liner conference practices, contracts for the transfer of technology, and external financing. Consequently, a fundamental part of the resources needed for national development is subject to circumstances beyond the control of the Latin American countries, such as the economic growth —especially in industry— of the developed countries, and market conditions over which they have no influence. A few countries have increased their export income despite the decline in the volume of their exports, but this has been due to the application of policies for the protection of their natural resources. At the same time, there is growing external indebtedness which has raised the total debt servicing commitments of some countries to half of their total income from exports of goods and services.

11. The overall indicators of economic growth give a broad outline of the situation in the region, but may not be representative of individual cases. Moreover, the same indicator may vary in significance if the cases to which it is applied differ appreciably. It is therefore necessary to complement the series of economic indicators with a series of social indicators that reflect the characteristics of the various countries, sub-regions and social groups.

C. Human development and social change

12. In the words of the International Development Strategy, "the ultimate purpose of development is to provide increasing opportunities to all people for a better life". It goes without saying that the achievement of this objective requires a profound social change and a new unified approach to development. It is therefore necessary to assess the impact of economic changes on the social situation and their relevance to it. It must be appreciated, however, that the quantitative, qualitative and structural changes and the reduction of existing regional, sectoral and social disparities "are both determining factors and end-results of development". Consequently, as the Strategy puts it, rapid economic growth and structural changes should be viewed "as integrated parts of the same dynamic process and would require a unified approach".

13. Analysis of the past decade and the first two years of the Second Development Decade indicates that important changes in the social situation have taken place in Latin America. The population grew from 210 million in 1960 to 279 million in 1970, and it will have risen to 372 million by 1980. The percentage of the population living in localities with over 20 000 inhabitants rose from 33 to 41 per cent. At the same time, the negative aspects of urban concentration and the deterioration of the environment have got worse. The proportion of the population feeling the impact of societal change and unequal economic growth has increased to the point where these phenomena are beginning to affect almost the entire population. Unemployment problems have become more serious, since a substantial proportion of the supposed growth in employment has taken place in the tertiary sectors, i.e., services and commerce, which are characterized in the region by typical situations of unemployment and low productivity. On the other hand, overt unemployment has clearly increased over the long term. All this has placed large sectors of the population in an even more marginal position as regards both consumption and employment.

14. The concentration of the population in urban areas has been accompanied by improvements in the quantity, and in some cases the quality, of certain social services, particularly education and health. The educational sector has expanded somewhat, but although there has been a decline in the number of illiterates, illiteracy continues to be one of the most serious problems in the region. Moreover, although the proportion of Latin American children that have never attended school is now small, a high proportion still fail to complete the full primary cycle. At the same time, it should be noted that considerable efforts have been undertaken to give education a new direction in keeping with the requirements of the process of development.

15. Although surveys on nutrition in the home are still very limited, the food balances are sufficient to show that the present per capita availability of calories and proteins continues to be below international standards in many countries, that little progress has been made in 1970 and 1971 compared with the 1960's, and that, if present conditions and trends persist, the deficit will not be fully eliminated even by 1980. In this situation of inadequate supply, and in view of the prevailing inequality of income, it must be assumed that the level of nutrition in the lowest income groups and the most under-privileged areas is far below acceptable minima. Surveys carried out in 16 Latin American countries show that the phenomena of underfeeding and malnutrition, especially of children under five years of age, could have the gravest and most unfavourable consequences on the future quality of the population.

16. Most of the national authorities of the region made calculations on the housing deficit at the beginning of the 1960's and arrived at alarming conclusions, especially when projections of the urban housing deficit were made on the basis of the rate of formation of new families and

the rate of deterioration of the stock of existing dwellings. Since then, the deficit has increased to the point where studies made by various international agencies show an estimated deficit of between 15 and 20 million housing units.

17. The behaviour of the main indicators indicates that health conditions improved appreciably in the 1960's. It is possible, however, that in many cases this improvement is only apparent, the favourable increases in statistics being due to more efficient collection of data. The fact remains that in Latin America there are still many countries with less than 5 doctors per 10 000 inhabitants; that the now traditional shortage of hospital beds is growing still worse because the increase in the number of beds is less than the increase in population; that for various reasons medical services continue to be beyond the reach of broad sections of the community in much of the region, and that in several countries the child mortality rate between 1 and 4 years of age has reached the appalling level of between 15.7 and 32.4 per thousand.

18. The unified approach to development must not be restricted to the diagnosis of each sphere of social action and the proposal of recommendations. The very concept of development must be improved and the fragmentary approach to economic growth and human development discarded. The factors affecting these two problems cannot be determined merely in the light of economic growth: it is necessary to take an integrated view of all the social, economic and political determinants. Moreover, human development is not just a question of expanding sectoral action in education, health, etc., but must include a social system that gives priority to the equality and dignity of man and respects and fosters the cultural expression of the population.

19. The objective of income redistribution, in the form set out by the Strategy, remains unfulfilled in most countries of the region. Surveys made in a number of countries confirm that income in most of Latin America is more concentrated than in most of the developed market-economy countries, and much more concentrated than in the countries with socialist economies. The objectives of development in Latin America must be the creation of a new society and a new type of man. Social participation in all forms of the development process must be increased in order to achieve a juster society.

D. Mobilization of internal resources

20. The primary responsibility for the development of the developing countries rests upon themselves.

21. Considerable progress has been made in connexion with planning systems in recent years. In some countries, the planning bodies have been given a greater say in the adoption of basic decisions on economic and social issues. Techniques for developing plans and programmes have been improved, and there is now more awareness of their relationship with the political processes and the particular circumstances found in the various countries. There is still ample scope, however, for progress towards a planning system of truly operational significance.

22. Important changes have taken place in the institutional systems of economic and social relations in several countries of the region. These cover a wide spectrum, including the system of ownership and the structure of enterprises; links with foreign investment; machinery for the protection of primary products; the systems of land tenure; the administrative machinery, and economic policy instruments.

23. The nature of these changes is closely bound up with the political definitions or characteristics of the various countries, a fact which has to be taken into account in view of the widely differing situations found in the region. From this standpoint, transcendental changes have been and are taking place in Latin America, mainly in connexion with natural resources, public enterprises and public administration. In order to institute these changes the Governments have adopted various policy measures and have used a wide range of mechanisms in line with the particular conditions prevailing in each country. However, the common characteristic has been the adoption of measures designed to give the State fuller participation in the management and control of the production process.

24. Institutional changes with regard to natural resources in the last few years have been aimed at more efficient utilization of resources and fuller participation of the State in their development. In some countries the nationalization of enterprises, the association of the State with foreign enterprises, and modifications in the concessions and arrangements for the exploitation, marketing and shipping of basic natural resources have been the principal means used to bring about these changes. The greater participation of the State in the development of natural resources is a particularly significant fact in a region where two-thirds of exports revenue is accounted for by ten agricultural commodities, six mining products, and petroleum.

25. Agrarian reform has proceeded at an accelerated pace in some countries of the region. Most countries have enacted agrarian reform laws and set up special bodies for carrying them out. What has been achieved in the region as a whole cannot be considered satisfactory, however, since the systems of land tenure, use and development are still largely inadequate to satisfy the increasing economic and social development needs of the Latin American countries.

26. Another aspect worthy of note is the renewal of financial systems and the growing importance of a variety of new institutions which are being set up to meet the demand for financing deriving from the new methods of development. A further noteworthy feature is the continuing expansion of public initiative and the accompanying changes in the tax structure and in the composition of investment and public expenditure. Taking an overall view, there is a clearly discernible trend towards the diversification of public activity which goes beyond the traditional area of action and involves new responsibilities and aims.

27. To sum up, it may be inferred that the majority of the Latin American Governments have been or are currently making significant efforts to introduce institutional changes designed to promote economic and social development, but in many cases they have been hampered by a number of external factors, such as inadequacies as regards financing, technology and technical assistance, and the deterioration in the terms of trade.

E. Latin America's position within the context of international relations

(a) Targets of international co-operation and their achievement

28. As regards international co-operation, the balance of achievement of the aims and targets of the International Development Strategy at the end of the second year of the second United Nations Development Decade must be generally regarded as disappointing.

29. Thus, for example, the aim of securing international action before 31 December 1972 on the commodities mentioned in UNCTAD resolution 16 (II), as laid down in paragraph 21 of the

IDS, has not been fulfilled. The only progress achieved in that connexion is represented by the negotiation of the international cocoa agreement, the ratification of which by some of the main importing countries is pending. As regards the other commodities listed in the above-mentioned resolution, no concrete action has been taken.

30. The conclusion of international agreements or arrangements covering new commodities has been opposed by certain importing countries, with the exception of the International Cocoa Agreement, the negotiation of which took more than 10 years. The support expressed in paragraphs 21 and 22 of the IDS for the negotiation of agreements and their revision in order to make them more efficacious contrasts with the attitude adopted by some developed countries in this respect. It must be considered that there has been a regression in this field, as the present international agreement on wheat contains no operational clauses on exports and prices, and the situation existing as regards the International Coffee Agreement makes its renewal a matter of doubt.

31. The International Cocoa Agreement provides for the creation and operation of a buffer stock, which would be the second in existence for a commodity of importance to the Latin American countries. As regards the pre-financing of such buffer stocks, the IDS only mentions, in paragraph 23, the need to consider all possible sources. The source of financing, however, has been exclusively the developing countries exporting cocoa. The decision of the International Monetary Fund to grant loans to the developing countries to finance buffer stocks provides these countries with the means of contributing to the financing of these stocks, but may aggravate short- or medium-term external debt problems.

32. The aim of reaching an agreement, before the third session of UNCTAD, on a set of general principles on commodity pricing policy, as described in paragraph 24 of the IDS, has not been fulfilled either. The discussions held during UNCTAD III have not led to any agreement, and responsibility for continuing them has been delegated to the Trade and Development Board. The situation has become worse owing to the international monetary fluctuations. This disappointing experience backs up the conclusion that commodity pricing policy —where it is not possible to conclude commodity agreements— should be regarded as the responsibility of the exporting developing countries. The Latin American country which is a member of the Organization of Petroleum Exporting Countries and the exporting members of the International Coffee Organization have acted accordingly.

33. The standstill recommendation has not been complied with insofar as there have been many instances of new restrictions being introduced, or existing restrictions tightened, on imports of products of special interest to the developing countries. It is essential that this principle should be effectively applied, thus avoiding unilateral recourse to the general escape clauses by the developed countries. It would also appear necessary to take account of the new situations that arise when several developed countries form a customs union, since the process of standardizing tariffs and other trade barriers, such as is currently taking place in the enlarged European Economic Community, often means a deterioration in the tariff or non-tariff treatment previously enjoyed by the developing countries.

34. Progress has also been extremely limited in improving the conditions of access to markets of developed countries. In practice, the priority which the Strategy accorded in paragraph 26 to the adoption of unilateral or joint measures for the reduction or elimination of duties and other barriers to imports from developing countries, with a view to achieving specific results before 31 December 1972, has not been applied to any significant extent. Apart from the trade

liberalization measures adopted by Japan in 1971 and 1972 —removal of quantitative restrictions on certain products and 20 per cent reduction in duties on industrial products— and the EEC tariff cuts on coffee and cocoa, it is difficult to point to any real progress in this field, especially since Japan's liberalization measures mainly concern industrial products and only apply to a small number of processed agricultural products of importance to Latin America. These developments emphasize the urgent need for the developing countries to diversify their exports.

35. Similarly, very little effort has been made to help the developing countries to carry out research programmes designed to increase the competitiveness of natural products against synthetics and substitutes.

36. The objective of promoting and expanding the export trade of developing countries in manufactures and semi-manufactures has been partly achieved as a result of the application of the generalized system of preferences between mid-1971 and the first few months of 1972. Progress in this respect, however, has been limited. The United States, which is the leading industrialized country and is Latin America's most important customer, still has not implemented its scheme. As regards Japan, the information available is still preliminary but indicates that the effects have been relatively insignificant. Two facts may contribute to this: the very restrictive nature of the quota system and the high concentration of Latin American exports in the category of raw materials, for which no concessions have been granted. While no conclusions can yet be reached regarding results in other countries, the small share of manufactures in Latin American exports and the limitations and safeguards that characterize preference schemes mean that only very few countries in the region will be able to obtain benefits of any significance. The Latin American countries should therefore intensify their efforts to ensure that a revision and extension of the various schemes of general preferences is initiated at the next session of the Special Committee on Preferences. In addition, they should endeavour to induce the developed countries which have not yet put their schemes into operation to do so as soon as possible.

37. In relation to the real possibilities offered for the expansion of exports of manufactures from developing countries, it is necessary to reaffirm the serious nature of the forthcoming multilateral trade negotiations. In the first place, the majority of the European countries have already established the necessary conditions for the full liberalization of trade in industrial products within the EEC and between the Community and former members of the European Free Trade Association. The creation of new preferences among the industrialized countries of Western Europe will increase the difficulty of access of Latin American manufactures to these markets. Secondly, if the trade negotiations are successful, the liberalization of trade in industrial products will be extended to the rest of the developed countries. The preferential tariff margin from which the developing countries at present benefit under schemes of general preferences will therefore be reduced or will disappear. These countries will thus suffer, especially if no adequate compensation is provided either by giving non-tariff preferential treatment to products affected directly or indirectly by the tariff cuts, or by extending the preferential treatment to products of interest to the developing countries which are currently excluded, or through any other measure of a compensatory nature.

38. With regard to invisibles, the IDS establishes as one of its main objectives that of promoting the net earnings of developing countries from invisible trade. For maritime transport, the attainment of this objective means increasing the region's participation in world shipping through the creation and expansion of national fleets. However, with a few exceptions, the situation of the Latin American countries is deteriorating instead of improving. Latin America is lagging behind in terms of both the growth of the world merchant fleet —its share in world tonnage

declined from 4.1 per cent in 1955 to 2.4 per cent in 1972— and its qualitative composition. Moreover, the continual increases in freight rates imposed by the shipping conferences have made Latin America's imports more expensive and have reduced its possibilities of diversifying exports. Consequently, the balance-of-payments deficit under the head of transport for all the Latin American countries continues to increase, and it is a matter of urgency that they should have an adequate measure of co-operation from the developed countries so that they can attain the goals of the IDS, both in maritime transport and in insurance and tourism. In such co-operation, stress should be laid on the need for the Latin American countries to take advantage of the new maritime transport technology or to be able to share adequately in it through new international arrangements.

39. In particular, attention should be drawn to two fields of action in maritime transport: (i) the conference convened by the United Nations General Assembly to prepare a code of conduct for shipping conferences, in connexion with which adequate advantage must be taken of the periods between the successive meetings of the preparatory committee in order to establish a common Latin American position; and (ii) the work which the secretariat of UNCTAD is carrying out, in co-ordination with ECLA and other agencies, on the options open to the developing countries in the field of international intermodal transport. Since these studies are being undertaken with a view to the convening in 1975 of a conference for the preparation of a convention, priority should be given to the studies designed to ensure that Latin America's interests and problems are taken duly into account.

(b) Recent development and future prospects

40. In addition to the scanty progress made towards the fulfilment of the objectives of the International Development Strategy, there have been a number of recent developments and immediate prospects which inspire deep concern regarding the evolution of the Latin American external sector in the immediate future. These developments have a generally adverse effect on the possibilities of achieving the goals and objectives of the IDS and constitute a negative prospect for the relations of Latin America —and of the developing countries in general— with the developed nations.

41. The enlargement of the EEC through the entry of Denmark, Ireland and the United Kingdom could mean that preferential trade arrangements may be extended to the developing countries which formerly enjoyed British Commonwealth preferences, while the three new members may accord similar treatment to the developing countries already associated with the EEC. The reverse preferences which this might entail could prove to be an obstacle to co-operation among the developing countries, since they might restrict the scope for the exchange of reciprocal preferences between the latter. A solution to the problem of discriminatory trading areas should therefore be urgently pursued at the international level.

42. The EEC's Mediterranean policy, which has so far been based on arrangements of a preferential nature, is evolving towards the formation of yet another free trade area in addition to that formed with the ex-members of EFTA. This is a further cause for concern, in that it signifies the extension, accentuation and consolidation of discriminatory trade policies to the detriment of other developing countries. These developments also represent a clear trend towards verticalization of the EEC's economic relations with other countries a trend which is unfavourable for the developing countries inasmuch as it helps to establish a situation where certain developed countries have overt influence over some groups of developing nations. It is equally clear that it tends to create conflicting interests among these countries.

43. The EEC's common agricultural policy, based on concepts of protectionism and self-sufficiency, is a source of concern because of the unfair competition which it represents for the exports of Latin American countries. The unfavourable repercussions which the high guaranteed prices have on demand for agricultural products and the impact of the severe restriction or elimination of competitive imports from outside the Community are aggravated by the existence of exportable surpluses that are disposed of outside the EEC with the aid of high subsidies. It is therefore particularly important for the Latin American countries that the 1973 multilateral trade negotiations should cover and resolve the question of trade in agricultural products.

44. The state of affairs described above implies a worsening in the conditions governing access by Latin American products to the Western European market.

45. The trends and prospects as regards trade with the United States are also discouraging. Trade relations with that country have been characterized over the past decade by a chronic imbalance between exports and imports which has resulted in the accumulation of a large and growing trade deficit to the detriment of Latin America. With a few exceptions, exports to the United States expanded more slowly than any other sector of Latin America's foreign trade between 1961-1965 and 1966-1970. The growth of Latin America's sales to the United States over the last decade has been hindered by the maintenance and, in certain cases, the actual strengthening of protective trade barriers despite the undertakings given in international and regional forums to the effect that there would be easier access to the United States market for products from the developing countries in general and the Latin American countries in particular. In actual fact, not only has no progress been made towards liberalizing trade with the Latin American countries, but in some instances restrictions —particularly non-tariff restrictions— have been tightened. The quite marked protectionist trends that still remain and are even becoming more acute are clearly apparent in the draft legislation before the United States Congress relating to the forthcoming trade negotiations.

46. Furthermore, the Special Committee for Consultation and Negotiation (CECON) of the Inter-American Economic and Social Council (IA-ECOSOC) has not made any significant progress towards liberalizing access for Latin American products to the United States market. The hopes that the CECLA member countries placed in the Latin American Consensus of Viña del Mar as regards strengthening inter-American co-operation have failed to materialize, and there is no sign of a policy specifically aimed at taking account of Latin American interests.

47. The problems that have been arising in the world monetary situation since 1971 and have recently become more acute, and the agreements for the forthcoming 1973 multilateral trade negotiations, are additional causes for concern. Decisions in these two important spheres will define the broad lines of a new system of international economic relations. It is essential for the developing countries to participate to a satisfactory degree in the working out of these decisions and for their interests to be given priority attention in them. This means that the developing countries themselves bear a heavy responsibility for working out a clear position. The basic question is whether the multilateral trade negotiations are to be an exercise in solving the problems that the market economies at the centre have among themselves, or whether they will really come to grips with the problems of both the developing and the developed countries.

48. Another important aspect relating to the forthcoming trade negotiations is the attitude that will be taken by the developed countries which are members of GATT during the course of the negotiations as regards adopting decisions on the developing countries' problems. It is anticipated that the negotiations may last three years. It is therefore essential to think of ways

and means of ensuring that during this period the developing countries will be able to continue progressing towards their objectives either within the framework of the generalized system of preferences or outside it. Otherwise, all initiatives to promote the trade of the developing countries would be frozen until 1975 or 1976, well into the Second United Nations Development Decade. If this period were to end without the developed countries achieving any significant targets for the liberalization of trade, such as those included in the IDS, the fulfilment of the Strategy will be jeopardized in a key area.

49. Despite all the differences observed in the growth rates of the export trade in 1971 and 1972, certain unfavourable characteristics are common to most countries: (i) irregular or inadequate export growth rates compared with those of world trade, and (ii) a high degree of dependence on exports of primary products in most of the countries of the region, making them excessively vulnerable to fluctuations in the external markets. It is therefore urgently necessary to provide suitable instruments for implementing the trade policy measures included in the IDS, as well as measures such as export diversification to reduce the high degree of dependence on primary products.

50. The Latin American countries have made substantial efforts to expand and diversify their exports of manufactures and semi-manufactures, which increased at an annual rate of 18 per cent between 1960 and 1970, with a quickening towards the second half of the decade. For the region as a whole, the absolute value of these exports is still relatively minor, although in certain countries they have reached significant levels. Intra-regional trade, associated with efforts to promote regional economic co-operation, has played a very important part in this growth, not only because it has represented a high proportion of total exports of manufactures and semi-manufactures, but also because it has provided very useful experience on the basis of which countries have been able to begin to export such products to the rest of the world.

51. With respect to trade relations with the socialist countries, and in line with the recommendations made in paragraph 38 of the IDS and reiterated at the third session of UNCTAD, it is important for the socialist countries of Eastern Europe gradually to introduce elements of flexibility and multilateralism in their trade and payments arrangements with the developing countries. The generalized systems of preferences of such countries should exempt products originating in the developing countries from the administrative import regulations usually applied by the socialist countries.

F. External financing

(a) General aspects

52. It is important that the transfer of external savings towards the developing countries should make an effective contribution to promoting the domestic efforts of those countries and should, in particular, help to raise their domestic savings coefficients, since in many instances it is doubtful whether this has been the case. Moreover, the orientation of investment financed out of external resources is an important factor, and such investment should be suited to and of priority importance for the promotion of national development processes.

53. It is appropriate to reiterate that developing nations that undertake profound social changes and different structural reforms may require unrestricted financial and technical assistance from the international community, since their mobilizable domestic resources are often insufficient to meet the diverse additional and simultaneous demands that are generated. There have

been recent cases in Latin America where this has not been the approach taken, and indeed the level of external co-operation furnished to some nations that have been engaged in such changes has actually fallen.

(b) Volume and terms of the inflow of financial resources to the developing countries

54. In the first years of the Second Development Decade, progress towards achieving, by 1975, net transfers of external resources from the developed countries amounting to 1 and 0.7 per cent of their GNP has been very unsatisfactory. As regards official assistance, the current trend and future prospects in the next few years are especially frustrating, since the current average rate achieved by the member countries of the Development Assistance Committee (DAC) of the OECD is around 0.35 per cent and international experts have estimated that this level will remain relatively stable until 1975. The scant progress, and even retrogression, in assistance provided by most of the leading industrialized countries within DAC has had particular impact on the flow of official assistance.

55. Latin America has felt particularly keenly the effects of the unfavourable trend in the total level of official assistance, which has forced it to take out more and more loans on increasingly hard terms, mainly from private sources, in order to finance its external savings gap. This has led to a rapid deterioration in the average terms for loans to the region, and this trend has been accentuated by the fact that there has also been some degree of deterioration in the terms for the official assistance granted it. These circumstances, together with the servicing of existing foreign investment, have meant that the region is devoting an ever larger proportion of its income from external sources, and also from its exports of goods and services, to servicing foreign capital.

56. It is vitally important for Latin America to improve its access to the official assistance provided by the developed world. At the same time it must press energetically, in conjunction with the rest of the Third World, for the 0.7 per cent target to be met rapidly and effectively by the industrialized countries. In fact, at the beginning of the 1970's, 50 per cent of the net transfers effected consisted of purely commercial financial flows, which clearly distorts and is in contradiction with the purpose of that target. For these reasons, it is especially vital for Latin America to secure an objective redefinition of the 1 per cent target in the terms that have been proposed in a number of forums, such as UNCTAD and the Group of 77, in the sense that the target should not include elements that must be distinguished from assistance, such as direct investment and suppliers' and purchasers' credit, and should be net of reserve flows of interest.

57. UNDP assistance to the region should take into account, among the indicators for establishing the indicative planning figures, the internal effort made to achieve economic and social development and the capacity of each country to profit by international co-operation now or in the future.

58. Increasing proportions of financial assistance should be channelled through multilateral institutions, because this approach has several advantages and in particular because multilateral co-operation is less variable than bilateral and less dependent on political considerations. Efforts are required, however, to improve certain of the features of such institutions, as regards their constitution, their operating procedures, and the level of control over their decision-making exerted by certain developed countries. Furthermore, the programme approach to assistance has been used very little by the multilateral institutions and, given its advantages, it is highly desirable for more use to be made of it.

59. Progress with respect to untying the use of bilateral credit has been little and slow, and it is urgently necessary to work out a comprehensive international agreement to cover this issue.

60. As to other matters relating to the deterioration of the terms of the financial assistance granted to Latin America, certain other factors have had an unfavourable impact, particularly as regards raising the cost of assistance, and this is generally not appreciated at first sight. In this connexion, attention must be drawn to the negative and growing impact of the collection of unjustified commitment commissions and other surcharges, such as miscellaneous commissions, parity realignment clauses, etc.

61. Since the entire issue of the volume and terms of the financial assistance contracted by Latin America has taken on characteristics which make it difficult to undertake a timely and appropriate appraisal of what is actually happening, permanent machinery for information and analysis is required in order to promote new means and sources of financing.

(c) Special aspects of development financing

62. For Latin America, as for other developing areas, the imperative need for the establishment of supplementary financing machinery is of the utmost importance, since the region's exports have been and continue to be subject to unforeseen fluctuations. Even when Latin America's exports of goods and services expanded more or less regularly, as between 1960 and 1971, there were several instances of reductions of more than 5 per cent from one year to the next. Although such situations were generally followed by a fairly swift recovery, there were nonetheless a number of negative domestic repercussions in the interim which could be avoided in future by means of supplementary financial assistance from the World Bank. It is therefore disappointing to note that obstacles continue to be placed in the way of moves to arrange such assistance both by the majority of the developed countries and by the Bank itself. This supplementary financing should be extended, as planned by the Bank, to cover export shortfalls caused by a deterioration in prices or in the conditions of access of certain products, due to causes which cannot be considered the responsibility of the exporting countries.

63. As to the establishment of a link between the allocation of Special Drawing Rights and the provision of additional financial assistance to the developing countries, progress along these lines has been slow despite the attempts of the latter to initiate negotiations in various international fora. It is vital to Latin America that one of the fundamental points of the reform of the monetary system now under way should be the creation of a substantial volume of international liquidity in the form of Special Drawing Rights by means of the operation of the link mechanism.

(d) The problem of the external debt

64. At the end of 1970, Latin America's external debt amounted to approximately 20 000 million dollars; as a result, in recent years the problem of servicing the debt has become more acute in the countries of the region. The growing difficulty of servicing this debt is largely attributable to the deterioration in the average terms on which loans are granted.

65. In the light of these difficulties —which take the form of a high and increasing ratio of debt servicing to value of exports and, often enough, of payments crises and renegotiations— the

solutions adopted have been on a case-by-case basis, of a commercial nature, and not particularly appropriate. This policy must be modified, and there is a need for more comprehensive solutions reached in the proper fora without waiting for the situation to become really critical before tackling the problem. It would also be advisable to establish formulas for the automatic refinancing of external debt servicing in specified circumstances.

66. In view of the considerable relative size of Latin America's debt servicing payments, emphasis must be placed on the importance of the granting by the creditor countries, the United States in particular, of moratoria on such payments, where these payments affect countries' resources for development and their possibilities of attaining the targets of the IDS.

(e) Regulation of external private investment and transfer of technology

67. In view of negative aspects displayed by private foreign investment and the activities of transnational enterprises, some countries have judged it expedient in recent years to institutionalize their relations with foreign investors by establishing or studying the establishment of definite guidelines and legal provisions, applicable to such investment and to the transfer of technology. In addition to some national measures, the regional agreement concluded by the countries of the Andean Group is of interest in this respect.

(f) Transfer, adaption and creation of technology

68. As regards the transfer of technology, UNCTAD resolution 39 (III) and the recent resolution adopted by the Inter-governmental Group for the Transfer of Technology (IGTT) are of great importance for the region, especially in connexion with the setting up of national institutions responsible for the control and negotiation of contracts on the transfer of technology, patents and trademarks, and also technical know-how and other related matters. Emphasis should be placed on the need to intensify the joint effort to adapt foreign technology and establish conditions for the countries to devise their own technological solutions.

G. The forthcoming multilateral trade negotiations

69. Within the context of world economic relations a phenomenon deserving of special attention is the breakdown of the international monetary system, which has resulted in successive and increasingly frequent crisis acting to the detriment of the developing countries, which are in no way responsible for them, and in a trend towards the expansion of preferential trade among the developed market economy countries, which discriminate against Latin America's exports. With regard to the negotiations for the reform of the world economic system, there is a danger that the voice of the developing countries may once again be ignored, if these negotiations take place mainly among countries or groups of countries which have obtained a significant degree of economic power, to say nothing of the role played by the interests of the great transnational enterprises. The multilateral trade negotiations have so far been characterized by agreements concluded basically between industrialized countries. It is worth recalling in this connexion some concepts of the Smithsonian Agreement and of the joint statements issued by the European Economic Community, Japan and the United States, which form the basis for the developed countries' position in the preparatory stage of the negotiations. The developed countries tend to centre their attention on some traditional objectives, while the developing countries in general and the Latin American countries in particular demand the definition of specific objectives which will take due account of the solution of their trade problems.

70. In UNCTAD resolution 82 (III) the developing countries established a number of basic principles regarding their participation in the negotiations. The objectives of the negotiations have not yet been clearly determined by GATT, although the summary of the President of the Contracting Parties of GATT at its twenty-eighth session recognizes that the Parties should ensure additional advantages for the developing countries.

71. Even if, with the active participation of the developing countries, positive results were to be obtained in the multilateral trade negotiations, these results would not begin to take effect until after the negotiations are concluded, i.e., towards the middle of the 1970's. This delay will frustrate the attainment of the goals established in the Strategy, unless some advance results can be obtained in connexion with certain specific questions such as world commodity agreements and the development and expansion of the schemes of general preferences.

72. Stress must be placed on the importance of the work which the ECLA secretariat is carrying out under a UNDP-financed joint programme with UNCTAD to assist the Latin American countries in the preparatory stage of the negotiations. Government experts are participating in this programme, and other competent international and Latin American agencies (GATT, FAO, LAFTA, SIECA, and the Andean Group) are lending their co-operation.

H. International monetary problems

73. A matter worthy of special attention is the international monetary crisis and the impact of the recent devaluation of the dollar and the realignment of parities or floating of the currencies of the main developed market economies on the developing countries, especially as regards the value of the latter's reserves, the prices of export products, and the terms of trade. Hitherto, the measures and solutions adopted have been exclusively directed towards the interests of the developed countries, which have resorted to the threat of trade reprisals to induce changes in exchange rates. In this respect the latest devaluation made by the United States has shown up once again the unavoidable linkage between international monetary and trade matters. If a satisfactory solution to the international monetary problems is not reached soon, there will be a risk of aggravating and consolidating protectionist tendencies in the developed market-economy countries, which would inevitably have unfavourable repercussions on the developing countries.

74. As regards the restructuring of the international monetary system, any new system planned should promote an adequate growth of international liquidity, in order to help rectify balance-of-payments disequilibria and meet the needs of countries engaged in a process of economic development.

75. In connexion with the first revision of the monetary system as a whole, which has been the concern of the Committee of 20, emphasis must be placed on the role which internationally established and regulated Special Drawing Rights should play in the creation of future liquidity and on their present unsatisfactory form of distribution. Some problems connected with the process of transition to the new monetary system are also worthy of mention, especially in connexion with the handling of the dollar surpluses accumulated outside the United States.

76. As regards the position of the developing countries in the discussions taking place on monetary matters, and the meeting of the Committee of 20 (Washington, D.C., March 1973), all the problems connected with the reform of the international monetary system are of concern to the developing countries. Special concern is warranted, *inter alia*, regarding the following:

- (i) Recognition of the specific structural problems of the developing countries and the need for a sufficiently flexible system to cope with their different situations and structures;
- (ii) Revision of the form of operation of the International Monetary Fund, especially with a view to providing longer periods for the payment of current and stand-by credits, modification of the compensatory financing system, and greater flexibility and liberality in granting financing for commodity buffer stocks;
- (iii) Revision of the quota structure to secure greater relative participation by the developing countries, and
- (iv) Establishment of the link between new allocations of SDR's and additional financing for development.

I. Regional integration and co-operation among developing countries

77. The analysis of the development process in Latin America and of its burning problems and needs, as well as the serious prospects which loom ahead for the region's external economic relations, bring out the urgent need to strengthen the concerted action of the countries in the region so that, on the basis of their joint action, the necessary conditions may be created in order to overcome the obstacles hampering economic and social progress. This joint effort should be reflected, *inter alia*, in the following areas:

(a) Regional integration

78. Although the integration processes under way in the region have continued to develop in line with their own models and guidelines, it is imperative at this stage to return to the idea of building up a united and integrated Latin America. The urgent need for measures to deal with the problems referred to above makes it necessary to give the integration process renewed impetus and to seek, in the consolidation of efforts and space, a basis for the organization of an accelerated and independent form of integrated regional development which at the same time will enable Latin America to have an appropriate share in the life of the international community.

79. In order to achieve these objectives the existing integration systems must be strengthened: a task in which international co-operation has an important role to play, as specified in the IDS. Another necessary step is to consider devising new instruments for facilitating reciprocal co-operation between these systems, particularly as regards industrial and agricultural development, the treatment of private foreign investment and the transfer of technology. Similarly, a search must be made for ways and means of organizing a system of integration that will cover the whole region, guided by principles such as independent, harmonious and balanced development, based on social justice and solidarity.

80. Without prejudice to assistance given to the various integration mechanisms in this search for concepts and formulas, ECLA should play an important part in advising the Latin American Governments, as it did in the 1950's.

81. Stress is laid on the hope that the integration systems in Latin America will devote particular attention to social aspects of development, especially education and health.

(b) Co-operation among developing countries

82. It is indispensable that there should be more co-operation among the developing countries, and particularly those of Latin America, in order to protect their permanent sovereignty over their natural resources, to defend the prices of their commodity exports, to improve conditions of access, and to stabilize commodity markets.

83. In view of the limited and disappointing results of the IDS and, in particular, of the fact that the negotiations and confrontations of the developing countries with the developed world, have not yielded very significant results, what is achieved through the implementation of programmes of mutual co-operation at the bilateral, inter-regional and global levels is of extreme importance. Attention is also drawn to the importance of the agreements reached at the meeting at the ministerial level of the Group of 77 held in Lima in November 1971 and of the Georgetown Conference of Foreign Ministers of the Non-Aligned Countries in August 1972. Those meetings adopted action programmes which contained concrete measures for reciprocal co-operation among the developing countries.

84. Great importance is attached to support for the various agencies concerned with co-operation among developing countries, which have made considerable progress in the defense of the interests of raw materials producing and exporting countries, such as: (i) the Intergovernmental Council of Copper Exporting Countries (CIPEC); (ii) the Organization of Petroleum Exporting Countries (OPEC); (iii) the Alliance of Cocoa Producing Countries; (iv) the Group of Coffee Producing Countries, and (v) the informal Group of Iron Ore Producing Countries, as well as to other measures for achieving these aims.

85. Importance is also attached to the use of the machinery afforded by the Protocol relating to trade negotiations among developing countries, which is open to them all whether or not they are members of GATT, but which is not open to the developed countries.

J. Further improvement and practical instrumentation of the international development strategy

86. The first regional appraisal of the IDS establishes, in general terms, that although the developing countries have adopted internal policies and made efforts to attain the goals and objectives stipulated therein, the necessary co-operation has not been forthcoming from the developed countries to complement those efforts, particularly with regard to the policy measures in the field of international trade, financial assistance for development and the transfer of technology.

87. According to paragraph 79 of the Strategy, "appropriate arrangements are necessary to keep under systematic scrutiny the progress towards achieving the goals and objectives of the Decade —to identify shortfalls in their achievement and the factors which account for them and to recommend positive measures, including new goals and policies as needed". It is therefore necessary:

- (i) That the Latin American countries should redouble their efforts at each stage of the process of review and appraisal of the IDS, at the regional, sectoral and global level, to improve the provisions of the Strategy and secure their full implementation by the developed countries;
- (ii) That during the process of appraisal, the formulation of policy measures should be re-examined with a view to defining them more clearly and also to specifying how they should be instrumented, taking into account the conditions and prerequisites which would make them practicable and deciding the time-limits for their implementation;
- (iii) That, with the object of establishing a more binding international commitment in relation to policy measures, work should begin immediately (in accordance with paragraph 20 of resolution 3041 (XXVII) adopted without objection by the General Assembly, with the abstention of Belgium, Portugal, South Africa, the United Kingdom and the United States) on the selection of areas in which action should be initiated for the negotiation and adoption of multilateral legal instruments; some of these areas are mentioned in paragraph 15 of that resolution.

88. In its activities in the immediate future, it is important that ECLA should bear in mind the various aspects considered in the present appraisal of economic and social development problems in the region, with a view to the fulfilment of the targets and objectives of the IDS and with the aim of developing programmes of future work, it being especially necessary for it to bring its technical and socio-economic approach into line with the spirit and content of the agreements reached at the fifteenth session of the Commission.

89. The studies undertaken by the secretariat, in addition to analysing the current economic and social situation and its origins and history, should also examine the prospects over the medium and long term. In this connexion, it is recommended that the secretariat should attach importance to the study of projections which indicate the possible future trend of the major economic and social variables, in accordance with the assumptions adopted and the alternatives proposed.

90. ECLA and the other regional economic commissions of the United Nations should give their attention to the promotion of domestic efforts and mutual co-operation and should collaborate among themselves at the inter-regional level to that end.

91. It is necessary to intensify efforts to secure the adoption of the Charter of Economic Rights and Duties of States, the draft of which is being considered by a United Nations working group. The Charter should not only be a restatement of the general and specific principles for which the developing world has fought in international forums, but should constitute a dynamic set of rules governing international co-operation, reflecting a new and rigorous approach which will give impetus and reality to the new possibilities offered by the world situation and which will protect the legitimate interest of all countries, particularly the rights of the developing countries.

POWER AND DEVELOPMENT STYLES *

Jorge Graciarena

* Published in CEPAL Review, No. 1, Santiago, ECLAC, first semester 1976. United Nations publication, Sales No. E.76.II.G.2.

I. INTRODUCTION

This exploratory paper refers to some aspects —both methodological and substantive— of the idea of “styles of development”. Since the use of this concept has become familiar in recent years and the writers using it for different explanatory or instrumental purposes are already quite numerous, these notes, which merely aim to identify some specific problems and raise certain queries, deal first with some recent contributions in this field, mainly in connexion with the “unified approach”,¹ and then go on to explore some substantive aspects.

It may be noted that in the whole group of contributions in question there is nothing resembling any reasonable degree of methodological integration. On the contrary, comparison of them reveals a certain diversity, if not confusion, in the conceptual constructions. Possibly this discrepancy is inevitable, considering that the similarity of the terms used conceals marked differences in the theoretical and methodological assumptions, in the actual areas considered in the analysis, in the value judgements involved, and in the underlying ideological and intellectual origin. It is certainly not our intention to try to unify these differences, since such eclectic attempts generally prove fruitless. If observed closely, this very diversity may be the source of a new wealth of content and may stimulate us to gain a more thorough grasp of this elusive phenomenon of development. On the other hand, it could also involve considerable confusion between present and future, reality-based and value-based judgements, ideology and utopia, and not less between levels of analysis. To put so many different concepts together might bring serious disadvantages.

This is not the moment to investigate the origins of these concepts —an erudite undertaking which would be foreign to our purposes— but it is not out of place to say that the need for this has arisen mainly since the late post-war period, when development was seen to be a complex and fascinating process, full of facets and dimensions which it was necessary to synthesize. The original models, or at least the most widely disseminated ones (Domar-Harrod, for example), were economic and very simple”.² Shortly afterwards, sociologists, political scientists and historians joined the movement started by the economists and thus began the proliferation of models and styles which is still vigorously continuing today. So far, the efforts made to establish and demarcate the theoretical location of these categories and to define their relations with other similar categories have been few and unsuccessful. Greater progress has been made in carrying out more specific studies identifying national and subregional types and models suitable for an empirical approach to the problem.

The United Nations’ concern to find a “unified approach” to explain the development process goes back several years. As far back as 1970 the Economic and Social Council and the General Assembly called for a fresh exploration to seek “a unified approach to development analysis and planning”. Implicit in this request was “a judgement that in many previous attempts did not penetrate deeply enough into the reasons why the processes of economic growth and societal change... are having such ambiguous consequences for human well-being, and why

¹ The most recent studies on the unified approach project include the United Nations *Report on a Unified Approach to Development Analysis and Planning. Note by the Secretary-General* (E/CN.5/519). On a more critical note is Marshall Wolfe’s important contribution, contained in this same issue, entitled “*Approaches to Development: Who is Approaching What?*”. From a different but also critical angle is the valuable study of the unified approach by J.B.W. Kuitenbrouwer in *Premises and Implications of a Unified Approach to Development Analysis and Planning*. United Nations Economic and Social Commission for Asia and the Pacific (SD/BP/3), 9 July 1975.

² This does not mean that the long tradition lying behind these synthetic concepts relating to both economic growth and social development has been overlooked. Their origins go at least as far back as Quesnay and Adam Smith and are also contained in the intellectual contributions of such notable figures as Ricardo Marx, Max Weber, Sombart and Pareto, who explained in various ways the growth dynamics of the capitalist “model” or “system”. They all felt the need for sufficiently broad categories capable at the same time of providing an insight into the essential nature of the complex overall development process.

the disciplines of development analysis and planning from which so much was expected a few years ago are demonstrating so limited a capacity to explain or direct these processes of growth and change”.³

The result of this pragmatic concern, both in international agencies and in academic and intellectual circles, has been a considerable volume of studies of widely varying value which already form a copious bibliography. Many of the original problems persist, however, and the progress achieved falls far short of the hopes placed in these efforts. Indeed, it might almost be said that the frustrations seem to be increasing inasmuch as the original misunderstandings are growing instead of diminishing.

Thus, not a few of the essential questions as to what the term “style of development” means still persist, and the efforts to answer them have been unsuccessful. It might rather be suggested —perhaps over pessimistically— that some difficulties have increased and that the confusion regarding terminology is worse than before, partly owing to the active (and no doubt involuntary) contribution of the various international technical groups concerned with the unified approach project, which have contributed imaginatively and generously to the profusion of nouns and adjectives currently in use, as pointed out with some irony in the aforementioned study by Marshall Wolfe. There is something smacking of magic about these pretensions to solve substantive problems, underlain with complex theories of development, by means of a play of words and terms which probably do more to obscure them than otherwise. When the word styles was first used, not a few believed that this meant the end of a stage in the process of trial and error in development thinking based on value-oriented and ideological positions and expressed in obsolete terminology, and that a broad and promising avenue was opening up towards the future. This has not been the case, however, and the old problems have been cast in a new mould without this amounting to anything but a nominal change.

II. SOME HETERODOX POSITION

When we refer to development styles (or models), a number of fundamental questions immediately arise: what does this concept mean, to what aspect of reality does it relate? What place does it occupy in the theoretical analysis of development processes? What are its fundamental and secondary elements and what kind of relations exist between them? In what time context does it fit? In other words, is it a static or a dynamic concept, a synchronic or a diachronic problem? And —not to make the list too long— what is the best way of dealing with the problems involved? The questions do not end here, but these will suffice to show the sort of difficulties involved in examining the various documents and studies relating to the unified approach project.

Strictly speaking, the first problem is one of method, and relates to the definition of the term, i.e., the significance given to it. I have searched unsuccessfully in the various studies analysed for a clear-cut definition or description of this central concept. There can be no denying that some highly interesting elements and tines of thought have emerged which might be useful in an attempt to reconstruct the basic ideas underlying the voluminous output on the subject. A whole series of ingenious classifications relating to a variety of possible viewpoints from which the development process may be analysed have also emerged. At any rate, it is known that the question of development should be dealt with by means of a unified approach, which should globalize and integrate the partial viewpoints of economic, social, political and

³ *United Nations*, Report on a Unified Approach to Development Analysis and Planning (E/CN.5/477), 25 October 1972. For further information, see *United Nations, International Social Development Review*, No. 3, 1971.

cultural development. Whether or not this integration of viewpoints has been achieved is, to say the least, open to question. What is certain, however, is that beyond the formulation of good intentions and needs, there is still no clear definition of the substantive meaning to be ascribed to styles of development conceived as overall dynamic processes, which is the aim of the unified approach perspective.

To some, this might seem a formal and academic concern. I could on no account share such a view, however, because that would mean accepting that it was right to use such complex concepts without showing the theoretical context from which they derive or indicating methodically and systematically their basic elements and relations. In other words, I would have to admit that they could be given an exclusively empirical basis and that the purpose of this effort could be reduced to serving the pragmatic aims of development planning. This is not the spirit in which the unified approach project was formulated, and still less that found in several of the studies on the subject. Nevertheless, the danger persists that the type of approach which is likely to predominate is that which M. Wolfe calls the technocratic-rationalistic style,⁴ which is precisely a style that is divorced from methodological concerns and has a decidedly “practical” orientation.

It is difficult to imagine a unified approach to styles of development which does not involve the adoption of a theoretical (and value-oriented) position with regard to the actual process of development, i.e., with regard to the factors which generate, condition and curb its dynamism and the utilization of its results. The adoption of such a position, whether explicitly or implicitly, is inevitable, and since this is so, it seems reasonable to adopt it and formulate it explicitly, both because the ideas are clarified and obvious confusion is avoided in this manner, and also because, with a clearer understanding, more rational and efficient instruments can be forged with which to act on development.

One noteworthy feature of the literature on a unified approach and on styles of development is that there is rarely any attempt to explain the development process or to make a critical analysis of the economic, social, cultural and other theories which provide partial and segmentary explanations of development and seem to be in the process of being refuted. In reality, the whole unified approach movement is, on the one hand, a reaction against the predominance in development thinking and action of theories based exclusively on economic assumptions, which came to the fore in the years immediately following the Second World War, while on the other hand it is also a reaction against disciplinary segmentation (as already noted), and no less so —although without saying so in as many words— against the wide variety of ideological approaches and concepts of development.

Criticisms of exclusively economic theoretical interpretations of growth were already in vogue in the mid-1950s and have become particularly sharp since then, to the extent that they have led to changes in development strategies and policies. This is evident from the attempts to integrate the so-called “social aspects” into the main body of development doctrines. The original concept of social aspects was extremely limited and included only education, health, housing and nutrition. Some time was to pass before it was admitted —and then only to a limited degree— that certain social dimensions not previously considered, such as the social classes, power relations, and the political nature of the State, are of fundamental importance in the orientation of development strategies, especially in Latin America. From that moment onwards, concepts such as political development models or styles began to be used, together with other terms such as “system”, “pattern” and “profile”, which indicate a more comprehensive, synthetic and dynamic approach while bringing in new elements which were neither clearly expressed nor taken into account previously.

⁴ See, M. Wolfe, *Approaches to development: Who is approaching what?*, op. cit., p. 45.

There is no point in investigating the origin and evolution of the broad vocabulary in use, nor how the transitions which led to an ever broader idea of development came about, because we are concerned with a different problem. However, it is not out of place to say that the transition has in some cases been so rapid that it has led to the other extreme, and instead of the economists specific and restricted formulas whereby growth was dependent on the rate of investment and the capital-output ratio, the formulas in use now are so general and abstract that they have barely any specific meaning or practical application. For example, the statement that development is conceived as an overall process of interrelated societal changes is, by its very nature and vagueness, beyond discussion and could be accepted by the most antagonistic and opposite theoretical and ideological currents. However, if the meaning of some of the individual terms used had to be defined —for example, the concepts of “change”, “overall process” and “interrelation”—, it is quite possible that such agreement would rapidly disappear, to be replaced by theoretical differences with regard to other questions (for example, how the change comes about, what overall process means and, lastly, whether the interrelationship is symmetrical or asymmetrical in terms of the circulation and transfer of resources and power).

What still further impedes a clear understanding of the idea of styles of development is the wide range of adjectival phrases applied to the styles for want of a theoretical definition, thus giving them a variety of meanings.⁵

The use of adjectives is neither a substitute for theory, nor is it a good way of identifying problems and their specific objects or distinguishing clearly between the levels of analysis to which they relate. The question that must be asked, then, is what relationship there is between the styles and other concepts from the theoretical arsenal of the social sciences with varying degrees of abstraction such as system, structure, regime, process, strategy, etc.

In other words, to what level of analysis and theoretical structure does the concept belong? There are practical reasons for this concern, since the concept of style sometimes seems to correspond to that of system, while at other times it is much less general and can perfectly well be taken to mean strategy. Thus, when reference is made in general to the *prevailing* styles of development, this would appear to mean capitalism, which is a historical system in the current nomenclature of the social sciences. On the other hand, a reference to “national style”, with a specific sense, cannot mean capitalism because it would be inaccurate, and this is also true in the case of “current” style or “viable” and “acceptable” styles of development, all of which are closer to strategies. I have doubts about the heuristic usefulness of a concept which becomes a kind of potpourri since it is applied at so many levels of analysis with so many different meanings; so that the central idea is difficult to grasp and lacks an explicit theoretical reference.

It may be useful here to revert to a problem referral to briefly above, which is connected less with partial disciplinary approaches and much more with the evolution of concepts and the area covered by the various terms used by development analysts. Until comparatively recently, economists and international agencies spoke of development strategies or policies in referring to fairly rational, coherent and integrated sets of measures for the promotion of growth (or development), which were considered to form groups relatively independent of the sources from which they originated and vaguely linked with the non-economic conditions in which development was taking place. That is to say, the old division between the State and the

⁵ For example, one of the studies on the unified approach project refers to the following types of styles: “value-oriented” and “eventual value-oriented styles”; “current world styles”, “national” and “viable national styles”; “politically possible”, “conventional”, “preferred” and “prevailing style”; “original”, “radically original”, “innovative style” and “new style” (with respect to Cuba); and, lastly, “styles of polarized development”. There may be more and further contributions to this repertory of terms which may be found in other studies. In any case, it is my impression that their number does nothing to clarify the concept of style, even if it is felt that there is no difficulty in understanding such a phrase as a conventionally-defined style of development. What does “conventionally-defined style of development” mean? To what conventions does it refer, who imposes them and how, etc.? It is obvious in any case that development styles are not “spontaneously generated” nor are they distinguished by the qualifying terms applied to them.

economy was maintained, and the power components were dissociated from the development process and kept as constants. The State thus appeared as a relatively immutable entity that acted as a generating source of economic policies which could change without altering the nature of the State or its relations with society.

This approach had some advantages since, besides being simple, it enabled the economists to keep comfortably to an intellectual plane dominated by their own discipline. This position could not be sustained when, first on distinguishing between growth and development and later on incorporating the “social aspects” in the analysis, the demands for broader theoretical perspectives made themselves vigorously felt: so much so that in response to these demands other significant elements were added which had appeared only marginally in the previous analytical schemes. These were the international “system”, historical trends and national structures which, together with the specific and concrete circumstances of the various regions and countries, determined their possibilities of development.

The next move was to pass on from the idea of strategies and policies to other more expressive types of concepts which would take into account the new “social” concept of development. The solution adopted to this end consisted largely of the addition of new elements, which led to the complete reformulation of existing ideas. The economic policies and strategies (conceived always in a strictly limited neoclassic or neo-Keynesian context) were complemented with other elements, but what was basically incorporated was the dimension of the power of the State in the limited sense of a generating source of economic growth policies. For this purpose concepts were borrowed from other social disciplines, mainly sociology and political science, where there had long been discussion of political and social models or styles. These possessed some of the integrative characteristics sought, but were nevertheless charged with connotations it was desired to avoid, or at least leave aside. In order to adapt them to the aseptic and bureaucratic language of the international agencies, the political models or styles were rephrased and the obviously political connotations which many of them possessed were eliminated. The popular belief that if the symptoms are removed there is no longer any need to worry about the sickness itself did not work in this case. The differences disappeared from view, but their sources did not disappear. What role does power play in development? Who are the ones who possess power, what kind of power, how do they mobilize it, to fulfil what objectives, and to serve what interests? How is the concept of power incorporated in the whole theme of strategies and policies, and what theoretical meaning is ascribed to it?

This brings us to a crossroad with, on the one hand, the problem of power (what person or persons have power and how do they use it?) and, on the other, that of the generation of change or development (what person or persons promote change and with what purpose?). Although established power is generally conservative, so in various respects is the idea of development when, for example, its “prevailing”, “dominant”, “current”, “real” or “conventional” forms are referred to. In the concept of styles, the concurrence of power and development has to do with the generation of the latter, which is assumed to be promoted by one or more determinable sources of power. If this reasoning were correct, the logical question would be: what is that source of power, how does it operate and in what direction?

This brings us close to the philosophy of history. I shall avoid digressing on the movement and sense of history, however. Although our own concern is more mundane, it is worth mentioning that the division which was first pointed out centuries ago is as clear as ever: on the one hand there are those who feel that trust should be placed in individuals who have been “enlightened” (by God, Reason, an Idea or History), in great personalities and in key groups; while at the other extreme it is felt that an answer to the question can be found only by observing the historical-structural dynamisms of the economic and social bases and the development of the productive forces.

The first position corresponds to the postulation of “development agents”, and the problem becomes that of finding out and identifying the kind of persons or groups that carry out this task and the manner in which they promote development. For years the main concern in Latin American social science was precisely this: to locate the *deus ex machina*, seeking among Schumpeterian entrepreneurs or in the middle classes the existence of a national bourgeoisie with a hegemonic vocation and the capacity to promote modernization after the style of the central capitalist countries. The modernization theories follow these analytical lines.

A theoretical approach of this kind is “action-oriented” when it emphasizes the position of the actors (development agents) as the dynamic elements in a process aimed at fulfilling certain objectives defined by them, in specific circumstances and with limited resources. Structure and history may come to have only secondary importance, if any, in such an approach, which to a great extent is ahistorical. In this approach there is a voluntaristic component, often indicated in the past, which emphasizes the fact that social situations and processes do not have determining influence. Of course, history and structure do enter into this analytical context, but only as a distant backdrop which sets the stage but does not restrict the autonomy of the actors as central personages in the drama of development.

The essential problem is to determine first *how far* and then *in what manner* the historical-structural trends are incorporated in the development analysis scheme with respect to the actor-agents. It is precisely at this point that differences of opinion arise regarding the interpretation of the force of historical factors in social change (or in development).

At all events, the nature of a style of development depends in this approach both on the quality and on the guiding principles and aims of the “agents” —which use certain means to pursue a number of objectives— and also on the acceptance (consensus) they win for their strategies. Hence, the style’s “viability” depends on the social forces it can mobilize to overcome obstacles and resistance to its implementation or continuity.

There are, however, some methodological problems as regards the manner of inserting the concept of viability into this context and the meaning ascribed to it. The idea of *viability*, as used in the context of the unified approach project, gives rise to some difficulties when an attempt is made to reconcile it with so flexible a process as development. It is sometimes my impression that the dynamic elements involved in this idea of viability are not properly defined, since it appears rather as a static concept. Viability is closely linked with the available *means* for achieving the objectives of a development strategy, which will come up against resistance and conflicts that will modify its course. The viability of a development process would therefore be bound to undergo changes whenever the conditions of the process altered. The notion as to what the *means* are is of fundamental importance in order to understand their role in the formation and operation of the styles. As always, there are various alternative ways of analysing this question. If the means are considered not to be variables, the possibilities of a style persisting (its viability) will depend on the continuity of the existing historical conditions, and its adaptability to change will certainly be limited by the rigidity of the means.

It would be quite a different matter if the concept of viability were considered in a more dynamic context and the means were taken as a group of instrumental resources closely linked with the objectives but not exclusively dependent on them. The nature of the means would determine the possibilities of a style, but once this was established, and whenever necessary and possible, it could reformulate them, creating new means more flexibly adapted to the evolving historical and social circumstances. The advantage of this approach is that it makes the definition of means more flexible. Under this approach styles would be less dependent on the definition given, since they could partly recreate their own means.

This reasoning has its limits, however. The most important of these is the idea of *contradiction*, which stems from the lack of complete convergence between means and objectives. In such a case, the gap may tend to widen in the course of time, with the result that the style would eventually decline and be overtaken and replaced by another. This point will be referred to again later.

The problem of how to start from a correct theoretical approach is not solved by allocating the dynamics of development to the agents and attempting some classification of them without indicating what possibilities they have of exerting decisive influence or defining the strategies ascribed to them. Strictly speaking, the question is none other than finding out which are the key agents, i.e., *identifying* them so as to determine the values, interests and capacities with which they will define and impose the development strategies they support and promote. The following questions then become almost unnecessary: How can the real agents be identified from among the many possible potential agents to be found in any society? What are their special characteristics: how can it be determined whether they are more capable or “strategic” than others, whether they have the necessary consensus (and coercive force) to impose their objectives in the face of the resistance they will inevitably encounter? What guarantee is there that their style is more acceptable than any of the other available in the “styles market” at any given time?

We are once again confronted by the theoretical and methodological problem indicated at the outset, for which there are few useful guidelines. Short of suggesting that the events are decided by historical chance, it is clearly necessary to have a theory which, besides affirming that all the existing agents (and the lists are long) are equally potential candidates for hegemonic power, maintains that among them one or more are “more equal than others” as in Orwell’s fantasy.

This type of approach almost inevitably brings us to another question: What relationship is there between the agents and the power elites? I believe that the idea of agents is only meaningful if it is admitted that they and the power elites are one and the same thing (or very similar). If that is so, the crux of the problem is to establish first who they are, and then the kind and quantity of power resources they possess and how they are utilized. The State seems to be the main supporting basis for the agents and power elites, and they promote their policies from it, although this may not be explicit. Notwithstanding its central importance when discussing a concept of “agent-promoted” development, very little is done in the unified approach project to distinguish the features and functions of the State, that is, its nature as an instrument of power and an economic agent under different styles of development involving different agents which have succeeded in imposing their hegemony and promoting development strategies pursuing their objectives and interests. Some provisional studies in the unified approach project analyse the problem of social and political structures within the context of development, but the analysis centres more on *nation-building*, on a very general scale as yet, without there really being an explicit concept of power in development. Be that as it may, these studies offer promising prospects for the future exploration of this important aspect.

Accordingly, what ought to be the focal point of this type of action-oriented approach is rather the concept of the role played by power in development, because the agents, in order to be effective and to be able to make their styles viable, must necessarily be a power elite, a dominating group, coalition or class, an “Establishment”, or some other similar entity which controls the State apparatus. It seems essential, therefore, to endeavour to build up a suitable methodological approach recognizing the factors determining the agents’ position of power and the autonomy ascribed to them in the specific context of a nation-State and at a given point in time. This is a necessary requisite if any progress is to be made towards an explanation of the styles and their acceptability and viability in the development process.

This problem cannot be solved, however, without first finding an answer to some other questions: What are the structural and ideological factors that generate the central forces of the development process? Who stimulates and guides it? Towards what viable objectives and goals, with what means and resources, in the face of what conflicts, and for the benefit of whom? In the following pages some exploratory suggestions are put forward in this connexion.

III. NEW FORMULATIONS OF SOME FUNDAMENTAL PROBLEM

It seems clear that in turning from consideration of development strategies and policies to consideration of styles of development there is a qualitative jump which is not always fully recognized. Previously the central problem was more limited and more concrete, since only strategies and policies were involved. It was above all a question of understanding the mechanisms for stimulating economic growth and its main short-term targets, within a limited historico-social framework determined by constant structural parameters. This intellectual and practical position has recently been labelled "developmentism".

With the inclusion of the idea of styles and models, there is a considerable, largely qualitative change in the intellectual goal. The object now is nothing less than to embrace the entire development process in a broad and comprehensive intellectual framework so as to be able to view the constellation of its circumstances and elements suitably integrated in a theoretical scheme. Such a theory should explain how a specific society is mobilized and uses its resources to attain not only economic growth but also other goals which are permanent human values (human rights, personality development, creativity, social justice and equity, individual and family welfare, conservation of the environment, etc.). This is the position of the United Nations, and it is the task facing those who must define what development styles are.

Some authors maintain that in Latin America there are currently two polarized types of development which are so opposed that their features may be considered as corresponding to different economic and social systems. They delimit what appear to be the "objective possibilities" or real alternatives existing at present in the region.

The first has been called the "associated development model", thereby stressing its dependent relationship with the central capitalist countries and their big transnational corporations. In this model, the power structure consists of a coalition primarily composed of a civil and military techno-bureaucracy which controls the State apparatus in association with the large national and foreign companies, which occupy a dominant position in the modern sector and consequently in the whole economy. A variety of upper middle level groups, including middle-level businessmen, top executive and professional people, also participate in the coalition, although in a somewhat accessory capacity. The political style is generally authoritarian and demobilizing, since the "hibernation" of the mass of the people is promoted through the disarticulation of their autonomous political and social organizations. Open dissent is directly repressed. The central economic objective is accelerated economic growth, for which all available resources are articulated and mobilized so as to maximize capital formation and the profitability of companies, attract foreign investment and contain the wage and distribution pressures of the large groups which are left behind in a process involving high income concentration. The long-term political objective in "national greatness", and many social goals which, in another perspective, would deserve more immediate attention, are subordinated to this.

The central objective of the type of development at the other pole is "social development" or "popular participation", which is given priority over economic growth. A monolithic and

authoritarian State, without political pluralism, is the nucleus of this development style and is also the main motive force (at least in the initial stages). Mass participation is widespread and increasingly equalitarian in production, consumption and income distribution. The formula for economic and social organization may be either State capitalism or socialism in the strict sense.⁶

Anibal Pinto has adopted a somewhat different approach in drawing attention to some dynamic factors of a “scheme of supply and distribution”, in which particular importance is attached to the question of “for whom” in the definition of what he calls a “political style of development”. His approach is nevertheless more economic than political because of the emphasis placed on the central importance of the concept of income distribution in the definition of the “scheme” and because of the other factors taken into account, as will be seen below.

The *most relevant dynamic factors* of the model mentioned by this author are contained in the following questions:

- (c) What are the nature and origin of the *main stimulus to demand* (external or domestic demand, its volume, and degree of diversification)? This is related to income distribution and its tendencies towards concentration (the groups which accumulate more and those which accumulate less), as regards its influence on the structure of demand.
- (d) *What is the key production sector?* In other words, what is the “spearhead” sector which imparts orientation and dynamism to the productive system and the supply of goods? How is the latter structured?⁷
- (e) What is the *main structural contradiction* (or predominant structural feature) *of the dynamics of the economy*? The idea here is to locate the main source of economic conflict, which is also the fundamental key for estimating the possibilities of continuity and future economic viability of the style.

The author goes on to state that there are two main “motive forces” which may act jointly or exclusively: (a) an ideology fostered by the State and a political apparatus; (b) nationalism .

This scheme has a number of features which appear to me to be of great importance: in the first place, because the dynamic character of the model stems from both the nature of the factors chosen and the manner in which they are conceived, and because it is situated in a historical framework of well-defined phases; secondly, because of the incorporation of political variables; and finally because of the significance attached to the concept of contradiction, which rapidly leads to a more general idea of conflict transcending the economic dimension.

Consideration of the problem of models constitutes a positive contribution inasmuch as they represent, albeit from differing points of view, an attempt to provide a theoretical framework for the problems of Latin American development, using national societies at a specific historical moment as a reference.

From a methodological point of view, this theoretical scheme goes well beyond what we have so far been considering under the heading of styles of development. The two types outlined do not fit easily within the same economic and social system (capitalism or socialism), which is one of the prerequisites of the idea of styles, viewed here as variations of intra-systematic historical configurations. They are, however, useful because they are concrete and also because they relate very closely to the concerns underlying the analysis of styles.

⁶ Various sources may be consulted on these models, including F. H. Cardoso, *O Modelo Político Brasileiro*, (Sao Paulo, Difusao Européia do Livro, 1972), chapter 3; and J. Cotler, *Unified Approach to Development Analysis and Planning, Case Study: Peru* (United Nations, UNRISD/72/C.69, August 1972).

⁷ See A. Pinto, “El modelo político latinoamericano”, in *Política y desarrollo*, Editorial Universitaria, Santiago, 1968, pp. 60 *et seq.*

A problem which is no less important but naturally more formal is that of the *level of analysis*. The methodological position underlying the idea of style is rather confused, since as was shown above the term often refers to potential or concrete situations of very different scale. This is the case, for example, when reference is made to a "world" style, to a "national" style, and finally to situations whose scope is more restricted and which belong to the order of circumstantial strategies. Thus "style" appears at times to be an equivalent for "system" (capitalist, socialist), "structure" or "regime"; at other times, on the other hand, it would appear to mean something like a stage in the development process, as in the case of "outward-looking development", "import substitution" or "internationalization of the market", which might be (and have been) described as "prevailing" styles of development (economic and political).

The upshot of all this is that the problem of the relation between systems and styles, of how to relate styles to economic and social systems, still remains. If it is accepted that the latter are more general and abstract conceptions, it may perhaps be said that *a style is the specific and dynamic modality adopted by a social system within a particular context and at a particular moment in history*. It may be observed that this proposition relates to a structure (or social formation) rather than a style. However, the idea of style has a different origin, although in its present version it is somewhat akin to the concept of structure. In any event, what is signified in the idea of structure is something more static and not focused, as style is, on the development strategies and policies promoted by a political will in particular historical and structural conditions.

From this point of view, it may be supposed that a "style" is a kind of integration of development strategies with the power factors which enable them to be carried out within an economic and social system existing at a historically determined time and oriented towards certain goals. This idea of linking strategies with power in the framework of a historico-social formation should certainly not be abandoned, because it introduces a greater sense of reality into the concept of style. In my opinion, the idea of style should be an auxiliary element in concrete reflection upon national development. Inasmuch as they represent desired and perhaps potential styles, utopias are important, if they are sufficiently specific, for understanding a historical situation and its possible tendencies, but they should never be confused with the concrete styles which point more towards historically identifiable realities.

IV. SUGGESTIONS FOR A CHARACTERIZATION OF STYLES

After a summary review of the historico-concrete aspects of the concept of style, it now seems necessary to return to the problem of its dynamic content. What ultimately promotes a style? It has already been pointed out that this question leads us directly to an old controversy, stemming from the philosophy of history, which has run through the social sciences from the very beginning. At a risk of superfluity, I shall recall the two fundamental positions: there are those who postulate that the leading figures and power elites (or strategic groups) act autonomously in formulating and imposing the objectives and policies which define a style, while at the other extreme there are those who concentrate on the role of the socioeconomic structural base and the trends of historical circumstances, both internal and external, in the configuration of a development style.

These are the two extremes in the argument over the generation of styles. The complexity of the problem allows for a great variety of intermediary positions. A reasonable question which should be raised is the following: What optional styles are possible and viable, bearing in mind the historical circumstances and the structural features existing in a society which is

organized according to a specific economic and social system? In other words, what are the frameworks and sets of objectives arising from specific social class and power relationships in a society which condition the orientations and variations of its viable strategies and policies?

If it is argued that it is the agents of development or “strategic groups” which are responsible for defining and implementing a style, there would be good grounds for replying that even so they would inevitably have to act within the conditions and limits established by historico-structural parameters, and on no account in a social vacuum in which everything is possible and nothing probable. There remains another aspect of the problem: should greater importance be attached to the agents or to the historico-structural processes of development? This opens the way for an essentially mistaken theoretical and ideological argument if stated antinomically, since neither agents nor structural processes can be understood in isolation. Their relationship is basically dialectical, and it is only in the framework of the whole made up of the two of them that is possible correctly to state the dilemma in which, without good reason, they are opposed.

Still at the risk of repetition, it should be made quite clear that the concrete, real style is always one of a number of historically possible and potentially viable alternatives. The choice and implementation of one of the possible alternatives is a political act, the decision of a political will formed by the dominant coalition of groups which represent social forces with sufficient power to be able to impose their choice over the other options. In sum, the style is a product neither of chance nor of the “logic of history” nor yet of “structural conditioning” working blindly and inexorably. This is because it has flesh and blood (individuals and groups), as well as a social and political will which acts in a specific historical dimension and is guided by ideologies. The importance of individuals and groups, their lives and needs, goes beyond their status of “supporters of the structure” and mere passive agents of history. In turn, both history and structure are more than frameworks which condition the set of alternatives, because —and this must be repeated— in a national situation which is historically concrete and conditioned, there is always more than one possible choice.

What makes any one of these choices viable is the emergence of a dominant class or coalition, the agent of development of the hour which will have to confront and impose itself upon other groups with conflicting interests and overcome real contradictions which stand in the way of harmonizing and carrying out its social project. Hence the central importance of conflict as an attribute of a style. What kind of structural conflict typifies it? Between whom and over what? What are the real objectives and the concrete consequences of a style, which become sources of conflicts? To answer these questions it is necessary to define largely what the nucleus of a style is, what gives it its main direction.⁸

How can development be approached as a whole, and the fragmentary and often conflicting approaches of different disciplines be overcome? What kind of synthesis is a style? What is its essential content? The opposition between economic and social development was not exclusively the consequence of the division between economics and sociology as separate disciplines. It was also connected with a broad ideological spectrum ranging from the “economists” position of those who thought that economic growth would necessarily produce economic modernization and, by its mere presence, the transformation and development of society, to those at the other extreme who believed that both economic growth and social development

⁸ The idea of “contradiction”, in the sense of a style’s lack of consistency, may be a mere problem of logical incoherence or it may be a symptom of ideological incoherence reflecting one or more latent, underlying conflicts which make it impossible to attain a satisfactory level of agreement among the various policies and objectives. The need to reach a political compromise by conciliating opposing interests makes it difficult, if not impossible, for policies and their goals to be completely compatible. In our opinion, however, this does not imply that a style does not exist, since style does not depend —as will be seen— upon internal consistency, but on the contrary is identified by its structural tensions and conflictual confrontations, by which its real nature as a historical entity may be distinguished.

represented successive stages or phases, and that the latter could only be achieved after and on the basis of the advance of the former. A different opposition is to be found in the "political science" or "sociological" view upheld by those who believe that political development (or political revolution) must necessarily precede any economic and social transformation, or by the partisans of progressive but gradual social reform, or even progressive conservatism.

Discussion has now moved to the problem of income distribution. On this subject there are many who defend the view that it is imperative for growth to be consistent with increasingly equitable distribution. They are opposed by those who argue the contrary, i.e., that it is first necessary to enlarge the cake before sharing it out and that it is impossible to do both at once.

It is clear that this is not merely a formal problem, since it is of considerable relevance to the economic and social conflicts and struggles which, as stated earlier, are the nucleus of styles. Perhaps nothing helps to identify more clearly the internal contradictions of a real style than the fundamental conflicts which arise in the implementation of its strategies. It does not matter whether these conflicts are latent or open, so long as they relate to the main objectives. *In order to characterize the situations which typify a style, it is of the greatest importance to know the sources of conflicts which are reflected in the confrontations of incompatible or irreconcilable interest, in social differentiation which are neither legitimized nor institutionalized, and in the contradictions at the heart of the fundamental social processes.*

The sources of conflict are not always the same, nor do their original potentially or actually antagonistic positions and attributes remain constant. The key questions therefore appear to be the following: What are the problems facing a development strategy and what are the requirements for overcoming them? Who wins and who loses (workers, businessmen, the military, technocrats, national or foreign capitalists)? What is transferred among them (wealth, income, power, prestige, education, etc.)? Does growth tend towards increased concentration or conversely towards increasingly equitable decentralization? Where are the important decisions taken, who takes part in them and how? From what source and by what institutional means is the current development strategy promoted?

These questions barely do more than illustrate the type of problem to which priority must be given in the conceptualization of styles. The social sciences (and those who make use of them: technocrats and planners) must be in a position to anticipate and foresee both the stability and continuity of a style as well as its crises and final collapse. In a sense, the stability and continuity of a style is little more than the neutralization, postponement or overcoming of its basic crises and conflicts. *From a dynamic and integrated viewpoint, a development style is therefore a dialectical process involving power relations and conflicts between social groups and classes, which arise from the dominant forms of capital accumulation, the structure and trends of income distribution, historical circumstances and foreign dependence, as well as from values and ideologies.* All this takes place among other types of structural conditioning (technology, natural resources, population) which must be analysed as an integrated whole delimiting the historical possibilities of a style.

In another sense, *a style is the strategy of a coalition of social forces which impose their objectives and interests until it comes to an end as a result of its implicit contradictions.* A historically outdated style is replaced by another, which better reflects the new social forces emerging from the process and the alliances and conflicts which arise between some of its components when they have accumulated sufficient power resources to constitute a dominant coalition capable of formulating and carrying out new projects and objectives more attuned to their interests. It should be noted, however, that the succession of styles does not entail discontinuity of the existing social system, but rather may merely reflect different combinations and arrangements of its basic constitutive elements.

Although they are used in different contexts with varying abstract and concrete meanings, when styles and models refer to real configurations they have a very close relationship —perhaps of dependency— with the particular existing form of power and with the orientations of the dominant groups. *However, it is not always possible to infer from them with mathematical precision what type of development strategy they will put into effect.*⁹ Nevertheless, in a more specific sense, real (or dominant) styles or models consist essentially —as was pointed out above— of development policies in action, together with the contradictions and conflicts which are being produced deliberately or not.

In this dialectical context particular importance must be attached to the *position and role of the State*, its organization and essential functions, and the position of the groups or elites which predominate within it and attempt to establish or maintain a given style of development. Obviously, the strategy of a style arises (and is carried out) within the framework of the conditions and in the midst of the conflicts which make up its historico-structural possibilities, since they delimit the objectives, means and resources which may be used and the interests and objectives which will benefit.

In Latin America, the national State is an essential part of the machinery which promotes development and contributes to the definition of the dominant style: indeed, it is even more essential than in the “countries of original capitalist development”.¹⁰

Because of this special feature, it may acquire a pre-eminent position which allows it some autonomy, in establishing its policies, with regard to the claims of its dominant groups. This may be explained by the transfer of power to the State as the highest political institution, power which is largely appropriated by the various technocracies which plan and execute its strategies. Thus, the national State and its strategies must be regarded as the context within which styles acquire concrete meaning and historical dimensions.

There remains for our consideration the “unified approach” to development styles. It has by no means been forgotten, and much of the foregoing should perhaps be viewed as a contribution —sometimes tangential, sometimes more direct— to the discussion of this problem, focused on the possibility of integrating viewpoints and conceptions on development. The unified approach is an attempt to go beyond the interpretations which have hitherto been dispersed in a multiplicity of fragmentary, unrelated approaches, largely as a result of the disciplinary “diaspora” and different ideologies and values.

Our small contribution here is perhaps limited to indicating some of the main difficulties of the problem. In the first place it must be pointed out that a “unified approach” involves a number of interrelated aspects and levels, in the field of practical action and integrated planning, methodological and theoretical questions and —equally important— in the field of value judgements, ranging from basic assumptions about society and social justice to more specific positions on ends and means, the particular combination of which constitutes the substance of the ruling development style.

In a similar vein, it may be suggested that there are three facets to the problem: the pragmatic, involving the planning of development policies; the epistemological, stemming from differentiation among disciplines; and the ideological, focusing on the question of ideologies and social values.

⁹ Here it is a question of *conditioning and not determination*. We emphatically reject any mechanistic causal link between the “historico-structural situation” and the filiation and nature of a style. The future, far from being predetermined, is open and may follow courses which are difficult to predict, *but remain within certain historical bounds which delimit what is circumstantially possible*. In this sense, the social system functions as a historical matrix which conditions the diverse elements of “the possible”, reducing the alternatives to those which are compatible with its continuity (although *not* with its immutability).

¹⁰ See M. Kaplan, *Formación del estado nacional en América Latina* (Santiago, Editorial Universitaria, 1969), *passim*.

In fact, the gordian knot of the unified approach lies in the need for thought and action regarding development to be reasonably integrated. What is really being integrated in a unified approach to development? It must be, without any doubt, the conception of development, because this alone is a conceptual construct and therefore an ideal entity which provides a compact overall view of a multitude of partial processes. The real processes are the social situations and actions, as well as the policies which promote and orient development, and they are what may be more or less unified on the basis of that conception.

This is one level of reality. At the other are the states of mind and thoughts of individuals, their perception of their interests and values, which is what orients and conditions their attitudes to development. The predominant tendency at this level is towards the interest-based evaluation and, consequently, the ideological judgement of the orientations and consequences of development.

A unified approach should, strictly speaking, begin by integrating these two levels, which would require a relatively high degree of complementarity and correspondence between social awareness and political action. There are many interactions between the two levels, but what is vital in order to build a bridge to link them globally is a concept of development which ultimately can only be ideological. It seems impossible to avoid the need for a value base linked to the existential situation, whose function is to integrate individual awareness and social action around the only thing which can unite them, namely, a coherent collection of values professed and carried out by collectivities which represent the dominant social forces.

Politics reappears here as a central component of any conception of styles of development. The values may vary, but styles must distinguish and decide as regards how much, how, what and for whom, since these are the alternatives normally facing a development process and the choice rests with the political order. The function of choosing between them is institutionalized, and it is the business of the political apparatus, more than of any other institutional order, to choose the direction of development and promote progress along the chosen path.

V. GUIDELINES FOR THE IDENTIFICATION OF A “CONCRETE” DEVELOPMENT STYLE

By way of summing up, some guidelines are provisionally suggested for identifying the nature and basic elements of a real (actual, dominant, prevailing, etc.) style, using a historico-structural perspective which differs from the approach emphasizing the role of agents of development. They are as follows:

- (a) A real style, from this point of view, is not merely one or more strategies of development (plans, programmes, etc.) with a more or less coherent collection of policies and with instruments and objectives which are legally sanctioned by the State and promoted by some “agents of development”. Over and above all this, it is what emerges from political and social practice, as a result of the inevitably conflictual confrontation between that strategy and the other possible (and sometimes partially or potentially feasible) alternatives guided by the pressures of the non-beneficiary sectors or groups and of those who are definitely harmed or are for some reason in opposition to the current style.
- (b) There are a number of fundamental elements in an analysis of this type: (i) the State, as the source which generates policies, and the political regime (dominant coalition plus political resources) which formulates (or chooses) the style and promotes it in an attempt to impose it on society through a strategy whose policies, both in means and objectives, are supposedly appropriate; (ii) the different social groups and classes

which have power resources, promote their interests and propose alternative policies; (iii) the conflicts which stem from the incompatible (or irreconcilable) aspirations of the various groups either within or outside the circles of political power and of State administration, whose claims, divergences and antagonisms increase or restrict the possibilities of carrying out the current development strategy; (iv) the structural features, ideological frameworks and historico-social circumstances and trends which limit the possible objectives and condition the rules of the game; (v) the possibilities of legitimizing a style through varying combinations of consensus and coercion. In other words, this emphasizes the nature of the support which the style receives and the degree of participation in it by the majority groups and the "power factors".

- (c) Among the *conditioning* elements the following appear to be fundamental: (i) the geographical size, population and natural resource endowment of a country; (ii) the level and trend of technological change and (iii) the combination of international economic and political circumstances and the way and extent they influence the structure and dynamics of a country's economic and political life.
- (d) Finally, there remains to be defined what may be considered *the direction* of the main movement of a style. What identifies it as definite style and how is it distinguished from other actual or possible styles? What is a style's central project? What national and group interests are promoted, what conflicts emerge and what resources (how much and in what way) are used first to impose the style and then to implement and maintain it? Who wins and who loses? All the above elements are significant for this diagnosis, to an extent which varies according to their nature and circumstances, on condition that after they are identified an intellectual effort is made to synthesize them, bringing out what is essential About them as a whole. In some cases a style may centre upon an overt "national project", which may be the ideal of "national greatness and power", "freedom from foreign dependence", the creation of a new equalitarian style of social life, the imposition of "savage" capitalism to provide the greatest possible stimulus to economic growth and maintain a hegemonistic regime, or "national integration".

Whatever its nature, a national project of this kind contains all the elements indicated above. In addition to being a national undertaking, it is a hegemonistic project on the part of certain social sectors and classes, which define it (and also the style) in a way which agrees with their particular interests and in accordance with a specific form of insertion into the international order. The analysis of it may therefore be a starting point from which to discover the degree to which it has an integrating effect on the strategies devised and carried out by the State and other power centres, as well as to identify the possible main direction of the style, i.e., what the fundamental objectives of its long-term strategies may be, taking into account its concrete possibilities at the internal and international levels.

Without wishing to exaggerate the significance of the distant future for present circumstances, I believe that it is in the convergence of both, in the influence of long-term demands on the here and now, that the answer must be sought to the elusive problem of the connexion between time in the intellectual formulation of a style.

APPROACHES TO DEVELOPMENT: WHO IS APPROACHING WHAT? *

Marshall Wolfe

* Selected pages (131 - 151 and 160 - 172) in CEPAL Review, No. 1, Santiago, ECLAC, first semester 1976. United Nations publication, Sales No. S76.II.G.2.

I. “DEVELOPMENT” UNDER QUESTION: THE FEASIBILITY OF NATIONAL CHOICE BETWEEN ALTERNATIVE STYLES

International discourse since the 1940s has postulated that the term “development” refers to an intelligible process that can be furthered by rational action within the framework of nation-States—that is, by “planning”. The participants in the discourse have disagreed radically with one another concerning the nature of the national and international orders within which development is to take place, in their evaluations of what is happening, and in their prescriptions for action. Variants on the vision of linear, progress, according to which the “developed” countries have both the capacity and the duty to help others follow in their own path, have continually clashed with variants on the vision of societal transformation, according to which the development of poor countries requires *inter alia* liberation from exploitative relationships that have made the “developed” countries rich and dominant. Nevertheless, arguments have proceeded within an implicit consensus that there can be only one kind of development: a process with certain societal preconditions, going through predictable stages, requiring accelerated capital accumulation and technological-entrepreneurial innovation, leading to the formation of national societies and economies predominantly urban and industrial, imbued with “modern” attitudes towards the world and citizenship, capable of continually rising production of goods and services and, eventually, of ample satisfaction of the consumption demands of their members. It follows that there can be only one optimal way to develop; the task, then, is to define it, diagnose the deviations from it of the society in question, and prescribe means of setting that society on the correct path.

At present, while the international machinery deriving from this interplay of conflict and consensus over development continues to ramify and the list of internationally accepted requisites for development continues to lengthen, the view of development as a uniform definable sequence to which all national societies must conform under penalty of remaining poor and backward is being challenged from many different theoretical, ideological and valorative positions. Some critics question whether “development” is a meaningful concept and trace it to an ethnocentric supposition of the duplicability of the experience of a few “Western” societies during a certain period of history, or to a misleading analogy, deeply rooted in “Western” thought, between change in societies and “development” in living organisms. For example:

“A fair amount of effort has been given to attempts at definition as well as to the argument that development ‘in general’ or ‘as such’ is a proper or sufficient goal of national and international activity. But it is insufficiently pondered how strange and remarkable is our use of the term. We proceed as though ‘everyone knows’ what it means. And, to be sure, at a common-sense level everyone does... The common-sense meaning is clear: to be developed is to be Western. Or, if this seems ethnocentric, offensive, ‘modern’... The defining characteristics of modernity in the West have not been achieved by an effort, consciously and nominally, ‘to develop’. This is a *post-hoc* rationalization, a convenient fiction to give history ‘meaning’... We do not know, with anything approaching completeness and certainty, how to make a pre-modern State modern... Even if we had such knowledge, it would not solve the problem of development if this is conceived as achievement of a certain set of now-known, defining characteristics which, if achieved, would make all nations ‘developed’. For the most highly developed nations are in a period of rapid transformation... When developing countries seek to become developed through the use of administrative means currently favoured in industrialized countries, they will, if successful, be re-creating ‘vanished civilizations’... The present enthusiasm

for development is a wondrous thing: everyone is for it, but what it is —other than a transient pattern— is open-ended, baffling”.¹

“The more concrete, empirical, and behavioural our subject matter, the less the applicability to it of the theory of development and its several conceptual elements. It is tempting enough to apply these elements to the constructed entities which abound in Western social thought: to civilization as a whole, to mankind, to total society; to such entities as capitalism, democracy, and culture... Having endowed one or other of these with life through the familiar process of reification, it is but a short step to further endowment with growth... It is something else entirely, however, when we try, as much social theory at present is trying, to impose these concepts of developmentalism upon, not constructed entities but the kind of subject matter that has become basic in the social sciences today: *the social behaviour of human beings in specific areas and within finite limits of time*... The model of Western Europe and its seeming direction of social change during the past half-dozen centuries... is made the trend of social change for all human civilization and, as countless studies of the so-called modernizing nations suggest, the stereotype for their individual analysis —and also their reconstruction”.²

The dismissal of “development” as an updated version of the “Western” myth of progress naturally cannot satisfy political leaders and ideologists who start from the premise that the present situation and future prospects of their societies are unacceptable, however congenial they may find the discrediting of “Western” models. Rational action based on a valid interpretation of the society in question and aimed at a preferable future must be possible. If “development” as previously conceived is unattainable, undesirable, or meaningless for the society, then “true” development must mean something else. “Development” becomes a path to be chosen by each national society on the basis of its values rather than a mould to be imposed on it. The undercurrents of voluntarism in developmental discourse continually reappear in differing forms in response to political demands. Several related questions then come to the fore: Can “development” mean anything anyone wants it to mean? Do all of the national societies now on the world stage have the capacity as well as the right to “develop”? Can a society or agents acting in the name of a society choose images of the future different from those hitherto current, unconstrained by the society’s past and present, and convert these images into reality through rational action? Under what conditions? If it is granted that development can and should mean different things for different societies and that the attainment of viable and acceptable national style of development³ depends as much on political will as on economic and cultural preconditions, what is the relevance of international prescriptions laying down what “development” should be?

In the International Development Strategy adopted by the General Assembly in 1970 and in numerous other declarations within the framework of the United Nations, Governments have agreed on utopian-normative standards for development that have not been met convincingly

¹ Dwight Waldo, “Reflexions on Public Administration and National Development”, *International Social Science Journal*, XXI, 2, 1969.

² Robert A. Nesbit, *Social Change and History: Aspects of the Western Theory of Development* (Oxford University Press, London, 1969).

³ See *Report on a Unified Approach to Development Analysis and Planning*, Preliminary Report of the Secretary-General (E/CN.5/477, 25 October 1972) which distinguishes between the “real style of development” of a national society (that is, what is actually happening, on the supposition that no society is static), and “preferred styles” (that is, what certain forces in the society want to happen). It is assumed that several preferred styles will normally be competing for attention within a given society and that overt preferences can mask quite different real preferences. In the present paper, the term “prevailing style” is used as equivalent to “real style”, and refers to the variants of dependent capitalism prevailing in most of Latin America. The terms “original”, “autonomous” and “value-oriented” refer to preferred styles that correspond to the criteria for styles combining “acceptability” and “viability” set forth in the “unified approach” report. “Styles of development” emanate from social systems, as conceptualizations of their processes of growth and change, and may or may not give rise to explicit strategies.

anywhere in the world and have called for studies demonstrating how to bring development processes into closer correspondence with these standards. The international declarations juxtapose and try to reconcile propositions deriving from quite different conceptions of development. The most authoritative and coherent formulation—in paragraph 18 of the International Development Strategy—contains at least three separable propositions: (i) that “the ultimate purpose of development is to provide increasing opportunities to all people for a better life”; (ii) that the more specific objectives associated with this purpose (rapid growth, structural change, more equitable distribution of income and wealth, expansion of social services, safeguarding of the environment) are “parts of the same dynamic process”, simultaneously ends and means; (iii) that it is feasible as well as desirable to move toward all objectives at the same time and in a “unified” way. The Strategy spells out the social objectives that are to be unified in a formidable list of commitments expressed in general terms; elsewhere it concentrates on the more traditional economic objective of a rate of growth in production of at least 6 per cent annually and (in relatively precise terms) on the economic requisites for attainment of this objective.

The above propositions are compatible with one another, but endorsement of any one of them does not require acceptance of all the others. The social objectives remain vulnerable to arguments that accomplishment of the “ultimate” purpose of development requires immediate concentration on rapid growth, that no society is capable of “unified” pursuit of all the other objectives set forth in the Strategy, and that governmental attempts to do so within existing political systems and resource limitations will simply paralyze the capacity—in sufficient at best—to accelerate economic growth. The economic target, for its part, is equally vulnerable to arguments that policy concentration on very high rates of economic growth unavoidably exacerbates societal tensions, heightens maldistribution of wealth and power, and distorts life styles in ways that will make the “ultimate purpose” ever harder to approach.

It is probable that international discourse concerning development will continue to vacillate between conceptions of development subject to the economic kingdom of necessity (however this may be envisaged) and conceptions of development as at least potentially a variable embodiment of societal values and choices.⁴ Experiences up to the present strengthen the negative sides of both the arguments summarized above: the real processes of “development” are not incontrovertibly enhancing human welfare even in the high-income countries and their long-term viability is in doubt, while the attempts to formulate and apply original, autonomous, human-oriented styles of development continue to founder in their confrontations with reality or to survive at a price that leaves their promise unfulfilled.

The present paper will explore the value-oriented propositions in the more recent international declarations as elements for a coherent reconceptualization of development and for the definition of original styles of development compatible with real national situations within the real world order. It will confront the elements with the central suppositions of development theories up to the present; with the characteristics of the world economic and political order; with the position of Latin America within this order; and with the different types of national societies and life-styles now emerging in Latin America. The exploration will treat conceptions, aspirations and societal images as capable of exerting real influence on what happens and as not entirely predetermined by economic laws or class interests, but it will avoid reifying them, or treating “development” as an ideal reality existing apart from what societies actually do, and to which they can approximate to the extent that they broaden their understanding of what it “really” is. The paper assumes that present international demands for a “unified approach

⁴ Questions of this kind, of course, were debated in Latin America as well as other parts of the world long before the term “development” became current. Most of the present arguments were paralleled in Mexico, in particular, prior to and during the Revolution. See Arnaldo Córdova, *La ideología de la revolución mexicana: Formación del nuevo régimen* (Mexico, Ediciones Era, 1973).

to development”, for “autonomous and original styles of development”, etc., derive from a justified rejection of present trends and prospects, and present a challenge to all would-be analysts and agents of development that should not be ignored or evaded. It also assumes that the expressions of this challenge are susceptible to over-generalization, evasion of the more formidable difficulties, contentment with ritualistic reiteration of good intentions, and delusions that infallible and painless solutions to all problems are somewhere waiting to be discovered. These shortcomings are associated with the extremely varied and partly incompatible pressures and preoccupations that impinge on the demands for normative approaches to the problems of development, and that can be reconciled, at the level of international discourse, only through eclectic compromise formulas. The main pressures and preoccupations can be set forth as follows:

- (a) Since the beginning of international concern over development, certain currents of opinion have concentrated on the formulation of ever more inclusive formulations of human rights, including rights to defined levels of living and social services. The proponents of human rights have dealt in absolutes: rights are the same everywhere and should be enforceable immediately, whatever the specific circumstances of the society. It follows that only one style of development is acceptable —and that must be a style very different from any of those prevailing. The standards for rights have derived mainly from the high-income industrialized countries, in which it can be assumed that material capacity for honouring of the rights is present, and in which strong political movements and pressure groups demand that they be honoured. In most of the rest of the world neither of these conditions has been present.

Governmental endorsement of rights requiring the commitment of important resources (e.g., universal education) has served partly as a symbolic substitute for action or promise of future action, and partly as a basis for demands on the high-income countries that they help finance observance of the rights they have endorsed. Development analysts and planners, for the most part, have treated the “rights” as non-binding expressions of good intentions, even when, within their own production-oriented conceptions of development, they have given high priority to improvement of education, nutrition and public health. Within national societies arguments based on “rights” that are universal in principle become weapons of different classes or groups to strengthen their claims to a larger share of public resources that cannot be stretched thin enough to satisfy all the claims.

The State confronts an incessant clamour from interest-groups and localities demanding that it “solve their problems” as a matter of right. Meanwhile, movements centering in the high-income countries continue to generate and obtain international approval for new formulations of rights, particularly in regard to public social services. The continuing confrontation of real development processes with “rights” that stand for international consensus on the content of a just social order is indispensable to the rethinking of development. However, permanent tension is to be expected between the universalistic pretensions of the rights formulations (with their derivation from certain types of societies and historical processes) and the quest for autonomous and viable styles of development under conditions in which no conceivable agents of development will be able to “take into account” all the desiderata that are thrust upon them.

- (b) The high-income industrialized societies, in both the “capitalist” and the “socialist” variants, have encountered multiple crises —of values, of resources, of capacity of their dominant forces to accomplish their declared aims, of capacity to maintain high levels of employment and consumption except at the price of inflation and environmental degradation— that have shaken their self-confidence and partly discredited them as models for “development”, “modernization”, or the “welfare State”. Their advances in planning, information systems and social science research have not saved them from

drifting to the brink of such crises, then taking action in an atmosphere of improvisation and catastrophist publicity. The question comes to the fore whether they are not as much in need of a rethinking of development as the rest of the world, and even more inhibited in making the needed changes by the expectations and institutional rigidities that derive from their past successes. In the present context, it is worth emphasizing that their special preoccupations project themselves into the discussion of new styles of development for the rest of the world through the dominance of their academic and cultural institutions, and through the extent to which their shifts in resource use, consumption patterns, environmental standards, etc., affect what can actually be done elsewhere. The problems of "post-industrial" or "post-modern" societies unavoidably become intertwined in the developmental thinking of societies that have experienced the process of "industrialization" and "modernization" only in partial and distorted forms.

- (c) The "developing" countries that have attained high rates of economic growth and "modernization" have not been able to convert these processes into generalized enhancement of welfare and societal participation. The dominant forces in some of them remain convinced that they will eventually be able to do so and that there is no other practicable path to the "provision of increasing opportunities to all people for a better life"; consequently, they feel that the discussion of different styles of development is dangerous nonsense. Their critics argue that their present patterns of growth and modernization are accompanied by increasing tensions that cannot be repressed or managed indefinitely, and point to certain countries previously held up as developmental good examples for their high rates of economic growth that have since undergone economic and political disasters. There is no way of proving that either thesis is universally sound, but at best the path of rapid, concentrated economic growth seems open only to a minority among the developing countries, and for this minority its desirability and long-term viability seem less self-evident than a few years ago.
- (d) The number of formally independent national units now on the world stage is much larger than at any time since the rise of the "modern" nation-State. Many of them are so lacking in what have been considered the basic preconditions for development, or even the basic preconditions for "national" independence, that they can only despair of matching up to the conventional development prescriptions. If they are not to resign themselves to permanent dependence on international aid combined with the proceeds of raw material exports (which may be real possibilities for some but not for others), they must seek original paths to the future. They may rely on solidarity with societies in a like position, subordinating their "national" autonomy to the formation of units large enough to be economically and politically viable, or they may move toward a closed, austere, equalitarian national life-style, excluding stimuli toward consumption levels they cannot attain. In either case, or in trying to combine the two strategies, their political leaders and ideologists find no dependable precedents or prescriptions for what they are trying to do.
- (e) Both the rich and the poor societies have awakened quite suddenly to the implications of present levels and geographical distribution of natural resources, as they interact with population and consumption growth trends. It is obvious, once the problem is stated, that the societies representing the overwhelming majority of the world's population will never be able to attain levels of per capita resource use remotely similar to those already attained by a few high-income societies in North America and in Europe. It is doubtful whether the latter societies will be able to maintain their present levels and patterns of resource use for much longer. For most of the world a viable style of development must envisage relatively modest levels of consumption of non-renewable resources, substitution of renewable for non-renewable resources wherever feasible, and adequate ecological controls to ensure that the latter really are "renewable". The probability emerges that the low-income countries will gradually

shift from maximizing exports of their non-renewable resources to husbanding these resources for their own use, in the face of increasingly desperate demands for them from the high-income countries. Paradoxically, the prospect also emerges that the low-income predominantly rural-agricultural countries will become increasingly dependent for food supplies on the high-income predominantly urban-industrial countries at a time when food production surpluses in the latter are vanishing.

- (f) The conventional international approaches have assumed that “countries” develop and that development is closely associated with processes labelled “modernization” and “nation-building”. It has been postulated that planned action at the national level to further these processes is both feasible and essential, that countries should depend on mobilization of internal resources as far as possible, but that they can rightfully and realistically demand financial and technical “co-operation” from the high-income “developed” countries. Enormous and labyrinthically complex international machinery has come into being on the basis of these suppositions. Factors such as those mentioned above, along with certain traits of the international co-operation machinery itself —the dubious applicability of many of the technical transfers, the failure of “planning” to respond to the hopes invested in it, the crippling indebtedness that has resulted from the conditions of financial transfers, etc.— have brought the basic suppositions into question. Experience has given increased plausibility to an alternative viewpoint that has been argued (in several differing versions) since the beginning of the international development effort: that autonomous development at the national level is an illusion within the present world order, that the reality is an international market system that generates “development” (by the conventional economic criterion) at one pole and “underdevelopment” or “dependent development” (in the more qualified versions) at the other, within which imitative modernization simply internalizes the patterns of dependence and “nation-building” can be no more than a facade. Under such interpretations, the phenomenon is not simply one of exploitation of poor “countries” by rich “countries”. The processes of polarization are not delimited by national frontiers, since “modernizing” interests in all countries identify themselves with the dominant centres and benefit from the system at the expense of the rest of the population. It follows that the rich countries are inherently incapable of helping others to “develop”, as long as both adhere to the market order. Some versions go farther and question whether relations between “socialist” non-market societies of the centre and the periphery could overcome polarization and dependency as long as prevailing tactics of modernization and technological transfers are perpetuated. International technical and financial co-operation, then, unavoidably conforms to the traits of the dominant world order. It necessarily strengthens the ties of dependency and helps the dominant forces in the dependent societies evade the choices and sacrifices required for “authentic” development, whether or not it brings them short-term advantages. Since the international co-operation movement represents a major intellectual and emotional investment, as well as a source of livelihood for thousands of persons skilled in manipulating developmental symbols, and since there are very few societies where the dominant forces are prepared to renounce altogether the hopes and material advantages it has offered, however disillusioned they may be with it, its present crisis contributes another current to the quest for new conceptions of development. Like development itself, if international co-operation is judged futile or deceptive in the forms it has taken then it must mean something else.

The above pressures and preoccupations, taken together, suggest that the international debate over the meaning of “development” (or some other term designating hopes for a better future, if the term “development” falls into discredit) and the tension between determinist and voluntarist-normative views, between universalist views and culturally specific views, and between revolutionary-catastrophist views and evolutionary-linear-progress views will continue

for the foreseeable future. The international impingement of basically incompatible viewpoints will continue to generate eclectic, compromise formulations of ends and means.

Each “country” by the fact of its formal independence has a recognized right to determine its own ends and means, but it cannot expect to do so with impunity if it defies the real constraints imposed by the international order and its own endowment of human and other resources. It should not expect to do so with impunity if it disregards the values of social justice, human welfare, participation and freedom on which the international community has reached a consensus. But are the “countries” real entities capable of making choices and claiming rights? Who speaks for them? Is “development”, however conceived, really uppermost in the purposes of the spokesmen and of the masses of their populations?

If the quest for original styles of development oriented towards the “ultimate purpose” set forth in the International Development Strategy is to be more than a utopian exercise, it must not only seek to demonstrate the viability and desirability of such styles, but must identify potential agents of them and propose strategies in terms intelligible to these agents. In international discourse, this is the aspect most likely to be evaded. Statements are either couched in the passive voice, or use the term “we” in a manner that suggests that their authors are certified spokesmen for public opinion in the societies striving to develop. One of the most explicit formulations in an international document up to the present affirms that: “To achieve the desired objective, more radical measures... have to be adopted. Whether they are feasible or not depends heavily on the balance of political forces in the country concerned... Unless there is sufficient political commitment to the surmounting of these constraints, efforts to combat poverty are destined to fail”.⁵

Formulations of this kind implicitly challenge the realism of most normative declarations. It is one thing to suppose that a well-meaning government is unaware of the things it ought to be doing, and quite another to suppose that it may be uninterested in or incapable of doing these things even after exhortation or scolding. If the “balance of political forces” is such that a government cannot apply the “radical measures” required for a value-oriented development strategy, what follows? One can fall back on warnings of dire consequences if the advice is not followed, as does the Committee for Development Planning document quoted above: “In mustering the political will and in organizing the required national consensus... Governments need to recognize that failing to act —or making no more than token responses to mass poverty and unemployment problems— is likely to yield even more disruptive outcomes”.⁶

These warnings have not proved convincing in the face of historical evidence that the

⁵ Committee for Development Planning, *Attack on Mass Poverty and Unemployment* (United Nations Publication, Sales No. E.72.II.A.11).

⁶ The same point of view is expressed with particular clarity in an address delivered by Mr. Robert S. McNamara to the annual meeting of the Board of Governors of the International Bank for Reconstruction and Development (*Summary Proceedings*, Washington, D.C., 25 September 1972): “Governments exist to promote the welfare of all of their citizens —not just that of a privileged few... absolute human degradation —when it reaches the proportions of 30 to 40 per cent of an entire citizenry —cannot be ignored, cannot be suppressed, and cannot be tolerated for too long a time by any government hoping to preserve civil order”. “To underprice capital for the wealthy and make credit expensive for the poor; to allow liberal access to scarce resources for the privileged, and price them out of reach of the deprived; to provide subsidies for the powerful, and deny them to the powerless —these are wholly self-defeating approaches to development. Such policies lead a nation inevitably toward economic imbalance and social instability.” The “powerful” and the “privileged” might answer that the State exists precisely to look after their welfare, that there is no infallible way of guaranteeing economic balance and social stability, but that they have in mind ways that are more likely to work for them than those demanded by Mr. McNamara, or they might see fit to agree with him publicly and follow their own counsel privately. A remark by Dudley Seers is apposite: “A familiar joke in the international scene today is the attempt by the ‘progressive’ economist, domestic or foreign, to sell land reform or industrialization, or more effective tax collection, or wider educational opportunity, or greater independence from a foreign power to a government whose *raison d’être* is precisely the *prevention* of such developments, or at least limiting them to the greatest extent possible”. (“The Prevalence of Pseudo-Planning”, in Mike Faber and Dudley Seers, Ed. *The Crisis in Planning* (Chatto and Windus for Sussex University Press, London, 1972)).

deliberate organization of radical structural changes in societies is a path with unpredictable consequences for the leaders and social forces entering upon it, and that if the values and perceived immediate interests of the forces controlling the State do not require such changes, it is safer and cheaper for them to allocate resources to an effective repressive apparatus.

In some respects, the constraints set by the dominant world order now seem less rigid than they did a few years ago. At least, the present multifaceted crisis is changing their character in ways that make their future problematic. Nevertheless, certain elements in the world order remain so pervasive that no country can embark on a developmental path radically incompatible with them without the certainty of enormous difficulties and sacrifices. The dominant life-styles and consumption aspirations may prove even harder to change than the centre-periphery patterns of political, financial, trade, and technological dependency to which so much attention has been devoted. Prescriptions such as that advanced by the Development Planning Committee for the elimination of mass poverty and unemployment may be viable only at the price of protracted social struggles with unpredictable results, involving the emergence of an entirely new power structure. Under other circumstances, the quest for value-oriented autonomous styles of development may make real policies even more confused and self-contradictory than hitherto, and may terminate in disaster for regimes embarking on the quest without the will or the capacity to handle the consequences.

Value-oriented styles of development will require not only agents capable of setting the society in motion in the desired direction and mobilizing popular participation and support. They must also meet minimum performance standards in terms of resource mobilization and allocation, production and distribution of goods and services, enforcement of priorities, etc., without generating unmanageable societal resistance. The circumstances under which such styles become politically possible also ensure considerable inefficiency and cross-purposes during a transitional period of learning by experience. There is no reason to expect existing interest-groups to take the virtues of the new styles for granted, and real shortcomings are bound to reinforce their scepticism or hostility. The proponents of a new style will be under continual temptation to fall back on propaganda, intolerance of criticism, exaggeration of achievements and concealment of mistakes, if they have a monopoly of power, and on compromises whose costs make the original objectives unattainable, if they do not.

If one assumes that nation-States will continue to be the basic framework within which processes identifiable as "development" will be attempted and will succeed or fail, the final question is whether and under what conditions social forces will become dominant that will make the required choices, accept the required sacrifices, and hold to the thread of rational purpose.

II. THE SETTING WITHIN WHICH DEVELOPMENTAL CHOICES PRESENT THEMSELVES

(a) Central elements in the international consensus on value-oriented development

The most comprehensively normative-utopian among the many international formulations of criteria for development is the Declaration on Social Progress and Development approved by the United Nations General Assembly in 1969 as resolution 2542 (XXIV). The Declaration proposes, in considerable detail, the "elimination" of all the ills that afflict mankind and the provision of all the services that any sector of mankind might require, within a setting of freedom, equal rights, and participation of "all members of society". This Declaration is the culmination of a series of attempts to define "social development" as a reality separate from "economic development" and hospitably includes such a wide range of the meanings that specialists in

the different sectors of public social action have attached to the term that it is of little help towards distinguishing the central elements in the international consensus. The unanimous approval of such a sweeping text, which if taken literally would call for transformation of the practices and priorities of all the organized societies of the world, and the minimal attention that has been paid to it since, even in the secretariats of the international agencies, are worthy of note.

The pursuit of universalist “social” standards for development could hardly go farther. Since then international efforts have taken a somewhat different direction, also foreshadowed in various earlier initiatives: towards the definition of a “unified approach” to development, conceived as a societal process in which “economic” means cannot be satisfactorily separated from “social” ends, and in which the meaning of what is done depends on the characteristics of the society in which it is done and the overall purposes of the dominant forces in the society.

The International Development Strategy mentioned above states that: ...qualitative and structural changes in the society must go hand in hand with rapid economic growth, and existing disparities —regional, sectoral and social— should be substantially reduced. These objectives are both determining factors and end-results of development; they should therefore be viewed as integrated parts of the same dynamic process, and would require a unified approach”. Another General Assembly resolution of the same year —2681 (XXV): Unified approach to economic and social planning in national development— specifies “the need to include in such an approach components which are designed: (a) To leave no section of the population outside the scope of change and development, (b) To effect structural change which favours national development and to activate all sectors of the population to participate in the development process, (c) To aim at social equity, including the achievement of an equitable distribution of income and wealth in the nation...”. It hedges these general prescriptions by a clause to the effect they “should be borne in mind in development analysis and planning processes... according to the particular developmental needs of each country”.

Most recently, the fifteenth session of the Economic Commission for Latin America in 1973 adopted as resolution 320 (xv) the “Quito Appraisal” of the International Development Strategy, which goes some distance farther in stating criteria for “integrated development” or “human development”. Such development, according to the Quito Appraisal:⁷

Aims at a “new type of society”, or “a social system that gives priority to the equality and dignity of man and respects and fosters the cultural expression of the population”. “Social participation in all forms of the development process must be increased in order to achieve a juster society”.

— Is incompatible with “traditional” social and economic structures and requires “qualitative and structural changes”. The Appraisal does not define the “traditional” structures, but states that the needed changes “include the control and sovereign utilization of natural resources, the reform of land tenure systems..., the establishment of such forms of public or mixed ownership of property as each country may consider appropriate and any other type of substantive reform needed to secure that objective”.

— “Cannot be achieved through partial efforts in particular sectors of the economy or the social system, but only through concerted progress in all aspects.” “The very concept of development must be improved and the fragmentary approach to economic growth and human development discarded... it is necessary to take an integrated view of all the social, economic and political determinants”.

⁷ Quito Evaluation (First Biennium of the International Development Strategy), United Nations/ECLA, 1973.

— Should not be identified with economic growth, which “has frequently failed to bring with it qualitative changes of equal importance in human wellbeing and social justice” and has coincided with “the continued existence of serious problems such as mass poverty, the incapacity of the system of production to provide employment for the growing labour force, and the lack of economic and social participation of broad strata of the population”. However, “accelerated, harmonious and independent growth is essential to the success of these qualitative and structural changes”.

Should be self-sustaining and independent at the national level. However, when “a country simultaneously tackles all aspects of development and promotes the structural reforms needed to achieve integrated development”, experience indicates that imbalances occur in the initial stages which make it difficult to continue the process. The social injustices and tensions which have accumulated over the years manifest themselves in demands which domestic resources cannot meet. In order to correct these imbalances, the international co-operation received by such a country should not be subject to restrictions.

The Appraisal assumes that endorsement of the above criteria for “integrated development” by the Latin American countries is compatible with “a high degree of heterogeneity in their economies and societies” and also with “different approaches to the development process, with each model having different options or methods of implementation”, and with the pursuit of “medium and long-term policies... whose basic principles, both political and economic, differ substantially. Hence, there is no single model to which the appraisal can refer”.

Taken together, the above criteria and suppositions constitute elements for a conception of development that is both value-oriented and “structural”, but compatible with diverse combinations of ends and means. They call implicitly for a considerable amplification of action by the State, informed and given coherence by values and the pursuit of structural change. They assume that such action is compatible with the character of the internal social forces controlling the State. They assume that full “participation” by all strata of the population is not merely compatible with “integrated development” oriented by the State, but is an essential component of such development.

The Appraisal states that “the developing countries have adopted internal policies and made efforts to attain the goals and objectives stipulated” in the International Development Strategy. However, “imbalances”, “tensions”, and “demands which domestic resources cannot meet” have endangered or frustrated the efforts of the countries embarking on structural changes, this indicating a contradiction between the ideal of integrated policy and the ideal of full participation. The Appraisal indicates that up to the present the role of the international order has on the whole been negative: “the necessary co-operation has not been forthcoming from the developed countries to complement (internal) efforts”; “countries undertaking structural changes in conformity with the IDS, sometimes have to face hostility and economic aggression from abroad”. Nevertheless, the Appraisal falls back on future international co-operation, governed by a “dynamic set of rules”, to be achieved through united action of the developing countries, to resolve the contradictions between integrated policy aimed at structural change, limited resources, and the need for broader participation, or at least reduce to manageable proportions.

The criteria for integrated development advanced by the Quito Appraisal are more focused and coherent as well as more flexible than those of earlier international declarations; they represent a clear advance over the conceptions of “economic development” as a process with its own inexorable laws and requirements, to be somehow tamed and humanized by “social development” governed by detailed universal norms derived from the social legislation and services of high-income countries. Inevitably, considering the circumstances of its adoption, while the Appraisal calls for far-reaching changes in the role of the State and of national social

forces, in the international order of relations between States, and in the relations between economic processes and human purposes, it does not face up to the questions of basic compatibility with the national and international order and of the capacities of these orders for self-transformation. It is open to the criticism that it requires a *deus ex machina* at the national level to bring order out of the clash of purposes and strategies of different groups and the complex repercussions, not necessarily wanted or intended by any group, of the economic, social, political, and demographic processes that are now working themselves out in each national society, plus another *deus ex machina* at the international level to meet the needs that cannot be met nationally, or that can be met only at a price—in terms of privations and compulsion—incompatible with the criteria.

(b) Central elements in the previous international consensus on “development” as a process with uniform requirements

As was indicated above, the interminable international discussions on development during the past three decades, never arrived at clear agreement on the meaning of development and how to attain it, but in spite of the continual confrontation of propositions deriving from Marx and from Keynes and of practices ranging between the extremes of “central planning” based on State ownership of the means of production and “market economies” restricting State intervention to a minimum of regulation and infrastructural investment, a partially explicit international consensus emerged on the requirements of “development” for societies labelled “underdeveloped” or “developing” or simply “poor”. It is these requirements that are now coming under question, in regard to their feasibility or their desirability or their meaningfulness, although even the most radical challenges can hardly reject them wholesale, or evade their central premise on the indispensability of much higher levels of productive capacity.

They can be summarized as follows:

- (i) *Accumulation.* Development supposes high rates of capital investment so as to increase future capacity for production of goods and services. For most national societies, accumulation must come mainly from domestic resources; main reliance for their mobilization and allocation may be placed either on the State or on individuals responding to economic incentives.
- (ii) *Industrialization.* No country can attain “development” as long as it remains predominantly rural-agricultural, although export-oriented agriculture may support considerable increases in per capita income and make accumulation possible. The literature often uses “industrialized” as a synonym for “developed”.
- (iii) *Agricultural modernization.* “Traditional” systems of land ownership and rural social relationships are associated with low productivity, immobilization of human resources, unresponsiveness to market incentives. According to different conceptions the changes may be limited to modernization of incentives and productive techniques, or may involve revolutionary changes in property and power.
- (iv) *Standardization of consumer demands.* With many variations and qualifications it has been assumed that development requires the bringing of continually wider strata, and eventually the whole population, into a national market for consumer goods, in which the rewards of sacrifice in the early stages of accumulation will be increasing capacity to acquire a wider range of industrially-produced goods, with rising production and consumption continually stimulating each other. The culmination of development is then mass private ownership of automobiles, television receivers, and electrical appliances.

- (v) *Entrepreneurship*. Development requires special kinds of responsiveness to economic incentives, capacity to organize large-scale production, innovate, and take risks. This function, according to different conceptions, may best be carried out by private entrepreneurs seeking profit, by managers acting on behalf of the State and compensated by power or pride in contributions to the good of society, or by a combination of the two.
- (vi) *Technological and scientific diffusion*. Development requires continual technological innovation, based largely on scientific research. In view of the technological superiority of the rich countries over the poor and their vastly greater research capacities, the needs of the latter can be met mainly by selective borrowing. This requires "technical assistance" furnished by "experts" from the technologically advanced countries.
- (vii) *Universal education*. Development requires many kinds of specialized "human resources" and a population capable of grasping and responding to "modern" incentives. This requisite can be attained only through the universalization of primary education and the expansion of many kinds of secondary, technical and higher education, along lines for which the "developed" countries offer models.
- (viii) *Provision of social services and social security*. Modernization, urbanization, and associated changes accompanying development require a widening range of public services and protective mechanisms, in addition to education, to alleviate social tensions and enable individuals to function as "human resources", consumers and citizens. Views differ as to the priority to be given to such services and mechanisms, but even the most concentrated economic conceptions of development admit their unavoidability. Once again, the "developed" countries offer models for the organization of social security, social welfare, public health, family planning, etc., that can be introduced and adapted to the extent that the stage of development permits.
- (ix) *Continually expanding participation in world trade*. Development requires a high level of imports to meet the demands of industrialization and agricultural modernization, and rising incomes mean a demand for consumer goods that cannot be satisfied from domestic production. Thus exports must continually rise to pay for imports, the prices of exports must not undergo pronounced slumps, and, ideally, exports of manufactures must gradually gain in importance relative to raw materials, although volume and prices of exports of the latter will continue to be of crucial importance.
- (x) *Rising net financial flows from "developed" (rich) countries to "developing" (poor) countries*. Only in exceptional circumstances can the preceding requirements be met through the unaided mobilization of internal resources and through foreign exchange derived from exports. The development of poor countries requires some combination of financial grants, low-interest loans, and direct investments coming from the rich countries, with the needed proportions depending on the initial situation and development strategy of the poor country.

Different schools of thought have advanced many additional requirements for "development", ranging from the taking of power by a class capable of imposing determined modes of accumulation and production to the transformation of child-rearing practices in the family, as more basic than any of the above. Consensus on those listed, however, has been fairly general. Even the proponents of different priorities have had to argue, in order to get a hearing, that their proposals would contribute to the attainment of these requirements. It was accepted that the future world, to the extent that more and more national societies conformed to these requirements, would become more homogeneous, less conflict-ridden, and more capable of supporting satisfactory levels of welfare for most of its population.

In the course of national and international efforts to meet the requirements, and as a result of unplanned social and economic processes pointing in the same direction, most human societies have changed enormously since the 1940s. A different world order has emerged, in many respects more interdependent, imposing more complex constraints on change in national societies than ever before. In other respects, paradoxically, the possibilities for autonomous voluntarist action, for better or worse, have widened, and also the possibilities for societal changes or breakdowns escaping from the control of any power centre, national or international. The deliberate political and economic constraints imposed by the world centres on the development of the periphery may be weakening, and the capacity of the centres to offer the periphery coherent and attractive models for change is weakening more incontrovertibly, but other constraints inherent in the partial and distorted attainment of the development requirements listed above are becoming more formidable. The next stage in the present exploration will be to try to summarize certain central features of the world order that have emerged in the course of the struggle for development, to which declarations such as the IDS and the Quito Appraisal are reacting.

(c) Characteristics of the present world order in relation to the conventionally-defined requirements of development and the possibility of autonomous national choices of styles and strategies

An interpretative description of the world economic and political order in its present state of flux, in which the events of each year confound the expectations of the preceding one, would be a risky undertaking and beyond the pretensions of the present discussion. The most that can be done is to single out certain features that seem particularly relevant:

- (i) Continual changes in the dominant preoccupations in the world centres are generating corresponding changes and increasing diversity in the forms of control, advice and co-operation through which the governments and interest-groups of these centres try to deal with the peripheral societies. A certain loss of confidence in previous prescriptions, or even of interest in the very theme of aided development, in the main centres coincides with increasing sympathy and support in certain smaller high-income countries for original and autonomous styles of development elsewhere. A kind of vicarious utopianism has appeared which, although it may under-estimate or misjudge the real difficulties of value-oriented development in poor and dependent countries, does something to widen the options open to them. At the same time, the "visibility" of more specific developmental problems is shifting and dominant currents of opinion in the world centres continually urge, through the international organizations, new priorities on the peripheral societies. The most conspicuous examples are the rise of worldwide campaigns, backed by significant resources from the world centres, relating to "population" and the "environment". Equitable income distribution and full employment have similarly come to the fore, although without a comparable disposition in the world centres to allocate resources to their attainment. With increasingly coherent tactics, the spokesmen of the peripheral societies seek to adapt the campaigns and resource availabilities deriving from the changing visibility of problems to their own conceptions of needs, especially for more favourable terms of trade and aid.
- (ii) While the disproportion in per capita wealth and in power between the world centres and the periphery is certainly not diminishing, the forms of dominance and dependency are changing and becoming in some respects ambivalent. The spread of industrialization and its increasing dominance by transnational corporations whose national affiliates are capable of self-financing transforms the previous patterns of exchange of raw materials for manufactured goods and renders obsolete the previous conceptions of "foreign

investment". The latest technological innovations in the centres are increasingly remote from the needs and capacities of the peripheral societies, or possibly even from those of the centres (as in the case of supersonic transport), but the search for technological alternatives progresses very little. The low-income predominantly rural countries find themselves increasingly dependent on the high-income urbanized countries for food supplies, but the latter countries rather suddenly find that their own life-styles, with their reliance on automotive transport and high consumption of electrical energy, have led them into a trap of dependence on peripheral societies as well as an environmental nightmare. Economic aggression has become a more diversified as well as a more menacing weapon than heretofore, and some of the peripheral societies are becoming able to use it as effectively as the centres. Both have the capacity of making "normal" functioning in other countries impossible by withholding supplies.

- (iii) The processes of "development" or "modernization" in the peripheral countries, to the extent that they have taken place, and the rather compartmentalized economic and social programmes undertaken in their name, have invariably been characterized by polarization between groups able to "modernize" and benefit materially, and larger groups that do so only "marginally" or suffer absolute deprivation. In one way or another all of the programmes counted on to enhance welfare and generalize development — from industrialization and agricultural modernization to education, public health and social security— seem to contribute to this polarization, or "structural heterogeneity". Policies proposed specifically to improve the relative positions of the more marginal groups, such as community development, regional development, and agrarian reform, conform to the same pattern of polarized gains, or remain puny and impotent, or encounter structural resistance that destroys them. The problem is not simply that some parts of the national populations progress while others stagnate. The forms of "progress" impinge on the latter groups in ways that prevent them from "stagnating". The momentum of what has been done, the expectations of all social groups, and the differential access to power of the modernized groups make basic changes in the pattern of polarized growth problematic, conflictive and costly, even if dominant political forces have a clear strategy for change, which is rarely the case.
- (iv) As polarization emerges more clearly as a key characteristic of "developing" societies, and to some extent even of societies previously identified as "developed", and as wider strata of the population "participate", at least to the extent of becoming conscious of the impact of change processes and seeking means of defending themselves, the compatibility of "development" and "participation" and the viability of democratic institutions and processes comes under question. Whether the aim is to maintain the prevailing polarized style of development —if it is judged the only viable style— or to transform it, authoritarian and technocratic solutions come to seem unavoidable. The national armed forces, preferably guided by social scientists and planners, are measured for the role of *deus ex machina*, whether they want it or not, and even by sectors of opinion with no stomach for authoritarian rule. In the minds of groups seeking means of implanting a preferred style of development, it comes to seem more practicable to apply Disraeli's saying, "We must educate our masters", to the armed forces than to the people. Within the present world order, military leaders are trying to impose an extraordinarily wide range of styles of development in different countries, as a consequence of the failure of previous regimes to reconcile "development" and "participation". Such regimes present the likelihood of more coherent and original policy choices —sometimes to the point of arbitrariness— than the regimes dependent on open political bargaining and compromise, but it remains to be seen whether such

choices will be more consistently enforceable than the previous ones. Within the pattern of partial frustration of development, or unsatisfying “dependent development”, the long-term trend may be cyclical rather than consistently in the direction of military-authoritarian solutions: the failure of political compromise leads to military takeovers, but the inability of the military and their technocratic-ideological advisers to cope with the complexity of the processes leads back to open political competition.

- (v) The identification of the “modern” sectors of the populations of the peripheral societies with the standards of their counterparts in the advanced societies becomes more complex and ambiguous as this identification clashes with the crises of standards in their countries of origin.

Interest-groups or organizations (from chambers of commerce to trade unions), political parties, academic structures, transnational corporations, bureaucracies, brands of manufactured consumer goods, mass media content, all these experience world standardization and simultaneous reactions against standardization. The polarized peripheral societies import ideological “antibodies” along with the traits of the “affluent” societies and also develop their own antibodies that are re-exported to the high-income societies and enter into their cultural-political conflicts.

In this sense, a world society is taking shape, characterized not by the harmonious incorporation of standardized high production and high consumption previously looked to as a consequence of “development”, but by a self-contradictory combination of increasing assimilation of this pattern and increasing rejection of or frustration with it. In the peripheral societies the non-incorporation or marginalization of part of the population exacerbates this contradictory process in two ways: by heightening the defensiveness of the “modernized” strata towards their privileged position, and by heightening the ideological rejection of dependent development. The two reactions can, of course, coexist conflictively in the same individual or the same policy formulation.

III. POLICY APPROACHES TO THE CHALLENGE OF “UNIFIED”, “ORIGINAL”, AND “VALUE-ORIENTED” OR “HUMAN-ORIENTED” STYLES OF DEVELOPMENT

The present paper supposes —with reservations— that development is a legitimately identifiable process subject to certain uniformities and preconditions, but that these uniformities and preconditions are not rigidly binding nor a satisfactory basis for prediction of the future. It also supposes that human reason and human values can and should try to shape the future into national styles different from those prevailing up to the present.⁸ “Development” cannot mean anything anyone wants it to mean, but, if it is to continue to serve as a focus for human aspirations, it must embrace a certain range of differing combinations of ends and means. Three main kinds of approach to the definition of these ends and means can be distinguished: the utopian-normative, the technocratic-rationalistic and the socio-political.

⁸ This position is set forth in the *Report on a Unified Approach to Development Analysis and Planning* (op. cit., pp. 9-10). “Development” is “a perceived advance toward specified ends based on societal values” and also “a system of interrelated societal changes that underlies and conditions the feasibility of the advance”. “The first sense assumes human capability of shaping the future for human ends. It also implies that the existing society has the right and the ability, through general consensus or through agents claiming to represent the best interests of the society, to make choices and enforce sacrifices in the name of development”. “The second sense assumes that development is an intelligible phenomenon susceptible to diagnosis and objective propositions concerning the interrelations of factors and the probable wider consequences of changes in or action on key components of the system”.

Up to a point, these are complementary. The pursuit of more acceptable and viable styles of development must be referred to images of the future social order—in other words, to a “utopia”—and to norms setting limits on the means to be used. The quest for more rational and efficient techniques for mobilization and allocation of resources, provision of services, and accomplishment of whatever objectives the society sets itself is unavoidable, whatever caveats may be entertained as to the lengths to which this quest should be followed and the virtues of the market or of participatory democracy. Finally, social and political forces, however these may be defined, must choose the utopias and norms and create and apply the technocratic-rationalistic planning and administrative mechanisms.

For obvious reasons, the utopian-normative and technocratic-rationalistic approaches have received a good deal more attention in official and semi-official international discourse than the socio-political. The fact that such discourse is conducted by government representatives or by “experts” addressing themselves to governments, as the opening section of the present paper points out, promotes the supposition that the governments stand for rational, benevolent and coherent entities preoccupied with development and the welfare of all their people, anxiously seeking advice on how to accomplish these ends, and capable of acting on the advice. If their behaviour does not correspond to this image, they deserve scolding for corruption, for the pursuit of irrelevant objectives such as military power, for slackness and evasiveness in pursuing their declared policies (in Gunnar Myrdal’s words for being “soft States”), but the supposition remains that the “government” or the “State” has sufficient autonomy to do better if “it” wants to, or if “it” is sufficiently alarmed at the dire consequences of not doing better. Non-official academic and ideological discourse, particularly in the “developing” countries, shows a different world, in which external domination and internal distribution of power determine what governments can do, in which the governments are commonly incoherent aggregates of diverse personalistic, bureaucratic and other purposes, and in which it is naive or intellectually dishonest to expect them to act differently on the basis of moral exhortations or rational arguments.

The utopian-normative and the technocratic-rationalistic approaches have to a large extent been pursued separately, by different groups in the national governments and the intergovernmental organizations, but the advocates of each have tried to borrow strength from the other. The proponents of universalistic social norms have aspired to guide the technocratic planners and administrators, and have commonly exaggerated the power of the planners and the results to be expected from “convincing” them of the importance of social justice or placing spokesmen for the “social” point of view in planning bodies. The planners and administrators have commonly tried to justify their techniques and enlist wider support by hinting at eventual contributions to the attainment of social justice.

In recent years both of these approaches—although numerous institutions continue to elaborate and teach them along previous lines—have been increasingly frustrated by confrontation with socio-political realities and increasingly complicated or adulterated by attempts to adjust them to these realities or adjust the realities to them. Apologies for both approaches fall back continually on what might be labelled the “bureaucratic passive voice” or on the wistful assertion of a “growing awareness” in order to evade the obligations to identify the socio-political agents to whom they are addressed. Enough has been said about the utopian-normative approach in previous sections of this paper. Its shortcomings when pursued in isolation (or its illegitimate uses as an evasion of reality) are cruelly exposed in a world in which the dimensions of injustice, insecurity and violence continue to grow while the list of “rights” to which all human beings are entitled by the votes of their governments continues to lengthen.

The confrontation of the technocratic-rationalistic approach with recalcitrant realities is more complex, since its practitioners are more intimately involved in the machinery of the State, the demands of classes and groups, and the need of the political leadership for “solutions” to “problems”. One result has been an extensive literature on the “crisis in planning”.⁹ As in the case of “development” itself, if the meaning previously attached to planning is discredited, it is assumed that “planning” must mean something else, and the alternatives proposed range from a continuous, diffused rationalizing activity in which the whole society participates, to the formulation of operational guidelines for short-term choices between projects. Public administration as a “discipline” shows a similar loss of confidence and diversification of prescriptions, combined with a similar clinging to faith that it must mean *something* generalizable and applicable to the rationalization of what the State does in the name of society. One critic has retorted: “If planning is everything, maybe it’s nothing”.¹⁰

From the standpoint of the present paper, the utopian-normative and technocratic-rationalistic approaches can escape from the blind alley of verbalism and ritual action only to the extent that their proponents relate them to socio-political approaches that identify agents and propose strategies consonant with the values, interests, and capabilities of these agents. This position, however, is vulnerable to criticism from several directions; it certainly does not offer any straightforward or universally “applicable” “solution” to the problem of advancing towards original and value-oriented styles of development. The kinds of agents of development that are sought and the range of choice attributed to them in the shaping of a style of development naturally depend on the conception of development and the interpretation of the nature and functioning of human societies.

There is no *a priori* reason to assume that the agents “needed” for an acceptable and viable style of development will emerge in any given society, or that, if they do emerge, they will be able to accomplish their “historic mission”, or that if they do accomplish such a mission, the society will be unequivocally and permanently better off than before. Nor does it seem necessary to assume *a priori* that the same kind of agent, whether collective and acting out a predetermined role, or individual and with a large measure of free will, must play *deus ex machina* in all societies, as most schools of theory and ideology assert. The would-be intellectual agents of development —the last of the five categories distinguished below— might

⁹ See, in particular, Mike Faber and Dudley Seers, Ed., *The Crisis in Planning* (Chatto and Windus for Sussex University Press, two volumes, London, 1972). See also section III of “Report on a Unified Approach to Development Analysis and Planning”, *op. cit.*

¹⁰ Despite intermittent disaffection with planning —the contrast between the plan and the nation mocked the planners— it was difficult for national elites to lose sight of the promised land. They so wanted an easy way out of their troubles. Besides, they soon discovered that the non-operational quality of planning could be helpful... Formal planning may be useful as an escape from the insurmountable problems of the day... If groups cannot be indulged in the present, they can be shown the larger places they occupy in future plans. Formal planning can also be a way of buying off the apostles of rationality by involving them in tasks that take them away from the real decisions... If formal planning fails not merely in one nation at one time but in virtually all nations most of the time, the defects are unlikely to be found in maladroitness or untalented planners. Nor can a failure be argued rationally by saying that the countries in question are not prepared to behave rationally or to accept the advice of rational men called planners. That is only a way of saying that formal planning, after innumerable iterations, is still badly adapted to its surroundings. It cannot be rational to fail. To err is human; to sanctify the perpetuation of mistakes is something else. If governments persevere in national planning, it must be because their will to believe triumphs over their experience. Planning is not so much a subject for the social scientist as for the theologian”. (Aaron Wildavsky, “If Planning is Everything, Maybe It’s Nothing”, *Policy Sciences*, Elsevier, Amsterdam, 4, 1973.) A similar conclusion was foreshadowed several years ago in Albert O. Hirschman’s well-known comment on the planning activities of ECLA : “... ECLA design has a utopian ring for societies where simple ministerial changes frequently mean total reversals of policies and where the policy makers themselves take pride in being unpredictable... ECLA’s detailed projections where all economic sectors are made to mesh harmoniously are in a sense the twentieth —century equivalent of Latin America’s nineteenth century constitutions— and are as far removed from the real world. They are a protest, both pathetic and subtle, against a reality where politicians relying on brilliant or disastrous improvisations hold away, where decisions are taken under multiple pressures rather than in advance of crisis and emergency situations, and where conflicts are resolved on the basis of personal considerations after the contending parties have revealed their strength in more or less open battle rather than in accordance with objective principles and scientific criteria”. (“Ideologies of Economic Development in Latin America”, in A.O. Hirschman, Ed., *Latin American Issues: Essays and Comments* (New York, Twentieth Century Fund, 1961.))

well assume that any of the categories can be decisive in certain conjunctures but marginal or even illusory in others. The five categories are as follows:

- (i) Social classes and groups that fill key roles in the “working out” of a conventionally-defined style of development, on the basis of their relations to production and their collective views of their own interests: entrepreneurs, investors, technological innovators, technicians, “middle classes”, workers, etc. Collective agents such as these can fill their roles more or less adequately, or can find that the economic and social structure or the terms of dependency are incompatible with the filling of such roles adequately, but the associated conceptions of development do not allow for major creativeness or voluntarism in changing the style, whether the underlying conception is Marxian or non-Marxian. A large part of the discussion of styles of development in Latin America up to the present has consisted in attempts to identify plausible collective agents, to measure the adequacy of existing classes and groups to fill roles defined on the basis of previous examples of “development”, and to explain why the classes and groups have rarely seemed to carry out the tasks assigned to them: take, for example, the persistent expectation that an “industrial bourgeoisie” would remove a “landlord oligarchy” from its path by promoting agrarian reforms. The discussion has tended to reify the classes and groups looked to as collective agents, and in many cases, the agents to be discussed next seem, instead of “representing” them, to have brought them into being or into a distorted kind of self-consciousness for their own purposes.
- (ii) Individuals or small groups that articulate the demands of larger groups or classes, act as brokers, and mould public opinion: politicians, leaders of trade unions and other interest-group organizations, journalists, religious leaders, etc. In view of the relative lack of coherence of the larger groups or classes, agents of this kind are able to play relatively autonomous roles, but at the price of limited and precarious real capacity to enforce demands and influence change processes. Their apparent importance is likely to be suddenly inflated and deflated, as in the case of populist leaders elected to the presidency with large popular votes and then easily forced out of office. Their influence may depend more on their ties with the kinds of agents next to be discussed than on the groups they aspire to represent. As “agents of development” their effectiveness is limited not only by these factors but also by the importance of brokerage and manoeuvring in their roles. They are likely to view the advocacy of a “style of development” as an additional tactic to lend plausibility to the role or to reinforce more concrete objectives, rather than as an overriding purpose.
- (iii) Individuals or small groups holding power deriving from control of armed forces, ownership of capital, or representation of one of the dominant world centres. Since the power of these potential agents does not depend on ability to mobilize support from part of the population and build coalitions, they might be expected to be in a position to act more coherently (or arbitrarily) in pursuit of a style of development than the agents in the second group. Their *applicable* power, however, is limited by several aspects of their own situations: (a) Their primary power rests on a specific conjuncture and can suddenly disappear; the military leader can be ousted by his subordinates, the capitalist can be crippled by a financial crisis, the world centre may be diverted by internal problems or its overall political strategy may shift so as to undermine the position of its representative, (b) The power holders’ values and conceptions of their own roles do not usually extend to the implantation of an original style of development; they are more concerned with the preservation of existing order and warding off threats to their privileged position, (c) Their detachment from the representation of large classes or groups limits their capacity to induce the population to act in accordance with their objectives. Once they

set themselves the task of implanting a coherent style of development, they must enlist the aid of agents of the second type, attempt to fill these roles themselves, or find effective means of isolating the population from political appeals and interest-group representation.

- (iv) The chief of State or national executive: the individual or collective entity formally responsible for public decision-making, appointment of public functionaries, broad choices concerning allocation of resources, formulation of guidelines for development. This entity is the conventional target for developmental advice, the modern successor of Machiavelli's Prince. Utopian-normative and technocratic-rational prescriptions are formally addressed to the Prince; a good deal of the more recent socio-political discussion addresses the question: How to give him advice that he can use, on the assumption that he is playing a difficult game with limited "political resources" and inadequate information?¹¹ In practice, the Prince may turn out to be elusive, even in authoritarian settings; his formal representation decides very little and absorbs hardly any of the advice showered on him; the real sources of decisions are dispersed and hidden.¹²
- (v) Individuals or small groups aspiring to explain the functioning of a society articulate images of preferable future societies, based on their values and on their diagnosis of the existing situation, formulate corresponding strategies, and enlist support from one or more of the preceding types of agents. A well-known remark by John Maynard Keynes summed up forty years ago the potentialities, shortcomings, and dangers of their influence on the other agents: "... the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual *encroachment* of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest".¹³

These last "agents of development" include the proponents of the utopian-normative and technocratic-rationalistic approaches discussed above, to the extent that these try to confront the socio-political application of their prescriptions. They notoriously offer a bewilderingly wide range of prescriptions, none of which have as yet been incontrovertibly successful in

¹¹ In particular, Warren F. Ilichman and Norman Thomas Uphoff, *The Political Economy of Change* (Berkeley and Los Angeles, University of California Press, 1969). According to their "simplifying assumptions", "first, the statesman has at his command limited resources, in varying amounts and types, with which to implement choices affecting the character and quality of the polity's collective life; second, as a result of the division of labour that defines authority roles in a society, the statesman alone has the resource of authority at his disposal; third, the statesman wishes to remain in authority; and fourth, the statesman, to realize his valued ends, will make choices that formally aim at increasing the productivity of his political resources" (p. 33). "In the face of frequent mutual exclusiveness of demands and the persistent scarcity of resources, the statesman has various options. He may choose to meet some demands wholly or in part. Some demands he will ignore or explicitly reject. Sometimes when a demand from the sectors cannot be met, the statesman may seek to substitute resources that he thinks will be temporarily acceptable... He may employ coercion to remove the effects of certain demands, or he may institute education to remove the causes... Given the necessity of choices, the statesman must figure out on whom, how much, in what combination, when, where, why, and for what return the regime's scarce political resources should be spent" (p. 38).

¹² "There is, as a rule no single and invariant 'locus of sovereignty'. Sovereignty is shared among various groups in different constellations at different times... The existence of a cabinet (or a *junta*) may conceal the extent to which the decision-making process is, in fact, dispersed". (Colin Leys, "A New Conception of Planning?", *Crisis in Planning*, *op. cit.*, Vol. I, p. 60.)

¹³ John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York, Harcourt Brace and Co., 1936, p. 383-384).

their contacts with reality. They fall into three roughly distinguishable groups: the planners, the reformist-meliorists, and the revolutionaries.

The planners, as the most conspicuous representatives of the technocratic-rationalistic approach, have already been discussed. For a brief period the impression gained ground in circles concerned with development that neutral techniques had been devised or were on the point of being devised that could be “applied” by any government taking them seriously so as to bring forth a predictable product — “development”. This impression has gone by the board, and the planners have been scolded repeatedly — and have scolded themselves — for their isolation from political realities and the inadequacy of their techniques.¹⁴ They have tried to define their relationships to political agents, to associate themselves with “participation”, to find means of transforming rather than furthering the prevailing style of economic development. The question then arises, as Wildavsky suggests in the quotation above, whether they retain any plausible case for remaining a “discipline” with common techniques, offering definable services to public policy, whether they are not merging into the other categories of intellectual agents of development. To the extent that the planning approach remains distinct, and its practitioners do not resign themselves to ornamental roles and academic exercises, it supposes the possibility of completely rational management of human affairs in pursuit of quantified goals... if only the correct prescription can be discovered and the right agents convinced of its correctness and marshalled to apply it.¹⁵

The reformist-meliorists have in common a distrust for utopias, infallible technocratic prescriptions, and catastrophist demonstrations that a prevailing pattern of growth and change cannot continue because it functions unjustly and inefficiently. They aspire to understand socio-economic-political structures so as to work within them for value-oriented ends, on the supposition that these structures are never going to be perfectly rational and oriented to human welfare, on the one hand, nor irremediably oppressive and incompatible with value-oriented development, on the other. National consensus on societal goals is not to be expected.¹⁶ Uncertainty is a permanently unavoidable concomitant of human affairs, and development is an open-ended process calling for flexible tactics to take advantage of opportunities as they present themselves. The reformist-meliorists prefer to act in societies with open political competition and articulate interest-groups, but they are not surprised nor moved to withdraw from attempts to influence policy if these conditions are not present. They do not see revolution as a precondition to an acceptable style of development, but if revolutions occur they view

¹⁴ The following remarks by Dudley Seers are representative: “...his approach is likely to be static. The planner’s university education is not likely to have provided him with much help in thinking about how economies operate at different levels of development (and with different institutions). He is hardly prepared, therefore, to look at the economic, let alone the social, realities and ask how the resources of the country might be mobilized for change — as some politicians would really like him to do. It is especially likely... that the planner will fail to understand the extent to which political realities determine the geographical patterns of government expenditures or the sources of foreign aid... His social life brings him into contact with the (usually articulate) residents of the capital; so indeed does his official life. Yet the population of the capital is very different in income, occupation, etc., not merely from that of the countryside, but also from the public in other cities... the planner will tend to incorporate in his model the myths prevalent in the capital about the consumption and production functions of the rest of the country... Perhaps most significant of all is the planner’s attitude to the quality of the statistics he is using... the economics student is taught to handle numbers as if they were objective facts, instead of being, as they usually are, nothing more than enlightened guesses”. (“The Prevalence of Pseudo-Planning”, *The Crisis in Planning*, *op. cit.*, Vol. I, p. 25-28).

¹⁵ “If planning is a universal tool, planners find it reasonable to ask why their countries cannot live up to the requirements of rational decision-making. If planning is valid, they feel, nations should adjust to its demands rather than other way round. To save planning, planners may actually accept the blame. For if better behaviour on their part would make planning work, the solution is not to abandon plans but to hire more talented planners”. (Aaron Wildavsky, *op. cit.*).

¹⁶ “There is no such thing as a collective national ‘objective function’. There is rather a complicated mix of goals, which may be understood partly in terms of a limited number of themes around which there is something like consensus or for which there is at least a substantial majority support, but which for most of the time is fluid and changing. At different moments, different groups have priority and different perceptions of self-interest and collective interest dominate. The planner’s problem is to be able to build plans around a limited number of goals, isolated from the rest, for which a necessary minimum of support appears to be assurable during a necessary minimum period.” (Colin Leys, “A New Conception of Planning?”, *Crisis in Planning*, *op. cit.*, p. 72.)

them as new concatenations of challenges and opportunities, to be studied sympathetically. The reformist-meliorist outlook permits a subtle appreciation of the complexities of policy-making and the ambiguities of most change processes in terms of their impact on human welfare, but it also supports a certain Panglossian smugness, a predisposition to find reasons for affirming that all is for the best, if not in the best of all possible worlds, at least in as good a world as humanity has any reason to expect, and that incremental reforms combined with human genius for muddling through will gradually make it a little better.¹⁷ In practice, reforms and spontaneous developmental processes that have been hailed as shining examples have so often later collapsed or stagnated that the reformist-meliorist approaches, like the technocratic planning approaches, are less credible than a few years ago. At best, they offer no comfort to the international demands for an immediate end to poverty and injustice. Nevertheless no convincing real alternative is at hand for the international organizations and the “experts” aspiring to influence policy within concrete national situations —however much intellectual allegiance they may owe to utopian-normative and technocratic-rationalistic schemes.

The revolutionary or “counterplanning” outlook —to the extent that it is not contaminated by technocratic or reformist-meliorist hopes— starts from the premise that the existing socio-political order is radically incompatible with a value-oriented style of development, or with full unfolding of the human potential. Therefore —depending on the diagnosis of the stage this order has reached, the way it functions, and the constraints imposed on national action by the world order —the primary task is either to demolish it or to promote its ripening to a point at which demolition will become feasible. The agents that have been previously assessed —classes and groups, their mobilizers and spokesmen, holders of primary power, the personified State or national executive— and the policies advanced by technocrats and reformist-meliorists are then assessed in terms of their potential contributions to demolition, the accomplishment of stages of “development” leading to ripeness for demolition, or the strengthening of the existing order against demolition.

The place of the agents in an eventual value-oriented style of development and the concrete policies required recede to a secondary level of speculation or become confused with the immediate instrumental role of agents and policies. In relation to national societies undergoing polarized and dependent “development” the revolutionary outlook is bolstered by the obvious and persisting lack of correspondence of the existing situation with human values, and the abundant evidence that the best-intentioned technocratic and reformist-meliorist schemes are either ineffectual or contribute to the polarization between classes and groups. At the same time, the outlook is fragmented and frustrated by the failure of the societies to meet the preconditions for revolution set by the theories underlying the revolutionary outlook. The “proletarian” class that should be the grave-digger of the existing order is not growing markedly in relative size nor organizational coherence and seems more disposed to uphold the order than to overturn it. The “marginalized” or “sub-proletarian” strata whose wellbeing seems most incompatible with perpetuation of the existing order, in their ambiguous relations to the systems of production and employment and to the State, respond poorly to coherent revolutionary appeals. Moreover, the pervasiveness and complexity of present economic, political and cultural interdependence with the world centres, suggests that demolition of the existing order at the national level will either be altogether impracticable or will imply costs in terms of societal disruption, repression and enforced closure of the society, that would

¹⁷ Albert O. Hirschman has labelled this approach “reform-mongering”, and has been one of its most avowed and ingenious practitioners. See, in particular, *A Bias for Hope: Essays on Development and Latin America* (New Haven and London: Yale University Press, 1971). The writings of Aaron Wildavsky, John Friedman, and Albert Waterston, along with most of the contributions to *Crisis in Planning*, *op. cit.*, offer variants on the approach. The most explicit formulations of it come from the English-speaking countries. Elsewhere, there seems to be more reluctance on the part of persons concerned with development policy to acknowledge it as a guiding principle and as a virtue, although their practical tactics cannot help following it.

make posterior value-oriented development problematic. To the extent that this last constraint is acknowledged, the national revolutionary must take into account international as well as national “ripeness” for change.

The revolutionary rejection of the existing order as a framework or starting point toward a style of development deserving support can obviously lead to a wide range of different tactical conclusions. The revolutionary can concentrate on the task of immediate demolition, or at least of making the existing order unworkable, on the assumption that this will help generate the preconditions for transformation. Or he can try to redefine the preconditions, experiment with tactical alliances, and await favourable conjunctures in a manner indistinguishable from the reformist-meliorist approach, except in the underlying suppositions. Or he can try to create and mobilize support for a utopia so compelling that its appeal will outweigh unfavourable objective conditions. And the reformist-meliorist tactics may, in the end, even find some variants of the revolutionary outlook positive in their capacity to generate a dynamism that their own views of needed changes require but cannot muster.¹⁸

IV. IN LIEU OF CONCLUSIONS

The above exploration of approaches to development, starting from the question “Who is approaching what?”, has encountered many different would-be agents acting within many different combinations of opportunities and constraints, in pursuit of an objective that is continually being redefined, falling back on verbal and organizational rituals for lack of ability to foresee and control the course of events, and sometimes violently rejecting reality for its failure to conform to their concepts and values. One finds, internationally and nationally, a chorus of agreement on the need for “unified”, “human oriented” approaches to development, combined with real concentrations of power, resources, and public attention on sums that are either irrelevant to such approaches or obviously incompatible with them. One finds that the promotion of “development” has become an industry in which supply creates its own continually diversifying demand for “experts”, in which conferences beget conferences and declarations beget declarations, in which major “problem areas” incorporating different conceptions of developmental priorities continually hive off organizationally, receive symbolic recognition in “years”, inflate themselves to cover all aspects of “development”, and spawn infinitely ramifying co-ordinating mechanisms. Under these conditions, explorers sent out with instructions to find a “unified approach” to development risk assuming two folkloric roles at once —that of the blind men describing the elephant and that of the mice discussing how to bell the cat.

Such an exploration is inevitably unsettling to the proponents of utopian- normative, technocratic-rationalistic and socio-political approaches, to the revolutionaries as well as the reformists. At the end, all on them can be expected to retort: What positive, practical proposals do you have? The present paper, of course, does not set out to demolish previous how to develop prescriptions and then propose an infallible new one, nor to reject previous societal candidates for the honour of leading the way to development and then nominate different agents who can really do the job. As was indicated at the beginning, this paper is a personal by-product of a continuing policy-oriented research project that has formulated certain proposals, without pretension to the discovery of a developmental panacea. These proposals which in the main

¹⁸ “...there is a special justification for the direct search for novelty, creativity, and uniqueness: without these attributes change, at least large-scale social change, may not be possible at all. For, in the first place, the powerful social forces opposed to change will be quite proficient at blocking off those paths to change that have already been trod. Secondly, revolutionaries or radical reformers are unlikely to generate the extraordinary social energy they need to achieve change unless they are exhilaratingly conscious of writing an entirely new page of human history” (Albert O. Hirschman, *A. Bias for Hope*, *op. cit.*, p. 28).

select and re-combine ideas already current in international developmental discourse, are being published elsewhere.

This paper does not argue that any of the approaches it describes are illegitimate or altogether on the wrong track, although it does suggest that each of them in different ways lends itself to oversimplification and mystification. It really points to an existential approach to development, in which the would-be agents should cultivate an awareness that theirs is a possibly Sysyphean task of trying to impose a measure of value-oriented rationality on realities that will remain permanently recalcitrant to such rationality. All societies that survive will have to strive to “develop”, in the sense of enhancing their capacity to function over the long term for the well-being of their members. None will ever reach a blessed terminal state of “being developed”. Apparent success may, in the long term, lead into a trap of relative incapacity for further innovation.

From this point of view all national societies at all points of time and at all levels of poverty or prosperity confront a certain range of accessible alternatives with different combinations of advantages and disadvantages. The capacity of their dominant forces to choose specific alternatives depends not only on objective conditions but also on their subjective appreciation of these conditions and on the momentum of what has already been done. Choices or failures to choose are continually closing doors and opening different ones. If opportunities are not seized, if choices do not correspond to realities, if capacity for adaptation and innovation fail, then in the words of W.H. Auden, “History to the defeated may say alas, but cannot help or pardon”. Neither can the international development movement.

The international demand for a “unified approach” is aimed at interpretations and strategies of development more directly oriented to social justice and the meeting of basic human needs than heretofore. Such interpretations and strategies will not be any more “unified” in a literal sense than their predecessors. In fact, they are bound to be more diversified than the strategies concentrated on maximization of investment and production, in their striving to reconcile multiple objectives, respond to differing national potentialities and values, and enlist creative popular participation. The change of focus from a “unified approach” to exploration of the viability and acceptability of differing “styles of development” within specific national settings recognizes this. The attempt to introduce the theme of “styles of development” into international discourse, however, is not immune from the temptation to seize upon verbal novelties, new packaging for old prescriptions, token solutions that do not match the magnitude of the problems to which they are addressed or the intentions of the power structures that would have to apply them. The present paper from its vantage point within international developmental discourse, has been —perhaps obsessively— preoccupied with this temptation.

It looks back over a quarter of a century of international reports speaking of successive “growing awarenesses” of the need for more “balanced” or “comprehensive” approaches to development. If awareness had really grown at such a rate, the international community should have attained total enlightenment by now.

Ideally, the “unified approach” should embrace the whole human race and the international community should attach a positive value to diversity in styles of development, if only for the sake of experimentation and cross-fertilization, as long as they do not diverge grossly from the international consensus on human rights and values. Within these limits, each national society should be free to pursue its own style and to count on the co-operation it needs to do so. In practice however, no national society is in a position to evolve its own style without careful attention to external constraints and manoeuvring within the limits of the practicable. The meeting of needs through international co-operation remains precarious, inhibiting, and in part illusory; national societies striving to develop cannot dispense with such co-operation,

but neither can they lean on it, particularly when they leave the conventional paths. Finally, the very conception of "national societies" "choosing" styles of development is of dubious applicability to many of the countries now on the world stage. The recognition of the legitimacy of alternative styles of development and of the possibility of value-oriented choice is a step forward from the conception of a single path to be discovered and followed, under penalty of permanent backwardness, but it leaves more questions than it answers. The present paper is intended mainly to stimulate would be agents of development to preoccupy themselves with these questions, and it is appropriate to return to some of them at the end: Who is to choose a national style of development? Who gains and who loses? Are the dominant social forces able and entitled to commit a society to a given style? Will styles of development corresponding to the international norms for social justice set forth above, within the limits of austerity and sacrifice set by national resources supplemented by problematic external co-operation, really be acceptable to the articulate and organized population groups whose acquiescence will be essential, or even to the ideologists and planners who are calling for more equitable and autonomous styles? Will national societies in the real world be able to attain the degree of consensus and rational organization called for except at a price that will distort the new style into something quite different from the image of the just and free future society informing it at the beginning?

ADJUSTMENT POLICIES AND RENEGOTIATION OF THE EXTERNAL DEBT IN LATIN AMERICA *

ECLAC

* Chapters II.B (pages 24-39) and III.E (pages 19-89) and Appendix (pages 95-102) in Cuadernos de la CEPAL, N° 48 (LC/G.1332), Santiago, Chile, December 1984.

A. Towards a more efficient adjustment

As indicated above, the adjustment made by the region thus far has had serious limitations and has been obtained at a high cost. Although the deficit on current account was reduced sharply and rapidly, this was only possible because imports were reduced brutally and this in turn was the main cause of the slowdown in economic activity and the drop in employment. Moreover, precisely because of the way in which Latin America achieved its substantial trade surplus during the period 1982-1983, should domestic production recover and grow, the external disequilibrium would tend to increase, although, with real exchange rates being much higher now, it would not reach the magnitude it did in 1981.

It is important to stress, however, that these unsatisfactory results were in large measure due to the extremely unfavourable external environment, as regards both trade and finance, in which the adjustment process had to be made. Hence, in order for a more efficient adjustment to be made in future, there must be some change in those external circumstances which have a decisive effect on the rate and nature of the growth of Latin America's trade and the net result of its financial relations with the rest of the world. It is also clear, however, that the characteristics of the domestic policies applied will play an important role in the achievement of an adjustment that is economically less costly and socially more equitable.

1. External factors

Essentially, there are four external factors that determine what kind of adjustment the region can make: the amount of net external financing, the level of international interest rates, the real rate of growth of world trade, and the international prices of the main Latin American exports.

The amount of financing is important because it determines not only the share of the current-account deficit that must be covered by the adjustment but also the time that is available for doing so. If, as happened recently, the net inflow of capital drops precisely when there is a cyclical deterioration in the terms of trade and an increase in interest rates, a greater proportion of the external disequilibrium will have to be eliminated by means of adjustment measures and there will be less time in which to do it. In that event, as has been explained before, the fundamental mechanism for reducing the deficit on current account would have to be that of sharply reducing imports. Because they are already at an extremely low level, this additional reduction would have an even more negative impact on economic activity and employment than it did during the period 1982-1983. If, on the other hand, a greater amount of external financing is available, the adjustment policies will be relatively less difficult to implement and can be carried out more gradually. In other words, it will not be necessary to reduce imports and there will be more time in which changes in relative prices can promote the necessary transfer of resources from the sectors producing non-tradeable goods, towards export and import-substitution activities. It will thus not only be possible to avoid, to a large extent, the reduction of economic activity that is usually brought about by a sharp reduction in the volume of imports, but also to achieve a more lasting correction of the external disequilibrium, inasmuch as there will be a true restructuring of the apparatus of production.

Nevertheless, as the recent experience of the region has shown, what is important is not only how much external financing is received but also how much it costs. If interest rates remain at the high levels now prevailing or if substantial surcharges continue to be imposed

under arrangements for the renewal or extension of loans, the deficit on current account will increase and so will the difference that has to be covered by the adjustment policies.

That is why the future trend of international interest rates, in the first place, the terms to be established in the new series of renegotiations of the external debt, in the second place, and the amount of new additional credit that can be obtained either from private commercial banks or, preferably, from public international financial bodies, in the third place, are all so important to the countries of Latin America. If basic interest rates fall, if the various surcharges imposed in the renegotiation of the external debt are also lower, and if the net inflow of loans and investment increases, the region will be able to carry out a less traumatic adjustment process with more definitive results than those attained in recent years and it will also be able to increase its imports, thus embarking upon a moderate process of economic recovery and growth without being faced with another unmanageable deficit in the balance-of-payments current account.

In the last analysis, however, if Latin America is to achieve a satisfactory degree of economic development and obtain an adequate amount of external financing to facilitate the adjustment process, it will have to increase and diversify its exports. As has been explained above, over the last three years, many of the countries of the region have taken measures —e.g., considerably increasing their real effective exchange rates— which are fundamental to the achievement of this objective. Nonetheless, as has also been pointed out, the effect of these measures has been considerably neutralized by the stagnation and decline of international trade and by the deterioration of the terms of trade. These trends must be reversed in order for a growth-oriented adjustment process —based on the rapid and steady growth of exports— to replace the heretofore recessive adjustment based on a radical and untenable contraction of imports. In order for this to be possible, however, there must be a consolidation and strengthening of the recovery of the economies of the industrialized countries, and these countries, as they recover their economic dynamism, must drastically cut down on the protectionist measures they have introduced in recent years.

2. Internal policies

Although to a large extent determined by external factors, the success of an efficient adjustment also depends on certain internal circumstances and, above all, on the economic policies which are applied to reduce the deficit on current account. Thus, the possibilities of covering this deficit and at the same time maintaining or even increasing economic activity and employment are greater in an economic situation characterized by low or moderate inflation and by considerable and widespread underutilization of the production capacity. The task is, on the other hand, made more difficult if the implementation of the adjustment policies must be initiated when the inflationary process is very intensive and there is less underemployment of the labour force and underutilization of the installed capacity.

Thus, the best combination of internal policies from the point of view of decreasing the external imbalance is not necessarily the same in all countries or at all times in the economic evolution of any particular country. These policies may also differ depending on what have been the main causes of the external deficit. If the deficit has basically been caused by the excessive expansion of internal expenditure —as was true in certain Latin American countries—, policies such as fiscal, monetary and incomes policies which promote the adjustment by acting directly on the level of the aggregate demand will be more important. If, on the other hand, as happened in other countries of the region, the main cause of the imbalance on current account is the maintenance of a very low exchange rate or the structural deterioration of the terms

of trade, adjustment policies in such fields as exchange rates, tariffs or export promotion, which alter the relative prices of tradeable and non-tradeable goods and in the end manage to correct the external imbalance by changing the composition of expenditure and the structure of production, will be called upon to play a more decisive role.

In spite of the fact that these various types of adjustment policy differ, and with good reason, as to the priority assigned to them and the importance of the role they play in different circumstances, there are certain general principles which should guide in their selection and in deciding on the extent to which they are actually applied. Thus, in the course of the adjustment, there should be a continual effort to abide by the principle that the social cost of saving on foreign currency by decreasing internal demand should be matched by measures to save or earn foreign currency by applying reallocation policies at the expenditure and production levels. This is especially important in the short term, since although policies which put a ceiling on the level of aggregate demand may rapidly result in a significant saving of foreign currency, due, in particular, to the depressive effect which they have on imports, this result is achieved at the expense of drops in production. Conversely, policies which change the relative prices correct the external imbalance more slowly, but they do not have a negative effect on the level of economic activity.¹ Precisely because of this difference in the speed with which the two categories of policy work in the short term, in many cases it will be advisable, in order to avoid drops in production, to apply “overswitching” measures during the initial phases of the adjustment process.

In addition, in order also to keep the recessive and distributive problems associated with policies calling for a reduction in internal demand down to a minimum, cuts in expenditure should be made primarily in those categories with a high imported content and as little as possible in those which benefit labour-intensive activities. In particular, an attempt should be made to see that the decline in the production of non-tradeable goods which the adjustment policy calls for in a situation of near full-employment occurs, as far as possible, at the same time that the production of tradeable goods is increased, and not before.

(a) Policies for controlling domestic demand

As has already been pointed out, the reduction of domestic expenditure plays an essential role in the adjustment process. Control of aggregate demand is also an indispensable element in stabilization programmes. This is the reason for the basic importance of restrictive fiscal and monetary policies, both for redressing the external imbalance and for moderating the inflationary process.

However, if the adjustment is to be efficient and the stabilization effort is to have lasting and equitable effects, it is not enough merely to eliminate the fiscal deficit or to bring out a sharp reduction in monetary expansion. If those objectives are to be reached, the formats and mechanisms by which the balance in the fiscal accounts is restored, together with the relationship between the growth rate of the means of payment and the rate of change of other leading economic variables, are no less important.

- (i) *Fiscal policy.* In many countries of Latin America, the excessively rapid expansion of public expenditure and the equally notable increase in the magnitude of the fiscal deficit have undoubtedly been leading causes of the increase in the external imbalance and of the acceleration of the inflationary process. For that reason, in such countries, the rapid and substantial reduction of the fiscal deficit, *sine qua non* both for adjustment and for stabilization. Thus, it is necessary either to reduce expenditure or to increase

¹ See sections 2 and 3 in the appendix.

the income of the public sector or to take both those steps at once. However, the respective policies must be applied in such a way, as to ensure that their contribution to the adjustment and stabilization effort is, as great as possible, and that their negative effects on production and employment are kept down to a minimum.

Thus, with regard to expenditure, preference should be given to reducing current outlays more than bringing down expenditure on investment, since a marked and, above all, indiscriminant decrease in the latter would not only affect future economic growth, but would also limit the possibilities for setting an efficient adjustment process in motion. As indicated above, in the last analysis a positive and lasting adjustment calls for changes in the structures of production and employment, of a kind which increase the absolute size and the relative participation of the production of exports and of import substitutes. In the short term, this increase in production should be achieved basically through more intensive use of the installed capacity, of the activities producing tradeable goods, which is at present very much underutilized in many countries of the region. In the medium term, however, the reallocation of resources which the adjustment process necessarily involves makes it necessary to expand the production capacity in these activities. This is why it is advisable to maintain, as far as possible, the real volume of public investment.

However, the strongest likelihood is that, owing to natural and legitimate social pressures applied for the purpose of avoiding sizeable cuts in public sector employment and remunerations as well as because of the size of the fiscal deficit which must be covered, public investment will decrease. If this happens, it is essential to adopt measures to change its composition. As the basic objectives of an efficient adjustment are to reduce the external imbalance and to maintain or increase levels of production and employment, investments which have a high imported content should be reduced and, on the other hand, those which require relatively few imported inputs and are highly labour-intensive should be favoured. In general, this means reducing the investment in machinery and equipment and maintaining the amounts spent on construction. In the majority of Latin American countries, construction has a very low imported content but is directly or indirectly responsible for the employment of a considerable volume of labour. For this reason, the sudden curtailment of public works and housing programmes, frequently decided upon as one of the first steps to be taken under programmes aimed at reducing the fiscal deficit, yields very few benefits from the point of view of adjustment in that while resulting in hardly any reduction in imports, it has a high economic and social cost since it leaves many labourers out of work who cannot easily find short-term employment in export activities or import substitution. It is therefore advisable initially to maintain the level of expenditure on construction and to reduce it only gradually as the decisions adopted in respect of the exchange rate and tariffs and aimed at raising the levels of activity and employment of the sectors producing tradeable goods, begin to have the desired effect.

For the purpose of achieving an adjustment which is more efficient and less costly in social terms, in addition to giving higher priority to investment in construction, than to that which requires more machinery and imported inputs, governments should assign greater priority to investment projects which take less time to mature than to those which facilitate the increase in the production of tradeable goods and those for which external financing can be obtained.

So long as the net inflow of capital is not regained and it is necessary to apply a restrictive monetary policy, interest rates need be very high and consequently it will be a good idea to defer investment projects with very long gestation periods; such projects can be undertaken once the crisis in the external sector is over, when, financially speaking, there will be greater room to operate and a more abundant supply of foreign currency, so that

projects taking a long time to mature and having a higher import content can be viewed in a more favourable light.

In selecting public works, it will also be necessary to show systematic preference for those which increase or promote the production of exports and import substitutes, such as, for example, irrigation canals, road construction, improvements in agricultural and mining areas, extension of ports, etc., over those which only improve the living conditions of certain groups living in the larger and richer cities (such as the construction of underground railways, road works and urban modernization schemes, etc.).

During the adjustment process, finally, special priority should be assigned to those investments for which external financing can be obtained, particularly if it is long-term financing at interest rates lower than those charged by international commercial banks. In addition to their positive effects on production and employment, such investments have the advantage of increasing only that part of the public sector deficit which is not covered by external financing, and external financing is of direct help in reducing the imbalance in the current account, whose elimination is one of the *raisons d'être* of the adjustment process.²

In most cases, in order to decrease the public sector deficit significantly, it would be necessary to reduce the current outlays, and obviously such a reduction would have to be higher if it were desired to maintain, or at least not to effect a sudden cut in investment. This would present difficult problems of a political nature, since in the majority of the countries the main component of current expenditure is remunerations. Therefore, if it were necessary to reduce total government disbursements while at the same time maintaining the level of public investment, it would very probably, be necessary to lower the remunerations of the public sector. So that this would not have a direct effect on employment, it would in turn be absolutely essential to effect some decrease in the wages paid in the public administration and in the State enterprises. It is likely that, although difficult from a political point of view, this decision would in many cases be preferable to its alternative —cutting employment in the public sector. The latter would not only be a very regressive measure, in general, from the point of view of distribution, but would almost inevitably affect the volume of the services supplied or of the goods produced in the public sector.³

Subsidies constitute another large component of current expenditure, and in many cases they would have to be reduced in order to balance the fiscal budget. However, if such a decision is unavoidable, it should be put into practice in a way which maximizes its contribution to the re-establishment of the external balance and minimizes any possible negative effect it may have on the poorest groups. Although most subsidies tend to benefit such groups, only really progressive subsidies benefit the poor more than other sectors of the society. In this sense, the food subsidy is more progressive than the fuel subsidy, and therefore, the latter should be decreased much more than the former.⁴

In order to keep the negative redistributive effect of the decrease in subsidies down to a minimum, those applied to prices, which lower the purchase cost of a subsidized good for

² For this reason and also because of the large external debt of many countries of the region, it is now advisable, from a purely economic angle, to raise the relative share of foreign investment in total external financing. Naturally, this decision must be assessed on the basis of political criteria of a more general nature.

³ Of course, the relative advantages of reducing wages or employment in the public sector depend on the prevailing circumstances in each country. Thus, if the global rate of unemployment is relatively low, there are a considerable number of redundant workers in the public sector and the average wages paid in it are very low, it may be preferable to reduce government expenditure on remunerations by decreasing the number of government employees rather than by lowering their wages. Of course, these two ways of reducing the total remunerations paid in the public sector could also be combined in varying proportions and, moreover, not necessary in the same proportion in all the different branches of the civil service or in all the various State enterprises.

⁴ In order to mitigate the impact had by the reduction of the fuel subsidy on the poor as much as possible, a direct subsidy can be applied to public transport, which would, in fact, benefit a greater proportion of the poor (especially in the big cities) than of the rest of the urban population.

everybody who buys it, whether he is rich or poor, should be replaced, as far as possible, by direct transfers to the most needy groups.⁵ In this way, the effect of the price rise caused by the withdrawal of the subsidy would be neutralized for the poorest groups through the transfer of income to them; in addition, the price rise would provide a disincentive to the consumption of goods by the middle- and high-income sectors in addition to encouraging them to increase their production.

In addition to these considerations which relate to distribution, subsidy policies must take account of the effect they will have on domestic demand for tradeable and non-tradeable goods. In general, in order to facilitate an efficient adjustment process, it will be advisable to decrease the consumption of the former and increase that of the latter, since lower consumption of tradeable goods will reduce imports or increase the exportable surpluses, while an increase in the consumption of non-tradeable goods will tend to increase the domestic levels of production and employment. This differentiated subsidy policy may be applied even in the case of essential goods such as foodstuffs, with a distinction being drawn between imports and exports and foods produced exclusively for local consumption. The latter are usually produced by small farmers and, because of relatively high transport costs or reasons relating to different preference structures, are not exported. The former, on the other hand, are frequently produced in medium-sized or large agricultural units. Therefore, because of its effect on the external equilibrium as well as its social consequences, the reduction of food subsidies should be concentrated on products which can be traded on the international market.

Moreover, while changes of this kind in subsidy policy mechanisms may increase the redistributive effects which can result if the volume of resources remains constant (or even if it decreases), other changes in the structure and destination of the subsidies may also make a significant contribution to the adjustment process. Mention should be made, for example, of the possibility of reallocating the resources used to subsidize the domestic consumption of tradeable goods to an export subsidy programme or of using them as an incentive to increase production by raising the number of shifts worked in industry, particularly in industry with export potential.

The option just mentioned is very important, especially in the short term, since if increases in production and employment had to depend on new investments, they would necessarily be slow. However, in view of the present-wide margin of underutilization of production capacity which is the general rule in many Latin American economies, it is possible to effect a rapid increase in both production and employment by using the existing capital more intensively, and, an expeditious way of achieving this is to increase the number of shifts. Studies, carried out in six countries (Brazil, Colombia, Costa Rica, Chile, Peru and Venezuela) before the onset of the current crisis showed that in the manufacturing industry only slightly more than one and a half shifts a day were worked on average, and that, except in Brazil, close to two-thirds of the industrial enterprises worked only one shift.⁶ Because of the severe contraction in industrial production in the majority of the countries of the region over the past three years, the number of shifts worked in the manufacturing sector is probably now considerably lower. There is therefore considerable potential for significantly raising employment in production and —more important— for doing so at a much lower cost in terms of new investment. However, in order to realize this potential it is necessary to solve two problems: that of how to sell the increased output and that of the larger amount of imported inputs required for that output. Both can be solved at the same time if the increase in production is sold in the exterior; it is therefore necessary to link the incentives for increasing the number of shifts worked to an export promotion and subsidy programme.

⁵ Although this principle of the efficiency of subsidy policies is always valid, it acquires special importance when it is necessary to reduce the total amount of the subsidies, as may become necessary during the adjustment process.

⁶ See Daniel M. Schydowsky, *Capital utilization, growth employment and balance of payments and price stabilization*, Center for Latin American Development Studies, Boston University, December 1976.

Finally, consideration should be given to a third way of decreasing total government expenditure which does not involve reducing current outlays or investment —namely, cutting defence spending. Although the decisions taken by governments in this aspect of national policy cannot be appraised solely or primarily from an economic point of view, it seems reasonable to assume that in many cases lowering such spending would result in appreciable progress towards redressing the balance of public finances and reducing the external deficit. The latter effect would be particularly significant if the contraction in defence spending were concentrated on armaments, which have a very high imported component in the majority of the Latin American countries.

However, to reduce the often sizeable deficit of the public sector, it is not enough to reduce expenditure, but it is also necessary to increase income, which in turn means increasing the tax levy and raising the prices and rates charged by State enterprises.

Of course, the mechanisms and procedures for achieving these objectives, as well as their relative importance, would be different in different countries. Nevertheless, there are two ways of increasing fiscal income which have proved to be particularly effective in the recent experience of some Latin American economies: the indexing of the tax system and the reduction of tax evasion.

In actual fact, in the presence of an inflationary process of any size (such as now exists in a much larger number of Latin American countries than approximately ten years ago), indexing is indispensable for maintaining the real level of tax earnings. In such cases, if the tax system is not indexed and there are lags between the time a tax is levied and the time it is paid, there will be a drop in real terms in tax earnings, and the more intensive the inflation and the longer the lag, the greater the drop will be. In order to gain some idea of the magnitude of the impact which this phenomenon can have in the generation and expansion of the fiscal deficit, it should be borne in mind that with an annual rate of inflation of 40% and an average legal lag of three months, the real level of the taxes collected will fall by 10%.

Another negative effect of an unindexed tax system in a context of inflation is the incentive it provides for a deliberate delay in meeting tax obligations, which results in the extension of the real lag well beyond its legal limits. This occurs because if the fines and interest which are applied on account of the delay are not adjusted on the basis of the inflation, the taxpayer profits by postponing the payment of his taxes, thereby causing a *de facto* reduction in the real amount of the taxes he owes.

Therefore, the integral indexing of the tax system is one of the basic mechanisms used to reduce the fiscal deficit in countries facing a significant inflationary process and also helps to reduce the intensity of the inflation.

In addition, in many countries of Latin America there is known to be a considerable amount of tax evasion. In order to increase fiscal income, there is a greater need to control evasion than to raise the tax rates established by law, which are sometimes very high precisely because of the extent to which tax evasion is practiced. Recent experience in the region shows that this task is possible and that the basic requirements for carrying it out are not excessive. In addition to the essential requirement of the political determination to see that the tax legislation is respected, the following steps must be taken:

- (a) a drastic simplification of the tax system in respect both of the number and rates of the taxes and of special discriminatory exemptions and schedules. This will facilitate tax controls by traditional means tremendously and is indispensable for strengthening these controls by applying modern computer methods;
- (b) turning tax departments into divisions with special status within the public administration and providing them with the means of carrying out their controls and with a sufficient number of highly qualified and well-paid technical staff;

- (c) the establishment by law and the effective and rapid application of rigorous sanctions against tax offenders, and sanctions to be designed in such a way as to make tax controls more effective as well as to give taxpayers the general idea that it is economically more beneficial to meet their tax obligations than to run the risk of failing to do so.

For the purpose of reducing the public sector deficit, the amount collected by the central government in taxes should be supplemented by a rise in the prices and rates charged by State enterprises, some of which usually generate a considerable share of the total public deficit. In addition to having to strike a better balance between the income and the expenditure of the public sector, higher rates and prices have two further advantages. The first of these is that they cause State resources to increase much more rapidly than do changes in tax legislation, and the second is the adjustments they introduce in the price system, which have a direct positive impact on the adjustment process. In not a few cases, the artificially low prices charged by State enterprises encourage excessive domestic consumption of tradeable goods, such as fuels, which tends to increase the external imbalance, either by giving rise to more imports or by decreasing the exportable stocks.

- (ii) *Monetary policy.* Monitoring the expansion of the money supply and of credit is essential to any adjustment and stabilization policy, since if the means of payment continue to grow too quickly, domestic demand will also continue to expand at an exaggerated rate, and as a result the external imbalance and inflation will grow worse.

However, it is not enough simply to reduce the growth rate of the money supply. In order to avoid recessive effects on the real level of economic activity, deceleration is necessary not only in the case of monetary expansion, but also in that of the growth rates of the nominal values of other key variables, such as prices, wages, the exchange rate and the rate of interest; it thus becomes necessary to bring the monetary policy into harmony with incomes policy, with the policy governing price controls and guidelines, and with expectations for the evolution of inflation.

Monetary deceleration can in practice be either contractive or stabilizing, depending in the last analysis on the outlook for inflation. If producers continue to adjust their prices and labour contracts on the basis of the inflation in the past rather than the inflation targeted by the economic authority, reducing the growth rate of the monetary supply will have a contractive effect, since there will not be enough money available to purchase the goods produced at the new higher prices. As a result, and because prices are originally determined by the expectations regarding inflation, a monetary restriction will result in a drop in the product rather than in slower inflation, and the stabilization programme might well end in "stagflation", i.e., inflation accompanied by recession.

Naturally, inflation cannot be kept at the same level indefinitely only because of the expectations for it. If the line is to be held, the forecast must be borne out by the monetary policy. A problem which frequently arises is that pressures are exerted by the drop in production which tends to occur when the inflation targeted in the monetary policy is significantly lower than the inflationary expectations of the producers and trade unions; these pressures work at cross purposes since there is a tendency, on the one hand, to try to reduce the expectations for inflation and, on the other, to relax the monetary policy so as to reduce its recessive aspects.

The latter case, instead of its being the expectations which are adjusted in the monetary policy, it is the policy which is moulded to fit the expectations, so that in effect the economic authorities end by putting their stamp of approval on inflation targeted by the producers and abandoning their own original forecasts. It is therefore important, that they should try to influence the outlook for inflation so as to bring it into line with the stabilization programme.

One consequence of all this is that the monetary and credit targets agreed to with the International Monetary Fund should be set in conditional rather than in absolute terms, in particular with regard to a decrease in inflation. Thus, for example, if the inflation actually declines as originally forecast, the postulated reduction in the growth rate of the money supply should be maintained. If, on the other hand, the inflation falls more slowly than foreseen so that rigid adherence to the projected deceleration in the growth of the means-of-payment supply might result in a drop in production, a way should be left open for increasing the growth rate of the means-of-payment supply on the basis of a previously agreed criterion.

To keep a restrictive monetary policy from generating too many recessive and redistributive effects, it is important also to bear in mind that its impact is not neutral, since it has a more than proportional effect on those sectors which are particularly sensitive to variations in the interest rate and to the availability of credit. Such sectors include construction and agriculture, whose use of working capital is relatively more intensive, so that they are affected more directly by credit restrictions and also medium-sized and small manufacturing firms, which would in all probability see their access to bank financing decrease markedly if the banks allocated credit directly on the basis of the guarantees which their clients could offer, instead of doing so by raising their interest rates. In addition, all three of these sectors are labour-intensive, so that a decline in their level of activity tends to produce a disproportionate drop in employment. For this reason, it is a good idea, in implementing a restrictive monetary policy, to set guidelines to ensure that the share of these activities in the total credit line remains the same and that, as far as possible, the real long-term interest rate is applied rather than the considerably higher rate which is usually applied during the adjustment period.

- (iii) *Prices and incomes policy.* As already noted, if a stabilization policy is not to give rise to recessive effects, it is indispensable for the nominal changes in the main macroeconomic variables to decelerate simultaneously and in line with the inflation target on which the monetary and fiscal restrictions posited in the policy are based.

Simultaneous deceleration is one very important way in which an incomes policy can constitute to stabilization. In addition, an incomes policy should strive to bring the values of the variables (exchange rate, wages, interest rate) close to the long-term equilibrium values, thereby avoiding destabilizing contractions of economic activity.

However, it makes no sense to control the *nominal* values of wages and interest and exchange rates if the prices of goods are not also controlled, since the aim is to affect the real levels of remunerations and of interest and exchange rates.

Guiding or controlling (rather than freezing) the prices of certain goods is all the more important when, in order to make progress towards external balance and internal stabilization, some relative prices must be adjusted, such as, typically, the exchange rate and public service prices. If no attempt is made to guide the rest of the prices towards a new point of equilibrium, it is likely that, at least at first, decisions to raise the real exchange rate and the relative prices of the public services will bring about considerable increases in the prices of the other goods, owing primarily to the tendency of their producers to resist the decline in earnings which they expect will result from the attempt to change relative prices through devaluation and by adjusting public service rates and to confuse this change with generalized inflationary pressure. On the other hand, the possibility of bringing about this kind of change in relative prices becomes greater, if the producers can see that by monitoring prices, the economic authorities are able to limit price rises to those goods whose prices were primarily very low.

This is by no means the same thing as reducing inflationary pressures by the government's setting artificial prices or by creating complex bureaucratic price-control machinery. It needs

relatively simple rules of price adjustment, which can be easily applied and whose effects are sufficiently generalized so that different sectors can be reached. These regulations should preferably be applied to industrial prices, since they are the most sensitive to the expectations for inflation and to oligopolistic controls; and to make matters easier, the effort should be focused on the control of the leading enterprises, since they usually enjoy a certain amount of oligopolistic power, and can put pressure on the suppliers of their inputs to accept prices which are in line with those paid for the products they manufacture. They are also normally more capital-intensive, which makes them better able to absorb any temporary lowering of their operational income which may result from the price control policy by reducing their margins of profit.

Another sector in which prices can be guided or monitored is that in which certain basic inputs for construction are produced. As seen above, during the adjustment process the public works programme must play a basic role in maintaining the level of activity of the construction sector. The government may therefore negotiate the price of some basic inputs, such as cement, bricks and iron, taking the total public works and housing programme into account.

For purposes of facilitating a stabilization process which avoids the risk of recession, the incomes policy must also attempt to establish certain general principles in connection with wage adjustments, taking into account the fact that wages are a component both of demand and of cost. When wages rise but stop below their level of equilibrium, the demand effect usually prevails; the wage increase promotes production, and therefore employment, more than higher wage costs discourage employment. It is for this reason that in such an economic situation real wages may rise without harming employment or putting greater pressure on prices, since other factors affect them more. On the other hand, when real wages are already close to their point of equilibrium, the cost effect predominates, and their rise tends to discourage the hiring of labour and production.

Once real wages are close to their point of equilibrium, their real increase should be brought into line with the growth of the national income per worker and not with the domestic product per worker. Adjustment programmes aimed at reducing external imbalances caused by deterioration in the terms of trade or by higher interest payments can therefore have a neutral effect from the point of view of distribution only if wage variations are co-ordinated not with the domestic product per worker (which can be expected to rise), but with the national income per worker, which may drop even if the product grows, owing to drops in the terms of trade or to higher interest payments. For example, since 1979 the terms of trade of the non-oil-exporting Latin American countries have fallen by 20%, which means that this has been responsible for the transfer of close to 3% of the gross domestic product to the exterior (since international trade is equal to approximately 15% of the domestic product). As for the share of interest payments in the GDP in the same period, it rose from around 2.5% to 5%. In other words, during this period, these two factors were responsible for a total transfer of resources to the exterior of about 5 1/2% of the gross domestic product; this means that during these four years real wages should have grown by 1.4% a year less than the product per worker. Although this is a large figure, if the product per worker had grown at its normal post-war rate (3% a year), wages would, in any case, have grown at a rate of close to 1.5% a year. The really serious thing is that, due to the recessive nature of the adjustment, during this period the product per worker has fallen at an annual rate of approximately 1.5%, thereby exacerbating the wage contraction.

However, a more immediate problem which must be tackled by the remunerations policy in many countries of the region is that of setting rules which regulate wage readjustments in relation to inflation. In this respect, the ground rules for maintaining the real level of wages

during a stabilization process are: a) that wage rises should be based not only on the rate of inflation in the past but also on that expected for the future and b) that the periodicity of wage adjustments should vary.

In periods when inflation decelerates, the indexing of the wage on the basis of the inflation in the past causes the real wage to rise, since the average annual wage (which is the relevant wage) increases when the rate of inflation decreases.⁷ For this reason, tying wages to the past rate of inflation is one way of ensuring that either inflation in the future will be the same as in the past rate, or that real wages will rise (which may or may not be good depending on the economic situation at the start). Conversely, if nominal wages are adjusted solely on the basis of the future inflation, real wages will fall even if the target is met and the more so if it turns out to be impossible to reduce inflation by the amount envisaged.⁸

Therefore, if it is desired to keep the real level of remunerations steady, they must be readjusted on the basis of the inflation in both the past and the future.⁹ Even then there is the risk that if the inflation does not decrease as much as predicted, real wages will decline or that, if the inflation decelerates more than predicted, they will rise. Thus, a formula which is even more stable and less risky is the following: a) to readjust wages on the basis of both the past inflation and the projected inflation and b) to readjust them again when the inflation reaches the target level, whether that happens at the end of 12 months or sooner or later than that.¹⁰ If this is done, the average real wage for the period covered by the readjustment is sure to be the constant real wage postulated as a target.

Finally, the stabilization policy must establish guidelines in respect of the level and growth of interest rates. This does not of course mean setting them, in such a way that they are negative in real terms, as frequently happened in the past, because obviously not everybody can receive all the credit he wants at subsidized rates. In actual fact, a negative real interest rate is known to divide the market between those who have and those who lack access to credit whose cost has been artificially reduced by fixing the interest rate. In order to take advantage of this cheap credit, those who benefit from it tend to make their installations too large or to over-mechanize them or else to use the resources for the purchase of assets whose values are lowered by the fact that credit is tight, so that wealth also tends to be concentrated. In addition, the segmentation of the market discourages the expansion of activities with less access to the banks (usually the small and medium-sized enterprises, which use relatively more labour), forcing them to have recourse to credit in the informal sector at rates very much higher than the equilibrium rate. However, there are also problems when the real interest rate is higher than normal, at least when such a rate is maintained for a long time; it raises the financial cost sharply and therefore helps to reduce production. Moreover, as the recent experience of a number of countries of the region shows, it is obviously impossible for real interest rates

⁷ If the nominal wage is 100 during a year and inflation is 100%, the annual average real wage is approximately 75:100 on the first day of the year and 50:100 on the last day. Thus, if the nominal wage is doubled the following year (200), the real wage at the beginning of the year is 100 and, if the inflation decelerates to 50%, the real wage falls to 67 at the end of the year, 200/300; in other words, the average wage is approximately 83, or 11% (83:75) higher than the preceding year.

⁸ With this kind of adjustment, if an attempt is made to reduce the inflation to 50% in year 2 (after a situation of 100% inflation in year 1) and if the nominal wages are adjusted by 50%, at the beginning of the year they will rise from 100 to 150 in nominal terms and from 50 (100/200) to 75 (150/200) in real terms. If the inflation decelerates to 50%, at the end of year 2 the real wages will be 50 (150/300); i.e., in year 2 an average real wage of approximately , i.e., 16% less than that paid in year 1 (63:75), will have been paid.

⁹ In the case described earlier, if it is desired to keep the real wage equal to that paid in year 1 and inflation of 50% is anticipated, nominal wages should be adjusted by 80%, i.e., raised from 100 to 180, so that in real terms they rise to 90 (180:200) at the beginning of the year and then fall during the year until they reach 60 (180:300) at year end. Thus, the average real wage paid during the year will be equal to approximately 75 in year 2, the same real value as in year 1.

¹⁰ In the case already referred to, this example works out to an 80% readjustment, and another readjustment is made when the inflation reaches 50%. If it reaches 50% in 12 months, we have, as in the preceding case, an annual readjustment. If the inflation reaches 50% in 10 months, the readjustment is put forward, since the average wage for the ten months was already 75 (the real wage targeted); in contrast, the opposite occurs if prices take longer than 12 months to rise by 50%.

of 25%-30% to be paid over a very long period in economies whose growth rates of 5%-6% a year without a financial crisis occurring.

As the credit market is subject to rapid change in terms of price (i.e., the interest rate), imbalances in other markets (goods, foreign currency, assets) tend to be reflected in it not only in the form of sharp variations in the real interest rate, but also in ridiculously high real rates, which are maintained for as long as these imbalances remain. In actual fact, a high interest rate reflects such imbalances but is unable to solve them. While they persist, a real interest rate slightly higher than the international rate must be maintained (or "suggested") since this is the price of obtaining additional capital for the economy.

A natural concomitant of this is that in such situations credit must needs be rationed in terms not only of quantity, but also of price until the excess demand arising out of the imbalances existing in other markets disappears. Meanwhile, it will be necessary to decide what part of the demand for credit is "legitimate" (i.e., based on a production potential which deserves to be realized) and what part is "illegitimate" (i.e., arising out of the desire of the applicant for credit to avoid liquidating his inventories or assets when their price is at its lowest). It is true that such a decision is not always easy to make or to put into practice, but it is better to be guided by it than to risk a crisis throughout the financial system because of real interest rates which can obviously not be paid except in rare cases or on a temporary basis.

(b) Reallocation policies

As already noted, if the adjustment process is to be efficient, it is indispensable for the restrictive demand policies aimed at reducing the level of domestic expenditure to be accompanied by other policies which change the relative prices of non-tradeable and tradeable goods, in such a way as to provide an incentive for the production of the latter and to discourage their consumption.¹¹ The reallocation policy with the most widespread effects is exchange rate policy. Unlike tariffs policies or export promotion policies, which stimulate the production of a group of tradeable commodities at the expense of another group, devaluation favours all such commodities.

It is because of this that it is important to set a high real exchange rate for any programme aimed at reducing the external imbalance. However, since export activities and those which produce goods in competition with imports or used as substitutes for them are sensitive not only to the real level of the exchange rate over a relatively short period of time but also to its stability, the exchange policy should not be open to sudden change but should be managed in such a way as to provide the producers with a clear indication of the real value of the currency in the long term. The application of a policy which eliminates sudden and frequent variations in the real exchange rate has the advantage of decreasing the uncertainty concerning the future level of the exchange parity and the risk of capital movements, which has destabilizing effects on the balance of payments, the economic activity and the level of prices.

In order then to cope with a cyclical short-term deficit on current account for which financing is not available, it may be more appropriate to resort to the temporary application of selective tariff surcharges in the case of imports and special subsidies in the case of exports, using significant variations in the real exchange rate only to reduce external deficits related to more permanent factors or as a remedy for unmistakable cases of exchange rate lag. Such a policy has the additional advantage of not subjecting costs to inflationary pressures so generalized as to give rise to devaluation and, above all, is much less likely to give rise to galloping inflation or to increase the expectations of its occurring.

¹¹ For an analysis of this subject, see section 2 in the appendix.

In the present circumstances in the majority of the Latin American countries, export incentives are likely to yield better results from the point of view of foreign currency earnings than tariff surcharges on imports. In general, export promotion is more productive in periods of recovery and growth of the international economy (as the period just beginning is hoped to be), while import substitution, on the other hand, is relatively more beneficial in periods of international recession, such as the period 1981-1983. In addition, in view of the tremendous reductions in the volume of imports in most Latin American countries over the past two years, it is reasonable to assume that the possibilities for producing a significant amount of additional import substitutes in the short term are limited. Finally, the existence of a considerable margin of idle capacity in manufacturing industry represents an export potential which could be put to use if sufficient incentives were given.¹²

The special incentives for the production of tradeable goods should not only be applied on a temporary basis, but should also be selective and should favour activities with a highly elastic supply in the short term.¹³ Such activities are likely to include a significant proportion of the industrial enterprises which are at present underutilizing a considerable share of their installed capacity. As for tariff surcharges, they should preferably be applied to non-essential imports, such as luxury goods and those for which substitutes can be produced relatively easily. They would be counterproductive if applied to imports of intermediate goods for which few substitutes were available locally.

In order to ensure that such special incentives are appropriately structured, it would be advisable as far as possible to abide by the basic principle of efficiency according to which the cost of earning a certain additional amount of foreign currency by expanding the export trade must equal the cost of saving the same amount of foreign currency through import substitution. This is why in theory an export incentive equal to the tariff protection provided for import substitution is justified. This means roughly that the subsidy given to exports of a certain commodity must be equal to the tariff rate which protects that commodity in the domestic market. If the tariff structure is differentiated (usually with higher tariffs for final products, lower tariffs for intermediate goods and minimum tariffs for raw materials), the export incentives should also be differentiated so as to equalize the incentives as between exports and import substitution and also among the various potential exports.

This policy of providing special temporary incentives for exports and for import substitution, which tends to reduce the trade imbalance, can be complemented by a policy which establishes a higher financial exchange rate than the commercial exchange rate for a limited period of time with a view to promoting the inflow of new capital and the return of some of the considerable amount of national capital which has flowed out in recent years. During this period, the financial exchange rate would be increased at a lower rate than the commercial exchange rate, so that at the end of the period in question, the two rates would be levelling out. If the commercial exchange rate were adjusted on the basis of the difference between the internal and the external inflation, this decision would make it more attractive to bring in capital from the exterior, since, as a result of the slower increase in the financial exchange rate by comparison with the commercial rate, anyone who brought in capital would obtain a very attractive interest rate.

In the last analysis, the temporarily higher financial exchange rate would, so far as capital flows are concerned, be the same as a tariff surtax on the more non-essential or easily

¹² In theory, this capacity could be used also for increasing production for the domestic market. This would make it necessary to import more intermediate inputs, which would be difficult to finance under present conditions, but there would be no obstacle if the additional output were sold in the exterior.

¹³ In actual fact, if the application of special incentives were generalized and even, their effects would be the same as those of raising the foreign trade exchange rate, but their administrative cost would be higher.

substituted imports and as a special incentive for the more elastic exports. Thus, all highly elastic foreign currency flows, whether commercial or financial, would temporarily enjoy the equivalent of a higher exchange rate, while a lower exchange rate, similar to the equilibrium exchange rate in the long term would be applied to imports and exports of less elasticity.

It is true that in some cases it might be administratively easier to obtain the same result by setting a single exchange rate which was much higher than the long-term exchange rate and establishing a temporary tax for traditional exports and a very low tariff (or even a special subsidy) for essential imports. However, the basic principle would remain the same, i.e., the establishment of a higher real exchange rate, while the external crisis is being resolved, for those categories which in the short term respond rapidly to the price incentive, and a lower real exchange rate for those components with less elasticity.

B. Towards more equitable renegotiation

1. Overview

The current debt crisis in Latin America clearly requires quick remedial action because without this efficient adjustment becomes all but impossible. Actions to alleviate the crisis can be taken at three different levels: a) national; b) international and c) regional. In considering formulas one must also take into account an additional dimension: that of time. In other words, in sorting out the possible solutions to the problem it is important to distinguish between actions that can provide immediate relief and those that are more of a medium or long-term proposition.

This latter type of distinction becomes necessary because in Latin America the debt problem has ceased to be a theoretical problem and is now of the highest practical urgency. Latin America needs relief from the crisis today, since socioeconomic tensions in the borrowing countries are at unprecedented levels. To quote President Hurtado of Ecuador in his opening address at the January 1984 Latin American Economic Conference in Quito, "if the economic crisis of our nations is not solved, it could give rise to a new cause of serious and unsettling social and political conflicts which will inevitably upset the shaky world equilibrium".

The countries of the region have taken extraordinary measures to adjust and make payments to their creditors. But as already pointed out, the adjustment has been undertaken in a depressive world economic environment. It has been made more difficult by conditions in which an unbalanced international financial system has been unable to provide adequate amounts of anti-cyclical finance. With simultaneous depressive trends in both trade and finance, it is not surprising that the adjustment process carried out so far can best be characterized as having been perverse: it was achieved basically via a brutal compression of imports and unprecedented falls in per capita income.

In at least one important sense the adjustment in Latin America is probably complete: after a 41% fall in the value of imported goods in 1982-1983 it is difficult to believe that there is any "fat" left in the region's import structure. For this reason alone it is of paramount importance that Latin America avoid further reductions in imports.

But the problem is not only to detain the further squeezing of vital imports. One suspects that the rapid adjustment in Latin America has been somewhat artificial; it has been motivated by desperation and has been negative in character inasmuch as it was won largely by greatly weakening the productive capacity of the region. In contrast, a positive, efficient adjustment is one that comes about by strengthening productive capacity, and this in turn requires, among other things, economic restructuring, investment, reactivation and a greater capacity to import.

Unfortunately, the weight of Latin America's debt service —even after the first round of reschedulings— provides little or no margin for economic growth and recovery of international reserve positions. Thus, any type of economic recovery restructuring will require new and direct remedies to relieve the burden of the debt.

The theoretically most appropriate measures to tackle the debt crisis are at the international and regional levels; but because of political and economic obstacles such solutions cannot be sufficiently timely and provide the immediate relief that Latin America so urgently needs in 1984 and 1985. In view of this, borrowing countries must explore other solutions which could involve much higher costs for the international community.

2. The best solution: a multilateral settlement involving the banks, their governments and debtor countries

(a) The public nature of the debt crisis

The current debt crisis in Latin America must be viewed as a public problem, the cost of which is not borne by those responsible for it, but by others: in other words, the costs are externalized.

From the standpoint of the debtors, servicing problems for a major borrower, i.e., Mexico in mid-1982, created a panic in financial markets and were perceived by bankers as a "Latin American problem", so that the ensuing general restriction of new loans quickly sucked almost all other Latin American debtors into the crisis. The importance of this negative externality in the development of the crisis comes to light when one remembers that in normal market conditions debtors invariably are permitted to repay loans with the contracting of new ones.¹⁴ With the spilling over of the Mexican crisis to all of Latin America, the countries of that region lost the very resources (new loans) that had been permitting the smooth servicing of private bank debt for more than 15 years.

From the standpoint of the banks, the negative-externalities surrounding the crisis are just as impressive and tend to intensify the problem. For instance, a bank could not possibly agree to extend new credit to a borrowing country without knowing that all other creditors would do the same; otherwise, that bank's new loans would just be used to repay loans to other institutions which were retrenching from the market, with no net benefit from the borrower and considerably increased risk for the bank.

Negative externalities are also present in the so-called "market solution" to the debt problem. For example, losses on a portfolio derived from poor risk assessment by an individual lending institution could very well set off a panic in financial markets that would adversely affect the viability of other institutions which technically had not erred in the evaluation of their own risks.

But the externalities also abound when one seeks to pinpoint just who is to blame for the problem, and hence where the costs of the problem should lie. Again, in the purely competitive framework outlined earlier, where all decisions by the economic actors are made independently, the costs should be fully borne by the inefficient lenders because they charged premiums on the basis of their assessment of risk, and recourse to those premiums should be taken when the risks materialize. The real world, however, is not so simple. It has already been pointed out that externalities will prevent the incidence of losses from being limited to banks which pursued poor lending criteria. But more importantly, risk evaluation by creditors in the 1970s was not formulated independently. Banks, in fact, were strongly encouraged by

¹⁴ See Pierre Dhonte, *Clockwork debt*, Lexington Books, Lexington, Mass., 1979; W.A. Lewis, *The Evolution of the International Economic Order*, Princeton University Press, New Jersey, 1977 and R. Devlin (1978), *op. cit.*

their governments, as members of OECD, to lend to LDCs, both through direct exhortations that banks must recycle petrodollars and, indirectly, by i) expansionary fiscal and monetary policy which produced excess liquidity in the banking system, ii) the asymmetry between tight regulation of the home financial market and unregulated international markets, and iii) the failure to support international lenders such as the IBRD, IDB, IMF, etc., which could have been a more appropriate alternative for recycling.

Additional externalities were generated by the structure of financial markets itself. As already noted, the banking system has two tiers: the big international banks that search out markets and evaluate risk, and medium and small banks which provide the bulk of the funds and lend on the basis of the assessments of the big banks. Furthermore, the big international banks themselves are locked into an oligopolistic structure and do not make lending decisions independently of what they expect their competitors to do.

Finally, examining the problem from the standpoint of the debtors, it must be remembered that while during the 1970s Latin American countries borrowed on the basis of their own needs and decisions, they were also encouraged to do so by a form of conventional wisdom prevalent in important international circles that argued that bank credits were “cheap” in real terms and that foreign indebtedness was “good business”.

In sum then, what one is confronting is a big “public problem”. Both in terms of the causes of the crisis as well as its nature, one can perceive that the banks, their governments, and the LDC borrowers are subject to important interdependencies that condition all solutions to the crisis and suggest that a sharing of the costs is appropriate.

(b) A public problem demands a public solution

A *sine qua non* for efficient adjustment in Latin America and a lasting solution to the crisis is a co-ordinated effort on the part of the OECD governments to reactivate their own economies and bring interest rates down to historical levels. Indeed, if Latin America’s terms of trade had been similar to those prevailing in 1980 (25% higher than at present), and if at the same time real interest rates mirrored those in force at the time when the bulk of the debt was contracted (4 points less), the region would have available to it US\$ 25 billion of additional resources, enough to meet debt services without a dramatic compression of imports and hence of growth. It also must be remembered that this a terrain where debtors, creditors and their governments have strong mutual interests: economic recovery would reduce unemployment and social tensions in both the North and South, while lower interest rates would promote recovery and restore the repayment of loans by debtors without threatening the profits of the lending institutions.

In the absence of a strong and sustained recovery of the OECD countries, debt service will depress Latin America’s growth prospects and, in the context of “short leash” reschedulings, continue to occupy a disproportionate share of bankers’ and developing country authorities’ time.

Nevertheless, proposals abound to alleviate the problem by joint multilateral public action. A summary of the contents of some of the proposals is presented in table 20. In addition to these global ideas, specific measures have frequently been suggested concerning reform of the international financial structure. These include:¹⁵

- (a) increasing available long-term finance from the World Bank via a change in the gearing ratio of this institution;
- (b) authorisation of direct access by the IMF to private capital markets;

¹⁵ See also the Brandt Commission, *North-South: a programme for survival*, Cambridge, Mass.: the MIT Press, 1980.

- (c) co-financing between the World Bank and private banks-,
- (d) elimination of the concept of graduation for middle-income countries;
- (e) modification of IMF conditionality; and
- (f) increasing the importance of programme loans in the World Bank.

On the regional front there are similarly many proposals to help Latin America overcome the crisis. To mention just a few of them here:¹⁶

- (a) a freeze on protectionism, together with efforts to promote the expansion of regional trade and preference schemes;
- (b) the expansion and interconnection of the various interregional financial programmes already in existence such as multilateral payments mechanisms,¹⁷ schemes for balance-of-payments support,¹⁸ import credit insurance plans¹⁹ and the establishment of institutions dedicated to the financing of projects;²⁰
- (c) the enlargement of the role of the Inter-American Development Bank; and
- (d) effective, direct and confidential exchange of information on the conditions on which the external debt of the countries of the region is being refinanced and reprogrammed.

¹⁶ For a complete review of regional schemes see C. Alzamora and E. Iglesias, "Bases for a Latin American response to the international economic crisis", *CEPAL Review*, No. 20, August 1983, pp.17-46.

¹⁷ Central American Clearing House, Caribbean Multilateral Payments Clearing System, and the ALADI System for Clearing Mutual Balances and Credits.

¹⁸ Santo Domingo Agreement, Central American Fund for Monetary Stabilization, and Fund for Financing Debit Balances of the Central American Clearing House.

¹⁹ Latin American Export Bank, Andean Trade Financing System, and Latin American Association of Export Credit Guarantee Organizations.

²⁰ Central American Bank for Economic Integration, Caribbean Development Bank, Andean Development Corporation, and Financial Fund of the River Plate Basin.

■ Table 1

SUMMARY OF SELECTED PROPOSALS TO ALLEVIATE THE DEBT CRISIS

Government of Mexico ^a	A new window at the IMF that would provide lightly conditional finance to countries facing interest payments in excess of 2% real. This represents an expansion of the concept underlying the Fund's current compensatory finance facility.
Kenen ^b	In this scheme private banks trade their LDC loans for 10-15 years bonds to be emitted by a newly created OECD supported international organization. The loans would be traded at a 10% discount and the devaluation of the banks' assets would allow the new institution to reschedule LDC loans on more favourable terms.
Weinert ^c	Private banks would trade their LDC loans for bonds to be emitted by the World Bank and the Bank, in turn, would reschedule the loans on better terms. The trade would be at face value, but the bonds would carry a reduced interest rate; this would distribute losses over a longer period than would occur in the Kenen plan with its immediate 10% devaluation of assets.
Zombanakis ^d	The IMF would extend its adjustment programme to 10-15 years. The private banks would then reschedule their loans in a way that is compatible with the longer adjustment programme and in turn would receive an IMF guarantee for the latter maturities of the rescheduling.
Bolin and del Canto ^e	Propose the establishment of a new public institution to provide loans that bridge the short-term maturities of private banks and the longer-term maturities of multilateral lenders. They also envision a bigger financing role for OECD export credit agencies. As for the fluctuation in interest rates, it is suggested that the World Bank provide residual finance that would effectively guarantee a maximum interest rate for debtor countries.
Lever ^f	On the basis of an evaluation of what constitutes a reasonable current account deficit, countries should have made available to them a maximum amount of finance. This evaluation will be made in conjunction with the IMF. Bank loans in this programme also should enjoy OECD government guarantees.
Avramovic ^g Massad ^h	Both propose increases in LDC liquidity via new emissions of SDRs.

Source: Developed from data in M. Guerguil, "La crisis financiera internacional: diagnósticos y prescripciones" (mimeo), *ECLA Review* No. 24, Economic Development Division, November 1983.

^a "Facilidad para el financiamiento del déficit de balanza de pagos provocado por las altas tasas de interés" (mimeo), August 1983.

^b P. Kenen, "A Bailout for the Banks", *New York Times*, 5 March 1983.

^c R. Weinert, "Banks and Bankruptcy", *Foreign Policy*, No. 50, Spring 1983, pp. 138-149.

^d M. Zombanakis, "The International Debt Threat: A Way to Avoid a Crash", *The Economist*, 30 April 1983, pp. 11-14.

^e W. Bolin and J. del Canto, "LDC Debt: Beyond Crisis Management", *Foreign Affairs*, Summer 1983, pp. 1099-1112.

^f H. Lever, "The International Debt Threat: A Concerted Way Out", *The Economist*, 9 July 1983, pp. 18-20.

^g D. Avramovic, "The Debt Problem of Developing Countries at End 1982", *Aussenwirtschaft*, March 1983, pp. 55-85.

^h C. Massad, "The external debt and the financial problems of Latin America", *CEPAL Review*, No. 20, August 1983, pp. 149-154.

The spirit and intent of all these proposals is correct: public problems require public solutions. However, their efficacy is conditioned by the aforementioned element of time: most of the proposals are at best a medium-term proposition. It must be remembered that an economic system based on private markets tends to underproduce public solutions (i.e., public goods). Furthermore, pressures for a public solution are usually minimal until the externalized costs of a problem become internalized *vis-à-vis* the major economic agents of the system.

So far, the ability of the banks to successfully reschedule debts on terms highly favourable to them has allowed the capital exporting countries to keep the costs of the debt crisis externalized, i.e., the debtor countries have borne them and what benefits there are have been largely accrued to the creditors.²¹

Solutions at the regional level also encounter similar obstacles. The major difference, however, is that the costs of the crisis have already been internalized for the most important

²¹ A recent study by A. Fishlow notes that the nine biggest United States banks obtained extraordinary profits totalling between US\$ 70 million and US\$ 130 million in 1983 from renegotiation of debts with the Third World. See *El Mercurio* (Chile), 16 January 1984.

economic actors of the region, thus giving greater impulse to regional solutions. But in any event, time remains a factor and regional accords cannot be expected to provide immediate relief from the debt crisis.

3. An alternative solution: bilateral agreements compatible with positive adjustment

A public solution to the crisis, while entirely desirable and urgently needed, does not seem feasible in the near future. This reduces the field of action to the national level, where the response could be a bilateral agreement between the borrowing country and its creditor banks involving a rescheduling suitable for positive adjustment.

It has already been observed that Latin America must reduce its external vulnerability by restructuring its relations with foreign creditors and adopting more efficient strategies of indebtedness and growth. Nevertheless, the region presumably will want and need future external financing. The value of a bilateral settlement involving a rescheduling on terms suitable for a positive adjustment process is that it is less conflictive than unilateral action and thereby may avoid serious negative repercussions with respect to the future access to credit. Such a settlement should be in keeping with the terms and conditions agreed at the January 1984 Quito Latin American Economic Conference already referred to.

(a) The terms of an agreement in line with the criteria of the Quito Plan

Assuming that the effects on Latin America of the present world economic upturn will be more gradual than has been the case in past recoveries since World War II, and assuming that in the near future nominal and real interest rates will remain unusually high, rough and ready estimates would suggest that for Latin America to grow by 5% per annum in the triennium 1984-1986 and to begin a modest recuperation of its international reserves, it will need to reschedule all its amortization payments, and on average have 80% of its interest payments rescheduled or refinanced.

In this light, bankers and debtor countries should arrive at a rescheduling package that at a minimum covers the triennium 1984-1986, although ideally the two should pursue a restructuring of the entire stock of debt owed to the banks. It is absolutely essential to eliminate the traumatic yearly rescheduling exercises which consume so much time of government authorities and bankers, raise uncertainties, and inhibit restoration of a normal credit environment for Latin America. Thus, a debt relief package providing a once-and-for-all definitive breathing space on upcoming payments is called for. Such a new debt relief package could coincide with the IMF's extended adjustment programmes, thus providing bankers with the security of the Fund's conditionality.

Amortization of debt, however, is really not the problem as bankers have shown a disposition to reschedule. The real bottleneck to recovery in Latin America, and the issue on which the focus of attention must lie, is the problem of interest payments. As has been seen, banks have been refinancing about 40%-50% of interest payments. Even so, the GDP continues to fall as countries must generate large trade surpluses (in the face of external constraints on export performance) to cover the remaining interest payments, which come to a very large sum due to the extraordinary level of nominal interest rates. *Ceteris paribus*, then, formulas must be found to reduce these interest payments not financed with fresh loans.

Therefore, as an integral part of the rescheduling agreement, creditors should provide an *ex ante* guarantee of 80% refinancing of interest payments²² during the period 1984-1986.

²² The guarantee, of course, would be tied to compliance with IMF adjustment programmes, which presumably could be less severe due to the greater available financing derived from the greater roll-over of interest payments.

This could very well involve a sliding scale, e.g., 90% in 1984; 80% in 1985, and 70% in 1986, to take into account the possibility of a gradual improvement in the world economy and somewhat lower world interest rates. An historically useful instrument called a “*bisque* clause” could also be inserted into the agreement to provide for less automatic refinancing of interest payments in the event of a dramatic and unforeseen favourable change in the world economic situation and/or a sudden drop in interest rates.²³

The rescheduled amortization payments and refinanced interest should bear a repayment schedule that pushes against the limit of what could be considered a commercial transaction. It is already known that this schedule should be at least 10-12 years (with a 6 year grace period), since a 10-year amortization period (6 of grace) was agreed to in the second round of the Mexican rescheduling and 12 years were awarded to Nicaragua in 1980, all with no negative repercussions or sanctions from the creditors’ local banking authorities. But an even more acceptable goal would be 15 years (6 of grace): a maturity plan that banks extended with some frequency on loans during the 1970s.²⁴ On the other hand, the 20-year repayment plan often proposed in Latin American forums risks going beyond the threshold of tolerance of local banking supervisors, since it represents a period that traditionally is outside a bankers’ business horizon and enters into the terrain of an institutional investor. While OECD government guarantees on the tail end maturities could overcome this latter problem, such a scheme is outside the self-imposed constraint of a bilateral agreement.

As for the margins over LIBOR —another of the elements determining the negotiated cost of credit— charged on rescheduled debt and refinanced interest payments, they must be as low as possible, yet satisfy the requirements of a commercial framework. This would involve spreads well below those charged in the first round of reschedulings and in most cases below those originally contracted on the debt to be rescheduled. These spreads cannot really be specified theoretically, since the relationship between the banks and the debtor country is in the nature of a bilateral monopoly, so that the rate finally fixed will depend on the relative bargaining power of the banks on the one hand and the country on the other.

But even within the banking community itself there have appeared proposals to the effect that while the banks could not accept a spread below their marginal cost of funds (which is the LIBOR), a 1% margin would be feasible as a temporary measure.²⁵ An even better arrangement, however, would be one providing for a 1% spread, or the margin originally contracted on the debt to be rescheduled/ refinanced, whichever be lower. This would allow countries like Mexico, with traditionally excellent images of creditworthiness, to approach their normal negotiated cost of credit (which is below 1%); most other countries on the other hand would enjoy a spread somewhat lower than that originally contracted on the debt. There is moreover a precedent for this type of treatment inasmuch as the successful bank restructuring of United States and Canadian corporate debt involved special “soft” market rates of interest. Indeed, respected experts in the OECD area have recommended that this strategy for problem debtors in domestic markets be extended to the international plane.²⁶

²³ *Bisque* clauses were employed by the United States Government on some of its post-war loans. For example, in 1945 the Government made a US\$ 4 billion loan to the United Kingdom, to be repaid over 50 years, in which a *bisque* clause allowed the repayment schedule to adjust to the economic conditions of the borrower. See G. Abbott, “The case for cancellation”, *Inter-Economics*, No. 7, July 1975, pp. 217-221.

²⁴ The 15-year loans most often appeared in the early phase of the bankers’ expansion into LDCs, that is, in the first half of the 1970s. See the annexes of the World Bank study, *Borrowing in International Capital Markets*, Washington, D.C., Supplement EC 181, August 1976.

²⁵ See P.P. Kuczynski, “Latin American Debt: Act Two”, *Foreign Affairs*, Autumn 1983. On the other hand, Robert Roosa, a former Under-Secretary of the Treasury of the United States and now a partner in the investment bank of Brown Brothers Harriman, has declared that interest rates should be close to LIBOR. See “Robert Roosa delivers Sturc Memorial Lecture emphasizing a broader role for the Fund and Bank”, *IMF Survey*, 15 December 1983.

²⁶ See R. Roosa, *op. cit.*, and R. Weinert, “Banks and Bankruptcy”, *Foreign Policy*, No. 5, Spring 1983.

As for commissions, they in principle should not be charged in the rescheduling/refinancing package, since one is, dealing with an administration of existing debt in which commissions were already originally paid. However, following normal banking practices, there is no reason why payment of commissions could not be agreed to in exchange for an interest spread somewhat lower than that proposed here.

(b) Co-operation among debtor countries

Achieving the above rescheduling conditions is a question of bargaining power. As noted earlier, the banks' bargaining power and ability to impose conditions may have been somewhat eroded by negative reactions in certain influential circles of the centre and periphery concerning what appear to be excessive charges on reschedulings. The Latin American countries could further increase the pressure, however.

The simplest and least controversial way of doing this would be an exchange of information among the countries concerning the bargaining tactics of the banks. This idea, which was proposed by the Executive Secretaries of ECLA and SELA in the Plan of Action presented to President Hurtado of Ecuador in 1983,²⁷ would help to counterbalance the advantages enjoyed by the banks, which exchange information through their committees, as well as through a new institute recently organized by them in Washington, D.C. In the first round of reschedulings, the borrower countries negotiated in relative secrecy and to little advantage, as witnessed by the fact that the terms of the agreements are practically identical for all the countries. The establishment of a credit information system within an existing regional institution would seem to be an easy way to enhance the bargaining power of the Latin American countries.

(c) Interest rate ceilings

The refinancing of an average of 80% of interest payments means that current cash payments to the banks would be only a low percentage of debt outstanding. This is quite reasonable because even cash payments equivalent to a "normal" 2% real interest rate would be very burdensome in the current abnormal world economic conditions. Thus, if it is sought to achieve even moderate economic growth, it is reasonable to assume that interest payments on a cash basis must be well below 2% real. Nevertheless, as a proposal for the future, if and when the world economy returns to a degree of stability, it would be constructive to try to stabilize interest payments around a "normal" rate —say 2% real— with the balance over this being capitalized with interest by creditors.²⁸ This would provide debtors with a degree of stability in interest payments. Moreover, the international financial markets would then have an "automatic" mechanism to roll over interest payments and thereby avoid the trauma and uncertainties that excessively high interest rates generate in financial markets via their negative and transitory effect on the debt servicing capacity of borrowers.

4. Other action

Two unilateral solutions to the debt problem have recently been put forward and discussed in political and academic circles: a moratorium, and unilateral conversion of the debt into long-term bonds. In fact, both solutions are very similar, since proponents of a moratorium are not suggesting repudiation of the debt, but rather a temporary halt in current commercial

²⁷ See Alzamora and Iglesias, *op. cit.*

²⁸ In the 1960s the banks frequently set floor and ceiling interest rates for loans with floating interest, but there was no machinery for capitalization and finally the system ceased to be attractive for the banks.

repayment schedules and their eventual replacement by very long-term service calendars. In this context there also would be no need to submit to an IMF adjustment programme.

While the precise terms of repayment differ among the various proponents of these schemes, they are similar in principle. Payments of interest and principal would be halted for a period of 2-5 years, with reimbursement of principal being affected over a 20-30 year period. Interest rate proposals vary from less than market rates to a 2% real rate.

The proponents of these plans argue that they would: i) provide considerable and immediate relief from the burden of debt; ii) offer a repayment scheme that is much more compatible with development than any commercial scheme that would conceivably be acceptable to the banks, and iii) eliminate the need for endless multiple reschedulings with their ensuing costs of time and resources.

Another potential benefit, often cited by proponents of unilateral debt conversions into bonds, is that such an emission would help to create a secondary market for Latin American debt paper. On the one hand, this would allow the banks to free themselves of unwanted assets by selling them off in such a market. On the other hand, countries would gain valuable information on their creditworthiness via the fluctuations in the market value of their paper. Also, any sharp devaluation of the assets in the market could provide potential debt relief via the opportunity to repurchase the obligations at their new lower values.

The proponents of these solutions must be aware, however, that they also involve some important costs. The first cost is related to what would happen to the bonds and future access to credit. A generalized debt conversion into bonds, or moratorium, would force the banks to write off a considerable part of the value of their loans to LDCs. This would imply large accounting losses for the banks. Moreover, the losses would be disproportionately assumed by the big United States lending institutions which are the least diversified with respect to Latin American debt.²⁹

These losses would probably prejudice future access to credit. On the one hand, the losses would seriously threaten the solvency of many of the world's largest financial institutions. The resulting uncertainty would paralyse credit markets and spark a major rise in interest rates from their already excessively high levels. According to some analysts, this in turn could cause the debt crisis to spread to Northern markets, stifle the economic recovery of the OECD countries,³⁰ and hence make even more problematical the recovery of Latin America's creditworthiness.

On the other hand, creditors have long memories with regard to accounting losses, as witnessed by the reluctance of institutional investors to re-enter the LDC bond market after their disastrous experience in the earlier half of this century. These negative repercussions are intensified in a modern banking system. First, there are the aforementioned negative externalities that make the crisis permeate the entire financial network. Second, the losses would be disproportionately concentrated in the big banks, which are the most internationally oriented and to a large extent are responsible for mobilizing credit from the hundreds of smaller domestically-oriented banks that provide the bulk of loanable funds in the market. Furthermore, the big banks also have some control over bond markets, since they frequently underwrite such instruments.³¹

²⁹ See D. Wyss and R. Napier, "The World Debt Crisis and the U.S. Economy", *Data Resources U.S. Review*, September, 1983, pp. 124-129.

³⁰ *Ibid.*

³¹ There is of course the theoretical possibility of emitting bonds with respect of debts to banks that find such an arrangement acceptable, such as United States banks and European institutions which are relatively less exposed in Latin America. But this theoretical possibility is stifled by the legal requirements of cross-default clauses, which put all banks into the same boat. Moreover, this boat is piloted by the big United States institutions.

As for the benefits of developing a secondary market, these too are problematical. First, there is the question of who would purchase the paper. Second, a unilateral bond emission by one or several small borrowers would involve values that are too low to support efficient secondary market operation. Furthermore, although such action by a big borrower and/or smaller borrowers would create values sufficient to form a secondary market, the losses imposed on the banking system could be so large and immediate that the primary market would probably be in disarray for a considerable length of time, while the secondary market would not emerge, thus adversely affecting both access to new credits and conversion of old debt.

APPENDIX

C. Conceptual aspects of the adjustment policies

1. Adjustment and financing

The need to initiate an adjustment process arises when an economy is faced with a deficit on its balance-of-payments current account which it cannot finance in a regular fashion. In other words, an adjustment is inevitable when the difference between domestic expenditure and income—which, by definition, is the deficit on current account—exceeds the maximum amount which the economy, is able to finance, either by attracting a net amount in foreign loans and investment or by using its international reserves. Under such circumstances, the adjustment process becomes inevitable because, in the last analysis, there is a fundamental budgetary restriction, i.e., the economy simply cannot spend (“absorb”) more resources than it has, including its own and borrowed resources.

The origin of the external disequilibrium which the adjustment policies must correct may be found in internal factors—such as an excessive growth of aggregate demand or the maintenance of an excessively low real rate of exchange—or in external factors. The latter may be of a temporary nature—e.g., a temporary increase in international interest rates or a cyclical drop in the terms of trade—or of a permanent nature e.g., a deterioration in the purchasing power of exports caused by the partial or total displacement of an export product on the world market by more efficient and less expensive substitutes.

These distinctions are important because, in principle, an adjustment policy should be limited to correcting the deficits arising from internal causes and those which arise from external causes of a permanent nature. Negative balances on the current account that are caused by temporary external factors should not be eliminated through adjustments in the economy, but rather they should be financed with international reserves or external indebtedness. In practice, of course, if international reserves are inadequate or if the necessary external financing is not available, adjustment policies will also have to be applied to cover at least part of the negative balance arising from temporary external factors.

2. Basic adjustment policies

Essentially, there are two types of adjustment policies: those which reduce the level (or growth rate) of domestic demand and those which raise the relative prices of internationally tradeable goods (i.e., exports or exportable goods, imported goods and goods which replace imports) *vis-à-vis* the prices of non-tradeable goods.

As will be seen, both groups of policies are necessary in order for the adjustment process not only to achieve its basic objective of reducing the external disequilibrium to a level where it can be financed,, but also to achieve this result in a more efficient fashion.

Policies for controlling the aggregate demand —typically, fiscal, monetary and income policies— help restore the external equilibrium through three basic mechanisms. Firstly, by limiting domestic expenditure, they directly reduce imports and make available for export goods which had previously been absorbed by domestic consumption or investment demand. Secondly, by also reducing domestic expenditure for non-tradeable goods, they free real resources (in activities which produce them), which can then be used to increase the production of exports and imports substitutes. Lastly, by raising domestic interest rates, restrictive monetary policies tend to attract a greater amount of external financing and thus reduce the amount of the external disequilibrium that must be eliminated.

Policies such as those pertaining to the exchange rate, export subsidies' and promotion and tariff increases, which raise the relative prices of all or some tradeable goods, supplement the effect of policies aimed at controlling the aggregate demand by generating changes in the composition of domestic expenditure and in the structure of production.

Thus, for example, by raising the national-currency value of exports, imports and import substitutes, a devaluation tends, first of all, to reduce domestic demand for all these goods, thus helping to increase exports and decrease imports by virtue of the decline in domestic expenditure deriving from policies aimed at restricting the aggregate demand. Moreover, as a devaluation raises the relative price of tradeable goods, this in turn increases the profitability of the industries producing them, thus fostering an increase in the production of exports and of goods that compete with imports. Naturally, the devaluation has exactly the opposite effect on the demand and supply in respect of non-tradeable goods, i.e., by reducing their relative price, it stimulates their consumption, on the one hand, and, on the other, it discourages their production. The latter change reinforces the change brought about by the decline of total domestic expenditure deriving from policies aimed at controlling demand and therefore tends to facilitate the reallocation of resources from the production of non-tradeable goods to the production of exports and import substitutes. The other change, i.e., the reduction of the relative price of non-tradeable- goods, tends to neutralize the effect of the decline in total domestic demand and thus helps attenuate the resulting decline in levels of activity and employment of the sectors which produce non-tradeable goods and services.

In brief, it is possible, by simultaneously applying policies aimed at controlling demand and policies aimed at changing relative prices, to reduce the extent of the external disequilibrium by reducing total domestic demand through an adjustment in the composition of expenditure (from tradeable to non-tradeable goods) and through adjustments in the structure of production (from the production of non-tradeable goods to the production of tradeable goods). In theory, moreover, this combination of policies should make it possible to restore the external equilibrium while maintaining the overall level of employment.

In order for the latter to occur, of course, resources must be reallocated from the production of non-tradeable goods to the production of exports and import substitutes. Because

such resources, particularly over the short term, are relatively specific in nature, and because it is necessary to expand the installed capacity of the sectors producing tradeable goods, this process of reallocation takes time and requires additional investment. In practice, therefore, adjustment can only succeed in a dynamic context of economic growth. To achieve this, policies aimed at restricting demand and at changing relative prices must be complemented by others aimed at promoting investment in export and import-substitution activities and facilitating the movement and readaptation of labour.

3. The cost of the adjustment

As has been indicated above, when a current-account deficit can no longer be financed, an adjustment is inevitable. When this happens, the difference between domestic expenditure and income must be reduced to an amount that is compatible with the actual flow of external financing. The central concern, therefore, is not how to avoid going through an adjustment, for when international reserves fall below the minimum level required to allow for a smooth operation of international trade and no additional external financing is available, there is no question but that an equilibrium must be brought to the balance of payments; rather, the main concern is how to minimize the cost of the adjustment. Consequently, the two fundamental objectives of an adjustment process are to reduce the current-account deficit to an amount that can be financed and to achieve this at the lowest possible cost.

Strictly speaking, the greater or lesser efficiency of an adjustment process depends on the extent to which it achieves the second objective. Indeed, the achievement of the first objective —to reduce the external disequilibrium— necessarily entails a cost to society, at least in relative terms, i.e., it means that exports must be increased, imports decreased or both.

The three alternatives have one fundamental effect in common that must be stressed, i.e., they cause a reduction in the volume of goods that remain available on the domestic market to meet consumption and investment expenditure. From the social standpoint, the inevitable cost of making an adjustment to an external disequilibrium lies precisely in this real reduction of available goods (or of their rate of growth). The more external financing is available, the more this cost can be distributed in different ways over time; as will be noted later on, this aspect may be a crucial one, particularly from the viewpoint of the political and social viability of adjustment programmes. Sooner or later, at any rate, the price must be paid.

A clear distinction should be made, however, between the cost that is inherent in the process of correcting an external disequilibrium and another social cost that, in practice, often goes hand in hand with adjustment policies, namely, the decline of the domestic product. Contrary to what happens when there is a decrease in domestic *expenditure* —and its counterpart, *available goods*— the contraction of domestic *production* is *not* an inevitable consequence of adjustment policies. As explained above, adjustment policies require a reduction of the ratio of expenditure to income and this objective —to the extent that expenditure is restricted— can be achieved more easily when domestic production increases, while it is more difficult when domestic production goes down.

This becomes even more evident when it is borne in mind that in order to reduce the external disequilibrium, in addition to reducing imports, it is normally necessary to increase exports. The efficient way to achieve both results would be to increase production, both of exports and of import substitutes. Depending on the extent to which existing resources are utilized and the ease and speed with which they can be moved from one sector to another, such increases in production may require a decrease in the production of non-tradeable goods. Even in this case, there is no reason for overall economic activity to slow down, since, in theory, a

decrease in the production of non-tradeable goods could and should be offset by the increase in the production of exports and import substitutes.

Consequently, an adjustment policy causes a decline not only in domestic expenditure but also in domestic production entails an excessive social sacrifice and must be qualified as inefficient because, to the inevitable drop in the volume of available goods that is required to correct the external disequilibrium, it adds an unnecessary and definitely counterproductive drop in the production of tradeable goods.

The ideal adjustment to an external disequilibrium, therefore, is characterized by an increase in exports, the replacement of some imports of intermediate goods by domestic products and the elimination of non-essential imports or their replacement by local products whenever possible. A less desirable adjustment, on the other hand, would be one which would lead to the reduction but not the replacement of imports of necessary intermediate goods; in that case, the external disequilibrium is corrected at the expense of a slowdown in economic activity and a drop in employment.

The advantage of the latter type of adjustment is the speed with which it works. Indeed, it is possible, under such an adjustment policy, to bring about a short-term and very drastic contraction of imports, provided there is a willingness to incur the recessive cost this entails. The ideal adjustment, on the other hand, works more slowly because, as explained above, it calls for structural changes to be made in the supply and, in order for this to happen, changes must also be made in the spheres of production and marketing.

It is true that, in principle, if there is an idle capacity or if the only concern is to divert abroad that part of production that is freed through the restriction of domestic expenditure, the response in terms of production must be speedy. In practice, however, this is likely to be limited by the need to fit the quality and type of goods produced to the requirements of the external market, and by the fact that relatively long time periods are required for introducing them on those markets. In fact, even when goods that are internationally competitive in terms of price, quality and financing are available, it takes time and effort to sell them on the external markets, because buyers must be assured of a stable and constant supply. Obviously, this penetration of new markets is even more difficult when the international economy is at a standstill or going through a decline, as it then becomes necessary to displace from the markets in question other competitors who also probably have no better alternative for selling their production.

Consequently, the more time is available to make these changes, the greater will be the likelihood of the adjustment and correction of the external disequilibrium being implemented through changes in the structure of supply and, more specifically, through an increase in the production of tradeable goods rather than through excessive reductions in demand, with the resulting negative effect on overall economic activity.

Hence, also, it is important that there be a more abundant flow of external financing, since that allows time for resources to be reallocated towards the production of tradeable goods, a step that is essential to an efficient adjustment process.

In this regard, the recent experience of the region provides a clear illustration of the negative effect which the lack of adequate external financing has on the adjustment process. As indicated above, during the period 1982-1983, the net inflow of capital fell dramatically. Partly because of this, and partly because international trade fell at the same time, the adjustment process was necessarily very abrupt and led to a tremendous reduction of imports and a very small increase in exports. Since the reduction of imports affected not only purchases of non-essential final goods but also those of intermediate goods that are essential for maintaining adequate levels of domestic activity, it was partly responsible for bringing about a considerable decline in the gross domestic product.

4. Adjustment and inflation

External disequilibrium often goes hand in hand with inflation. This happens particularly when the main cause of the disequilibrium is the excessive expansion of domestic expenditure. When domestic expenditure grows too fast, prices and imports also tend to rise rapidly. Under such circumstances, economic policy is faced with a complex double challenge, i.e., to correct the external disequilibrium by means of adjustment processes and to reduce or eliminate a form of domestic disequilibrium —inflation— by means of stabilization policies.

Although the two problems and the policies designed to solve them are closely interrelated, it is advisable initially to separate them, since there are also significant analytical and practical differences between them.

One important difference is that which has to do with the possibility of delaying a solution to the external disequilibrium, on the one hand, and to inflation, on the other. For the reasons mentioned above, when the *deficit* on the balance-of-payments current account reaches a level where it cannot be financed through the net inflow of capital or the reduction of reserves, the application of adjustment measures is inevitable. On the other hand —and as the Latin American experience clearly shows— countries are able to live —although not very well— with inflationary processes of some magnitude for relatively long periods of time.

Another significant difference is the difference between the social cost of stabilization policies and that of adjustment processes. As indicated above, the latter necessarily entails a real cost, inasmuch as in order to correct the external disequilibrium, it is necessary to reduce the volume (or the growth rate) of the goods that remain available on the domestic market to meet consumption and investment demands. On the other hand, at least from a theoretical point of view, policies aimed at controlling inflation do not entail an inevitable real cost.

In theory, there is no reason why the reduction of inflation should entail a reduction of economic activity. This is so because, essentially, what an efficient stabilization policy should achieve is the simultaneous deceleration of the rates of change of the nominal values of several key variables, such as the money supply, the exchange rate, wages, profits and interest rates, and this, in principle, can be achieved without affecting the real sphere of the economy.

It is well known, nonetheless, that in practice, stabilization policies often go hand in hand with a decline in economic activity and employment. One fundamental reason for this is precisely the fact that the rates of increase of the aforementioned variables are not synchronized. If, as is often the case, the deceleration of the increase in wages and in the money supply precedes or is more intense than the deceleration of the increase in interest rates and prices, the stabilization policy will tend to bring about a contraction of real economic activity.

A third important difference between adjustment and stabilization processes has to do with the speed or intensity with which they can be implemented. In the case of an adjustment process, it is clearly preferable for it to be carried out gradually because, as mentioned before, the ideal way to correct an external disequilibrium is to change the structure of production, and this requires a reallocation of resources. All of this takes time. On the other hand, in order to control inflation, it is essential to make adjustments on the demand side. Although this calls for a co-ordinated policy that allows for a simultaneous deceleration of nominal changes in a series of key variables, it does not entail any significant modification in the structure of production. In principle, therefore, the goal of reducing inflation can be achieved rapidly.

In practice, however, stabilization processes frequently move at a slow pace. The fundamental reason for this is that the progress of a stabilization programme as determined by the speed at which the inflationary expectations of economic agents can be changed.

Strictly speaking, it is because such expectations are relatively rigid that it is preferable to apply stabilization policies that can be implemented gradually. That is why if, in an effort to reduce inflation abruptly, economic policy sets goals with respect to price increases that are much lower than the inflationary expectations of the main economic agents, the level of production will fall along with the rate of inflation. It is therefore important that the stabilization policy establish goals that seem credible, given the prevailing inflationary expectations. Similarly, because such expectations tend to change slowly, a gradual type of stabilization policy is often advisable.

However, if the “spontaneously” credible reduction of inflation is small and, above all, if the existing rate of inflation is very high, a gradual reduction may take so long that, in practice, what may not be credible is precisely that the government should continue with its gradual policy for as long as necessary.

Under such circumstances, it may be preferable to apply a “shock” treatment based on an income policy calling for a simultaneous and drastic adjustment of prices, wages, interest rates, exchange rates, rents, etc., and accompanied by substantial reductions in the fiscal deficit and in monetary expansion. In this case, however, it is of vital importance that such measures be adopted simultaneously with respect to all the aforementioned variables. If, as has happened in the past, the “shock” treatment consists of abruptly halting increases in some variables —typically, the money supply and wages— while leaving the others free, the result will be a tendency to generate undesirable and unnecessary distributive effects and equally undesirable and avoidable decreases in the level of production.

5. Adjustment, stabilization and reactivation

As mentioned above, it is much more difficult to apply adjustment policies —aimed at reducing the external disequilibrium— and stabilization policies —aimed at reducing the rate of inflation— simultaneously than it is to deal with only one or the other of these situations. When it is necessary to attenuate both the current-account deficit and the intensity of the inflationary process, it is more likely that economic policy will involuntarily cause drops in production and employment instead of only reducing domestic expenditure and the rate of price increases.

Nonetheless, if there is a second significant internal disequilibrium consisting of a substantial idle capacity for production in practically every sector there will be a greater chance of applying a *growth-oriented adjustment and stabilization policy*. This option also depends on the potential for increasing the volume of imports, particularly of intermediate goods, since under circumstances such as those described above, the scarcity of imported inputs is the main obstacle preventing an increase in the level of economic activity.

To a large extent, this hypothetical scenario reflects the current situation of quite a few Latin American economies. That is why it is so important to the region that the recovery of the world economy be strengthened, since this would have a positive effect on the volume and prices of exports, thus making it possible to finance a greater amount of imports. If this happened and if, in addition, coherent economic policies were applied, it would be possible at the same time to achieve a moderate rate of economic growth and to reduce the magnitude of the external disequilibrium and the intensity of the inflationary process. Naturally, much more progress could be made in these three fundamental areas if, as a result of negotiations with the international banks, less burdensome terms were granted for the service of the external debt and if interest rates on the main world financial markets went down. This would allow for a more rapid increase in the volume of imports —which, as already indicated, is the main obstacle to the achievement of greater economic growth— without such an increase bringing about an untenable increase in the deficit on current account.

CHANGE AND CRISIS: LATIN AMERICA AND THE CARIBBEAN 1950-1984 *

ECLAC

* Sections 3, 4, 5 and 6 (pages 19-36) of chapter I "Development styles of Latin American peripheral capitalism from the postwar period to the crisis", in "Crisis and development: The present situation and future prospects of Latin America and the Caribbean" (LC/L.332(Sem.22/3)), vol. 1, Santiago, April 1985.

1. From the 1960s onward. the boom in foreign trade and the oil crisis

(a) The economic process

From the middle of the 1960s the evolution of world trade, both through its dynamism and through a greater openness to supplies from Latin America, gradually increased the opportunities of the region. The potential of diversification and expansion which had not existed during the 1950s was changing one of the decisive elements which had characterized the development style of some countries since the 1930s.

The external commercial and political changes originated in the recovery of Europe, the rise of Japan, the emergence of an incipient multipolarity and a greater degree of *detente* following the cold war. The new situation brought with it a greater dynamism and capacity of access to world trade, a potential expansion of the degree of political action in the developing countries, and a greater interest on the part of foreign investment to share in Latin American economic activity.

At the same time, the external capital market began to change for Latin America. The European economies, which had absorbed an appreciable percentage of this capital in the post-war period, was freeing part of it and the transnationalization of enterprises was rapidly increasing. Thus, together with the greater availability of funds, a very aggressive agent was coming to the fore, which meant that the external changes, while offering opportunities, involved pressures and sometimes constraints on the possible options.

Nor should it be forgotten that the triumph of the Cuban revolution signified a radical change in development style for one of the countries of the region. Already in 1961 the United States was countering this in Punta del Este with a new organization project through which the region would be more fully incorporated into the world economic system and in which foreign capital would play a new and decisive role.

As a result of these events, and of the economic and political difficulties of a domestic nature described above, midway through the 1960s changes began to be introduced into the policies designed to modify the previous style of economic development. This first attempt at a change in style should have been completed when the crisis unleashed in 1973 and the major changes that occurred in the international scene from 1974 necessitated new qualitative changes in the style of development.

In this first stage, which covers from halfway through the 1960s to the crisis of 1973-1974, the countries were gradually modifying their economic policies in an effort to profit from the dynamism of external trade and the rise of new poles of demand. They promoted schemes of integration or co-operation on regional, subregional and bilateral levels in an effort to give external markets a more important role than in the previous stage; they tried to adjust industrialization to wider markets and extend their technical advances to agriculture in order to profit from the new external conditions; they gave a major role to the promotion of exports and at the same time, with the improvement in their current and capital accounts in the balance of payments, they explored the liberalization of imports and tended to give uniformity to the exchange rates. All this was aimed at eliminating the distortions of the past and creating conditions for fuller incorporation into the central capitalist economy.

They also reformed the legislation affecting foreign capital with the double purpose of obtaining greater amounts of direct foreign investment and of yielding to external pressures. Some countries limited their action to certain sectors and put restrictions on the returns of capital, while others had a more liberal attitude. On the whole, the criterion at this stage was

to give a complementary role to foreign capital, limiting its action to the productive sectors and restricting its access to the financial sector. Nonetheless, in the sectors of more dynamic demand and more advanced technology, the penetration of foreign capital was significant. On the other hand, in relation to natural resources, with the exception of agriculture there was a general trend towards nationalization, which enabled the countries to maintain or recover control of their activity in the mining and energy fields.

The external changes were accompanied by changes in domestic policies. The transformation of production represented a change in emphasis rather than direction. Industrialization continued to be its pivot, but the projects now included not only the domestic market but also an attempt at complementation with the subregional, regional or world markets. This entailed, in some cases, an increase in the processing of the natural resources exported, whether traditional or new. In others, it meant the incorporation of new branches aimed at consumer durables, basic intermediate inputs or capital goods.

In several countries reforms were also attempted in the agrarian sector. In theory, the aims simultaneously pursued were the expansion of the domestic market by the incorporation into the money markets of groups hitherto marginated, a more intense exploitation of natural resources which had been little used, and a greater penetration of technical progress. Industry not only produced the supplies for this transformation but also took advantage of the domestic expansion of the markets.

In the Central American countries the expansion of modern agriculture diversified supply on the national plane by incorporating products such as cotton, sugar and meat in countries which were not exporting them with a view to entering the North American market. In view of the difficulties in expanding the agricultural frontier, growth in some countries meant pressure on land already occupied and the displacement of peasants dedicated to traditional crops or the eradication of small farmers.

There were no doubts about the role of industry in the transformation, but it became involved in wider markets and was technically integrated in other sectors both domestic and subregional. In the large and medium-sized countries where foreign trade had been restricted to small percentages of the output, the new productive approach sought to flexibilize supplies, but it was not claimed that it was the external markets that gave direction to the transformation.

The new external conditions provided opportunities, but it was by no means easy to take advantage of them within the framework of the prevailing development style. It was imperative to change the functions of the State and to establish a new type of relationship with the transnational enterprises and different conditions for the functioning of foreign trade and finance. Naturally such changes depended on the particular conditions of each country, and especially on the stage it had reached in its productive transformation and its resource endowment. In some cases there was a need for a vigorous expansion of the role of the public enterprises; in others, for the support of national private groups which had to modernize some sector; and everywhere for a greater capacity of manoeuvre for transnational enterprise, an enlargement of the tasks of the general government and reforms of economic policies. As will be seen, the countries reacted in different ways and obtained very different results.

Many countries made major changes in the institutional structure of their economies. Little by little the governments advanced in the planning of their activities, both in the short and the long term. Although they did not always succeed in fitting their action into the framework of a formal plan, public activity did in fact gain in coherence and clarity of aim. The growing experience of the public bureaucracies and technocracies enabled major investments to be carried forward both in infrastructure and in industrial sectors, and led to a management of

economic policies which facilitated the adoption of long-term strategies and their adaptation to the changing external conditions.

Advances were also made, although with more disparity, in taxation, administrative and agrarian reforms. Naturally these reforms, especially the agrarian, aroused more reactions than the rest, so that the results fell short of the aims that had been proposed.

The financial markets were organized by means of changes in the process of accumulation and a greater insertion in the international sphere. Mechanisms for adjusting inflation were gradually introduced into these markets, which lessened the distortions of the past and added a new instrument to the management of inflationary situations.

As will be seen later on, the changes in style on the political level differ widely from country to country. In some, in accordance with the economic changes and even as a prior condition to them, the economic and social support of the governments was re-established. A greater role was given to transnational enterprise, to the armed forces, to technocracies and bureaucracies representing middle groups in ascent and excluding the popular urban groups which had been one of the mainstays of populism. In others an attempt was made to broaden the base of the populist and developmentist regimes by increasingly incorporating into the electoral processes large urban and rural groups. In general the governments which arose from these latter processes faced growing contradictions as a result of pressures to satisfy rapidly increasing demands. Lastly, in other countries the government alliances managed to consolidate the functioning of the political machine and were able to curb and absorb the demands of the economic and social groups that supported them.

The economic results of this period can be summarized, for the region as a whole, in a notable increase of economic dynamism and a visible enlargement of the role of foreign trade in the transformation of production. This summary, however, conceals a wide range of results.

Between the middle of the 1960s and 1974 the economic dynamism of the region exceeded an annual 6.5% and between 1970 and 1974 it exceeded 7%. The acceleration of growth was common to the great majority of the countries. In some net oil-exporting countries, especially in Venezuela, the smaller growth in output was accompanied by the positive effect of the terms of trade and an appreciable dynamism in national revenue (see table 4).

The two largest countries from an economic and demographic standpoint notably increased their economic growth, especially Brazil, whose average rates bordered on 10% per annum. This growth was due to a vigorous process of industrialization and a growing utilization of natural resources, including an expansion of the agricultural frontier.

■ **Table 1****LATIN AMERICA: ANNUAL GROWTH RATES^a OF THE PURCHASING POWER OF EXPORTS, 1950-1980**

	1950-1965	1965-1974	1974-1980
Latin America	1.9	7.3	6.8
Argentina	3.1	3.9	8.1
Bolivia	0.4	8.1	0.2
Brazil	-0.9	11.9	5.6
Chile	3.2	2.4	6.2
Colombia	0.9	6.5	9.8
Costa Rica	3.6	8.8	7.3
Dominican Republic	3.0	13.2	-2.1
Ecuador	3.4	14.5	6.6
El Salvador	4.5	3.2	7.1
Guatemala	4.2	4.9	8.9
Haiti	-8.4	3.8	11.3
Honduras	2.8	1.6	10.7
Mexico	1.8	7.0	16.2
Nicaragua	5.6	3.5	-4.5
Panama	5.3	7.2	1.2
Paraguay	2.3	6.2	12.2
Peru	6.9	3.4	7.8
Uruguay	-2.3	2.5	10.0
Venezuela	2.2	8.1	0.7

Source: ECLAC, on the basis of official data.

^a Percentages obtained through regression.

■ **Table 2****LATIN AMERICA: ANNUAL GROWTH RATES^a OF EXPORTS, 1950-1980**

	1950-1965	1965-1974	1974-1980
Latin America	4.7	3.6	6.4
Argentina	2.9	1.3	11.8
Bolivia	-1.7	7.0	-1.1
Brazil	2.8	10.6	9.5
Chile	3.0	1.6	13.7
Colombia	3.6	5.8	3.9
Costa Rica	4.9	11.9	1.9
Dominican Republic	3.4	11.5	1.3
Ecuador	7.1	10.4	2.7
El Salvador	8.0	4.2	2.7
Guatemala	7.8	8.6	2.9
Haiti	-14.2	3.7	9.7
Honduras	3.6	4.5	8.4
Mexico	4.4	5.4	12.6
Nicaragua	8.7	4.6	-4.8
Panama	6.5	6.9	6.7
Paraguay	3.9	4.7	12.1
Peru	8.7	-0.4	9.4
Uruguay	0.5	-1.7	9.4
Venezuela	6.0	-0.1	-4.0

Source: ECLAC, on the basis of official data.

^a Percentages obtained through regression.

Other small countries, such as Bolivia, Costa Rica, Ecuador and the Dominican Republic, combined the dynamic incorporation of new natural resources into their export products with progress in the first stages of industrialization, since they had begun the period with only slight advances in this direction. In this way they achieved high rates of economic growth. Agricultural and industrial modernization enabled Guatemala and Colombia also to grow at a rapid pace.

In contrast to these successes the countries of the Southern Cone, which had been in the vanguard of the region in their economic and social transformation, achieved only moderate and sometimes very low rates of growth. The growth rate likewise slackened in other countries in which industrialization had made little progress, so that they failed to cope with the problems, relating to restricted external markets and incorporation into regional and international trade.

The disparity in results observed in the economic dynamism is also noticeable in external trade. The changes in economic policies and the new conditions of external trade enabled the annual growth in the volume of exports during the period 1965-1974 to reach or exceed 7% in seven countries and 10% in four of them, while the purchasing power of exports exceeded 7% in eight countries and 8% in six of them (see tables 1 and 2). In contrast, in some countries, such as those of the Southern Cone, the growth of the volume of exports did not reach an annual average of 2%. Similar differences can be noted between the countries as regards their capacity to obtain direct foreign investment or external credit.

As a result of these performances the capacity to import suffered appreciable changes in relation to the post-war period analysed above. Some countries which had severely compressed their import coefficients, such as Brazil and Mexico, rapidly increased their imports and gave more flexibility to supply. The first of these countries performed a notable feat in reaching an annual average rate of 19% of growth in the volume of its imports, which, although they may have been partly destined for accumulation of stock, assisted the industrial transformation and the economic growth achieved during the period.

In contrast, some of the small and medium-sized countries suffered a fall in the growth rate of their imports, which had a negative effect on their economic dynamism; the imports of Peru and the Central American countries, except Costa Rica, grew at annual rates of between 3 and 4%, very much lower than those of the former period.

(b) The political process and the social groups

In political terms, this period underwent major changes. The transformation in the external conditions seemed to provide economic and political support for developmentist alliances which succeeded in reconciling the interests of very dissimilar groups by means of moderate reforms and economic dynamism. Sometimes, as in the case of the countries which created the Andean Pact, these alliances sought to rely on a subregional framework, through the creation of social, economic and political institutions which reflected the national agreements in a wider context. This project, however, made progress only in a small group of countries; in general these alliances dissolved and the democratic mechanisms which supported them were displaced by authoritarian regimes.

The incorporation of the rural groups through the agrarian reform encountered stronger social resistance than had been foreseen, especially when its economic cost competed with public expenditure on consumption and accumulation which benefited other more powerful groups.

The expansion of the economic base of the industrial sector involved the need to undertake new stages of development. Faced with this challenge, the industrial enterprises linked with the exporting and financial sectors, both national and foreign, regarded the latter as more reliable

partners in the new conditions than those who formed part of the developmentist alliance, and increased their criticisms of a State which they now considered to be an ineffective entrepreneur.

The middle sectors likewise felt threatened by the growth of popular demand, which they regarded as affecting their own possibilities, especially when the satisfaction of this demand involved inflation.

The changes in performance were the reflection of potential tensions which were barely and badly concealed by the regimes. The rapid growth of the urban sector found no outlet in the capacity of the economy to absorb it sufficiently and at an adequate level as a labour force. The agrarian structure, in growing contrast to the urban, raised the political status of its population and land-tenure problems. The rising proportion of the juvenile groups in the population called for the channelling of demands which put a strain on the education and employment systems and on the very values which sustained the political alliances. It is interesting to observe that these strains were manifest more often within the power coalition than as an independent expression of the sectors affected.

The political system required for its functioning complex equilibria which only a very favourable social and economic framework could provide. If the economic and social situations, internal or external, were adverse, this equilibrium tended to fall apart owing to the enormous difficulty of generating self corrective policies; any change in the position of some groups affected all the rest, since the equilibrium had little scope for manoeuvre. The maintenance of the equilibrium was based on the capacity of the State to reconcile the demands of the groups that supported it with the flow of resources that it was capable of generating or obtaining.

In the aforesaid countries the delicate internal equilibrium could barely resist the domestic problems, and succumbed when it had to cope at the same time with the challenges of the international system. In such circumstances, the complex polyclass equilibrium was replaced by an elite which monopolized power and attempted not only to rearrange economic relations but also to reformulate the system of social and political relations; it believed that the solution of the crisis should be based on a reinforcement of political and economic ties with the centres. It proposed, therefore, to reorganize the very structure of the productive system as well as the nature of the State and the civil society. This alternative made it necessary to restrain wages and public expenditure, lay emphasis on export economies based on comparative advantages, abandon a backward industrial sector to envisage, in a possible future, a new industrial economy which would be selective and highly modernized. The project was bound to come up against a hostile popular demand.

The solution of this antagonism was in some cases reached at the cost of democracy and participation. Nevertheless the economic aspects of the project did not always develop in accordance with the assumptions of its supporters.

(c) The situation towards the end of the period

Towards the end of the period it was evident that the economic, social and political bases of the style of development had undergone drastic changes.

In the economic field these changes were concerned with the linkage between industrialization, markets and external trade. Industrialization continued to be the support of the economic transformation and of its dynamism. Gradually, however, its linkage with the domestic markets declined in relative terms, while it increased with the external markets, both regional and international, as a reflection of the new government alliances and of the new external conditions. Economic dynamism varied widely from country to country, since

it depended on the degree of solidity of the social support of the government, on whether its international insertion was favourable and consolidated, and on the extent to which it had strengthened its capital accumulation.

In the social and political field one group of countries had met the challenge *by* maintaining the democratic system, while in others there was a predominance of elites in which the military sectors had increasing power.

At the beginning of the 1970s the attempts to establish a new style were, however, only outlined; the economic changes were not yet sufficiently consolidated to be able to sustain in stable form the new political schemes. The equilibrium between a rapid accumulation, the stability of the new markets and the quest for a viable form of productive transformation in the medium and long term was still not attained.

The two largest countries, economically and demographically speaking, appeared to make better progress and to increase their distance from the rest; but the smaller ones, including those which had achieved greater dynamism, still had a productive structure which was industrially incipient and depended decisively on external markets. Their domestic markets, small and generally concentrated, could not by themselves assure a stable process of productive transformation. In some cases, particularly in Central America, the scale of peasant exclusion and impoverishment was very high and in the urban area they had not established middle groups of a size comparable with those in the large and medium-sized countries and even in small countries like Costa Rica and Uruguay. As the situation of the marginated groups deteriorated and the middle groups could not find an adequate response to their demands, a general questioning of the style of development arose which on occasion resulted in violence.

The oil-exporting countries appeared to have the best chance of stabilizing their processes through their privileged connection with the world economy, while in the countries of the Southern Cone the political changes and attempts at reorientation occurred towards the end of the period, when international conditions were again beginning to change.

The following years were to demonstrate how unstable and dependent on external conditions was the position achieved, and bring to the fore the defects inherent in the new development styles that had been planned.

2. Irruption of the transnational banks, external indebtedness and crisis

The Latin American countries were making efforts to change their styles of development and, as already said, one of the central aspects was to adapt them to the new external conditions. In this respect, the bulk of the effort had been devoted to commercial aspects and to the role of the non-financial transnational enterprises.

From midway in the 1970s the international economy was undergoing changes of the greatest importance. There was a notable increase in the role of the transnational banking system. The supply of credit to the developing countries and especially to Latin America rose significantly. World inflation soared and there was a rise in interest rates.

The changes in international prices that occurred from 1973 caused major changes in the balance of payments of the Latin American countries. The sources of supply of commercial energy evolved in Latin America in parallel with that of the world economy. In 1950 hydrocarbons

supplied somewhat more than a third of the world consumption of commercial energy, a proportion which rose to over two thirds in 1975, relegating coal to second place. Latin America recorded even higher percentages owing to the cheap access to petroleum and to the limitations on use imposed by the poor quality of the coal.

The widespread policy of consumption was not in line either with the spatial distribution of production or in general with the reserves of hydrocarbons. Hence, when prices changed radically between 1973 and 1980, the countries of the region faced very different situations. The net oil exporters saw their revenues vastly increased and for some years enjoyed large surpluses on their trade balance. A few countries had and maintained a certain equilibrium between production and consumption, but a majority were faced with serious imbalances which were manifest in large deficits on their balance of payments.

The notable differences in performance which this situation might have caused were largely annulled by the influence of the transnational banks. In fact, the attraction of easy borrowing is reflected in the fact that all the countries, practically without exception, incurred an enormous debt. In other words, early or late in the period 1974-1980 the economies altered their economic policies to have access to or permit the entrance of the abundant financial resources.

The economic and political irruption of the transnational banks into the development styles gave rise to very different forms of economic and social transformation in the region.

At one extreme, the two largest countries from an economic and demographic standpoint used external indebtedness to make further advances in their industrialization.

Brazil, which began the period with a large trade deficit, did not use the credits for promoting a liberal import policy. On the contrary, it initiated a set of large projects destined simultaneously to replace imports and expand exports. These included energy and industrial infrastructure and the capital goods industry. Thus the indebtedness, despite the errors and excessive consumption which may have taken place, served in the main to convert what might have been a period of recession into one of expansion of the productive capacity. It is worth noting that the volume of Brazilian imports grew at an annual average of 1% between 1974 and 1980, while the volume of exports increased by close on 10% per annum, a large share of which were of industrial origin (see tables 2 and 3).

Mexico during this period made a great effort to expand its oil production, as a result of which in the 1980s it became one of the leading oil exporters in the world. The volume of its imports grew at rates of around 12%, largely owing to the fact that the country had not yet the domestic productive capacity to be able to carry out more ambitious plans on this basis.

■ **Table 3****LATIN AMERICA: ANNUAL GROWTH RATES^a OF IMPORTS, 1950-1980**

	1950-1965	1965-1974	1974-1980
Latin America	2.0	9.1	6.5
Argentina	2.6	4.9	10.3
Bolivia	2.8	2.5	3.3
Brazil	-1.5	19.5	0.7
Chile	5.2	5.7	9.6
Colombia	1.6	6.5	9.0
Costa Rica	7.0	8.8	7.7
Dominican Republic	5.5	11.9	2.4
Ecuador	5.1	12.0	10.1
El Salvador	6.4	3.0	4.7
Guatemala	5.5	4.2	9.5
Haiti	-1.9	3.1	12.6
Honduras	4.8	3.1	7.9
Mexico	2.2	8.6	11.9
Nicaragua	7.5	3.7	-6.1
Panama	6.9	8.2	-1.0
Paraguay	4.5	3.8	16.0
Peru	6.0	3.7	-6.9
Uruguay	-2.7	7.0	12.5
Venezuela	1.4	6.0	10.4

Source: ECLAC, on the basis of official figures.

^a Percentages obtained through regression.

■ **Table 4****LATIN AMERICA: ANNUAL GROWTH RATES^a OF THE GROSS DOMESTIC PRODUCT, 1950-1980**

	1950-1965	1965-1974	1974-1980
Latin America	5.2	6.7	5.1
Argentina	3.1	4.4	1.8
Bolivia	1.5	5.6	4.2
Brazil	6.4	10.0	6.1
Chile	4.0	3.1	5.6
Colombia	4.7	6.4	4.5
Costa Rica	5.8	6.9	5.4
Dominican Republic	5.0	8.3	4.6
Ecuador	4.9	8.7	6.7
El Salvador	5.4	4.5	2.4
Guatemala	4.4	6.1	5.4
Haiti	-2.6	3.5	4.2
Honduras	3.7	4.5	6.4
Mexico	5.9	6.6	6.3
Nicaragua	6.0	4.2	-3.1
Panama	6.6	7.4	5.0
Paraguay	3.2	5.3	10.2
Peru	5.4	3.9	1.9
Uruguay	2.1	1.5	4.9
Venezuela	5.9	3.2	2.9

Source: ECLAC, on the basis of official figures.

^a Percentages obtained through regression.

Ecuador and Paraguay also grew rapidly in this period, relying on their energy resources. Ecuador, which had a very backward industrial structure, concentrated its efforts on this sector. In Paraguay the expansion was mainly associated with the construction of the great dam at Itaipú, but it also achieved a high industrial dynamism.

In these countries, especially in Brazil and Mexico, there were no notable changes during the period in the development styles current at the time. The governmental sector was strengthened by the expansion of public enterprises. The political system did not undergo radical changes, although the power of the transnational banks was reinforced by the increase in the debt. In both cases the real and potential expansion of exports continued to strengthen their hope of incorporation as a semi-periphery in the international economy. Rules for the non-financial transnational enterprises remained in force in the productive sector, with a view to creating a style in which the internal sectors would maintain an appreciable quota of power in the government alliance.

At the other extreme, the countries of the Southern Cone introduced a radical change in their economic policies, with the adoption of a neo-liberal style of insertion in the international economy. To this end they liberalized their external trade and financial policies, reducing tariffs to very low levels, especially in Argentina and Chile. Similarly they granted great facilities of access to the transnational, banking, and non-financial enterprises.

At the outset the main emphasis seemed to be placed on the promotion of exports. Nonetheless, the explosive dynamism of imports created deficits on the trade and current accounts which gradually made it essential to obtain new external credit. Hence the economic policy concentrated on financial aspects, eventually favouring the maintenance of a high real interest rate and undervalued exchange rates. As a result, the policies of export promotion clashed with those of obtaining new external finance. The position adopted revealed the power acquired by the internal and external financial sectors. Imports increased in the Southern Cone countries at rates close on 10% per annum in the period 1974-1980 and with the reduction of tariffs and the undervaluation of the exchange rate many industrial branches were faced with a competition which they could not sustain. This encouraged many entrepreneurs to replace industrial by commercial enterprise, in view of its greater profit and lower risk. Hence the share of the output of the manufacturing sector in the total fell in Argentina from 30% to 27% and in Chile from 19% to 16% (see table 5).

In these countries the neo-liberal scheme did not succeed in raising the rate of accumulation or in giving a clear meaning to the productive transformation. Only Uruguay, which did not substantially reduce its tariffs maintained public investment and succeeded in channelling foreign investment into capital goods, thus achieving a high economic growth which reached close on 7% per annum in non-agricultural goods (see table 6).

■ **Table 5****LATIN AMERICA: SHARE OF MANUFACTURING IN THE GROSS DOMESTIC PRODUCT**
(Percentages)

	1950-1952	1964-1966	1973-1974	1979-1980
Latin America	16.5	20.7	24.1	24.3
Argentina	22.3	27.6	30.5	27.4
Bolivia	10.8	11.1	12.9	13.7
Brazil	20.6	26.7	30.7	31.0
Chile	15.5	18.7	19.2	15.8
Colombia	13.7	16.9	19.5	17.2
Costa Rica	10.5	12.4	15.7	16.9
Dominican Republic	13.8	14.8	18.7	18.8
Ecuador	12.7	13.3	11.5	14.6
El Salvador	12.7	16.0	17.6	17.0
Guatemala	11.4	13.6	15.3	16.0
Haiti	10.1	10.2	13.5	13.8
Honduras	9.9	13.4	14.9	16.5
Mexico	16.1	18.9	21.5	22.3
Nicaragua	11.8	16.5	20.9	22.1
Panama	8.5	13.2	13.5	11.9
Paraguay	15.2	15.5	17.4	16.2
Peru	15.6	20.7	22.4	21.4
Uruguay	23.8	24.3	25.7	25.9
Venezuela	7.7	12.1	14.3	16.7

Source: ECLAC, on the basis of official figures.

■ **Table 6****LATIN AMERICA: ANNUAL GROWTH RATES^a OF OUTPUT OF NON-AGRICULTURAL GOODS, 1950-1980**

	1950-1965	1965-1974	1974-1980
Latin America	6.2	7.1	5.0
Argentina	4.0	6.1	1.3
Bolivia	0.3	6.7	2.7
Brazil	7.5	11.8	6.8
Chile	4.4	2.4	3.0
Colombia	5.9	7.4	1.9
Costa Rica	7.0	9.3	7.2
Dominican Republic	5.5	14.0	4.5
Ecuador	6.0	15.7	6.1
El Salvador	6.5	4.9	1.9
Guatemala	4.6	6.9	8.9
Haiti	-3.9	7.9	4.3
Honduras	3.0	5.7	7.1
Mexico	6.9	7.9	7.2
Nicaragua	8.9	6.8	-5.3
Panama	9.7	8.2	3.6
Paraguay	3.7	6.9	13.9
Peru	7.1	4.5	1.7
Uruguay	1.4	2.3	6.9
Venezuela	6.5	1.0	0.8

Source: ECLAC, on the basis of official figures.

^a Percentages obtained through regression.

In the case of Chile, the annual overall growth of 5.6% was achieved with a reduced rate of growth in the value added generated in the sectors producing non-agricultural goods (3%) and originating basically in the annual increase of over 10% in the commercial and finance sector. This last was closely associated with the expansion of imports and the external indebtedness.

Between these extreme cases of the use of external indebtedness come the rest of the countries of the region. At all events, there was a noticeable fall in the growth rate of the industrial sector and a general declining trend in the share of the sector in production. External indebtedness was used, in most cases, to support a greater growth of consumption than of output. The attempts to find a new development style did not produce an economic solution which would accelerate accumulation and channel the productive transformation, despite which, during part of the period (1976-1980), most of the countries managed to increase the value of their exports at very high rates, in some cases through price rises and in others through increases in volume.

The lack of economic dynamism in many countries may suggest economies that underwent few changes in their form of functioning. The truth is quite the opposite. External indebtedness and the growing internal participation of the transnational banks profoundly altered the relations of domestic power and the attitude to accumulation and economic policy. As the countries increased their debt a change was produced in the relations between the non-financial productive sector and the financial sector. A capital market was admitted and fomented which ended by strengthening financial capitalism.

The separation of entrepreneurial productive functions from financial capitalist functions is accentuated with the emission of securities not directly associated with productive enterprises but with investment societies. The revaluation of these securities may depend on speculative operations, both in their launching and in their rounds of the markets of financial securities. It is then possible to concentrate a large part of the saving in the guise of financial capital, which is not necessarily converted into investment of physical capital, but may favour the concentration of previously accumulated wealth in the hands of those who dominate the financial capital. Simultaneously the credit system may transform part of the saving into consumption, especially if external indebtedness enables the pressure on the balance of payments to be met by way of imports. This tends to accentuate the monopolist aspect of capitalism, its speculative character and the subordination of the productive sector.

In the countries in which this type of operation was in general use, the public sector gradually lost control over financial procedure. Through a credit policy in which new and varied forms of quasi-money made their appearance, the monetary policy lost part of its impact and the State its capacity for control. The same effect was produced when the private sector was able to obtain credit from abroad without the sanction of the public sector. In the cases where this practice became widespread the public sector lost part of the control over the balance of payments, which it was only to recover in the crisis when on occasion it was pressed to guarantee these debts. At the same time, the exchange rate policies produced patrimonial and operational effects on all the indebted sectors.

Thus the indebted productive sectors became dependent not only on the domestic monetary and credit policy, but also on the international interest rates and the situation of the balance of payments.

As these financial changes became more extreme the productive system lost an appreciable part of its economic and political power. A new pivot for the organization of the national economies was introduced. Taken to extremes, it might be said that the mechanisms of control of the national economy tended to be reduced since the composition of certain norms for the functioning of the international economic system restricted the sphere and capacity of the local groups for autonomous decision.

The dominant groups set themselves to reorganize the domestic system so as to facilitate the introduction of a new mode of dependence. To ensure their participation in power, as

already said, they found it necessary on occasion to change their centre of activity from the productive system to the financial system.

As growth declined and demand was concentrated in the high-income groups it became impossible to satisfy the demands of the masses. The policy of wage restraint, which was frequently applied, often led to repressive practices against the union organizations.

With the worsening of economic conditions, only the countries which maintained a democratic system could negotiate solutions without restricting participation. In the authoritarian regimes extremely repressive measures had to be applied. With the passage of time the demands for a return to democracy increased, as a mechanism capable of channelling the demands for participation. In other countries, in which the very process of modernization sharpened conflict, movements arose which favoured revolutionary reforms of the development style and fomented riots which in some cases ended in civil war. It should be borne in mind that the struggle of the popular sectors, and particularly of the workers, is not necessarily only a protest against deteriorating economic conditions. The worker groups with a greater union tradition also tend to claim better working conditions and some degree of participation, not only in their own enterprise, but also at national level. In the societies where this type of conflict does not find "valid spokesmen" the problem can acquire a general political dimension through the association of other groups whose problem also lies in the absence of channels of participation.

At the beginning of the 1980s it was obvious that the endeavours to create a new style of development were in worse shape than in the middle of the 1970s. The external changes ended in many countries with the disarticulation of the schemes of economic policy designed to take advantage of the commercial dynamism. The productive transformation was curbed by the very abundance of financial resources. The entry of the transnational banks and the creation of a financial market conspired at times against the accumulation of fixed capital by stimulating a consumption which was satisfied by imports. On the political plane the lack of economic dynamism led to a hardening of the system, restricting democracy and participation. This scheme was called into question in some cases by a demand for democratization and in other countries by armed conflict. Naturally these situations, coupled with the absence of a long-term project for economic transformation, discouraged capital accumulation. By contrast, in some countries the government alliance based on democracy showed its vitality and helped to find a negotiated solution to the situational crises. Lastly, the two largest countries broke into world trade and finance with greater vigour and in better conditions. Their foreign trade, in close association with their domestic markets and with their productive transformation, gave the impression that they were beginning to create a new development style based on a new form of international insertion.

3. The outbreak and nature of the crisis

In 1981 most of the Latin American countries were caught up in an economic and financial crisis which may be regarded as the most profound and prolonged since the world crisis of the 1930s, and which arose from an accumulation of negative factors of external and internal origin.

From the middle of the 1960s the dynamism of international trade and the economic growth of many countries of the region called into question the arguments in favour of the need to transform economic relations at international, regional and national level. From midway in the decade of the 1970s the abundant external credit encouraged in many groups the conviction that the best solution for the external disequilibrium would be the liberalization of external

economic relations, since the orientation of production should be increasingly guided by the signals coming from the world market.

Thus they continued to develop, or attempted to reintroduce, a policy of economic growth based on liberal principles of national and international economic relations. These were based on a particular view of the functioning of the international economy, on the validity of market signals and on a forecast of the evolution of the developed world.

On the theoretical plane, the promotion of wider external relations was assigned a more important role in the development process than it had had in the past. Despite this, the different countries and groups of opinion differed as to the function that these external relations should fulfil. For some foreign trade should be the fundamental engine of growth. Others gave it a role of essential complement in a productive transformation directed basically by the domestic market. In each case there was a desire to increase the share of external trade in the national economy.

It was commonly thought that the evolution of production in the developed countries and the trend of world trade would be in the last instance relatively favourable. The recession in the years 1974-1975 in the industrial countries was largely attributed to the effects of the rise in the price of fuels, although the incidence of other factors was not overlooked. Some recovery in the growth rates of a number of developed countries in the period 1974-1979 (more than 4% in the United States and 5% in Japan) encouraged the belief that the fuel crisis would be gradually surmounted and that this growth would soon accelerate. Hence world trade would once again play a very active role in the region. This optimism was fostered by the dynamism displayed by Latin American exports, since it was thought that if these results were achieved at a slack time in the world economy, they could be expected to continue or even increase in the near future.

The combination of theoretic support and optimistic expectations gave rise to policies of expansion and diversification of exports and the acceptance of external trade deficits which were assumed to be transitory. The net oil-exporters looked forward to a slow but steady improvement in real fuel prices, and the importers relied on plans of substitution and conservation and on the development of their own sources of energy. Others saw in the increased oil prices the possibility of an improvement in the prices of raw materials, and trusted that a liberalization of external relations would reactivate the old idea of comparative advantages and bring with it a steady increase in the value of exports.

The trends of foreign trade and external financing during the period 1976-1980 supported in many countries the view that, by following market signals, they were surmounting a severe recession with a moderate rate of growth. During this period exports increased in volume and value at the most rapid rates since the post-war. Imports likewise increased, and in some years did so at surprising rates in the countries of the Southern Cone and in some net oil-exporting countries. At the same time, in most cases and in most years the deficit on the trade balance of goods and services was maintained. Thus a situation arose, uncommon in the post-war period, of a very dynamic foreign trade which showed a permanent deficit in the medium term.

The rapid growth in the value of exports had different origins. In the countries which were net exporters of oil or fuels it arose from the rise in prices, combined in some cases with falls and in others with increases in the volumes exported. In the other countries the situation varied: there were diversions of production previously destined for the domestic market, diversification of the production of raw materials, greater industrial processing of the raw materials exported, and expansion of the exports of manufactures. In the last case use was

made of previously installed capacity which was idle or in process of maturation, and of the rapid expansion of the industrial sector that had occurred in some countries. The evolution of prices was very uneven so that the domestic effort which accompanied the growth in the value of exports also varied considerably.

There was also a great variety of motivations and structures in the growth of imports. In some cases it gave rise to an intense process of investment, while in others it supported the growth of consumption and the fight against inflation. Generally speaking, there was a simultaneous rise in the volume and prices of imports, the latter being more stable in their periodic increases.

In these circumstances it was usual to find a foreign trade deficit in the transactions of goods and services. This deficit was supported, though not justified, by the inflow or availability of foreign credit, which was offered in abundance to almost all the countries, was channelled through the transnational banking system, and at the outset had low real interest rates. Gradually, however, the average maturity periods were reduced and the interest rates increased.

External credit was increasing considerably to cater for the deficits on the trade balance and the growing commitments deriving from direct investment and the external debt. Hence the volume of interest was growing in absolute and relative figures, both by way of increases in the debt and the rise in the interest rates.

This brief description of the evolution of trade and external finance shows the simultaneous presence of three factors, common to most of the countries dynamism in trade, deficit on the balance of goods and services and abundant net external credit.

These factors are also interwoven through causal relations which sustain their co-existence. In effect, in so far as the ratio between debt and export value is used as one of the most important indicators of the capacity of a country to make external payments, the high growth of the latter variable tends to support increased indebtedness. During the period 1976-1980 exports grew at values close on 20%, and the nominal rate of interest remained at around 10%. In these circumstances, even for countries in which the aforesaid ratio was high, the increased indebtedness could be justified on the basis of certain assumptions. Thus, for example, if the ratio was near to three, as happened in a number of countries, this could be maintained if both the debt and the value of exports grew by 20%; half of the new indebtedness would finance the nominal interest rate of 10%, while the other 10%, which represented 30% of the value of the exports, provided support for a major trade deficit and an increase in the monetary reserves.

Consequently, on the basis of a stable situation of rapid growth in the value of exports and much lower nominal interest rates, the external debt could be increased without risk in terms of capacity to make external payments, and at the same time to maintain large trade deficits and expand the reserves. This trend permitted a considerable degree of liberty in the field of economic policy and the political administration of the governments. Indeed, in many cases the policies relating to the exchange rate, credit, fiscal measures and international reserves helped to stimulate domestic expenditure, which produced a transitory boom that stimulated the needs for external finance.

Unfortunately, this form of reasoning was based on numerous assumptions which, if erroneous, could cause serious problems. Hence as early as 1977 the Secretariat, in its studies of perspective, called attention to the vulnerability inherent in the level of indebtedness which was being incurred.

It did not seem reasonable to assume simultaneously, in the medium term, a growth of 20% in the value of exports and of 10% in the nominal interest rate. As already said, there were many different situations behind that 20%. In the case of a very rapid growth in volume, it was foreseeable that this could not be sustained in the long run and, as regards primary products, it was well-known that the growth of world demand was low and that the developed countries returned to protectionism when the exports of the developing countries began to gain a significant share of their markets.

On the other hand, the maintenance in the medium term of high and significant export values on the basis of manufactured goods called for industrialization policies which very few Latin American countries were applying. At the same time, the recrudescence of protectionist policies which also began to be observed in this field signified a serious obstacle to the continued expansion of the value of exports. In relation to prices there was no doubt that part of the growth of the value of exports was due to a rapidly increasing world inflation. This made it difficult to maintain the nominal rates of interest which implied very low or even negative real interest rates.

With regard to the trade deficit on goods and services, it was equally irrational to treat it apart from domestic policies and the terms of trade. The persistence of the trade deficit concealed dangerous relations with the internal economy. In many cases the rapid growth of exports was achieved at considerable domestic cost which it would not be easy to increase in the event of a crisis. On the other hand, the high growth of imports was vital for the maintenance of policies of economic growth and of liberalization of the economies or anti-inflationary policies. It is common knowledge that trade deficits also depend on the terms of trade. During the period 1976-1980 the governments acted, as previously stated, on the basis of prospects of improvement or, at worse, of a stabilization of the terms of trade. An unfavourable development, whether in external demand, the terms of trade, or a combination of both, would raise the deficit beyond the estimations or would cause a drastic deterioration in the national economy.

Finally, the reasoning was based on the implicit assumption that "debts are not paid but renewed". Renewal appears therefore as a relatively automatic mechanism. If the average maturity period of the debt is extended, what is renewed actually represents small percentages of the exports. With an average maturity period of 10 years and a ratio between debt and export value of three, what will need to be renewed represents 30% of the value of the exports. If the average maturity period is shorter, if it is cut year by year or, what is more serious, if the debt maturing in less than a year represents an appreciable percentage of the total, the proportion that has to be renewed may easily represent values of around 100% of the value of the exports. In this last case any unfavourable development can prejudice the automatic renewal of the debt.

From 1981 events began to contradict the optimistic assumptions postulated by the policies of economic and financial relations with the exterior. In most cases there was a simultaneous worsening of the various factors considered, which gave rise to a profound crisis in the balance of payments and in the pattern of growth.

Confidence in the recovery of the economy of the developed countries was impugned by the declining growth in 1981, followed by a fall in 1982. World trade tended to stagnate and the protectionist trends were sharpened in the central economies.

World inflation yielded to some extent and the nominal interest rate rose at real levels unprecedented in the post-war period. The terms of trade deteriorated for the great majority of the countries.

In these circumstances, already in 1981 the value of the region's exports as a whole grew at much lower rates; the interest on the debt rose substantially; the value of imports did not yield in their growth in relation to the previous year, with the result that the region acquired a deficit on current account of over US\$ 40 billion. This deficit was 45% higher than that of 1980 and was double that of 1979, these latter deficits having been higher than those of the preceding years. New credit was granted for very short periods, so that the debt for periods of less than a year already at the end of 1981 represented more than 65% of the value of the exports (excluding from this estimate Panama and the Bahamas), and in the countries of large size economically and demographically it exceeded 70%.

In 1982 the situation grew still worse. The fall in price of many primary products ended by toppling the terms of trade, while the real rates of interest persisted or increased. The value of exports declined for the first time in many years and the ratio between debt and exports reached unprecedented values in almost all the countries, with indexes close on 4 in the three most indebted countries; at the same time the debt with a maturity of under a year exceeded the value of exports in one country and grew rapidly in the rest. Automatic renewal now became a utopian dream. Furthermore, it was obvious that the mechanisms of adjustment represented by the reduction of imports, or by the degree of utilization or the level itself of the reserves, were insufficient in themselves to pay the interest on the debt. It became imperative to renegotiate the debt and the banks had to provide net external credit and increase their risk. So, in 1981 in some countries and in 1982 in the rest, the process of renegotiation began.

4. The policies of economic and financial adjustment

The evolution of world trade and of protectionism had made it evident by the end of 1981 that, at least in the short term, the greater part of the debt problem would have to be solved in the financial field.

For many countries it was clear that the most serious problem in respect of indebtedness lay in the renewal of credits, especially those for a short period. In some cases these almost equalled the total value of exports and exceeded, as is obvious, all capacity to pay. At the same time the interest that had to be paid exceeded the possibilities of surplus on the trade balance of goods and services, or of a reduction in reserves. Consequently, not only was it a matter of renewing maturities or part of them but, on the contrary, it was imperative to obtain new credits. The creditors, for their part, tried to reduce to the minimum the new net financing that they had to concede.

From 1981 most of the countries embarked on a process of renegotiation which was accompanied by domestic adjustment policies designed to meet the requirements of a specific balance-of-payments programme. In these processes the governments of the region have played an active part, together with the transnational banks and the International Monetary Fund. The transnational banks do not recognize joint responsibility for the situation, and, as is natural in their situation, are in favour of greater domestic efforts to guarantee a greater capacity to make external payments. Hence they have made the renegotiation of the debt conditional on the signing of agreements with the Fund, which incorporate the well-known rules of conditionality in relation to domestic policies.

Some countries have managed to negotiate this conditionality on the basis of their own strategies and national policies, and in some cases considerable deviations are observable in this respect from what have been the traditional adjustments.

The general principles of traditional conditionality are widely known. As regards the general direction of development, they reaffirm the supposed advantages of the liberalization

of the economies, of the reduction of the public sector and the enlargement of the private sector, and they underline the important role that international trade should have as guide in the allocation of resources. In their interpretation of the crisis they lay stress on excessive public expenditure and the inadequacy of the existing price system *vis-à-vis* the new circumstances, and in particular the exchange rate. Consequently, faced with inflationary pressures or severe deficits on the balance of payments, the national policies should achieve a reduction of the fiscal and public deficit, the adjustment of real wages, the limitation of domestic credit and of the indebtedness of the public sector, an increase in tax revenues and controlled prices, the elimination of subsidies, and a surplus on the external trade account.

In general terms, compared with agreements of other periods, there is now a marked change of emphasis, in underscoring the importance of the external trade account and accepting greater flexibility in the limits that were customarily placed on certain domestic goals, such as those relating to inflation.

The nature of these agreements and their objectives have been the subject of differences of opinion and argument during the whole of the post-war period. Nonetheless, in the present circumstances these are more polemical than in the past, for several reasons.

In particular, there are doubts nowadays about the central role attributed to international trade in circumstances in which this has lost dynamism and protectionist pressures have grown in the developed countries; about the efficacy of overall macroeconomic measures, in circumstances in which the crisis has pointed up the economic and social heterogeneity of the regional economies, and about the limitation of public sector action at a time when the private sector seems overwhelmed by the complexity of the problems and demands government intervention to cope with them.

These doubts about the efficacy of the agreements in present circumstances have been confirmed by events. Indeed, the results usually fall far short of the goals and objectives originally proposed. Almost as soon as the agreements have been signed it has been necessary to subject them to major revisions or suspend for some time their application. At the same time, the results in economic and social terms have not been satisfactory in every case. The falls in production and employment have been greater than was originally bargained for, and during 1983 there have been growing signs of stagnation, if not of an out-and-out fall in production. Some countries, however, have managed to control the more immediate effects of the crisis, especially as regards their balance-of-payments problems.

The greatest doubts arise in connection with the possible capacity of the Latin American economies to stand the current recession for much longer, if the conditions of the world economy do not rapidly change. Indeed, the tenacious effort to obtain a relatively high surplus on the trade balance of goods and services, which generally implies an even greater surplus on the trade in goods, has produced effects which exceed mere falls in output. Profound imbalances are occurring in the employment, inflationary and budgetary fields, and in some cases plants have begun to be dismantled in a process which threatens to increase; at the same time entrepreneurial discouragement is deepening, expansion projects are being abandoned and, in all probability, many branches of production will lack investment.

It is equally evident that these policies have distributed the external and internal costs of the crisis in a very inequitable manner. On the external side the Latin American countries have been severely castigated to the benefit of the international banks. The renegotiations are carried out as if the erroneous allocation of loans, when it existed, or the high real rates of interest, had been the sole responsibility of the debtors and there were no obligation to share the costs. Moreover, surcharges, fines and costs are applied in renegotiations which

raise even higher the interest rates and the potential profit of the banks. Conditions have also been applied to obtain the guarantee of the State for credits which were granted to the private sector without it. On the domestic side, a large part of the costs have been transmitted to the lower-income sectors, eloquent proofs of which are the high indexes of unemployment and the falls in real wages.

In sum, up to now the adjustment process, although it is producing, and even exceeding the trade surpluses which were its aim, has frequently turned out to be inefficient, destructive and inequitable, and requires a thorough revision. To do this it will be necessary to find external commercial and financial solutions which will distribute more equitably and gradually the costs of the adjustment, and which on the domestic side will lead to a rapid and effective reactivation of the regional economy.

INDUSTRIALIZATION IN LATIN AMERICA: FROM THE “BLACKBOX” TO THE “EMPTY BOX” *

Fernando Fajnzylber

* Chapters I (pages11-33) and VII (pages165-167) , in Cuadernos de la CEPAL, N° 60 (LC/G. 1534/Rev. 1 -P), Santiago, Chile, 1990.

I. THE EMPTY BOX

1. Industrialization, growth and equity in Latin America

We shall define dynamism as the rate of growth attained by the advanced countries over the past 20 years (GDP per capita annual rate, 2.4%), and equity as the ratio between the income of 40% of the lowest-income population and of 10% of the highest-income population. In the advanced countries, this ratio averaged 0.8 in the late 1970s and early 1980s, i.e., 40% of the lowest-income population has an income equivalent to 80% of the income of 10% of the highest-income population. Let us assume that in Latin America, the dividing line between the countries that have attained the highest and the lowest levels of equity is defined by this same ratio, but at a value of 0.4, i.e., half that of the industrialized countries (World Bank, 1986a). When the growth and the equity variables are crossed, with the dividing line of dynamism being the average growth of the advanced countries during the period 1965-1984, and the dividing line for equity being the ratio between the poorest 40% and the richest 10% (table 1), a dual-entry matrix is generated in which one box remains empty, representing those countries which could have simultaneously attained a higher rate of growth than that of the advanced countries and a level of equity of more than 0.4. This empty box brings to light the key question we shall try to address in this study.

Approximately 73% of the region's gross domestic product is generated in countries which might be called dynamic disarticulated countries (Brazil, Colombia, Dominican Republic, Ecuador, Mexico, Panama, and Paraguay); 11% is accounted for by countries at the other end of the scale, i.e., countries that are integrated or articulated but stagnant (Argentina and Uruguay), and the remaining 16% is accounted for by countries which are both disarticulated and stagnant. The latter category includes some potentially explosive cases, inasmuch as stagnation and social disarticulation lead to an unjust income distribution, giving rise to a wide range of proposals aimed at stirring society to do something to remedy the situation.

So far, the box representing growth with equity is empty, at least in the case of the countries for which comparable information is available. As is to be expected, the place assigned to each country on the chart depends on the point at which the waters divide. Thus, for example, if the equity borderline moved slightly downward, the upper right-hand box would include countries such as Costa Rica, Chile and Venezuela; if the growth borderline moved slightly upward, the number of dynamic countries would decrease, with Brazil, Mexico, Ecuador and Colombia keeping their place in that box.

One might assume that the empty box could only be filled by countries that had advanced in their development process. This assumption is proved false, however, by the case of countries in other regions that have attained levels of income and development comparable to those of Latin America. There are at least six countries in different regions and, in fact, with different socioeconomic and political systems (table 2) which, according to the same sources of information (World Bank), could be placed in the box which remains empty for Latin America, i.e., South Korea, Spain, Yugoslavia, Hungary, Israel and Portugal.

■ Table 1

LATIN AMERICA: STRATEGIC OBJECTIVES: GROWTH-EQUITY

Equity:	40% lowest-income 10% highest-income		(1970-1984)
	<0.4 ^a		>0.4
<2.4% ^b	Bolivia Chile Peru Venezuela	Costa Rica El Salvador Guatemala Honduras Nicaragua	Argentina Uruguay
	Haití		
Growth GDP per capita (1965-1984)	(15.9) ^c		(15.5) ^c
	Brazil Colombia	Panama Dominican Republic	
>2.4%	Ecuador Mexico Paraguay		
	(72.6) ^c		

Source: Joint ECLAC/UNIDO Industry and Technology Division, based on World Bank data.

^a Industrialized countries half comparable ratio.

^b Industrialized countries GDP per capita average annual growth rate (1965-1984).

^c Share of regional GDP.

■ Table 2

OTHER COUNTRIES: STRATEGIC OBJECTIVES: GROWTH-EQUITY

Equity:	40% lowest-income 10% highest-income		(1970-1984)
	<0.4 ^a		>0.4
<2.4% ^b			
Growth GDP per capita (1965-1984)			
			South Korea Spain Yugoslavia Hungary Israel Portugal
>2.4%			

Source: Joint ECLAC/UNIDO Industry and Technology Division, based on World Bank data.

^a Industrialized countries half comparable ratio.

^b Industrialized countries GDP per capita average annual growth rate (1965-1984).

These are countries whose size and economies are comparable to certain Latin American countries. Because of certain characteristics pertaining to the origin of their societies and their geopolitical role, they meet the requirements of economic growth and equity. The question arises, therefore, whether it is the specific nature of Latin America's development which gives rise to the empty box.

In this study, we shall try to understand the Latin American situation in the light of a comparative study of certain countries inside and outside the region. Historians realize that if we are to understand a region such as Latin America, we must be familiar with the rest of the world; this fact has not always been taken into account, however, in studies on the development of the region.

To begin with, it may be worthwhile to compare the relative situation of Latin America in different branches of activity as they relate to the international economy. Thus, a fact comes to light which may provide a clue with which to begin our study: the region contributes more in terms of population than of any other indicator of economic activity. In addition, there are clear indications that the share of the region decreases as the intellectual value added increases. In terms of population, the region accounts for 8%; as regards the gross domestic product, for 7%, and as regards the manufacturing product, for 6%. With regard to manufacturing, if attention is centered on capital goods, the region's share drops sharply to 3%; engineers and scientists account for 2.4%, and the resources available to these engineers and scientists to carry out their activities represent barely 1.8%. Finally, as regards authors of scientific works, this indicator, although not very reliable, shows a Latin American participation of slightly over 1%.

A fundamental feature of Latin American development would thus be a very scanty intellectual value added to human and natural resources; in one way or another, this implies that development has been brought about more by imitation than by a process of reflection on internal shortcomings and potentialities. The inadequacy, in several respects, of the development process with respect to specific shortcomings and potentialities of the different countries of the region will be a recurring theme in our subsequent discussion and in the comparisons we make at the international level. Thus, it would seem that the central feature of the process of development in Latin America has been its inadequate adoption of technical progress, and its scanty contribution to original thinking based on the true situation in order to define the range of decisions involved in economic and social change. The empty box would appear to be directly related to what might be called an inability to open the "black box" of technical progress; this is partly due to the origin of Latin American societies, their institutional structure, their cultural context and a set of economic and structural factors which have a complex but indisputable bearing on the social and political environment. Although this view of the situation only provides a preliminary working hypothesis, it is useful as the thread with which to weave our subsequent arguments.

Acknowledgment of this shortcoming associated with the empty box is perfectly compatible with recognition of the profound changes that took place in the Latin American economies and societies between 1950 and 1981, those years which Hirschman (1986) calls the glorious 30 years of Latin American history. Indeed, during that time, the product increased fivefold, while the population rose from 155 million to almost 400 million; the process of urbanization took place at such a rapid pace that in several of the countries of the region in which more than half the population was devoted to agriculture in 1950, no more than one-fourth or one-third are currently in this activity; education and health levels improved, with life expectancy rising considerably in every country of the region, and institutions were created which favoured the economic, social, political and cultural integration of the region. In addition, the groundwork was laid for technological development in some very important branches having to do with agriculture, public works and energy.

The world has grown and has undergone economic, social, political and cultural changes since World War II, at a rate never before seen in history, and many of these changes have also taken place in Latin America. These positive changes in the region should not, however, lead us into complacency.

2. Common features of Latin American industrialization

Four features characterize the pattern of industrialization followed in Latin America: a) participation in the international market based almost exclusively on a trade surplus generated through natural resources, agriculture, energy and mining, and a systematic trade deficit in the manufacturing sector (except in the case of Brazil, from 1982 on); b) an industrial structure conceived for and directed fundamentally at the domestic market; c) a desire to reproduce the lifestyle of the advanced countries, both as regards consumption and, in varying degrees, as regards domestic production; and d) underestimation of the social role of entrepreneurs and weak leadership on the part of public and private national corporations in those sectors whose dynamism and content define the industrial profile of each country.

(a) International insertion on the basis of raw materials

After more than 40 years of industrialization, and having soon become aware of the deteriorating trend in the terms of trade for natural resources —which, as in the United States, are abundant in the region— with respect to manufactures, all the countries of the region, without exception up to 1982, had a positive trade balance only in respect of agriculture, energy or mining, depending on the country concerned, and had a deficit in respect of manufacturing (table 3). Beginning in 1982, Brazil had a surplus in the manufacturing sector, but the other countries still showed deficits. As regards Brazil, there are several views as to the possible structural nature of the surplus of the manufacturing sector. Some hold that it is a passing situation that has to do with the contraction of the domestic market (1980-1983), with the dynamism of imports from the United States in 1984 and with the relative decline in the rate of domestic investment during the first half of the 1980s; others feel that the great investment effort made by Brazil during the 1970s in the industrial sector laid the foundation for generating a sound and growing manufacturing surplus (Barros de Castro, 1985). The deterioration of the trade balance in the manufacturing sector in 1986, associated with a strong increase in domestic demand, has revived this controversy, which has important implications for the rest of the region.

As regards the terms of trade, it is evident that the misgivings of the 1940s were fully justified: between 1950 and 1985, the index of relative prices as between agriculture and manufacturing fell from 168 to 81 (1979-1981=100); in mining, from 124 to 79; and for oil, from 26 in 1950, it fell to 13 in 1970, rose to 107 in 1980, and dropped again to 101 in 1985 (World Bank, 1986b).

■ Table 3

LATIN AMERICA: TRADE BALANCE BY SECTORS OF ECONOMIC ACTIVITY, 1985*(Millions of dollars)*

	Total sectors	Agriculture	Manufacturing industry ^a	Energy	Mining	Other sectors
Total Latin America	34 541	19 372	-13 649	22 593	6 282	-57
Oil-exporting countries	20 241	-285	-11 606	29 566	2 593	-27
Bolivia (Estado Plurinacional de)	-17	-107	-538	371	257	-
Ecuador	1 258	743	-1 346	1 897	-35	-1
Mexico	9 197	-209	-5 092	14 049	455	-6
Peru	1 084	224	-948	637	1 171	-
Venezuela (República Bolivariana de)	8 719	-936	-3 682	12 612	745	-20
Non-oil-exporting countries	14 300	19 657	-2 043	-6 973	3 689	-30
Argentina	4 581	5 576	-1 113	151	-34	1
Brazil	11 265	8 567	5 791	-4 901	1 822	-14
Colombia	-559	1 748	-2 271	94	-114	-16
Costa Rica	-159	595	-570	-165	-19	.
Chile	904	887	-1 523	-512	2 052	-
El Salvador	-493	234	-470	-253	-4	-
Guatemala	-305	641	-487	-447	-12	-
Honduras	-171	549	-520	-220	21	-1
Nicaragua	-799	143	-596	-339	-7	-
Paraguay	-197	237	-286	-142	-6	-
Uruguay	233	480	2	-239	-10	-

Source: Joint ECLAC/UNIDO Industry and Technology Division, updated on the basis of Data Bank on Latin American and Caribbean Foreign Trade (BADECEL).

^a Manufacturing industry includes SITC sections 5-8, except division 68 (non-ferrous metals).

The region denounced these trends, but the changes made in the structure of production were not sufficient to neutralize their adverse effects. In the mid-1970s, some countries of the region, noting the unsatisfactory results of this industrialization pattern, adopted policies which led to an increase in the manufacturing sector's deficit without having much impact on the surplus in the natural resources sectors. Their international financial liquidity temporarily mitigated the impact of this problem, but it came up again, in even more serious proportions, in 1982, when the net flow of financial resources showed a negative balance, and the terms of trade fell even more sharply (ECLAC, 1986 a) and b)).

The problem is further aggravated by the fact that the manufacturing deficit is concentrated precisely in the sectors having a greater content of technology and greater growth, i.e., capital goods, chemicals and the automobile industry. The region's position is poor precisely in those areas which offer a promising future for international trade, and strong in those which are not so promising.

(b) Industrialization directed at the domestic market

Whatever may be the specific situation in individual countries —a matter we shall discuss later on—, in every case, industrial exports represent a low percentage of industrial production and, judging by the technology applied in production, processing and manufacturing, it would appear that such activities have been conceived fundamentally for purposes of supplying the domestic market. This does not mean that there were no exceptions in certain periods, sectors and countries, or that no export promotion policies were applied during the mid-1960s. The crucial fact is that the domestic market has always been more profitable than the international market (table 4).

Since the late 1970s, investment in exports has had to compete not only with easily reached and protected domestic market, but also with an even more attractive option, i.e., that of placing money on the international financial market at high dollar interest rates. To give an

idea of the magnitude of this new phenomenon —which works against productive investment in exports and in the domestic market and which is related, among other factors, to the United States deficit— suffice it to say that on the Eurodollar market alone, the volume of trading each year is equivalent to 25 times the volume of international trade in goods and services. Even allowing for some duplication in the recording of these transactions, the orders of magnitude involved show that this is a new phenomenon which is potentially very significant.

Even in the case of Brazil, whose industrial exports represent half the manufacturing exports of the region and more than 50% of its own total exports, the coefficient of industrial exports is low, and the domestic market remains the priority target of most enterprises and sectors. In 1980, the export coefficient in respect of industrial output was 5.3%, using a strict definition of manufactures, and 8.0%, using a broader definition. This applies, with no major variations, to national and foreign private firms and State firms. While this is serious in a country whose GNP is equivalent to that of Sweden, Norway, Denmark and Finland all together (all oriented towards the international market), it is even more serious in the small and medium-sized countries of the region (with export coefficients in the order of 10%). Thus, there is a repetition of the pattern seen in the United States, where production is concentrated on the domestic market, with the difference that the country with the largest domestic market of the region (Brazil) currently represents 1/13 that of the United States. At the end of World War II, it represented 1/25 that of the United States, when the latter was generating 40% of the world product and 60% of world exports, with a population equivalent to 6% of the world total.

■ Table 4

LATIN AMERICA: MANUFACTURING^A EXPORT COEFFICIENT
(Percentages)

	1965	1970	1975	1980	1981	1982	1983	1984	1985
Argentina	2.0	7.0	2.9	3.9	4.5	5.6	4.5	3.8	5.5
Brazil	2.1	2.8	3.0	5.3	6.1	5.0	7.4	17.3	28.4
Mexico		2.5	2.2	2.8	2.5	3.7	6.3	6.0	7.1
Bolivia (Estado Plurinacional de)	4.8	2.6	3.5	3.2	2.1	1.6			
Colombia	1.4	2.0	4.9	4.9	5.0	4.5	3.5	3.6	4.6
Chile	1.3	2.2	5.4	6.1	4.4	5.1	5.4	6.0	6.6
Ecuador	1.8	1.9	5.4	9.8	7.4	6.6	2.4	4.4	
Paraguay	12.5	9.0	10.6 ^b						
Peru	0.6	0.5	0.5	5.1	3.3	3.5	2.5	3.1	
Uruguay	3.9 ^c	2.3 ^d	4.8	7.8	6.6	7.6	11.3	11.7	10.3
Venezuela (República Bolivariana de)	1.2	0.6	0.8	1.0	1.3	1.0	0.7	1.9	5.0
Costa Rica	3.8	9.7	11.5	12.3	18.3	13.5	11.8		
El Salvador	5.0	15.7	17.6	24.3	17.0	15.9	13.2		
Guatemala	26.8 ^c	18.3 ^d	15.8	21.2	17.1	16.4	16.5	14.4	
Honduras	5.5	10.4 ^d	15.3	13.3	11.6	10.3	9.4	7.6	
Nicaragua	2.6	9.2	8.9	7.6	5.0	2.7	2.7	1.6	
Dominican Republic	1.8	1.8	7.1	6.7	6.6	3.9	4.9	4.0	

Source: Joint ECLAC/UNIDO Industry and Technology Division, on the basis of UNIDO data; United Nations, *Industrial Statistics Yearbook* 1983; and ECLAC, *América Latina y el Caribe: exportaciones de manufacturas por países y según su origen industrial desde 1961 hasta 1982* (LC/L.351), Santiago, Chile, 1985.

^a Definition of manufactures and semimanufactures based on UNCTAD document TD/B/C.2/3.

^b 1974.

^c 1968.

^d 1971.

The region's particular problem, however, does not lie in the application of an import-substitution policy —this was done throughout the world, except in England, in the late eighteenth and early nineteenth centuries—, but rather in the economic model it applied. Import substitution has been an integral part of an industrialization pattern that is characterized by a set of elements

that work together and strengthen each other; it may be easier to isolate one of these components and centre all attention on it, but this does not work when it comes to designing different industrialization strategies. It should be stressed, however, that a region in which the hourly cost of the manufacturing sector ranges between 1/7 and 1/20 of that prevailing in the developed countries, with a lower tax burden, with productivity levels that are less than 50% of those of the developed countries and with similar access to technologies, can hardly afford to passively maintain a high and indiscriminate level of protectionism. International experience has shown that radical and candid opening up of the economy is not wise either, but that the countries should, for the time being, establish, at a sectoral level, a strategy allowing for domestic industries to learn technologies that will enable them to attain a secure place on the international market.

(c) The consumption pattern

The desire to reproduce the lifestyle of the advanced countries, especially that of the United States, is a common feature of all the countries in the region; this desire seems to be shared by an overwhelming majority of the world's population, regardless of level of development, socioeconomic system or ethnic background. What is specific to the region is the way in which it is becoming an integral part of industrial demand and supply, the energy platform, marketing, communications and consumer finance. The degree to which different objects are disseminated from the top to the base of the income pyramid depends on unit prices. When cheap goods (beverages, wearing apparel and some household appliances) are concerned, dissemination even reaches the rural sectors. When consumer electronics are included, it reaches the popular urban sectors and, in the case of the automobile (the good which in a way symbolizes this consumption pattern), it reaches the middle-income sectors. The reference lifestyle has arisen in a country whose per capita income is currently equivalent to more than seven times the per capita income of Latin America, and whose economy is practically five times larger than that of the Latin American countries taken together. Moreover, the very country in which it originated has recently noted that this lifestyle is so expensive that its own domestic resources are not sufficient to sustain it, so that the United States has recently fallen into the category of a net debtor, with the sole difference that it issues the currency in which its debt is figured. In order to recover its international competitiveness and avoid falling back in terms of growth and productivity, it has had to resort to devaluation so as to erode the relative level of domestic wages.

In Latin America, physical objects have been transplanted to a greater extent than the know-how and the institutions required to design, produce and adapt these objects to local conditions. The desire to have them has been greater than the desire to assimilate the modern know-how and the interpersonal relations that went into their design.

Assuming that the United States lifestyle is part of a collective ideal, the challenge consists in making this fact compatible with the search for social and economic articulation at the domestic level, and securing a sound position in the international economy. In Latin America, the desire to reproduce the United States lifestyle, in that part of the income pyramid that is able to pay the prices of the various goods, has prevailed over the objectives of articulation at the national level and of securing a good position at the international level. This may be seen, for example, in the density of consumption of certain expensive objects (automobiles), which is much greater than in other recently industrialized countries with a comparable level of income. Moreover, contrary to the case in other countries and regions, local production of these objects for the domestic market has been set up in a large number of small-scale factories, which are structurally incompatible, in most cases, with the requirements of the international market. Access to these goods has been facilitated through "carbon-copies" of the consumer credit mechanisms applied in the countries of origin, with the inevitable implications this has for family savings and the availability of resources for investment.

In an advanced country such as Japan, which was also a latecomer on the industrial scene, and whose per capita income represents almost 80% that of the United States, the density of automobiles is equivalent to 40% that of the United States, and consumer credit availability is equivalent to 1/7 of the GNP. It is interesting to note that Japan is the primary foreign supplier of automobiles for the United States. Several of the Scandinavian countries having per capita incomes comparable to those of the United States and whose markets, in terms of GNP, are larger than those of the medium-sized countries of the region, have a high density of automobile consumption, but have not yet started to produce them domestically. South Korea, with a per capita income similar to that of the larger countries of the region, a product equivalent to 1/3 that of Brazil and 1/2 that of Mexico, and which currently exports automobiles to Canada and the United States through national firms, has an automobile density equivalent to between 1/5 and 1/10 that prevailing in the Latin American countries.

As regards foodstuffs, it is clear that commodities have been neglected on the domestic markets of Brazil and Mexico. Over the past 10 years, there has been a significant increase in agricultural production for export and in the production of sugar cane as a substitute for oil in Brazil, along with a drop in per capita cereal production; the cereal import coefficient has been rising regularly in both countries, reaching a level of approximately 20% in the early 1980s. In Argentina, these products are some of the main export items.

In Argentina and Korea, the problem of supplying basic foods for domestic consumption has been solved, inasmuch as Argentina has an abundance of natural resources and Korea has placed a high value on attaining self-sufficiency in food production. (Per capita calorie consumption in Argentina is similar to that of the United States and higher than that of Europe and Japan.)

As regards dietary content, as shown in table 5, there is a clear contrast between a country which seeks to make up for its own shortcomings and potentialities (Republic of Korea) and the Latin American countries, which try to reproduce, at the top of the income pyramid, the food pattern of the United States, with a large part of the diet consisting of foods of animal origin, especially beef, whereas in Korea consumption of grains and fish is predominant. Although calorie and protein content are comparable, the composition of the diet is quite different. In Latin America, the diet of the middle- and upper-income urban sectors, which is very similar to that of the United States, has been superimposed on that of the rural and lower-income urban sectors, whose diet is much lower in absolute terms as well as in terms of meat and milk content.

Another contrast between the food patterns under consideration has to do with the energy efficiency (this being understood as the biological or commercial energy required per calorie consumed by the average consumer) of the different countries. Suffice it to say that the loss of efficiency involved in the transformation of grains into animal foods and the estimates made for the United States food system—which is the pattern usually imitated—show that around nine calories of fossil energy are required for each calorie available “on the consumer’s plate” (Steihart and Steihart, 1985). The Japanese consumption model, and even more so the Korean one, would quite probably require less than half this amount. Only the great disparities among food consumption patterns in Latin America make it possible for the reference pattern to be fully reproduced at the top of the income scale, inasmuch as, according to Schejtman, in the specific case of South America, twice the current gross total consumption of oil (1980) would be required if production and consumption patterns like those of the model usually imitated were to be generally adopted (Schejtman, 1985, p. 53).

Japan and Korea have also tended to gravitate towards the American lifestyle, both as regards vehicles and as regards diet, but this trend, which is a worldwide one, has been moderated in order to protect growth, international competitiveness and minimum standards of equity, and promote the process of social integration.

Table 5
LATIN AMERICA AND REPUBLIC OF KOREA: DAILY INTAKE

	Consumption			Calories			Proteins		
	Latin America	Korea		Latin America	Korea		Latin America	Korea	
	Kg/year (1979- 1981)	Percentage	Kg/year (1975)	Value (1979- 1981)	Percentage	(1975)	Value (1979- 1981)	Percentage	
Vegetable origin	459.9	76.1	364.4	88.6	83.3	2 282	93.2	59.2	
Rice	39.7	6.6	126.0	29.8	10.1	1 243	50.8	7.9	
Wheat	58.1	9.6	40.9	9.7	15.3	408	16.6	17.7	
Corn	37.7	6.2	-	-	12.8	-	-	12.6	
Other grains	3.7	0.6	48.6	11.5	1.0	472	19.3	1.1	
Total food grains	139.2	23.0	215.5	51.0	39.2	2 123	86.7	39.3	
Fruits	102.7	17.0	15.2	3.6	5.5	24	1.0	2.4	
Vegetables	37.6	6.2	105.1	24.9	1.2	40	1.6	1.9	
Potatoes	-	-	27.6	8.9		86	3.5	2	
Total fruits and vegetables	140.3	23.2	147.9	37.4	6.7	150	6.1	4.3	
Others of vegetable origin	171.4	38.4	-	-	34.2	-	-	6.3	
Pulses	9.0	1.5	1.0	0.2	3.2	9	0.4	9.3	
Animal origin	144.8	23.9	48.2	11.3	16.7	166	6.8	40.8	
Beef	16.6	2.7	1.9	0.4	3.7	9	0.4	9.5	
Pork	6.1	1.0	4.7	1.1	1.3	48	2.0	2.9	
Chicken	7.0	1.2	1.9	0.4	1.1	6	0.2	3.2	
Fish and seafood	13.5	2.2	24.9	5.9	0.9	68	2.8	5.1	
Other meats	5.4	0.9	-	-	0.7	.	2.4	3.7	
Total meats and fish	48.6	8.0	33.4	7.8	7.7	131	5.4	24.4	
Milk	87.4	14.5	11.3	2.7	5.9	19	0.8	13.8	
Eggs	6.2	1.0	3.5	0.8	0.8	16	0.6	2.6	
Animal oils and fats	2.6	0.4	-	-	2.2	-	-	-	
Total	604.7	100.0	412.6	99.9	100.0	2 488	100.0	100.0	

Source: Joint ECLAC/FAO Agriculture Division and World Bank.

(d) Failure to recognize the social value of national entrepreneurs and weakness of their leadership

In most cases, national private enterprises have not exercised leadership in the more dynamic industrial sectors (automobiles, chemicals, capital goods) which bring in technical progress and determine the national profile of production; among the largest companies in each country, national private firms rank in a modest third place, after public enterprises and transnational corporations (Fajnzylber, in press); a study of the position of the countries of the region as regards the presence and the importance of small and medium-sized enterprises, which by definition are national private companies, will show that they are much less important than in the advanced and recently industrialized countries of other regions (Italy, Japan, India and Spain).

The strong role played by small and medium-sized industries and the increasing attention being given to them in the advanced countries, in several different sectors, all of which are exposed to international competition, suggests that some objections may be made to the determinism with which the small size of domestic markets is often viewed. This is often used as an excuse both for the absence of investment opportunities and the maintenance of highly protectionist policies. Moreover, since the mid-1970s, empirical observation in the advanced countries has confirmed the fact that these companies are much more dynamic not only as regards employment but also as regards flexibility and technological innovation. Finally, an analysis of the role of the national private sector in technological research and development show that, even in the more advanced countries of the region, their participation is marginal.

To the above facts are added two others which, although difficult to quantify, are nevertheless significant: the role of corporations as such, independently of the ownership system followed, is not appreciated by society in Latin America, but the issue of ownership, which has become deeply associated with ideology, arouses great interest in public debate. Although the similarities with the United States hold, as regards consumption patterns, the domestic orientation of production, and international insertion by way of natural resources, the difference could not be greater as regards this fourth aspect. This is, moreover, one of the features which distinguishes the region from those recently industrialized countries which have succeeded in competing on the international market. The Latin American countries will not be able to get away from this "showcase modernness" until such time as their societies properly appreciate the role of their enterprises and their entrepreneurs exercise creativity. This is a very complex issue which goes beyond the sphere of trade, fiscal or monetary policy; hence, it cannot be considered merely in the light of doctrinaire positions to be imposed by decree. Economic policy instruments and decrees may have positive or negative effects, but they are not sufficient in and of themselves. A cultural and axiological dimension is involved, and a crucial role is played by political debate based on realities, social agreement, transparency in the transmittal of information, the mass communications media and the educational process.

In this regard, there are several basic differences between the Republic of Korea and the Latin American countries. In Korea, a predominant characteristic, which is even more pronounced than in Japan, is the close linkage between the State and a number of national conglomerates centered especially in the manufacturing sector, but also showing a high degree of diversification. The 10 largest conglomerates (table 6) generate almost one-fourth of the gross national product and the 46 largest conglomerates originate 43% of the GNP. The national private conglomerates of Latin America do not come anywhere near to carrying that much weight, and their organic linkage with the State is much weaker. Moreover, whereas in Korea the public sector has played a decisive role in financial intermediation, public development banks in Latin America, although relatively important, coexist with a private banking system which accounts for the bulk of short-term financial intermediation (*Asian Development Review*, 1984).

The subsidiaries of transnational corporations play a much less important role in Korea than in the Latin American countries, where they exercise leadership and concentrate on the domestic market.

Finally, public enterprises account for a much greater share of investment in Korea than they do in Argentina and Brazil, and a lesser share only by comparison with Mexico, where the petroleum sector (PEMEX) is particularly strong. In brief, whereas in Korea leadership is provided by a strong, planning-oriented State which is organically articulated with a small number of powerful national conglomerates, with a number of TNC subsidiaries playing a minor, complementary role in certain export-oriented sectors, what we see in Latin America is a distribution of functions in which transnational corporations exercise leadership in the more dynamic industrial sectors, public enterprises take care of infrastructure branches, and national private companies are relegated to less dynamic and less technologically complex industrial activities and the production of services, including financial intermediation (table 6).

■ Table 6

IMPORTANCE OF DIFFERENT ENTREPRENEURIAL AGENTS

	Argentina	Brazil	Mexico	Republic of Korea
Foreign investment: stock of foreign investment (end of 1970s) (millions of dollars) ^a	5 489 (1983)	13 005	3 868	737
Share of transnational corporations in manufacturing gross output ^a	31 (1972)	44 (1977)	39 (1970)	11 (1975)
Share of transnational corporations in exports of manufactures ^a	>30 (1969)	43 (1969)	34 (1974)	27 (1978)
Public enterprises: share in fixed total investment ^b (1974-1977)	20 (1978-1980)	23 (1980)	29 (1978)	25 (1974-1977)
Contribution of private national conglomerates to GDP (1978): 10 largest 46 largest				23.4 43.0
State corporations (I) Private national corporations (II) Transnational corporations (III) Percentage structure in total sales (1983) ^c				
	I III	I II	III I	II III
10 largest corporations	45.1 7.1 47.8	59.3 11.2	29.5 83.7	14.2 2.1
50 largest corporations	37.1 24.5 38.4	47.4 20.8	31.8 65.9	24.5 9.6

Source: Joint ECLAC/UNIDO Industry and Technology Division.

^a Centre on Transnational Corporations, *Transnational Corporations in World Development*. Third study, New York, 1983.

^b J. Sachs, External debts and microeconomic performance in Latin America and East Asia, *Brookings Papers on Economic Activity* No. 219, 1985; and K.S. Kim, Industrial policy and industrialization in South Korea, *Kellogg Institute Working Paper No. 39*, 1985.

^c Joint ECLAC/UNIDO Industry and Technology Division, *Industrialización y desarrollo tecnológico, Informe No. 1*, Santiago, Chile, September 1985; and ECLAC, *Las empresas transnacionales en Argentina*, Estudios e Informes de la CEPAL, No. 56, Santiago, Chile, United Nations publication, Sales No. S.86.11.G.6.

(e) Interrelationships among the fundamental characteristics

The four common characteristics mentioned above are interrelated and mutually reinforcing. It is therefore difficult to understand the transplanting of "showcase modernness" and systematic orientation towards the domestic market without taking into account the weakness of national corporations, and vice versa. The convergence of the three factors, for its part, explains why, after several decades of industrialization, the countries still depend on natural resources for gaining access to the international market. The availability of those resources in turn influences the pattern of industrialization adopted.

From the standpoint of the formulation of new industrialization strategies, what is important is to assume the interdependency of these factors and deal with them as a whole. If, for example, attention is directed solely towards the need to open up domestic markets, the immediate effect will be an increase in "showcase modernness", a further weakening of the entrepreneurial base and an accentuation of insertion by way of natural resources. Moreover, it is arbitrary to try to strengthen the national entrepreneurial base by applying the seemingly effective expedient of transferring ownership of established enterprises to different agents (changing to private or to State ownership), while maintaining a pattern of consumption that is hardly compatible with growth, especially at a time when net capital flows to the region are disappearing and it has become so easy to place private savings abroad.

Regional and international experience suggests that if the general objectives of development are to be achieved, it is important to advance simultaneously towards the articulation of the domestic economy and society and towards a sound participation in the international economy. It is unrealistic to think that this participation can be achieved while partially excluding certain social sectors and regions, inasmuch as the latent social tensions will inevitably lead to uncertainty and, in the last analysis, jeopardize growth and investment. Moreover, concentrating attention entirely on domestic articulation at the expense of international insertion is very risky, both because of the increasing efficiency of communications and the resulting transmittal of expectations and behaviour patterns, and because of the even more decisive fact that the improvement of living standards is associated with the improvement of productivity. This has to do with the process of adoption of technical progress, which requires growth and is encouraged and facilitated by international insertion.

The pattern of industrialization that is characterized by the convergence of "showcase modernness", an easy domestic market, international insertion by way of natural resources and weak national entrepreneurs reflects the weakness of what has been defined, in a previous study (Fajnzylber, 1983), as an endogenous nucleus of technological dynamization. To change this pattern would, in fact, involve reinforcing and articulating that nucleus and the goods and services subsystems of which it is made.

The national expressions of this pattern are the result of a combination of these common characteristics and the specific features of each society and of the industrial sector itself.

3. Differential features of the industrialization of Latin American societies

The industrialization pattern described above may be seen in societies that are very different from each other. The specific features of an industrialization process, as regards content, results, challenges for the future and strategies and policies required to face them are directly affected by the interaction of the common characteristics of the industrialization pattern and the unique features which distinguish national societies. We shall centre our attention on certain aspects in which the similarities and differences appear to exert the greatest influence: the type of natural resources, the characteristics of the agricultural system, the historical moment in which industrialization takes on momentum, the population dynamics, the size of markets and the prevailing political system.

(a) Type of natural resource

The type of natural resource that has enabled a country to gain access to the international economy and the type of enterprises involved in its exploitation influence, in varying degrees, the level, evolution and stability of foreign-exchange income; the distribution of the available

foreign-exchange income among the different economic agents; the relative economic weight of the State in society as a whole and abroad, and variations in productivity. Consequently, the type and nature of the natural resource involved, and the particular form of enterprise developed to manage it will have a direct influence on the backward linkages in the industrial sector (raw materials, inputs and equipment), as well as on the population's demand for industrial goods.

A variety of situations have arisen in the different countries of the region. There are mining enclaves managed by outside entrepreneurs which have subsequently been transferred to public enterprises and have thus become a mainstay of public finance in foreign currency and, partially, in local currency. Agriculture has been predominantly devoted to industrial crops managed by large modern enterprises belonging to national capital, which subsequently play a leading role in industrial development. In similar situations, entrepreneurial responsibility has been borne by enterprises that act on the international scene. The different ways in which the latter two situations affect the linkages and subsequent role of the State, as well as on the country's development style, are far from negligible. Also, in some situations, export-oriented agriculture has coincided with the production of basic foods for domestic consumption, with ownership, although relatively concentrated, including a large number of medium- and small-scale farmers. In this case, structural diversity is attenuated, income distribution is more favourable, and the relative autonomy of the society with respect to the State tends to be strengthened.

A very simplified typology of Latin American agriculture might show the distinction between the extreme cases of Argentina and Uruguay, on the one hand, and the rest of the region, on the other. Argentina and Uruguay have fertile lands that are fairly uniform and sparsely populated; their basic exports are consistent with the domestic diet of meat and grains, medium- to large-scale commercial enterprises are predominant, the peasantry plays a minor role, agricultural technology is at an advanced stage, and there is little technological dualism within agriculture or between agriculture and the rest of the economy. In the other countries, although there are subsystems similar to those just described, and they may be increasing in importance, industrial crops are prevalent, soil fertility varies greatly, irrigation plays an important role, large modern exploitations are combined with a significant peasant economy and a growing dependency on imports to supply basic food consumption (cereals); in this case, there is a strong technological dualism within agriculture and between agriculture and the rest of the economy.

(b) The belatedness of industrialization

The particular point in history at which the process of industrialization is unleashed will also have a significant effect on its scope and content. Although reference is often made to the "belated industrialization" of the region, this generalization actually includes countries in which the process began at the end of the nineteenth century (the *Unión Industrial* of Argentina was founded in 1887, and the *Sociedad de Fomento Fabril* was started in Chile in 1883), others in which the process seems to have started after World War II, and other intermediate situations in which World War I and the crisis of the 1930s seem to have triggered the process. It could be argued that the later a country begins to industrialize, the more advanced will be the level of technology to which it has access. This advantage, however, is offset by the fact that there will be a greater gap between the way in which a preindustrial society works and the requirements which the introduction of the industrial rationale entails. The longer a preindustrial society persists, the greater will be the lag and the latent social tensions. To this is added the fact that the modernization of health services will take place more rapidly than industrial development, and this will have an effect on population dynamics. In Latin America, the migration of the

population from the tedium of farm life to the neon lights of the cities is reaching proportions never seen in the process of industrialization of the developed countries. It used to be that those who were excluded from progress were also excluded from access to information and political participation; this situation ended with the appearance of the transistor radio, which has brought both the urban poor and most of the peasantry the collective expectation of a modern lifestyle, represented by certain symbols of consumption and lifestyles. The social tensions generated in preindustrial society are reinforced in the early stages of industrialization with the inclusion of the poor in the shared expectation of entering into the modern age, even if only through the precarious means of physical contact with certain objects.

No reliable and comparable empirical data are available to assess the influence of the industrial sector on the economy of Latin America as a whole during the latter part of the nineteenth century. Nevertheless, from the sources available, it would appear that Argentina, Brazil, Chile, Mexico and Cuba had some degree of industrial development by the beginning of World War I, particularly in the area of textiles, clothing, mills, footwear and some metal tools. Between World War I, the crisis of the 1930s and World War II, industrialization took hold in Colombia, Peru, Costa Rica and Bolivia, and after World War II, it began in Venezuela, Paraguay, Honduras, Guatemala, Panama, Ecuador, Nicaragua, Dominican Republic, Haiti and other Caribbean countries. This is just a rough estimate but it gives an idea of the wide range of situations covered by the term "late industrialization", i.e., from countries that have been industrialized for more than a century to others with an industrial history of no more than three decades.

(c) The size of the national economy

Evidently, the economic size of the different countries is a factor which explains some of the differences in their industrialization processes, especially in view of the fact that certain goods, such as widely used intermediate inputs (cement, steel, petrochemicals), automobiles and some mass-produced capital goods, require a minimum plant size that is hardly compatible with the domestic markets of some countries. Moreover, certain infrastructure works (transport, energy, communications) require a very high fixed investment, and this can be raised more easily in countries having a larger economy. In general, the smaller the size of the country the more specialized will be its industry and the more diversified the profile of the sectoral structure.

When these facts are considered in the light of the actual production structure of the region, it becomes apparent that the latter has not been a fundamental criterion in the design of industrial strategy and policy. Moreover, in many countries, other considerations, which are hardly justifiable from the economic or technological standpoint, have led to the development of industries the minimum scale of which is incompatible with the size of the country (steel, automobiles); at the same time, other industries which would have been better suited to the country, such as certain non-mass-produced capital goods, have not been developed. In fact, a highly fragmented structure of production and a high level of idle capacity were characteristic of several sectors and many countries of the region over long periods of time; this situation was made possible, from the economic standpoint, by the indiscriminate protectionism that prevailed in these economies. In the Central American Common Market, integration helped compensate for the limitations of domestic markets, and in the Andean Group, the same effect was achieved, although just barely. In general, the limitations arising from the small size of domestic markets have been aggravated by the impact of domestic policies, and not enough attention has been given, in practice, to efforts to compensate for these limitations through integration.

(d) Political systems

Judging from the texts of their constitutions, it would appear that most of the political systems of the region are based on the liberal doctrine of nineteenth-century Europe; this seems contradictory, considering that only a very small percentage of the population of Latin America has lived for more than a few decades under a representative democracy. Since the early 1980s, most of the region's population has succeeded in adopting this type of political system as a routine way of life. The fact that representative democracy has been almost absent as a structural feature in the political history of Latin America may help explain why regional integration has advanced so slowly; international and regional experience has shown that integration works better under democratic regimes. The most significant step taken recently has been the signing of an agreement between Argentina and Brazil, which contains certain qualitative innovations with respect to the region's experience with integration (ECLAC, 1987).

4. The industrial crisis of the 1980s

(a) Relative magnitude of the Latin American industrial crisis

Mainly as a result of external factors, but also because of internal factors of a structural nature and of the economic policies implemented, the Latin American economies have, since 1980, been undergoing a crisis which has particularly affected the industrial sector. It was inevitable that the increasing scarcity of foreign exchange would most seriously affect that sector of production which required the greatest amount of imports and had a very limited export capacity and hence a heavy trade deficit. On the demand side, industry was disproportionately affected by the drop in national income and on the supply side, the scarcity of foreign exchange made it difficult to obtain inputs, parts and equipment, which became more expensive. Except in a few countries and sectors, inexperience and the nature of the production facilities concerned prevented industrialists from offsetting the decline of the domestic market with exports; to this problem was added the rise in interest rates and the overindebtedness carried over from the 1970s.

In 1985, Latin America's manufacturing product per capita was at an index figure of 89 (1980=100) and its GDP per capita was 93 (1980=100). The recovery attained by industry in 1984 and 1985 (2.6% and 1.9%, for the manufacturing product per capita) was not sufficient to restore the 1980 levels. Despite the notable differences in the performance of the different countries, the manufacturing product per capita in 1985 did not improve, with respect to 1980, in any of the countries for which comparable data were available.

Disregarding population growth and considering only the level of the manufacturing product, some extreme cases come to light, such as those of Colombia, Ecuador and Venezuela, whose 1985 manufacturing product was 8% higher than in 1980, on the one hand, and Bolivia, whose 1985 manufacturing product was 61% of the level attained in 1980 (53% in terms of the manufacturing product per capita).

(b) Explanatory factors and evolution of the industrial crisis

This disparity in the development of manufacturing is explained, among other factors, by the degree of industrialization and integration of the industrial apparatus, the volume and sectoral distribution of investment and the industrial growth of the preceding decade, the nature and intensity of the negative impact of external factors (terms of trade, indebtedness, capital

flows, interest rates and trend in the quantum of exports) and the domestic macroeconomic and sectoral policies adopted by the different countries during the crisis.

Brazil, which accounts for about one-third of the region's manufacturing product, has played a major role in the overall decline of the per capita product during the period 1980-1983 and in the recovery experienced in 1984-1985. That country saw its manufacturing product fall steadily up to 1983 and then recover steadily in the subsequent years; this was not the case, however, in most of the other countries of the region. In some of these, the decline has continued from 1980 to the present (Bolivia, Guatemala, Honduras, Panama); in others, after an initial fall, up to 1982-1983-1984, there was still no clear recovery in the following years (Argentina, Uruguay); and in others, there was little or no decline at the beginning, but the situation later deteriorated (1982-1983 in Mexico and Ecuador). Mexico drew up and implemented a programme explicitly designed to protect the production plant, and this mitigated and delayed the impact of adjustment. Another category would be that of those countries whose industrial recession never actually reached major proportions (Colombia, Venezuela and Paraguay): the lowest level of the manufacturing product in these countries was 96 for Colombia in 1982, 98 for Venezuela in 1981, and 97 for Panama in 1983; the manufacturing product per capita was 91 in Colombia and Venezuela in 1983 and 88 in Panama in 1985.

The case of Brazil is an exception. This is the only country of the region that had a trade surplus in the manufacturing sector during that period. It accounts for 50% of total exports of manufactures from Latin America, has attained the highest degree of relative development in the capital goods sector, and, because of its procyclical behaviour, it experienced both the fastest fall of the industrial sector during the period 1980-1983 and a steady growth during the following years, up until 1986. In 1984, when the world economy was stimulated by an increase in imports from the United States (27%), Brazil's exports to the United States rose by 54%, whereas exports from Latin America as a whole only rose by 7%. Exports from southeastern Asia to the United States rose by 34% during that year. The results obtained by Brazil were the fruit of a steady flow of investment over a period of 30 years, especially during the second half of the 1970s, which seems to have contributed to increasing the industrial sector's foreign exchange balance from US\$ 3 billion in 1981-1982 to US\$ 5 billion in 1983 and US\$ 7 billion in 1984 (UNIDO, 1985).

Those countries whose industry was more dynamic during the 1970s, regardless of their level of industrialization and the size of their domestic market (Brazil, Mexico, Venezuela, Colombia, Ecuador, Costa Rica, Panama, Paraguay and Dominican Republic) showed a more positive evolution during the 1980s than the other countries (Argentina, Chile, Uruguay and Peru). In the latter, the external crisis overrode domestic factors.

■ Table 7

**GROWTH OF MANUFACTURING VALUE ADDED PER CAPITA,^a BY ECONOMIC GROUPING
AND BY DEVELOPING REGION, 1963-1985**
(Average annual rates, in percentages)

	1963/1973	1973/1980	1981	1982	1983 ^b	1984 ^b	1985 ^c	1980/1985
Developed market economies	4.6	1.0	-0.1	-2.9	2.4	6.1	2.5	1.6
Centrally-planned economies	8.6	6.1	1.9	2.1	3.7	3.5	2.7	2.8
Developing countries	5.1	3.5	-1.9	-2.0	1.0	7.0	3.7	1.5
Africa	4.5	2.7	-0.2	-0.9	-2.0	1.3	2.0	0.1
West Asia South and East	6.2	2.3	-2.0	5.1	8.0	9.6	6.2	7.9 ^d
Asia	4.6	5.4	3.6	1.0				
Latin America	5.1	2.8	-5.1	-3.9	-5.3	2.6	1.9	-2.0

Source: Joint ECLAC/UNIDO Industry and Technology Division, based on data from UNIDO, *World industry: A statistical review*, 1985 (UNIDO/IS.590), Vienna, 1985.

^a At constant 1975 prices.

^b Preliminary figures.

^c Estimates. ^d 1982-1985.

(c) Changes in the sectoral profile

The different trends in the industrial sector also affect the sectoral profile. Before the crisis, the most dynamic sectors in the region were transport equipment, chemicals and capital goods, while the least dynamic were textiles, clothing and leather. This profile, which is similar to that of the developed countries, originated mainly in the more industrially advanced countries of the region. For example, in Colombia, whose good economic performance we have mentioned, the food sector was one of the most dynamic during the pre-crisis period, and this was also the case in the less industrialized countries.

From the standpoint of the changes which occurred in the sectoral profile, three major developments stand out during the period 1980-1983: the transport equipment and capital goods sectors moved over into the category of less dynamic sectors, which is understandable, given their role in the investment process and the complementary impact of the rise in interest rates and the fall in the GDP; the industrial chemicals sector (ISIC, 351) remained dynamic both before and during the crisis, which is an indication of the widespread use of this type of goods in overall production activities (agriculture, mining, construction, non-durable consumer goods); and, in the third place, the food sector, whose growth is associated with basic survival needs, in 1980 became a highly dynamic sector in such different countries as Brazil, Mexico, Chile, Dominican Republic and Venezuela.

In the region as a whole, the more dynamic sectors during the crisis have been the food sector and two intermediate input sectors, i.e., chemicals and steel, the latter being influenced by Brazilian exports. As some of the countries recovered, around 1984 and 1985, it appears, despite the lack of complete information, that the pre-crisis production profile was reconstructed, with the automobile industry showing a marked recovery and in some countries, especially Brazil, with the capital goods sector also improving greatly.

So far, there are no signs of industrial recovery in most countries of the region, and it would be premature to try to forecast the changes that will take place in the production profile,

although certain sectors, such as the automobile industry and some industries producing widely used intermediate inputs (e.g., petrochemicals and steel) will no doubt undergo far-reaching rationalization processes, in addition to the overall reorganization of industry that is bound to take place.

(d) Impact on scientific research and technology

Perhaps the most revealing feature of Latin American industry is the fact that, in marked contrast with the situation in the advanced countries, expenditures on research and technological development closely associated with the public budget have fallen steadily, even in Brazil. This trend has been quantified in respect of Argentina, Brazil, Mexico, Chile, Peru and Venezuela.

This shows how little social and political importance is attached to such activities in the region, and how weak is the link between research and development activities and industrial production for the domestic market. In regard to countries which rely on the industry sector for their international competitiveness, it is inconceivable that budgetary constraints should lead them to sacrifice resources for scientific and technological research, which plays such a decisive role in a country's position on the international market.

(e) General description of the current situation

The current situation of the Latin American industrial sector might be described as follows: relatively high margins of idle capacity in several countries and sectors; weak financial position of firms associated with the decline of the domestic market; overindebtedness; high interest rates; and, in several countries, a serious impact of successive devaluations on imports and on the service of the foreign debt.

The collapse of the rate of investment, which in several countries was barely high enough to allow for replacement, has hastened the obsolescence of the industrial park, inasmuch as the existing equipment was aging precisely at a time of rapid technological change (on the international scene) in the capital goods sector. To this must be added the weakening and, in some cases, the dismantling of design groups in manufacturing firms and engineering companies, and the deterioration of the level of training of that part of the industrial labour force which was obliged by the unemployment situation to move into other activities.

In the public sector, in addition to the lack of investment resources, attention was centered on trying to solve short-term problems; this inevitably led to neglect in drawing up the strategies that would be necessary in order to provide a minimum of guidance for entrepreneurial activity. Moreover, the decline in public-sector wages and the restrictions placed on hiring may have helped eliminate unnecessary activities, but they have also weakened public support for certain key sectors, such as that of technological development. This combination of unfavourable factors seems to have had the most serious effect on smaller companies which had weaker links with government departments.

The issue is not one of specific problems affecting only certain agents or sectors, but rather, what is being questioned is the entire industrial system —the public and private agents of production, finance, and technology—, as well as the validity of the policies required for industrialization. The countries are faced simultaneously with the challenge of reactivating the entrepreneurial sector, reorienting production activity, promoting the articulation of industry with natural resources and with services, thinking up strategies and policies, and strengthening different public and private institutions which influence the operation of the industrial sector.

II. CONCLUSIONS

Among the lessons to be learned from this exploratory exercise, it seems worthwhile to stress the following:

The soundness of a country's participation in the international market is closely linked with its ability to add intellectual value to its supply of natural resources. It would be naive to aspire to a strong position on the world market without incorporating technical progress into those resources. The fact that a country has natural resources does not mean it has to give up the rents these can bring, but it is essential that such rents must be applied to the transformation and modernization of the agricultural sector and to the strengthening of an industrial sector that is able to increase its share and its competitiveness on the international market.

The widely disseminated idea that there is a law of compensation between growth and equity does not hold up under examination of the empirical evidence in a wide range of national situations. It is true that within Latin America, the two objectives have not coincided and that countries with greater equity have had stagnation and countries with great dynamism have not had equity, but this localistic approach to the relationship between the two objectives is refuted by a comparison of the Latin American pattern and the patterns of other regions having different socioeconomic systems and levels of development. Contrary to the case with sporadic growth, sustained growth calls for an equitable society that is well-articulated internally, creating the right conditions for a sustained effort to incorporate technical progress and raise productivity and hence, growth.

As long as the elites of Latin American societies continue to set their hopes on the short-sighted and prosaic goal of copying, at the top of the income pyramid, the lifestyle of the developed countries, ignoring the fact that even the United States, where this lifestyle originated, is already having difficulty sustaining it and, moreover, trying to propagate it as a collective goal to the rest of society (adjusting the structure of land use, energy, transport and communications to that objective), the situation might well change unpredictably, so that while today there is an empty box, it might be that tomorrow the fullest box would be the one showing stagnation with social disarticulation.

The opening of the black box of technical progress is a task which goes beyond the scope of industry and entrepreneurship, and becomes a part of an attitude on the part of overall society with regard to this issue. This new activity, in which creative imagination is valued by society, i.e., the search for formulas that will respond to a country's shortcomings and internal potentialities, calls for a change in the elite who shape the values and orientation that are disseminated throughout society as a whole. It would be difficult to establish compatibility between a leadership which is strongly influenced by rentier sectors and financial intermediaries, either private or public, and the dissemination throughout society of values in which internal shortcomings and potentialities become the leading axis for economic and social transformation. The growing dissemination of modern objects in Latin America in no way changes the weakness of the traditional social relations into which these objects are incorporated. How modern a society is has less to do with the objects that are disseminated within it than with the modernness of its institutions and of the relationships on which the design, acquisition, selection and evaluation of the usefulness of those objects are based.

It is difficult to conceive how the countries of the region will handle the task with which they are faced, of changing not only the economic structures but also the concepts which the

different strata of society have of the challenge before them and how to meet it, unless the forces of the different social strata are able to work together wholeheartedly in the search for solutions. It is difficult to believe that there will be any change for the better unless Latin American societies become democratic, and allow the active and permanent participation of those who thus far have not benefited from the development pattern followed. Nevertheless, we must not forget that there is no guarantee that the democratization process will be able to legitimate itself economically in a context such as the one described above, nor can it be guaranteed to respond quickly to the shortcomings currently being faced. Democratization in some countries of the region has partly been a reflection of the inability of the authoritarian regimes that preceded it to solve those problems, and it would be naive to assume that the symbolic goods that democratization disseminates can continue for much longer to make up for the concrete solutions which some of the problems urgently require. Consequently, the medium and long- term potential of the democratization process is at odds, over the short term, with the urgent need to find forms of legitimation in fundamental sectors.

The above necessarily leads us to consider the possibility of having access to resources from the developed countries, in order to support this recovery. So far, emphasis has been placed on the importance of internal change and it has even been suggested that external financial aid would not be appropriate if it simply led to a prolonging of the former development pattern. However, the economic, social, political and cultural transformation that is required in Latin America, which is supported by internal effort, requires a complementary external support. If the surplus countries, i.e., those that are able to channel resources outside their own boundaries (Japan and the Federal Republic of Germany, mainly) take no interest in the situation of the developing countries and continue, as in recent years, centering their attention on the possibility of resolving the disequilibria among them, especially in view of the United States' deficit in its external and fiscal positions, they may indeed find some formula for civilized coexistence among themselves, turning their backs on the increasingly dramatic situation which is developing in the southern hemisphere. The main debtor country, the United States, would have to take the necessary measures to live within its means, and the surplus countries, instead of orienting resources to maintain the United States consumption pattern, should direct them to the southern countries. It is extremely important that those countries undertake, on their own, certain economic and social changes that would enable them to absorb those resources so as to transform their development patterns, and those resources should allow for compatibility between the short-term requirements associated with the current crisis, generating changes that will make it possible to fill the box which now stands empty.

The sequence which seems to emerge from the study is the following: equity, austerity, growth and competitiveness. Thus, the reality is different from the theory, which starts with competitiveness and does not stress the technological content of exported goods, in the view that growth will follow from the dynamic effect of the international market, which would gradually incorporate the previously excluded population. Both experience and internal and external political and economic considerations show that in Latin America, it will be increasingly difficult to put off dealing with the issue of equity, even though this will mean bringing up unpleasant issues from the past which seem to have been overtaken by modern developments.

An important factor in the generation of resources in the north and in the way they are utilized in the south, is the reduction of expenditures on armaments. In the north, there seems to be a reverse relationship between industrial competitiveness and the war effort, which suggests that a reduction of expenditures on armaments would facilitate.

CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY

THE PRIME TASK OF LATIN AMERICAN AND CARIBBEAN DEVELOPMENT IN THE 1990s *

ECLAC

* Chapter I "Introduction and summary" (pages 11 - 18) and chapter V "Some basic policy lines" (pages 97 to 100), in *Changing production patterns with social equity: the prime task of Latin American and Caribbean development in the 1990s* (LC/G.1601-P), Santiago, March 1990. United Nations publication, Sales No. E.90.II.G.6. Document coordinated by Fernando Fajnzylber.

I. INTRODUCTION AND SUMMARY

A. The starting point

The development experience of Latin America and the Caribbean in the 1980s has already been thoroughly explored by the ECLAC Secretariat in numerous documents, which stress the setbacks suffered by the vast majority of the countries in the economic and social sphere. These setbacks can be better appreciated in the light of the progress achieved in previous decades and also, in the 1980s themselves, in the light of the progress made by other regions of the world, especially the industrialized member countries of the Organization for Economic Co-operation and Development (OECD) and various Southeast Asian countries.

The ECLAC documents referred to above used the expression “lost decade” to illustrate the magnitude of the setback suffered in terms of development. If measurement is limited to a global indicator such as the evolution of the per capita gross domestic product, this expression even falls short, for at the end of 1989 the real per capita product stood at the level, not of ten years earlier, but thirteen, and even more in some economies. Consequently, the countries of the region are entering the 1990s under the burden of the recessionary inertia of the 1980s, the heavy load of their external debt commitments and the fundamental lack of correspondence between the structures of international demand and the structures of Latin American and Caribbean exports.

Furthermore, the region continues to suffer from a number of serious shortcomings, including in particular unsolved macroeconomic disequilibria, the increasingly obsolete stock of capital goods and physical infrastructure (due to depressed levels of investment), a growing gap between the intensive technological changes taking place in the world and their application in the region, the erosion of the financial and managerial capacity of governments, the frustration of an ever-increasing number of people who are trying to enter the work force, the misuse and destruction of natural resources, and the degradation of the environment.

The 1980s did not only witness setbacks, however. There were also advances: partial and sometimes shaky in the economic field, but substantial in the political sphere. In this respect, the 1980s was also a decade of “painful learning”. In the politico-institutional field, many countries progressed towards pluralist and participative societies, and the end of the decade witnessed the progressive reduction of ideological considerations in the political and economic debate. This is reflected in the various forms that political and social consensus building have taken. At the level of intraregional relations, most of the rivalries between neighbouring countries became a thing of the past, being replaced in some cases by creative schemes of co-operation. In the economic field, it became abundantly clear that the region’s asymmetrical participation in the international economy must be redressed; governments also became more aware of the importance of maintaining short-term macroeconomic equilibria and complementing them with sectoral policies to support the process of change. Efforts to take greater advantage of the potential offered by regional integration were redoubled, and substantial progress was made in overcoming false dilemmas regarding the relations between industry versus agriculture, the domestic versus the external markets, the State versus the private sector, and planning versus the market.

The by no means negligible economic changes which took place, even in the context of the frail performance of the region’s economies in the 1980s, were also part of the painful learning process. The heterogeneous performance of different areas of industrial activity was brought out, and the relative vitality of the agricultural sector was confirmed: also, in many

countries the big urban concentrations suffered a heavier impact than smaller cities and rural areas. The export coefficient was raised in a wide range of activities, an increasing number of dynamic entrepreneurs emerged, and the coverage of certain social services, such as education, was maintained in spite of budgetary restrictions. The demand for certain kinds of goods and services continued to expand: home electricity consumption and the per capita availability of television receivers maintained their upward trend, in contrast with the regressive performance of aggregate economic indicators.

Thus, in the 1980s opposing trends existed side by side. In the institutional sphere, political interaction was strengthened, but public institutions were weakened. Adjustment had a very high social cost, especially for the middle-level and popular strata, but those who were most seriously affected often devised their own defence mechanisms. The economies were characterized by a generalized loss of dynamism and a marked deterioration in the levels of equity, but at the same time a process of adaptation to the changing circumstances began, and in the course of it many enterprises improved their international competitiveness, while there were many examples of creativity and originality.

In short, the 1980s represented, in historical terms, a turning point between the previous pattern of development of Latin America and the Caribbean and a phase which is not yet fully defined but will undoubtedly be different and which will mark the future development of the region. This lost decade of painful learning might parallel past periods which other nations have had to go through in all the successful cases of late industrialization. Perhaps this will prove to be the basis on which the region will be able to resume the path of growth, with different modalities regarding institutions and policies, and accompanied, this time, by a sustained effort to overcome shortcomings in the areas of equity and international competitiveness; all this within an environmentally sustainable context. The purpose of this document is precisely to contribute to this task.

B. The challenges of the 1990s

Thus, as they enter upon the decade preceding the new millennium, Latin America and the Caribbean stand at a new crossroads. The challenge is none other than to find the path that leads to development: a path from which the countries seem to have gone astray in the turbulent decade which has just ended. The task of overcoming the crisis brings with it an extraordinary mass of demands. For example: on the one hand it is necessary to strengthen democracy, while on the other countries are called on to adjust their economies, stabilize them, bring them into a world of intensive technological change, modernize their public sectors, increase savings, improve income distribution, introduce more austere consumption patterns, and moreover do all this within the context of environmentally sustainable development.

Debilitated economies, societies and States can hardly tackle this mass of demands successfully without carefully weighing, in a climate of consensual mutual support, various kinds of options, priorities and sacrifices. Indeed, the task before them is so great and so complex that it would hardly be possible to tackle it from a single holistic perspective, especially in view of the enormous diversity of situations which exists in the region. There are, in addition, pressing immediate matters which have so far obliged the authorities to focus their attention on short-term economic policy to the detriment of longer-term projects and proposals, even though these may be essential in order to correct the existing imbalances: this happens to be the case, for example, regarding the balance of payments. In this respect —taking advantage of the longer time horizon offered by the beginning of the 1990s— this document stresses what it considers to be the prime common task of all the countries: the transformation of the productive structures of the region in a context of growing social equity.

C. Some conditions for the transformation of the productive structures

The direction and results of the domestic efforts to overcome the crisis will depend to a considerable extent on the external environment, which will always decisively influence the performance of the economies of the region. Among the various elements conditioning this performance are, in particular, the degree of openness of international trade; the way in which excessive indebtedness — a problem that limits both the import capacity and the investment possibilities of many economies of the region — is managed; and the possibilities of gaining access to technologies and know-how on terms that facilitate changing production patterns so as to achieve international competitiveness.

The conditioning factors of external origin are intermingled with others of internal origin and often act to strengthen them. Among the latter factors, in particular, there is the need to correct macroeconomic disequilibria, which were the dominant feature of the 1980s. A major query also arises as to the manner in which development will be financed, in view of the massive negative transfer of financial resources of recent years. Thirdly, the guidelines offered by this document take into account the need to maintain social cohesion, a matter which places clear limits on the content of economic policies and strategies.

D. The domestic effort and international co-operation

Promoting the transformation of the productive structure and clearing the way for greater social equity are tasks that call for decided, persistent and whole-hearted efforts by governments and all members of society. These efforts will only bear fruit, as already noted, in an external environment which provides conditions that are at least minimally favourable to such vital matters as financing in general (including, more specifically, a solution to the external debt problem), trade, and the transfer of technology and know-how. All this raises more forcibly and enhances the priority of the need for international economic co-operation.

In this respect, it is to be hoped that the region will be able to face the international dialogue and negotiations from a more favourable position than in the past, for if the countries of Latin America and the Caribbean adopt their own strategies which enable them to progress in changing their pattern of production, this would put them in a more legitimate, credible and efficacious position for demanding that the industrialized countries should shoulder their own responsibilities in the ordering of a vigorous world economy capable of offering dynamic growth to all countries. Moreover, the reactivation of the economies of the region, accompanied by a higher degree of intraregional co-ordination, would strengthen the bargaining power of the Latin American and Caribbean countries *vis-à-vis* other nations.

Furthermore, the industrialized countries themselves seem to be rediscovering at least some of the advantages of multilateral-type arrangements. In connection with subjects such as the environment or marine resources, it has become clear that the bilateral arrangements so dear to the main developed economies in recent times are insufficient for dealing effectively with certain problems. It is to be hoped, then, that those economies will also accept, more specifically, the idea that the possibility of keeping up a sustained and orderly expansion of the world economy as a whole depends in essence on finding ways and means which benefit both the developed and the developing countries.

E. The central proposals of this document

The statements set forth below all stem from a single conviction: that although the countries of the region do indeed face serious obstacles, there are ways of overcoming them. In some respects, this conviction allays the discouragement generally felt when viewing the situation of Latin America and the Caribbean as the new decade unfolds. It is based on the advances made in other parts of the world, where structural and short-term difficulties have also been encountered (some of them similar to those now affecting the development of most of the countries of the region), as well as on the painful lessons of the last decade and on the rich store of assets built up by the region in the chequered course of recent decades.

The complexity and magnitude of the task at hand call for a more or less lengthy period of learning and adaptation. Many countries have already completed part of this process, so that concrete achievements may be expected in the early years of the 1990s. Even so, there is still a long way to go. This statement also holds implications for the field of international co-operation: the countries need a certain amount of leeway in their external sector in order for their efforts to bear fruit, and time is also needed before the benefits are borne out.

The following sections set forth the criteria on which ECLAC's proposals are based, the guidelines for designing the policies needed to implement them, and the institutional support they require.

(i) The main criteria

Changing production patterns with equity must be achieved within the context of greater international competitiveness, based more on the deliberate and systematic absorption of technical progress by the production process (with corresponding rises in productivity) than on the maintenance of low real wages. In this respect, proper account must be taken of the need for learning and dissemination of internationally available know-how: a possibility which has not been sufficiently exploited by the region in the past. What is needed is to progress from the "transitory rents" derived from natural resources to "continuing rents" offered by the absorption of technical change by productive activities.

Emphasis must be placed on the systemic nature of competitiveness. In the international market, competition takes place among economies in which the enterprise, though of crucial importance, forms an integral part of a network of linkages with the educational system, the technological, energy and transport infrastructure, the relations between employees and employers, public and private institutions, and the financial sector: in other words, it is integrated into an entire economic and social system. From this point of view, promoting changes in the pattern of production calls for decided, persistent and above all properly integrated efforts.

Industrialization is the kingpin of change in the pattern of production, mainly because it is the vehicle for the absorption and dissemination of technical progress, but also because in today's circumstances it is necessary to go beyond the narrow sectoral framework within which it has so far been approached, so as to link it with the areas of primary production and services in order to integrate the productive system and further the progressive homogenization of productivity levels. Overcoming rigid sectoral divisions is one of the keys to transforming the pattern of production and entering into the new phase of industrialization.

Changes in productive patterns must be compatible with conservation of the physical environment, and consequently the environmental and geographic-spatial dimension must be fully incorporated into the development process. What is needed is, on the one hand, to reverse the negative tendencies towards the depletion of natural resources and the increasing deterioration through contamination and global imbalances, and on the other hand to take advantage of the opportunities for making use of natural resources on the basis of research and conservation.

Sustained growth based on competitiveness is **incompatible with the continued existence of lags as regards equity**. This is not to ignore the difficulty of simultaneously attaining equity and growth, for trade-offs naturally arise in connection with the values to be assigned to these objectives and the capacity of the system to absorb and assimilate changes. In this respect, the urgency of correcting shortcomings in different fields will differ from one country to another: for some, strengthening the weakened social fabric is almost a *sine qua non* for survival, while for others the first priority is to promote competitiveness, without however suffering any substantial setbacks in equity.

(ii) Some guidelines for policy design

The desired changes in productive patterns **can hardly be achieved merely by creating a stable and appropriate macroeconomic climate** or applying a policy of “the right prices”. They also demand the combination of macroeconomic management with sectoral policies, as well as the integration of short- and long-term policies. In addition, they will call for institutional changes in line with strategic orientations that are likewise of a long-term nature, and which would offer a foundation to new forms of interaction between public and private agents, as essential ingredients for achieving equity and social harmony. Such an interaction must, in fact, form part of a new global system of relations between the State and its citizens.

The imperative of equity means that **changes in production patterns must be accompanied by redistributive measures**. No matter how intensive the effort to secure changes is, it will undoubtedly be a long time before it is possible to overcome the existing structural heterogeneity through the absorption of all marginalized sectors into activities of greater productivity. It will therefore be necessary to think in terms of supplementary redistributive measures, including technical, financial and marketing services as well as mass training programmes for micro-entrepreneurs, self-employed workers and peasants; the reform of various kinds of regulations which hinder the establishment of micro-businesses; the adaptation of social services to the needs of the poorest sectors; the promotion of reciprocal aid arrangements and proper representation of the needs of the most under-privileged groups to the State authorities; and measures to take full advantage of the redistributive potential of fiscal policy, both on the income side and as regards the orientation of public spending.

Latin American and Caribbean integration and intraregional co-operation are essential, as they make a vital contribution to strengthening changes in production patterns, democratization, and greater justice in income distribution. In this field, concrete measures are proposed, based on sectoral —preferably subregional— and gradual criteria which lay stress on competitiveness and profitability and which presuppose a leading role for the enterprises, institutions and associations already existing in the region. Such action is designed to ensure that integration assists and strengthens the proposed development strategy.

(iii) The institutional context

All the foregoing is based on **the recognition that the economic strategies and policies must be applied within a democratic, pluralistic and participatory context**. This affects the content and scope of economic policies and strategies, the way they are formulated and applied,

and the forms of interaction between public and private agents. In this respect, the policies and strategies must faithfully respect the will expressed by the broad masses and must be subject to change, in accordance with expressions of the majority opinion.

In democratic societies, the concept of “concerted strategies” takes on decisive importance. Such strategies comprise a set of broad-ranging explicit and implicit agreements between the State and the main political and social actors with regard to changing production patterns with equity and the series of policies and institutional innovations required in order to achieve them. What is at issue is the due legitimization of mechanisms and actions which, on the one hand, give rise to forms of behaviour consistent with the common aims and, on the other, prevent the actions of group interests which could harm collective aims. The capacity of governments to generate agreement on long-term goals and targets, as well as the means to be used to attain them, is directly related with the degree of pluralist participation, the suitability of the policies selected, and the effectiveness of their implementation.

The style of State intervention will no doubt change in relation to past decades. During the 1980s, the priorities of the States in the region were frequently reduced to seeking a form of growth which would make it possible to service foreign debt. Now, however, these priorities must be shifted towards the strengthening of a form of competitiveness based on the absorption of technical progress together with a trend towards reasonable levels of equity. This does not necessarily mean either increasing or decreasing the role of the public sector, but rather increasing its positive impact on the efficiency and effectiveness of the economic system as a whole. It also calls for a change in the State’s traditional procedures in the field of planning in order to create closer links between the short-, medium- and long-term decision-making processes; to promote intersectoral co-ordination, and to provide technical support for the necessary efforts of dialogue and social consensus building. Clearly, the strategies adopted will be put to the test daily as regards their effects and their degree of acceptance by the various participants.

F. The main elements of the proposals¹

In addition to the central postulates set forth above, this document makes a number of proposals aimed at improving the region’s participation in the international economy, promoting better linkages of productive activities, and inducing a creative interaction between public and private agents, all with the objective of fulfilling the strategic goal of generating real competitiveness: an objective which brings together all these specific aims and would constitute a guide for changing production patterns. These proposals are based on the idea of incorporating the positive experience already put into practice in various countries of the region. They should therefore be considered in the broader context of their capacity to help achieve changes in production patterns with equity.

The macroeconomic sphere and the policies which make it up are of vital importance, both for correcting the disequilibria which marked the 1980s and for achieving the sought-for changes in the medium and long term. One of the lessons learnt in the past decade was that the imbalances in the main macroeconomic variables can only be allowed to reach certain limits, and market prices must at least approximate social prices. Another lesson was that the marked emphasis placed on stabilization, on adjustment, and on measures to influence demand and the reallocation of resources conflicted, to some extent, with policies designed to stimulate supply.

¹ Summary of chapters V and VI of this document.

There is no need to go into detail here about the content and scope of short-term economic policy, which will vary significantly from one situation to another. Emphasis should be placed, however, on the importance of a policy framework which imparts coherence to its various components and on the need for a reasonable degree of stability in its application. Stress should also be laid on the extraordinary importance which has been acquired by fiscal policy in the range of instruments available to governments for tackling sometimes conflicting objectives such as stabilization, growth and greater equity in income distribution. Financing changes in the production patterns naturally calls for some reorganization of fiscal policy in order to increase public savings that can be used for investment. Every effort should be made to improve the allocation of expenditure, but it seems clear that most of the fiscal adjustment must be through tax reform. A system with relatively few, but broad, tax bases, using preferentially uniform rates of taxation, is preferable to a complex system with multiple nominal rates. The adoption of broad tax bases represents an important step towards the objective of greater equity, and moreover it simplifies tax administration and enables revenue to be increased.

With regard to trade and exchange policy, achieving changes in productive patterns calls for greater openness of the economy, as a means of generating increases in productivity and stimulating the absorption of technical progress. There is no single formula for securing trade liberalization, but in order for said liberalization to strengthen the growth process rather than hindering it, it is essential that it should lead not only to greater imports but also to a rapid and sustained increase in exports. It should therefore be graduated in line with the availability of foreign exchange. In addition, it involves the harmonization of tariff and para-tariff protection, exchange policy and export promotion policies, all with the aim of bringing the level of effective protection for export activities to a level similar to that of the import substitution sector. An essential requisite to ensure that greater trade liberalization contributes to growth and changing production patterns is the maintenance of a high and stable real exchange rate. During the critical stage in which the conversion and modernization of the industrial system is being carried out, the selective intervention of the State through the granting of tax, credit and trade incentives could serve as an important supplement to tariff policy.

In connection with technology policy, the region's status of "late industrialization" offers hitherto insufficiently exploited opportunities as regards the learning, absorption and dissemination in the productive sector of the internationally available stock of technology. As guidelines for the 1990s, it is necessary to supplement and adapt the technological infrastructure in the most backward priority activities; to promote a greater propensity to incorporate technical progress and innovations within enterprises; and to further a proper appreciation of technology as a strategic variable and source of benefits by giving government incentives to existing businesses to undertake innovative activities and supporting the establishment of new enterprises with a high technological component. It is also suggested that efforts should be made, through various institutional arrangements, to set up a network linking the research system and the rest of the technological infrastructure, on the one hand, with the productive sector on the other, as well as to promote within the latter a system of close contacts between users and producers of goods and services. This latter objective could be achieved through various integrated systems of production in which basic experience and competition has already been built up at the local level (as in the case of certain sectors which process natural resources and the industries associated therewith). Finally, selective criteria must be applied, as only in this way will it be possible to generate endogenous nuclei of technological innovation in the region.

With regard to the training of human resources, emphasis should be placed on its crucial role in changing production patterns. This is the area where there is the best possible conjunction of economic growth considerations with those relating to social equity. The speeding-up of

technical change, the heterogeneity within and among the countries of the region, the changing needs as regards labour skills, and the diversification of the agents of production mean that it cannot be expected that one single agent should be responsible for the tasks of educating, training and retraining human resources. In addition, the shortage of resources available for improving training systems means that it is essential to make the fullest use of the various contributions that different institutions can make in the field of training human resources. All this fully justifies the need for a long-term strategy designed to raise, gradually and steadily, the educational supply in the various phases and areas: the pre-school, basic and secondary cycles, universities, research centres, training systems, mass education and adult education programmes, and occupational retraining programmes.

As regards the establishment of enterprises, there is a need to design policies to stimulate the formation of enterprises and the training of entrepreneurs. It is recognized that this is a complex task, as the investment process involves factors that are not always included in traditional economic approaches, and even some that are intangible, such as human creativity. The current conception of the problem, however, involves giving particular attention to the creation of groups with entrepreneurial potential, the formulation and implementation of projects, the financing of enterprises, and the rationalization of the different forms of productive employment at the national level. At the same time, there is another aspect of special importance for Latin America and the Caribbean: the need to assign an enhanced social value to entrepreneurial activities.

The industrial policy outlines offered form part of the set of proposals designed to promote, *inter alia*, an improvement in production linkages. This set includes gradual and selective trade liberalization, the integral promotion of industrial exports, the absorption and dissemination of technical progress, and support for small- and medium-scale enterprises. The proposed actions will have to be embarked upon in a context of financial restrictions and weakening of public sector institutions, which gives rise to three challenges: making a coherent selection of those areas that warrant government intervention; giving priority to the strategic reconstruction of public sector institutions, and assigning priority to institutional innovation in the management of the productive process.

With regard to agriculture, intersectoral linkages, and international competitiveness, in general it is desirable to get away from the urban/industrial bias in the allocation of economic investments and social spending, as well as assigning new and higher status to rural areas; to modify the current bias in favour of large modern agricultural enterprises through a more selective approach which envisages, as appropriate, the strengthening and modernization of small-scale agriculture; to avoid the concentration of investment in large-scale water projects, with emphasis instead on the maintenance, complementation and development of smaller works, as well as the integrated management of water resources; to strengthen intersectoral linkages and the consolidation of efficient production, transport and marketing arrangements, while avoiding enclosure in sectoral compartments; and to end the persistent disputes over land and other ownership by regularizing legitimate title deeds.

The subject of natural resources and production linkages is also dealt with. A policy for the rational use of the region's natural resources in the next decade must be aimed at correcting the shortcomings of the past and making progress in a number of aspects. Natural resources cannot be left at the mercy of a short-sighted system of maximum immediate exploitation, but must be subject to a system of careful management which calculates the appropriate rates of use of non-renewable resources in the light of the present situation and future prospects of the markets and ensures the maintenance of the reproductive capacity of renewable resources. Nor must the natural resources sector be viewed as a mere source of income for transfer to other sectors; instead, steps must be taken to build up productive systems linked with industry and

services, so as to heighten the value of the resources and contribute to a process of technological and organizational change which will strengthen their competitiveness.

With regard to basic support services and their production linkages, the proposed changes will need the support of the various basic services such as electricity, water, communications, banking, insurance and transport. Some of these will have to be adapted to the circumstances of the 1990s. In the case of transport, for example, the use of the market mechanisms should be favoured where they already exist or can be created on suitably competitive terms, while it will also be necessary to prevent the continued concentration of investment in physical infrastructure and to try to ensure that the transport services are appropriate, in terms of quality and cost, for the process of change in productive patterns. Furthermore, isolated actions in the individual transport media must give way to the establishment of properly integrated transport systems.

In respect of financial systems and changing production patterns, it is noted that in the 1990s a basic objective of the banks and development funds will be to procure on the market medium- and long-term resources to supplement those that may be provided or channelled by the public sectors. This points to the importance of issuing securities that offer a good yield, the emphasis that must be placed on the profitability of investment projects, and the need for project financing formulas that keep down the loan risks of the development institutions.

Measures to secure active interaction between public and private agents and the restructuring of the public sector will form part of a process whose content and scope cannot be subject to preconceived formulas. They will depend not only on the institutional, social, economic and political context in which they take place, but must also arise from a broad effort at consensus building among the various representative forces. Consequently, this document only offers some general principles for State action in support of changing production patterns with equity. Outstanding among these principles are selectivity in the actions of the State, the self-limitation of such actions, the simplification and decentralization of State intervention, and improvements in the medium-term forecasting capacity through new forms of planning.

Economic integration, as a process which contributes to changing production patterns with social equity, will be an aspect that acquires fresh relevance and support in the 1990s. In the context of the objectives of change in the patterns of production, it is proposed to promote innovation, learning and the dissemination of technology through the expansion and extension of relations between enterprises, sectors and institutions at the subregional and regional level, together with the application of flexible integration instruments and geographical groupings. Liberalization of intraregional trade, co-operation in transport and in trade facilitation together with the rehabilitation of payments mechanisms, would expand markets and promote competition, thus helping to create a symbiosis between external and regional demand. This would increase competitiveness and the possibilities of increasing exports to the region and to the rest of the world. All this would be facilitated by selective co-operation in the field of sectoral policies and through the establishment of a wider scientific and technological outreach, with joint actions in such aspects as intellectual property and information technology. Furthermore, it is proposed to explore the possibilities of making use of joint trade liberalization, perhaps by selectively binding tariffs, as a negotiating instrument for guaranteeing access to external markets. Emphasis is also placed on the need to strengthen the institutional basis of integration, with greater participation of the various types of actors, both public and private, in the decision-making process.

II. SOME BASIC POLICY LINES

Reference is made below to some of the policies which can be used to support the instrumental objectives defined earlier in this study, including an improved insertion into the world economy, the establishment of production linkages and creative interaction between public and private agents (see synoptic table). For purposes of presentation, the policies have been grouped in accordance with each of these objectives. Taken together, the three objectives make up the strategic criterion of the proposed changes in production patterns, which is the strengthening of genuine competitiveness.

The policies briefly explored here support both the three instrumental objectives referred to and also, when taken together, the strategic criterion expressed. They must be designed and implemented in the institutional context defined as “strategic consensus-building”, which refers to the institutional support of the proposal for changing production patterns with equity.

The term “strategic consensus-building” refers to a number of long-term agreements, both explicit and implicit, between the State and the principal political and social actors in respect of the instrumental objectives and the sets of policies and institutional innovations needed to achieve those objectives. We are dealing here with a means of bestowing legitimacy on actions and mechanisms which on the one hand promote behaviour in keeping with shared purposes and, on the other, impede the dynamics of group interests which, if unleashed, could jeopardize the realization of the collectively held purposes.

The capacity of governments to agree on long-term targets and instrumental objectives as well as on usable means for achieving those targets and objectives is directly related to the degree of pluralist participation, the suitability of the policies practised and the efficiency with which they are implemented. Strategic consensus-building is put to the test every day on the basis of its effects and the degree to which it is accepted by its different protagonists. These considerations are especially important in the region because of the imperious need to strengthen plural, participative political systems and to bestow legitimacy upon them.

■ Table 1

BASIC POLICIES: SIMPLIFIED DIAGRAM

ORTHODOX APPROACH IN THE 1950S AND 1960S ORTHODOX APPROACH IN THE 1980S CHANGES IN PRODUCTION PATTERNS IN THE 1990S

1. Policies used to support incorporation in the international economy		
(a) Commercial and exchange-rate policy		
A high degree of permanent protection through high and dispersed tariffs and quantitative restrictions.	Trade and financial liberalization, and simultaneous rapid deregulation.	Tendency towards a low level of protection, low dispersion and lack of quantitative restrictions. Temporary protection provided on a selective basis for new sectors contributing to technical progress. Use of compensatory mechanisms in approved cases.
Anti-export bias partially redressed by export promotion schemes.	Tendential neutrality between domestic and external market. Generation of trade surplus in the short term.	Application of neutrality criterion in tariffs and exchange-rate policy, combined. Integral system for promotion of exports of manufactures.
Multiple exchange rates tending to overvaluation, especially in respect of mass consumer goods.	Exchange rate determined by market.	High and stable real exchange rate to promote competitiveness.
Regional integration to expand domestic market.	Free international trade.	Regional integration designed to strengthen the capacity to compete in regional and international markets. (Research and development, marketing, communications.)

(b) Technological policy		
Various instruments to support technological activity, with little effect because of small demand on the part of enterprises and institutions in the process of consolidation.	Reduction of fiscal resources for technology and little institutional support.	Set of instruments covering a broad range of entrepreneurial requirements, ranging from efforts to increase awareness to the marketing phase. Decisive strengthening of bodies working in this field. Availability of resources in line with the growing demand associated with the requirements arising out of incorporation into the international economy.
(c) Manpower training		
Laying of institutional bases for initiating massive manpower training process and centralized, relatively rigid schemes, removed from entrepreneurial activity.	Weakening of public training institutions. Recommendations that this task be handled in the entrepreneurial sector.	Priority for these activities, with regard both to the absorption and dissemination of technical change and the promotion of equity. Institutional pluralism, differentiated programmes for different groups of workers, national training scheme.
(d) Creation of enterprises		
Generation of large public and private enterprises operating in captive markets with oligopolistic structures. Insufficient development of small- and medium-sized industry.	Policy furthering growing domestic and external competition.	Provision of systematic support for the creation of enterprises and for entrepreneurs: greater respect for the role of the entrepreneur, identification of groups with entrepreneurial potential, support for the formulation and financing of projects, reduction of bureaucracy, establishment of technological infrastructure and "incubators" for new enterprises. Support for small- and medium-sized enterprises.
2. Policies to strengthen production links		
(a) Industry		
Geared to the domestic market in the following sequence: consumption of non-durables, more generalized use, consumption of durables and consumption of capital goods. In the larger countries, progress made towards the final stages. Leading role taken by transnationals in sectors showing the greatest growth and technological content and by public enterprises in the most capital-intensive fields	Generalized doubts concerning efficiency. Increased export of manufactures related to drop in domestic markets.	Neutrality criteria applied in wide range of sectors in combination with criteria of market stimulation, selectivity based on indivisibility and intersectoral co-ordination.
(b) Agriculture		
Policy design within narrow sectoral framework with very little regional differentiation and on the basis of types of producer, with pre-eminence of a casuistic approach in line with the demands of producer organizations capable of exerting greatest pressure.	Transfer to the private sector of public activities in the domestic and external supply and marketing of basic commodities. Emphasis on supervision and information activities designed to make markets more transparent. Occasional recourse to anti-dumping measures.	Systematic approach which seeks to strengthen the links between agriculture, industry and services, on the basis of the capacity of para-agroindustry and agroindustry to induce technological progress in processes and products, using strategies which differ by region and by type of producer.
(c) Natural resources		
Exploitation of resources perceived as unlimited.	Intensification of the use of resources for export. Use of market mechanisms to determine scope and technology of resource use ("correct prices").	Combination of market mechanisms with market regulations and intervention in such a way as to simultaneously ensure proper exploitation. Structuring of production networks including industries and services. Movement away from public participation in property to regulation, tapping of income and surveillance of the use of resources.
(d) Infrastructure and services relating to products		
Expansion of the physical capacity to support industry supplying the domestic market and exports of natural resources.	Financial orientation; self-financing and charging users for the cost of infrastructure.	Support for changes in production patterns with emphasis initially on maintenance and on significant changes in management. Priority for the expansion of telecommunications and producer services. Quality of services given preference over new works.

(e) Financial system

Public development institutions (development banks); formulation and promotion of large projects preferably public industrial projects geared to the domestic market. Specialized sectoral banking with no systemic approach.

Development institutions (development banks); financial agents transfer external credit to commercial banks which invest it in the production sector.

Change in role of banks and development funds in financial systems: must take responsibility for attracting medium- and long-term investments in the market to supplement resources provided by or channelled through the public sector. Priority is shifted to credit for small- and medium-sized enterprises.

Private financial system: a passive intermediary in the attraction of funds; preferential transfer of funds to large enterprises and financial groups. Absence of selectivity and viability criterion.

Generalized erosion of solvency of financial systems of the region partly because of the recessive adjustment and changes in exchange rates and in the price system brought on by the external debt crisis and also, in part, by defects in the systems for regulating and supervising credit institutions, especially in countries where the financial sector has been liberalized.

Considerable domestic savings effort to finance larger investment made necessary by changes in production patterns and also to service the external debt during the 1990s. Savings requirements point to the need to expand all domestic sources of funds, including voluntary private savings, institutional savings and public savings.

3. Policies to promote interaction between public and private agents**(a) Regulation**

Extensive, non-selective public regulation with a substantial gap between the range of objectives and the institutional capacity for evaluation.

Generalized liberalization and use of market to guide decisions of economic agents.

Specific definition of areas subject to public regulation and those in which the market mechanism prevails. Institutional excellence in areas of selective intervention. State responsibility for the surveillance of the results of market action. A degree of uncertainty concerning areas regulated because of consensus-building involved in pluralistic political systems.

(b) Public enterprises

Establishment of basic infrastructure. Higher priority given to public works than to the provision of services. Generalized subsidies.

Privatization, elimination of subsidies, restriction of investments.

Innovations in the management and financial reorganization of enterprises remaining in the public sector. Consistent personnel policies and remunerations. Transparency with regard to suppliers. Strengthening of technological synergies with the private sector.

(c) Small- and medium-sized enterprises

Insufficient development in low-technology areas. Support institutions and policies with little operational content. Weak links with large enterprises.

Decline in the number of small- and medium-sized enterprises. Further weakening of institutions engaged in sectoral development policies.

Distinction drawn between economic and social objectives of small- and medium-sized enterprises and development of institutions and policies consistent with those objectives. Integration of policy on small- and medium-sized enterprises with policies on changes in production patterns. Decentralization of support. Priority to dissemination of technology. Neutralization of weak spots of small- and medium-sized enterprises in the areas of technology, financing and trade.

(d) The social sector

With the exception of isolated countries and sectors, weak and insufficient presence of self-managed, labour- or peasant-owned co-operative enterprises and other co-operative enterprises. Centralized, declarative and ineffective support policies.

Apparent informal expansion of the social sector under survival strategies to cope with the recession. Further reduction of the weak public support offered previously.

Explicit decentralized policy to promote forms of social association for associations for production purposes. Within these associations, support and promote the development of technical assistance, financial and training bodies.

EDUCATION AND KNOWLEDGE: BASIC PILLARS OF CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY *

ECLAC/UNESCO

* Summary and conclusions (pages 17 - 20), in *Education and Knowledge: Basic Pillars of Changing Production Patterns with Social Equity* (LC/G.1702/Rev.1-P), Santiago, 1992. United Nations publication, Sales No. E.92.II.G.6. Document coordinated by Fernando Fajnzylber.

Summary and conclusions

1. The challenges

In the coming decade, the countries of Latin America and the Caribbean will face both internal and external challenges. Internally, the challenges will be to consolidate and heighten democracy, social cohesion, equity and participation: in short, to build up modern citizenship. Externally, the challenges will be to reconcile the aspirations for access to modern goods and services with the generation of the means which will effectively permit such access, i.e., international competitiveness. The intensity of these challenges in the different countries of the region will vary, but in all of them they will be of outstanding importance.

2. The central role of education and the generation of knowledge

In the developed countries and the successful cases of so-called “late industrialization” in other areas, there is a clear recognition of the central role that education and the generation of knowledge play in the development process, and this attitude has been spreading gradually in the countries of the region. The transmission of values, the ethical dimension and the forms of behaviour typical of modern citizenship, together with the generation of the capacities and skills which are essential for international competitiveness (which is increasingly based on technical progress), receive a decisive boost from education and the production of knowledge in a society. Reform of the system of production and dissemination of knowledge is consequently a crucial instrument for tackling both the internal challenge, which is that of building citizenship, and the external challenge, which is that of competitiveness. It will therefore be understood why this dimension has a central place in the ECLAC proposal on changing production patterns with equity.¹

3. The regional situation

In recent decades, the systems of education, training and scientific and technological development have registered noteworthy, albeit incomplete, expansion in most of the countries of the region. However, they still display obvious shortcomings with regard to the quality of their results, their degree of adaptation to the requirements of the economic and social environment, and the degree of equity in the access of the different strata of society to them. As far as their institutions are concerned, they tend to be excessively rigid and bureaucratic and to have scanty links with the external environment. The past decade, which was distinguished by constraints on public resources, growing liberalization of economies and increasing democratization, marked the end of a cycle, and it is therefore urgent to make the transition to a period whose dynamism and performance will be indicated by the degree of primacy which societies give to education and the production of knowledge.

4. The need for a strategy

In these circumstances, it is of fundamental importance to design and put into effect a strategy for promoting the transformation of education and training and increasing the scientific and technological potential of the region, with a view to the formation of a modern type of citizenship —linked to democracy and equity just as much as to the international competitiveness of the

¹ ECLAC, *Changing production patterns with social equity...*, op. cit.

countries— which will make possible sustained growth based on the incorporation and spread of technical progress. To imagine that such a form of citizenship can become fully valid without an effective effort with regard to competitiveness is just as groundless in this decade of the 1990s as to think that competitiveness —which is necessarily of a systemic nature— can be maintained even though there are serious shortcomings in the area of citizenship.

5. Objectives, criteria and main guidelines

The proposed strategy revolves around the objectives of citizenship and competitiveness; it takes equity and performance as the guiding principles of its policies, while the main lines of the proposed institutional reform are national integration and decentralization.

In the past, frequent reference has been made to the strategic objective of *citizenship*, to the concept of *equity* as the main guideline for policies, and to *national integration* as the driving force behind the institutional system. Substantial advances have been made on all three planes, but the shortcomings in each one of them are linked at least partly with the omissions committed with regard to the other three components of the present strategic proposal: *competitiveness* as an objective, *performance* as a policy guideline, and *decentralization* as a component of the institutional scheme. In the 1980s, there were energetic defenders of these three previously neglected issues, and indeed there were often excesses in the opposite direction: competitiveness, performance and decentralization were given priority over the previously prevailing motivations, as explained in part three. The present proposal acknowledges the existence of tensions between citizenship and competitiveness, equity and performance and integration and decentralization, but it concentrates rather on the areas of complementarity which exist on each of these levels.

6. The main features of the proposal

The strategy has three main features. It is *inductive*, which is the feature that lies at the root of its viability and is reflected in its design, based as it is on recognition of the changes taking place in regional and international conditions, on the assignment of their true value to the emerging *idée-force* which influence the positions, aspirations and perceptions of the various actors in the process of generation and dissemination of knowledge, and on the analysis of specific current experiences both inside and outside the region which suggest trends that could become more general. It is also *systemic*: that is to say, it takes into account both the linkages between education, training and science and technology on the one hand and the system of production on the other, and the many bridges which link the economy and society at the individual and collective level. Finally, it places great emphasis on *institutional change*. It takes into account, and even estimates in quantitative terms, the additional financial resources needed, but it seeks to show that these resources —although essential for the reforms— would not of themselves be enough to correct the shortcomings unless they were accompanied by profound changes giving rise to an institutional structure open to the requirements of society. The criteria and guidelines of the strategy are illustrated at length in the case of some aspects, whereas in others, such as that of university education, more general guidelines are presented.

7. The main directions of the strategy

The changes proposed point in the following main directions: i) from the political point of view, the activities of the production and dissemination of knowledge are seen as long-term strategic

tasks which call for the broadest possible consensus among the various social actors and a stable financial commitment for their execution; ii) from the point of view of content, the action is focused on improvement of the results of education, training and scientific and technological development and their linkages with the requirements for the improved performance of persons, enterprises and institutions at the various levels of society; and iii) from the institutional point of view, the aim is to break the isolation of establishments concerned with education and the generation and transmission of knowledge and to introduce forms of action where the actors have a greater degree of autonomy in taking their decisions as well as greater responsibility for the results.

8. The policies

Seven policy areas are identified and described. The first of them emphasizes the strategic purpose of overcoming the relative isolation of the system of education, training and acquisition of scientific and technological knowledge by opening it up to social needs. Overcoming such isolation is considered the most fertile source of dynamism and change in each subsystem and in the relations between all of them. The next two areas concern the results sought for through such greater openness: namely, ensuring universal access to the codes of modernity,² and promoting creativeness in access, dissemination and innovation in scientific and technological matters. The last four areas are of an instrumental nature: responsible institutional management; professionalization and heightening of the role of educators; a financial commitment by society to education, training and the scientific and technological effort, and regional and international cooperation. In these various policy areas, guidelines are formulated which affect the various components of formal education (preschool, primary, secondary and higher), training and the scientific and technological effort, and especially the links among them and with the productive sector.

9. Special national features

The drafting and detailed preparation of policies, as well as their application in the different national circumstances, is a task which is the responsibility of each individual country. There are many different ways of access to and participation in, the modern world and, moreover, highly diversified experiences and situations coexist and intermingle in many ways within each country. Only within each national society is it possible to determine priorities, design action plans and put them into effect by assembling the conditions, resources and support needed to make the proposed reforms viable and reconcile them with the maintenance and further enrichment of the many and varied channels of knowledge in each country's culture. The specific guidelines outlined in the text must be interpreted from this standpoint.

10. Regional and international cooperation

There are four main fields in which regional and international cooperation can play an important role in the application of the strategies and policies proposed in this document. These are the training of human resources in the countries of Latin America and the Caribbean, with a view to more efficient use of the installed capacity of the universities and academic centres of the region; improvement of the linkages between the system of education and generation of knowledge, on the one hand, and the productive or social development sectors on the other; research into education and the process of the generation, dissemination and use of knowledge;

² The codes of modernity are taken to mean the set of knowledge and skills needed to participate in public life and play a productive part in modern society. See chapter VI, section 2, below.

and the process of implementation of the strategy and policy proposals put forward in this document in operational and institutional terms at the level of the particular countries.

Specifically, emphasis is placed on the following lines of cooperation: improvement of quality; innovations in secondary education; accreditation of institutions, programmes and units of higher education; training of academics and researchers; institutional reform and local administration; technical training; educational research; student exchanges; and strategic cooperation.

11. The development banking system and education and the production of knowledge

Carrying out the proposed tasks will naturally need financial support for the changes suggested in each of the subsystems and the strengthening of the links between them. In the past, the development banking system played a decisive role in a phase where priority was given to the expansion of production capacity and the development of new sectors, especially by large public and private enterprises. During the 1980s, the development banking system reduced its capacity for action, both in terms of resources and of the profile of its activities. In the 1990s, however, there is new scope for it: namely, in tasks directly related to education and the production of knowledge, which are seen as the hub of changing production patterns with equity. Specifically, in collaboration with the private financial sector, it could promote institutional machinery for supporting investment in human resources, scientific and technological development and the expansion of small and medium-scale enterprises and establishing linkages between the various subsystems.

12. Final comments

The proposed strategy makes education and knowledge the hub of the process of changing production patterns with social equity, since they are seen as vital areas for promoting the development of the region and as objectives which could realistically be attained through the application of a coherent set of policies. In the present context, the partial efforts now being made and the perceptions of the leading actors in the process of education and the production and dissemination of knowledge are tending to converge in the direction of the proposed lines of action. This is a complex and far-reaching task which is unavoidable and is indeed already under way: its results will condition both the domestic economic and social evolution of the countries of the region and the importance they will have in the world context.

THE EQUITY GAP LATIN AMERICA, THE CARIBBEAN AND THE SOCIAL SUMMIT *

ECLAC

* Summary and conclusions (pp. 13-20), in *The Equity Gap. Latin America, the Caribbean and the Social Summit* (LC/G.1954/Rev.1-P), Santiago, Chile, 1997. United Nations publication, Sales No. E.97.II.G.11

SUMMARY AND CONCLUSIONS

Although the World Summit for Social Development took place only recently, the guidelines that emerged from the Summit proved to be broadly consistent with the general thrust of the actions Governments in the region were taking in the economic and social spheres during the 1990s. This document attempts to summarize the situation in Latin America and the Caribbean in relation to the three main issues addressed at the Summit —poverty, employment and social integration— within the wider context of economic change and social policy reform, and to formulate proposals on these issues that will help in fulfilling the commitments undertaken in Copenhagen.

The context of economic reform

1. Latin America and the Caribbean are presently undergoing a period of intensive change characterized by progress towards democratic pluralism and governability and by far-reaching economic reforms. Some of these reforms have brought significant advances in terms of macroeconomic stability, international linkages and regional integration. These advances have improved access to enhanced external financing, which, if administered appropriately, could provide an opportunity to boost growth in the next few years.
2. At the same time, however, recent economic trends have brought to light a number of major deficiencies. First, with very few exceptions, rates of growth have been only moderate (3% per year between 1990 and 1996), falling short of both past performance levels (5.5% per year between 1945 and 1980) and the levels ECLAC estimates are necessary (6% per year) in order for the region to be able to catch up in technological and social development. Second, the development of most economies in the region still rests on a shaky foundation; many countries have achieved macroeconomic stability by relying on large current-account deficits, sometimes financed with volatile capital, and this situation has tended to produce short cycles of growth and contraction, reflecting the movements of short-term capital flows. On a number of occasions the situation has been compounded by the fragility of financial systems, at high cost to the public purse. Third, the 1990s have seen only slow recovery from the sudden drop in the savings ratio and, even more importantly, in the investment ratio that occurred during the crisis of the 1980s. The great majority of countries still have not regained pre-crisis levels of saving and investment.
3. Moreover, the depth of economic restructuring has produced new winners and losers. The structural disparities characteristic of the region's systems of production have been exacerbated by the increasing productivity gap between large companies in the vanguard of the modernization process and the wide assortment of activities that have failed to keep pace, where the bulk of employment is concentrated. Not only does this situation provide a material basis for greater social inequities by emphasizing domestic disparities in productivity and income; it also affects the capacity for growth by restricting linkages between different sectors of production, the dissemination of technical progress and the momentum that exports could provide.
4. The most significant deficiency, and one that is closely related to the phenomena described above, is to be found in precisely the areas addressed by the Summit in Copenhagen. The great accumulation of social deficits that built up during the economic crisis of the 1980s is diminishing only slowly, particularly in three interrelated areas: employment, poverty and social exclusion.

Poverty and social integration

5. Poverty trends in the region vary considerably from country to country in terms of both extent and direction. On average, the incidence of poverty declined from 41% to 39% of all households during the first half of the 1990s, not enough to offset the increase in the 1980s (from 35% to 41%). In absolute terms, the number of people living in poverty —210 million— in Latin America and the Caribbean is higher now than ever before.

6. Even so, a certain amount of progress has been made recently, particularly where there has been sustained economic recovery. Between 1990 and 1994 for example, out of 12 countries poverty declined in nine and increased in only one. This trend of gradual improvement was interrupted in 1995 —perhaps only temporarily— by the slowdown in growth in a number of countries (notably Mexico and Argentina). The trend was greatly reinforced, however, when the incidence of poverty in Brazil fell sharply as a result of the country's stabilization programme. Less headway was made in reducing indigence, which dropped only from 18% of families to 17%, still two percentage points higher than the 1980 figure.

7. The chief determining factors in the reduction of poverty have been the level of economic growth and inflation reduction; the next most important has been the continuing effort to increase social expenditure and, more recently, to find more efficient ways to allocate it. The countries that have made most progress in reducing poverty are those that have successfully combined relatively high growth rates over a period of years with a reduction in unemployment rates and an increase in the number of persons employed among the poorest families. Cutting the inflation rate has also made it possible to improve earnings and in some cases pensions in real terms and ensured continuity of investment, with a favourable impact on the labour market.

8. It is not only macroeconomic equilibria *per se* that are critical for rapid and more equitable growth, but also the manner in which they are achieved. In addition to reducing the rate of inflation and strengthening fiscal equilibrium, it is also necessary to reduce the current account deficit to a sustainable level to maintain an appropriate real exchange rate and to achieve a domestic savings rate commensurate with the investment process and a level of domestic expenditure consistent with sustainable utilization of productive capacity. Moreover, growth does not in itself guarantee better income distribution. What is crucial is the quality of that growth, i.e., whether it can continue over time —which is a matter of macroeconomic management—, whether it translates into productive employment and wages and, lastly, how efficient social policy is and how social and economic policies interact.

Employment, wages and productivity

9. As mentioned above, the region's scant progress in combating poverty is associated with inadequate growth, the low impact of growth on the labour market and the almost total lack of improvement in average labour productivity, a problem that must be tackled to attain improved international competitiveness and higher sustainable growth rates.

10. Most of the employment created during the 1990s has been in the informal sector. According to International Labour Organization (ILO) estimates, out of every 100 new jobs created between 1990 and 1995, 84 were in the informal sector, and it is in this sector that 56% of all employed people in the region work. This explains the current sluggishness of average labour productivity levels (a figure which, nevertheless, conceals significant differences between countries).

11. The foregoing helps to explain why wage levels are below those of 1980 and also why wage differentials between occupational strata are widening. Real average wages, despite marked differences between countries, have increased almost across the board during the 1990s. Even so, wage levels are still lower than they were in 1980.

12. Except for a few countries where the upward trend continued, the wage recovery seemed to stall in 1996. This is explainable by the fact that the income effect of slowing inflation on real wages diminishes as the inflation rate falls, while lower inflation rates mean longer periods between wage adjustments. More generally, competitive retooling in modern enterprises favours productivity increases and labour flexibility, with a marked decline in job creation per unit of output.

13. The slow growth of real average wages reflects the counteracting tendencies of large wage increases among those employed in skilled work in more vigorous and modern sectors and moderate wage increases or declining pay in the remainder of the economy. The real minimum wage in 1995 in 13 out of 17 countries was lower than in 1980. Informal workers earn on average half what manual and non-manual workers in modern enterprises are paid. Since they also work longer hours, this inequality increases when the factorial distribution of informal and formal earnings is corrected for hours worked.

14. The gap between earnings of professional and technical workers and those of workers in low-productivity sectors grew by 40%-60% between 1990 and 1994. Constant or widening differentials in earned income reflect marked disparities in productivity among companies and sectors and are good indicators of the inelasticity of income distribution that has characterized recent economic growth, even where growth has been most vigorous.

15. In order to boost productivity in lagging sectors, it seems essential to complement general policies with some specific measures, including credit, marketing and technical assistance programmes and heavy investment in education and training. The push towards technological modernization is crucial, not only to cope with the demands of international competition, but also to meet the need for better-quality employment and higher wages. This objective ranks rather low on the agendas of most of the countries, however, since they lack both the requisite resources and institutional networks capable of coping with a challenge of this magnitude.

16. The impact of economic reforms on labour markets has been uneven, owing in large part to significant national differences in their scope and timing. Other factors that have contributed to the unevenness of labour market response are the differences between countries in their productive and technological bases and labour institutions, and in demographic and social characteristics.

17. At present, growth in the region is closely tied to the dynamism of natural resource-based activities. In order to heighten the impact of growth on employment, then, stronger linkages should be fostered between these activities and those of the other productive sectors. Such linkages not only create an intermediate demand for goods, services and labour, but also provide a stimulus for improvements in quality and the spread of technical progress and business and management practices: they foster the establishment of quality standards; they lead to the creation of institutions providing technical training and modern support services to productive activity; and they give rise to training activities and technical, financial and organizational support for small, medium-sized and micro-enterprises.

18. During the 1990s, a number of countries have amended their labour legislation, especially with regard to employment contracts, dismissals and collective bargaining. The direction of

these reforms has been mixed, so that it is difficult to discern a uniform trend, but most of the recent changes have introduced more flexibility into hiring and firing procedures. Other legislation has been aimed at improving working conditions and minimum wages; protecting particular labour sectors (seasonal workers, wage earners in small and medium-sized firms, domestic workers); preventing discrimination against women; abolishing child labour and regulating youth labour.

19. Another new concern is that labour legislation should also address the issue of unemployment insurance or income protection for the unemployed. Consideration has been given to a number of alternatives that would allow unemployed workers' needs to be covered for a certain period of time without creating major administrative snarls or incurring the same microeconomic and budgetary inefficiencies that unemployment insurance has generated in other parts of the world.

20. The concern is to reconcile increased labour flexibility with minimum levels of social safeguards for the worker by protecting income rather than job security, i.e., encouraging labour mobility. For such measures to work properly, they need to be backed up by fuller training and redeployment programmes, and there should be a link between unemployment insurance and initiatives of that kind.

Social integration

21. In the space of a decade, the increase in poverty —already at high levels— and the deterioration or stagnation of income distribution in the region have coincided with an explosion of access to communications that has tended to produce a common set of consumer aspirations. Whole sectors of society see their expectations frustrated, particularly urban youth, whose educational levels are greater than that of their parents but whose unemployment rates are higher. These young people are exposed to information and stimuli about a wide range of novel goods and services that are symbols of social mobility, but inaccessible for the majority of them.

22. The intensification of “hard-core poverty”, ethnic discrimination and residential segregation, the proliferation of private urban security services and the rise of violence in the cities all seriously affect levels of social integration and governability. Strengthening governability under democracy requires above all —and urgently— transparent, fair and effective judicial machinery that can restore citizens' confidence in their systems of justice, protection and security. It also demands perseverance in the search for pluralistic and participatory political systems capable of absorbing internal differences and mediating national agreements on broad lines of development.

23. Such national agreements might have greater appeal if they included more social safety-net mechanisms to reduce the social costs of economic transition and provide safeguards in the event of retooling or redeployment that could affect large segments of the population. Such mechanisms might include, for example, work training schemes for urban youth who have little formal education and are excluded from the social networks that furnish access to productive life. Other initiatives already under way to improve social integration are support programmes for female-headed low-income families, protection for children, young people and mothers exposed to domestic violence, and drug-abuse prevention programmes. There are also projects to support personal and community development, and public housing programmes designed to transform living spaces by providing communal equipment and areas for cultural and recreational activity.

Social reforms

24. In contrast to the 1980s, when social expenditure fell considerably as a result of financial constraints on Governments, during the 1990s the level of public spending allocated to social sectors has risen in most countries in the region. This is a clear indication of the political will of Governments to tackle the social deficit, and bodes well for social policy reform. In 7 out of the 11 countries that reported social spending increases, expenditure levels exceeded those at the beginning of the 1980s. Public social expenditure as a proportion of GDP rose on average by 1.8%, even in countries where the public expenditure ratio fell.

25. The greatest increase in social expenditure between 1990 and 1995 occurred in the education and social security sectors. In education, real per capita spending went up in 12 out of 15 countries; in social security, in 10 out of 15 countries; and in health, in 10 out of 13 countries. Spending on education expanded as a reflection not only of increased coverage, but also of improvements in quality, relevance and social equity thanks to a series of educational reforms that were the focus of lively national debates. Increases in spending on social security were chiefly due to adjustments in retirement and other pensions, payment of retirement pension liabilities and extensions of coverage.

26. The educational reforms currently under way, with variations from country to country, seek to correct the deficiencies of the region's educational systems in terms of quality, social equity and the relevance of what is taught. A number of countries are trying to change outdated curricula and teaching methods, alter the social segmentation of access to education, improve the quality of education available and reverse the decline of teaching as a profession. Towards the same ends, countries are making changes to educational financing and resource-allocation systems and expanding the scope for private input; they are also trying to decentralize educational administration, train teachers and improve the quality of education, gradually bringing it into line with the requirements of the labour market.

27. Clearly, new relationships need to be established between education, society and production. This will require qualitative changes in educational systems, aided by an ongoing assessment of performance, and closer ties with companies and the labour market. This could be accomplished by setting up a system of appropriate incentives, such as national scholastic achievement tests, support for innovative initiatives in schools, competitions with prizes for contributions that result in improved quality and financial incentives for schools and teachers who succeed in improving their students' performances.

28. ECLAC has estimated that, for the region as a whole, the additional cost of implementing a strategy to improve the quality of school and pre-school education would amount to 3.9% of gross domestic product (GDP). Since this is more than budgets can support, Governments will have to concentrate their spending on areas of education where the social and economic impact are greatest, while at the same time encouraging any private initiatives that could make a positive contribution to educational equity.

29. The technological change in education implies changing both methods and materials. In terms of methods, the key will be to adapt teaching practices by applying new technologies effectively to learning. In terms of materials the key will be to encourage broad-based networks for industrial-scale production of educational aids, drawing on the state-of-the-art educational technologies and creating new institutions to promote the technologies and adapt them to suit local needs. All this will require changes in school infrastructure, individual and institutional

investment in equipment and materials, and training and redeployment of teachers. Private initiative could play an important part in such developments.

30. Health service coverage in the region varies widely. Coverage, however, is only a rough measure, concealing significant differences in the quality, efficiency and cost of care. The regional health reform agenda —with variations from country to country— includes improving the equity of access to benefits and the efficiency and quality of care and raising sector productivity by reforming management, encouraging synergies between the public and private health systems, bringing escalating costs under control and regulating private medicine. A number of reforms that aim at a more integrated approach focus on aspects of financing, intersectoral competition, regulation and administration. Despite differences, national programmes have several points in common: promoting health campaigns, strengthening primary care, supporting decentralization of local health services and systems and dealing with inequities of access through basic universal care or targeted interventions.

31. Reforms in the health sector must also extend to the institutional framework and aim at increasing the efficiency, coverage and quality of care, targeting subsidies more accurately and strengthening regulatory and supervisory capacity. The public health system could benefit from a greater separation between the different functions: the regulatory and institutional frameworks; financial operations and procurement; and service providers and producers. The greater effort of coordination this entails might then require contractual undertakings specifying the resources needed to supply a service, the quality and type of service to be supplied and indicators enabling the service to be evaluated. Experience has shown the need for all the parties involved in public health to reach agreement from the start on performance indicators and their interpretation; and for new remuneration systems that include flexible components and incentives related to performance and quality of service.

32. Private health care provision can raise the efficiency of the sector if there is an improvement in the regulatory system regarding contract transparency, access by the private sector to subsidies, cost control (encouraging greater integration between service providers and insurance companies), the treatment of some categories of catastrophic illnesses and illnesses of the elderly and, in relation to risk insurance, the inclusion of some altruistic mechanisms.

33. The need for housing construction has diminished only marginally despite the recent easing of demographic pressures. Construction has also had to adapt to a greater variety of family structures, which in turn has brought new demands in terms of standards. The regional housing deficit is estimated at roughly 50 million dwellings; the figure includes both new construction and renovation of older stock. Out of every 100 households in the region, 60 have adequate housing, 22 need housing repairs and 18 need either new housing or reconstruction of their present dwelling. In view of the rate at which new households are forming, the deficit will expand by 2.7 million per year.

34. Government policy is gradually coming to grips with the reality of this situation, and public expenditure on housing has risen again in the 1990s. To deal with the housing deficit, the countries are trying, on the one hand, to bring in private-sector resources and, on the other, to adjust their programmes to improve efficiency and to allocate available resources more precisely. A number of countries are moving from the traditional system of specialized home-loan banks —operating separately from the rest of the financial system— to open financing systems. Supply-side subsidies such as tax exemptions or preferential credits for the production of housing are being replaced by demand-side subsidies in the form of direct transfers to families. With adequate application and allocation procedures, this approach allows for more accurate targeting. Public housing policy makers are also trying to avoid increasing urban segregation despite the fact that they are forced to look for low-cost land.

35. Pension systems in the region are characterized in general by low coverage and a multiplicity of plans offering different benefits. This situation is not conducive to equity, either between members of different plans or between those who have a plan and those who do not. Costs are often excessive and funds poorly administered, so that they incur large actuarial or cash deficits. The challenge for reformers under these circumstances is to broaden coverage, improve benefits through more efficient fund management and establish an altruistic mechanism (with appropriate financing) for those who are unable to save for their old age. Hence, the reforms currently under way aim to administer fund finances efficiently without threatening macroeconomic stability, by separating risks and adjusting fund management to the likelihood of occurrence of given events and by increasing private-sector participation in fund management and service provision.

36. With current trends leaning towards fully funded (capitalization) schemes and private administration of social security contributions, it is essential to look closely at the fiscal cost such changes would entail, at ways of covering that cost and at how the funds accumulated through financial intermediation are to be used. By way of illustration, mention may be made of two policies that could be conducive to social equity: making social insurance contributions and taxes progressive; and using pension funds in such a way as to stimulate productive investment and help eliminate the obstacles in the way of achieving high, stable growth rates. Analysis of the pension system reforms being carried out in the region shows that they vary in two respects: i) in the design of the altruistic component and ii) in the institutional framework that is set up in order to ensure that workers' savings contribute to the vigour and efficiency of the economy.

37. Social policy reform puts special emphasis on more efficient resource management. It is therefore essential that such reforms should go hand in hand with institutional changes aimed at better service to the user, better targeting and greater decentralization and linking resources to performance and quality of service. The current fragmented institutional structure of State social services tends to scatter resources and duplicate functions. This situation needs to be changed in order to improve programme supervision and enable a standard set of criteria to be used in programme evaluation. Superfluous programmes could be discontinued and others updated in order to deal with enclaves of "hard-core poverty". On the other hand, links could be forged or strengthened between social programmes and productive development initiatives, i.e., training, dissemination of technology and support for small and medium-sized enterprises and micro-enterprises.

A vision of the whole

38. More effective progress in fulfilling the commitments made at the World Summit for Social Development demands an approach that integrates economic and social policy in a mutually supportive relationship and permits complementarity between measures to encourage competitiveness and measures to promote social cohesion. Although they may seem to conflict in the short run, public policy can benefit from the many points of complementarity between economic and social measures, chiefly in the areas of macroeconomic management capable of stimulating high, stable growth rates; promotion of competitiveness; and public policies that enhance the contribution of growth to employment. Investment in human resources and an approach that integrates the concepts of territory, business linkages and productive development offer the most promise for progress in these tasks. In addition, agricultural modernization can assist in overcoming rural poverty, provided there are public policies to grant access to land and regularize land tenure and provided an effort to improve the infrastructure of production and establish closer links between agro-industry and small-scale producers.

OPEN REGIONALISM IN LATIN AMERICA AND THE CARIBBEAN: ECONOMIC INTEGRATION AS A CONTRIBUTION TO CHANGING PRODUCTION PATTERNS WITH SOCIAL EQUITY *

ECLAC

* Summary and conclusions (pages 9 - 19), in *Open regionalism in Latin America and the Caribbean: economic integration as a contribution to changing production patterns with social equity* (LC/G.1801/Rev.1-P), Santiago, 1994. United Nations publication, Sales No. E.94.II.G.3. Document coordinated by Gert Rosenthal.

SUMMARY AND CONCLUSIONS

1. Integration and changing production patterns with social equity

1. The effects of integration, whether positive or potentially negative, are well known. One positive effect is the chance to benefit from economies of scale, especially if protectionist practices prevent this in world markets. Integration also helps reduce non-productive rents deriving from a lack of competition, although this effect has an ambiguous influence in terms of the incentives needed to promote innovation. These effects are intensified under agreements that involve large trading partners and that provide for low levels of protection against third-party competition.

2. Integration may also yield significant benefits by influencing expectations of domestic and foreign investment, or by cutting transaction costs, which erode the competitiveness of goods and services produced in the region, as a consequence of geographic, institutional, legal and social barriers. In addition, greater efficiency may be reflected in higher levels of savings, in more investment and in greater productivity of the factors of production as a whole. Thus, integration may have a major, lasting impact on the growth rates of the participating countries.

3. Another important potential of integration lies in the area of absorption of technological progress and production linkages. This includes increasing the rate of return of innovative activities, lowering trade barriers, promoting uniformity of standards and regulations, fostering the creation of centres of excellence and reducing the costs of pure and applied research. The way in which each country takes advantage of these opportunities may vary significantly, and in some cases there is even a danger that integration may reinforce patterns of specialization in sectors where technological progress is slow. Together with further action to strengthen national and regional technological development capacity, another way of avoiding or minimizing this last-mentioned potential effect is to step up the flow of technological information between countries.

4. To further the changing of production patterns, intraregional trade liberalization should also be promoted in support of the intra-industrial specialization process currently under way, since the industrial goods exchanged within the region tend to be more technology-intensive than those exported to the rest of the world. Moreover, the specialization process can spur greater efficiency and generate externalities as a result of the employment of a skilled workforce, the strengthening of enterprises through various forms of linkage with foreign investment, and the existence of a closer relationship between suppliers and users. This specialization process has now become even more important, owing to the use of a series of managerial practices associated with liberalization and deregulation in a context of globalization, which includes the deverticalization of firms and the consequent increase in linkages between firms and independent suppliers at various levels.

5. The development of these linkages associated with a spontaneous or “de facto” integration entails the acquisition and dissemination of information, training and financial services, and involves the establishment of networks with a potential for specialization and innovation that could become an engine of integration. This in turn implies a growing reciprocal flow of persons, capital, information and technology among firms and countries, in addition to the purely trade-oriented integration, based on the exchange of goods, which tended to predominate in the past.

6. Integration may help increase agricultural production and productivity. The expansion of intraregional trade in agricultural products would be even greater if international trade in these products were liberalized; otherwise, the subsidies in the member countries of the Organization for Economic Cooperation and Development (OECD) would continue to inhibit regional production. Selective protection may be justified in order to neutralize the distortional effect of such subsidies. A number of countries of the region have already taken such steps, in the form of systems of price bands. Likewise, support policies would be required (cold chains, means of transport, streamlined land and credit markets) to avoid the dangers of polarization or inequity that could arise from trade liberalization in the presence of imperfect or incomplete markets.

7. Integration agreements may also contribute to stability and increased investment by enhancing the efficiency of economic policy decision-making in the participating countries. This is because economic policies are strengthened when they are adopted jointly by several countries. This potential effect could justify the financial support provided by international agencies to large-scale integration processes, whose success could boost the credibility of all the participating countries.

8. The benefits of integration are not limited to firms, but also extend to the economic and institutional system in which they operate. For example, by undertaking joint physical and energy infrastructure projects, countries may also achieve economies of scale and obtain greater returns on their investment. Likewise, advantages can be gained from cooperation in such diverse areas as education and the development of capital markets.

9. With regard to social equity, it was widely held in the 1960s that while integration agreements could promote the modernization of production, the correction of social backwardness was exclusively the province of each country's domestic policy. Today, according to the ECLAC proposal on changing production patterns with social equity (ECLAC, 1992a), integration is seen as a way of achieving a development model in which economic growth and social equity are enhanced simultaneously. Accordingly, the horizontal expansion of aggregate demand as a result of market integration would be compounded by a vertical expansion of demand, owing to country-level social integration.¹

2. Towards an open regionalism

(a) International linkages and integration agreements

10. All the region's Governments have made strenuous efforts in recent years to improve their countries' linkages with the international economy in response to growing economic globalization and to the fact that the previous industrialization strategy was in many cases inadequate. Public action in this regard has focused on the more efficient promotion of the international competitiveness of the goods and services which each country has to offer.²

11. In the mid-1980s, intraregional trade agreements did not play a relevant role in this process. This was due, first, to the persistent idea that trade agreements were more useful for import-substituting industrialization than for increasing exports; and second, to the fact that the Latin

¹ This is also associated with the need to improve the organization of each country's labour, credit, education and land markets (ECLAC, 1992a). Both market expansion processes would benefit from a reduction in transaction costs.

² The broader topic of how to improve the linkages of the Latin American and Caribbean economies with global trade and financial flows is discussed in ECLAC (1994).

American and Caribbean market was relatively small as compared to the market of the main OECD economies, and showed little or no growth. This explains in part why efforts at that time concentrated on gaining access to wide-ranging, highly dynamic markets.

12. Nevertheless, at least in theory, it may be postulated that integration agreements between countries not only may be compatible with the goal of steadily increasing international competitiveness but also may be instrumental in achieving it. In fact, none of the countries—developed or developing—that have concluded integration agreements have seen them as alternatives to a more dynamic role in the international economy; they are viewed, instead, as processes that complement the effort towards that goal. Their purpose, for both groups of countries, is to usher in a more open, transparent international economy; in other words, integration is seen as a building block of a future international economy free of protectionism and barriers to the exchange of goods and services.

13. At the same time, it is universally acknowledged that the formation of economic blocs by developed countries could result in a fragmented world dominated by free trade within these groups and more managed trade between them and other countries. From this standpoint, integration still makes sense, this time as a defence mechanism to offset some of the costs of even greater isolation resulting from any increase in protectionism in the developed countries.

14. Thus, from a regional standpoint, Latin American and Caribbean integration is justified—though for different reasons—in both of these scenarios (ECLAC, 1992a, p. 48). In the first case, regional integration is consistent with a more open, transparent world economic order; in the alternative case, it becomes a mechanism for diversifying risk in an international economy fraught with uncertainty.

15. The North American Free Trade Agreement (NAFTA) should be evaluated from this perspective. To Mexico, in particular, it represents a means of gaining more stable access to the country's principal market, bolstering the credibility of its policies and guaranteeing its incorporation into the globalization process. As the first reciprocal free trade agreement concluded between a developed country and a developing one, NAFTA may set an important precedent for other countries of the region. It is hoped that the Agreement will be an open one, which the countries of the region will be able to join under clear, mutually agreed conditions, with preference given to those countries that are already participating in integration agreements in accordance with an open regionalism approach.

(b) De facto integration and policy-driven integration

16. Whereas formal economic integration agreements in Latin America and the Caribbean were viewed with skepticism in the 1980s, the region is now witnessing a proliferation of different kinds of arrangements that vary widely with respect to their modalities and geographical configuration. This is demonstrated by the signing of numerous preferential trading agreements, usually in the context of the Partial Scope Agreements provided for in the Montevideo Treaty of 1980, and also by initiatives to form reciprocal free trade areas (which do not necessarily involve the adoption of common tariffs), customs unions (free trade areas with common tariffs) or common markets (customs unions with free movement of labour and capital among countries, generally giving rise to the need to coordinate certain macroeconomic and migration policies).

17. In Latin America and the Caribbean, the various formal integration agreements have been accompanied by a parallel process of “*de facto*” integration impelled by a series of macroeconomic and trade policies which, although non-discriminatory with respect to trade with third countries, have had the effect of creating similar conditions in a growing number (now a majority) of countries in the region, and have thereby fostered reciprocal trade and investment. The ensuing increase in economic interdependence reflects a number of factors: a shared tendency towards the consolidation of a coherent, stable macroeconomic framework, unilateral trade liberalization, non-discriminatory promotion of exports, deregulation and elimination of obstacles to foreign investment, privatizations and the lifting of payment restrictions. This similarity of tendencies, in turn, has been bolstered by geographical proximity and cultural affinity.

18. In practice, private investment and reciprocal trade between countries in the region have grown significantly since 1990. As part of an internationalization process, many firms in larger countries are investing abroad, sometimes within the region; smaller countries tend to attract a larger share of investment of regional origin than bigger ones. A process of rationalization and deverticalization is also under way in many subsidiaries of transnational corporations, in keeping with their greater degree of international and regional specialization.

19. While formal integration agreements may, at times, contradict the *de facto* economic interdependence fostered by firms under the aforementioned conditions, mutual complementarity between the two elements is both desirable and feasible. Whether it becomes a reality depends, essentially, on the features of the agreements, whose content and scope should enable the two types of interdependence—officially negotiated and market-driven—to support each other. The conditions which formal agreements must meet to achieve this will be analysed later in this study.

(c) Open regionalism

20. This document uses the term “open regionalism” to refer to a new process that results from reconciling the two phenomena described in the above paragraphs: the interdependence that stems from special, preferential agreements, and that which basically arises from the market signals that are produced by trade liberalization in general. What open regionalism seeks to accomplish is to make explicit integration policies compatible with, and complementary to, policies to enhance international competitiveness.

21. What differentiates open regionalism from trade liberalization and non-discriminatory export promotion is that it includes a preferential element, which is reflected in integration agreements and reinforced by the geographical closeness and cultural affinity of the countries of the region.

22. A complementary objective is to make integration a building block of a more open, transparent international economy, instead of turning it into an obstacle to such an economy, thus curbing the options available to the Latin American and Caribbean countries. This means that integration agreements should tend to eliminate the barriers applicable to most trade in goods and services among the signatories, in line with their trade liberalization policies towards third parties, while at the same time making it easier for new members to accede to the agreements.

23. However, as noted above, if a less optimistic international scenario should develop, open regionalism is still justifiable as the least objectionable alternative for dealing with an external environment which is unfavourable to the countries of the region, since it at least preserves the expanded market of the member countries of integration agreements.

24. In view of the foregoing, the open regionalism approach to integration means that agreements should be designed with certain characteristics in mind: they should contribute to a gradual reduction of intraregional discrimination, to macroeconomic stabilization in each country, to the establishment of suitable payment and trade-promotion mechanisms, to the building of infrastructure and to the harmonization or non-discriminatory application of trade rules, domestic regulations and standards. Moreover, the reduction of transaction costs and discrimination within the region could be reinforced by sectoral arrangements or policies to take advantage, in turn, of the synergetic effects of integration.

3. Characteristics favouring open regionalism

25. In order to promote open regionalism, integration agreements should first provide for an extensive liberalization of markets in terms of sectors. This means establishing few exceptions; i.e., drawing up negative lists of goods and services excluded from the regime rather than positive lists of those to which the intraregional free trade agreement applies. This does not, however, preclude the possibility of providing for various transition periods. Moreover, considering the beneficial effects of recent cases of unilateral liberalization on intraregional trade, it would seem advisable not to increase the tariff and non-tariff barriers applied to such trade.

26. Secondly, a broad liberalization of markets in terms of countries is also needed. This means formulating agreements that have flexible membership criteria. There are at least three mechanisms that would ease the expansion of these agreements' geographical coverage and also their harmonization: first, making the criteria for new members to join more flexible; second, harmonizing standards on the basis of those established at the multilateral level; and third, according investment of intraregional origin the same treatment as national investment.

27. The extensive liberalization of markets in terms of sectors and countries would reduce the economic costs entailed by restrictive sectoral agreements, investment polarization and contradictory, uncertainty-producing commitments, while at the same time encouraging the expansion of investment, the absorption of technological progress and the utilization of economies of scale.

28. Third, the integration process should be governed by stable, transparent rules, so that reciprocal integration agreements can serve as unequivocal guarantees against all possible risks or uncertainties about access to the expanded market. To this end, clear and precise rules must be elaborated on origin, safeguards, countervailing duties and dispute settlement. In this connection, the agreements discussed within the Uruguay Round should serve as a frame of reference for integration agreements.

29. Fourth, as stabilization is consolidated throughout Latin America and the Caribbean, less weight will be given to arguments in favour of restricting preferential trade liberalization agreements to those few countries which have made the most progress in terms of internal and external balances and therefore offer a stable, predictable and coherent economic environment. As more countries advance along the path of stabilization, it will be possible to reach more ambitious integration agreements; in other words, to multilateralize the process.

In this sense, despite the diversity of current subregional integration agreements, it is not unrealistic to suggest the possibility of launching an integration process that culminates — without a pre-established deadline— in the formation of a regional (or perhaps hemispheric) free trade area.

30. Fifth, in today's international context, common external tariffs and moderate levels of protection against third-party competitors are efficient instruments for reducing incentives for smuggling and avoiding accusations of unfair trade practices related to the use of inputs with different levels of protection. They also lessen the need for strict rules of origin, which can represent a serious obstacle to trade liberalization. Common tariffs, which can be phased in gradually, can give priority to sectors where their absence would cause the greatest distortions, and to nearby countries with which intensive reciprocal trade is carried on and whose production structures are similar.

31. Sixth, the possibility of wide-ranging intraregional liberalization of trade and investment should not obscure the danger that rules of origin could become a hidden instrument of protectionism that discriminates more against countries less able to take advantage of the expanded market's potential or against those with a greater proportion of extraregional investment. While these rules may be necessary, especially in the absence of common tariffs, considerations of competitiveness and equity imply that their requirements should be limited.

32. Seventh, the extension of national treatment to intraregional investment, which is also partially provided for in some integration agreements, may, as a side effect, create investment opportunities in formerly closed sectors (particularly services) and may boost the confidence of enterprises in the region that wish to invest outside their home countries. This effect may be strengthened by devising clauses or agreements that protect intraregional investment and avoid double taxation. Since privatization and deregulation of services may increase the number of firms that can provide these services, while opening up opportunities for taking better advantage of the geographical proximity and cultural affinity of the countries of the region, the conditions that favour an increase in trade in services and intra- and extraregional investment in this sector in particular would be strengthened.

33. Eighth, integration can also help to cut down on factors that make transactions more difficult or costly, which, in addition to tariff and non-tariff trade barriers, increase costs to regional suppliers and effectively obstruct reciprocal trade. Reducing these transaction costs involves building infrastructure to link countries together, eliminating or harmonizing rules and regulations and implementing institutional reforms that make it easier for incomplete or fragmented markets to become integrated. These actions may require considerable financial resources, meaning that they must be evaluated and prioritized in terms of their net benefits.

34. Ninth, in view of the existing trade imbalances among the countries of the region, it should be recognized that a country may have an intraregional deficit (or surplus) and at the same time a global surplus (or deficit) in its trade balance. This does not mean that an intraregional trade imbalance necessarily justifies special arrangements. However, if temporary intraregional and global imbalances exist, it is better to decide how to deal with them on the basis of negotiations or prior consultations, in order to avoid the risk of escalating reprisals. In one type of cooperative arrangement, countries with global surpluses could take various measures to facilitate the importation of goods from the economies running a deficit. This would be a desirable alternative to correcting macroeconomic asymmetries exclusively by cutting back on reciprocal trade.

35. Tenth, since intraregional trade is vulnerable to temporary global deficits in the balance of payments (and their potential impact on exchange rates), regional institutions that work to shore up the balance of payments should be legally and financially strengthened. This would help the countries to adjust their external accounts by degrees, thereby encouraging their participation —and increasing their confidence— in integration processes.

36. Eleventh, payment systems could also become a basic tool for facilitating the expansion of reciprocal trade and investment flows. Their importance will decline as the convertibility of currencies is provided for, private foreign-exchange markets are re-established and national currencies become more attractive as means of payment; however, as long as the latter are not used extensively in the region for that purpose, instruments for creating regional liquidity will become more necessary.

37. Twelfth, to promote the absorption of technological progress, the harmonization of standards must be made a basic component of the integration process. In a context of open regionalism, integration agreements may serve as a mechanism for the adoption of international rules. Among other benefits, harmonization could be expected to free up resources which enterprises have had to use to cover differentiated standards, allowing them to invest in activities with a higher rate of return, such as research and development, including activities that help firms to adapt or absorb technological advances transferred from abroad.

4. The need for flexible, open sectoral arrangements

38. An integration process intended to promote the absorption of technological progress requires, in addition to the extensive liberalization of markets, flexible sectoral arrangements to help enterprises reap the potential benefits of integration. Governments should play a catalytic role in this respect by generating flexible business coordination structures that facilitate the intermediation of technology transfer, the creation of information networks and the opening of channels or forums for exchanges of views, reflection, consensus-building and mobilization of support resources. These forums could also serve to develop joint business projects or to promote other types of agreements between enterprises in different countries of the region. The Bolívar Programme, for example, is a proposal that points in this direction.

39. In this regard, the sectoral arrangements established under integration agreements should be reoriented so that they are no longer confined to trade regulation (including quotas, restrictive trade practices or stringent rules of origin) and become more flexible and open-ended, for purposes such as eliminating obstacles through projects (in the areas of transport and energy, for example), or facilitating trade and investment.

40. These commitments would thus become forums for cooperation between the public and private sectors, and could be designed to fulfil some of the systemic requirements of competitiveness in the participating countries. To correct certain distortions, including restrictive trade practices such as the distribution of markets among firms, policies to regulate competition might be needed. Other disparities, such as those resulting from the use of inputs whose costs vary widely (petroleum, for example) or from regulations that hamper reciprocal flows of trade in goods and services, could be a justifiable reason for concluding sectoral harmonization agreements.

41. In order to foster interdependence, the absorption of technologies should be expedited at the regional level by various means, such as through greater mobility of skilled labour

from one enterprise to another, reciprocal investment, the joint use of infrastructure, the production of inputs that can be used in a number of different industries, the adoption of new technological systems and the exchange of technological data, experience and opportunities. Geographical propinquity and cultural affinity, whose importance increases in the context of a more open integration process, will make it easier than in the past to take full advantage of these opportunities.

42. The process of technological dissemination and innovation which integration seeks to promote requires the strengthening of relations with countries outside the region where most major technological innovations originate. For countries like those of Latin America and the Caribbean, often limited to following these advances from a certain distance, this is a crucial point, since technology transfer in the context of trade opening is a basic component of their growth prospects. This fact underlines the desirability of encouraging the sort of intraregional integration that will help strengthen the Latin American and Caribbean countries' relationship with the rest of the world.

43. There is a need for mechanisms to make it easier for small and medium-sized enterprises, which may be among the prime beneficiaries of Latin American and Caribbean integration, to obtain financing and technology. This is one of the complementary efforts being made as part of the thrust to change production patterns with social equity, laying the groundwork for making the best possible use of the potential benefits of integration, while at the same time helping to cut some of the costs of adjusting to the trade liberalization resulting from the implementation of integration agreements.

44. In general, the aim should be to promote actions that stimulate the shoring up of supply to meet the greater, more exacting demand created by broadened, liberalized markets. The linkage of these activities, so that they will be both catalysts and beneficiaries of a dynamic integration process and will not be confined to specific, isolated measures, will depend largely on an extensive liberalization of trade in goods and services among the participating countries, as well as competition and favourable investment prospects. It will also involve national efforts to improve the functioning of local markets for merchandise, services and factors and the implementation of the institutional arrangements needed to reap all the potential benefits of trade liberalization.

45. Finally, social integration within each country, through the enactment of policies aimed at reducing marginalization, plays a crucial role in regional integration, not only by increasing the size of the markets being integrated, but also by making a contribution to a more participatory, solid development of international competitiveness. Moreover, to the extent that integration helps promote a change in production patterns with social equity, national and regional integration processes will complement and mutually reinforce one another.

5. Equality of opportunity for all countries

46. In the 1960s and 1970s, one of the main obstacles to economic integration among countries that were different from one another in terms of economic size or level of development was the uneven distribution of the costs and benefits of the process. Although in today's environment of trade liberalization there is less concern about the cost aspect, the problem of equality of opportunities to reap the potential benefits of integration persists, either among Latin American and Caribbean countries, or even between one of the countries of the region and a developed country. Thus, business associations in certain countries that are regarded for

various reasons as backward point to their structural inferiority when it comes to competing with firms in countries that offer better conditions in terms of economies of scale, access to technology, access to inputs or the systemic circumstances in which the firms operate. This argument is relevant in a number of contexts, whether it is a question of the Latin American countries compared to the developed countries in the hemisphere, or of the relatively less developed countries or smaller economic size compared to those with opposite characteristics.

47. One way of reconciling these viewpoints is to implement the tariff reduction processes that result from integration agreements gradually and progressively to ease the adjustment of production activities to the new circumstances. This would also imply that countries or sectors considered to be less able to take advantage of the broadened market would make this adjustment through slower, but clearly established, tariff reduction processes.

48. Another way of reconciling these differences would be to adopt agreements on special treatment that would generate benefits both for countries with less capacity to take advantage of the potential of integration and for the other countries. It should be noted, in this connection, that certain integration actions may be desirable when they provide benefits for some countries, even if they do not affect the situation of others. This principle could be extended to situations where the countries that received the most benefits from integration would compensate those countries faced with higher potential costs; this would be a way of preventing integration from hurting the latter countries, while it would ensure benefits for the other countries.

49. Thus, in addition to protection clauses and extension of national treatment to investment from within the region (if such treatment has not already been granted), credit or fiscal mechanisms could be used to provide incentives for intraregional investment in countries with less capacity to take advantage of the potential of integration. Possible measures include the financing of private-sector investment projects on somewhat softer terms, or providing fiscal incentives to private enterprises that invest in those countries. Both the mechanism chosen and the origin of the resources could be multilateral, and could use regional and subregional financial agencies as the institutional framework for applying these measures.

50. The foregoing reflects the fact that integration can play an important role in encouraging the imitation and spread of technologies by facilitating the mobility of skilled human resources among countries and promoting intraregional investment. The spread of technology helps reduce impediments to innovation in smaller or less efficient countries.

51. A third way of reconciling differences of opinion on the treatment of countries less able to take advantage of the potential of integration is to take steps to facilitate their integration without the need for discriminatory or special measures. One of these, as noted earlier, is to avoid very stringent rules of origin. Another is to forestall the generation of polarized investment and competitive advantages as a result of compartmentalized (bilateral or trilateral) free trade agreements that give a small group of countries access to larger markets and lower-cost inputs. To avoid this situation, it would be desirable —as indicated earlier— to include provisions that effectively enable the greatest possible number of members to accede to existing agreements.

52. As part of this last set of measures, countries less capable of taking advantage of the potential of integration should adopt appropriate policies to combat possible unfair competition from larger firms in the region. In the short term, this would involve anti-dumping policies which, through objective, non-discriminatory and transparent procedures —either national or subregional—, and based on the agreements negotiated within the Uruguay Round, would ward off the effects of predatory practices. For the longer term, the possibility of including a policy on competition as

part of integration agreements could be considered, with the aim of discouraging these types of practices through punitive measures that do not involve restriction of trade.

6. Medium- and long-term policy coordination

53. Trade integration may increase the need to coordinate macroeconomic policies. However, although MERCOSUR has given a great deal of attention to the topic, such coordination tends to be limited in Latin America and the Caribbean, particularly where conditions of instability weaken a country's effective control over its own policy instruments. Moreover, it must be recalled that the most solid forms of coordination result from a somewhat lengthy process, during which integration gradually gathers momentum and macroeconomic policies constantly interact.

54. Current trade restrictions call for the definition of a coordination procedure that could begin with an exchange of information and an examination of the potential impacts of some economies on others. This would involve a learning process that would not only provide a multilateral perspective, but could also facilitate cooperation and help reduce the risk of actions and reactions that could create conflicts. As a complementary form of coordination, general rules could be established on the type of policies which the parties agreed to adopt and on the measures (multiple exchange rates, certain subsidies, surcharges) they agreed to avoid.

55. Furthermore, the lack of consensus on the best exchange rate regime, difficulties in achieving a convergence of fiscal and monetary policies, and the European experience suggest that the coordination of exchange-rate policy, in a narrow context, is not a practical option at the current early stage of Latin American and Caribbean integration processes. However, the progress of such a regime will require not only the use of monetary and fiscal policies to reconcile —within certain limits— the internal imbalances of the participating countries, but also the taking of similar steps with respect to external imbalances. Once trade between the partners has reached a significant volume, the establishment of a flexible exchange-rate alignment mechanism could be an operative element within the proposed scheme of loosely coordinated macroeconomic policies.

56. The growing interdependence that results from integration also heightens the need for cooperation and harmonization in new areas, including labour standards and regulations. Although there are wide differences of opinion on whether trade policy should be linked to the harmonization of labour standards, migration and the increased mobility of individuals call for complex regulations, particularly if different categories of workers are not to be treated in the same way.

57. Another topic that deserves attention concerns policies on competition, since they may complement liberalization policies and, at the same time, represent a preferable substitute for the protection instruments used thus far to combat unfair competition from imports. In particular, the implementation of supranational policies on competition, such as those applied within the European Community, could help to avert the anti-competitive dangers posed by the use of certain trade policy instruments, such as anti-dumping duties, among countries bound by an integration agreement.

58. Lastly, the thematic scope of future integration agreements will be conditioned by both increased interdependence in the region and the requirements of the international market. Apart from issues related to macroeconomics, labour and competition, other items on the world economic relations agenda, such as the environment and intellectual property, are likely to receive growing attention.

7. Institutional aspects

59. The institutions in charge of implementing economic integration processes must reflect the degree of advancement of those processes. If the aim is merely to abolish obstacles to the free circulation of merchandise, those institutions can be predominantly intergovernmental and relatively simple. In contrast, more complex processes that contemplate policy coordination require more highly developed institutions of an intergovernmental nature.

60. At any rate, it would be advisable to avoid rigid commitments in favour of flexible schemes that are adaptable enough to ensure that the pace of institutional development is determined by the momentum of the process itself. It would also be desirable to encourage and facilitate greater participation by organizations representing various social interests, in accordance with the democratic spirit pervading the region. These considerations justify the establishment of authorities such as the Latin American Parliament, which place the topic of integration on the political agenda of each country in the region.

LATIN AMERICA AND THE CARIBBEAN: POLICIES TO IMPROVE LINKAGES WITH THE GLOBAL ECONOMY *

ECLAC

* Chapter XIII "Ingreso de capitales e implicaciones de política: recapitulación" (pages 427-437), in *América Latina y el Caribe: políticas para mejorar la inserción en la economía mundial*, segunda edición revisada y actualizada, Santiago, Chile, Fondo de Cultura Económica, 1998.

CAPITAL INFLOWS AND POLICY IMPLICATIONS: RECAPITULATION

The region's return to international financial markets provides it with an opportunity to supplement domestic saving in order to meet the demands involved in changing production patterns with social equity. It is especially important for the region to promote investments that will enhance the competitiveness of its economies and the well-being of its population.

International capital markets have grown dramatically since the mid-1960s. This expansion is, in part, reflected in the fact that the movement of funds in international foreign exchange markets currently averages nearly US\$ 1 trillion per day. Thus, in a single day, total transactions exceed the annual GDP of many industrialized countries and amount to the equivalent of over one quarter of the annual value of world trade.

International capital movements are partly a reflection of growing economies, expanding world trade and the globalization of production; however, to a very large and increasing degree, they also are a manifestation of purely financial factors. In the 1960s, the growing presence of lightly-regulated offshore financial centres stimulated capital movements by enabling creditors and debtors alike to evade national financial regulations, capital controls and taxes. Then, in the 1970s and 1980s, many countries began to deregulate their domestic financial sectors and to relax or eliminate regulations applying to foreign exchange transactions. This, combined with revolutionary technological advances in information management and telecommunications and the emergence of increasingly sophisticated techniques of financial engineering, has contributed to a spectacular increase in both national and international financial flows.

It may be premature to speak of integrated financial markets, since international capital mobility is clearly far from perfect. Yet there is no doubt that the international circulation of capital and global financial integration are steadily on the rise. These developments have sparked controversy. At one extreme, there are those who see increasing integration as a sign of greater efficiency; according to their interpretation of events, markets are in the process of overcoming the financial repression characteristic of inefficient governments. At the other extreme, there are those who see the boom in capital flows as no more than a high-risk form of speculation that threatens national sovereignty. Of course, between these two extremes there are various intermediate positions which recognize the significant potential advantages of greater international capital mobility, but are also concerned about issues such as the composition and terms of capital flows and the need to ensure that they are compatible with macroeconomic stability, investment, growth, social equity and national autonomy. Whether the achievement of all of these objectives will be facilitated or hindered by financial liberalization depends on how it is carried out. This, then, is an area in which the design of active economic policies has a central role to play.

Recently, this controversy has assumed greater importance for Latin America and the Caribbean. It is true that, in the 1980s, the region's links with international capital markets were largely severed as a consequence of the massive debt crisis brought about by international commercial banks' permissive lending policies during the preceding decade. However, the region has witnessed a strong resurgence of capital inflows during the early 1990s. In fact, in 1992 and 1993, average net capital inflows reached a record level of over US\$ 63 billion a year (ECLAC, 1994d).

One of the main benefits of these inflows has been a reduction of the severe external constraints that not only contributed to inflation and low investment levels but also brought on a severe economic recession in the region. Increased external saving -so long as it supplements national saving rather than taking its place- makes it possible to achieve a higher rate of investment

and growth. Nevertheless, these inflows have also had an unwelcome effect on exchange rates, the degree of control over the money supply and aggregate demand, the price stability of financial assets, external liabilities and the region's vulnerability to further external shocks in the future.

Financial markets play a number of important roles in development. For the countries of the region, active participation in international financial markets affords them the advantage of providing their economies with a means of attracting capital to activities that offer high rates of return in international terms. For investors, it offers a means of diversifying risk. Unfortunately, international financial markets are also the most imperfect markets in the economy. They have a long history of phases of burgeoning growth followed by contractions of varying severity (Kindleberger, 1978), and there are no compelling reasons to believe that these markets will not continue to exhibit this volatility in the future.

Perhaps one of the best illustrations of the serious flaws affecting the operation of these markets is the virtual stagnation of international capital flows between the time of the Great Depression and the early 1960s. Even when foreign capital inflows are maintained, an excessive percentage of that capital may be channeled towards short-term transactions. Moreover, adjustments in the volume and prices of flows can be sudden and unpredictable.

From a public policy perspective, the ideal solution would be to separate the permanent components of capital inflows from the temporary ones. If the inflow of capital is of a permanent nature, then such related phenomena as an appreciation of the real exchange rate, a widening of the deficit on current account and increased consumption could be interpreted as stabilizing adjustments and, hence, as economically sound developments. If, on the other hand, capital flows were temporary, the aforesaid movements in key variables would be distortionary, since they would create economic imbalances that would greatly increase the likelihood of disruptive adjustments in the future involving high social costs. This distinction is, of course, very difficult to make in practice. There are, however, certain types of economic policy measures which can have a differentiated impact on short- and long-term flows or on flows of productive as opposed to purely financial investment.

The externalities and other serious imperfections of international capital markets give rise, among other things, to frequent cycles of alternating abundance and shortages of resources and to systemic crises; consequently, even potentially permanent flows can evaporate overnight (Guttentag and Herring, 1984). Accordingly, it is always advisable for Governments to exercise caution where capital inflows are concerned if they are to succeed in fostering a situation where the aggregate amount and main components of such flows are in keeping with macroeconomic stability, investment, and growth based on international competitiveness. If the size and composition of capital flows are incompatible with these parameters, sooner or later their sustainability could be threatened, making it necessary to resort to compulsory, potentially destabilizing and socially costly national adjustments. In addition to this problem of domestic absorptive capacity, consideration must also be given to the inherent risks of any short-term external shock in international financial markets.

Since capital flows can affect, and are affected by, national economic variables, Governments should exercise caution on two fronts. First, they need to forestall any situation in which capital inflows would create atypical values or major distortions in key national economic indicators, such as real exchange rates, domestic interest rates, sectoral and national indebtedness, inflation (including asset prices), consumption, investment and the production of tradables.

Second, Governments should guard against using external capital flows as the mainstay for efforts to achieve a rigid or extreme target for a single domestic economic variable (e.g., inflation), especially over a prolonged period of time. By doing so, they would run the risk

of achieving their objective at the cost of throwing other important variables out of balance, thereby impairing the very instrument they tried to use in the first place, namely, external capital inflows.

Capital flows are not always compatible with the objectives of macroeconomic stability in a broad sense, sustained economic growth or social equity. A degree of direct or indirect public “management” aimed at influencing the volume and composition of these flows is therefore justified. There have been numerous cases in which such an approach has been taken -successfully and unsuccessfully- in the past. The extent to which the capital account should be opened may vary over time, depending on short-term domestic and international conditions and the stage and demands of the development process.

In order to maintain a stable real exchange rate, the speed at which the capital account is opened should be tailored to fit the economy’s capacity to absorb and efficiently allocate external resources. For instance, a distinction might be drawn between capital inflows and outflows (Williamson, 1992). It may be desirable to liberalize long-term capital inflows first, before facilitating short-term financial transactions. In the case of capital outflows, it may be advisable to give priority to credits for export promotion and to direct overseas investments by national firms, which would also be another way of improving such firms’ export platform.

The liberalization of the capital account in industrialized countries has been a fairly slow and gradual process whose pace has accelerated only in the past 10 years as the globalization of capital markets has proceeded. However, it is interesting to note that Spain, Portugal and Ireland introduced certain restrictions on capital movements in 1992 in an effort to combat exchange rate instability. Once their objectives in this regard were achieved, the restrictions were lifted. This highlights the importance of having flexible instruments which, when circumstances so warrant, allow temporary constraints to be imposed on capital movements in order to support efforts to promote macroeconomic stability.

In times of scarcity, there may be sound reasons for seeking out both specific and more general ways of attracting capital inflows and for using some means of screening capital outflows. Just the opposite would be true in cases where there is clearly an abundance of capital in a country’s markets; it would then be a question of restricting certain types of inflows while promoting channels for capital outflows.

Using special instruments to regulate capital flows obviously entails some costs. However, experience has shown that always allowing the market to determine the volume and composition of such flows may also have major costs¹. No single instrument, or set of instruments, works perfectly or with complete efficiency; in an imperfect world, instruments must be judged by their overall results. Thus, pragmatic use must be made of the policy instruments that offer the greatest net benefits in terms of macroeconomic stability and growth, while minimizing their costs.

The inflow of capital has done away with the external constraints on growth and offers an opportunity to obtain financing both for reactivating the region’s economies and for making the investments necessary for sustained and sustainable growth. In order to seize this opportunity, action must be taken in regard to two aspects of financial policy: i) its interaction with macroeconomic policy, with a view to engendering a stable economic environment that offers suitable incentives for economic agents; and ii) its interaction with domestic capital markets, with a view to supplementing national saving efforts and matching them up with investment needs.

¹ During the 1970s, most Latin American countries let the market determine the volume and terms of external credit; the adverse consequences of this course of action are well known by all.

Promoting a strategy of changing production patterns with social equity necessarily entails, at a strictly macroeconomic level, an effort to manage aggregate demand and its composition. The instruments available for this purpose are fiscal, income, monetary and exchange policies. In the absence of active fiscal and income policies, the only means of achieving this objective is through the simultaneous control of the real interest rate (as a monetary policy tool for purposes of stabilization and the control of aggregate domestic expenditure) and the real exchange rate (as a trade policy tool for purposes of promoting the growth of tradables production and influencing the composition of aggregate expenditure).

A conflict arises, however, when the level of the domestic interest rate that is in keeping with the objective of curbing inflation and stabilizing economic activity (by sterilizing the monetary effects of the build-up in reserves) is higher than the international rate (once the latter has been adjusted for expectations of devaluation), since this spurs the inflow of capital and heightens the appreciation of the currency, thereby jeopardizing the objective of protecting the tradables sector of the economy. If, on the other hand, real domestic interest rates are allowed to fall, then both objectives may be thwarted, since the higher expenditure prompted by lower interest rates will put pressure on prices and rapidly widen the current account deficit, thus posing the danger of an unsustainable macroeconomic imbalance. The way to resolve this conflict is to take direct or indirect action on capital flows, as some Latin American and Caribbean countries have been doing in the 1990s.

When the authorities are faced with an unexpected abundance of external finance which they consider to be partly of a temporary nature or which is flowing too fast for the economy to absorb, they can intervene at three decision-making levels. At the first level, they can act to moderate the inflow's impact on the exchange rate by having the Central Bank buy up foreign exchange (which will push up the level of reserves). At the second level, they can adopt sterilization policies to mitigate the monetary impact of the increase in reserves caused by intervention at the first level. At the third level, they can use incentives, surcharges or quantitative controls to influence the composition and volume of capital inflows; the aim here would be to encourage a volume of flow that is compatible with the economy's domestic absorptive capacity and to channel those funds into productive investment projects while discouraging the entry of short-term speculative capital.

Some Governments have chosen an approach referred to as non-sterilized intervention, meaning that they intervene at the first level by having the Central Bank buy up foreign exchange, but refrain from sterilizing the resulting monetary effect. If this option is combined with the liberalization of capital movements in a situation where the Government is committed to holding the nominal exchange rate to a predetermined rate of variation, then the authorities may lose control over monetary aggregates. Another option, known as sterilized intervention, broadens the scope of action of the first alternative by offsetting the monetary impact of the accumulation of reserves by means of active measures to regulate the money supply. This is intended to keep the real exchange rate within a desirable range in terms of medium- and long-term objectives.

Most countries in the region have at some point opted for sterilized intervention and have had to deal with serious conflicts between their exchange and monetary policies. In order to ease those conflicts, they have used supplementary measures, such as providing for a degree of flexibility in fiscal policy in order to regulate aggregate demand; establishing stabilization funds for their main export products to cushion shocks in their price cycles (as in the case of Chilean copper and Colombian coffee); and using income policies to adjust relative factor prices to changes in productivity.

As mentioned earlier, when fiscal policy makers do not have sufficiently flexible instruments at their command, then monetary policy (interest rates) and exchange policy (exchange rates) are the only means of controlling aggregate demand. To resolve the conflicts that may arise in terms of the simultaneous management of these two variables, the authorities have the option of intervening at the third level by adopting measures intended to change the volume and composition of capital flows; the aim here would be to give priority to long-term flows through the use of incentives (reserve requirements or taxes, and exchange rate measures that generate greater uncertainty for short-term capital flows) or quantitative controls.

Direct quantitative controls include such measures as compulsory minimum maturity periods; minimum volumes for bond issues; and regulations regarding the involvement of foreign capital in the stock market.

In the area of exchange management, the aim is not only to dampen the tendency towards a real appreciation of the currency but also to discourage international interest-rate arbitrage, particularly by raising the level of uncertainty surrounding short-term price trends for hard currencies through the use of mechanisms which permit a greater degree of intervention. For example, one option is to implement a "dirty" float within a pre-established band using a benchmark value for the dollar based on market conditions in the relevant country's trading partners.

Under the current circumstances of an abundant supply of external funds and what are still comparatively low international interest rates, third-level intervention policies -as well as sterilized intervention- act on monetary aggregates to prevent overspending on the part of the private or public sector by forestalling artificial, temporary increases in domestic expenditure which could cause steep decreases in national saving and excessive increases in external liabilities unmatched by a corresponding increase in the production capacity for tradables.

The extent to which foreign capital flows can further the aims of a strategy for changing production patterns with social equity largely depends on the characteristics of the relevant domestic financial markets. This observation is based on the experience of the external debt crisis, which was caused by heavy inflows of foreign bank credit.

The reorganization of a country's financial system (including the liberalization of capital movements) should give priority to channelling resources into savings and investment, and should do so in close coordination with the development of production capacity. Closer attention needs to be paid to the relationship between the financial system and national saving and investment processes, and between the financial system and external financial markets. The present situation is clearly unsatisfactory, since too small a percentage of the increase in capital inflows has been used to bolster the region's productive investment levels in recent years.

Where the relationship between financial markets and capital formation for development is concerned, an institutional framework is needed that will complete or refine those markets on the basis of three criteria. The first is that a segment of the dynamic, long-term financial market must be included in order to provide financing for production projects. This means that speculative segments must be discouraged and that attention should be concentrated on long-term international capital, together with access to technology and export markets. Capital inflows that take the form of foreign direct investment in the region are an important factor in this regard when the nature of that investment makes a genuine contribution to the creation of additional production capacity.

The second criterion is that the institutional framework must promote access to financing for small and medium-sized firms that are suffering from the effects of the capital market's segmentation. To that end, this market must operate on the basis of a number of selective

criteria that reflect the needs of small production firms in the areas of training, development promotion and modernization. Credit institutions and guarantee mechanisms are needed to accomplish what the region's capital markets have failed to do spontaneously. The aim is not to subsidize the cost of credit, but to promote access to financing at normal interest rates, as well as access to technology, inputs and services, marketing channels, long-term financing and infrastructure that will enhance the production capacity of these sectors of the population.

The third criterion is based on a recognition of the fact that when a country with an emerging market pursues a financial liberalization programme that opens up the capital account to international portfolio investment, it runs the risk of overborrowing from external sources and excessive fluctuations in the stock market and the exchange rate. Large-scale inflows of foreign capital to domestic markets can trigger stock-market bubbles and a decrease in the exchange rate at one and the same time. The subsequent decline in stock market quotations can, in turn, prompt capital outflows and push up the exchange rate. Hence the need to regulate and supervise financial institutions operating in such capital markets in order to ensure their stability.

Concern about such financial-market risks as the generation of speculative bubbles, perverse selection and moral hazard has underscored the need to introduce regulatory and supervisory mechanisms to ensure the stability of the financial institutions operating in capital markets. Such mechanisms are particularly necessary in open, free-market economies. By contrast with what took place during the debt crisis, when the prudential and financial regulatory apparatus was weakened, the reinforcement of that apparatus can counter the above risks and help make the attraction of overseas portfolio investments a more orderly and stable process.

In short, the region's economies can take better advantage of the opportunity afforded by access to international financial markets if their domestic economic policies manage to achieve the following three objectives:

(i) To ensure stable access to foreign capital flows while making sure that such flows do not contribute to distortions in key economic variables such as the exchange rate and interest rates. The exchange rate should be maintained at a level that will stimulate the international competitiveness of the production apparatus, while real interest rates should be kept relatively low -but not so low as to generate an excessive level of aggregate demand- in order to encourage private national investment, reduce the risk of insolvency in the financial system and forestall macroeconomic distortions. A number of countries in the region have opted for simultaneous intervention in the foreign exchange and money markets in conjunction with such measures as the establishment of reserve requirements and taxes and other disincentives for short-term capital movements.

(ii) To seek to ensure that a large proportion of funds are channelled into efficient investments which will enhance the international competitiveness of the region's economies. In order to make this possible, the absorption of those resources should take place within the framework of an export promotion policy which is based on a realistic, stable exchange rate in keeping with medium-term economic conditions and which is bolstered by a sufficient pace of technological and human resources development. This will enable the economy to generate sufficient external resources to stave off any future debt crises. To this end, the region would be well advised to strengthen its financial markets by further developing their long-term segment and reducing their segmentation so that these markets' allocation of resources will truly be based on a cost-benefit analysis of such investment projects.

(iii) To step up the supervision and regulation of financial institutions (particularly of a prudential nature) to ensure that the increase in assets and liabilities generated by external flows does not endanger their future solvency.



Economic Commission for Latin America and the Caribbean (ECLAC)
Comisión Económica para América Latina y el Caribe (CEPAL)
www.eclac.org