

Inter-American Development Bank



# *The Legacy of Raúl Prebisch*

*Enrique V. Iglesias  
Editor*

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## **THE LEGACY OF RAUL PREBISCH**

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Enrique V. Iglesias  
Editor

**Inter-American Development Bank**  
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### **THE LEGACY OF RAUL PREBISCH**

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## INTRODUCTION

This volume comprises a collection of the papers presented at the seminar “Latin American Thought: Past, Present and Future,” convened by the Inter-American Development Bank in Washington, D.C. on November 14 and 15, 1991. Several factors influenced the selection of both the topic and the institution that hosted this seminar.

The IDB is one of the most significant embodiments of the Latin American concern for development. In a paper (later a book) entitled *Reflections on Economic Development: Toward a New Latin American Consensus*, which I presented at the Annual Meeting of the Board of Governors of the Bank held in Santo Domingo in 1991, I recalled the efforts made by countries of the region during the postwar period to turn the attention of the international community—particularly in the hemispheric arena—from security-related issues to those connected with development. These efforts began to bear fruit in the late 1950s with Operation Pan Americana, out of which grew the IDB’s creation in 1959 and the launching of the Alliance for Progress in 1961.

During the subsequent three decades, the Bank has been continuously identified with the development process of its member countries at the intellectual, technical and operational levels. International cooperation for development must proceed with a proper understanding of the differences posed by different countries and time periods in order to strengthen the analyses which Latin American countries undertake to enhance their understanding of these problems and thus improve the qualities of their policies. One of the ways in which a multilateral organization such as the IDB can be helpful in this connection is by providing a focal point for its member countries to exchange experiences on these issues. The Bank has been fulfilling this function uninteruptedly. Now that the debate unleashed by the economic crisis of the eighties is evolving into an economic consensus emerging from the lessons learned during that period, the Bank is prepared to do so in an even more systematic manner than in the past. That prospect was the main reason for organizing this seminar.

The topic of the seminar has been a fundamental one in the recent history of Latin America. The drive for development has been a determining factor not only in shaping economic policies throughout the region during the postwar years, but also in their social and political evolution. Latin America was an important participant in the birth and growth of development as a concept and a concern. It has asserted its influence in that regard since the inception of the United Nations and the inter-American system that soon followed. The IDB is, as noted, an embodi-

ment thereof. Raúl Prebisch and other prominent economists, such as Sir Arthur Lewis, left the imprint of their thought on development theory early in the postwar era. The eclipse of this concern during the last 20 years, in terms of academic work as well as policy objectives, is not only reflected in the crisis experienced by the Latin American economies during those two decades but is an integral part of that same period. That eclipse made the crisis possible and complicated subsequent efforts emerging from it. We are not alone in pointing this out: such a deficiency has gradually gained recognition in authoritative circles, and interest in this issue has enjoyed a strong revival. At the same time, the meticulous efforts by prominent leadership and academic groups to isolate the economic from the political and social spheres have often been ill-considered or disingenuous. Today no one would maintain that economic growth can be guaranteed without social equity and without stable and participatory democracy. The seminar whose papers are contained in the pages to follow adopted, as its point of departure, the recognition of a renewed concern for the problems of development and of the fact that this concern is taking an increasingly interdisciplinary form.

The principal reason for convening this seminar was that, a little over 20 years ago, when the IDB had completed its initial decade of work, the Bank's first president, Felipe Herrera, entrusted Raúl Prebisch to prepare a report on the characteristics, problems and prospects of Latin American development up to that time. Prebisch's report, entitled *Change and Development: Latin America's Great Task*, was presented at the Board of Governors meeting at Punta del Este, Uruguay, in April 1970 and published soon afterwards by the Fondo de Cultura Económica of Mexico. I had the honor of collaborating with Raúl Prebisch on the study. It is now important to examine what happened to Latin American development during the subsequent 20 years, and the Prebisch Report therefore became the immediate inspiration of this seminar. However, the seminar did not limit itself to looking back to the past or to projecting the interpretation and forecasts of the Prebisch Report over the next 20 years. It also used the report as a point of departure for analyzing trends that countries of the region had followed during the period in question and, in particular, for anticipating some of the challenges ahead and possible policy responses to them.

The structure of the seminar reflected these three types of concerns. The moderator in the first session was Victor L. Urquidi, who began the proceedings with a presentation by David H. Pollock and Edgar J. Dosman on the life and work of Raúl Prebisch, with Hans Singer, Celso Furtado and Joseph Love acting as panelists. These discussions cast fresh light on Prebisch's thought through different phases of his life, and his influence on the development theory that was being produced both in

the region and in the more developed countries, as well as on the economic policies of the Latin American countries until the publication of Prebisch's *Change and Development*. The second session, moderated by Maurice Williams, was based on my work, *Reflections on Economic Development: Toward a New Latin American Consensus*. This book examines the evolution of the region's economies during the 20 years from 1971-91, their crisis, and the reforms being attempted at present, suggesting that these reforms are based on the profound transformation undergone by those economies during the 1980s and inspired by a new economic consensus achieved in the region. Comments were sought in this regard from Antonio Casas, Pedro Malán, Dragoslav Avramovic and Albert Fishlow. The third topic, "Toward a New Regional Development Strategy for the 1990s," was coordinated by Louis Emmery. It deliberately avoided starting from any fixed position in order that conclusions about the future might spring from exchanges between various analysts representing different disciplines and points of view. The analysts were Oscar Godoy, José Nun, Colin Bradford, John Williamson, Gerald Helleiner and Gert Rosenthal. This book offers the papers presented in the order in which they were discussed.

In singling out some of the book's characteristics, I would like to start by referring to those relating to the context in which the conference was designed. That framework grew out of the exhaustion of the development model prevailing in Latin America during the initial post-World War II period, followed by the external debt crisis, the subsequent adjustment policies in the 1980s, and the more recent attempts made by Latin America to effect economic reforms aimed at facilitating debt service while simultaneously resuming growth under more sustainable conditions than in the past. Against such a variegated background, it is not surprising that the period was characterized by a high degree of confusion, uncertainty and drama, as is apt to occur in any transition to new ground. In this case, those features are due particularly to the fact that the transition was marked by sharp dichotomies and debates, based on opposing views, generally of ancient origin, which at times complicated the search for solutions geared to the new realities. Thus, to divergent points of view on economic orthodoxies was added the conflict between loyalty to traditional Latin American economic thought and responsibility for carrying out the necessary reforms, as well as a debate concerning the extent to which these reforms addressed the recommendations of the international economic community and the multilateral financial agencies, or the perceptions and aims of Latin American leaders themselves.

The presence of prominent figures and experts on trends in international and Latin American development theory—belonging to different generations—clearly revealed the artificial character of these dichoto-

mies and encouraged an understanding of the view that current positions with respect to this process are an inextricable mixture of change and continuity.

Continuity here refers above all to recognizing the validity and importance of the policies derived from Raúl Prebisch's interpretation of postwar Latin American development problems and the appropriate strategies for tackling them under the circumstances of that earlier era. Secondly, it refers to the fact that several elements of that analysis have stood the test of time: these include the concept of development as a complex process that requires paying attention to several variables simultaneously, attributing the influence to international factors, and assigning importance to the incorporation of technical progress in economic growth. Finally, certain categories of analysis remain useful, such as those focusing on the development process from a systemic standpoint, examining it from a multidisciplinary perspective, articulating both the domestic and international factors involved in it, and paying attention to the short term as well as the medium and long terms.

The elements of change are determined, in turn, by the profound transformation that economic, social and political conditions have undergone in Latin America and the rest of the world, and by the need to keep an open mind toward those changes. Here one should follow Prebisch's own example, as the Dosman and Pollock biographical essay demonstrates by explaining his "multiple images" in terms of the different ways in which he addressed the ever-varying circumstances he had to deal with throughout his life.

This combination of continuity and change has not been an exclusive feature of Latin American economic thought but has broader and more longstanding antecedents. Some of these were emphasized by Joseph Love in his recollection of the work of the League of Nations' Economic Department, which, though committed to the principles of free trade prevailing at that time, criticized the policies of the more developed countries and created a climate favorable to the subsequent theses of Prebisch and Singer, among others.

The seminar also helped dispel doubts and expand common ground with respect to the origin of the economic reforms and, in general, of the new development policies that the Latin American nations are currently following. Some think that these strategies obey the ideas and recommendations formulated by the international financial organizations, which John Williamson some time ago grouped under the heading of the "Washington Consensus," while others hold that they sprang from endogenous needs and ideas. My feeling is that Latin American leaders are more concerned with responding to their countries' internal needs than with adapting to the recommendations of the organizations in question; thus, what is emerging

is a new Latin American economic consensus based primarily on the painful experiences of the past. This is a more realistic outlook and, without doubt, one more in tune with major international trends.

For his part, Williamson confessed that he had come to regret the term “Washington Consensus” that he had coined, inasmuch as it might seem to imply that the international financial organizations had decreed the course to be followed by the developing countries and then dispatched “missionaries” to teach them how to comply. Actually, economic thinking had evolved in parallel fashion within both Washington and Latin America, as part of a global intellectual movement that had manifested itself most dramatically in the old CMEA (Council for Mutual Economic Assistance) area.

A corollary of this more balanced view of the role that continuity and change play in current Latin American economic thought is the steady fading of conflict between orthodoxies. I have already stated that, in my judgment, this antagonism has long complicated the search for solutions to the problems of the Latin American nations and led to stubborn arguments, false dilemmas and costly Utopian fantasies. In his notes, Gert Rosenthal points out that just two or three years ago the discussion of the topic “new development strategies” would have triggered major divisions. Since then, a consensus seems to have grown regarding the general direction in which development should be pointed, and this could implicitly be regarded as a new strategy. In his view, those who, in another era, would have offered sharply divergent interpretations and proposals on development find themselves today in broad agreement, at least in the general thrust of their positions. “This consensus,” he adds, “stems from several factors, most notably the finding that the production and marketing of goods and services tend to become global, a phenomenon from which no country can stand aloof.”

Colin Bradford notes that the evolution of Latin American economic thought has been marked by dichotomies, and therefore he stresses the importance of building a consensual framework within which the selection of policies can proceed. “When one recalls,” says Bradford, “the controversies that dominated the decades just past—monetarism versus structuralism, domestic shortcomings versus external obstacles, trade-driven growth versus growth spurred by borrowing, inward-directed versus outward-directed growth, stabilization versus structural adjustments aimed at growth—one really discovers some patterns in the speech.”

One consequence of this greater degree of consensus is the weakening of the paradigms that were once so influential in charting the course of development. Modern rationalism, to which we are all heirs to some extent, sought to propose unilateral and complete paradigms, each

of which claimed superiority over the others and implicitly or explicitly attempted to “put an end to history.” If this last century and a half has taught us anything—after the hopes placed in the industrial capitalist societies of the last century, the socialisms of this one, or the welfare state following the 1930s and World War II—it is to mistrust absolute models. This tendency influenced past Latin American economic debates, but today we know it is inadvisable to allow any paradigm, whether on the right or on the left, conservative or anti-establishment, that imprisons economic and social thinking and limits our capacity to interpret and confront new realities. I believe that despite the combining of the elements of continuity and change that exists in Latin American economic thought—for as one of the participants pointed out, the way in which one anticipates the region’s thinking in the future depends on how one interprets its evolution in the past—in this seminar not a voice was raised to defend one model over another.

Lastly—and here international organizations still have much to think about and act upon—an important feature of the seminar was that it underscored the systemic and interdisciplinary character of development. Though always present, this character has become noticeably more evident during the recent past. The new international political economy, in addition to becoming more global in nature, is characterized by the importance of linking knowledge to economic growth. In fact, growth has ceased to depend so fundamentally on conventional productive resources—natural resources, work and even capital in its traditional form—and is coming to depend more and more on the skill of economic agents, their organization and technology. Today, a country’s international competitiveness depends chiefly on these factors.

But the creation of favorable conditions in these areas depends closely, in turn, on the existence of an adequate social, educational and cultural environment encompassing training, predominant attitudes and values, and prevailing forms of organization in society at large, work and business. Economic growth today depends basically on investment and improved social conditions, a trained work force and changed attitudes, all of which can be addressed once critical levels of poverty have been overcome. These in turn depend on the existence of democratic, open and participatory political systems, freedom, respect for human rights, the eradication of violence and the removal of fear, and on the governability of the societies concerned. Any attempt to separate those elements, or to confine them to successive stages, is bound to compromise development.

In outlining the papers considered at the seminar, I do not wish to go further than these common denominators nor to summarize each one. It should also be kept in mind that, as a general rule, the Bank did not request a specific topic of each author but only their comments on the

three major themes that constituted the program. However, the preceding conclusions could be expanded by proceeding from the seminar's chronological structure to a thematic structure. This would make it possible to group the papers under headings referring to economic development issues, political and social questions and the international arena, respectively, and then to highlight some of the ideas put forward in them in order to examine the developments taking place in each of these three realms.

The central concern taking shape in the course of the seminar, together with a recognition of the need for ongoing reforms, was the necessity of going beyond policies related only to achieving macroeconomic balance. Most of the participants voiced their conviction that economic reforms are a necessary but not sufficient condition to resume development. John Williamson expressed his fear that implementing the modernizing reforms adopted by many Latin American nations in recent years may not be enough to set growth in motion. He cited examples and questioned what will be needed to speed that process once the reforms have been completed. In his paper he framed suggestions for supplementing or redirecting the measures included in what he formerly called the "Washington Consensus." Colin Bradford presented parameters for a conceptual framework within which development strategies of the countries achieving growth in the nineties should be formulated, emphasizing the importance of technological innovation for the attainment of dynamic growth; of participatory development as the only means of improving productivity and equity at the same time; and finally of harmonizing economic growth with environmental protection. Gerald Helleiner, after noting that growth is fundamentally a product of technological change, stressed the importance of economic behavior in the developing countries, the continuing significance of traditional factors of production (particularly capital goods and a trained labor force), and the importance of extending technological progress to agriculture. He also discussed the need for a consensus regarding macroeconomic policies, trade policy and foreign investment, and underscored the need to build a more sophisticated relationship with Latin America's leading economic partner, the United States. Antonio Casas emphasized the need to review the relationship between the state and society, to turn away from arguments over abstract models and focus instead on the actual conditions of our economies and the global economy, and to avoid separating the concepts of efficiency and equity. Gert Rosenthal also emphasized the importance of disseminating technical progress, which includes strengthening business and technological infrastructure and training human resources. He further underscored the systemic character of competitiveness and the need to update the style of state intervention and issued a call for political participation.

In organizing the seminar, we had in mind the multidimensional nature of development and therefore invited views from the political and social spheres. The resulting contributions not only showed that these dimensions are inseparable from the concept of development, but also that the history of political and social systems in Latin America has interacted closely with the alternative development strategies of the countries concerned, often indeed explaining the adoption or sustainability of these models. José Nun noted that recent political transitions in Latin America are unburdened with interpretative paradigms of the kind generally accompanying them in the past, as also seems to be occurring in the economic field. He pointed out that 40 years ago he regarded social modernization as a precondition for political democracy in our countries, whereas today that sequence appears to have been reversed, with political democratization increasingly perceived as a means of setting the stage for modernization.

Nun sees the first thesis, of a more technocratic character, as closely linked to the primacy of the state as protagonist of the development process, while the second, more political in nature, would represent a more participatory, competitive or market-oriented vision. Lastly he warns us against three forms of reductionism that could affect the design of economic reforms and hence could ignore the markedly political character possessed by these processes today. The first is to insist that the economy constitutes a sphere analytically separate from the rest of society; the second attributes to economic agents a rationality and predictability which, given Latin America's present social conditions, they do not possess; and the third seeks to divorce growth from equity. It is interesting to note that the preoccupation with political participation and social equity was present in most of the contributions to the seminar in the economic area, which reinforces the thesis that emphasizes their inseparability.

Oscar Godoy referred specifically to the linkages between democracy and economic and social development, and joined Nun in affirming that the current decade is marked by a dual consensus, arrived at by different avenues, involving both the economic and political systems. Never before, in his opinion, has there existed in Latin America such a broad consensus on these two dimensions. Godoy analyzes the economic requisites for a thriving democratic system, points out that a history of political regimes shows democracy to be a very complex system, and makes suggestions regarding the search for an approach to democracy combining the essential elements of any democratic system with the living features of societies as different as those in Latin America. In conclusion, he finds that the establishment or enhancement of pluralistic

and representative democracies currently constitutes the dominant trend in our nations.

Most of the presentations made to the seminar contain references to the international economy and its influence on the outlook for development in Latin America. Dragoslav Avramovic makes use of his long and profound experience to examine the evolution of the principal external variables that are currently affecting the performance of the region: trends in primary commodity prices, manufactures, voluntary credit flows and the repatriation of capital. His appraisal is negative for the first two and positive for the latter two. This focus on external factors complements the historical perspective offered by Celso Furtado, starting with Prebisch's original theses on center-periphery relationships in the actual evolution of the international economy; the loss of the hegemonic center represented by the United States; the chiefly monetary fluctuations and upheavals (not to mention their sequels in the areas of trade and production); and the consequent need for their multilateral coordination.

Readers of the papers that follow will find the richness and complementarity of their contents rewarding. Our only regret is that, as so often happens in such cases, the insights provided by the debates that followed the presentations cannot be made available.

**Enrique V. Iglesias**

President

Inter-American Development Bank

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## RAUL PREBISCH: THE CONTINUING QUEST

Edgar J. Dosman<sup>1</sup> and David H. Pollock<sup>2</sup>

After several years of research into the life and work of Raúl Prebisch, the authors were struck by the following paradox: despite the large number of writings about and by Prebisch, little has been published to date of a comprehensive biographical nature. Virtually everything written about Prebisch—by his supporters and his critics alike—has focused on his substantive achievements: on his “trinity” of theoretical writings, managerial responsibilities, and the different policies he designed and implemented during the course of his long and productive life.

In short, although there are thousands of pages in national and international libraries, university research centers, public and private sector files, and the archives of intergovernmental organizations around the world on various elements of “Prebischiana,” they have focused almost exclusively on his controversial views on terms of trade, import-substitution industrialization, regional and subregional integration, commodity market organization, a generalized system of global preferences, planning as an essential technique for national development programming, and the like. Yet, virtually nothing of a scholarly and balanced nature has been written of a biographical bent, even though such information is essential if one is to put Prebisch’s substantive ideas into their historical framework. For as we will see later on, the need to transcend must be accompanied by the need to understand. This is particularly relevant when one realizes that most people knew Prebisch as an international personality. Yet more than half of his life was spent in Argentina, before entering the United Nations. It should therefore be a minimum prerequisite to know the facts of his initial 48 years if his entire career—in Argentina, Latin America and globally—is to be given a balanced and long-term perspective.

The new information we have assembled from our research provides a historical context for Prebisch’s life and work, and points to how that biographical information influenced his theoretical, managerial and policy contributions to global development during his influential and contentious years up to 1971.

Raúl Prebisch was a key mover of people and events in the twentieth century world of economic and social development. He was

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<sup>1</sup>Director of the Canada-Latin America Forum.

<sup>2</sup>Assistant Professor of International Relations, Carleton University, Ottawa, Canada.

also a complex and highly controversial man. But however critically or supportively one may view his achievements and shortcomings, it is undeniable that he left an indelible personal imprint on Argentina, on inter-American affairs, and on North-South relations viewed generally. Yet, surprisingly, the full span of his activities is known to only a relatively few specialists in the arcane realm of international development, in which he lived so long and where his influence continues to be substantial. Thus in this paper (as in the larger work from which it is abstracted), we hope to shed light upon, and attract critical attention to, what Raúl Prebisch accomplished and the significance of his actions up to 1971.<sup>3</sup>

*Change and Development: Latin America's Great Task*, published by the Inter-American Development Bank in 1971, marked the beginning of a new era in the life and work of Raúl Prebisch. His decision to write it was no ordinary event. On the contrary, his abrupt decision to resign as Secretary General of UNCTAD in November, 1968—terminating an influential career in the United Nations which went back 20 years—reflected a growing conviction that his former United Nations paradigm no longer applied to the new Latin America emerging as the 1970s began. The tremendous excitement of his first ECLAC years, and even the founding of UNCTAD, reflected earlier historic moments that had become *passé*. He was now convinced that the conceptual approach he had developed during those earlier years was no longer relevant, and hence that the time had come to rethink the fundamental dynamics of Latin American development. It was a typically Prebischian decision. By recognizing that the initial “ECLAC Doctrine” or “Prebisch Thesis” (the terms are used interchangeably) required a basic reexamination, Prebisch had signaled to the Latin American region during the 1960s that it should move away from inherited dogmas, even those as entrenched as import-substitution industrialization.

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<sup>3</sup>This paper synthesizes portions of a larger manuscript currently being completed by the authors which seeks to chronicle the main personal and substantive milestones in the long and multifaceted life of Raúl Prebisch. Our format is chronological, covering the first seven decades of his 85 years. We begin with his family and childhood in Tucumán, and continue through his academic and career activities at the University of Buenos Aires, which he entered in 1918. The paper then addresses Prebisch's early career and meteoric rise in the service of the Argentine government until his forced resignation in 1943. We then turn to his period as scholar and consultant, 1943-48, and subsequent United Nations tenure—initially as head of ECLAC and then of UNCTAD—that ended in March, 1969 (with the exception of ILPES, from which he formally resigned in 1973, and continuing advisory roles and special assignments). We conclude the paper with his decision to return to Latin America, initially to accept an invitation by Felipe Herrera to prepare the watershed IDB document *Change and Development: Latin America's Great Task*, which was published in 1971. Prebisch's resignation from UNCTAD forms the cutoff date for our paper.

The present paper seeks to clarify Prebisch's rationale for undertaking *Change and Development* by placing this decision within the context of his broader contributions to regional and global development that had been evolving until 1971. In particular, it attempts to clarify the main features and origins of his United Nations vision that some observers see as his enduring legacy. But it also seeks to explain why that vision no longer satisfied him as the decade of the 1960s wound to a close, and hence why he decided to resign from UNCTAD.

### **The Interpretive Problem: Unity of Life and Work vs. Multiple and Conflicting Images**

Although Raúl Prebisch was a pioneer in the new post-World War II disciplines of economic and social development, and his life (1901-1986) spans virtually the entire twentieth century, constituting itself a major chapter in the evolution of modern Latin America, scholarly work on Prebisch has been very selective. It has been either highly specialized, period-specific, or either polemical or hagiographic rather than comprehensive and critical. In particular, and despite a growing number of special studies and important contributions by supporters and critics, work on Prebisch remains compartmentalized by period—Central Bank, ECLAC, UNCTAD, ILPES (Latin American Institute for Economic and Social Planning), *Revista*—and heavily animated by ancient cliques, claques and feuds.

At one level, this is not difficult to understand. Raúl Prebisch was a man of power and a born leader, often reveling in uncompromising and iconoclastic views. In each of the major segments of his life—especially those dealing with the Argentine Central Bank and the United Nations—he led some unusually strong and committed teams, united behind a new concept of development. Throughout his life Prebisch inspired conviction, and he had a unique talent for combining the powerful “trinity” of theory, institution building and policy formulation. Just as surely, therefore, he provoked strong personal and institutional opposition. It may be the ultimate compliment to Raúl Prebisch that he injected passion into the technical world of international development, even though the emotions he roused have subsequently distorted the scholarly study of his overall contributions. It is surprising, for example, that publication of Prebisch's manifold writings during his Argentine years ending in 1948 has been so long delayed. This is a significant historical gap that is only now being filled by the Prebisch Foundation.<sup>4</sup> Ritualistic denunciations of Prebisch for

<sup>4</sup>The authors gratefully acknowledge an advance copy of Mateos Magariños' *Diálogos con Raúl Prebisch*, Fondo de Cultura Económica, Mexico, 1991. Our larger work will present a

distorting Latin American economic growth and trade policy continue unabated to this day. This is so even though his own reevaluation of the “Prebisch Thesis”—which had been formulated for the immediate postwar years—permitted him during the 1960s to challenge his own earlier premises. This intellectual reevaluation process was significantly accelerated and clarified in *Change and Development: Latin America's Great Task*.

Viewed in segments, and trapped by controversies, the innate cohesion of Prebisch's life and work vanishes, replaced by what some economic historians have termed his “multiple and conflicting images.” To give but one of the most notorious examples, he is seen by some as the “radical of ECLAC” whereas to others he appears as a “confidant of the Argentine oligarchy.” Yet to us, the striking feature of Prebisch's enduring legacy is its surprising consistency. Just as Prebisch's career trajectory in Argentina was largely determined by his unusual family background and the timing of his university years, so too the evolution of his United Nations vision cannot be understood outside the context of his achievements and disappointments recorded in Buenos Aires before leaving in 1948 for the United Nations. However self evident this observation may be on the surface, Prebisch's manifold personal and professional inter-linkages remain largely unexplored—hampering a full understanding of his enormous achievements.

Certainly Prebisch left behind, as his enduring legacy, both costs and benefits in the global ledger of international discourse. Every theory is time-bound to some extent, the product of formative events beyond duplication. Prebisch's work is no exception. But the need to transcend must be accompanied by the need to understand. Our focus on the shift from “multiple and conflicting images” to the “unity” of Don Raúl's life and work will, it is hoped, make a positive contribution to Latin American economic thought and help stimulate discussion on new developmental options for the region in the evolving global economy of the 1990s.

## **Evolution of the Prebisch Vision**

### ***Tucumán: Mixed Parentage***

Raúl Federico Prebisch Linares was born in the state capital of Tucumán on April 17, 1901, the product of what he liked to call “old Spanish and

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detailed bibliographic essay on the present state of Prebisch studies. While this paper will therefore not duplicate individual references, we acknowledge the growing contributions of scholars and specialists, as well as the generous assistance of numerous individuals, agencies and private sources.

good German” blood. He was the youngest son in a family of four boys and four girls. Rosa Linares Uriburu, his mother, came from a distinguished family lineage with bloodlines going back to Pizarro, and whose relatives included presidents, senators, bishops and generals. Raúl immersed himself in his mother’s family traditions, including constant visits to her parents’ mansion in Jujuy with its multiple courtyards and magnificent library with windows framing the snow-capped Andes. He was a particular favorite of his grandfather Segundo Linares, himself a former Senator, who encouraged Raúl’s interest in public affairs. In this task he was entirely successful: the young Prebisch would retain a lifelong obsession with contributing to the destiny of Argentina.

But if Raúl’s national commitment, intellectual self-confidence and personal warmth bore the stamp of his mother and her parents, he was also his father’s son in boundless energy, unpredictability and relentless capacity for work. Albin Prebisch had found his way to Argentina from a rural village near Dresden, Germany, by way of global wanderings that had taken him to England and even as far abroad as India—a man without history who was determined to found a famous family in his adopted country. Restless and determined, Albin moved from job to job, including the overland transport company Mensajerías’ mail coach service from Buenos Aires to Jujuy, on the Bolivian border. In Jujuy he met Rosa Linares Uriburu, who was 16 years old. This strange foreigner attracted her attention, and they married despite strong family disapproval.

Albin quickly left a sinecure with a wealthy branch of the Uriburu clan, settling instead in Tucumán where he opened a printing shop, while also teaching English during evenings at the local college. His modest income permitted a middle-class life for his family of eight children, even though he could not afford to purchase a home. The parents shared a passion for education: the home was always full of good books and Albin Prebisch would parade around the German Club of Tucumán with young Raúl’s latest report card. Foreign languages were encouraged except for German, which was forbidden in the house for fear it would undermine the children’s patriotism. Raúl would be, like Albin, a workaholic—a trait that was fortified after leaving home by an almost fanatical desire for financial independence from his father, whom he saw as critical and aloof, lacking the warm family supportiveness of his mother.

Apart from participating in a student strike in Tucumán, which sent him to Jujuy for his final year of secondary school, Prebisch’s childhood appears orthodox and religious: provincial Tucumán was not exactly immersed in radical ideas. But his family origins and upbringing in the stratified state capital of that era permanently affected his class

orientation. To an important degree, Prebisch would see himself as an outsider socially, the consequences of his mother's decision to marry down. The Prebisch children were related to, but not within, the Argentine elite. To many, Raúl remained the son of a German immigrant. Growing up in Tucumán, Prebisch had seen the local agricultural elite at first hand and was not impressed. But neither were they. The status-obsessed aristocracy of early twentieth century Argentina was a world apart: Raúl Prebisch would never become a member of the Jockey Club. He inherited from Tucumán a lasting dislike of the Argentine oligarchy and military.

Prebisch's self-image of an outsider molded his ambivalence toward power. He was a brilliant schoolboy, immediately recognized by his peers and professors in Buenos Aires as a future leader within the gifted Argentine *jeunesse dorée* of the 1920s. Prebisch demonstrated quickly that he wanted power, and he openly admired those who knew how to wield it successfully. His intellectual independence astonished his generation. He stunned his fellow university students—indeed the political circles of Buenos Aires—by daring to contradict, openly and in writing, the views of the influential Socialist intellectual Juan B. Justo.

But this intellectual assurance was not always matched by social self-assurance. Prebisch retained a sensitivity and ambivalence about his place within Argentine society. Later in life he was often offended by yellow press attacks that he was a “foreigner.” In the U.S. or Canada, Prebisch could well have been President or Prime Minister, yet in Argentina he never felt himself to be “presidenciable.” When urged to compete in party politics he invariably responded “no es mi campo.”

The tension here was inescapable. Prebisch's drive for power on the one hand, and his inability or unwillingness to challenge the power structure directly within the political system on the other, limited his career options to a choice of technocratic or “insider” roles within a state politically dominated by an oligarchy he disliked. The feeling was mutual. Personal friendships aside—Prebisch respected individual qualities, regardless of class background, and rose to influence through the support of powerful individuals within the landed elite—the oligarchy never trusted Prebisch, although they would use him. On his part, although he cooperated with the ancient regime—including the Rural Society and the 1930-43 Conservative Restoration—Raúl remained an outside reformer politically, even as he became increasingly incorporated into Argentine public life.

### ***Buenos Aires: Power and Idealism***

The timing of Prebisch's student years (1918-22) in the Faculty of Economic Sciences at the University of Buenos Aires was decisive in

terms of his intellectual formation and political thinking. Buenos Aires was then at its peak, caught up in the ferment of ideas accompanying the Russian Revolution of 1917 and the aftermath of World War I. The cosmopolitan society of the capital city was a discovery which further galvanized his pent-up interest in Argentina and the world. Although the quality of the faculty professorate proved disappointing to him (the Reforma Universitaria of 1917 permitted young Raúl to jettison most formal courses after his first year), the library, his fellow students, the overall atmosphere of the university, and indeed the dynamics of the city itself challenged him from the day of his arrival from Tucumán.

Prebisch's intellectual promise and academic virtuosity soon became apparent. Aside from his work in the faculty, he translated Professor John Williams' book on Argentina, as well as several European texts then unavailable to Spanish readers. By 1920 he concentrated on reading and writing, already publishing several articles including a review in the *Revista de Economía Argentina* on postwar adjustment problems in Belgium. The European rather than the U.S. intellectual scene commanded his early attention, a natural recognition of Buenos Aires' traditional links with the old continent. Although he immersed himself in historical and contemporary texts on economic theory—both neoclassical and Marxist—Prebisch shared Argentina's fascination with the cultural ferment and political restructuring of Europe, culminating in the victory of fascism in Italy. The writings of European social scientists such as Weber, Mannheim and Pareto provided new conceptual lenses for Prebisch's preoccupation with the gathering political crises in his own country.

During this university phase, part-time teaching in the faculty and at La Plata University did not prevent his growing visibility in Buenos Aires as an intellectual on the move. In an extraordinary decision, the university allowed the faculty to hire Prebisch as a professor of economics, despite the absence of even a first degree. He developed a reputation as a good listener as well as a highly disciplined empirical researcher, with an extraordinary capacity to motivate. From the very beginning, Prebisch formed working groups on special research subjects within the faculty. Many of these consisted of close friends, such as Ernesto Malaccorto, who would later form the inner core of what became widely known as the "Prebisch brain trust."

By 1923, Prebisch was transformed. Formally graduated as an accountant, he was instead a self-taught economist. In terms of personal commitment, an intense nationalism replaced religious observance, which Raúl had now dropped. Politically, although never a registered member, he leaned toward the Independent Socialist Party. Ideologically he had read *Das Kapital* in 1918, and in one of his first published fragments had rejected Marxism's applicability to the Argentine case.

For Prebisch, Argentina was an obvious success story rather than a failure. Indeed those postwar years convinced him of Argentina's potential as a rising young world power, and he saw his mission as helping his country clear away the remaining obstacles to the realization of this destiny. The problems that confronted it were serious, but not associated with the free market. Quite the reverse. Until the end of his life Prebisch viewed the market as a necessary though not a sufficient condition for both economic and political liberty. Moreover he had read Pareto and foresaw the bureaucratic consequences of the type of command economy implicit in communist modernization. He saw that path as inappropriate for Argentina, and he viewed the formation of the Argentine Communist Party as another symptom of political crisis.

In the course of his debate over Marxism, Prebisch finalized his own vocation. In terms of career, his commitment to Argentine national life was too deep for him to consider full-time work in the faculty—even if he could have survived on an academic salary. He was a born activist—someone who wanted to participate directly and fully in events rather than be a detached scholar or observer. Although he sought a continuous connection with the faculty as a stimulus for creative thought and access to bright students, Prebisch's goal was to use his talents as an economist to help modernize the Argentine state. The institutional lag in Argentina's political and state mechanisms, which flawed the exceptional economic achievements of his country, had to be corrected. He believed that gradual structural change, not revolution, was the answer. Working within Argentina's existing power structure offered the means for its reform.

Thus, after graduation, Prebisch welcomed his first consultancies, including those from the Rural Society (to analyze the role of foreign investment in Argentina's meat industry) and from the Ministry of Finance (to visit Australia and New Zealand and study their income tax legislation) as initial building blocks towards a subsequent public administration career. In this he was successful. After winning a nationwide competition for the post of Deputy Director in the National Statistical Bureau, Prebisch was selected to write another influential report on the meat packing industry—again for the Rural Society—and then to join the President of that Society, Luis Duhau, on an extended working visit to the U.S. and Canada. Both events were milestones in his advancing career as a technocratic insider.

Upon his return to Buenos Aires in 1927, Prebisch was asked to become Director of the newly-created Division of Economic Research in the Banco de la Nación Argentina. From that post he inaugurated a new *Revista Económica* dealing with a variety of agricultural, commer-

cial and financial policy issues confronting the Republic. This *Revista* rapidly became one of Argentina's most widely read and influential government journals, launching him into the top ranks of Argentina's economic analysts. His political breakthrough came two years later, when the September 6, 1930 military coup ended the long era of constitutional government in Argentina. Prebisch was offered the important post of Undersecretary of Finance and he accepted it. Suddenly, at 29 years of age, he had reached the epicenter of the Argentine state system.

But what of Prebisch's supposed idealism, his antipathy for the oligarchy and military, his writings advocating land reform, and the like? How did all this square with the corporatist leanings of some backers of the Uriburu coup? Or his previous work with the Rural Society? Some authors have recently used the term "enlightened conservative" to explain the apparent contradiction. But neither Prebisch nor his closest associates perceived themselves as conservatives in the political sense and certainly not as lackeys of the oligarchy. Their mission, consistent with their intellectual inheritance from the Independent Socialist Party, was to bring the Argentine state into the twentieth century. This they were more likely to accomplish by working with Uriburu than with the hapless radicals, around whom the Argentine state appeared to be collapsing. Viewing themselves as politically neutral and technocratically oriented professionals, they felt a duty to shield their country from worse damage by direct intervention rather than cavilling from the sidelines.

Prebisch prided himself and his brain trust on scrupulous intellectual honesty, to set them aside from the ancient regime. While Prebisch would later reconsider the long-term political impact of the 1930 coup, he never questioned the sincerity of his 1930 choice in the interwar context (unlike his continuing lament for having returned briefly to Argentina in 1955, which he called the worst decision in his life, based as it was on an emotional response to the fall of Peron). Indeed Prebisch looked on the Argentine era of 1930-43 as one of strong administrative achievements, later destroyed by a flawed political system against which he and his team were ultimately powerless. In effect, his defense of the decision to work for the Uriburu government mirrored the European situation of the 1930s, when a similar sociopolitical breakdown confronted intellectuals with the hard decision of participation versus withdrawal.

In mid-1932, following a change of Minister, Prebisch was dropped without warning as Undersecretary. While he could return to the Banco de la Nación, Prebisch now realized his vulnerability as "power-carrier"—an advisor without consistent political support or an institutional

base of his own. He was upset and preoccupied. In the following two months, while on vacation in Italy, Prebisch pondered the outsider's dilemma, a continuation of his Tucumán inheritance. How could he move beyond an advisory role in the Argentine state? How could he construct an island of rationality and influence within the Argentine system, from which he could administer an autonomous technical elite capable of modernizing the economy at a time of national emergency and political decay?

### ***Geneva: Heterodoxy***

Prebisch would later maintain that he went into the Great Depression with a conventional neoclassical and monetarist mind set. Certainly his behavior then was consistent with the reactions of conservative approaches in many other Western countries. As Undersecretary of Finance, he had cut public expenditures savagely to reduce the fiscal deficit and balance the national budget; an orthodox response to the collapse of international trade and the run on gold.

However, before leaving the Department of Finance in 1932, Prebisch had already begun to experiment with more controversial expansionist measures and had established a small select committee to prepare the blueprint for a new Central Bank. Indeed his wide-ranging and often iconoclastic writings from the mid-1920s into the early 1930s suggested an intellectual openness and a pragmatic bent—a willingness to change policies in the light of changing realities. He was, after all, largely self-taught, with an overwhelming public policy focus. Prebisch was thus poised for a new stage of learning. And the next phase of his career—an international one, centering around Geneva and London—jolted him irrevocably out of his earlier inherited dogmas.

After his fall from favor in the Finance Ministry, Prebisch was asked to travel to the League of Nations in Geneva with the Argentine delegation to carry out the preparatory work for the World Monetary Conference scheduled for London in 1933. Newly married, Prebisch left in October 1932 and spent nearly a year in Geneva and London, with side trips to Germany and Paris. It was an extraordinary moment in European history. The continent was in depression and political convulsion. Nazism was on the rise. In January 1933 Adolf Hitler was sworn in as Chancellor of a transformed Germany, bent on power and revenge. The League of Nations was in crisis, with a dispirited secretariat begging for strong leadership from the failing Western democracies—a leadership that never materialized.

Geneva and London completed an important new stage in Prebisch's international education. His earlier trips abroad had all been

relatively short working visits or vacations. Now, for the first time, Prebisch actually lived and worked in a foreign country. And Geneva was more than that. Not only was it in the heart of Europe but additionally the League of Nations—which he was now observing first-hand—was exciting as a crossroads of ideas, even though barren of diplomatic promise.

Prebisch could now reorient basic premises. Almost immediately he received a rude awakening about Argentina's ranking and role in the global scheme of things. For him, Buenos Aires was one of the great capitals of the world, and Argentina the eighth economic power. Hence Prebisch had arrived in Geneva eager to get to work and with a certain sense of importance. Instead he found that his country counted for little among the world powers. No one seemed to care much about what he said or wrote. Argentina had been invited as a symbolic overture to the outlying regions, but for all its per capita wealth and future potential, it remained on the outside. Instead of multilateralism, he saw the Western powers currying favor with Nazi Germany, competing in a mutually destructive cycle of competitive devaluation and protectionism while simultaneously extolling the virtues of free trade for the excluded and weak. He was particularly disappointed with Neville Chamberlain (Britain's powerful Chancellor of the Exchequer), and even with Franklin Roosevelt's rhetoric, since he had expected forceful leadership from the new U.S. President.

Although Prebisch had discussed trade issues in his *Revista* after 1928, Geneva consolidated his lifelong preoccupation with the theory and reality of international trade. There were few subtleties concealed in the open sores of the world trading system as Prebisch observed it from the League of Nations. The currency of international trade was power. Some countries possessed it but most—Argentina, for example—did not. There was indeed a global trading system, but it was sharply stratified into a core of dominant subjects with a broad band of peripheral objects.

Prebisch drew two lessons from his international experiences of 1932-33. First, Geneva convinced him that countries such as Argentina—important but vulnerable trading nations—required stable international trade rules for their future prosperity. They had a huge stake in promoting a multilateral system in which, for example, the vulnerability of countries like Argentina would be reduced. But multilateralism had to wait until the future, since bilateralism was so sharply in the ascendant. Hence Argentine policy makers should not be laggards in understanding and adapting to the realities of international trade. If conventional theories of international trade had to be stood on their head—so be it. In a period of Hobbesian anarchy, such as existed in the 1930s,

Argentina could count only on itself to surmount the Great Depression. It would have to chart new paths, with an activist role for the state, abandoning the hoary academic baggage contained in the Western textbooks current in Argentina up to that time.

It was a traumatic but liberating period for Prebisch. He encountered the works of Keynes, Schacht and others against the tragic backdrop of the indecisive World Monetary Conference. With one stroke Prebisch jettisoned much of his prior neoclassical economic theory, already frayed by his year and a half of experience in the Ministry of Finance. He had entered a new and uncharted world in which the choice of policy options would be based on one criterion only: effectiveness. Henceforth Prebisch would not hesitate to act forcefully, interventionist or not, even if (as he would later reminisce with amusement) he had to justify his actions in neoclassicist liturgy to reassure the conservative dinosaurs surrounding him in Buenos Aires. Prebisch was no longer innocent. He had transcended inherited doctrine and was determined to be as experimental as necessary. Certainly he would be no less innovative than the Western powers which themselves were using the state in new and interventionist ways.

The corollary of Prebisch's new intellectual toughness was an appreciation of *realpolitik*. From the vantage point of Geneva, he had seen Argentina as a dangerously isolated and vulnerable small power; the opposite of the overoptimism about its bargaining options so characteristic of Argentina's ruling class. Even Canada, closer to the center than Argentina, was floundering, although Ottawa was at least aware of its weakness. Prebisch never apologized for his role in negotiating the 1933 Roca-Runciman Treaty, which is still condemned in Argentina as one of the great betrayals in the history of the Republic and a cynical manipulation of trade policy by Argentina's dominant beef interests. Prebisch did not like the Roca-Runciman Treaty either, but saw no alternative. The British press was howling for even harsher terms, and Argentina's bargaining position was too weak to resist. Prebisch saw the treaty as a purely defensive measure, one that would enable Argentina to buy time in order to restore its economic growth. He believed that Argentina's inherent strength, under sound economic management, would permit a rapid recovery if breathing room could be achieved through a bilateral agreement with Britain, its main trading partner. He explained that he was neither a pessimist nor an optimist but only a realist. Argentina came through the recession in better shape than Canada, the U.S., Italy, or France. But many Argentineans never forgave him for what they considered a sellout to British imperial interests and the Rural Society.

The breakthrough for Prebisch in London was quite different than in Geneva, concerned more with the institutional dilemma he encountered after his dismissal as Undersecretary of Finance than with trade or economic theory. During his months in England, he became a close acquaintance of Sir Otto Niemeyer of the Bank of England, and other senior British officials. His discussions with them proved as significant, in an institutional sense, as his Geneva experience had been in terms of radicalizing his intellectual approach to international trade theory. Prebisch wanted an in-depth look at the structure of the Bank of England, but became equally if not more interested in the workings of the British Treasury. He was greatly impressed with its vital behind-the-scenes steering role that guaranteed economic and monetary stability against the ebb and flow of party politics. While primarily protected by convention rather than statute, its status and informal power were such that it was politically untouchable. For the private as well as public sectors, the invisible hand of the Treasury provided the essential touchstone of continuity, legitimacy and influence.

Prebisch realized the potential importance of a similar concept for Argentina, which needed an analogous institution to form the missing backbone of the state as a shield against the corruption and erratic shifts of political life. His solution was clear. The British Treasury model would not work in a presidential system such as Argentina's. But a Central Bank structure could be devised which could replicate the British Treasury's concept of a state-within-a-state—equally powerful and at arm's-length from the government of the day.

Prebisch returned to Buenos Aires consumed with implementing his ideas. He agreed to become an ex-officio advisor to Argentina's two most powerful Ministers—Pinedo in Finance and Duhau in Agriculture—convincing them on the idea of a Central Bank and having Sir Otto Niemeyer invited by the Argentine government as a consultant to help prepare the project. The respective drafts of Niemeyer and Prebisch differed in some basic aspects, but those differences were not aired publicly since the Argentine cabinet did not want outsiders to know there were disagreements with such an authoritative figure from the Bank of England. In effect, Prebisch revised and adapted Sir Otto's draft project to what he saw as Argentina's two key requirements: greater power and more autonomy. With Pinedo's political leadership, his draft gained cabinet approval in 1934 and became operational in 1935, with Prebisch designated as its first general manager. Although Dr. Ernesto Bosch was President, his functions were basically front-office and honorary. De facto control over both administration and policy rested firmly and unequivocally in the hands of Raúl Prebisch.

### *The Central Bank: Synthesis*

To the end of his life Prebisch still recalled his Central Bank years as the most satisfying, to be compared only with his initial years in ECLAC. Indeed, his Central Bank concept, grasped with Niemeyer in London in 1933 and implemented with precisely the right timing, was an exhilarating personal triumph. He saw it, correctly, as a rare “historical moment.” Until his dismissal in October 1943—which caught him entirely unaware (so convinced had he become by this time of his indispensability)—the Argentine Central Bank had unquestionably become the directing force in Argentina’s fiscal, monetary, industrial and international trade policy, just as Prebisch had envisioned. A growing literature in this field confirms the extraordinary achievements of the Prebisch brain trust in Argentina’s economic management—despite the framework of international crisis, war and political decay surrounding the Republic after the Central Bank was created.

Although somewhat damaged by unsubstantiated accusations during the tense Lisandro de la Torre scandal of 1935, Prebisch’s successes through the Central Bank—in stabilizing the economy, sanitizing the banking system and reigniting economic growth—greatly impressed both domestic and external observers. By 1937 the economy was in full expansion, with grain prices significantly strengthened by drought in North America. The next year was even better. In 1939 Europe was consumed with crisis, but the momentary panic on the Buenos Aires stock market following the outbreak of war on September 1, 1939 was quickly snuffed out by strong Central Bank action. After the fall of France in June 1940, decisive Central Bank intervention again calmed investors. Industrial production accelerated and the Argentine peso became a currency of choice for flight capital. Despite such problems as import constraints, market disruption and tensions with the U.S. following its December 1941 entry into the war, the Argentine economy remained stable. Then—just when Central Bank planning for the post-war period was well underway, including the problem of dealing with its growing blocked sterling balances—Prebisch and the leaders of his team were abruptly dismissed.

The Central Bank was an extraordinary personal achievement because it was more than just another powerful bureaucracy. During Prebisch’s eight-year tenure as its head, the Bank combined theory, policy and management: a heterodox conceptual approach, a coherent policy framework by a strongly motivated group of technical specialists, and an equally forceful institution-building role. Prebisch saw his team of Central Bank professionals as a leadership group—a modernizing elite—within the Argentine state, united behind a coherent vision of national develop-

ment and comprising top young professionals. His role was to provide the intellectual and administrative leadership of this core group, in which competence would be the only criterion for advancement. Occupying a strategic position in the economic direction of Argentina, the Central Bank coordinated its work with members of the Prebisch brain trust in other important Ministries such as Finance and Agriculture. Thus both the public and private sectors in Argentina now had a comprehensive but tightly focused point of contact that reassured them in troubled times. Although Prebisch was a severe taskmaster—or perhaps because of it—the Central Bank became the single most prestigious governmental agency in Argentina, and Prebisch himself rapidly gained international recognition for the quality of its work. By 1943, he was Latin America's best-known banker and economist.

Prebisch felt that an educative role was a particularly important component of the Central Bank's institution-building objective. His university courses at the Faculty of Economic Sciences offered a forum for identifying talented young professionals while simultaneously providing a framework to discuss Argentina's place in the global economy. But he was unhappy with the teaching and research standards in the faculty, and with the growing politicization and declining quality of Argentine universities in general. His own course ("Dynamic Economics") became increasingly popular as his stature grew, but he worried that the faculty was losing touch with the international current of thought. In consequence he had the Central Bank establish a strong Research Division to compensate for the lack of facilities and staff in the Faculty of Economic Sciences. On another level, the annual reports of the Central Bank—to which he often contributed directly—were serious and well-written documents, informing the public at large about the Argentine economy in both its domestic and external aspects.

In addition, Prebisch set up a special graduate exchange program for promising young members of his Central Bank staff with Harvard University, which included short visits for practical training with the U.S. Federal Reserve Banks in Washington, D.C. and New York. As the Pax Americana dawned, he felt increasingly that Central Bank professionals should increase their contacts with U.S. universities and banking institutions if they were to remain intellectually competitive on global issues. He invited U.S. and U.K. specialists to visit and study the Argentine Central Bank, again to prevent intellectual marginalization by strengthening international links. By 1943 the Argentine Central Bank was established as one of the most innovative financial institutions in the world, with Prebisch an internationally respected figure.

But Prebisch's political obstacles were growing as the Conservative Restoration tottered to a close. He drafted the Pinedo National

Recovery Plan, negotiated the 1940 Brazil-Argentine trade accord and personally conducted the historic Argentine-U.S. negotiations of 1940-41, but none were implemented in the general climate of institutional crisis. He became the object of opposition by nationalist and pro-Axis forces in Argentina, while the growing volume of foreign exchange reserves in the Central Bank vaults increasingly tempted those who wished to utilize that treasure to mobilize the restless urban working class created by rapid industrial growth.

Although Prebisch thought the Central Bank would be as immune to political storms as the British Treasury had been, and that the Bank was now so important in the financial world that no government would dare touch him, his “island of rationality” was becoming increasingly friendless and vulnerable. Distrusted by the political right, Prebisch was targeted by the GOU (a group of right-wing colonels surrounding Peron) and by other Peronists as a scion of the landed oligarchy, of Britain and of the U.S. Federal Reserve. On October 27, 1943, he and key members of his brain trust were suddenly sacked. In 1946, with Peron finally in full command, the Central Bank was “nationalized.” Its directing role in the Argentine economy—so carefully designed and managed by Don Raúl—was destroyed.

## **The United Nations Vision**

### ***Origins: The Discovery of Latin America***

Until October 1943, Prebisch had quite naturally viewed Argentina's neighbors from the perspective of his own country's national and geopolitical interests. Since Argentina was then the most powerful country in South America, his orientation was the continuation of that regional leadership within the complex diplomatic triangle that had emerged among Argentina, Brazil and Chile with the buffer states of Uruguay, Paraguay and Bolivia. Culturally, Buenos Aires was the cosmopolitan metropolis of South America. After his trips to Australia and Canada, with their surprisingly small provincial cities, and then to race-divided and self-important Washington, Prebisch felt comfortable comparing his city's achievements with those of New York or the capitals of Western Europe. For him and his generation, although Argentina was located in Latin America, de facto it was psychologically a world away.

For those of Prebisch's generation, Argentina's reference point in the international economic order lay outside of Latin America, among the leading world economies (or at least with such large frontier countries as Canada and Australia). This Argentine self-perception was irritating to other Latin Americans, but Prebisch certainly shared it until 1939. The

notion that Latin America was something more than a geographic expression, to be ritualistically endorsed in meetings of the Pan American Union or League of Nations, had not occurred to him. Apart from traveling to Uruguay and Brazil on government business, he had not visited other Latin American countries. In contrast with his wide knowledge of European history, Prebisch was not well versed in the history of the region, including Mexico. In Geneva and London in 1932-33, he had appeared almost oblivious to Mexican participation, assuming that he was the main if not the sole Latin American representative present.

The outbreak of World War II, however, forced Prebisch into at least a partial reconsideration of the emerging inter-American system, and in particular the new hegemonic thrust of Washington in Central and South America. With the fall of France, he realized that a drastic reordering of the Americas was beginning, one that potentially threatened Argentina's traditional interests. Between September 1939 and December 1941 he devoted as much attention to this new challenge as to the conflagration in Europe. His policy was based on two thrusts: first, balancing the loss of European markets through rapprochement with Brazil, Chile and the smaller countries of the Southern Cone; and second, improving diplomatic relations with Washington to heal old wounds and prepare a new basis for bilateral cooperation. Prebisch led a successful Argentine mission to Washington in November 1940, meeting with President Roosevelt, after discussions with Brazilian President Getulio Vargas in Rio de Janeiro.

Pearl Harbor and the advent of World War II realized Prebisch's worst nightmare. Brazil rapidly rallied to the Allied cause, whereas Argentina's deepening political crisis and strong pro-Axis elements increasingly provoked Washington's resentment. Domestic political stalemate, wartime diplomacy, and growing U.S. intervention and hostility left Argentina isolated and vulnerable. Prebisch's increasing alignment with the pro-Allied camp in Argentina (his brother-in-law was active in the German underground, and would be executed after the ill-fated coup attempt of July 1944 against Hitler) contributed to attacks against Prebisch by the Nazi-funded press in Buenos Aires.

Prebisch's dismissal was harsh and without warning. His salary was immediately cut off and no Argentine public or private sector employer at that highly politicized time was willing to hire him. His new house in a Buenos Aires suburb was mortgaged; he had to rent it without delay and even sell his car to save it. Watched by the police and the GOU, Prebisch faced a financial and professional *cul de sac*.

At that crucial moment a letter arrived from the Mexican Embassy, inviting him for an initial visit and then an extended consultancy in Mexico's Central Bank. It was an invitation that significantly changed

his bleak prospects. For years afterwards, Prebisch would reiterate his debt of gratitude to Mexico for rescuing him at one of the most critical and depressing points in his life. Financially, personally, and also conceptually, this new "voyage to Latin America" was a turning point in his life and work.

If Prebisch's analytic framework for examining the emerging post-war world during 1939-43 was centered on Argentina's national interests, the Mexican experience initiated the change toward a regional optic that would mature fully in his seminal "Manifiesto" presented to ECLAC's second session in Havana in 1949. He was fascinated by Mexico's historical and cultural wealth, and by the myths and reality of its revolution. He was particularly impressed by the emerging generation of Mexican economists and their network of intellectual connections with U.S. and European universities. The feeling was mutual: his Mexican visit generated permanent friendships in a rapidly growing web of regional contacts.

Following his stay in Mexico, Prebisch received offers for other Central Bank consultancies from Venezuela, the Dominican Republic, Guatemala, Brazil and Paraguay, all the while blending such practical work with lectures and research at the faculty in the University of Buenos Aires. The many Latin American friends he made during this period, and with whom he continued to correspond afterwards, would remain a key network for his next quarter century of work in ECLAC and UNCTAD. His U.S. contacts, which had been initiated during the earlier Harvard-Federal Reserve connection, were also strengthened.

With these associates and his students, Prebisch pondered the theoretical implications of Pax Americana. By 1948 he had visited much of Latin America, including countries at very different levels of development. Throughout Latin America, Prebisch participated in the growing debate about the future and the need for new institutions of higher learning, including those for economic teaching and research, to understand the implications of the new postwar realities. In a word, Prebisch was becoming "Latinized."

After his last attempt in 1945 to regain access to the Central Bank, and especially after the historic election of Peron in 1946, Prebisch's future in Argentina was becoming increasingly problematic. Life was complex and concentration on work difficult. Despite all this, his book on Keynes appeared in 1947. He was convinced that he was now on the verge of a theoretical breakthrough, but because he had to continue both teaching and consulting, progress was slower than anticipated. By 1948 he needed, he felt, very few months to complete his work. But then, once again, the axe fell. Suddenly, in the autumn of 1948, he was sacked from the university faculty. The pieces of what was later to emerge as the "Prebisch Thesis" had begun to coalesce, although they

had not yet been melded into a single organic paradigm. It would have to be completed outside the country.

Nor would the pieces have come together had it not been for the paradoxical consequence of the IMF Board of Directors rejecting a job offer (to head up the new Exchange Restrictions Department) that had been extended personally to Prebisch by Camille Gutt, the IMF Managing Director, and Edward M. Bernstein, Director of the Fund's Research Department, during a trip to Buenos Aires in December 1948. Although Prebisch had accepted the offer, the Fund then bowed to U.S. pressures and informed him one month later that a U.S. candidate—one more responsive to policy priorities of the U.S. Treasury—would be chosen. At this critical juncture of his life, facing hostility from the Peron government and with no other employment prospects in sight, Prebisch accepted a short-term consultancy offered by ECLAC's Executive Secretary, Gustavo Martínez-Cabanas, to help finalize the *Economic Survey* for its second annual meeting in Havana. Prebisch himself had been offered, but had rejected, the leadership of the new ECLAC, remembering the rigidity and timidity of the League of Nations. But now there was no alternative: Santiago was the only option, with all other doors closed, and he was in exile.

The drama of this moment has been told elsewhere. While preparing the first draft of his paper for Havana, Prebisch encountered Dr. Hans Singer's landmark terms of trade study. It was the stimulus he needed—the final element in the emerging synthesis which he knew to be imminent, and which he had anticipated with such impatience since 1947. In three hectic days and nights he re-drafted his Havana paper with the same excitement that had accompanied the founding moments of the Argentine Central Bank. The triumphant reception of the Prebisch "Manifesto"—personally signed at United Nations request—and his first-hand experience with the new ECLAC, opened a new period of his life. At Havana he saw another potential breakthrough—a second "historical moment."

But this time Prebisch had a regional, not national, optic. If the Central Bank was designed as the backbone of the Argentine state, so now Prebisch saw ECLAC as a unique instrument to project a regional vision. Prebisch offered an indigenous economic paradigm and vocabulary for viewing Latin America within a single conceptual and policy framework. In this sense he "created" Latin America.

### ***The ECLAC Achievement***

Throughout his life, Prebisch was driven by a search for "historical moments" in which the timing of a new concept could transform an organization into a movement. Theory, machinery and policy: this

powerful trinity—linking an idea to an institutional mechanism in order to implement policy—comprised the core of the Prebisch vision. The Central Bank had offered one such opportunity, in the mid-1930s, and the correctness of his intuition at that time deeply affected Prebisch after his forced departure from the Bank in 1943. During the following half-decade in the wilderness he had sought another opportunity for leadership, finally finding it in the United Nations and ECLAC.

Prebisch's sophisticated yet deceptively simple Havana Manifesto offered the theoretical and policy message yearned for by young post-war Latin American economists as an indigenous response to the orthodoxy flooding into the region from the industrialized north, especially from the U.S. After Havana, Prebisch was a man reborn. His energy was magnetic—a sharp contrast to his mood prior to the meeting, when he had been distant and reclusive in Santiago. His succession to head ECLAC was now just a matter of time, and he effortlessly engineered his becoming Executive Secretary in 1950, following the Commission's third annual session in Montevideo.

The magnitude of Prebisch's achievement can scarcely be exaggerated. ECLAC captivated the imagination of Latin America, a region waiting to be created. The ECLAC Doctrine/Prebisch Thesis<sup>5</sup> liberated and empowered Latin Americans, who had so long been accustomed to importing their ideas from abroad. In particular, it represented a cognitive breakthrough at a critical point in history when many of Latin America's capable young economic professionals were being attracted away from the region to staff the new post-war international organizations then emerging in New York and Washington. Many individual ideas presented by Prebisch at Havana were already in discussion, but his synthesis and presentation were original and compelling. It was a document which changed readers, and transformed the political debate regarding economic development in the region. Certain questions at the heart of this debate were simply transcended. Should Latin American countries industrialize? Should the state assume a leadership role in economic development? After Havana the question was no longer whether to industrialize (or whether the state should be activist), but what strategies, instruments and policies were most appropriate to such ends.

In retrospect the ECLAC Doctrine cannot be analyzed out of the specific context of the early 1950s. Its principal policy outgrowths (import-substitution industrialization; export pessimism; commodity market stabilization; international financial transfers; and so forth) reflected the specific international circumstances of those years. Even by

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<sup>5</sup>Essentially the Havana paper, and the major documents submitted to the Montevideo and Mexico meetings of ECLAC.

the late 1950s Prebisch recognized the need for intellectual renewal in ECLAC as circumstances changed. Moreover, ECLAC was not a university; it was a United Nations body responsive to Latin American governments. To achieve consensus it was hardly surprising that Prebisch emphasized obstacles affecting the external sector. As underlined repeatedly in the wealth of critical literature regarding this period of Prebisch's work, aspects of the ECLAC Doctrine later became entrenched in his disciples, whereupon they aggravated, rather than facilitated, economic modernization.

But in ECLAC's unforgettable years of triumph, 1950-55, there was no place like it in the United Nations. The annual *Economic Review of Latin America* was a best-seller in the region. In their early postwar phase of modernization, Latin American countries needed the entire knowledge infrastructure of development: ideas, statistics, basic studies and technical assistance. They also needed confidence. Prebisch and ECLAC were able to assist at both levels.

ECLAC's headquarters in Santiago became a center of excitement and creativity, with the region's most gifted economists working themselves to exhaustion for "the great heresiarch." It was the Central Bank model all over again—a chosen elite working within the system—but this time united behind a crusading regional development ethic. The trinity—of doctrine, institution and policy—all converged behind a magnetic and forceful personality. As with the Central Bank, Prebisch combined teaching with ECLAC's other work, offering special courses as early as 1951 for promising young economists throughout the region. Eventually formalized in 1961 into the Latin American Institute for Economic and Social Planning (ILPES), the effect was to convert ECLAC into an influential and energizing training forum, with participants and adherents in every country of Latin America.

The vision worked even better within the United Nations system than it had in Argentina. The "island of rationality" model was ideally tailored for its emerging development mission. By definition, the United Nations functioned by influence rather than by power. Since knowledge-sharing and respect were the basic sources of United Nations leverage, Prebisch's ECLAC model had a powerful legitimizing role within the region, and even beyond. Professionals felt specially chosen; working not just for their own careers but also for the broader cause of development. And all the while Don Raúl was becoming an increasingly important regional personality. Only Dag Hammarskjöld equalled Prebisch in his capacity to project a coherent and compelling United Nations vision to the global community.

Region-building also involved a new vision for the Americas. In the early 1950s, with the U.S. in the grip of McCarthyism and rigid

economic orthodoxy, ECLAC seemed to many a beacon of developmental rationality in the inter-American system. Prebisch was advocating a new approach to hemispheric relations; one based on mutual economic interests, long-term planning, regional integration, new institutions (such as the long-discussed but always postponed IDB), and a more equitable trade policy globally. Previously rejected by Washington as a dangerous radical, he was later accepted as the father of the Alliance for Progress and the Inter-American Committee of the Alliance for Progress (CIAP), both of which he initially considered as models for global as well as regional relations.

Despite a diminished magic that followed his disastrous return as Special Adviser to the post-Peron military government in 1955-56 to draft an economic recovery plan for Argentina, Prebisch tried to revitalize Santiago by shifting ECLAC's policy focus. Regional and subregional integration dominated the last half of the 1950s, after which Prebisch was caught up in implementing the Alliance for Progress and the formation of ILPES. At one level the new institute itself, at greater arms-length from Latin governments than ECLAC, reflected Prebisch's growing impatience with ECLAC's intellectual lag and the consequent need for conceptual innovation. By 1957 strong internal disagreements within Prebisch's core ECLAC team had already surfaced. In 1961, and even more specifically in his 1963 Mar del Plata farewell address to ECLAC—based on his new study *Towards a Dynamic Development Policy for Latin America*—Prebisch shifted ground considerably. He now spoke of institutional weak points in the region (feudal social structures, inequalities in income distribution, and a lack of genuine commitment to economic planning, among others) that went well beyond ECLAC's familiar external constraints.

### ***UNCTAD: Global Challenge and Fatigue***

Before he could begin his ILPES work in earnest, Prebisch was offered an opportunity to reformulate his vision of development at the global level. U Thant's invitation for Prebisch to head the UNCTAD Preparatory Committee in early 1963 coincided with another significant turning point; this time a North-South dialogue in which global development would seek to join the Cold War as a priority item on the agenda of the United Nations General Assembly.

The elements for one more of Prebisch's "historical moments" seemed present. International trade had become the dominant issue at the United Nations. The potential constituency was there in the General Assembly, as the G-77 began to coalesce behind the leadership of several

important developing countries. Latin America was a powerful base. In the U.S. there was a newly-committed generation, led by young and forceful President Kennedy who seemed sympathetic to the concept of Third World development. And UNCTAD's ethical dimension of a more just North-South order would prove irresistible to many committed economists who would flock to this new, and last, Prebisch team.

Indeed, Prebisch's first three years of UNCTAD captured some of the same quality of teamwork in earlier ECLAC years. The 1964 Geneva Conference created a permanent organization; UNCTAD was in the headlines—an intellectual counterpoint to the GATT in which developing countries placed less hope for results. Moreover, there were signals (for example, from George Woods in the World Bank) that important multilateral reforms were possible.

Yet by 1966 Prebisch was frustrated and blocked. And the obstacles facing him multiplied as UNCTAD II—inaugurated in New Delhi during February, 1968—failed to achieve even his minimal expectations. Prebisch was not only physically exhausted from spreading the gospel of UNCTAD, but he was also bereft of the conceptual vision he always required to sustain him in his work. UNCTAD's implicit theoretical underpinnings, adapted from ECLAC, were no longer persuasive. The institutional mechanism he had created in Geneva was not working either. To be successful it required a constituency united behind a coherent vision. In fact the G-77 was in disarray, and Latin America was in crisis. UNCTAD's achievements were therefore entirely unsatisfactory; this time the Prebisch trinity—his vision—had failed.

### ***Theory: The Need for Renewal***

Although Prebisch's concern for theoretical renewal preceded the creation of UNCTAD, it was to be expected that ECLAC's intellectual inheritance would carry over to the new global body. UNCTAD was basically a Latin American creation, with Prebisch in charge of drafting its basic document (*Toward a New Trade Policy for Development*) containing the conceptual core of the inaugural 1964 founding conference in Geneva. But the trade gap concept—the central element in Prebisch's report to UNCTAD I—seemed almost too derivative to excite much theoretical interest among leading economists. Instead it served mainly as a call to action by the three main contending parties—the developed North, the developing South, and the centrally planned East—which had already chosen their premises and general negotiating positions regarding international trade.

The trade gap concept was poorly received by the OECD countries. Prebisch maddened his critics with his reaction to their demand

for greater empirical work on the \$20 billion Third World trade gap estimate contained in his Report, saying "These are the people who do not notice it is raining because they cannot measure the quantity of rain that falls at any particular moment." And while the Prebisch Report at Geneva criticized developing countries along the lines of the Mar del Plata speech a year earlier, he was denounced for trying to be their prophet.

It is not surprising that the UNCTAD years stand out as his most theoretically barren. If the trade gap concept of 1964 was vulnerable, the core concept of his 1968 report to New Delhi (*Toward a Global Strategy for Development*) was basically a reformulation of the CIAP strategy elaborated five years earlier. From the first, Prebisch and the UNCTAD Secretariat were on the run. Denied a deputy, Prebisch's schedule was simply overwhelming.

Immediately after the three-month Geneva Conference ended in June 1964, Prebisch engrossed himself in the design and approval by the General Assembly of UNCTAD's administrative structure, and the subsequent organization of his new Secretariat in Geneva. By then, planning for UNCTAD II—scheduled for New Delhi during February and March 1968—dominated the Secretariat's work. And his insistence on concrete results at UNCTAD II meant that the research agenda for his staff would focus around those few specific items (especially supplementary financing, international commodity agreements, and a generalized system of preferences) which had emerged in 1964 as potential areas of future North-South consensus.

By mid-1966, when negotiating progress on virtually all priority UNCTAD items had fallen victim to the North-South malaise, Prebisch's discontent with both the North and the South accelerated (the Soviet Bloc countries having by then been relegated permanently to the margin). The idealism of the North, and there had been more than he had expected at Geneva, disintegrated under the onset of major political and economic crises in virtually every industrialized country, most notably in the U.S. due to its Vietnam involvement.

But among many developing countries he also observed a growing irresponsibility: the willful abuse of the trade gap concept. Many such countries had continued using the familiar criticism of external unfairness, while conveniently avoiding internal problems—such as the reform of irrationally-applied policies of import substitution. These policies, far from making economic sense, were driven by special demands of privileged groups to avoid competition from abroad.

Prebisch was upset with himself. He had seen this happen in Argentina during the mid-1950s. He had seen it in other Latin American countries before 1963. Both his friends and his critics had warned him

of the potential excesses of import-substitution industrialization. The difference now was the incontrovertible evidence from Southeast Asia, where Taiwan, South Korea, Hong Kong and even newly independent Singapore, had fashioned far more dynamic economies than their Latin American counterparts. Their states also pursued strong leadership roles, but they had chosen more open export-oriented strategies. In Latin America he saw the glimmering of export-competitive industries in some new manufacturing sectors, particularly in Brazil and Mexico, but he was worried about a lack of dynamism for the region as a whole. Yes, the region was growing, but not like Southeast Asia. Relatively, the Latin American region was falling behind.

Contrary to the trade gap concept, world trade was booming. As Prebisch realized this, he now spoke less of the trade gap and more about a savings gap. He now felt that his previous writings were too narrow in approach; he was unhappy about the theoretical void into which he had wandered. Observers, both friendly and hostile, were surprised by his criticism of the new United Nations Industrial Development Organization (UNIDO)—on this both Prebisch and the GATT could agree—for its uncritical support of import-substitution industrialization.

Conditionality—the prerequisite for developing countries' access to economic resources from the North—became more definitive in his prescription for a global development strategy. Only those Third World governments truly committed to development—as determined by a CIAP-type process of evaluation by neutral experts—should expect significant resource transfers from the North. At New Delhi, Prebisch was brutally frank. “Converging measures,” to be taken simultaneously by developing and developed countries, were, he said, “a vital aspect of global development.” But international cooperation, he added, “will be largely wasted” unless developing countries realized that the prime responsibility for action rested within their own borders. He went on to emphasize that “...this policy of internal development makes it absolutely necessary for developing countries to undertake, with determination, a series of internal transformations of their structures and attitudes, where this had not already been done. And it also requires them to adhere to the discipline of a development plan; to spur on their reciprocal trade by means of regional and sub-regional groupings aimed at economic integration; and to promote interregional measures for the expansion of trade.”

### *Disunity in the G-77*

The second element of the Prebisch trinity was organization. If UNCTAD was to be an effective new mechanism after 1964, success in building

the foundation for a new world order would depend on the unity and momentum of the G-77. It was, as Prebisch put it, "an open struggle." Power relations rather than rhetoric were, in the final analysis, what determined the rules of the game in international trade. Thus, unless the G-77 could develop the same degree of consensus on overall objectives (however much they might disagree on detail) as had the Group B countries which controlled the GATT (all of them united institutionally by the OECD), UNCTAD would remain forever at the margin in the sense of influencing world trade policy.

It was a Faustian bargain. Prebisch needed the G-77, but cohesion of the G-77 depended on their obtaining concrete and visible results from UNCTAD. De facto, therefore, Group B controlled the UNCTAD agenda. Still, Prebisch had no option. UNCTAD had to be Third World in orientation, despite OECD charges that United Nations civil servants should not "take sides" in international organization activities. Prebisch agreed that the UNCTAD Secretariat should be objective and impartial but not necessarily neutral. Why single out UNCTAD on grounds of "bias" and not do the same for the IMF, World Bank and GATT? True, the UNCTAD Secretariat was supportive of southern perspectives, but the civil servants of the two Bretton Woods institutions (the IMF and World Bank) and GATT followed the economic ideology and shared the policy objectives of the Group B countries that controlled the voting structure of those three powerful organizations. Prebisch saw no contradiction in all this, saying "The UNCTAD Secretariat cannot be any more neutral on development problems than the World Health Organization (WHO) Secretariat can be neutral on the drive to eradicate malaria." Thus he viewed the charge of "bias" as missing the point. He was presenting a brief for the weak. However unequal the international power relations might be, he had no option but to gamble on the G-77 and seek to deflect the OECD's inevitable opposition after UNCTAD I. He hoped the Group B countries would eventually recognize that their own long-term interests would be furthered in a more equilibrated world economy, and hence would accept a greater degree of multilateralism in global economic management. Thus he tried to convince them that "mutual benefits" could result from "converging commitments."

But even UNCTAD I had demonstrated the inherent weakness of this first-ever attempt by the Third World to attain tactical solidarity. The G-77 was sorely divided by geographic differences, by intraregional rivalries, by levels of development, and by an overall lack of commonality of purpose. In this regard, Prebisch's strategy in preparing for UNCTAD II was the same as the build-up to UNCTAD I: that is, to consolidate his core block of support in Group C (Latin America) and

then move forward with key allies in Group A (Asia, Africa and Yugoslavia).

This effort to unify the G-77 countries behind an agreed negotiating position for New Delhi met with some success in the Charter of Algiers, following their meeting of October 1967. Unlike some later polemical G-77 declarations, the Charter of Algiers was carefully molded by Prebisch for effectiveness. It was sober in tone, and moderate and business-like in its principal recommendations covering trade in commodities and manufactures, and in development finance.

Prebisch's dilemma, however, was that the G-77's bargaining power and unity at New Delhi were less, not greater, than in 1964, despite the surface show of unity in the Charter of Algiers. Differences among developing countries had grown. Established regional powers such as Brazil or India, with diversifying economies and complex international economic agendas, viewed UNCTAD as merely one foreign policy tool among many. They shared little with their less developed G-77 colleagues, including some immediate neighbors. Regional rivalries had increased, not fallen since 1964. Latin America feared that EEC trade initiatives for newly-independent African countries would give the latter unfair advantages. The 1967 Arab-Israeli war had diminished the role of Egypt, a key UNCTAD supporter in 1964. The war in Vietnam was poisoning G-77 relations (the South Vietnam delegation was held under house arrest in Algiers "for its own protection" while the Charter was being formulated, and had to be rescued personally by Prebisch, who then escorted it to the airport). The Tet offensive, spelling the beginning of U.S. defeat in Vietnam, occurred two days before Prime Minister Indira Gandhi opened UNCTAD II. Given all these circumstances, short-term expediency prevailed unequivocally over long-term mutual interests at the conference.

Prebisch had traveled 600,000 miles between 1964 and 1968 to build his constituency for UNCTAD II. But the complexity of the task was beyond him. GATT brilliantly exploited latent divisions within the G-77, playing on the self-importance of the more-advanced tier of developing countries in each geographic region. And all the while Group B delegations at New Delhi remained unyielding—stiffened in their recalcitrance by the end of the Kennedy Round of GATT negotiations in 1967.

### ***Latin America and the U.S.***

The G-77 region that concerned Prebisch most was Latin America. Although the gathering crisis in Latin America and the serious erosion of inter-American relations in the preceding years had serious implica-

tions for UNCTAD, Latin America was Don Raúl's life. Its problems affected him with a visceral immediacy that transcended Geneva and the G-77. They were another reminder that the Prebisch vision was in trouble.

ECLAC was no longer a regional leader—an ill omen for UNCTAD II.<sup>6</sup> Before the first conference in 1964, ECLAC had played a key role in designing UNCTAD's future shape and in the pre-conference caucusing that culminated in its eventual success. Indeed, Group C was so prominent during UNCTAD I that Afro-Asian delegations worried that their interests might be submerged by this organized Latin bloc.

The contrast between Geneva and New Delhi could not have been more marked. Latin American solidarity had so diminished after UNCTAD I that the split between Prebisch and the Brazilian delegation was the subject of constant corridor chitchat during the 1968 conference. Already evident by the final months of the 1967 Kennedy Round negotiations, Brazil was "playing on two pianos"; in GATT as well as in UNCTAD. In this it was not alone among the G-77. In addition, the tense standoff between Brazil and Argentina, in the general context of a fading impulse toward regional integration and a quickening descent into military dictatorships, seriously weakened Latin America's leadership role in UNCTAD II.

The deterioration in U.S.-Latin American relations preoccupied Prebisch. His earlier hopes for a unified Latin America within a healthy inter-American system were gone by 1968. As late as 1963-64 there had been some promising signs of progress, such as the creation of CIAP at the November 1963 meeting of the Inter-American Economic and Social Council. There was a brief revival of confidence about the Alliance when the new CIAP machinery was finally established. However the U.S. invasion of the Dominican Republic in 1965 signaled a

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<sup>6</sup>According to Prebisch, ECLAC had "paved the way for the creation of UNCTAD." In November 1963, CECLA (the Special Coordinating Committee for Latin America) was created as a special institutional mechanism for evolving a common Latin American trade policy, with ECLAC acting as its Secretariat and guiding hand. In January 1964 CECLA organized a meeting of experts which Prebisch attended and where he gave the lead paper. A month later, at ECLAC's Committee of the Whole, a position paper for Geneva was accepted in principle. CECLA then met in Alta Gracia, Argentina, for a final strategy discussion and as a show of Latin solidarity.

The decline of ECLAC was symptomatic of Latin America's problems in the mid-1960s. By 1965, effective collaboration between ECLAC and its inter-American economic partners, the OAS and IDB, had collapsed. Shortly thereafter, the Tripartite Committee—the backbone of the drive for a regional development strategy—was formally wound up. ILPES was not fulfilling its original expectations as an exciting new center of ideas to re-inspire the region. Without a strong ECLAC, the Group C countries in UNCTAD had effectively lost their Secretariat and momentum, even if CECLA would continue to convene periodic meetings.

return to hegemony rather than to partnership. The new U.S. policy cycle was advancing relentlessly as the latent premises of the 1969 Rockefeller Report were taking hold in official Washington. Geopolitically, U.S. attention was now tightly riveted on Southeast Asia, where the military build-up in Vietnam had begun in earnest. Latin America was being marginalized in U.S. foreign policy, and would remain so for two decades.

The first casualties of the growing divide between Latin America and the U.S. were the OAS, CIAP and the Alliance for Progress. In April 1966, CIAP's Panel of "Nine Wise Men" was downgraded to a technical group, destroying the autonomy that had been the rationale for its creation in 1961, and UNCTAD's prospects were also adversely affected. Not only did all this imply a hardening of Washington's attitude toward North-South issues, but it also undermined Prebisch's model for conditionality at the global level. For Prebisch, the CIAP process (particularly its Panel of "Nine Wise Men" designed to provide an objective evaluation of development plans as a demonstration of commitment to internal reform and hence as a precondition for assistance) was the most logical basis for ensuring successful North-South cooperation. How could this model possibly be accepted at New Delhi if it had failed in the Americas?

By autumn, 1968 Prebisch's frustration came to a head. He had renewed his UNCTAD contract for three years at New Delhi, but by late summer realized that his last big United Nations mission was over and that he had to leave. Some close friends and observers disagreed. UNCTAD, they maintained, was indeed a success but Don Raúl expected too much too soon. By normal United Nations performance criteria—such as the gradual inculcation of new concepts and standards, the educative function exerted through quality reports and expert-group meetings, and the adoption of limited but important measures such as trade preferences and shipping legislation—UNCTAD could become a new and important member of the multilateral economic community. But these were not Prebisch's standards for success. UNCTAD for him had to be a negotiating forum rather than just another United Nations consultative body. It could not be merely the G-77's General Assembly to the GATT's Security Council. Don Raúl had to have a mission, not merely a job. It was the end of the line.

In October, during a trip to the U.S., Felipe Herrera invited Prebisch to undertake a fundamental reexamination of Latin American development in the light of the changed international circumstances since the creation of the Inter-American Development Bank one decade earlier. Increasingly the IDB stood out as the authoritative voice and instrument of Latin American development. Prebisch agreed, opening a

new phase of his life in which *Change and Development: Latin America's Great Task* was the first major product.

### **Conclusion: The Enduring Legacy**

One analyst, seeking to explain the paradox of Prebisch's multiple images, emphasized the fact that "New ideas never have a single meaning in all settings. The meaning and acceptance of new ideas derive not only from their substantive content but also from the nature of *the political and ideological context into which they were introduced*" (our emphasis). Another analyst, after noting how differently Prebisch was viewed by different actors during his lifetime—sometimes positively, sometimes negatively—concluded that "Prebisch's influence on economic thought and policy has been diffuse and *the final impact of his writing is still in process*" (our emphasis). We agree with these judgments, and have attempted in this paper to provide some of the historical context surrounding the substance of Prebisch's trinity of theory, machinery and policy—a task that, to our knowledge, no one else has yet sought to undertake. In so doing, we have emphasized the unity of his life and work rather than the multiple images surrounding it. But we fully agree that the longer-term implications of the Prebisch image still remain to be fully and fairly assessed.

Raúl Prebisch was a complex and controversial man—intellectually challenging and iconoclastic. In consequence, strong and often bitter criticisms were constantly leveled against Prebisch throughout his long and variegated life. In Argentina, those criticisms arose because of his early consultancy assignments with the Argentine Rural Society; his short stint as Under Secretary of Finance with President Uriburu; the charge of British imperialism leveled against him resulting from the Roca-Runciman negotiations and the role played by Sir Otto Niemeyer in establishing the Central Bank; and especially because of the powerful impact of the public policies he designed and implemented during the 1930s and 1940s. After his move to ECLAC in 1948, Prebisch was accused of various types of theoretical and policy misdirections: industry at the expense of agriculture; the state at the expense of the market; and external constraint at the expense of domestic macroeconomic balance. In UNCTAD, during the 1960s, the latter criticisms were repeated and further embellished by the charge of "pitting the North against the South" in a rigid and adversarial relationship. He vigorously defended his position against all these charges, as did his many supporters, but there is little doubt that he was one of the most contentious Third World personalities to enter the international development arena during the past half century.

Given the manifold changes in the last decade however, the continuing debate about the relative weight of Prebisch's ideas as opposed to the institutions and policies associated with Prebisch's enduring legacy, and their relevance to the current economic environment, has taken on something of an antiquarian character. However, the biographical approach we have selected does permit the identification of certain underlying factors which help explain the continuing importance of his life and work at the current turning point in Latin American economic development. These factors include, among others:

*Intellectual Autonomy:* Prebisch insisted that Latin American economists maintain intellectual autonomy in analyzing post-war development in the region. Having learned from experience the lessons of unreflective acceptance of orthodoxies from abroad, he found in ECLAC the instrument for this task of elaborating an indigenous development paradigm appropriate for the 1950s. Although a tiny organization at that time, ECLAC's essential achievement was to provide balance and restore confidence to the post-1945 debate about development in Latin America. Prebisch's caution that Latin American economists maintain intellectual autonomy—warning Latin policy makers not to stampede without adequate research, including analytic models out of favor in developed industrial countries—is perhaps the most enduring lesson to be derived from his life experience. Today once again, as in the immediate aftermath of World War II, the Americas are facing a period of profound reorganization. Once again the pace of events threatens to outrun research and model-building.

*Praxis and Theory:* Prebisch was a “classic” thinker, but not a traditional intellectual in his style of work or writing. Essentially a self-taught economist, he was immersed in policy formation and institution-building early in his long career. Hence his *modus operandi* differed fundamentally from scholarly work in universities. Because of this rare unity of theory and practice, he aimed at practical results, and, more than many of his followers and protagonists, he remained constantly open to change and new ideas. *Change and Development: Latin America's Great Task* is an example of his constant intellectual evolution. The phenomenon that preoccupied him—power in international relations—remained his point of departure, but Prebisch was not a hide-bound dogmatist.

*Symmetrical Obligations:* Born between cultures, and from a provincial society, he brought the perspective and natural balance to his professional career that derives from understanding competing perspectives. He did not flinch from challenging conventional wisdom but his goal was peaceful coexistence, not unconditional surrender. He did not hold that—in the intellectual jousting between neoclassicists, structur-

alists and dependency theorists—one side was right and the other side was wrong. In the longstanding debates over the respective roles of the public and private sectors, he did not come down unequivocally on one side or the other. On the contrary, he recommended their judicious merging so that economic efficiency and social justice could be simultaneously attained. In United Nations debates over the relative priorities to be attached to international policies of cooperation and domestic structural adjustments, he argued consistently in favor of symmetrical obligations: i.e., that both developing and developed countries make “reciprocal commitments for reciprocal benefits.”

*Development as Vocation:* Prebisch was fundamentally committed to global development, which he increasingly saw in ethical terms; i.e., of economic equity. In this sense he was an advocate for the weaker partners in the international economic system. He was not neutral. Critics point out that he never developed an adequate theory of the state and that his approach to social change was incomplete. Indeed in the last stage of his career, following the completion of *Change and Development* and subsequent resignation as Director General of ILPES, he became more prophet and teacher than theorist. But Prebisch’s astonishing capacity to convince and lead—his basic belief in the capacity of dialogue to change events—remains an alternative vision to the prevailing cynicism in North-South relations.

Prebisch was too large and multifaceted an individual for easy categorizing and labelling. Hopefully, however, the present essay examining his career up to 1971 will help in deciphering his contentious, important and continuing legacy.

## COMMENTS ON “RAUL PREBISCH: THE CONTINUING QUEST”

Hans Singer<sup>1</sup>

Let me first of all pay a tribute to the quality of this paper and to the insights it has provided for me into the work of Raúl Prebisch and the “Continuing Quest” in appreciating the impact of his life and work. Perhaps what I can do is to supplement this paper, from the point of view of somebody outside Latin America who has been deeply influenced by Don Raúl.

My links with Don Raúl are twofold: I tried to share his continuing quest for a better world order within the same framework of the United Nations, although not in ECLAC and UNCTAD but at the center in New York. It has often struck me as paradoxical that Prebisch, whose thinking was so central in understanding development problems, should have been at the periphery of the United Nations system—in Santiago and in Geneva—whereas I who considered myself peripheral to Prebisch in development thinking should have been at the United Nations system’s center in New York. My second link refers to my membership in the Sussex Institute of Development Studies (IDS) and my close comradeship with Dudley Seers, its founder. Dudley Seers of course was a direct disciple and associate of Don Raúl in the early golden period of ECLAC. His insight derived from Raúl Prebisch—that the general body of economics unconsciously based on conditions in the rich countries of the center represented only a “special case,” whereas the development economics so brilliantly focused on by Prebisch and ECLAC represented the general case and the true body of economics—was the inspiration for the early work of the IDS. If I have any criticism of the paper it is perhaps that by concentrating on the role of Raúl Prebisch and his continuing quest within the context of Latin America, it may lead readers to underestimate his tremendous impact much beyond this regional context.

As someone under the strong intellectual influence of Keynes, I was struck by some of the similarities between Keynes and Prebisch. The paper describes how, under the influence of the economic and political breakdown of the 1930s, Prebisch was confronted “with the hard decision of participation versus withdrawal” and how he tried in response to “construct an island of rationality and influence.” The same could be said

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of Keynes. After the fiasco of the World Monetary Conference, Keynes was faced with the same option of withdrawal into the congenial academic life of Cambridge and the Bloomsbury Group, or engaging in the hard task of constructing a heretical system designed not only to understand but to change the contemporary world. He also constructed an island of rationality and influence in Cambridge where, surrounded by gifted disciples, he first provided an intellectual basis for a better country, with full employment and a social welfare state, and then for a better world in his preparation for and dominating influence on Bretton Woods. Both men had the quality of the born intellectual leader to inspire their followers with a strong sense of loyalty and exhilarating achievement. On my first visit to CEPAL—I believe in 1950, greeted at the airport by Celso Furtado—I was immediately struck by the parallels between the atmosphere at CEPAL and the Cambridge of the 1930s, and the similarity in the central role and radiating influence of their respective central figures.

Prebisch's trademark of the 1950s and 1960s—the "Prebisch Thesis" of deteriorating terms of trade for exporters of primary products—provides yet another link with Keynes, one not often realized. Keynes was also deeply concerned about the instability of primary commodity prices and the weak and unstable structure of primary commodity markets. He considered this a major threat to the stability of the world economy and already before World War II in 1938 he had advocated in an important article in the *Economic Journal* measures towards commodity price stabilization. He followed this up even more strongly in the preparations for Bretton Woods and the Bretton Woods negotiations themselves. He proposed, in fact, a world currency based not on gold, dollar, pounds sterling or SDR, but on 30 primary commodities whose average price would thus be automatically stabilized. However, his idea, like other more modest proposals for commodity prices stabilization, proved to be too utopian and unacceptable to the U.S. negotiators and the U.S. Congress. Keynes was strongly in support of the establishment of the International Trade Organization (ITO), which he considered an essential pillar of the Bretton Woods system and which would have had the major function of maintaining and stabilizing primary commodity prices. This also proved to be unacceptable to the U.S. Congress.

Keynes also proposed that countries in balance of payments deficit—and the primary product-exporting countries of the periphery were assumed to be in this position—should benefit from an automatic compensatory capital transfer financed by a tax (of one percent a month) on the balance of payments surpluses of surplus countries. In creating UNCTAD, Prebisch picked up some of Keynes' proposals at Bretton Woods, particularly with his two minor success stories of initiating the IMF Compensatory Financing Facility (CFF) and the Integrated Pro-

gramme for Commodities (IPC), which resulted in the vastly underfinanced Common Fund.

Like Keynes, however, Prebisch's enlightenment could not prevail against the strong political forces of conservatism and the established order suspicious of such innovative ideas.

The Prebisch Thesis of deteriorating terms of trade and unequal distribution of benefits from trade led to a passionate debate which even today shows no sign of dying down. Unfortunately, this debate has been largely in terms of whether or not there is a long-term downward trend in the barter terms of trade of primary products versus manufactures or developing countries versus industrial countries. With the experience of the 1980s added, the weight of evidence and opinion is gradually shifting towards support of the Prebisch Thesis. Even the IMF and World Bank, much as they ideologically detest Prebisch and his thesis, are now uttering dark warnings about the weakness of primary commodity prices and poor prospects for the 1990s, as well as the deteriorating terms of trade of Latin American and African countries under debt pressure. This is in marked contrast to their previous over-optimistic projections of commodity prices and policy advice largely based on such over-optimism. I do not, however, think that Don Raúl would have been happy at this belated vindication!

In any case the statistical debate on barter terms of trade has tended to divert attention away from what is really the core of the Prebisch Thesis, i.e., the question of double factorial terms of trade, differential increases in productivity in the center and periphery, and the unequal distribution of gains from technical progress as a result of different structures of labor markets and commodity markets in the center and periphery.

One point on which I would take issue with the paper is on the question of the "trade gap." The impression is given that Prebisch realized that he had been wrong about the trade gap and that this realization led him to criticize the new UNIDO. It is true that Prebisch realized he had been too pessimistic about the growth of world trade in general, and hence had put too much emphasis on import substitution and not enough on export promotion. It is also true that Prebisch, as clearly indicated in his keynote speeches in the early years of UNCTAD, hoped that exports of manufactures from developing countries, especially Latin America, would not only help to plug the trade gap, but would also solve the problem of deteriorating terms of trade. (In this latter assumption he turned out to be wrong, as I have argued in various recent articles.<sup>2</sup>)

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<sup>2</sup>See P. Sarkar and H. W. Singer, "Manufactured Exports and Terms of Trade Movements of Less Developed Countries in Recent Years (1980-87)," Institute of Development Studies, *Discussion Paper 270*, November 1989.

However, he was not really wrong about the trade gap. This exists only too visibly in the form of a North-South trade gap. That is indeed the “black box” of the world economy. It is an anomaly unexplained by conventional trade theory that the 80 percent of mankind living in the periphery do less than 10 percent of world trade with each other, whereas the 20 percent of world population residing in the industrial countries do 60 percent of world trade with each other. If that trade gap were filled we could certainly forget about export pessimism!

I was struck by the references in the Dosman-Pollock paper about Don Raúl’s move toward the involvement of neutral experts or a “Panel of Nine Wise Men” in the process of evaluating commitments to internal reforms and hence a precondition for external assistance in developing countries. This is a suggestion which has also been made by others as a method of improving the negotiating process in connection with structural adjustment programs. The present method of negotiation is deficient and unsatisfactory, and is now increasingly recognized to be so. The idea of three-week IMF or World Bank missions from Washington sitting across the table from officials of Ministries of Finance or central banks is not the best way to tackle the problems of the real economy and the social as well as economic concerns of people. The interposition of neutral experts, preferably familiar with the economies of the adjusting countries, should be seriously considered with the added weight of Prebisch’s posthumous advocacy. There could be no better tribute to him than seriously considering this suggestion now.

One of the worst obstacles to economic development with which we now struggle in the aftermath of the “lost decade” is the climate of ideology in which the respective roles and interactions of markets and governments are being discussed—and not only discussed but also decided! The paper reminds us that “regarding the role of the state versus the play of market forces, Prebisch...sought a balance and the avoidance of extreme positions.” Yet “extreme positions” is exactly what holds sway today, with the balance of power presently favoring the role of the market, to the neglect of market failures. This present imbalance and “extreme position” also throws much of the burden of adjustment on the weaker elements of the world system, whereas Prebisch, as the paper reminds us, sought a more widely shared burden of international adjustment. The present catchword of “good governance” is not a substitute for the proper balance which we must achieve. Prebisch’s work and ideas can help us fill it with real meaning.

The paper rightly emphasizes Don Raúl’s enduring hope that the industrialized (Group B) countries “would eventually recognize that their own long-term interests would be furthered in a more equilibrated world

economy and hence that they would accept a greater degree of multilateralism in global economic management." This still remains a hope today. Global economic management is effectively in the hands of the G-7, the group of major industrial countries. It is in this exclusive club that matters of vital interest to the developing countries are decided, such as exchange rates, control of inflation, rates of growth, rates of interest, the GATT round, protectionism, agricultural policies, etc. Yet there is no representation of the developing countries—nobody who (in the words of Julius Nyerere) "speaks for the world." Even the modest proposal that the United Nations Secretary-General should participate as a spokesman for "the world," has not so far proved acceptable. The communiqués of the G-7 are eloquent testimony of the subordinate role which problems of the periphery play in their deliberations.

The only trace of multilateralism in global management is the unreserved backing which the G-7 gives to the IMF and World Bank. But this is more a multilateral fig-leaf than reality. The reality is not so much that the G-7 backs the IMF and World Bank, but rather that it uses these institutions as its instrument. It is safe to back the IMF and World Bank because the G-7 can be sure that the IMF and World Bank backs the G-7. Meanwhile, the United Nations is eliminated from that role in global economic management which the original Bretton Woods arrangements and charters of international organizations had foreseen, and which Raúl Prebisch tried to restore in his work for CEPAL and UNCTAD.

May I conclude this comment with some more personal and autobiographical remarks? Having joined the United Nations in early 1947—two years before Raúl Prebisch—I left the United Nations' service on the very same day as he did, at the end of March 1969, and for very similar reasons. Without making undue comparisons, I too felt the need to return to a less bureaucratic and more academic atmosphere, to refresh ideas and express myself more freely. Raúl Prebisch's ILPES was my IDS. I would have left the United Nations earlier, during the dark days of McCarthyism, if it had not been for the support, encouragement, and example of the two men at the United Nations outposts (using the centralist language of New York) whom I admired so much: Raúl Prebisch in Santiago and Gunnar Myrdal in Geneva.

My initial bond with Raúl was of course our common convictions and virtually common views regarding terms of trade. Having been preconditioned by the collapse of commodity prices in the Great Depression of the 1930s and by Keynes' view on the need for price stabilization and commodity buffer stocks, I was struck by the fact that, judging by British terms of trade data, the long-term trend of terms of trade for exporters of primary products and importers of manufactures seemed to

be downward and not upward, as postulated by the classical economists.<sup>3</sup> It was Folke Hilgerdt, the Swedish economist and statistician who produced the League of Nations studies on “The Network of World Trade,” who first mentioned this long-term data source to me and expressed puzzlement about its behavior. It was then that I wrote one of my first major research publications for the United Nations on “Relative Prices of Exports and Imports of Underdeveloped Countries,” which was fortunate enough to catch Don Raúl’s eye. Meanwhile, independently I had worked on my own interpretation of the results of this study and presented it as a paper to the annual meeting of the American Economic Association in New York in December 1949—again practically to the day coinciding with Prebisch’s own CEPAL studies on *The Economic Development of Latin America and Its Principal Problems* and his 1949 *Economic Survey of Latin America*. As Raúl Prebisch told me on one occasion, he considered me a Latin American at heart. This was before President Kennedy went to Berlin to declare “Ich bin ein Berliner.” So perhaps on this occasion I may say: “Ich bin ein Lateinamerikaner!”

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<sup>3</sup>I make this last comment with some reservation, since I believe the views of Adam Smith are perfectly compatible with the Prebisch Thesis if they are interpreted as projections of factorial terms of trade rather than barter terms of trade, and if they are translated from the sphere of internal towards international terms of trade.

## PREBISCH'S GLOBAL VIEW

Celso Furtado<sup>1</sup>

From a theoretical point of view, Raúl Prebisch's greatest contribution was the idea of a structural rift in the international economy caused by the slow spread of technical progress and kept in place by the system of international division of labor framed at the inception of the industrial revolution. External trade was not viewed as a simple extension of the domestic economy but considered to have a dynamism of its own.

In a late synthesis of his theoretical works,<sup>2</sup> he referred to the earlier ideas of a system of international economic relations that he had named the "center-periphery system," which had arisen as a by-product of his reflections on the cyclical fluctuations that occur in international activities. It seemed to him that the cycles originated in the economies of the industrialized countries and then spread to the international sphere. In that process of spreading, the countries specializing in the production and export of primary commodities behaved in a "passive" manner.

His reflections on the spread of the cycle led Prebisch to perceive that the international division of labor had arisen primarily to serve the interests of the countries in the vanguard of the industrialization process. "The countries producing and exporting raw materials were thus linked with the center as a function of their natural resources, thereby forming a vast and heterogeneous periphery incorporated into the system in different ways and to different extents."<sup>3</sup>

This global view of the international economy formed the starting point for the theory of underdevelopment which dominated Latin American thinking after World War II. For Prebisch, underdevelopment stems from "the concentration of technical progress and its fruits in economic activities oriented towards exports," giving rise to heterogeneous social structures "in which a large part of the population remains on the sidelines of development."<sup>4</sup>

Prebisch limited his explanation of the "center-periphery" view to the structural imbalances caused by the slow spread of technical progress,

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<sup>2</sup>R. Prebisch, "Five Stages in My Thinking on Development," in *Pioneers in Development*, G. M. Meier and D. Seers (eds.), a World Bank publication, New York, Oxford University Press, 1984, p. 175.

<sup>3</sup>*Ibid.*, pp. 176-177.

<sup>4</sup>*Ibid.*, p. 177.

which he claimed were responsible for the long-term downward trend in the terms of trade of commodity-exporting countries. In his classic text of 1949,<sup>5</sup> however, Prebisch strove to construct the nucleus of a dynamic theory of the international economy on the basis of his “center-periphery” view. He started with a critique of the current theory of balance of payments imbalances, which was a mere extension of the quantitative theory of money, considered in this case as being a good with unlimited demand (gold). Prebisch denounced the static nature of this theory, which merely registers the fact that “each disturbance represents a transition from one period of equilibrium to another.”<sup>6</sup> In his criticism, however, he went further, noting that the prevailing theory might have had some validity when the center of the capitalist economy was the United Kingdom. The profound integration of that country into the system of the international division of labor, given the high degree of openness of the British economy (its import coefficient averaged over 30 percent between 1870 and 1914) meant that the United Kingdom had a considerable capacity to respond to external stimuli. In consequence, its exports “fulfilled a dynamic function similar to that of capital investment.”<sup>7</sup> If other industrialized countries stimulated their economies and increased their imports from the United Kingdom, the stimulating effect on the latter was felt immediately, so that British imports grew rapidly too. Thus, there was no tendency towards an accumulation of gold reserves by the then principal center.

According to Prebisch, this situation underwent a radical change when the United States took over the function of the principal center of the international economy, since its import coefficient was extremely low. If the cyclical reactivation began in the United States, then the external inductive power generated by that country’s imports was only small; if it began in another industrial economy, then the response of the U.S. economy was extremely slow. This unfavorable situation for the peripheral economies—which depend on external impulses for their growth—was rendered still more adverse by the constant downward trend in the U.S. import coefficient, which sank from 6 percent in 1925 to 3 percent in 1949.

For Prebisch, the world economy is not just a structure that reproduces itself, but rather a system that registers cyclical expansion under the influence of the spread of technical progress. Departing from

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<sup>5</sup>See ECLAC, “Growth, Disequilibrium and Disparities: Interpretation of the Process of Economic Development,” *Economic Survey of Latin America 1949* (E/CN. 12/164/Rev. 1), Part I, New York, United Nations, January 11, 1951.

<sup>6</sup>*Ibid.*, p. 38.

<sup>7</sup>*Ibid.*, p. 36.

the traditional approach, which sees external trade as a mere prolongation of domestic productive activity—a bartering of surpluses which makes it possible to increase productivity of the relatively most abundant factors—Prebisch assigns a dynamism of its own that depends on the linkages between the central economies and the efficiency with which the principal center carries out its regulatory functions.

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

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

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

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

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

In the period from the end of the Second World War to the end of the 1950s, the United States enjoyed a substantial trade surplus on current account which permitted it to finance heavy spending abroad in both the military and investment fields. This was the period of the "dollar shortage."

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

The official suspension of such convertibility took place in 1971 and gave rise to a large increase in the price of gold. The dollar value of reserves held in the form of this metal rose exorbitantly, thus greatly inflating international liquidity. Two years later, the U.S. government definitively abandoned the fixed exchange rate system.

The prolonged overvaluation of the dollar up to 1973 was a major influence in weakening the United States' position. The principal center is the country whose currency serves as a reserve for the whole of the system, a prerogative which naturally demands an exceptionally solid balance of payments current account position.

In the 10-year period from 1973, productivity in the United States grew no more than half the rate of the previous 10 years. Furthermore, the rate of saving dropped from 9.5 percent to 6.7 percent over the same period. Thus, the United States was no longer prepared to exercise the dominant international role that fell to its lot as a result of the Second World War.

The absence of a principal center is a major factor in the great instability observed in the global economy from the 1970s onward, the most striking manifestation of which is the enormous size of the peripheral countries' external debt.

The disorder that took root in the international monetary and financial systems as a result of the excess of liquidity, caused by the crisis of the dollar, was the factor that created favorable conditions for the process of indebtedness of almost all the peripheral countries. In 1973, real interest rates were not more than -2 percent, but the following year they went down to -6 percent, remaining extremely low until the end of the decade. The situation of maladjustment was aggravated in the second

half of 1973 by the abrupt rise in oil prices, which permitted the oil producing countries with little or no capacity to absorb large amounts of financial resources to rapidly build up enormous reserves in the form of certificates of deposit in the international banks.

In 1979, the U.S. government decided to abandon its carefree attitude to inflation and adopted a shock policy of the most uncompromising monetary type. The fact is that the international monetary system is based on the dollar, and Eurodollars are merely a credit multiplier based on dollar deposits outside the United States. The American monetary authorities therefore have the power to influence the international monetary market by manipulating the monetary base in the United States. If the Federal Reserve System authorities raise interest rates, there is immediately a flow of financial resources toward that country, together with a rise in interest rates on the international market.

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

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

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

The relative decline in the growth rate of productivity and simultaneous drop of the rate of savings, which were observed from the early 1970s on, has prevented the United States from playing its role as principal center.

An important indication of the changed situation of the U.S. economy is that, in the last quarter of 1987, interest payments and dividends abroad exceeded receipts under this heading. In 1980, the net external investments position of the United States was positive to the tune of \$106 billion, but from 1985 on the situation became negative. In 1986, U.S.

assets abroad totaled \$1.1 trillion, whereas foreign assets in the United States in the same year totaled \$1.3 trillion.<sup>8</sup>

The problem now facing us is to know how the function of the principal center is currently being carried out. The United States continues to fulfill part of this function, since the international monetary system is still based on the dollar. However, it no longer plays the role of the main supplier of international financial resources, which is now carried out by Japan and Germany. All we need to do is look at the balance of payments current account in recent years. This situation obviously cannot last forever, since it involves the growing indebtedness of the United States. As long as this situation of financial dependence continues, interest rates will continue to be high. The negative consequences of this situation for the highly indebted countries are only too obvious.

In order for the international economy to function properly in the absence of a principal center, it is necessary that the main central countries reach a consensus that can be regulated appropriately. One may wonder whether the appearance of such coordination groups as the G-7 and G-10 countries is not a step in this direction. However, there are only two countries that are really competing for the leadership of the system, and it remains to be seen whether these countries would not prefer to extend the present process of increasing financial dependence of the United States. There would seem to be no doubt that we are moving in the direction of a system of regulation by consensus. However, such consensus will only reflect the will of a few countries, and the relative weight of these nations still remains to be determined. In any event, the possibility of a single economy playing the role of the principal center no longer exists.

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<sup>8</sup>UNCTAD, *Trade and Development Report*, 1988 (UNCTAD/TDR/8), Geneva, United Nations, 1988, p. 68.

## A NEW LOOK AT THE INTERNATIONAL INTELLECTUAL ENVIRONMENT OF THE THIRTIES AND FORTIES

Joseph L. Love<sup>1</sup>

The Dosman-Pollock paper takes a new tack in Prebisch studies by adopting a biographical approach, focusing on the subject's life rather than the details of his intellectual, organizational and economic contributions. The authors succeed in providing new information about their subject, and their work will assume even greater importance when the full biography is published, with the documentation of sources.

My comment returns to the conventional arena for Prebischiana—ideas, policies and historical context. It concerns some ignored or insufficiently appreciated changes in attitude, as well as innovations in economic theory during the two decades before 1949-50, which helped make the Prebisch-Singer thesis possible.

The first matter is the economics of the League of Nations. After 1945 Prebisch made clear his view that “peripheral” nations had counted for little at the League; it is furthermore true that the League's Economic Department from its outset defended free trade orthodoxy and helped supply the rationale and empirical studies for reconstructing the pre-1914 international division of labor. But it is easy to overlook the fact that League studies were sometimes critical of the “central” countries' policies and ultimately provided a milieu in which the accents of Prebisch and Singer would not be totally foreign.

In the late 1920s, Prebisch's Argentina was among the many grain-trading nations experiencing a “price-scissors” problem—a widening gap between industrial and agricultural prices on the world market. The scissors opened farther and cut deeper in the 1930s.

The decline of prices for agricultural commodities relative to those for manufactured goods had two principal middle-term causes, both growing out of the First World War: one was the effort by major industrial countries of continental Europe to achieve self-sufficiency in wheat production during the twenties, hedging against another international conflict; the other was technological advance, notably the diffusion of the tractor, in the high-productivity agricultural-exporting nations. The process was stimulated by the vital need for grain during the Great War.

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The issue remained, however, of why industrial prices did not fall as well, given the greatly expanded manufacturing capacity in the belligerent powers and the tendency for industrialization to spread to new countries. During the Great Depression many economists noticed that industrial prices tended to be downwardly rigid, and the causes of the latter phenomenon were identified as early as 1927 by the Swedish economist Gustav Cassel, in his study for the League of Nations' International Economic Conference that year. Cassel pointed to monopolistic tendencies in the labor and manufactures markets of the industrial West.<sup>2</sup> "From 1913, a very serious dislocation of relative prices has taken place in the exchange of goods between Europe and the colonial world," owing to these monopolies, he wrote. Cassel's study scored the Western nations for their growing protectionism, as well as for establishing trade union monopolies and production cartels. Monopolistic pricing had adversely affected metropolitan and colonial producers of agriculture and raw materials, "the chief sufferers" from combines and protectionism, who saw the terms of trade turn against them.<sup>3</sup>

The League's Economic Committee in 1935 again cited trade unions and oligopolies as responsible for much of the price-scissors gap between industry and agriculture, and, among other things, found fault with efforts by European countries to protect and stimulate their own agricultural establishments in order to achieve self-sufficiency for strategic reasons.<sup>4</sup> In a study appended to the 1935 report, Sir Frederick Leith-Ross, the British financial expert, noted that European agricultural production, excluding that of the USSR, had risen faster than world farm output between 1929 and 1933. This development, he pointed out, was due largely to the protectionism of Germany, Italy and France. Traditional producers reacted by stepping up output, trying to maintain total sales at a lower price per unit, thereby aggravating the problem. Ultimately agricultural exporters could not sell their products, and consequently could not import European manufactures. Thus they began to produce their own industrial goods. This sequence resulted in a general impoverishment, wrote Leith-Ross, implicitly suggesting that "agricultural" countries could not efficiently produce the industrial goods they had formerly imported, just as "industrial" countries were inefficient at farming.<sup>5</sup> Therefore, by implication, the developed nations had themselves to

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<sup>2</sup>Cassel put the larger share of blame on trade union monopolies rather than on "monopolistic combines of enterprises," but argued that the two were mutually reinforcing. G. Cassel, *Recent Monopolistic Tendencies in Industry and Trade*, Geneva, 1927, pp. 43-44.

<sup>3</sup>*Ibid.*, pp. 27-29.

<sup>4</sup>Société des Nations (League of Nations): Comité Economique, *Considerations relatives à l'évolution actuelle du protectionnisme*, Geneva, 1935, pp. 9-10.

<sup>5</sup>*Ibid.*, pp. 25, 36.

blame for the sustained failure to restore the traditional international division of labor.

Before the League of Nations died, its economists had become more understanding of the industrial aspirations of “backward” countries. As early as 1937, a League committee report had judged that because emigration from overpopulated countries was blocked by post-World War I restrictions in most of the pre-war recipient nations, the former countries would have to industrialize.<sup>6</sup> Five years later, League economists recognized that much of the effort to achieve import-substitution industrialization by agrarian states in the Depression years was a reaction to surplus rural population, huge commodity price swings, and balance of payments difficulties. Furthermore, “the problem constituted by the multiplicity of small and poor economic units in Central and Eastern Europe, heavily indebted to the Western World, was extremely complex...”<sup>7</sup>

In 1945 the League’s Economic Department had concluded that, in the period 1875-1930, manufacturing nations had traded with each other more than with agricultural exporters, and that agricultural prices on a worldwide basis had fallen relative to prices of manufactures over the long term. Furthermore, “non-industrial countries can profit from [the international] division of labor only to the extent they enjoy a surplus of their production that can be exported in exchange for foreign manufactures...In the majority of non-industrial countries, the surplus is not large enough to ensure them a plentiful supply of imported manufactures.”<sup>8</sup> Consequently, though the League’s economists retained faith in the importance of trade for the development of the international economy, they acknowledged that specialization in agriculture had not been a beneficial arrangement for most agricultural countries. Not only Prebisch, but League economists as well, were succumbing to an “export pessimism.”

The less-developed nations for which the Eurocentric League had the most concern were those of East and Central Europe, referred to above. Indeed, they formed sort of a proto-Third World in the interwar years, having low per capita income and literacy levels, underemployed rural populations, and the problems of creating or consolidating new states and nationalities.

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<sup>6</sup>League of Nations, *Report of the Committee for the Study of the Problems of Raw Materials*, Geneva, 1937, pp. 10, 15. The Committee included well-known conservative advisors such as Leith-Ross and Charles Rist.

<sup>7</sup>League of Nations: Economic, Financial and Transit Department, *Commercial Policy in the Interwar Period*, Geneva, 1942, p. 133.

<sup>8</sup>League of Nations: Economic, Financial and Transit Department, *Industrialization and Foreign Trade* (N.P.), Geneva, 1945, pp. 5; 16, note 2; 34 (quotation). The principal author of the report was Folke Hilgerdt (p. 6).

The second theme of my comment is relevant to new ideas in the literature. In the late 1930s, Louise Sommer, an economist at the University of Geneva, was sympathetic to the European agrarian countries' aspirations for an intra-European trade-preference system, and noted the defense of that project by two economists, the Romanian Mihail Manoilescu and the Yugoslav Otto Franges, in League meetings in the 1920s and 1930s.<sup>9</sup> In 1938 Sommer published an article, though forgotten today, which summarized some elements later to be employed by Raúl Prebisch and Hans Singer in an argument for industrialization in underdeveloped countries. For one thing, she was probably the first to present the "Manoilescu argument" in its modern marginalist form.<sup>10</sup>

Sommer in 1938 observed what Raúl Prebisch had noted the previous year; namely that in the upswing of the international business cycle, agricultural products' prices rose faster than that of industrial products, but in the downswing, they fell faster.<sup>11</sup> Sommer noted that the explanation of this phenomenon had been provided in 1928 by the Soviet economist N. N. Kondratieff, the discoverer of "long waves" or "Kondratieff cycles."<sup>12</sup> Kondratieff had observed that the buying power of agricultural goods falls faster than that of industrial goods in times of depression, and that agricultural supply is inelastic with regard to price, compared to the supply of industrial goods. Further, he noted that the consumption of foodstuffs was price-inelastic, but that agricultural producers as a rule are poorly organized, and therefore relatively unable to defend themselves on the world market, vis-à-vis sellers of industrial goods.<sup>13</sup> (Hans Singer would emphasize this feature of international trade two decades later.)

Sommer also cited a 1937 article by the American trade theorist Charles Kindleberger, who pointed out that agricultural and industrial exporters have different income-elasticities of demand over the course of the international business cycle.<sup>14</sup> The former would expand their de-

<sup>9</sup>L. Sommer, *Neugestaltung der Handelspolitik*, Berlin, 1935, pp. 180, 188-189.

<sup>10</sup>Namely, that as the productivity of labor in agriculture approaches zero, additional workers should be transferred to industrial employment. (Manoilescu had written about average productivities.) See L. Sommer, "Pays agricoles —pays industriels: Une antithèse perimée," *Revue Economique Internationale*, 30e. année, July, 1938, p. 90.

<sup>11</sup>*Ibid.*, p. 107. Prebisch only notes the faster fall of agricultural prices in the downswing, but the faster rise in the upswing can readily be inferred. See R. Prebisch, *Economic Review*, Banco Central de la República Argentina, series 2, 1, no. 1, 1937, pp. 26-27.

<sup>12</sup>*Ibid.*, p. 107. See N.N. Kondratieff, "Long Waves in Economic Life," *Review of Economic Statistics*, 17, 6, Nov., 1935 (orig. Rus. ed., 1925), pp. 105-115.

<sup>13</sup>N.N. Kondratieff, "Preisdynamik der industriellen und landwirtschaftlichen Waren," *Archiv für Sozialwissenschaft und Sozialpolitik*, 60, 1928, pp. 58-59.

<sup>14</sup>C. Kindleberger, "Flexibility of Demand in International Trade Theory," *Quarterly Journal of Economics*, 51, 2, Feb., 1937, pp. 352-361.

mand for industrial goods more than proportionally to the cyclical rise in income, and contract it more than the fall in income in the cyclical slump. The industrial countries had a relatively income-inelastic demand for agricultural countries' exports over the course of the cycle.

Sommer misread Kindleberger, however, because she cited him in support of the idea of a differential price-elasticity of demand.<sup>15</sup> In the Prebisch-Singer thesis that would emerge in 1949-50, both types of elasticity were relevant to explain why the terms of trade over the long term turned against agricultural exporters. In any case, Sommer used these theoretical points to explain the differential cyclical behavior of agricultural and industrial prices on the world market, showing why agricultural prices were less stable in conjunctural terms, rather than examining the long-term consequences.<sup>16</sup>

In the literature mentioned above, we have seen that several elements of the Prebisch-Singer thesis had been laid out in the interwar years. Cassel had explained the price-scissors problem by factor (labor) and product monopolies in the developed countries. Kondratieff had noted the price-inelasticity of agricultural goods, and the lack of organization of agricultural producers in the world market. Kindleberger in 1937 had pointed to contrasting inelasticities of demand between agricultural and industrial countries for the other's products in international trade—although he did so only with reference to the action of the business cycle, and not yet the long term. Sommer had presented the Manoilescu argument in its postwar form. Thus it seems likely that Prebisch was aware of these precedents, because of the publication of Mario Pugliese's article on foreign trade and industrialization in the Argentine *Revista de Ciencias Económicas* in 1939.<sup>17</sup>

In a journal in which Prebisch himself had frequently published, and would publish again, Pugliese cited Manoilescu and Sommer on the first page of the lead article. The study appeared precisely at a time when Prebisch was wrestling at the Banco Central with the problems treated in the article. And if Prebisch did go on to read Sommer, he doubtless followed her discussion of Kondratieff and Kindleberger with intense interest. In any case, he was citing the American economist directly in 1944.

In 1943, Kindleberger had published two articles calling for the industrialization of agricultural and raw material producers on the basis

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<sup>15</sup>L. Sommer, "Pays agricoles—pays industriels," p. 108.

<sup>16</sup>*Ibid.*, p. 110.

<sup>17</sup>M. Pugliese, "Nacionalismo económico, comercio internacional bilateral, e industrialización de los países agrícolas, desde el punto de vista de la economía argentina" *Revista de Ciencias Económicas*, 27, 2, October 1939, p. 917.

of long-term deterioration of the terms of trade, and Prebisch was familiar with at least one of them.<sup>18</sup> In "International Monetary Stabilization," Kindleberger argued that the terms of trade moved against agricultural products "because of the institutional organization of production" in industry, a reference to internal and external economies and possibly to monopoly elements, and also because of differences in the elasticity of demand for agricultural and industrial products.<sup>19</sup>

Kindleberger pointed out that an agricultural country's increased productivity in primary activities under these conditions could only raise real income if the labor freed from agriculture were permitted to emigrate or found employment in industry—a proposition he borrowed from Colin Clark.<sup>20</sup> Otherwise, the terms of trade would move against the country, and it would have realized no benefit from the increased output of primary goods. But domestic industry need not be as efficient as that abroad: an agricultural country's real income would be increased if, "...at some level of costs, labor displaced from agriculture can produce industrial products previously imported to enable part of the proceeds of an unchanged volume of exports to be spent upon other types of imports," Kindleberger wrote, thereby endorsing import-substitution industrialization.<sup>21</sup>

Looking ahead to the postwar era, Kindleberger foresaw disequilibria in the international trading system. A specific instance was the case of two countries with differing marginal propensities to import. For the country heavily dependent on exports and having a high propensity to import, a rise in exports could eventually produce an unfavorable balance of trade. "It may be suggested that the United States has a comparatively low propensity to import and a low ratio of exports to national income, whereas the rest of the world has a relatively high elasticity of demand for United States exports of manufactured goods and a relatively high ratio of exports to income."<sup>22</sup> One may infer the external imbalance was, potentially at least, a structural problem. In fact, at Prebisch's seminar on central banking in Mexico in 1944, he cited Kindleberger's thesis that the U.S. would have a persistent trade imbalance.

<sup>18</sup>C. Kindleberger, "Planning for Foreign Investment," *American Economic Review*, 33, 1, March 1943, Supplement, pp. 347-354; and "International Monetary Stabilization" in Seymour E. Harris, ed., *Postwar Economic Problems*, London, 1943, pp. 375-395. Prebisch cited the latter article in "Observaciones sobre los planes monetarios internacionales," *Trimestre Económico*, 11, 2, July-September, 1944, pp. 195-196, though he did so in order to contest the American's references to the behavior of the Argentine economy.

<sup>19</sup>C. Kindleberger, "International Monetary Stabilization," p. 378.

<sup>20</sup>*Ibid.*, p. 377, citing Clark, *Economics of 1960*, 1942.

<sup>21</sup>C. Kindleberger, "International Monetary Stabilization," pp. 378-379.

<sup>22</sup>*Ibid.*, p. 381. The writer was referring both to income- and price-elasticity (p. 380).

ance with the rest of the world because of disparities in demand elasticities. At the time, Prebisch was not certain the thesis was valid.<sup>23</sup>

Kindleberger's contribution to Prebisch's original structuralism thus seems large. Perhaps the archival research by Dosman and Pollock will reveal the extent of Prebisch's debt to the American trade theorist and to other economists, including those mentioned above.

Yet to weave the several strands together into a coherent argument from the perspective of the periphery was the great contribution of Prebisch and Singer. As Nathan Rosenberg has noted, in the history of economic theory, as in that of natural science, it is less insight than systematization that counts.<sup>24</sup>

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<sup>23</sup>R. Prebisch, in Banco Central de la República Argentina, *La creación del Banco Central y la experiencia monetaria argentina entre los años 1935-43*, Buenos Aires, 1972, 1, pp. 530-531.

<sup>24</sup>As an example, Rosenberg cites Nobel Laureate Wassily Leontieff's input-output table, enormously useful in economic planning, since the table can determine the required kinds and amounts of inputs for a given output. François Quesneau's *Tableau économique* (1758) appears in retrospect as a primitive input-output table, but this was unsuspected in the eighteenth century. See Rosenberg, *Perspectives on Technology*, New York, 1976, p. 79. In the words of the Argentine poet and essayist Jorge Luis Borges, every writer creates his own predecessors.

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## THE SEARCH FOR A NEW ECONOMIC CONSENSUS IN LATIN AMERICA

Enrique V. Iglesias<sup>1</sup>

### Latin America at the Time of the Prebisch Report

Written approximately 20 years ago and entitled *Change and Development: Latin America's Great Task*, the Prebisch Report was published at a moment in history when the world economy was on the threshold of one of the most intense and dramatic transition periods of all time. In retrospect, it is interesting to note that this report by Dr. Raúl Prebisch was commissioned by the Inter-American Development Bank not because of the unprecedented historical process then unfolding but simply as part of the commemoration marking the Bank's 10th anniversary. This small irony in the report's origin highlights the fact that in 1970 the sweeping changes that were about to occur on the world economic and political scene during the subsequent two decades began quietly as extremely subtle, barely perceptible stirrings.

No matter how subtle the onset, the fact is that tremendous movement has taken place since 1970 both in the world at large and in Latin America. The changes in the Latin American region have been influenced by external and internal factors alike. Therefore, any discussion today of optimal policies for promoting economic development in the region must be based not only upon the usual theoretical considerations but also upon a pragmatic understanding of the sweeping transformations that have occurred in Latin America and the world during the past 20 years.

Observing the evolution of the international situation during that 20-year period, I have always been struck by the profundity and speed of the changes, and have often expressed the fear that new realities were rendering obsolete many of our traditional regional approaches to economic and social development. I have reached the conclusion that the best tactic would not necessarily be to change our whole approach nor to forget the long-held goals of Latin American development. Instead we should simply continue to pursue our development goals, but with open minds and a clarity of vision necessary for comprehending, incorporating and dealing with the new realities.

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<sup>1</sup>President of the Inter-American Development Bank.

Nearly everyone agrees that during the 1980s the region suffered its worst economic and social crisis since the Great Depression of the 1930s. In truth the 1980s crisis is not yet behind us; as of 1990, the Latin American countries' per capita income had declined to a level lower than that of the late 1970s, with all the social and political implications of such a fall. The 1980s have therefore been called a "lost decade." Even so, from another perspective one could look upon the 1990s as the beginning of a period of renewal and change. If by the word "crisis" we mean the turning point of a process, the precise moment in which the process can head either for revitalization or for collapse, then we can understand why history is replete with moments of crisis. Crisis can actually teach us valuable lessons if our minds are open enough to receive them.

What are the elements in the world and regional scenario that have changed during the past 20 years? Which would be the best paths to follow in seeking to reestablish the Latin American development process after the crisis? To what degree and in which aspects is the original analysis of Latin American economic thought still valid and essential for understanding our current situation and outlook? To what degree should this analysis incorporate and deal with new realities?

The world of the 1950s in which Dr. Prebisch formulated his earliest and very influential economic concepts at the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) was a world with several clearly defined landmarks. For one thing, the international scene of the 1950s was dominated by the United States and by the Cold War. The political and strategic priorities of the United States revolved around this Cold War and the formation of the North Atlantic Treaty Organization (NATO), as well as world economic recovery and reconstruction of the countries devastated by World War II. The role of the developing countries, in keeping with the traditional international division of labor, had historically been to produce and export commodities and to import equipment and other manufactured goods. The decades-old downward trend in the terms of world trade between commodities and manufactures—favoring manufactures—militated against Latin America's economic development possibilities.

The results of this long-term and negative trend in Latin America's terms of trade had been further aggravated by the disruption of trade and the breakup of world markets brought on by the Great Depression of the 1930s and by World War II. The commodity-exporting economies of Latin America—open to the world economy and dependent upon the evolution of world trade and the international business cycle—had known periods of both recession and boom. The earliest stages of Latin America's development process had long relied upon access to international capital markets—a period characterized both by a trend toward capital exports from

the industrialized nations and by the importance of commodities in the world economy. The prolonged world economic recession of the 1930s and the disruption caused by World War II, however, translated into a serious contraction of the Latin American economies, stemming from the decline in foreign demand for commodities and from the effects of the dual break in trade and in savings and investment.

Domestically, at the time when Dr. Prebisch was formulating his early ideas, the Latin American economies were characterized in varying degrees by the following: a low level of economic development, with most of the work force concentrated in the agricultural sector; fledgling or nonexistent industrial development; noteworthy imbalances in income distribution; weakness in the domestic-resource mobilization process because of the vicious cycle of poverty and the income distribution problem; unstable political systems; and inadequate development of national institutions.

At that time, political leaders and economic advisers in Latin America had very few policy options open to them. Although there was always room for a degree of improvisation and diversity, a general consensus quickly formed in the region regarding several fundamental economic issues. Let us briefly examine a few of the basic economic beliefs prevailing in the 1950s and thereafter.

Most Latin American countries quickly assigned high priority to the industrialization process. The negative world economic circumstances mentioned above forced them to begin to produce domestically a growing range of products that they had formerly imported. In that context, it was possible to promote only a protected and subsidized industrial base within Latin America, a strategy reminiscent of the nineteenth-century argument used by Germany and other European countries when protecting and stimulating their own "infant" industries. In any case, the level of protection in Latin America was not originally very high, although tariff levels quickly climbed in response to pressure from different domestic interest groups.

The cost of producing manufactures in a relatively inefficient form in the region at that time was actually not prohibitively high, since there simply did not exist any option of being able to finance the import of such products. Latin American economic thought at that time focused largely on rationalizing that particular brand of industrialization. Theorists of this import-substitution industrialization process asserted that such an approach would provide a training ground for Latin American industry to the point where it could eventually compete in the international marketplace when world economic conditions improved. Regional economic integration was viewed as an intermediate step in the export drive toward the world market.

These policies of import-substitution industrialization were accompanied by a relatively pessimistic view of the opportunities presented to Latin America by international trade and external markets. The Latin American countries' production structure itself, especially during a time of stagnation in world trade, further justified this lack of optimism. Many Latin Americans favored the signing of commodity stabilization agreements to regulate international commodity prices, since commodities constituted most of the region's exports. Overall, it was feared that opening up Latin America's economies to the world economy would unduly destabilize the countries' economic development processes.

The industrialization process required huge investments. This fact explains the emphasis that economic thinkers of that era placed on increasing savings and investment, in order to ensure a rapid expansion of capital accumulation and stimulate the incorporation of advanced technologies and equipment. High investment requirements also underscored the need to maximize the countries' limited capacity to mobilize domestic resources, complementing the latter with massive aid programs from abroad.

This policy approach presupposed the introduction of structural reforms into the Latin American economies, directed toward the following goals: to stimulate growth of the manufacturing sector and the transfer of the work force into industry; to change old production patterns, which had been heterogeneous, disjointed, vulnerable and unable to productively absorb the region's steadily-growing labor force; to modernize agriculture and modify the traditional system of land ownership; to correct flawed patterns of income distribution; to increase availability of basic social services; and to strengthen mechanisms by which governments could achieve these structural goals. It was believed that conventional economic theory—with its emphasis on more efficient allocation of productive resources—would be inadequate to the development task at hand unless the region's serious underlying structural economic distortions were first corrected.

These policies, as well as the reforms they posited, led Latin Americans to place much faith in government action to solve the countries' economic problems. Because of the countries' existing social structure—marked by poverty, illiteracy, a weak private sector and the lack of modern production and of significant capital markets—there was little faith in the ability of the marketplace alone to bring about the desired changes, particularly in the early stages of the development process.

Dr. Prebisch lucidly captured all of these trends in his first studies at ECLAC. He was very innovative in integrating the observed trends into an organic analytical framework, thereby enabling him not only to schema-

tize his different variables into a coherent whole but also to formulate specific recommendations on economic policy. I should like to emphasize that, in my opinion, the early structural framework devised by Dr. Prebisch did not constitute an abstract, idealized model to which the region was meant to aspire but rather an analysis of actual Latin American economic reality as influenced by the circumstances of the period.<sup>2</sup>

Questions and misgivings regarding the validity of some of these widely-held economic policy views in Latin America had been raised long before publication of the Prebisch Report in 1971. Some of these questions had their origins in theoretical disagreements, such as those between structuralists and monetarists during the 1950s. Other doubts stemmed from more pragmatic considerations relating to certain cases of policy extremes and the results thereof. Some of the questions and misgivings that had begun to appear were related to the following: the limits of an industrialization process based upon import substitution; the economic distortions exacerbated by protection of local industry; subsidies or preferential exchange rates; excessive emphasis on industry to the detriment of agriculture; industry's failure to generate as much employment as had been hoped for or to attract the financing necessary for industrial expansion; the fact that industrial financing was still coming to a large degree from the relatively embattled agricultural sector; and the fact that industrialization was generating an increasing demand for imports of capital goods, intermediate products and other manufactured goods, thereby contributing to the region's vulnerability to external economic fluctuations.

The Prebisch Report responded to these questions and doubts by going into more detail regarding several of Prebisch's original ideas. To these ends he focused his discussion on selected areas of his earlier thought—the most important areas as well as those that had left him with a lingering sense of frustration. The Prebisch Report was based upon those ideas and it analyzed Latin America's economic situation at the outset of the 1970s in terms of those same ideas.

From that analysis came Dr. Prebisch's positions on a number of new issues, including the following: the insufficient dynamism of Latin

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<sup>2</sup>This conclusion is reinforced by the fact that the economists who created development theory parallel to Dr. Prebisch have shared the major ideas contained in the Prebisch analysis. Dr. Prebisch adopted a starting point similar to that used by Harrod and Domar. H. Singer viewed international trade problems in a manner similar to Prebisch, and R. Nurske and P. Rosenstein-Rodan—through their respective assertions regarding the vicious cycle of poverty and the big push—emphasized the importance of the capital accumulation process during the first stages of economic development. In his theory of unbalanced development, A. Hirschman emphasized the role of creativity and overcoming inertia within this process.

American economic growth after decades of policies oriented toward industrial development; the continuation of an inadequate employment structure and a clearly suboptimal absorption of the work force; the unequal and even contradictory response of productivity growth and employment growth, neither of which responded uniformly to the rate of economic growth; the need to promote social integration and the expansion of domestic markets through improved income distribution policies; the acquisition and absorption of needed scientific and technological innovations, with all their advantages and contradictions; the need to accelerate strongly the accumulation of capital to underwrite the foregoing initiatives; and the need for more intensive financial and trade cooperation from abroad.

The translation of Dr. Prebisch's suggestions into policy would, according to the report, allow the region to transcend its stage of outward-oriented growth, avoid the dangerously seductive populist and redistributionist alternative, and finally to chart a course toward a new era of sensible "development discipline" much advised by Dr. Prebisch.

## **The Region's Problems 20 Years after the Prebisch Report**

### ***Transformation of the World Scenario***

The world of the 1990s is radically different from the world that existed when the Prebisch Report was published. This transformation stemmed in part from the three decades (1950-80, approximately) of unprecedented world prosperity that followed World War II. During this 30-year period the industrial countries grew on average by more than 5 percent per year; their production quadrupled, with an even larger increase posted by industrial production; and world trade grew 50 percent faster than did production, increasing by a factor of six during those 30 years. The rapid growth in world trade, the export of U.S. capital and technology to countries whose economies had been destroyed during World War II, and the expansion of multinational companies carrying out this process all gave rise to an increasingly interdependent and integrated world economy.

The most important changes, however, have been qualitative in nature. We have witnessed the end of one century dominated by the same industries, technologies and energy sources (oil and the petrochemical industry, the iron and steel industry, the internal-combustion engine, and the industries providing transport equipment and services and durable consumer goods) and dominated as well by the same countries and major economic sectors. And we are witnessing the beginning of a

new century and the inception of a new economic framework in which new countries, sectors, products and technologies have all begun their own revolutionary and dynamic interaction.

A new technological pattern or archetype has begun to emerge, based on information, microelectronics and know-how. The world economy, for the first time, is beginning to depend less heavily upon its historical labor and natural-resource base. A change is also occurring in the traditional relationship between the world of actual production and the world of finance—that is, between the real economy and the symbolic economy—now that the value of international capital flows is 25 times as large as the value of actual world trade flows. All of these changes are radically altering production structures, the work force configuration, social preferences, demand, national product composition, enterprises' operational approaches, and the role of services within these new-style enterprises, with emphasis on information and communications.

Within this profound transformation of the world economy, the role of technological change has been important. The process of rapid world economic growth that took place during the 1950s and 1960s was based on the utilization of available technologies: technologies that still had a wide margin of application to the production system or technologies that—having been invented for purposes of war—had not yet been used for nonmilitary purposes. Both types were largely in the hands of the United States. When the industrialized countries were able to incorporate that new technological acumen into their productive apparatus, their rhythm of growth accelerated. Once all the available technology had been incorporated, the rhythm of growth naturally tended to slow down. Nevertheless, at about this point some new and radical innovations would usually be introduced, creating a new technological archetype and turning the new element into the key factor in continued economic growth.

In this regard, a recent World Bank report asserts that “the factor that has contributed most to economic progress has been technological advances.”<sup>3</sup> To highlight the role of technological progress above all other factors in the present world economic context implicitly recognizes the demise of a world economy based upon natural resources, capital and the work force and simultaneously acknowledges the advent of a world economy based upon information and know-how. Knuna asserted that society's evolution is driven by a succession of technological revolutions, and Schumpeter believed that each new economic cycle is based

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<sup>3</sup>World Bank, *World Development Report: The Challenge of Development*, Washington, D.C., April 1991, pp. 1-2.

upon a combination of factors: technologies, entrepreneurial ability, social preferences and new markets.

The technological archetype underlying each of these evolutionary stages is itself predicated upon one key element which—given its abundance, flexibility and generalized use—lies at the base of nearly all existing production processes. This key element through the centuries has ranged from coal to steel to oil, and would now seem to be identified primarily with information and know-how. Other important elements (all assisted by the computer) within today's new technological archetype include the following: the information, transport and communications revolution; biotechnology advances; the production of new materials; the substitution and conservation of conventional energy sources; production system restructuring based upon greater flexibility in production facilities (plants) themselves and upon greater product diversity; and integration of design, production and the market. Furthermore, there exists unlimited potential for the development of new technological evolutionary archetypes in the future.

The growing importance of high technology appears to be the major causal factor behind the trend toward the globalization of economic processes. This latter phenomenon was ushered in with great fanfare 25 years ago along with Jean-Jacques Servin-Shriver's literary warning to Europeans, *The American Challenge*—a book detailing the potential dangers to Europe of U.S. leadership in the globalization of economic processes. Another famous volume on the phenomenon published at that time was Richard Cooper's *The Economics of Interdependence*. Even then, the value of production by the internationally scattered subsidiaries of large multinational corporations was easily surpassing the value of world trade.

This economic-process globalization has continued to intensify and even to change in character. After several years of uncertainty, the U.S.-based multinationals during the early 1980s regained their rhythm of growth—now accompanied by a multiplicity of aggressive Japanese and European multinationals. The division of production processes, facilitated by the conversion of companies into multinationals, has totally transformed prevailing production structures. Further, the great industrial conglomerates are not alone in the use of multiple production processes. Countless small and medium-sized companies—especially those specializing in technology, information and services—also divide up their production processes among various plants. No national economy today can afford to turn its back on the economic-process globalization trend currently underway.

This trend is also facilitated by the current transformation of the international financial system and by the increase of this financial sys-

tem's relative importance within the world economy. In a world in which the "symbolic" economy of finance is much larger than the "real" economy of actual production, economic change will clearly depend increasingly upon the course and volume of financial flows.

The geographic dispersion of the poles of world technological innovation and of economic growth (plus the constant switching of these poles from one country to the other), combined with the constantly changing rhythm of productivity from country to country and from sector to sector, has altered—and will continue to alter—regional visualization and projections of the new world political economy. During the 1960s the world political economy's center of gravity seemed to be moving from the Atlantic toward the Pacific. During the early 1990s a new balance will be created by the rise of a Europe without walls, based upon the convergence of the European Community, the European Free Trade Association, and the countries of Eastern Europe. As a result of these transformations, international relations will be very different in the year 2000 from what they have traditionally been, and the hierarchy of nations will change significantly. The Big Three of the world economy will replace the Big Two of nuclear arms competition and will eventually play a large role in the determination of the world power structure for the twenty-first century.<sup>4</sup>

### *The Origins of the Latin American Crisis*

Latin America has of course participated in the transformation of the world economic scenario that I have described above. Because of this participation, but perhaps more because of its own endogenous reasons, Latin America also finds itself in a process of transformation. Between 1950 and 1980 the region's gross domestic product grew at an average yearly rate of 5.5 percent—significantly higher than the GDP growth rates of other developing regions and slightly higher than the GDP growth rate of the industrialized economies. This growth was accompanied by a relatively intense process of investment and productive and technological transformation. The region's industrial estate grew and diversified remarkably, allowing Latin American industry to satisfy most of the region's domestic demand for consumer goods and a growing share of the regional demand for capital goods, thereby initiating a dynamic process of export expansion and diversification. The region's continuing infrastructural improvements facilitated a higher level of sectorial interdependence and integration among the Latin American economies—which,

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<sup>4</sup>C. Fred Bergsten, "The World Economy after the Cold War," *Foreign Affairs*, 69, 3, 1990.

after the crisis, would become very important for these economies' eventual restructuring or reform.

The 1973 oil crisis and the subsequent global recessions had a severe impact upon the region. The resurgence of international capital markets, swollen with petrodollar deposits in private banks, allowed the region to take on foreign debt and thereby temporarily soften the negative impact of the oil crisis. Not recognizing that they were compromising their future economic health, the Latin American countries made full use of the opportunities presented by the extraordinary climate of international financial permissiveness existing at the time, justifying their assumption of so much debt by their need to buffer the negative effects of the oil crisis. One could credibly assert that the 1970s constituted the real turning point in the development path chosen earlier by the Latin American countries during the post-World War II period and also that the region's abandonment of the sensible "development discipline" espoused by Raúl Prebisch made the 1970s—and not the 1980s—the region's true "lost decade."<sup>5</sup>

At the beginning of the 1980s, the combination of a sharp rise in world interest rates, a reduction in foreign capital inflows into the region, and a decline in the region's terms of trade plunged Latin America into its worst economic and social crisis since the Depression of the 1930s. The remainder of the 1980s was dominated by a succession of unilateral or joint strategies oriented toward managing the region's debt problem and by the application of a set of adjustment policies designed to cut imports, expand exports, and obtain the foreign exchange necessary for debt servicing. Our purpose here is not to enumerate the various strategies employed one after the other to deal with the debt problem. It is enough simply to say that the earlier policies were oriented primarily toward protecting the creditor banks, and the later policies, once the banks had been sufficiently protected, were oriented toward reducing the debt itself.

My own experience as an observer of the Latin American countries' development—from the vantage points of ECLAC headquarters and my own country—suggests that the primary causes of our countries' crisis situation lay in a combination of the following five problems: first, the way in which the region's economies were structurally managed during the past decades (domestic economic policy); second, the external debt problem; third, developments within the global economic framework; fourth, the Latin American countries' loss of international competitiveness; and fifth, the persistence of social inequality in the region. Let us now take a brief look at each of these five crises-engendering problems.

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<sup>5</sup>O. Sunkel, (ed.), *El desarrollo desde dentro: un enfoque neoestructuralista para América Latina*, Fondo de Cultura Económica, Mexico, 1991.

With respect to the first problem—namely, the domestic economic policies pursued during the past decades by the Latin American countries—several different errors call our attention. One of these errors consists of the price system distortions that tended to arise within the mixed economies prevalent in the region for so many years, together with excessive tolerance for inflation on the part of the region's political and economic systems, and adoption of often ill-conceived income redistribution policies that, among other negative effects, further contributed to inflation.

Another of these economic policy errors lay in the region's widespread overconfidence in the import substitution process. Admittedly, we are all good Monday morning quarterbacks, but the fact is that hardly anyone during the import substitution era ever questioned whether that policy was right or wrong. The result was that the Latin American countries closed their economies too tightly. They lost out on trade opportunities that became available in some sectors from the 1960s to the 1980s, and they only recently emerged from the import substitution process into greater openness to foreign trade.

Still another economic policy error relates to the Latin American governments' economic volunteerism, and the excessive degree of faith placed in government as the rightful promoter and creator of economic growth. Such confidence might not have been misplaced during the period immediately following World War II, but later it became clear that excessive government intervention in various aspects of national life entailed high costs and large inefficiencies and that often it would have been preferable to place more trust in the efficacy of market mechanisms.

Albert Hirschman asserted some time ago in ECLAC that one of the biggest mistakes we Latin Americans had made was to ask our governments to do more than they reasonably could. Furthermore, government's discriminatory power in its interventions—combined with the power accumulated by pressure groups—often led to paradoxical situations whereby policies applied in the name of the poorest societal sectors ended up benefiting the richest sectors and even many government officials themselves.

The second crisis-generating problem listed earlier relates to the region's accumulation of foreign debt, with delayed but serious consequences and profound implications both domestically and abroad. When the debt crisis exploded onto the scene in 1982, most Latin American countries chose to make huge sacrifices in order to honor their debt-servicing obligations. None of them wished to enter (at least openly) into a default situation such as they had once practiced in the past. On the one hand, the governments remembered that, in past situations of debt default such as during the crisis of the 1930s, most of the region's external

debt had consisted of securities sold on the international capital markets in a widely dispersed manner, which had made the effects of payment delays fall largely on the myriad holders of these securities who individually had little legal recourse in the face of the default. On the other hand, the Latin American governments also remembered that most of the payment delays did in fact result in punishments that excluded Latin America for years from world financial markets.

The massive resource transfer process engendered by the governments' refusal to enter into debt default during the 1980s not only created nearly unbearable pressures on the region's balance of payments but also distorted the domestic allocation of resources and severely cut into the availability of resources for needed investments, ultimately extinguishing the flame of vigorous regional economic growth. The extraordinarily high level of world interest rates during the early 1980s was the decisive factor worsening the crisis. The debt problem was further exacerbated by the sudden cutback in credit flows from abroad and by the drastic decline in the terms of trade of Latin America's major commodity exports.

A troubling phenomenon, born of the aforementioned situation, was the decline in investment from 24 percent of GDP in the 1974-80 period to 16 percent of GDP in the 1983-90 period. This investment slowdown seriously jeopardizes the Latin American countries' economic future. One result of the investment decline has been the deterioration suffered by the region's physical and institutional infrastructure. It is painful to compare the promising and sustained GDP growth rates registered in the region during the 1960s and 1970s (between 5 and 6 percent per year) with the 1 percent average annual decline experienced during the crisis years of the 1980s.

Now let us turn to the third problem contributing to the creation of the crisis: developments in the external arena. It would be difficult to overstate the importance that the world economic environment has had for the region's economic development and the importance that the world scenario will continue to have for the success of the structural reforms currently underway in the region and for Latin America's future economic progress. Unfortunately, the dynamics of the world economy have been affected in recent years by persistent recessionary trends. During the early 1980s, inflation accelerated in many industrialized countries as a result of cost pressures stemming from oil price rises and other price increases, as well as from the implementation of expansive fiscal policies. These industrialized countries quickly responded to the inflation threat by applying restrictive monetary policies that reduced credit availability and sharply raised interest rates. This response produced a slowdown in those countries' economic growth and a rise in their unemployment rates during the early 1980s. These trends, as we

know, severely and even violently worsened the terms of trade for the many vital commodity exports from developing countries. For Latin America, the decline in commodity terms of trade during the 1980s was even worse than that experienced during the Great Depression of the 1930s; between 1980 and 1986 the decline was 40 percent compared with the 30 percent decline registered between 1929 and 1932.

Furthermore, the world trading system overall continues to be based primarily upon administered trade and is severely lacking in transparency, even as developed countries reiterate their demand that Latin American countries liberalize their trade regimes. The world trading system's outlook will be even darker if the Uruguay Round should lead to greater protectionism through safeguard clauses, antidumping measures, the maintenance of protectionism for various countries' agricultural sectors, the renewal of the Multifiber Agreement, and other negative measures. The persistence of an unfavorable international economic framework could be viewed as the primary obstacle that must be contended with by the region's present economic reform efforts.

Latin America's export sector underwent a severe decline during the 1980s. In response to the second oil price hike and increases in other commodity prices, as well as the resultant acceleration of worldwide inflation, the industrialized nations during the early 1980s adopted restrictive monetary and credit policies, as noted earlier. These policies led to higher world interest rates and other recessionary phenomena. The negative effects on the Latin American economies are well known, particularly the effects on regional commodity exports.

The fall in the prices of their commodity exports stimulated the Latin American countries to expand their manufactured exports, with considerable success. In fact, during the first half of the 1980s, Latin American exports of manufactures grew twice as fast as did exports of world manufactures. The share of manufactures in Latin American total exports climbed from 12 percent in 1970 to 31 percent by the mid-1980s.

Unfortunately, this positive trend did not continue into the second half of the 1980s, due in part to the fourth crisis-generating problem listed earlier—the decreasing competitiveness of regional goods. Regional exports of manufactures began to lose momentum after 1985 because of supply side restrictions (related to the difficulty of importing basic inputs and equipment) and an increasing lack of competitiveness of Latin American manufactures in international markets.

Competitiveness problems of Latin American exporters were compounded by the dynamic and constantly evolving character of the international marketplace, the influence of technological factors on international competitiveness, the tendency toward the formation of trade blocs among certain countries or product groups, and new forms of

protectionism applied bilaterally or multilaterally by industrialized countries to encourage the formation of such blocs or to protect their own companies and workers. The following internal factors also contributed to the inability of Latin American manufacturers to sustain the earlier success of their export drive: restrictions on essential imports into Latin America because of the need to conserve foreign exchange for debt servicing; the regionwide decline in investment; and the tremendous amount of work still required if the Latin American economies are to become more modern and more flexible, with greater intersectorial cooperation and integration among the countries.

The fifth crisis-engendering problem listed earlier was Latin America's continuing inability to overcome its problems of social inequality, poverty and imbalances in income distribution. Let us be quick to point out that—contrary to certain oversimplified interpretations of the issue—the difficult realities just mentioned, although clearly aggravated by the adjustment policies implemented in response to the debt problem, did not arise from these adjustment policies and, indeed, have been in existence in the region for many long decades. They are the result of historical factors and also of the weakness of the development model implemented after World War II and its inability to generate appropriate and sufficient work for the region's growing labor force—just as Prebisch had asserted in 1970. Admittedly, the impressive economic growth rate of the region between 1950 and 1970 did make possible a significant improvement in the Latin American population's standard of living, even if most of the improvement occurred only through a spillover or trickle-down effect. But this improvement soon proved insufficient and also unequally distributed among countries, among areas within countries, and among social groups. This preexisting unsatisfactory distribution situation was subsequently aggravated during the 1980s by factors such as the decline of average regional per capita income to levels existing well before 1980, as a result of the debt crisis and subsequent adjustment policies; and the eventual application of economic policies designed primarily to maximize national economic growth, under the mistaken assumption that resumption of growth in and of itself would be sufficient to ensure a more equitable income distribution pattern.

Selected social indicators admittedly continued to improve during the 1980s: declining infant mortality rates, rising literacy rates, and rising life expectancy figures (the latter due largely to nutrition and health care improvements). Even so, these statistical improvements pale in importance compared to the 1980s per capita income losses and the decrease in Latin America's employment generation capacity brought on by investment cutbacks and by declines in the region's economic growth rate. Income levels stepped back in time 13 years—25 years in some cases—

while the employment situation deteriorated critically during the first half of the decade, later to recover only moderately. Inadequate quality of life and inadequate human resource formation and training are viewed by many Latin Americans as the major obstacles to the development of a more modern, competitive and dynamic economy.

### *The Crisis Itself and Its Aftermath*

Stated briefly, the crisis of the 1980s was strongly fueled by the negative energy from three stubborn elements implicit in the economic development model of post-World War II Latin America. These negative elements were instability, inefficiency and inequity.

These preexisting elements converged to the point of crisis, added to by pressures from the region's mammoth external debt problem. Instability was exemplified by the old development pattern's excessive tolerance for inflationary pressures. These pressures were allowed to build and finally became overwhelming and uncontrollable, leading many countries to the edge of hyperinflation even before the actual crisis. Inefficiency was associated especially with the excesses of protectionist trade policies and the extreme economic isolation of the region's countries at a time when open international competition was heating up and other economies were becoming increasingly active in, and open to, international trade and interdependence. Inequity was clearly present in the mechanisms of income distribution whereby the region's wealth was lopsidedly concentrated in the hands of a few, thus creating widespread and dramatic instances of desperate poverty among nearly one-third of the Latin American population.

The negative energy of these three elements was reinforced during the 1980s by problems associated with the region's huge foreign debt. As mentioned earlier, the Latin American countries had easy access to foreign credit during the 1970s and early 1980s because of the oversupply conditions then prevailing in world financial markets. The region borrowed heavily, in an effort to buffer the local effects of the world oil price shocks and of the worldwide recession. This palliative use of borrowed funds allowed the region to postpone addressing many of its chronic economic and social problems. Overall, however, the opportunities lost and the additional problems created by this expedient approach actually made the 1970s—even more than the 1980s—the best candidate for the title of a “lost decade.”

The servicing of the foreign debt became a tremendous problem after 1982, when the world's industrialized countries decided to raise their interest rates (thereby worsening recession) in an effort to fight inflation. Then, when foreign credits dried up, debt service became an

almost unbearable burden for the region. To make matters even more disastrous, the terms of trade for Latin America's major commodity exports also worsened significantly, within the recessionary external economic environment.

The consequences of these debt-related factors are well known. During the 1980s, Latin America transferred abroad more than \$220 billion for debt service. Investment in the region declined by one-third, and imports shrank by 40 percent. Such devastating economic and social crises had formerly occurred only in countries engaged in heavy warfare. In effect, Latin America's debt service payments during the 1980s, as a share of GDP, were larger than the corresponding capital outlay figure for Germany when that country paid its war reparations after the First World War.

### **Domestic Policy's Reaction to the Crisis**

Following Latin America's long process of transformation and development during the post-World War II years and the subsequent huge regional crisis precipitated by the foreign debt problem (with the attendant adjustment policies that dominated the 1980s and entailed tremendous sacrifices), the countries of the region have finally begun to apply—with differing focuses and intensities—a set of forward-looking adjustment and structural reform policies responding in part to purely domestic priorities and in part to approaches suggested from abroad. These measures are modifying the old model of Latin American development, and they also seek to transcend the limitations of the stopgap adjustment policies applied previously.

Most Latin Americans believe that these new policies originated primarily from economic authorities in the developed countries and in the multilateral financial organizations (in which developed countries have an important role). This perception contains a large grain of truth, but we cannot reduce the policy selection process to a simple act of reacting to signals from abroad. A gradual economic policy evolution has occurred within the region itself that has had an important role in shaping the approach being used today.

This gradual evolution of the region's policy response to the debt crisis has comprised at least five different and overlapping stages: from the application of purely monetary adjustment policies to the introduction of broader structural reforms; from the application of measures aimed exclusively at ensuring the servicing of the debt to an increasing concern for reducing the debt itself and for stimulating regional economic growth; from concerted management of the debt problem (primarily by the creditor banks) to new formulas that gave an important role to the IMF and later to the World Bank; from relative nonparticipation by

monetary authorities of the creditor countries to greater participation by these same authorities in seeking to solve the problem; and from strategies that included only those directly involved in the problem to a whole “menu” of market-based solutions. In these responses to the debt problem, it is difficult to distinguish between the influence of the creditor countries (principally the United States) and the initiatives of the Latin American countries. Therefore it is also extraordinarily difficult to pinpoint the exact national origins of the current set of reforms, even though some people do refer to them as the “Washington Consensus.”

The fact is that the new reforms did not originate unilaterally in U.S. banking institutions nor in the international financial bodies. Rather, the reforms are a mix of recommendations from the foregoing officials and from the Latin American countries’ own expressed policy desires as they move toward economic modernization and an opening up of their economies to international trade and private capital flows. The term “Washington Consensus” is not actually in common usage, although it is undeniably a catchy and apt term coined by a prestigious institution and by one of its distinguished members<sup>6</sup> to refer to a set of remedial and growth measures proposed in the past several years to the Latin American countries. Nevertheless, as we shall see when closely examining the actual evolution of the Latin American economies during the crisis of the 1980s, it seems more appropriate to believe that today’s reform measures have gradually taken shape in response to the progressive formation of a truly Latin American political and economic consensus.

Beyond the institutional origins of this consensus, it would also be interesting to explore its conceptual background. The new strategy implicit in this set of measures derives in part from the perceived unworkability of the development model pursued by the Latin American countries after World War II. Additionally, it derives from the weariness of the industrialized nations—especially the United States, in the case of Latin America—in regard to foreign aid, which had been an important component of the old post-World War II regional development model.

Beginning in the 1950s, the Latin American countries’ development strategies followed the general outlines of the very influential early interpretive thought of Dr. Prebisch. Generalized pessimism existed regarding the role of world markets in Latin America’s development and also regarding its possibility of dynamically participating in the world economy and of obtaining ever-increasing income from international trade. Given the circumstances existing at the time, this pessimism was justified.

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<sup>6</sup>John Williamson of the Institute for International Economics.

Based on this attitude, the region's post-World War II development strategy was designed to achieve the following two basic objectives: first, domestic industrialization through import substitution and second, a significant inflow of foreign resources (preferably on favorable terms) to finance the domestic industrialization effort in the face of the economic and other disruptions caused by World War II. These two objectives presupposed active participation by the government through the application of national economic development planning techniques introduced into the Latin American countries under the tutelage and influence of the United States, the World Bank and the Latin American regional institutions.<sup>7</sup>

National planning offices were viewed as the appropriate instruments for achieving industrialization and obtaining foreign aid. National planning as an institution had been successfully used by the United States during the New Deal, by U.S. and U.K. economic policy during World War II, and by the Soviet Union.

The region's governments sought to foster import-substitution industrialization through their pro-industrial input into the national planning processes, as well as through tariff, exchange rate and fiscal measures. But industrialization based on import substitution soon ran headlong into endogenous problems related to expansion, employment-generating capacity, financing, scale, markets, competitiveness, and the capacity to export and thereby generate the resources necessary for this industrialization's growth. Furthermore, as these industries grew, they fostered something that the countries had dearly wished to avoid—a growing dependence on essential imports of industry-supporting capital goods and foreign inputs, whose elasticity with respect to the industrial product was greater than one.

The import-substitution industrialization process had to contend not only with the aforementioned endogenous problems but also with a whole series of critical "outside" problems that suddenly confronted it from out of the blue. The oil price shocks, the foreign debt explosion and the subsequent debt crisis, the massive transfer of financial resources abroad to service the debt, and the need to apply painful adjustment policies—all these phenomena finally contributed to making unworkable the region's import-substituting industrial and development model in place during the postwar years, and they all helped finally to dissolve the dwindling consensus upon which this model had once been so solidly based.

The rise of economic liberalism in the industrialized countries (a

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<sup>7</sup>Most of the region's national planning offices were organized by the tripartite commission (Organization of American States, Inter-American Development Bank and Economic Commission for Latin America and the Caribbean) during the early 1960s as part of the Alliance for Progress program.

philosophy that had always been mainstream there, which perhaps helps to explain those countries' tremendous growth during the postwar period), combined with the two-tiered weakening of the region's old industrial and development model, stimulated doubts in the region regarding certain established economic ideas there and helped bring about an influx of alternative ideas. The latter were not necessarily totally new, but they at least represented a change from the ideologically bankrupt development concepts that had predominated in decades past.

The need to apply drastic adjustment policies in order to deal with the debt problem allowed the region to focus its efforts on a small range of policy objectives harmonious with the framework of remedial approaches suggested by the industrialized nations and international financial institutions on the one hand, and approaches that evolved in the Latin American nations themselves (even though not necessarily in equal proportion) on the other. In the application of these policies, two different stages can be discerned, although the dividing line between stage one and stage two is not clear-cut.

Stage one, as might well be expected, focused on the need to implement orthodox adjustment policies. Their costs and negative implications for regional economic development aside, these orthodox adjustment policies seemed to constitute a necessary condition for regional economic survival, for emergency management of the debt, and for avoiding eventual ostracism of the region from the world economy. The policies sought to adjust the Latin American economies, reducing imports to a level that, together with debt-servicing costs, could be financed by current foreign exchange income (in a barren period for income when foreign aid loans had decreased, private sources of credit had dried up, and the region's terms of trade for its commodity exports had significantly worsened). In any case, with respect to the social costs attributed to the orthodox adjustment policies, it should be borne in mind that these costs largely reflected chronic preexisting problems from years past related to former development policies, as explained clearly in the Prebisch Report.

During the second stage of these new adjustment policies, more attention began to be paid to the economic growth requirements of the Latin American countries and to the structural reforms necessary to achieve this growth. The approach that gradually crystallized on how to deal with the debt crisis seemed to have three major aspects: fiscal austerity, liberalization of domestic markets, and the opening up of the economy to international trade and private capital flows.

In order to achieve these goals, several structural reforms were proposed. These were very different from the structuralist reforms envisioned earlier in the old post-World War II structuralist approach. The old approach had involved import-substitution industrialization; orientation

toward the domestic market; protectionism through tariff, fiscal or exchange rate measures; income redistribution programs subsidized by the government; strong government intervention and national economic development planning; and heavy government spending. The new-style structural reforms and the new objectives proposed for Latin American economic policy depended largely upon the unfettered operation of market forces.

The new proposals nevertheless met with great resistance. The use of the term structural to describe the reforms only added to the confusion. That term has been used in various contexts throughout Latin America's long development history. Beginning in the 1950s, for instance, it was used to describe and identify the school of economic thought originally associated with ECLAC and Prebisch. During the 1970s, the term structural adjustment was used to denote the Latin American countries' response to world price hikes for oil and food—namely, to raise domestic prices of these products, with the rest of the economy adapting (or adjusting) as best it could to these new prices. During the 1980s, the term structural reforms now began to refer to a set of new measures designed to liberalize domestic markets, privatize government enterprises and certain social services, and open the region's economies to international trade and private capital flows.

Earlier associations with the term structural notwithstanding, no one could convincingly argue that this most recent set of proposed structural reforms has been fundamentally conflictive in terms of its underlying conceptual base. Lessons gleaned during the past several decades (particularly during the crisis of the 1980s)—combined with the emergence of a new generation with new ideas—have made many Latin American leaders and specialists begin to question the validity of the old ideas related to inwardly directed growth, import substitution, government interventionism, and the lack of trust in the efficacy of market mechanisms. This new open-mindedness allowed certain understandings to be reached, and above all, it opened the doors to meaningful conversations between representatives of the international community (primarily the United States and the Washington-based international financial organizations) and representatives of the Latin American countries. These conversations are taking place within a lively atmosphere on both sides that has not been experienced since the days of the Alliance for Progress.

## **From Adjustment Policies to Structural Reforms: Lessons from the 1980s**

### ***Latin America's Silent Transformation***

As is usually the case in periods of serious crisis, there is a silver lining to the Latin American debt crisis of the 1980s. Just as renovation of the world

economy was facilitated by the destruction caused by World War II, the Latin American economies can now be renovated after the destruction caused by the debt crisis and the adjustment process. The debt crisis and the adjustment period can be considered as “the moral equivalent of war.” What have we Latin Americans gained during the lost decade of the 1980s? The magnitude of the crisis and its painful costs tend to make us forget that we have learned valuable lessons and have even accomplished several important things as nations during—and sometimes because of—the crisis. These lessons and achievements constitute a sort of silent revolution expressed on various interrelated fronts.

### *The Recovery of Democracy*

Let us begin by highlighting the reinstatement of democracy in most countries of Latin America—an achievement of enormous importance. This fact should not be obscured by the existence of economic losses. The progress realized in the reconstruction of our countries’ democratic institutions, the practice of consensus and political convergence, and the increased observance of human rights all constitute historically transcendent achievements—all the more so because they occurred in the midst of the debilitating strictures imposed by the crisis. The new economic strategies that are oriented toward increasing the global competitiveness of countries require the incorporation of a greater number of economic agents into the productive process as a precondition for efficiency. This implies increasing levels of political participation. At the same time, the value placed on stability as a requisite for economic growth underlies the link between it and democratic governance.

### *The Quest for Stability*

Another silver lining resulting from the crisis has been the implementation of economic stabilization programs to combat the inflationary processes that in many countries reached the level of hyperinflation. The region can now point to several notable achievements in the war against severe inflationary processes—namely, the anti-inflation battles won by Bolivia, Chile and Costa Rica and more recently by Ecuador, Mexico and Venezuela. The drop in inflation rates during the past year is a clear indication of the success of the anti-inflation policies currently in place. Argentina, Nicaragua and Peru provide the most recent examples of that success.

The stabilization policies’ positive results owe a lot of their success to debt reduction programs, largely because of these programs’ beneficial effect upon the countries’ fiscal accounts. As part of the stabilization programs, most Latin American countries have also implemented very severe financial adjustment programs. The region now recognizes that the fiscal deficit has been at the heart of its past macroeconomic imbalances and that if it does not face this deficit with courage and resolve, the region will

have difficulty establishing even a minimum of stability upon which to build its long-term economic development process.

Latin America is now on the road to greater macroeconomic stability. This road has many stumbling blocks, and it holds many political and social costs. Even so, the region has time and again shown a strong political will to attack one of the elements perpetuating imbalances in income distribution—namely, the region's high inflation rates—even at a great short-term cost for every citizen. The Latin American public now clearly understands that the worst tax on the general population is inflicted by inflation. It understands that the high social costs of current stabilization programs are at least partially offset by a reduction of the sharp inflationary imbalances experienced by the region over the past several years. This understanding has inspired the people's political courage and their extraordinary degree of social tolerance, which have formed the backbone of many recent stabilization programs in Latin America.

### *Regional Openness to the World Economy*

One of the most important achievements of this silent revolution has been Latin America's growing openness to world trade and to private financial flows. The countries realize that today, in an increasingly interdependent world, there is no choice but to become more involved competitively in the international economy if a country wishes to achieve dynamic development. This is a fact that has been well assimilated by public opinion in Latin America. Economic development cannot take place in isolation, and therefore it is vital that countries of the region adjust their approach in order to claim their place within a demanding world economy where competitiveness is key.

To this end, programs have been initiated throughout Latin America designed to open up the region's economies, reduce tariffs, and promote exports. These new goals are true milestones for Latin America's economic development, particularly in view of the region's historical development experiences. Effective protection levels in Latin America now are nearly as low as in the industrialized countries; in some cases these low levels have been achieved with a dazzling speed and thoroughness unprecedented in world history. These efforts have all been made in the drive toward the creation of revamped Latin American economies that are more competitive than the region's economies of the past.

Unfortunately, the recessionary trends in the world economy continue unabated, and there also exists the disheartening possibility that today's international protectionist tendencies may continue as well (especially if the Uruguay Round of the GATT negotiations does not go well). These factors sow doubts in Latin America regarding the international

community's reciprocity of conditions vis-à-vis the region's good-faith reform efforts. If recession and protectionism continue, they can only discourage Latin America in its efforts to open its economies. The perpetuation of protectionism would create an unfortunate and ironic asymmetry between the protectionist economies abroad and the newly-open Latin American economies.

### *The Revision of Government's Role*

Another area in which the silent revolution has scored a victory has been the modification of Latin Americans' perception of the legitimate role of government, especially the quest for greater efficiency in the Latin American governments' performance and the region's concomitant effort to channel government activity into a more limited number of basic areas. This latter effort would exclude government from participating in the wide range of economic activities in which it had a role in the past. There has been also a growing effort in Latin America to achieve greater efficiency in the public sector (especially in state enterprises), as well as the privatization of state enterprises and the decentralization of government administration. Reform of the government now constitutes not only an important element in the drive to increase economic efficiency but also an important step toward carrying the democratization process to every level of the public sector.

### *Debt Management*

Application of recent adjustment policies and structural reforms was accompanied by action plans to solve the debt problem. Once the countries had achieved the urgent initial goal of protecting the creditor banks' position, subsequent action plans began to focus on alleviating some of the pressures resulting from the external financial obligations, as was achieved under the Brady Plan. This debt reduction approach has allowed several Latin American countries to be free at last from their long-standing crippling concern over their foreign debt. This is not to say that the issue of foreign debt is no longer an important one nor that the debt of the 1980s is no longer a deep concern for several countries of the region. It does mean, however, that the debt reduction effort can make a very positive contribution indeed to the countries' adjustment and structural reform programs, as in the case of Costa Rica, Mexico, Uruguay and Venezuela.

The results of the silent revolution have made themselves known on other fronts as well:

- The region's economic growth rate has improved. The most recent reports from ECLAC show that the region's GDP on the whole will

have grown by around 3.2 percent in 1991. This compares with less than 1 percent average growth during the past three years, and is in sharp contrast to the 0.3 percent recorded in 1990.

- Most of the Latin American countries' inflation rates have gone down, although several countries still register high rates because they are in the initial stages of their adjustment and reform programs. According to ECLAC, inflation indexes for the region as a whole, which had hovered at around 1,200 percent in 1989 and 1990, have fallen to 200 percent in 1991, and the expectation is for continued drops.
- Foreign capital flows are turning once again toward the region, and expatriate Latin American capital is coming home in increasing amounts. Furthermore, because of the revitalization of stock markets in most of the countries, foreign investment is being increasingly attracted to the region. According to a recent OECD report,<sup>8</sup> in 1990 the region received, for the first time since 1983, a positive net transfer of resources. Between 1983 and 1989, the region's negative transfers abroad ranged from \$15 billion to \$20 billion per year. In 1990 this transfer turned positive and amounted to a net capital inflow of \$10 billion into Latin America.

All of the foregoing are important indicators regarding early responses to the region's silent revolution.

### *The Subtle Change in Attitudes*

There have also occurred many unquantifiable and subtle changes for the good, in the form of lessons that we Latin Americans have learned from the crisis and attitude changes shaped by these experiences. Those of us who have worked for a long time in Latin America know that the region is constantly making progress of one form or another, not all of which is immediately or even ever reflected in the official statistics. A good part of this silent progress consists of attitudinal changes in individuals, or in our approach to organizing our businesses, or in the sphere of government, or in the underlying storehouse of knowledge and understanding we can draw on for the promotion of development.

Real progress recently seems to have been made, for instance, in the attitudes of most members of the region's political bodies. One by one these groups seem to be abandoning the rigid, ideology-ridden, conflictive and confrontational style so characteristic of them in the past

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<sup>8</sup>OECD, *Financing and External Debt of Developing Countries: 1990 Survey*, Paris, 1991.

and adopting instead a deliberative decision-making approach based on pragmatism, convergence and consensus. Our countries' political leaders have become more wary of populist and demagogic solutions and more committed to prudent policies oriented toward preserving vital economic balances. In turn, the region's economic leaders now understand the need to broaden the scope of adjustment policies and to pursue greater efficiency in the use of the region's economic resources—whether they be capital resources or human—in order to increase the countries' internal and external competitiveness.

Another beneficial attitude change has been the new appreciation for economic stability. Our countries' leaders now seem to understand more clearly than in the past that inflation is incompatible with economic growth; that inflation, in effect, constitutes a terrible tax upon the poorest sectors of the population. The population, in turn, is no longer willing to accept passively the indefinite continuation of inflation, and it now votes into office those candidates who promise to eliminate the inflationary scourge. As a result of these anti-inflation attitude changes, we Latin Americans are no longer swayed by monolithic monetarist or structuralist oversimplifications regarding the best policy approach for combating inflation. Even more importantly, the region is slowly beginning to recognize that macroeconomic equilibrium is a necessary (although not sufficient) condition for economic development and that macroeconomic balance constitutes a vital solid base upon which to build more deliberate structural reforms that in turn will ensure sustained growth and social equity.

Another favorable attitude change involves the rediscovery of the importance of the market as a mechanism for orienting economic activity, allocating resources, determining the shape of the production structure, identifying the necessary technological changes, and preparing our human resources. Market mechanisms are thus being given broader and more confident use than in past decades, when the government had participated excessively in economic processes. This shift involves a gradual decentralization of economic activities and deregulation of markets in order to encourage efficient resource use by both the public and private sectors. Nevertheless, history has also shown us that the market is not an infallible or sufficient mechanism for regulating economic activity, nor for ensuring such activity's compatibility with social equity. Therefore, we are now more sensitive to the need for an improved model of interaction between the market and the government.

The relationship between government and the market will involve a new attitude toward the private sector at all levels and toward other nongovernmental agents; both have an important role to play in our countries' economic and social development. Latin American business is being called upon to participate more vigorously than in the past in

investment decisions that shape the development process, in the financing of these investments, in the promotion and absorption of technological innovations, and in the search for new markets. Small businesses and the informal sector form a wide and valuable range of Latin American entrepreneurial acumen, although they certainly are not a panacea. Shoulder to shoulder with private businesses there also exist many nongovernmental organizations that can make a decisive contribution to the development process; these include scientific and professional organizations, regional and municipal groups, community-based organizations, and countless other bodies. The dialogue between the entrepreneurial and the labor sectors, and the social pacts that result from this dialogue, constitute a key element in a new Latin American development strategy.

Another recent positive change in attitude is the understanding that export expansion and diversification, and therefore foreign trade liberalization and the opening up of the region's economies, constitute vital factors not only for Latin American debt management but also for our successful economic transition during this difficult period. Concurrently, there also exists a new appreciation of the contribution that can be made by foreign investment. Such external resources can complement our own domestic investment capital, bringing in technological know-how from abroad and contributing to a closer relationship between Latin America and this foreign capital's home country markets—and eventually between Latin America and the world market in general.

One of the most notable recent attitude changes in the region has been the birth of a feeling that economic growth must be compatible with conservation of the environment and the region's natural resources. Our current regional environmental stance is by and large a moderate one, devoid of the economic development extremism of 20 years ago that espoused growth above all else, even at the cost of severe environmental damage and destruction of natural resources. At the same time, our current stance is also devoid of environmental extremism that is anti-growth. We are now able to visualize more clearly the careful balances that must be maintained between economic growth on the one hand, and, on the other hand, preservation of our environment as a basic condition for human life and development and as the provider of resources necessary to fuel economic development itself.

### ***Concerns and Limitations***

If I were asked to highlight some of the major concerns and limitations that I see on the Latin American development horizon, I would stress above all else the need to recognize the differences that exist among the region's many economies. These differences include size, production structure, sociopolitical system, and relationship with the world economy. One of the

main tenets of economic liberalism is that rational decision making and free choice are essential factors of economic systems operating under distortion-free market conditions. On the other hand, structuralism has contributed to economic analysis the important notion that the conduct of economic agents is framed by a set of behavioral rules stemming from these agents' particular historical, socioeconomic and institutional contexts. These differences go a long way toward explaining the varying degrees of resistance encountered from country to country by the structural reform effort, as well as the varying degrees of success of these reforms.

Another concern relates to the importance of the rhythm or cadence with which reforms are implemented. The experience of the industrialized economies shows that the implementation of reforms must be punctuated by strategic pauses or rest periods. The reform program must take place in stages. Marcelo Selowsky has proposed an interesting three-legged approach. The first stage should focus on reducing inflation and the financial deficit. The second stage should establish an incentive system and carry out reform of the public sector, including attempts to increase competition through deregulation. Finally, the third stage should strive for the renewal of economic growth through an increase in investment.

A final general concern posits the preservation of macroeconomic balances as a necessary although insufficient condition for the promotion of development. Development also requires a well-reasoned and thorough restructuring of the Latin American production sectors in order to ensure true economic competitiveness. There is no guarantee that economic stability in and of itself will automatically lead to the needed basic reforms. These reforms require vision and a deliberate, focused effort. Nor should the drive toward greater competitiveness be aimed exclusively inward, as in Latin America's early development years; i.e., it should also be directed toward the external market so that the region can gain experience in international competition. To this end, a major role must be assigned to the private sector, bearing in mind that the private sector does not operate in a vacuum but depends upon a broad network of relationships with labor, the education system, the technological infrastructure, the financial system, public and private institutions, and international markets. The government must play a key role within this network of relationships.

There currently exist broad areas of agreement between perceptions held in the world's large financial centers and perceptions held in Latin America on how to reinitiate the region's development process—agreement regarding basic goals and general approaches as well as many specific measures and policies. Nevertheless, Latin America must also fully recognize its own rich historic patrimony, its own special regional and local characteristics, its own particular social and political structure, and upon all these build the necessary consensus. During the 1990s an

authentic “Latin American Consensus” must be built that can serve as the foundation for future equity and sustained development in the region.

### **Toward a New Latin American Economic Consensus: Ten Challenges for the 1990s**

In the late 1980s the Latin American countries did indeed begin, little by little, to transcend old economic policies and undertake stabilization programs and economic reforms designed to lay the foundation for the renewal of growth—reforms based on the particular inspiration of each country and stemming from each economy’s own special circumstances. Although these programs and reforms acknowledge the influence of the international financial organizations through what has been called the “Washington Consensus,” there has also occurred a gradual formulation of relatively consensual Latin American responses vis-à-vis the new economic realities—responses based on a clearer perception of each country’s own agenda, problems and potential. In this context, the Latin American countries have focused on promoting structural reforms to create the necessary conditions for a thorough restructuring of the production sector; a politically sustainable restructuring based in part on the need to ensure social equity.

Therefore—and contrary to what is often believed in the economic circles of the industrialized countries and the international organizations—Latin Americans have already achieved a considerable consensus regarding the origins of and solutions to the crisis of the 1980s. This consensus has been arrived at from some very tough lessons learned during that decade. Above all, there now exists a clear idea in the region both of what caused the crisis and the nature of the crisis. There also exists a rather clear regional idea of the kinds of measures necessary to overcome the crisis, with an emphasis on avoiding adjustment measures that precipitate recessionary symptoms and instead undertaking structural reforms directed more at jump-starting regional economic growth.

This moderate yet significant advance toward a regional economic consensus would not have been possible without the preexistence of the new political consensus mentioned earlier. The same type of consensual process occurred years ago at the inception of the old model of inwardly-oriented development pursued in the postwar era. Today’s new political consensus is coming to life in a new civic culture—a culture that, in comparison with that of 40 years ago, is more pragmatic, less inclined toward conflict, more amenable to seeking convergence of ideas, less likely to embrace extremism, and oriented more toward the center range of public political ideology.

Despite the impressive progress made thus far in the building of a regional economic and political consensus and despite the wealth of

experience and common sense embodied therein, we should not forget that, in order to bear fruit, the consensus must also factor in the continued existence of a number of serious issues and challenges regarding Latin America's future development approach.

### ***Economic Sustainability***

One should never underestimate the importance of macroeconomic balances. By definition, the development process generates pressures on these balances, particularly on the fiscal side. In the past, Latin American countries dealt with macroeconomic balances in different ways, most of which were superficial and did not take seriously the strong inflationary and other pressures that were working against these balances. Today we must acknowledge that the achievement of macroeconomic equilibrium is a necessary, although not sufficient, condition for development. As noted earlier, development must also be promoted through substantive and deliberate measures and reforms. Even so, history has shown that the impact of macroeconomic imbalances on the development process can be devastating indeed, with social costs that most severely affect the low-income groups.

To ensure development and economic growth, then, these basic macroeconomic balances must be accompanied by a wide-ranging process of production sector modernization and transformation. As experience shows, it is vital to apply, in an integral fashion, macroeconomic policies oriented toward domestic economic liberalization, international competitiveness and economic openness. Among these policies we should highlight those related to the efficient operation of the financial system, providing for a good blend of financial market deregulation and supervision, skillful management of the interest rate, and an equilibrium real exchange rate compatible with trade liberalization and with promotion of foreign investment. At the microeconomic level, the successful transformation and modernization of the production sector will depend heavily upon flexibility in the country's production apparatus, more and better intersectorial linkages among the countries' respective production systems, and greater receptiveness to technological change.

Modernization of the Latin American economies will also require a tremendous investment effort. Perhaps the most devastating economic consequence of the crisis of the 1980s was the sharp fall in investment levels, which declined to only two-thirds of their average 1970 level. During the 1980s, in other words, there was an annual economic and social investment shortfall of \$70 billion to \$80 billion vis-à-vis the 1970s—a shortfall that is still adversely affecting our region's development and will continue to do so for years, even after investment resumes. Therefore, great emphasis must be placed upon the mobilization of

domestic savings, whether public or private, and upon the repatriation of flight capital. We must also, as is already occurring, adjust our attitude toward foreign direct investment.

### ***Social Sustainability***

The crisis and its painful consequences severely pushed the limits of the Latin American populations' social tolerance and forbearance. The grueling experience of the crisis has made our societies better understand the need to reestablish vital macroeconomic balances, not only as a precondition for economic growth but also to avoid the painful social deterioration that always accompanies inflation. This new understanding is the realization that populations do indeed have their breaking point. As we know, average per capita income during the 1980s plummeted to levels prevailing 13 years earlier. One-third of Latin America's population still lives in conditions of abject poverty, which is painfully reflected in the low-income sector's limited access to health services, proper nutrition, and education.

These poverty-related deficiencies are particularly hard on children, negatively affecting their personal potential and the quality of Latin America's future human resource base. The social and work status of women has also become an issue of tremendous concern that must be adequately addressed if economic development is to succeed. Problems exist also at the higher levels of the region's social pyramid: one of the greatest challenges facing us in the coming years relates to the low efficiency and the huge financing needs of our social security programs.

During the past several years, the informal sector of Latin America's economies has become very important. The number of persons working in the informal sector is believed to have increased by more than 50 percent since 1985, and around 30 percent of the region's total economic activity is carried out there.

In the past the informal sector was viewed merely as a pocket of disguised unemployment or unproductive work—as a social problem that needed attention. Nowadays that perception has radically changed, and the sector is currently considered as a potentially strong force for development. Thus countries need appropriate policies and adequate institutional reforms to allow the sector to make an even more meaningful contribution to the economy. The challenge is that the gradual incorporation of the informal sector into the economy must be achieved, in many instances, through nontraditional channels and imaginative organizational structures.

The Latin American countries have had many years of experience in income redistribution policies, much of it not very successful. They have recently learned to make income redistribution policies compatible with

the preservation of vital macroeconomic equilibriums. Nevertheless, because of the magnitude of the social problems facing the region, new ways of combating poverty must be sought. The possibilities include giving greater official attention to the following: the informal sector's role in the economy, women's role and status in the job market, and the compatibilization of Latin American education systems with the hard reality that many school age children must devote much time to earning a living. Latin Americans also have had many years of experience in other types of reforms (including tax reforms)—particularly those tailored to the realities and needs of low-income population groups. Specifically targeted policies to attend to needs and groups of the poor have often met with greater success than have the larger, less focused programs. Some countries are also beginning to create social security safety nets to help provide economic protection for the low-income groups.

### ***Reform of the State***

Given the importance of the government's role within the region's postwar development model, it is surprising to see such a broad consensus now among diverse sectors regarding the need to reform the government. There still exist minorities who defend the old traditional interventionist style of government, and there also exist extreme neoliberal minorities at the other end of the spectrum who are vocally advocating the total dismantling of the government—but these are simply minorities, however vocal. Latin Americans are beginning to realize that the pseudo-dilemma concerning the optimal size of the government is beside the point. What really matters is not the exact size of the government but how well government performs its legitimate functions (without stepping into functions that properly belong in private hands) and how well government handles its relationship to the market and to the various other sectors of society. Of course, government size cannot be completely ignored as an issue, but other concerns are also important, such as the degree of flexibility, efficiency and decentralization with which government carries out its role.

Many structural reforms now underway in Latin America are in fact oriented toward the government and its functions. The goals of government reform include the following: maintenance of fiscal discipline; priority allocation of public expenditure; establishment of the most broadly based tax system possible, endowed with adequate collection mechanisms; liberalization of the financial system and adequate management of interest rates; privatization of certain state enterprises to make them more efficient and to help reduce the fiscal deficit; transfer of certain government functions to different private or nongovernmental organizations, smaller

jurisdictions, or community groups; and deregulation of selected economic activities. Naturally, certain sectors and operations would be best left in the hands of the state enterprises, but these enterprises should be required to perform as efficiently as any private business.

### ***Strengthening the Private Sector***

The logical complement to reforming the government is strengthening the private sector. One of the factors justifying the adoption of the Latin American postwar development model was the weakness of the private sector. Since that era, the private sector has evolved significantly and will need to step up its future efforts in that same progressive direction if the region's economies are to be able to compete in the world market. In this regard, small and medium-sized Latin American enterprises—which in the past had only very limited access to normal technological, trade and credit resources—hold great potential. We have also noted the great potential inherent in the sector comprising the region's very small businesses (microenterprises). Even today, this sector is totally excluded from access to normal technological, trade and credit resources and therefore greatly in need of innovative outreach programs through a wide variety of intermediaries—programs that go beyond the usual sectorial and geographic parameters of traditional business support programs.

The three following conditions are essential for the development of private business in Latin America: first, establishing clear and stable rules of the game regarding the relationship between government and small business; second, creating and maintaining a favorable investment climate; and third, reorienting the relationship between capital and labor, by means of medium-term and visionary long-term social agreements based on greater linkages between a company's workers and the future success of that company.

Reforming the government and strengthening the private sector transcend the usual boundaries of government and business issues and therefore point to the need for a thorough reconstruction of our countries' institutional systems of support. In this sense, in keeping with these government and private sector reforms, Latin America needs to strengthen the hand of the many other social and economic agents that participate in the development process: e.g., local and regional organizations, community groups, professional organizations, and other such bodies.

### ***Technological Modernization***

Development of the Latin American countries in today's world depends heavily upon the form and degree of their participation in the internation-

al economy. As we know, world trade in manufactures has grown at a much faster rate than total world trade, and trade in manufactures embodying a high degree of technological innovation has grown the fastest of all. Latin America's possibilities of producing competitively and of entering the world market depend upon its capacity to keep up with international technological trends and to incorporate up-to-the-minute know-how into its production of exportable goods and services. This ability will require specific programs oriented toward promoting the development of science and technology. In addition, it will require specific programs oriented toward promoting the development of the organizational aspects of Latin American companies, these companies' relationships with the various production sectors and with marketing and financial services, human resource training programs, and each country's institutional, social and political framework.

In this regard, technological progress also demands stability and comity in the company's internal relationships among its entrepreneurs, professionals and labor force, as well as the ability of these three internal sectors to cooperate in actions that enhance company productivity. This stable and cooperative interrelationship can be fostered by participation in entrepreneurial, professional or labor organizations that not only seek to represent their membership but also help to foster cooperation within the company.

In addition, our economies can foster technological modernization of their production sectors and can encourage more technology-intensive exports through association with sources of foreign investment and with multinational companies. This association should be viewed as a healthy complement to and catalyst for the role of private Latin American companies in their efforts to produce and export competitively.

### ***Preparation of Human Resources***

The incorporation of modern technology into the Latin American economies cannot be achieved without an extraordinary effort to prepare and train the region's human resources. In this case, similarly to what happened to the informal sector, a problem once considered purely social in nature—the education and formation of human resources—has now taken on a whole new set of implications and is currently considered a fundamental factor in the region's future economic development. The gap that Latin America must bridge in regard to the preparation of human resources is defined on the one side by the region's persistent poverty and social inequality and on the other side by the region's urgent need for highly-skilled Latin American workers and technicians to help the production sector stay afloat in a world of dizzying technological

change. Resources must be mobilized for use by the education sector and by the human resource training sector, and existing resources already assigned to these sectors must be applied more efficiently and more in keeping with the major training goals pursued.

Clearly our countries are plagued by serious problems related to the quality of elementary and secondary education and the quality and accessibility of university education. But perhaps the most serious bottleneck in human resource formation is that existing in the region's technical and intermediate training programs. It is ironic that, despite the overwhelming demand for this type of technical and intermediate training programs, they still constitute an unresolved educational problem in most Latin American countries. These technical training programs must be intensified, increased and modernized. Additionally, their basic design must be modified to make the programs more harmonious with the new job opportunities being generated by the region's production transformation, and to provide the programs with the broadest and most flexible base possible so that program participants can obtain the fundamental skills necessary for dealing successfully with a rapidly evolving job market.

Therefore, these technical and intermediate training programs must be better integrated with the actual sectors of production; they must, as noted, be very flexible; and they must be oriented toward well-defined labor groups. These specific target labor groups clearly should include those usually in strong demand in small and medium-sized businesses and in the informal sector. Special attention also needs to be given to retraining workers who have lost their traditional types of jobs because of the rapid changes being made in the countries' production sectors.

To attend to all of these needs in the area of human resource preparation and training, we must design broad and flexible policies that incorporate elements taken from the countries' own current economic and social policies. In addition, we must encourage close training-oriented cooperation between the government and the private sector. On the one hand, it does seem logical to expect the private sector to contribute significantly to the training of human resources, because well-trained workers constitute a necessary input into private sector production. On the other hand, Latin America's private sector producers have not always been in a position to make such a contribution to training. Therefore, government and the private sector must work together to design and make available adequate worker preparation.

### ***Importance of the Integration Process***

After a long, uneven and largely unsuccessful history, economic integration among Latin American countries has changed significantly in charac-

ter and is beginning to play a very direct role in our countries' new development strategies. One difference between our earlier integration experiences and those of today is that the latter, as a general rule, have a more limited scope in terms of the countries, sectors and interests involved in them, as well as greater flexibility, greater sensitivity to market signals, and a less preprogrammed approach.

Another difference is that now, countries seeking effective economic complementation programs do so on the basis of affinities that are not necessarily related to geographical proximity or to similarity of per capita income levels but affinities related more to compatibility in terms of the orientation, rhythm and results of the integrating countries' economic reforms and in terms of the countries' relative levels of production competitiveness. A final difference between the economic integration approach of yesterday and that of today has to do with the following point: today's integration and cooperation efforts are strongly oriented toward the outside world, with an eye to better equipping their participants to export competitively in the world marketplace.

If the new Latin American integration agreements continue to have the characteristics just described, then they can play a decisive role in the Latin American countries' development strategies. One example of this entails the agreements signed between Argentina and Brazil, with later accession by Paraguay and Uruguay, and the formation of MERCOSUR. The agreements signed this year between Chile and Mexico and between Chile and Venezuela are additional indicators of these same trends.

In addition to paralyzing the region's earlier integration schemes (which had been showing serious signs of weakness), the crisis of the 1980s helped persuade countries to begin using economic complementation and integration to achieve greater exposure to international competition. For this reason, countries that in recent times have shown an interest in promoting integration or complementation agreements are very aware of the need for the integrating economies to have satisfied certain basic requirements related to national macroeconomic balances and to competitiveness of their production sectors. It is at this point that an old integration difficulty again crops up, and this time with renewed vigor—namely, the need for these integration initiatives to be based on growing participation by the private sectors.

### ***Increased Regional Participation in the World Economy***

There is now a strong consensus that the Latin American strategies for the 1990s must promote increased economic openness and greater integration into the world economy. As noted, the region's economies have already undertaken significant reforms with these goals in mind and have

achieved considerable increases in both their traditional and nontraditional exports. In addition to appropriate macroeconomic policies for tariffs and exchange rates, new sector-specific policies have also been designed for tax reduction, technological support, and market information. Equally important are recent policies designed to remove restrictions that dampened exports (such as the maintenance of government-administered prices). The countries will have to persevere in these policies of economic openness and liberalization. Nevertheless, they had clearly hoped for a more favorable reaction on the part of the international community, which seems not to have yet fully appreciated Latin America's efforts. Many countries worldwide, in fact, continue to apply subtle and shifting protectionist measures and therefore have not contributed as much as had been hoped to the success in the Uruguay Round of GATT negotiations.

In this context it is important to examine the potential of the Enterprise for the Americas Initiative announced in 1990 by U.S. President Bush. The initiative has earned the support of the region's political leaders and has set in motion a process of lively public discussion, in which the Inter-American Development Bank has actively participated. The initiative's most prominent aspects include first, the wide-ranging nature of the proposal, which covers trade, debt and investment; second, the proposal's potential to contribute significantly to alleviating the small and medium-sized Latin American countries' debt problems, through reduction of their public debt and through the possibility of their paying interest on the debt in local currency so that the money can be used in domestic environmental protection projects; and third, the proposal's potential for participation by a wide range of national and international figures, organizations and business interests.

The Enterprise for the Americas Initiative seems to fit well with the current world trend toward the formation of regional economic blocs. This trend, of course, can include different shadings and varied approaches, and in the case of the Western Hemisphere, such a bloc would have to assume very particular and special characteristics. Incidentally, we should not be confused by the pseudo-dilemma, posed by some Latin American sectors, regarding the region's supposed inability to participate in this initiative and simultaneously in regional or subregional integration efforts. To the degree that Latin American economic integration programs become more oriented toward helping the participating countries compete on the world market, to that same degree Latin American integration loses its potential to clash with the Enterprise for the Americas Initiative. In short, the Latin American integration process is complementary to the initiative.

The strengthening of Latin America's participation in the global economy depends heavily upon the region's financial relationships with

the rest of the world. Work must continue on improving the mechanisms whereby traditional financial flows to the region can be resumed—i.e., access to international capital markets, the creation of a hospitable climate for foreign investment, and the efficient use of resources provided by the international financial organizations.

### *Ecological Sustainability*

With respect to environmental issues, the world has come a long way between the Stockholm conference of 1972 and the Rio de Janeiro meeting of June 1992. The progress made in this two decade time span has been especially impressive in the case of Latin America. When concern for the environment became an important issue during the early 1970s, the developing countries to a degree distanced themselves ideologically from the industrialized countries, in the belief that the developing countries' economic growth policies necessitated a certain degree of pressure on those countries' environmental resources. Twenty years down the line, the developing countries in general—and those of Latin America in particular—have attained a clearer awareness of the nature of the problem facing them.

Our region now finds itself at a historic crossroads. We must undertake a huge productive transformation that, despite its vast scope, will nevertheless need to be executed in an ecologically conscientious manner if it is to ensure rational management of our natural resources and proper care of the environment. We do not, however, have the option of halting our economic growth process in the name of ecological conservation. For Latin America, in other words, the challenge is not, as in the industrialized countries, one of improving the quality of life even though living standards may consequently have to decline somewhat. The challenge in Latin America is instead that of improving living standards in an ecologically sustainable and responsible manner.

With respect to the link between economic development and the environment, the region has come to several important new understandings and changes in attitude. One of these changes is the realization that the planet's resources are limited and that mankind is engaged in a counterproductive process of destroying those resources throughout the world, even in Latin America. Another change in attitude is the recognition of the importance of all of earth's inhabitants' shared ecological responsibilities. This includes, among other things, the ozone layer, the oceans, and our air quality—any of whose continued deterioration will affect the entire human race and whose preservation has rightly become a topic of international conversations. Still another change in attitude, and one quite pragmatic, is recognition of the strong correlation existing

between high economic efficiency and high quality of the environmental conditions (and of the rural and urban habitat) in which a society lives.

### ***Political Sustainability***

Economists cannot ignore the political context in which the Latin American countries will be carrying out their renewed economic development process. This process, by definition, tends to generate social pressures that in turn affect the political system. The countries of the region inherited the historical tradition of the old European continent that existed at the time of their independence. Therefore, their political tradition has a dual nature: the ideologically pluralistic political system taken from the Europe of the 1800s and the style of authoritarian-type regimes left over from Latin America's colonial days.

Although in the past the Latin American countries' economic instability may have often been the cause of their political vicissitudes, in recent times their political vicissitudes have caused a good deal of their economic instability. The thoroughgoing economic and productive transformation that Latin America has undertaken and the region's urgent need to increase its participation in the world economy both necessitate a level of political stability that can be achieved only through a very broad new social consensus. The weakening of extreme right-wing and left-wing political tendencies that occurred in Latin America after the basic consensus of the 1960s, characterized by the emergence of moderate reformist regimes, marked the beginning of a return to intermediate and pragmatic positions, to the practice of consensus instead of conflict, and to a more practical and less ideology-bound vision in political matters.

Interestingly, in many Latin American countries, this trend has led to changes in their national constitutions to ensure that moderation, stability and the peaceful transfer of power from administration to administration will be key elements in the newly-emerging political environment. This is a very important task for the region, and one destined to give greater depth to their respective institutional reforms. These institutional reforms in turn are expected to harmonize the region's political and economic realities, which together with the structural reforms being implemented throughout Latin America will promote the social tolerance needed for the successful maturation of the region's overall structural economic transformation.

## COMMENTS ON “THE SEARCH FOR A NEW ECONOMIC CONSENSUS IN LATIN AMERICA”

Antonio Casas González<sup>1</sup>

Meditating on recent experiences in the economic and social development of Latin America means exchanging excitement and faith for doubt and perhaps dismay as one realizes how much was lost along the way. However, nothing can be more negative than defeatism or fatalism. We Latin Americans, as Hirschman suggests in his article on the political economy of Latin America,<sup>2</sup> tend toward pessimism.

The full picture of the Latin American past, with all its difficulties, is a positive one in terms of economic accomplishments, social progress and political development. Since independence, Latin America has sought new ways and formulated original positions and independent assessments in the political and economic spheres, the effects of which have been felt beyond our region's frontiers. One proof of that is the intellectual legacy of Raúl Prebisch: his memory and thought are indispensable sources when we confront the current, not always new, problems of building the Latin American nations.

Perhaps Prebisch's most important teaching, in light of the current debates and the claim by some representatives of the neoliberal school and some multilateral institutions that their prescriptions have universal application, is his eclectic, undogmatic approach. As Enrique Iglesias rightly points out in his paper, Prebisch stressed the study of the initial specific conditions of each economy: natural resources, size of domestic markets and population, and relations with the world economy.

This open attitude of Prebisch contrasts with the present posture of the neoliberal school, which tends to underestimate the importance of the international environment in the history of the economies of the developing countries and “assumes the cultural, social, historical and political homogeneity” of these countries.<sup>3</sup>

Iglesias' paper is a challenge to the intellect and a rejection of the expedient interpretations of recent history in Latin American thinking and political and economic praxis. I comment on Iglesias' observations with

<sup>1</sup>Senior executive at Petrovén, Venezuela.

<sup>2</sup>A. Hirschman, “The Political Economy of Latin American Development,” *Latin American Research Review*, 22, 26, 1986.

<sup>3</sup>J. Manor, “Politics and the Neoliberals,” in C. Cloclough, *States or Markets?*, New York, Oxford University Press, 1991.

the sole desire to render warm homage to the memory of Raúl Prebisch as a master of his field, and to contribute to the constructive debate concerning a few points that I consider especially important in the current Latin American and international context and which Prebisch broached at some time. Given Enrique Iglesias' intellectual caliber and his knowledge of Latin America, I knew beforehand that I would not be able to improve on anything he said.

Paradoxically, in the 1980s two processes of great importance to the region occurred simultaneously. The consequences of that simultaneity have not been sufficiently analyzed.

The first process was the external debt crisis and the consequent application of extremely harsh adjustment policies, with all their well-known socioeconomic effects. The second was the extraordinary movement toward democratization that swept the region and that considerably transcends the simple replacement of de facto governments by elected presidents. Today this political movement embraces the entire society and includes drives to modernize political and state structures; the participation of the community in the definition of measures affecting its daily existence; recognition of the rights of the opposition; protection of minorities; and, fittingly now that the quincentenary of Columbus' landfall is upon us, the belated acknowledgment that Latin American society is multiethnic, multicultural and multilingual. Consequently, given the strides made by democratic forces, the past decade can be considered "lost" only from a strictly economic point of view.

It was thought impossible for such progress to be made in strengthening institutions and democratic culture just as the region was sinking into the worst economic recession since the Second World War. What seemed imminent was a return to the social conflicts and confrontations of the sixties or a step back to the military dictatorships of the seventies, in that "swing of the pendulum" between democracy and despotism so familiar in Latin America. The best alternative that could be hoped for seemed to be a regression to situations in which hard-won civil liberties would be curtailed, giving rise to new forms of "rump," "restricted" or "limited" democracies.<sup>4</sup> But none of this came about and the region is undergoing, for the first time since independence, the rare experience of having popularly elected governments in almost all its countries.

This development has placed politicians, businesses, leaders and all of civil society in front of a formidable challenge: carrying out the political and economic commitments to cement democracy and reduce poverty. The expectations raised in the process, both within our societies

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<sup>4</sup>R. Pastor, *Democracy in Latin America*, New York, H.M., 1989.

and in the international community can, if not handled properly, end in frustration. Latin American governments and societies are faced with the dual task of paying the external debt and ensuring that investment required to maintain employment and capital formation reach levels necessary for sustained development in the region. At the same time they have to tackle poverty and meet the basic needs of populations reeling from economic adjustment. As if that were not enough, Latin America also has to respond in a timely and positive fashion to global political, economic, social and technological change. Further, it has to carve a place in the new world order following the collapse of the socialist bloc and on the new map of economic relations growing out of that collapse, including growing economic and political interdependence in the European Community, the Far East and North America.

The magnitude of the tasks and the relative urgency of each requires a resolution of the apparent dichotomy between political and economic processes, at least in the medium and long term. Democracy and economic development converge and point to the same end: just societies in which free, truly free, citizens fully participate in and enjoy the benefits of economic progress. In that context, neither economic growth nor democratic practices can be regarded as final ends, per se, as might have been the case at certain times in the past and as might happen again if the wrong circumstances are allowed to develop.<sup>5</sup>

In fact, the global political climate seems to favor giving priority to the goals of economic growth and postponing indefinitely those of social justice, or of leaving the latter to the play of market forces. In this scheme of priorities, democracy becomes a stabilizing agent for the status quo and not a catalyst for the change required by the "structural alterations of society and its consequent changes in power relationships induced by that same economic growth," as Prebisch analyzed it so brilliantly in his 1984 essay "The Global Crisis of Capitalism and its Theoretical Significance."<sup>6</sup>

In the Latin American context, the basic questions, some of which can help one understand the development problems faced by Latin America in recent years, must be analyzed and resolved in the light of local experiences and those of other countries.

I would like first to take up the subject, so often discussed these days, of the relationship between state and society. What one hears in academia, political circles and multilateral institutions is that the state should shrink and reduce its scope of action as defined by welfare

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<sup>5</sup>R. Huntington, "The Modest Meaning of Democracy," in Pastor, *op. cit.*, 1989.

<sup>6</sup>R. Prebisch, in the *ECLAC Review*, 22, Chile, 1984.

economics and Keynesian doctrine. The guiding precept, for purposes of economic growth, seems to be that an imperfect market is preferable to an interventionist state. A look at Latin American reality makes it difficult to accept that the state in Latin American countries has many of the familiar features of the British, Swedish or North American welfare states, whose alleged excesses gave rise to the ideological programs of the Reagan and Thatcher governments.

Nor, in most cases, does the Latin American state account for such a large share of the domestic product. The conclusion that the Southeast Asian countries' higher level of performance than Latin America's in terms of sustained economic growth came about because in the former the state was smaller and intervened less appears incorrect and unsupported by objective observation. The major difference seems to stem more from the effectiveness, flexibility and consistency of their policies than from their orientation.

For policies to be effective—that is to say, for them to produce the desired economic transformation—the state must be capable of defining and applying coherent economic strategies. This ability is in turn determined by the degree of the state's autonomy in dealing with pressure groups, by the effectiveness of the administrative structure and by the decision-making process in all fields of social activity, apart from the direct pressures of particular groups. The main difference is reflected in the findings of analysts who have studied the characteristics of our political reality.<sup>7</sup> The Southeast Asian state is more autonomous than the Latin American one: the latter not only has a narrower margin of freedom, but its administration and the economic planning process are much more politicized. In this perspective, the autonomy of the state means its "ability to adopt policies which further the economy as a whole, even when they conflict with the interests of particular sectors."<sup>8</sup> This autonomy is relative in the sense that no state can affect the long-term interests of these groups.

In this context, both the Korean and Japanese states are considered "strong states," in that they can set political goals independently of the particular forces acting on the civil society. In the Latin American case, the restricted autonomy of the state and public agencies leads to a lack of coherent policy and, very frequently, to such inflexibility that it is impossible to apply corrective measures or changes in course in a timely manner when policies prove mistaken. Examples of this apparent dog-

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<sup>7</sup>P. Cammack, "States and Markets in Latin America," mimeo, 1990.

<sup>8</sup>R. Jenkins, "The Political Economy of Industrialization. A Comparison of Latin American and East Asian Newly Industrializing Countries," *Development and Change*, 22, 1991, pp. 197-231.

matism are numerous. It is enough to cite the difficulty of reforming the import substitution model (even when its exhaustion was already obvious in the fifties), as Prebisch suggested when he stressed that it was necessary to move on to exports as a logical step in the industrialization process. Among the various alternatives, the option chosen was that of extending substitution toward capital and intermediate goods, without considering the costs implicit in the size of the market. It was, of course, the strategy defended by those sectors profiting from protection and fearful of the effect that liberalization of domestic markets would have, at least temporarily, on their interests. Much has already been written about the way the Korean state succeeded in imposing its export strategy when it deemed substitution to have run its course. Another example of that lack of flexibility is the insistence on maintaining a given exchange parity, based in many cases on reasons of national pride or sovereignty, when what an overvalued currency actually does is serve as a cover for special interest groups.

The lack of autonomy on the part of the state is obvious in the politicization of the administrative bureaucracy and the proliferation of agencies, many of which have become fiefdoms of one interest group or another, often feuding among themselves. The result is well-known: not only were policies inconsistent but the capacity to implement them and set them in motion was simply not in place. For example, in many Latin American countries agrarian reform programs designed in the appropriate institutes and passed by Congress were hamstrung by ministries or by agricultural development and credit agencies. Conversely the democratization of land ownership in postwar Japan, Korea and Taiwan is one of the factors often cited to explain the rapid economic growth and the modernization of agriculture in those countries. The modernization of agriculture occupies a prominent place in Prebisch's thinking as a base from which to raise productivity, increase per capita income and sustain the development of industrial activity. He made this point in the series of lectures he gave in Santiago, Chile in the early 1950s.<sup>9</sup> In many aspects (such as land ownership, the adoption of modern technology and income levels of the rural population), the modernization of rural Latin America is a task that has yet to be tackled.

No less serious is the failure to modernize tax policy. Such modernization means, first, designing tax rules and rates that would truly stimulate the economy and discourage a rentier mentality, and second, creating effective collection mechanisms. The failed tax reforms have

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<sup>9</sup>R. Prebisch, "El desarrollo económico de América Latina y sus principales problemas," United Nations (E/C. 12/R.1), 1950.

meant neither more nor less than defunding of the government, forced recourse to public borrowing, inflationary pressures and macroeconomic instability, with their pernicious effects on economic growth.

Of the countless parallels between the Asian and the Latin American countries, tax management is perhaps the most significant in terms of the autonomy and power of the state. In Korea and Mexico in 1960 the ratio of taxes collected to gross national product was close to 9 percent, and both countries registered considerable fiscal deficits. By the beginning of the seventies, Korea had raised its ratio to 15.4 percent and was accumulating a sizable fiscal surplus.

Following this line of thought, it is necessary today to urge economists and planners to abandon this unproductive polemic concerning abstract models in which it is assumed that the market is an efficient mechanism for the allocation of factors of production. It is necessary to center more on the real conditions of our economies and the world economy, and to take serious note of the magnitude of their shortcomings. I agree with Stiglitz when he suggests that observation of the “economic pathology”—the persistence of unemployment in developed economies and of absolute poverty in no less than 25 percent of the population of developing countries—should cause us to question the intrinsic efficiency of the “invisible hand” rather than take refuge in theoretical premises about unemployment being a preferred option, a voluntary decision, or a result of imperfections in the circulation of information.<sup>10</sup>

I believe it is impossible to take the attitude with respect to Latin America that the market allocates the factors of production and that—if the result is a more unequal income distribution and greater relative levels of poverty—all the state should do is to transfer resources, give out subsidies or otherwise palliate those effects. The classic prescription of neoliberal economics has not proved useful even for the developed economies: i.e., the number of homeless people in England is estimated at around 80,000. It is all the more impracticable in our countries, given the extent of economic and social destitution. And I say impracticable not on account of the resources required but because it is essential, if we intend to integrate our societies democratically, that all citizens have the opportunity to fully develop their potential and exercise their civic rights and duties. This will be possible only if conditions are created in which economic development is less exclusionary and brings about greater employment of the factors of production, starting with human resources,

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<sup>10</sup>E. Stiglitz, “The Invisible Hand and Modern Welfare Economics,” NBER papers, no. 3641, 1991.

the most important factor, as Prebisch advocated in his earlier works on Latin American development.<sup>11</sup> We are reminded, nostalgically, of the persistent message of former President Caldera of Venezuela (in his plans for governing, shared by several Latin American presidents of that era) that the fundamental objective of development is always man.

In other words, the concepts of effectiveness and equity cannot be separated so radically. The persistence of the recession and the rise of unemployment and poverty in the developed countries indicate that neither the neoliberal nor the monetarist analysis is the most suitable instrument for correcting the dynamic imbalances of capitalism, as suggested in the above-mentioned study by Prebisch on the economic crisis experienced by the industrial nations.<sup>12</sup> These elements of economic policy cannot be ignored and must be at the center of the discussion about the building of democracy and guide the efforts of the IDB and ECLAC, the region's most important development agencies.

Another field in which it is difficult to accept the correctness of the market (or better said, in which it is evident that the market does not operate according to the assumptions of classical theory) is that of technological development and dissemination. This essential point in Prebisch's model is now upheld by many highly respected economists, several of them not members of the structuralist school. Asymmetrical technological development and the trend to ever greater concentration of scientific progress justify actions by the state and the economic agents to break that inertia and develop the human, intellectual and scientific potential of the developing countries. To begin with, models derived from the classical theory of international trade (working with assumptions of incomplete markets and imperfect information) assume fixed technological parameters; i.e., technological development is regarded as exogenously determined. But as we well know, technological development is the result of deliberate efforts by firms to develop new products and cut production costs; it is the ultimate form of competition. Consequently, a model that does not include technological development cannot accurately reflect the real world. Technological development, whether achieved through learning by doing or through research and development, generates economies of scale and external economies and represents a true entry cost. All the foregoing limits competition. Therefore, industries in which research and development costs are high and patents burdensome are imperfectly competitive and can lead to ineffi-

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<sup>11</sup>R. Prebisch, *Toward a Dynamic Development Policy for Latin America*, United Nations (E/CNa2/680/R1), 1963.

<sup>12</sup>R. Prebisch, in the *ECLAC Review*, 22, 1984.

cient allocation of the factors of production. I do not think it necessary to dwell on the need to break this cycle of technological lag by means of measures neutralizing those market inefficiencies and those initial inequalities, as Prebisch advocated almost 50 years ago.

A process of involution of productive structures is at work throughout almost the entire region. Some consider this process a rationalization of the economy and others regard it as a utilization of natural comparative advantages. In fact, if appropriate measures are not taken it could be a net loss of an entire effort to build dynamic comparative advantages, assimilate and develop technological skills, and create technical capacity which, incidentally, has made the recent, significant expansion of manufacturing exports possible. If this process, which has positive aspects, is not to entail the frittering away of entire decades' worth of effort, the government, business, labor and scientific communities must undertake very serious steps to foster scientific and technological research and apply its results to the production of goods and services in order to boost the region's share of international trade. These observations may not be novel, but this seems to me to be a good time to reiterate them.

To prepare these notes I reread some of Raúl Prebisch's works, and, with the excitement of a disciple, found that his thinking is more relevant than ever today. We Latin Americans ought to acknowledge this and seek in his work the solutions to current economic problems. The barrier that prevents us from believing in our own strengths must be overcome, especially as regards our creative capacity. We must dare to contradict intellectual fashions that may be no more than sophisticated rationalizations of powerful entrenched interests.

## **DEVELOPING COUNTRIES: EXPORT PRICES OF COMMODITIES AND MANUFACTURES, TERMS OF BORROWING, AND RETURNS ON CAPITAL**

Dragoslav Avramovic<sup>1</sup>

### **Introduction**

I propose to discuss two points made in Dr. Iglesias' comprehensive study. First, he draws attention to the importance of world economic trends for economic policy of Latin America: "The persistence of an unfavorable international economic framework could be viewed as the primary obstacle that must be contended with by the region's present economic reform efforts." In this statement, he is referring to the terms of trade and to obstacles to Latin American exports due to protectionism abroad. Secondly, Dr. Iglesias considers that it was the 1970s—not the 1980s—that was the region's true "lost decade"; i.e., "the extraordinary climate of international financial permissiveness" existing in the 1970s was used for excessive Latin American foreign borrowing on unsustainable terms which led to the region's subsequent financial disaster, economic stagnation and decline.

I will put forward some facts regarding developments in the world economy which present a cause for concern for countries in the developing areas, including Latin America in the 1990s, and then draw some implications for the economic policies of these countries.

### **Commodity Problem**

Since 1950, many developing countries have gone through a significant industrialization drive, and since 1970 a limited but growing number have succeeded in developing considerable, and rising, exports of manufactures for the world market. Nonetheless, the majority of developing countries have remained dependent on primary products for welfare and growth. African countries depend on primary products for an overwhelming 90 percent of their total exports. Primary products account for more than 65 percent of Latin American exports, and similar dependence is encountered in many other developing countries.

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**Table 1. Weighted Index of Commodity Prices for 33 Products, 1980–91**  
(In constant U.S. dollars, 1979–80 = 100)<sup>a</sup>

1980	104.8	1986	69.3
1981	90.9	1987	63.4
1982	8.26	1988	71.1
1983	89.1	1989	70.3
1984	92.3	1990	62.1
1985	81.3	1991	57.0 <sup>b</sup>

Source: World Bank, *Quarterly Review of Commodity Markets*, June 1991.

<sup>a</sup> Excluding energy. Weighted by 1979–81 developing countries' export values.

<sup>b</sup> First half, preliminary.

### *The Commodity Slump of 1990-91*

Between early 1989 and mid-1991, export commodity prices of developing countries fell about 20 percent, according to the UNCTAD, World Bank and IMF indices, a rate of decline only slightly lower than during the slump in 1980-82, which triggered the international debt crisis. *The Economist's* index shows a decline of about 30 percent between 1988 and 1991.<sup>2</sup> Prices of primary products in real terms are much lower now than they were in the early 1980s, and therefore any additional fall is felt with ever greater hardship (Table 1).

Most of the key products are affected by the present commodity depression. "Aluminum prices are probably at an all-time low in real terms,"<sup>3</sup> tin prices in August 1991 were at a level "at which most of the world's tin mining and smelting operations are loss-makers"<sup>4</sup>; "our dollar metals index has fallen 27 percent over the past year and it is now more than 50 percent below its June 1988 peak"<sup>5</sup>; "combined stocks of base metals on the London Metal Exchange have risen to an all-time high"<sup>6</sup>; "Malaysian rubber output is at the lowest level for 20 years"<sup>7</sup>; prices of coffee and tea in real terms are lower than at any time since 1950<sup>8</sup>; cocoa is undergoing a major depression; the real price of jute since 1986 is a fraction of the historical level<sup>9</sup>; and sugar at 8.8 cents per pound<sup>10</sup> is once

<sup>2</sup> *The Economist*, April 13, 1991.

<sup>3</sup> *Financial Times*, October 23, 1991.

<sup>4</sup> *Ibid.*, August 2, 1991.

<sup>5</sup> *The Economist*, October 19, 1991.

<sup>6</sup> *Ibid.*, August 24, 1991.

<sup>7</sup> *Financial Times*, February 27, 1991.

<sup>8</sup> World Bank, *Price Projections 1990-2005*, vol 1.

<sup>9</sup> *Ibid.*

<sup>10</sup> Price on October 23, 1991.

again “cheaper than the sand scooped from the beaches,” in the phrase of the Australian Trade Minister during another sugar crisis, in the 1960s. Only tropical timber seems to have gone up in price.

Over vast areas of Latin America, Africa and part of Asia, the collapse of coffee and cocoa markets has caused enormous damage. Coffee export earnings have been cut in half, with a loss estimated at \$4 to \$7 billion per year.<sup>11</sup> Coffee is the second largest primary commodity export of developing countries after petroleum, and suspension of the operating provisions of the International Coffee Agreement in 1989 has affected some of the poorest developing countries and regions with large populations. An excessive investment in cocoa growing, partly financed from external sources and stimulated by currency devaluations, ended in the late 1980s when the price was driven to below \$1,000 per ton, compared to an average of more than \$2,000 in 1980-87. (The price has recovered somewhat recently. At its peak, in 1977, it was \$5,467.)

### ***Long-term Price Trend***

Prices in real terms of 33 commodities (excluding energy) during the five-year period from 1986-90 averaged barely one-half the level recorded 40 years ago, in 1948-55. Most of the decline occurred in 1980-90, but there also was a significant downward movement in the earlier decades (Table 2).

The study prepared by World Bank Analysts Dr. Enzo R. Grilli and Dr. Maw Cheng Yang<sup>12</sup> shows the real price indexes for the 1900-86 period, which refer to 24 commodities excluding energy, and 26 commodities, including oil and coal. They have linked to their index the indices for the period 1870-99 computed by *The Economist* and the Nobel Prize winner Professor Arthur Lewis. A downward trend over 120 years is unmistakable, although the two world wars, the Korean War and events in the Middle East in the 1970s provided what turned out to be only temporary relief. If the years 1987-91 were added to the chart, the picture would be even gloomier. *The Economist's* index of August 10, 1991 “has tumbled to virtually its lowest level in real terms in its 150-year history.”

Two conclusions follow. First, whether we look at the last 40, 120 or 150 years, a deterioration of primary product prices in relation to prices of manufactures is beyond doubt. Secondly, the present level of primary

<sup>11</sup>Estimates by the World Bank and by Mr. J.O. Santos, former Executive Director of the International Coffee Organization, respectively.

<sup>12</sup>E.R. Grilli and M.C. Yang, “Primary Commodity Prices, Manufactured Goods Prices, and the Terms of Trade of Developing Countries: What the Long Run Shows,” *World Bank Economic Review*, January 1988.

**Table 2. Weighted Index of Commodity Prices for 33 Products, 1948–90<sup>a</sup>**  
(In constant U.S. dollars, 1979–81=100)

1948–50	124.4 <sup>b</sup>	1971–75	110.0
1951–55	141.6	1976–80	109.1
1956–60	122.7	1981–85	87.2
1961–65	111.9	1986–90	67.2
1966–70	112.8		

Source: World Bank, *Quarterly Review of Commodity Markets*, June 1991.

<sup>a</sup> Weighted by 1979–81 developing country export values. Deflated by using the unit value index in U.S. dollars of manufactures exported by G-5 industrialized countries.

<sup>b</sup> Three-year averages.

product prices in relation to manufactures is at its single lowest point registered over the last 10, 40 and 120 years.

### **Projections**

The World Bank is projecting that non-oil commodity prices will stabilize at a level 10 percent below that of 1990. Since much of this decline had already occurred in the first nine months of 1991, the Bank essentially expects stabilization at the current level over the next several years, followed by about a 10 percent increase in the following decade. Recovery in oil prices would be somewhat stronger (Table 3).

These projections are based on the expectation of a 3 percent GNP annual growth rate in industrial countries and a continuing expansion of world trade at a rate somewhat faster than the 1965–89 trend. An implicit assumption apparently is that prices now are equal to or lower than the cost of production. But in developing countries, real wages, a major component of costs, have been falling as export prices fell. Hence production costs are to some extent a moving, rather than a stable, quantity and therefore further price declines are possible.

In the near future, commodity prices will be under pressure for several reasons:

- Demand in industrial countries, caught in slow growth and in some cases recession, is weak.
- Heavily indebted developing countries continue to be under pressure to expand exports in order to maintain debt service payments.
- Producers of metals and minerals in the former Soviet Union have increased their exports because of a desperate need for foreign exchange and disintegration of centralized control of sales. These

**Table 3. World Bank Price Projections***(In constant U.S. dollars, 1979–81=100)*

		33 Commodities <sup>1</sup>	Petroleum
Actual 1986–90 average		67.2	44.3
Actual 1990		62.1	53.5
Projections	1991	56.7	42.5
	1992	57.2	40.6
	1993	58.0	42.6
	1994	57.2	43.5
	1995	58.3	44.2
	2000	64.7	55.7
	2005	62.8	53.2

Source: World Bank, *Quarterly Review of Commodity Markets*, June 1991.

<sup>1</sup> Excluding energy.

factors will continue to operate, although the unfavorable state of mining equipment may dampen future exports.

- Iraq and Kuwait, major oil producers and exporters, are yet to resume their sales.
- Banks and trading houses are partly withdrawing from commodity finance because of increased risks associated with price falls and resulting losses on inventory.<sup>13</sup> This lack of finance will reduce the private demand for stocks and increase the pressure of sales.

### ***Requirements for Price Recovery***

If export commodity prices of developing countries are to stabilize and reverse course, a change which is badly needed, three conditions need to be met:

- Investment in expansion of primary production for exports must be brought in line with realistically estimated world demand. In the past, it has been excessive. Also, it has been argued that there has been no coordination among, and perhaps even within, the international agencies that have financed a considerable part of the investment.<sup>14</sup>

<sup>13</sup> See *International Herald Tribune*, February 25, 1991; and *Financial Times*, March 4, 1991 and April 25, 1991.

<sup>14</sup> S. C. Smith, *Industrial Policy in Developing Countries: Reconsidering the Real Sources of Export-led Growth*, Washington, D.C., Economic Policy Institute, 1991.

**Table 4. Fall in Developing Country Export Prices of Manufactures in Real Terms, 1980–90***(In percent)*

(1) When adjusted by the index of export prices	20
(2) When adjusted by the index of export prices of G-5 countries	24
(3) When adjusted by the index of export prices of machinery and equipment of four developed countries	32
(4) When adjusted by the consumer price index of G-7 countries	40
(5) When adjusted by the GNP deflator of G-5 countries	41
Average of (1) through (5)	31

*Sources:* Indices (1) and (3) from the United Nations, *Monthly Bulletin of Statistics*, June 1991 and August 1991; Indices (2), (4) and (5) from the World Bank, *Revision of Primary Commodity Prices and Quarterly Review of Commodity Markets*, 29 July 1991.

- New action is needed to conclude stabilization agreements on key commodities, which would operate price bands, adjustable over time, supported by international stocks, export controls, and stand-by production controls, and supplemented with diversification and productivity improvement programs.
- Capacity of the exporting developing countries (particularly those with low incomes) to time their sales properly must be improved, so that they can avoid distress selling and be able to deal with international trading and finance companies on a more equal footing than in the past. This improvement depends on the availability of international public funds to finance the occasional surpluses that inevitably arise in commodity economies and thus give producers some breathing room to adjust their production and deliveries to inevitable shifts in commodity demand and supply.

## **Export Prices of Manufactures**

### ***Export Growth***

During the last 35 years, developing countries as a group, in the wake of successful industrial and technological changes, have managed to increase their share of world exports of manufactures from 4.1 percent in 1955 to 18.75 percent in 1989.<sup>15</sup> The latter percentage exceeds that of the

<sup>15</sup>Exports of Eastern Europe and the USSR are not included.

former West Germany (14.9 percent), Japan (12.8 percent) and the United States (11.8 percent), and substantially exceeds that of France, Italy and England. Between 1975 and 1990, the volume of developing country exports of manufactures increased more than five-fold, compared to a two-fold increase for developed countries.<sup>16</sup>

The bulk of exports of manufactures from developing countries comes from a small number of economies: in 1988, the top five countries accounted for 54 percent of total developing country manufactured exports (South Korea, Taiwan, Singapore, Hong Kong and China). Brazil ranked sixth (exports of manufactures \$17,262 million), and Mexico seventh (\$10,393 million), followed by Yugoslavia, Malaysia and India. Nonetheless, both the number of countries exporting manufactures in significant amounts and their export volumes have been increasing rapidly. In 1988, there were 20 developing countries exporting more than \$1 billion each. From Latin America, this group included Argentina (\$2,899 million) and Colombia (\$1,207 million), in addition to Brazil and Mexico.<sup>17</sup>

### ***Falling Real Export Prices***

Between 1980 and 1990, prices of manufactures exported by developing countries rose 12 percent (unit values in U.S. dollars) in nominal terms. In comparison, prices of manufactures exported by developed countries rose by 35 percent in the same period. Furthermore, prices of manufactures exported by the G-5 developed countries (Germany, Japan, U.S., U.K., and France), weighted proportionately to the countries' exports to developing countries, rose by 39 percent; and prices of machinery and equipment exported by Germany, Japan, the U.S., and Sweden rose by 48 percent. The GNP deflator of G-5 countries, measuring the overall price increase in these countries, rose 58 percent and the consumer price index in G-7 countries (G-5 plus Canada and Italy) rose 57 percent. Consequently, in real terms, prices of manufactured goods exported by developing countries fell, the magnitude of the fall depending on which of these indices is considered most relevant. Broadly, the average of these adjustments, about 30 percent, can be taken as the probable fall in developing country export prices of manufactures in real terms during 1980-90 (Table 4) or 3.5 percent per year.

It is reported that in 1991 export prices of Latin American manufactures are falling both in real and nominal terms.

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<sup>16</sup>United Nations, *Monthly Bulletin of Statistics*, June 1991.

<sup>17</sup>UNCTAD Secretariat.

What causes the fall in developing country export prices of manufactures? Four reasons may be listed, and it is probable that all of them worked simultaneously:

- Devaluations in developing countries, partly under the pressure of debts and loan conditionality, forced out exports in excess of market demand at unchanged prices, thereby reducing prices.
- The slowdown in the world economy since 1980, compared to the earlier period, weakened the manufactures market.
- The sheer size of additional export production placed on the market by an increasing number of sellers (some of them operating from export processing zones and having no other outlet except exports, even when export demand is weak), tended to drive down selling prices.
- Trade restrictions in developed countries were increased, narrowing the market outlets for developing country exports. Those restrictions resulted in increased competition among different foreign suppliers, cutting down prices. Furthermore, exporters, who hold (import) quotas under restrictive schemes, shop around to find the cheapest producers, thus raising their profits but in so doing reduce export prices to assure their continuing quota entitlements.

### ***Possible Future Outcomes***

Two ways exist to avoid further declines in developing country export prices of manufactures. One is a substantial widening of access to developed country markets for developing country exports. The likelihood of this is not clear at present. The situation may be clearer as the Uruguay Round of GATT negotiations enters the final phase. The second way is a substantial expansion of trade among developing countries, which would lead to a widening of intra-zonal markets. This depends, to a considerable extent, on the availability of finance for trade and capacity expansion and modernization in those developing countries which are experiencing trade deficits in those areas.

If sufficient export outlets are not found either in developed country markets or in an expanded South-South trade, real export prices of manufactures of developing countries will continue to be under pressure, leading to further devaluations. This would partly sustain a competitive position in exports, but it would also stimulate import substitution. Furthermore, in light of possible losses on exports (private losses and official losses in the form of export subsidies) and resistance to devaluations, attractiveness of the domestic market may increase, both for market agents and for public authorities. There

would then be a partial shift away from an almost exclusive emphasis on export growth, which has dominated the scene in the past decade, to a mixed pattern of production expansion both for exports and for the home market, but the latter with considerably lower levels of protection than in the past.

### **Terms of Borrowing and Return on Capital**

#### ***Resumption of Voluntary Capital Inflow into Latin America and Borrowing Terms***

It has come as a surprise that a considerable inflow of private capital is taking place in Latin America in 1991. In principle, this is a welcome development since the region has been starved for funds for a decade. Capital inflow is occurring both in countries that have achieved macro-economic stability and in others that have only recently embarked on adjustment processes or are still only groping toward them. In Argentina and Mexico, these flows include foreign direct investment that is partly connected with the privatization of public enterprises, but there are also cases of substantial portfolio investments and even moderate sales of bonds. Further, in these and other countries, such as Chile, Colombia, Peru, Venezuela and Brazil, there have been considerable inflows of short-term capital.<sup>18</sup>

The key factors responsible for the resumption of capital inflow seem to be three: first, a large difference between high real domestic rates of interest in these countries (partly linked to stabilization policies) and declining U.S. rates; second, expectations of large gains in domestic stock markets from price appreciation; and third, confidence that these countries will give priority to maintaining convertibility of currencies, particularly for claims of foreign lenders and investors.

Interest rates offered by Brazil have ranged from 11.7 percent (five-year bonds) to 13.5 percent (two-year maturity) and by Argentina 11.3 percent (two-year bonds) per year. U.S. interest rates for similar maturities now (November 1991) range from 5.5 to 6.5 percent, or one-half the rates the Latin American countries are paying.

#### ***Expected Rates of Return on Capital***

Expectations of large gains in stock markets of developing countries are based on the recent, relatively short, experience with price apprecia-

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<sup>18</sup>ECLAC, *Economic Panorama of Latin America 1991*, Santiago, Chile, United Nations, 1991, p. 8.

tion. In 23 developing countries, a sample which includes countries from Latin America and from other regions, the median return on stocks was as high as 25.5 percent on the average per year during the 1980s.<sup>19</sup> This return includes both dividends and capital gains (stock appreciation). The impression of high returns on developing country stocks was shaken somewhat by the sharp fall in their prices in 1990: 32 percent in dollar terms in a single year, according to the composite index of the International Finance Corporation, which covers 20 “emerging markets.”<sup>20</sup> Nonetheless the index shows an annual return in current U.S. dollars of 20 percent between December 1985 and March 1991. This is considerably higher than the returns on stocks in U.S. and Europe.<sup>21</sup>

The rates of return on stocks, by their nature, contain a substantial element of expected rather than actually achieved profits. The 20-25 percent rate shown above is very close to the expected rates of return on a sample of 200 IFC-financed projects, which the IFC analyzed in 1990. This sample showed the expected (ex-ante) average financial real rate of return of 21.4 percent, and an economic rate of 23.8 percent.<sup>22</sup> (Financial rates are calculated on the basis of market prices for inputs and outputs paid by the enterprise. Economic rates are calculated on the basis of adjusted prices of inputs and outputs to exclude distortions such as those due to price controls, taxes and subsidies.) The coincidence between the return on stocks and the expected average return on specific projects is remarkable.

### ***Actual Returns***

In the IFC analysis, actual returns on capital fell substantially short of expected returns; i.e., by almost one-half. The average actual (ex-post) financial rate of return for all 200 projects, weighted by project costs, was 11.9 percent, and the economic rate was 13.3 percent. By industry, actual financial rates of return range from 4.5 percent in tourism and 5.6 percent in food and agri-business, to 16.4 percent in general manufacturing and 17.8 percent in mining.<sup>23</sup> By country group, actual financial rates of return range from 6.6 percent in Sub-Saharan Africa and 11.1 percent in Latin America and the Caribbean, to 13.5 percent in Asia and 15.1 percent in the developing countries of Europe, Middle East and North Africa.

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<sup>19</sup>D. Mansoor and M. Atkin, *Stock Markets in Developing Countries*, Working Paper of World Bank and IFC, October 1990, p. 18.

<sup>20</sup>*World Bank News*, February 7, 1991.

<sup>21</sup>International Finance Corporation, *Annual Report 1991*, p. 1.

<sup>22</sup>International Finance Corporation, *Development Impact of IFC Operations: 1990*, August 13, 1990.

<sup>23</sup>There is also a category of “others” (13 projects) showing a 32.9 percent return.

In explaining the large differences between the ex-ante and ex-post rates of return, the IFC analysts note: "To some extent, this may reflect the unexpected severity of the recession of the early and mid-1980s which depressed the performance of many developing country enterprises (because of the combination of sluggish world demand, low commodity prices and high international rate of interest). Certainly, prices for many products in the 1980s were lower than had been forecast in the late 1970s and early 1980s...Market problems, however, do not account for all of the difference between ex-ante and ex-post returns..."<sup>24</sup>

### ***Policy Implications***

Two major issues arise. First, the rates of return on share (stock) investments of 20-25 percent per annum do not appear sustainable in the face of returns on real investments of 12 percent per annum. Secondly, if current developing country borrowing in the international capital market is at or near 12 percent per annum, this also seems unsustainable in light of the average rate of return on real investments of the same order of magnitude.

The samples of countries and projects, which have yielded these averages, are not identical and therefore the comparisons are tenuous. Also, the large shortfall of actual profit rates compared to projections may be a matter of the past; the future may be better. But these comparisons serve as a general warning for countries that import foreign private capital to be careful in assessing the terms on which specific transactions are concluded.

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<sup>24</sup>IFC, *Development Impact of IFC Operations: 1990*, August 13, 1990, p. 9.

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## DEMOCRACY AND ECONOMIC AND SOCIAL DEVELOPMENT: REFLECTIONS ON THE POLITICAL CONDITIONS FOR A NEW ECONOMIC POLICY IN LATIN AMERICA

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### Introduction

This paper analyzes the main political elements that influence or affect the establishment and consolidation of the predominant economic and social development strategy in Latin America during the present decade. Its focus is on the democratic conditions required for the existence and effectiveness of that strategy. We must analyze the current and possible future relations between democratic institutions and the market economy because, in fact, the strategy to which we refer is founded on the market economy. In addition, Latin American countries, with Haiti and Cuba as the sole exceptions, are experiencing the emergence of the democratic system. Clearly, therefore, the coming years will produce a process of mutual dependence and feedback among institutions representing democracy and the market system.

In the past there has been an important flow of contributions to the study of economic and social conditions, requisites and prerequisites for the development of the political institutions of democracy. That work was part of an intense debate on various aspects of the economic viability of democracy. It includes hypotheses on the material conditions that make possible the emergence, consolidation and unfolding of the political system, as well as on that system's efficacy in ensuring strong and sustained economic and social development. In addition, since democracy in Latin America has alternated with authoritarian regimes, the above-mentioned hypotheses usually compare the relationship between authoritarian regimes and the results of the free economy with those which the democracies exhibit in the same field.

The present decade is marked by a dual consensus regarding the Latin American reality, arrived at by different avenues. This consensus refers to the political and economic systems.

After a long authoritarian cycle, Latin America has returned to democracy. The transition process takes many forms and there are no

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significant signs of an immediate reversal to the authoritarian regime. Since the 1980s, this transition has proceeded almost unchallenged in the direction of pluralist democracy. Many factors have contributed to this phenomenon, including not only the loss of political legitimacy by authoritarian regimes and their failure in the economic sphere—and the consequent re-evaluation of democratic pluralism—but also the crisis of other institutionally-based political options such as socialism and populism. The acceptance of democracy, in any of its contemporary versions, has spread powerfully. Some countries with entrenched forms of restricted pluralism, like Mexico, have even ventured forth on the road to fuller democracy by allowing members of different political parties equal opportunity to become popular representatives, thus opening up avenues for a possible change of government.

Nevertheless, when we talk about “one of the versions of democracy”—representative and pluralist—we do not mean that democracy is understood and applied in the same way throughout Latin America. The process of democratization is varied, with different levels or degrees of development that do not exclude eventual return to authoritarian formulas. The specifics must be carefully scrutinized before one embarks on any discussion of a Latin American political consensus.

In addition, a consensus seems to exist in the economic sphere, although it tends to be restricted to the technocratic elites of international organizations concerned with global economic and trade matters. The Latin American political class has begun to adopt that consensus very slowly, and it is still too early to gauge the extent and depth of its application. This consensus refers to the foundations of the economic policies that seem most likely to put Latin America back on the path of economic growth. Similar to the political consensus, this area also shows the effects of the crisis of centrally planned economies and populist projects. But even before that crisis had reached full force and visibility, a profound disenchantment with certain intermediate economic approaches, such as the welfare state and economic development based on import substitution, had made itself felt in Latin America.

The rise of the new economic policy and the stages by which it gained ground are topics outside the scope of this paper. The concrete result of this process is clear, and its principal characteristics should be recapitulated. They were recently summarized by John Williamson in his book *Latin American Adjustment: How Much Has Happened?*<sup>22</sup> This economic consensus is directed at reforming Latin America's macroeco-

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<sup>22</sup>J. Williamson, *Latin American Adjustment: How Much Has Happened?*, Washington, D.C., Institute for International Economics, 1990.

conomic structure, and refers to fiscal discipline, reduced public spending, tax reform, liberalization of the financial market, exchange policy, trade liberalization, privatization of the state's financial and productive apparatus, general deregulation of the economy, and the legal status of private property. This list reflects a desire to strengthen the market economy and the basic institutions of the capitalist development model. An attempt is being made to create the necessary conditions for Latin American economies to strengthen their role in international trade, with their structures readied for competition in an increasingly liberalized market. The economic program of action for the decade of the 1990s would consist of completing the transition from the populist statism of the past to an open and competitive economy. Selowsky has described three stages in which the reforms encompassed by this consensus were implemented: fiscal stabilization, followed by reform of the incentive system (the various liberalizations), and finally high rates of return on investment, which would indicate the revival of growth and development.<sup>3</sup>

Each consensus raises many questions. The most important one refers to the stability of democracy and the persistence and success of the new economic policies in the countries of the region. This inevitably leads us to question the relationship between democracy and the economic policy in effect. Some authors maintain that Latin America's political system alternates between democracy and authoritarianism. There would thus be a sort of inescapable authoritarianism-democracy-authoritarianism cycle that would have to be repeated indefinitely. Other authors, conversely, defend the thesis that orthodox economic policies are viable only when applied by authoritarian regimes and governments. Consequently, the topic dealt with in this paper is not only complex but highly controversial as well.

### **One Controversial Point: Requisites for Successful Democracy**

In the 1970s, Walt W. Rostow<sup>4</sup> argued the existence of a "take-off" point for economic development from which nations could go on to a social development stage and, ultimately, political development. Take-off was defined by this author as substantial growth of the productive investment rate (five to ten percent of income or net national product), through the development and consolidation of at least one industrial sector with a high growth rate, and through the swift appearance of an institutional

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<sup>3</sup>M. Selowsky, *Preconditions Necessary for the Recovery of Latin America's Growth*, Geneva, World Economic Forum, 1989.

<sup>4</sup>W. W. Rostow, *The Stages of Economic Growth*, Cambridge University Press, 1969, pp. 4-16.

framework capable of invigorating the society's modern sectors and the economy. Rostow defines take-off as an industrial revolution, tied directly to radical changes in production methods, whose effects are decisive and discernible in the short term.<sup>5</sup>

The hypothesis that Rostow intended to prove established a causal sequence between economic growth, social development and a democratic political system. The economic indicator to define passage from one stage to the next would be per capita income. In its day, the take-off theory enjoyed widespread acceptance by authoritarian regimes, which used it as a basis for establishing a timetable in which growth, development and political freedom occupied separate time slots. Samuel Huntington and Terry L. Karl remind us that López Rodó, Minister of Development in the Franco regime, set the threshold for Spain's accession to democracy at \$2,000 per capita.<sup>6</sup> General Videla, in Argentina, also proposed a three-stage program (economic, social and political) to establish an institutionalized democratic system in his country.

Rostow was widely criticized. Aside from those who established an analogy—as did Raymond Aron—between the take-off theory and Marx's deterministic explanation of the impact of the material production infrastructure (means of production) on the social, cultural and political superstructure, some analysts wondered about the nature of the rupture involved in the take-off. Cairncross, for example, raised questions like the following: does take-off involve a real discontinuity, rather than a simple acceleration of growth? If so, how does the discontinuity manifest itself? Or, in what sense does such a discontinuity signal a decisive break with the past?<sup>7</sup> These questions cannot be answered from Rostow's postulates and thus demonstrate the vulnerability of his thinking. Other authors reduced the hypothesis of the stages of development to a heuristic question. The notion of "stage" only has instrumental value, since in a deterministic sequence there are no steps from one stage to another; only movements within a process whose trajectory allows both advances and retreats. Those same authors adapted Rostow's ideas to apply them to the economic field,<sup>8</sup> without extending them to society in its totality.

The discussion reached beyond economics. Political scientists also appropriated it. Seymour M. Lipset, in a classic article of political science

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<sup>5</sup>*Ibid.*, p. 57.

<sup>6</sup>S. P. Huntington, "Will More Countries Become Democratic?," *Political Science Quarterly*, 99, 2, Summer 1984, p. 200.

<sup>7</sup>Cited by R. Holt and J. Turner, "The Political Basis of Economic Development. An Exploration in Comparative Political Analysis," p. 41.

<sup>8</sup>*Ibid.*, p. 49.

literature<sup>9</sup> and afterwards in a book,<sup>10</sup> came to grips directly with the issue of the requirements of democracy: economic development and political legitimacy. Lipset's studies show that in the 1950s, when the empirical research was done, stable democracies had a much higher per capita income and literacy rate than the unstable democracies and authoritarian societies whether stable or unstable.

Huntington revisited the subject closer to our own time. His argument, which also upholds a strong correlation between wealth and democracy, is much more finely put. That correlation explains why some analysts have assumed a causal connection. It is true that a greater availability of resources permits higher levels of literacy, education, means of communication and other factors conducive to democracy. From the viewpoint of political processes, it is also true that the existence of those resources eases the tensions of conflicts and competition by offering options to politicians who have not succeeded in achieving their goals, and that in general it facilitates agreement and compromise.<sup>11</sup> Furthermore, in more developed societies, income is typically distributed in a more egalitarian fashion than in less developed ones. In addition, the existence of wealth generates complex societies, with highly industrialized economies, which authoritarian regimes are generally unable to manage efficiently. This type of society and economy requires decentralized decision-making processes, dispersed over multiple power centers. The dispersion of powers in turn entails a socialization of decision-making rules based on free consent. All that fits in with the workings of democracy but goes against the grain with authoritarian regimes, in which decision-making tends to be centralized in a monolithic power center.

From the standpoint of social structure, Huntington argues that a society made up of relatively autonomous intermediate groups—social classes, occupational, regional, ethnic and religious groups—has a strong limiting effect on the power of the state and makes for democratic control over its institutions.<sup>12</sup>

The conclusion, then, is that if democracy assumes divided and shared power, with high levels of participation, the existence of a pluralist society is fundamental. On this point the arguments converge because the existence of intermediate groups capable of making decisions autonomously hinges to a large extent on economic growth.

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<sup>9</sup>S. M. Lipset, "Some Social Requisites of Democracy: Economic Development and Political Legitimacy," *American Political Science Review* 53, 1959.

<sup>10</sup>S. Lipset, *Political Man: the Social Bases of Politics*, Baltimore, Johns Hopkins University Press, 1981 (2nd Ed.).

<sup>11</sup>S.P. Huntington, "More Countries," p. 199.

<sup>12</sup>*Ibid.*, pp. 202-203.

Contemporary literature on this subject is abundant. It is revisited frequently from different angles. To conclude with the arguments on the relationship between economic growth and democratic development, mention should be made of the contributions made by public choice political economists. Recently, for instance, Abbas Pourgerami<sup>13</sup> published the empirical verification of his hypotheses on the influence of economic development on political change. This author posits the preconditions for the establishment of democracy: a market-oriented economy; a high level of economic well-being; a cultural tradition valuing tolerance for diversity and individualism; a high level of education; a high degree of urbanization; and marked social pluralism, including an autonomous and powerful bourgeoisie. According to Pourgerami, it can be demonstrated that a high level of economic development facilitates political development and that countries with democratic institutions are able to achieve rapid economic growth.<sup>14</sup> This demonstration is based on an analysis of the integrated and mutually reinforcing processes of economic, social, political and cultural development. To examine his hypotheses he constructs a model that measures economic and political development (through a quality of life index and a disparity reduction rate, plus extension of pluralistic competition and a political freedom and human rights index) and establishes the determining socioeconomic factors of political democracy through three equations: policy, development and growth.<sup>15</sup> Each equation includes dependent and independent variables that articulate the various relationships of the factors mentioned previously as preconditions of democracy.

Pourgerami concludes that the empirical findings confirm his theoretical hypothesis. Economic progress and political democracy create a cumulative causal process that enhances the quality of human life.<sup>16</sup> The positive correlations of development, democracy and growth show that the countries which reach high levels of development are more equipped to establish and maintain a democracy, and that nations with democratic institutions are better prepared to speed economic growth.

### **Building Democracy: Primacy of Politics**

Drankwart A. Rustow,<sup>17</sup> in the 1960s, criticized Lipset's hypothesis outlined above. To Rustow, structural studies amass analyses of systematic

<sup>13</sup>A. Pourgerami, "The Political Economy of Development. An Empirical Examination of the Wealth Theory of Democracy," *Journal of Theoretical Politics* 3, 2, 1991, pp. 189-201.

<sup>14</sup>*Ibid.*, p. 189.

<sup>15</sup>*Ibid.*, pp. 198-199.

<sup>16</sup>*Ibid.*, pp. 200-201.

<sup>17</sup>D. A. Rustow, "Transition to Democracy," *Comparative Politics*, April 1970.

balances, quantitative correlations and other statistical information that has only limited validity in time. He proposes an alternative model of analysis, which he calls genetic. The structure and function of the established democracies is important but insufficient. In Latin America, as in other regions of the Third World, the study of the functioning of democracy is interesting, but not as interesting as the problem of its origins: how it starts and restarts. This is a phenomenon that affects democracies directly. Rustow's model grows out of the premise that the factors which make a democracy stable are not the ones that explain its inception.

The genesis of democracy is not a uniform global process, nor is it continuous and homogeneous in time. Democracy is not brought about by uniform actors, agendas and methods, nor is there a lineal development of the transition phenomenon. There are the discontinuities typical of a diachronic process.<sup>18</sup>

Rustow distinguishes four phases in the transition to democracy. The first, "national unity," is a basic condition that has precedence over the other stages and at the same time is present in the entire process. Without attempting further analysis, the author points out that national unity refers to the sense of belonging possessed by the members of a community (not having "mental reservations with respect to the political community to which one belongs"). That sense is a given and arises spontaneously. It is an explicitly political, not economic or social, condition.<sup>19</sup>

The second phase, called "preparatory," is characterized by the eruption of a conflict or quarrel which polarizes society, involves antagonists and gives rise to an agenda of disputed and controversial issues. In this phase different antagonistic elites form and compete for positions of power and influence. The intensity of the conflict is kept within reasonable bounds in the framework of the basic condition or "national unity." Diversity emerges within unity. In this way the pluralization of the society is configured and rationalized.

The third phase, which Rustow calls "decisive," begins when the political actors and the contending elites deliberately accept diversity and institutionalize fundamental aspects of democratic procedure. This decision does not flow spontaneously and automatically out of the preceding phases. It is, rather, the result of voluntary and free actions of the political actors, who subordinate partiality to a common goal. The elites have an important role, perhaps unduly so, in comparison to that exercised by the leaders of established and consolidated democracies. They not only

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<sup>18</sup>*Ibid.*, p. 347.

<sup>19</sup>*Ibid.*, p. 351.

harmonize their ambitions through negotiations carried out in a context of uncertainty but also sacrifice their most radical options. For this reason, the content of democratic agreements is variable: what is essential for some is secondary for others. There is a real commitment which all are prepared to accept, but for most of the parties involved it is a fall-back from the principles or motives underlying their original positions. This explains, for example, the importance which so-called procedural democracy has acquired in recent times; namely, the predominance of procedures associated with agreement and consensus among a number of political players over their own comprehensive ideological positions.

The fact that agreements are reached among the elites means that initially they have little universality. The democratization process in this case comes "from the top" and thence permeates the rest of the society. Terry L. Karl distinguishes between "bottom up" democracies, which have their origins in revolution and popular movements, and "top down" democracies, which originate in the actions of a benevolent despot or agreements reached by elites.<sup>20</sup> The latter case is more common in Latin America.

In the fourth and final phase, whose central feature is familiarity, the political actors and society at large grow accustomed to the rationalized competition of democracy and to the solution of problems through debate and deliberation. Both practices take root through a learning process in which trial and error play a fundamental role. In this phase, political parties take the lead in offering alternatives of governance, mediating between public opinion and policy-making centers, nurturing the decision-making process, and offering a voice to large contingents of citizens.

The primacy of political factors in this model is complete. In this context, Rustow says that economic growth and social development "must be thought of as results of democracy."<sup>21</sup> This conclusion is shared by numerous political scientists: "What has in the past been considered as preconditions for democracy could be conceived of in the future as the results of democracy." "Models of greater economic growth and of a more just distribution of income, higher levels of literacy and education, increased social communication and media exposure: all of these should be regarded more as products of stable democracies than as indispensable requisites for their existence."<sup>22</sup>

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<sup>20</sup>T. Karl, "Dilemas de la Democratización en América Latina," *Foro Internacional*, Colegio de México, 21, January-March 1991, p. 3.

<sup>21</sup>D. Rustow, "Transition," p. 362.

<sup>22</sup>T. Karl, "Dilemas," p. 397.

Cultural factors and their relationship to democracy have also been minutely analyzed by various authors.<sup>23</sup> Some have proposed the existence of certain values as a prerequisite for the presence and development of democracy. In Rustow's genetic approach, those conditions are placed in another context. Here it is not a matter of values that must be in effect for democracy to emerge, but of values that take shape during the democratic process itself. Tolerance, negotiation and the habit of seeking agreements can develop over time. Clearly, the path will not always be smooth. In this respect, for example, it has been argued that Latin American authoritarian systems receive sustenance from values cultivated by the Catholic church (order, hierarchy, tradition). At the present time, it seems clear that there has been a change, as recent studies corroborate.<sup>24</sup>

The genealogy of political regimes indicates that democracy is the most complex and least spontaneous political system. Primary forms of political organization tend to centralize authority in one person, and in political philosophy it is usual to find arguments that validate the concentration of political decision-making in a single figure or in a minority. This would seem to be the most spontaneous form of authority and political organization. In contrast, the division of political power and the participation of broad majorities in decision-making processes would occupy the other extreme as an artificial, highly sophisticated political form requiring collective deliberation and, ultimately, free and autonomous individuals subject to minimal levels of coercive authority.

The existence of democracy relates to libertarian and egalitarian practices which foster a highly rational process of political development, in which decisions emanate from collective deliberations and agreements. For this reason, democracy is characteristically a regime that maximizes consent. Free will rationally applied is the basis of the system and the motor of its constructive character. That is why Rustow's model takes as its starting point the spontaneous association of individuals in a national community, where the ties of membership are spontaneous but rise to freely-taken decisions as a loftier mode requiring a high degree of rationality.

The foregoing confirms Karl's thesis about the change of focus on the part of political scientists studying the phenomenon of democracy in developing countries. The emphasis has now shifted to contingent processes and options.<sup>25</sup> Building democracy is an eminently political

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<sup>23</sup>S. Verba, "Comparative Political Culture," in *Political Culture and Political Development*, Princeton, Princeton University Press, 1965.

<sup>24</sup>M.E. Crahan, "Church and State in Latin America: Assassinating Some Old and New Stereotypes," *Daedalus*, September 1991.

<sup>25</sup>T. Karl, "Dilemas," p. 398.

activity, and it cannot be carried out without considering all aspects of a society's economic, social and cultural life. The main problem in this endeavor is how to consolidate the democratic system and at the same time successfully pursue economic growth, social development and cultural change. This challenge is inherent to the question of what kind of democracy should be sought in Latin America.

### **An Idea of Democracy for Latin America**

Democracy is given different definitions because different contents can be ascribed to it and because different aspects of the same content may be emphasized. The idea of democracy has gone through many changes, which will not be examined in this paper. In its most basic guise it allows the people to participate in public decisions, and democratic theory deals with the political and civil rights of individuals, the separation of power, popular representation, election to positions of power or authority (public office) by majority vote, and the drawing up of norms governing the political community (laws). Today, analysts looking beyond democracy's substantive characteristics in an effort to distinguish it from nonpluralistic forms of government are more interested in scrutinizing its procedures, which are what really make a democratic system work.

The procedural institutions of democracy are based on some historical and political characteristics of this system. The first is "representation." The practice of direct democracy is not possible given the size of contemporary political communities. The people govern "by means of" or "through" representatives elected by electoral procedures based on majority rule. Representation centers especially on the empowerment of legislators, or those who define the norms regulating the life of the political community in the name of the people. Secondly, democracies "directly" elect those who perform the state's executive tasks. Dahl points out that representation in our time is practiced over vast geographic spaces, citing the United States, India and Brazil as illustrations.<sup>26</sup> On the other hand, in comparison with the functions of citizens in the small democratic city-states of antiquity, representation of citizens under contemporary systems is limited. Dahl states, "Theoretical or practical political participation, even with modern means of electronic communication, diminishes as the citizen population grows." Another basic characteristic is diversity. Homogeneity is not a feature of modern societies. What

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<sup>26</sup>R.A. Dahl, *Democracy and Its Critics*, New Haven and London, Yale University Press, 1989, p. 217.

representative systems do, in fact, is extend to diverse electorates—with a variety of cultural perceptions and often drawn from different ethnic groups and religions—a framework of individual rights and liberties. Such diversity means sociopolitical enclaves with their own interests in a state of regulated conflict. These features result in a type of democracy that Dahl calls “polyarchy.”<sup>27</sup>

Polyarchy denotes a society segmented in relatively autonomous groups, as previously noted, enjoying greatly expanded individual rights. Dahl describes the procedural institutions of polyarchy:<sup>28</sup>

- Elective political office. Control over government decisions is constitutionally provided for and is exercised by elected representative authorities.
- Free and clean elections. Holders of elective offices are chosen in periodic, free and informed elections, in which there is no coercion.
- Inclusive suffrage. Practically all adults have the right to vote in elections for representatives.
- Right to run for elective office. Almost all adults have the right to be candidates and compete for available positions by means of elections.
- Freedom of expression. All citizens have the right to express themselves, free of coercion and of danger of punishment for their political opinions, including criticism of the government, the regime, the socioeconomic order and the prevailing ideology.
- Alternative information. Citizens have the right to turn to alternative sources of information. These sources, in turn, exist and are protected by law.
- Freedom of association. In order to be able to exercise their political and civil rights, citizens must be free to create and join autonomous and independent associations (political parties, interest groups, etc.).

The presence of these procedures makes possible this type of democracy, called polyarchy, in which the citizenry consists of a relatively high proportion of the adult population and expresses itself by participating in elections for governing representatives. However, societies in which democracy is emerging and unstable have to deal with the problem of limitations and impediments to its full development. Dahl enumerates some unfavorable conditions which can, however, be overcome.

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<sup>27</sup>*Ibid.*, p. 218.

<sup>28</sup>*Ibid.*, p. 221.

The first is ever-present in the countries of the region: military control of the state's enforcement power. There is no authority over the political community without enforcement. Under the rule of law, the state's monopoly of power is firmly regulated by law and by subordination of the armed forces to civil authority. By contrast, in political societies where enforcement power is in the hands of the military and the latter is not subordinate to civil authority, conditions do not favor the emergence of polyarchy. There is, nevertheless, reason to believe that this restraint or obstacle can be corrected. Dahl notes several ways in which this might be achieved: eliminate or diminish the coercive capacity of the armed forces and the police; disperse those forces among the local governments—a possibility that only exists in systems of a federal or similar type; recruit into the armed forces those people who share the democratic inclinations of the civilian population; and instill the doctrine of a professional military subordinate to, and under the control of, the representative authorities.

The second condition stems from the absence of factors specified earlier as economic and social requirements or prerequisites of democracy. While none is singled out as primary or causal, their absence works seriously against the emergence of a polyarchic system. Dahl subsumes them under three variables: modernity, dynamism and pluralism. Modernity is associated with high levels of income, consumption and education; broad occupational diversity; a large urban population; and a gradually shrinking rural population. Dynamism relates to economic growth and a rising quality of human life. Pluralism, as has been repeated several times, requires the existence of relatively autonomous groups and organizations. Societies with those three characteristics show a tendency to spread political power so as to give wealth, knowledge, status and access to organizations; to spread strategic positions, especially in the economic, scientific, educational and cultural fields; and to spread negotiating positions in economic affairs, communications, education and other areas.<sup>29</sup> This triple dispersal maximizes equality of opportunity in all sectors of society. The concentration of power, and of strategic and negotiating positions, forms a serious obstacle to the development of democracy. Here lies the challenge to the Latin American societies to grow and develop, and undertake the building of modernity. There does not appear to be any other solution to this problem.

A third set of limiting factors is attributable to the possible centrifugal effect of autonomous subcultures or groups living in a given political community. The fact that members of different subcultures, caught in a

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<sup>29</sup>*Ibid.*, p. 218.

zero-sum dynamic, feel their identities and existence to be at risk is incompatible with a thriving democracy. Societies that are culturally and socially homogeneous do not experience this problem. In heterogeneous societies the matter is highly complicated but has in several cases been successfully dealt with through "consociative democracy" or "democracy of consensus." These cases have been studied by Arend Lijphart.<sup>30</sup> In this type of democracy, government proceeds through broad coalitions that unite the various subcultures. Each group has veto power over the decisions of the whole, and this forces consensus. Groups are represented in collegial organs of government in proportion to their size, and each subculture enjoys substantial autonomy in all matters relating to its own life.

In the Latin American case, it seems obvious that democracy has not reached the level of polyarchy. The possibility of reversions to authoritarianism is latent. No one can say that the current process of redemocratization is irreversible. To begin with, there are no more than a handful of cases (Costa Rica is a universally accepted example) in which the security forces are clearly and permanently subordinated to the constitutionally consecrated civil authorities. Next, there are enormous disparities in the region regarding levels of modernity, dynamism and active acceptance of pluralism that should characterize polyarchic democracy. Lastly, it is clear that in Latin America the true integration of cultural diversity along consociative lines has not been attempted; instead, there is predominance of some groups over the rest, without a large process of consensus and integration.

There are also major disparities where procedural democracy is concerned. It does not seem evident that the seven procedures previously mentioned are being practiced, and that they are ensuring the actual practice of democracy. Applying Rustow's genetic model, we must also conclude that there are marked differences among the countries of Latin America. Some are in the preparatory, others in the decisive phase. It would be difficult to argue that there are many cases of the habituation or familiarity phase.

Latin American democracies so obviously fall short of polyarchy that various typologies have been devised to classify them. The terms "established democracies" and "democracies in transition" have been used for purposes of analysis.<sup>31</sup> Karl, taking as her criterion the various modalities of Latin American transition, discovers "conservative democra-

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<sup>30</sup>A. Lijphart, *Democracy in Plural Societies. A Comparative Exploration*, New Haven and London, Yale University Press, 1977.

<sup>31</sup>B. Stallings and R. Kaufman, *Debt and Democracy in Latin America*, Boulder, San Francisco and London, Westview Press, 1989, p. 205.

cies" (imposed by departing authoritarian regimes; she has also called them "bestowed"); "corporate" or "consensual" democracies (arising out of a pact between the former regime and the opposition, or between different elites); "competitive" democracies (results of a reform); and "democracies of a predominant party" (revolutionary transitions).<sup>32</sup> None of these democracies is a closed universe; they can all transform themselves and take another form.

Guillermo O'Donnell has advanced the analysis of a new category of democracy: a subtype of representative democracy, which is clearly differentiated from polyarchy. He has called it "delegative democracy."<sup>33</sup> Without entering into the data which O'Donnell attributes to this subtype of democracy, it is interesting to consider some of its characteristics. According to this author, delegative democracy is a strongly majority-based type of democracy whose chief political institution, the Presidency of the Republic, originates in clean and competitive elections. This point is important for O'Donnell, since, if the presidential election does not yield a clear majority, the "myth of legitimate delegation" loses its validity. The elected president is empowered to govern for the period specified by the constitution. His office permits him to govern without any regard to his electoral program. His position is "over" and "beyond" all the parties. The other basic state institutions, parliament and the judicial branch, are nuisances tied to the advantages that come with being democratically elected. In practice, the president is not "accountable" to those or other institutions, and the very idea of accountability appears as a hindrance to the exercise of the full powers vested in him. Representation includes a delegation factor, on condition of accountability to those charged with control of political power and the people itself. O'Donnell tells us that, in consolidated democracies, accountability operates both horizontally (*vis-à-vis* those who have elected a public authority) and vertically (*vis-à-vis* the autonomous authorities legally established to oversee public administration). Delegation without accountability violates one of the basic principles of representative democracy.

Democratically elected but purely delegative governments do not qualify as true polyarchies. Delegative democracies somewhat resemble bureaucratic authoritarian regimes in their approach: they restrict the political decision-making process to a narrow circle in the executive branch and lack mechanisms of accountability.

The prevalence of this type of presidential regime and the lack of pluralist integration indicate the need to reform Latin American democ-

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<sup>32</sup>T. Karl, "Dilemas," p. 205.

<sup>33</sup>G. O'Donnell, "Delegative Democracy?," CEBRAP-University of Notre Dame, 1991, mimeo.

racy. Such a reform should, in addition to adopting a consociative approach, institute a review of the presidential regimes currently in power.

## Conclusions

The existence of a political and an economic consensus would appear, subject to the reservations and considerations set forth in this paper, to be a defensible proposition. The idea of consensus implies almost unanimous concurrence, fully and freely shared by all the parties involved in its application to reality. The subject was broached in the introduction to this text, on the basis of the notion that the entire Western Hemisphere, except for Haiti and Cuba, is governed by democratic regimes. Now, following further analysis, it must be stated that the great majority of Latin American nations are in varying stages of transition, from which are emerging different types of democracy. Even when those processes emulate polyarchy, it is difficult to conclude how many and which ones are clearly and firmly committed to that model.

The forms of transition and levels of democratization do not show us that the Latin American democratic consensus has the same meaning for all its actors (elites and societies). Purely electoral democracy, delegative democracy, Bonapartism and other forms of governance are all Latin American realities. Serious flaws are discernible and reversions to authoritarian structures can by no means be ruled out, and the long-term outlook remains distinctly uncertain.

The political stability of the Latin American democracies rests on an uneven foundation, because of their diversity. However, the current environment bodes extremely well for its continuation. The international political situation points to good times for democracies well into the future. The idea of a community of democratic nations in the Western mold, (i.e., very close to the polyarchy model described in this paper), has gained ground. There are no attractive and viable alternative political models in sight. The socialist camp has generally laid down its ideological arms. In the sixties, socialism offered the Cuban model. Today that revolutionary option has been definitively foreclosed.

In some Latin American countries a phenomenon known as the renewal of socialism has been unveiled. It cannot be examined at length here, but it is worth bearing in mind that Spanish socialism has been influential in this renewal. In general terms, this phenomenon entails an abandonment of revolutionary radicalism on the part of large sectors of the Latin American leftist elite. At the political level, reformist socialism involves a commitment to pluralist democracy and the capitalist development model. Obviously, this twofold undertaking is colored by a prefer-

ence for collective action by the state and policies designed to redistribute wealth. All this means a lessening, in some countries of the region, of the polarizations characterizing the politics of the seventies and part of the eighties.

Communism throughout the world has fallen into utter discredit. It has nothing to offer. The only important threats to the *pax democratica* in Latin America might be populism and, in a structural sense, authoritarianism. However, the fact that Latin American nations are just emerging from experiments with those approaches seems to make an extended period of stable democracy likely.

The right has generally renewed itself by identifying with the defense of the market economy, economic adjustment policies and the institutions associated with them. It should not be forgotten that this Latin American political sector practically gave up its chief ideological positions in the seventies. Today it is benefiting from the momentum of the conservative movement in the United States and European liberalism. Nevertheless, caution on this point is also in order, for there are many forms of right-wing thought in Latin America, and the right exhibits unequal levels of political development. The right referred to here has assumed a leading role in some countries of Latin America where political conditions have permitted the private sector a major role in the country's development.

The absence of some of pluralist democracy's radical enemies is highly positive, but the fact that the democracies continue to be vulnerable to other enemies is troubling. The preceding paragraphs set out the agenda for making the democratic process take deeper root, which is the only way to prevent relapses into authoritarianism or populism.

At this point we must return to relations between market-based structural adjustment and democracy. Like any form of government, democracy faces the task of producing public goods and satisfying the demands of society. If a consensus exists on the market economy—the capitalist development model and the nature of adjustment, following the stages discerned by Selowsky—it means that Latin America should also undertake reform of the state.

The traditional tendency of the Latin American state has been to centralize and concentrate authority. This phenomenon has been accompanied in the last 50 years by expanding regulation and the expansion and growth of an inefficient bureaucracy steeped in party politics. As a consequence, reform of the state must be aimed in the opposite direction; i.e., at political and administrative decentralization, the decentralization of decision-making, and a drastic reform of the bureaucracy with a view to upgrading its technological quality and neutralizing its party politicking.

The issue of state reform, with reference to intervention and regulation, must be studied with care. The tendency to intervene and

regulate as much as possible must clearly be curbed. On the one hand, reform entails abandoning all spheres where the market allocates resources more efficiently. On the other, it entails encouraging the state to regulate all areas where the creation of public goods conflicts with the market, or where the market cannot function properly. The state obviously has wide scope for action in national defense, public safety, the administration of justice, investment in human capital, the execution and maintenance of public works, and environmental protection or improvement. Productive endeavors, self-regulated by the market, must remain in or be transferred to the private sector.

It would be difficult to argue, analytically or from the perspective of the historical development of mature democracies, that they emerged as the result of achieving certain levels of economic growth and social development. Each system articulates and pursues its political and economic decisions on the basis of a deliberate objective or a political project. The primacy of politics is clear. Nevertheless, among the variables involved in the building of democracy, those that spur modernization become part of a dynamic of interrelated, mutually reinforcing factors. Capitalist development, led by the market economy, rests on essentially democratic political foundations. Consequently, an authoritarian government can be very efficient in carrying out a structural adjustment but not in dealing with all the effects of successful capitalist development. Basic political conditions of the market economy are the dispersal and control of political power, the existence of autonomous intermediate entities between the individual and the state, and a government that is responsive or accountable to institutionalized power centers of the political community.

Representative democracy is clearly founded on respect for rights permitted by self-sufficient individuals, capable of making their own decisions and distinguishing between public and private goods. Those rights necessarily include private ownership of the means of production, freedom of association and the press, and other liberties which in combination ensure the existence and development of a strong and powerful private sector.

Democracy, however, also stresses the principle of equality. In this area the Latin American democratic systems cannot abandon income redistribution policies. The challenge is determining how political reforms should harmonize with situations created by structural adjustment. The high degree of extreme poverty affecting the region points to the existence of sectors that are denied the political benefits of democracy. This system cannot keep them in that situation without paying extremely high costs, including the possible emergence of authoritarian political regimes or populist economic policies.

The democracy best able to serve the goals of state reform and the new economic policy is the one based on broad consensus. We have previously referred to consociative democracy, and perhaps that is an appropriate formula. In practice, the political conditions of a new phase of Latin American development face three major tasks: state reform, the formation of broad multiparty governing alliances, and the construction of polyarchic democratic systems.

The high level of consensus necessary to harmonize democratic development goals with state reform and economic growth has no alternative other than the formation of broad alliances and socioeconomic pacts. This is especially the case in conditions of transition to, or as yet uncrystallized consolidation of, democracy in which economic adjustment policies are being applied. Alliances, in the Latin American context, must encompass several parties in order to ensure extensive participation of the political elites and the citizenry in the reform process. Socioeconomic pacts, meanwhile, must apply to the entire society in order to spread the costs of adjustment policies more fairly, contain social demands and accustom the labor sectors to the practice of the new economic policy.

## LATIN AMERICA IN THE 1990s: SOME CONJECTURES

José Nun<sup>1</sup>

In the second half of the nineteenth century, European transitions toward democratic liberalism generally occurred in the midst of intense debates over principles.<sup>2</sup> By contrast, a singular characteristic of current transitions in Latin America (and not only there) is that there is almost no discussion of the interpretative paradigms in use. An orthodox consensus has swiftly formed, which tends to naturalize both that type of political system and the “market economy,” which appears as the other side of the same coin.

The reasons for that are easily found. They range from the exhaustion of approaches to sociopolitical organization attempted in Latin American countries in the postwar period, and the recent collapse of the communist experiment, to the remarkable unifying role currently played by the international financing agencies, the international bureaucracies and, of course, the media. Reasons for concern are not lacking either. They begin with the question of the actual medium- and long-term viability of the present models and their ability to resolve the serious problems of the region. Another, the most obvious one, has to do with Latin America’s well-known internal diversity, which always reflects any universal prescription in particular ways. Accordingly, the third reason refers to the caution imposed by the famous and wise law on the undesired effects of social action: as Furet points out in his work on the French Revolution,<sup>3</sup> the principal error of the historiographical line begun by Michelet consisted precisely of giving too much credence to what revolutionaries said about themselves and what they were doing.

In addition to this, there is another particular feature of the present situation that I would like to expand on for a moment.

Thirty or forty years ago the dominant literature on modernization and political development postulated a sequence which can be summa-

<sup>1</sup>CONICET, Latin American Center for the Analysis of Democracy (OLADA), Argentina.

<sup>2</sup>As I have written elsewhere, the European experience indicates that what has been called *liberal democracy* has been the political form through which liberalism succeeded in acquiring a democratic rationale. It therefore seems to me more accurate (and less apologetic) to call the phenomenon *democratic liberalism*, which also incidentally removes the temptation to gloss over the adjective and make liberal democracy synonymous with democracy as such.

<sup>3</sup>F. Furet, *Penser la Révolution Française*, Gallimard, Paris, 1978, pp. 28-32.

rized as follows: (1) social modernization (economic growth with incorporation into the world market, urban development, development of education and the mass media, geographic mobility, etc.); (2) consequent dissemination of modern values (universalism, success, orientation to the future, social confidence, etc.); and (3) adoption of a representative democratic political system.

It should be noted that modernization appeared as the necessary condition for the emergence and stabilization of democratic government (in the sense of liberal democratic). This was due to several reasons. First, the possibility of limited and orderly participation of the people in politics depended on the existence of a broad consensus with respect to modern values. Second, this political culture of modernization needed the twin pillars of economic growth and an increasingly equitable distribution of income. Third, it was necessary for the citizenry of a representative democracy worthy of the name to have wide access to information. And finally, the establishment of trained, competent bureaucracies was deemed an essential requirement of governance.

Today, however, the sequence seems to have been inverted, with a growing number of authors conceiving of political democratization as a necessary step preceding economic and social modernization: "I do not believe it can be denied," writes Weffort, "that democracy is the only path which can lead the Latin American countries to modernity."<sup>4</sup> This statement would have caused surprise a few decades ago, especially when—as here—it concludes a very incisive text which maintains that Latin America modernization has stagnated "in the social and economic areas;" a worrisome "blocking of prospects" and "widespread anomie" are prevalent; "social disintegration" looms ahead; and feelings of "future loss" and "loss of a place in the world" have spread among the population.<sup>5</sup>

Tying this inversion to the observation regarding a more distant past with which I began this discussion is somewhat hypothetical. In the years following the Second World War—in large measure because of the successes of the communist bloc and the progress toward decolonization throughout the Third World—confidence in the state's ability to plan and lead the process of change burgeoned. This was reflected even in the United Nations' approach to its task. The state would be "the chisel in the

<sup>4</sup>F. C. Weffort, "A América errada," *Lua Nova*, 21, 1990, pp. 5-40.

<sup>5</sup>To illustrate what I am saying, contrast Apter, who some years ago concluded one of his most influential works with an assertion which at that time few would have challenged: "The experience of the nations in process of modernization indicates that democracy, as we understand it, is not appropriate for their stage of development." See D. Apter, *The Politics of Modernization*, Chicago, University of Chicago Press, 1965, p. 452.

hands of the new sculptors;<sup>6</sup> and the sculptors needed time and resources to complete their modernizing work before the political system could acquire a certain family resemblance to that of the Western industrial nations. The results of such efforts fell far short of the expectations accompanying them. Almost universally, the state was either too weak from the outset or weakened significantly afterwards, and at present it is hard put to oppose the charges of inefficiency and corruption directed at it. To many observers the time seems ripe to return all power to the marketplace, and, although this swing of the pendulum began in many cases under the protection of military dictatorships, the crisis of those regimes has left democratic liberalism as the only viable political alternative.

The ideas of modernization and then democratization were historically linked to the primacy of the state in the process of change, while the reverse sequence is associated with the determining functions now assigned to the market in the constitutional framework of representative democracy.<sup>7</sup>

Any conjecture about possible strategies in the years ahead involves taking a stand on an issue which is currently regarded as settled. In what follows I shall try to develop this point briefly and draw a few conclusions.

Williamson gave the name "Washington Consensus" to the package of measures currently promoted by "Washington politicians" and "Washington technocrats" to bring about stabilization and economic growth in Latin America.<sup>8</sup> All indications are that these measures have already become part of the new repertory of common sense truths about development problems prevalent among the regional elites. For my purposes, rather than show where those recommendations have their origin (which surely, as Lefebvre observes, makes them excessively dependent on the specific historical experience of the highly industrialized

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<sup>6</sup>J. S. Migdal, *Strong Societies and Weak States*, Princeton, Princeton University Press, 1988.

<sup>7</sup>I underscore historically to point up a concrete trend that has asserted itself in various parts of Latin America. Undoubtedly, however, many staunch market advocates also subscribed to the "modernization-democratization" sequence and sought to realize it through dictatorships such as those of Videla in Argentina and Pinochet in Chile. In other words, I am speaking of an empirical association and not of a theoretical necessity. In case of doubt on this score, see the statements of Friedrich von Hayek made in the early eighties in the Chilean newspaper *El Mercurio*, to the effect that if he had to choose he would prefer an authoritarian regime which defended the market economy to a democratic government which got in its way.

<sup>8</sup>J. Williamson, (ed.), "What Washington Means by Policy Reforms," in *Latin American Adjustment: How Much Has Happened?*, Washington, D.C., Institute for International Economics, 1990.

countries<sup>9</sup>), it is more important to emphasize their obvious roots in the postulates of neoclassical economics.

Of those postulates, I am interested here in three that are fundamental in the way they relate to neoclassical thinking as well as the discussion to follow. The first is that the economy constitutes an analytically autonomous realm, separate from the rest of society, which responds to its own internal dynamics and can therefore be adequately understood in terms thereof.<sup>10</sup> The second postulate concerns the rational nature of economic agents (individuals, households and businesses), whose preferences are taken as given and whose behavior is assumed to be aimed at maximizing their own utility. (Naturally, there is no shortsightedness in this case either. Economists are not unaware of irrational conduct or aims other than maximum utility, but treating these phenomena as deviations, and hence excluding them from the central analysis, has important consequences). The third premise entails the abandonment of what had been, since Adam Smith, one of the major preoccupations of the classical economists; i.e., relating to secondary status the problem of equitable income distribution, either because it is assumed that the institutional mechanisms for solving it are already in place outside the model, or because it is felt that this problem will eventually be solved when the production and distribution of goods find their equilibrium point and transactions in the goods, labor and capital markets are harmonized.

With respect to the first of those postulates, it revives a criticism directed many years ago, on the same grounds, at the classical economists: "Classical political economy has created an economic world that does not exist, a *Guterwelt*, an isolated world which is always identical to itself and in which conflicts among purely individual forces are solved in accordance with unchanging economic laws. In reality, it is within communities, which differ considerably among themselves, that individuals try to

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<sup>9</sup> L. Lefebvre, "What Remains of Development Economics?," *Indian Economic Review*, 1991.

<sup>10</sup> Naturally, one is dealing not with shortsightedness but with a methodological decision: "Economists are perfectly aware that economic behavior is influenced by politics and culture, but they see these as exogenous factors that can be safely bracketed as one develops a framework that focuses on purely economic factors" (F. Block, in *Postindustrial Possibilities*, Berkeley, University of California Press, 1990, p. 21). In any event, the subject echoes the classic debate between those who hold that the social sciences are differentiated by empirical objects from those that are occupied and those who hold that they all refer to the same empirical object, but are distinguished by the specific ways in which they outline it and structure their respective objects of analysis. For a sociological critique of the neoclassical paradigm that highlights its basic suppositions, see R. Swedberg, "Economic Sociology: Past and Present," *Current Sociology*, 35, 1, 1987.

enrich themselves, and both the nature and the success of these efforts change along with the nature of the community in which they take place."<sup>11</sup>

Hence the notion of a social system of capital formation is required to designate the complex, historically specific constellation of institutions and practices that influence the process of capital formation, viewing such formation as a macroeconomic activity of profit generation and investment decision-making.<sup>12</sup> Although that constellation encompasses the activity, the former is in large measure external to the latter, which "cannot be carried out either in a vacuum or in chaos."<sup>13</sup> Just as there is a political system of government, there is also a social system of capital formation, sustained by institutional frameworks, practices and interpretations of various kinds which provide the economic agents with certain minimum levels of coherence.

The composition and scope of this system vary historically from location to location. Against any functionalist or reproductionist reading, a social system of capital formation is always heterogeneous and full of contradictions that manifest themselves in varying degrees of inconsistency, and which constantly demonstrates the indispensable articulating role played by politics and ideology. Such a regime can accordingly be conceived as a changing pattern within which specific strategies of accumulation and various tactics for implementing them are interconnected, so that capital formation finally becomes "the contingent result of

<sup>11</sup>E. Durkheim, and P. Fauçonnet, "Sociologie et sciences sociales," *Revue Philosophique*, 1903, 55, pp. 465-497.

<sup>12</sup>J. Nun, "La teoría política y la transición democrática," in J. Nun and J. Portantiero, *Ensayos sobre la transición democrática en la Argentina*, Buenos Aires, Editorial Puntosur, 1978. The concept is closely related to two arguments that partly address similar concerns. One is the one put forward by M. Aglietta, in *Régulation et crise du capitalisme*, Paris, Calmann-Lévy, 1977, which gave rise to the formation of the "French regulation school," although in this case the term *accumulation regime* is reserved for economic relations and the collection of institutions and rules of conduct controlling them is called *mode of regulation* (see A. Lipietz, "Rebel Sons: The Regulation School," *French Politics and Society*, 5, 4, 1987, pp. 17-26). The other argument is that of D. Gordon, R. Edwards, and J. Reich in *Segmented Work, Divided Workers*, New York, Cambridge University Press, 1982, who constructed the category of social accumulation structure). A major difficulty with these propositions is that both, in my view, gave excessive weight to the form of work organization in the industrial firm. Other contributions along the lines indicated are those of B. Jessop, "Accumulation Strategies and Hegemonic Projects," 1983, mimeo; and F. Block, *op. cit.* and "Political Choice and the Multiple 'Logics' of Capital," *Theory and Society*, 15, 1986 and 1990, pp. 175-192. The influence of Polanyi's classic work *The Great Transformation*, [1944] Boston Beacon Press, 1957 hovers over all of them to a greater or lesser extent.

<sup>13</sup>Gordon *et al.*, *Segmented Work, Divided Workers*, New York, 1982, p. 23.

a dialectic of structures and strategies.”<sup>14</sup> Its study therefore transcends the strictly economic realm and belongs in what has appropriately been called the political sociology of political economy.<sup>15</sup>

It follows, then, that a social system of capital formation is a medium- or long-term multidimensional historical phenomenon, and that, analytically speaking, three major phases are discernible in it: its emergence, its consolidation and expansion, and its exhaustion and decay, which may or may not lead to a generalized crisis.<sup>16</sup> (It should be noted that such a crisis would be a crisis of the system and must not be confused with the crises in the system, which normally punctuate its life without casting doubt on its parameters.)

To the same extent that a social system of capital formation stabilizes and consolidates itself, the inertia of its modes of institutionalization and its characteristic practices increases, especially since this never settles the problem of “dialectic of structures and strategies.” This produces a process of naturalization, so that a particular organization of the marketplace or of the relations between capital and labor, or of the nexus between state agencies and corporations, becomes part of the normal scheme of things as the economic agents see it. When this happens, any attempt to modify the status quo can be ideologically portrayed by the defenders of the status quo as political interference rather than what it actually is: a move in the political chess game which everyone is presumably playing.

From this standpoint, it is simplistic to imagine that in the countries of Latin America one economic era has ended and another is starting, just as the current depiction of activity by the state and in the marketplace as wholly separate is misleading.

With respect to the first, the exhaustion of the model of industrialization through import substitution has not been an exclusively economic phenomenon, nor does it have just one single meaning. In some places it reflects decay and in others the crisis of a social system of capital formation which has had different sociopolitical traits in each country, with the result that its nature and the logic of its evolution both vary.

With respect to the second, the contrast drawn between state and market activity overlooks at least two things. First, any structuring of the marketplace always requires action by the state.<sup>17</sup> Second, both the market

<sup>14</sup>B. Jessop, “Accumulation Strategies and Hegemonic Projects,” 1983, mimeo, p. 98.

<sup>15</sup>P. Gourevitch, *Politics in Hard Times*, Ithaca, Cornell University Press, 1986, p. 19.

<sup>16</sup>F. Block, “Political Choice and the Multiple ‘Logics’ of Capital,” *Theory and Society*, 15, 1986, p. 182.

<sup>17</sup>“Remove the regime of capital and the state would remain although it might change dramatically; remove the state and the regime of capital would not last a day.” See R. Heilbroner, *The Nature and Logic of Capitalism*, New York, W.W. Norton, 1985, p. 105.

and the state are covered by a huge web of social regulation without which their joint operation would be literally impossible. In this connection Block aptly notes that the symmetrical error of the theories of market self-regulation consists of assuming that only one of these levels is necessary to produce rational and efficient results when, in fact, "the efficiency of a particular economy will depend on how the three [marketplace, social regulation and public policy] are adjusted and made compatible."<sup>18</sup>

One result of the suggested conceptualization is that it brings out the complex relationships established between current democratic transition processes (i.e., the emergence phase of a new political system of government) and the stage reached, in each case, by the one or more social systems of capital formation present.<sup>19</sup>

Thus the current Latin American transitions correspond to the phases of decay or crisis of such systems in their various expressions and to the still uncertain beginnings of new ones, whose agents are seeking to institutionalize, to varying degrees, the neoclassical precepts referred to above.

At first sight, the institutionalization being attempted seems well matched to the principles of democratic liberalism as currently practiced. It upholds the premise of a clear separation of economic and political affairs, as does democratic liberalism, and it is geared to a similar vision of man, centering on the acquisitive individualism of maximizing market man, the political consequences of which Macpherson has brought to light.<sup>20</sup>

However, for that very reason, in contexts such as the Latin American one, the third neoclassical postulate mentioned threatens to become the Achilles' heel of the entire project. Appropriate and effective redistribution mechanisms have not been institutionalized, nor have the neoliberal prescriptions given any tangible proof thus far that the question can be resolved simply by perseverance.<sup>21</sup> The opposite tends to be

<sup>18</sup>F. Block, *Postindustrial Possibilities*, Berkeley, University of California Press, 1990, p. 42.

<sup>19</sup>I can expand not on this point but on the mode of explanation. First, as I already said, the difference between the first frames or phases of a social system of capital formation is basically analytical, so that, for example, the decay of a system can coexist (and combine) with the emergence of another, generating the social and political tensions characteristic of those eras in which "the old takes its time dying and the new takes its time getting born." It is also possible for the decay phase to be brief or partial, depending on the vigor and style of the emerging system. It is, then, not a matter of reconstructing the phases as if their succession were inescapable, and of course a system can collapse even before entering a consolidation phase. Finally, the inability of a social system of capital formation to provide clear overall leadership is typical of a transitional situation.

<sup>20</sup>C. B. Macpherson, *The Rise and Fall of Economic Justice*, Oxford, 1985.

<sup>21</sup>The reasons for this are to be sought not only in the "ul Haq effect"—any productive scheme inherently contains elements that predetermine the distribution of income—but in

the case, given the concentrating and exclusionary bias of most ongoing economic modernization plans.<sup>22</sup>

The behavior of per capita social expenditure provides a good indicator. It is known that, in response to the general pressure on Latin American governments to reduce their fiscal deficits, this indicator has fallen. But the important thing is that, as shown by a recent analysis of the average change in this expenditure between 1977-81 and 1982-85 in Argentina, Brazil, Chile, Uruguay and Venezuela, the largest decline took place in capital expenditure, which was never less than 20 percent and in Argentina declined by an astonishing 72 percent. This not only says something about the current crisis in social services—which have not even expanded at the same rate as population growth—but shows how precariously these countries will face the future while trying to press forward with their adjustment programs.<sup>23</sup>

It would be worthwhile here to briefly mention West Germany's experience at the time of the 1948 monetary reform, because it enshrined the idea of the "social market economy." This term was coined by Alfred Muller-Armack, and now arouses much admiration among Latin American defenders of neoliberalism. All the known peculiarities of the German case aside (including the Marshall Plan), I wish to bring out two factors usually given scant attention by those who cast Ludwig Erhard, the champion of free prices, as the mastermind of the "German miracle." I refer to the strong political leadership provided by Konrad Adenauer and the importance attached by the ruling Christian Democratic Union to the principles of Catholic reform and trade union doctrine. If one adds to this the influence exercised at the time by the occupying powers and, especially, the British trade union leader and politician Ernest Bevin, one can begin to understand why the economic reconversion was accompanied by "codetermination in the coal and

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the evidence that there is no direct and necessary correlation between rates of growth and the pattern of income distribution, which invalidates the universal character once attributed to the well-known "Kuznets curve." See Lecaillon and Germidis, *Inégalités des revenus et développement économique*, Paris, PUF, 1977.

<sup>22</sup>I quote from the last *Informe del Diálogo Interamericano para 1990*, Aspen Institute, Queenstown, 1990, p. 27. "More people than ever are trapped in poverty. Unemployment and underemployment increased in practically all the countries. Wages eroded markedly, as much as fifty percent in some places. The quality of housing, medical care and education worsened steadily. Crime rates grew. Life has become much harder in Latin America and women and small children are the ones suffering the most."

<sup>23</sup>Although, as the authors say, current expenditures—mostly wages—have on the whole displayed considerable inelasticity, a more detailed examination shows cuts in the financing of such critical items as basic drugs, rudimentary medical equipment and elementary school materials. See E. Bustelo and A. Minujín, "Cirugía mayor sin anestesia [Major surgery without anesthesia]," October 1991, p. 12, based on their own elaborations of ECLAC and IMF data.

steel industry, a highly participatory 'business constitution,' an elaborate and expensive pension and retirement scheme for the elderly, and a public health care system, which together made Germany one of Europe's leading welfare states."<sup>24</sup>

I wish to highlight three points with this example. First, not only was a market economy introduced in West Germany but a new social system of capital formation was taking shape which transcended free competition or the elimination of price controls. Second, this system made social policy one of its main pillars, which bolstered its consolidation and at the same time enabled the ruling party to win the 1953 and 1957 federal elections. In the third place, the participatory practices that were established played a very important role in the process which, according to Habermas, led a people in whom "a republican outlook had no roots" to "accustom itself to the traditions of freedom."

I said earlier that any conjecture regarding possible future strategies requires situating oneself relative to what is now taken for granted, i.e., the naturalization of the market economy and democratic liberalism and the view that modernization follows democracy.

I also attempted to show that the economic changes now underway cannot be disassociated from public policy and the types of regulation which are unique to each nation. Consequently, to subordinate—as tends to be done in many places—action by the state and institutional procedures to a presumed logic of the economy is simply to encourage a particular capital formation strategy, and probably the most costly one in social terms. New social systems of capital formation must be created in the region; that is true. But there are more ways than one to do so.

The course most often followed in deference to the "Washington Consensus" is certainly having alarming effects, and not even its greatest advocates foresee any swift and comprehensive recovery. More importantly, the specific bias modernization is thus acquiring also affects the shape of the political systems of government that are trying to assert themselves in the region.

As the previously quoted report of the Inter-American Dialogue points out in one of its conclusions: "Democratic institutions cannot be expected to prosper under conditions of economic coercion when millions of citizens lack employment, adequate housing and proper food, basic education or hope in the future."<sup>25</sup> I would add that, under such conditions, democratic institutions can also not be expected to prosper when at the same time sectors of the population included in the model

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<sup>24</sup>R. Dahrendorf, *Reflexiones sobre la revolución en Europa*, Barcelona, Emecé Editores, (trad. A. Bixio), 1991, p. 114.

<sup>25</sup>Inter-American Dialogue, *The Americas in a New World*, p. 63.

have their own ideas about consumerism, withdraw into private concerns, and show low participation and lack of solidarity.

This undoubtedly has appreciable economic consequences in that it wastes the opportunity of mounting a national collective effort to create growth with equity. Above all it sets the tone for a political life which, often, is characterized by increasing apathy among the population and little faith in its leaders.

Years ago, Parsons called this loss of confidence in the leadership by subordinate groups "deflation of power" because, as a result, less power is generated in the system.<sup>26</sup> This phenomenon can become particularly serious in the Latin American transitional situations, where, with few exceptions, the new political system has not yet taken root and thus remains vulnerable. For one thing, under such conditions a government needs more power if it is to exercise real control over the major interest groups and the authoritarian sectors, beginning with the armed forces. In addition, in view of local traditions and their present frustrations, there is a likelihood of growth among segments of the population susceptible to manipulation by adventurers, demagogues and visionaries. The two processes can feed on each other. As a government becomes isolated, it can become more inclined to ally itself with powerful interest groups and even to join forces with authoritarian sectors, voluntarily or otherwise. In this way, public policy can become more and more unpopular and those subjected to it more ready to heed—or at least not resist—the siren songs of potential new tyrants.

A catastrophic scenario is not essential for my argument. All it requires is that, for the reasons set forth, democratic liberalism, though surviving, becomes emptied of content while people lose the ability and desire to involve themselves in a political process that appears to them as increasingly (or even cyclically) remote and devoid of credibility. After all, India has already had more than four decades of democratic liberalism, with 55 percent of the population in 1985 below the poverty line while its "political life at all levels appears associated with violence, corruption and crime."<sup>27, 28</sup>

In light of the foregoing I think that at present any development

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<sup>26</sup>T. Parsons, "On the Concept of Political Power," in H. Eckstein (ed.), *Internal War*, The Free Press, Glencoe, 1964.

<sup>27</sup>A. Kohli, "Interpreting India's Democracy: A State-Society Framework," in A. Kohli, (ed.), *India's Democracy*, Princeton, Princeton University Press, 1988, p. 3.

<sup>28</sup>Compare this with, for example, a recent analysis of Torres-Rivas: "How have millions of impoverished and terrorized Central American peasants voted? They vote but do not elect. They are only half citizens of a low-intensity political democracy." See E. Torres-Rivas, "Los mecanismos de la ilusión: Las elecciones centroamericanas," *Documento de Trabajo No. 1*, FLACSO, Costa Rica, 1991, p. 17.

program for Latin America that seeks to establish elementary standards of social justice and bolster democratic institutions cannot, by definition, be restricted to economic matters but must, as a minimum and simultaneously, establish:

- Social policies designed to meet the basic needs of the population, viewing these policies and their financial requirements as a vital part of the accumulation strategy that is pursued and not as a consequence of its success;
- Participatory schemes designed as critical components of the regulatory regime of the social system of capital formation being built and capable not only of sharply boosting productivity but of engendering in workers the sense of one's own ability, which is essential for an authentic democratic apprenticeship;
- The strengthening of institutions of the civil society, by fostering autonomous forms of organization and citizenship, and thus furthering a mix of direct participation and representation designed, at the same time, to spur modernization and democracy.

Of course, at this level such recommendations can only be couched in those general terms. They are however inspired by a specific principle which a French aristocrat expressed with enviable lucidity a century and a half ago: "For human beings to continue to be—or to become—civilized, the art of associating with each other must be developed and perfected at the same rate as the growth of social equality."<sup>29</sup>

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<sup>29</sup> A. de Tocqueville, *De la démocratie en Amérique* [1835], Paris, Gallimard, 1963, p. 282.

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## LATIN AMERICAN THOUGHT: FUTURE POLICY DIRECTIONS AND RELEVANCE

Colin I. Bradford, Jr.<sup>1</sup>

### Introduction

This is a conference on Latin American thought, not about Latin American economic policy practice. Of course there is a connection, or so hope we who are more in the world of ideas between economic thought and economic action. But this conference is not about the nitty gritty of tax policy reform, exchange rate adjustment, trade measures, budget systems and the like. Rather it is about the way in which the policy challenges in Latin America are, have been and might be conceptualized. In this sense the conference is about competing visions of policy priorities for the region and contrasting conceptualizations which drive policy debates and influence the approach and priorities of policy practice. What is stimulating about being involved in Latin American economic affairs is precisely the differences of perception, prescription and prognosis that for decades have fueled the policy discussion in the region. Thirty years later, we can echo Albert Hirschman's conclusion to his essay on Latin American thought when he wrote "the scene we have surveyed is varied and vigorous; it is part of the vitality which today characterizes the Latin American economy and society."<sup>2</sup>

As animated and stimulating as these debates have been, it is necessary now to reflect on their utility and whether we should readily accept the large chasm that sometimes seems to separate the world of thought from the world of policy. Are these intellectual struggles illuminating the policy frontier or locking us into an ideological debate?<sup>3</sup> Can we now agree on a common framework within which policy options can be explored that elucidate choices for policymakers and provide them with an understanding of the consequences of alternative actions?

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<sup>2</sup>A. Hirschman (ed.), *Latin American Issues: Essays and Comments*, New York, The Twentieth Century Fund, 1961, p. 36.

<sup>3</sup>Williamson defines an ideologue "as someone who knows the answer before he has heard the context of the problem." Hirschman's definition in 1961 was different: "The term 'ideology' (of economic development) is used here, without derogatory connotation, to designate any moderately consistent body of beliefs, ideas or propositions, tested or untested, that aims at explaining Latin America's economic backwardness and at indicating its cure".

How one sees Latin American thought in the future depends on how one interprets the evolution of the recent past. As one thinks back over the main controversies in recent decades—monetarism versus structuralism, internal failures versus external obstacles, debt-led versus trade-led growth, inward-looking versus outward-looking orientations, stabilization versus growth-oriented structural adjustment—there are indeed patterns in the discourse.

### **Pattern in the Discourse**

When one looks back over the last 30 years of Latin American economic policy debates, a significant characteristic is the degree to which these debates have been characterized by dichotomies. In the 1950s and into the 1960s, the great debate was between monetarism and structuralism as approaches to dealing with inflation. Monetarists saw structural rigidities and social tensions as the result of inflation (inflation was the evil that had to be eradicated by monetary and fiscal policy) and structuralists saw these rigidities and tensions as the causes of inflation, hence the structural bottlenecks had to be attacked through intervention. The debate was a confrontation of paradigms, each with its own priorities, preferred policy instruments, and politics.

In the 1960s, the debate evolved into one that pivoted around the degree to which internal failures or external obstacles were the cause of Latin American development problems. There was a strong current of thought from various sources, including the dependency theory, that assigned a major burden of the blame on international factors. This led to the demands for a “new international economic order” in the early 1970s. In a way the Prebisch Report is part of this genre in its call for international action, but it is more balanced in its treatment of required internal reforms and measures. After the oil shock, the international debate shifted somewhat to the question of whether the balance of payments deficit should be financed or adjusted. In a sense, this mirrored some of the earlier monetarist versus structuralist controversy in that the issue was whether adjustment could be achieved through growth—debt financed investment leading to trade surpluses in the future—or through stabilization now and growth later.

In the 1980s—when the interest rate shock triggered the debt crisis in Latin America and when East Asia was demonstrating a sustained performance of what appeared to be export-led growth—the center of the debate became inward versus outward orientation. The stylized versions framed Latin America as inward-looking, interventionist and price distorting while East Asia was seen as outward-looking, market oriented and

having gotten prices right. Alongside this confrontation, there was a debate about growth-oriented adjustment through measures enhancing supply response, echoing previous themes, and sequential demand contraction cum structural adjustment of the classic variety.

These debates seem to manifest a number of common characteristics. First, the debate has not always focused on development. Throughout the entire period there has been a preoccupation with short-run macroeconomic policy goals. The short-run macroeconomic focus, which all would agree is a necessary condition for development, is not the same subject. The long-run trajectory has often been lost in the intensity of debate about current macro policy.

Second, the debate has largely been about economics and has generally excluded social, political, institutional, human and other non-economic issues. Part of this is the influence of American economics in the debate which tends to confine analysis within disciplinary boundaries and regards with skepticism inter-disciplinary efforts. There has been a premium on rigor over relevance. Isolating the analysis of monetary variables from the study of trade regimes, and vice versa (for example), and both from noneconomic variables, is not realistic from a development or a policy perspective.

Third, even within the economic policy debate, the range of issues has been narrow. The debate in the 1950s focused on inflation, the 1960s on external flows, the 1970s on the balance of payments, and the 1980s on the trade regime and structural adjustment. By and large, the debates in recent years at each stage have focused sequentially on these quite specific issues and left most other economic policies out of the discussion. Economic policies were rarely taken up together. Rather the debate concentrated intellectual energy on one aspect which was seen at that moment as the most critical.

Fourth, dichotomies have been the predominant mode in the debates. The discourse has been seized with one or another dichotomy and intellectual energy has been focused on thrashing out conflicting paradigms or ideologies surrounding the dichotomies. As a result, until recently, there has been very little convergence of view, syntheses of perspectives and consensus on where we are headed. In this sense, although the economic debate may have been intellectually satisfying, presenting policymakers with once-and-for-all choices between competing paradigms is less useful than giving them a range of issues and options within a sensible framework.

Fifth, the debate about Latin American economic thought has not been a Latin American debate alone, but an international debate involving many thinkers from outside the region. As Richard Webb has said,

“Washington is, after all, the world’s think tank for macroeconomic policy.”<sup>4</sup> It is not surprising, then, that thinking in the United States, and in Washington in particular, has been an important part of the discussion. And American economics has, of course, had a major influence on the way that many, though not all, Latin American economists have thought about Latin America’s challenges. Prebisch himself, an independent-minded economist, projected his ideas into the international arena. It is the international discussion and literature on Latin America, including its external intellectual influences, that we are considering in this conference.

Sixth, because this has been an international debate, financial stakes are involved because it is not just a debate about “where Latin America is heading.” Rather it is a debate about where the external community thinks Latin America should head and what the international financial institutions should support or not support to push in the desired direction.

Have these debates served us well in providing a bridge between thinking and practice, between the world of ideas and the world of action, thereby assisting policymakers to be more effective in advancing economic development? My sense is that the future requires a more inclusive systemic long-run perspective on development; one which attempts to integrate diverse economic and noneconomic elements into a synthesis framework within which policy options, sequences and choices can be thought through and formulated.

At this time, when democracies have been restored in most of Latin America, it is particularly important to find a balance between a consensus framework and policy choice. Otherwise, we run the risk of having democratically elected governments with no real freedom of choice; and with no demonstrable reason why having democratic elections makes any difference in terms of future economic policy choices and directions open to nations.<sup>5</sup>

The burden of economic argument in recent years has been to narrow policy options rather than expand them. Much of the debate has been driven by the desire to persuade others that policy should follow a certain path, formula or model. That may have been warranted in the past when the range of systemic choice was wider than it is today. But it surely does not seem necessary today now that the Cold War is over and we understand better the growth experiences of recent years, including in

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<sup>4</sup>J. Williamson, (ed.) *Latin American Adjustment: How Much Has Happened?*, Washington, D.C., Institute for International Economics, 1990, p. 102.

<sup>5</sup>*Ibid.*, pp. 36-37 and 414.

Latin America, and can put them in a better perspective than that of several years ago.

With this as background, this paper will attempt to indicate a broad framework for thinking about Latin America's future challenges within which a range of issues can be explored and to identify some of those issues for further thought and discussion.

### **Toward a Framework for a Development Strategy for the Region in the 1990s**

From the most recent discussion on Latin American economic policy, I would suggest several tentative conclusions to put before this conference. First, macroeconomic policy reform—fiscal discipline, rationalization and control of public expenditure, tax reform, financial liberalization and competitive exchange rates—are necessary but not sufficient conditions for dynamic development. Second, trade liberalization, along with a competitive exchange rate, does not by itself constitute the impetus for dynamic export growth. Third, encouraging foreign direct investment, privatization, deregulation and the enforcement of property rights are helpful in removing impediments to private sector growth but do not necessarily cause it. Taken together, these ten areas of policy reform, which are the elements of the “Washington Consensus,” are vital ingredients but do not constitute a complete framework for dynamic development for the future. Why not?

They are only areas of reform. They correct past mistakes, remove distortions, diminish disincentives and reduce obstacles to growth. Although the effort required to achieve them is enormous, they are efforts to return a country to a set of initial conditions which allow it to move forward but do not themselves move the economy forward. They establish the “enabling environment” but they do not provide the dynamics for development nor the impetus for growth.

The dynamics of development come from sources other than macroeconomic stability, trade liberalization and unshackling the private sector, as crucial as these are.<sup>6</sup> The dynamics of development come from (a) technological innovation, human resource development, organizational innovation and institutional development, (b) political reform, democratization, equity and social mobilization, and (c) a greater focus on natural resources and harmony with the environment.

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<sup>6</sup>This is not an argument against the Washington Consensus, which I think is irrefutable, but rather an argument that it be complemented by other elements.

### ***Technological Innovation for Dynamic Development***

A prime example of the degree to which the economic debates of recent years have left out major explanatory variables of dynamic growth is the marginal treatment of technology. It illustrates, I regret to say, the breach between thinking and practice. As Simón Teitel and Larry Westphal point out, "the existing relationship between technological change and industrial development is an area in which practical efforts have fallen behind analytical understanding."<sup>7</sup> Not only has the place of technology in the traditional production analysis been redefined to endogenize it within the production function, principally by Roemer, Helpmans and Grossman, but the definition of international competitiveness involving the incorporation of technological change as a driving force has changed dramatically in international discourse.<sup>8</sup> The OECD has played a major role in bringing these conceptual shifts into the policy discussion.

A major recent OECD report on technology and the economy concludes that "competitiveness is now based increasingly on other factors than the cost of labor and other inputs and is waged by firms through nonprice as well as through price factors; sound macroeconomic policies remain a condition of competitiveness but cost indicators such as relative labor unit costs can no longer be considered as reflecting competitiveness or capable of predicting trade performance; comparative advantage based on very general economy-wide factor endowments began to give way from the 1960s; the competitiveness of firms is not exclusively of their own making: it is also an expression of domestic institutional and macrosocial environments; it has a structural component and is supported by a wide range of externalities...."<sup>9</sup>

These understandings have led to new definitions. Several new terms connote the conceptual changes. "Structural competitiveness" is defined to stress "the interactive nature of the innovation process, the systemic features of technology, the learning processes associated with innovation, the vital importance of human capital, the significance of organizational and institutional factors in innovation and, of course, the central role of firms in competition."<sup>10</sup> "Constructive competitive advan-

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<sup>7</sup>S. Teitel and L. Westphal (eds.), *Cambio tecnológico y desarrollo industrial*, Inter-American Development Bank and Fondo de Cultura Económica, 1990.

<sup>8</sup>C. Bradford, "New Theories on Old Issues: Perspectives on the Prospects for Restoring Economic Growth in Latin America in the Nineties," in L. Emmerij, and E. Iglesias, (eds.), *Restoring Financial Flows to Latin America*, Paris, Development Center of the OECD and Inter-American Development Bank, 1991, p. 87.

<sup>9</sup>OECD, *Trade, Investment and Technology in the 1990s*, Paris, 1991, p. 321.

<sup>10</sup>OECD, "Background Report Concluding the Technology/Economy Programme," *Report to the Secretary General*, May 1991, p. 309.

tage” suggests that “competitiveness now depends on the successful establishment of systemic foundations for capturing the cumulative, learning and dynamic-increasing features of technological advance” and on “dynamic growth efficiency” (rather than static allocative efficiency), the foundations of which “rest on the cumulative and dynamic increasing returns associated in combination with technology and ... interactive and organizational factors.”<sup>11</sup>

What is fascinating about these new definitions is the degree to which they emerge out of an analysis of OECD economies. This is so even though, as we shall see subsequently, the experience of the dynamic Asian economies indicates that many of the same factors highlighted in the above definitions were of determining importance in the case of these development success stories. “There is a difference between the studies that focus on OECD countries and those that focus on developing countries. The latter tend, in general, to converge on the effects of government trade and industrial policies, almost invariably joining the debate over export-oriented versus import-substitution industrialization strategies and neglecting other determinants of technological development. Studies on OECD countries, on the other hand, usually look at innovation efforts, the functioning of labor and capital markets, industry-university ties, education systems and so on. The result has been a schism between the two schools, with each benefiting little from, and often ignorant of, the other. This schism has resulted in incomplete analyses of the industrialization process in developing countries.”<sup>12</sup>

Nonetheless, Sanjaya Lall has analyzed the building of industrial competitiveness in developing countries. He argues that both firm-level technological capability (FTC) and national technological capabilities (NTC) are required.<sup>13</sup> FTC consists of investment, production and linkage capabilities in addition to entrepreneurial and managerial capabilities. There is a high premium on process innovation and networking in order to incorporate new ideas into the firms’ operations. NTC embraces a variety of elements which Lall draws from the economics literature on growth accounting, education and training, technology, incentives, and institutions. From this he develops a “three pronged approach, involving the interplay of capabilities, incentives and institutions.”<sup>14</sup> After surveying the experience of 10 developing countries (the East Asian NICs, Malaysia, Thailand, Brazil, Mexico and Kenya), Lall concludes that “it is

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<sup>11</sup>*Ibid.*, p. 333.

<sup>12</sup>L. Emmerij, in S. Lall, *Building Industrial Competitiveness in Developing Countries*, Studies of the OECD Development Center, Paris, 1990, p. 9.

<sup>13</sup>*Ibid.*, p. 20.

<sup>14</sup>*Ibid.*, pp. 26-30.

not one set of policies that matters to the exclusion of others, but the complex interaction of incentives, endowments, institutions and technological effort; a framework which concentrates on the interaction of these critical variables provides a fairly satisfactory explanation of industrial performance; success has depended on how (countries) combined incentives ensuing from trade and industrial policies with an adequate base of human capital, investments in technological learning and innovation, and institutions to overcome market failures in the technological system."<sup>15</sup>

The lessons he derives from the historical experiences of the 10 developing countries are the following. Export orientation is important for building up NTC but requires other ingredients such as human capital development, research and development (R&D) tightly linked to the production process, a technology strategy, and even protection for technological learning. Whereas he sees market incentives and skilled manpower as being sufficient for early stages of industrialization, upgrading and diversification require a technology strategy for channeling, matching and diffusing technology.

Other analysts of technological innovation in the East Asian NICs have come to similar conclusions. "Technology policy in Taiwan is slowly moving from a stage of sheer technology importation and diffusion to technology development and innovation. Since the 1980s, emphasis has been on a comprehensive program to upgrade indigenous technological capabilities through improved research and development, institution building, and manpower planning. These efforts have taken place within the framework of the National Science and Technology Program, which aims at integrating science and technology policies with economic development strategy. At the implementation level, this has meant increased national R&D expenditures mostly by government."<sup>16</sup> As David O'Connor points out, "judging from the Asian NIE experience, the appropriate government role changes as a country moves through different stages in its industrial development, and it also depends on such factors as the prevalent industrial structure."<sup>17</sup> This active role for government in R&D and technological innovation has been complemented by heavy investment in education, training and human resource development.

In Korea, Taiwan and Singapore there has been a deliberate strategy for technology incorporation that has been an important feature

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<sup>15</sup>*Ibid.*, p. 59.

<sup>16</sup>C. Dahlman and O. Sananikone, "Technology Strategy in the Economy of Taiwan: Exploiting Foreign Linkages and Investing in Local Capability," Washington, D.C., World Bank, December 1990, p. 220.

<sup>17</sup>D. O'Connor, "Technology and Industrial Development in the Asian NIEs: Past Performance and Future Prospects," Study prepared for the Conference on the Emerging Technological Trend in the Pacific Basin, Fletcher School of Diplomacy, Tufts University, Boston, October 4-6, 1991, Development Center of the OECD, Paris, p. 2.

of the “catch-up” thrust of these countries. “In large measure, the success of Taiwan’s science and technology development program can be attributed to the fact that it was formulated within the context of a well-defined industrial strategy...Whenever it has intervened, the Taiwanese government has focused policies particularly on greater value-added industries to enhance Taiwan’s international competitiveness, as in the 1980s when it targeted development of ‘strategic’ industries.”<sup>18</sup> “While governments invested in human capital formation, infrastructure development, and other preconditions for a broader advance, they selectively promoted the development of ‘strategic’ technologies and industries.”<sup>19</sup>

Consistent with the accounts in both papers cited, O’Connor points out that “as the industrial and technological capabilities of the Asian NIEs have evolved, government R&D targeting has diminished in relative importance. Private sector resources devoted to R&D have increased substantially and technological catch-up is proceeding along a much broader front than in the past.”<sup>20</sup> But a positive, facilitative, flexible and selective role for government appears to be an essential ingredient of the East Asian success stories which is increasingly seen as critical to their performance.<sup>21</sup>

It is clear from this brief survey of recent research that FTC and NTC depend on each other and that great capability in one without the other is not effective. The crucial nexus is the interaction of enterprises, educational, training and research institutions, technological development, absorption and diffusion, communications networks, national policies, market incentives, resource endowments, and innovation strategies at a variety of levels and dimensions. This is an approach that identifies sources of dynamic development in the private sector, in non-profit institutions, and in public policy, and most importantly in their effective, multiplicative and synergistic interactions. In a word, though Lall doesn’t use it, the approach is systemic.<sup>22</sup>

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<sup>18</sup>C. Dahlman and O. Sananikone, “Technology and Industrial Development,” pp. 210 and 220.

<sup>19</sup>D. O’Connor, “Technology and Industrial Development,” p. 14.

<sup>20</sup>*Ibid.*

<sup>21</sup>*Ibid.*, p. 19. “Recently the government of Hong Kong—traditionally opposed to anything which resembled the fixing of goals in the technological sphere—decided to support the establishment of a center devoted to the training of design engineers, with the aid of computers and application specific integrated circuits (ASICs). Government policymakers apparently concluded that a laissez-faire approach is one factor explaining why Hong Kong’s electronics industry has been lagging behind those of the other three NIEs.”

<sup>22</sup>As indicated by S. Lall, *op. cit.*, p. 65, “the whole area of policy-making is ‘under-researched’...the recent obsession with trade strategies may have diverted attention away from such concerns, in the search for the Holy Grail of a simple policy panacea that meets all the needs of all developing countries. No such panacea exists.”

The OECD study, even though it is focused on industrial countries, also finds that this holistic or systemic characteristic is critical for an effective approach to competitiveness. "The only meaningful approaches to the relationship between technology and competitiveness are holistic. This is why the studies which have broken new ground and/or stirred significant public debate are those which have adopted such an approach."<sup>23</sup> The OECD study then goes on to cite a book by Michael Porter on the competitive advantage of nations in which he sets out his own definition of NTC (for sectors) involving four characteristics: factor conditions, demand conditions, related and supporting industries and firm strategy, structure and rivalry. The interesting point about Porter's typology which is brought out in the study is its systemic character. The interaction among the four components is the key element making it a mutually reinforcing system. "The effect of one determinant is contingent on the state of others...Advantages in one determinant can also create or upgrade advantages in others." Because of this systemic, interactive quality, the study finds that "the linkages, mechanisms, and factors which relate different determinants one to another are of key importance."<sup>24</sup>

With few exceptions the discussion of competitiveness in developing countries has yet to fully absorb the insights generated in the discussion of technology in advanced industrial countries. The foregoing analysis seems to make clear that the dichotomous mode of debate on Latin American economic development does not serve us well if we are looking for policy relevance. In the economic realm alone, we need a wider lens, a less discipline-driven approach that can capture the full range of factors and variables that affect firm-level and national competitiveness. Institutional capacity, human resource development, and organizational innovation are as important in determining the capacity of a country to manage technological change and integrate it into economic activity as are market incentives, macropolicies, and openness to international trade. There is not only a tendency to ignore these aspects of development in the international discourse but there has also been a tendency to specialize in such subjects so that their relationship with the rest of the elements of the economy has, by and large, been missed. The interactive aspect is crucial. Hence it is not just that more attention is needed to these new elements as add-ons to our inventory of development lessons, but that the new elements must be fully integrated into a broader framework.

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<sup>23</sup>OECD, "Background Report," p. 318.

<sup>24</sup>*Ibid.*, p. 320.

### ***Participatory Development as a Vehicle for Increased Productivity and Equity***

Having just argued for a broader and different economic framework, it is nonetheless necessary to argue that even such a framework is inadequate. The experience of recent years seems to show a variety of ways in which the relationship of society to economic policy matters in the effectiveness of the economic policy itself. We have learned some lessons. Adjustment programs have not been effective unless they have been “owned” by the societies and governments that have to implement them. Development directions are not sustained unless there is political support. Growth without equity over long periods is destabilizing. The lack of accountability and transparency has opened the door to rent-seeking and corruption, undermining policy efforts. Frequent changes in government create uncertainty, insecurity and lack of clarity about the rules of the game, which in turn discourage savings and investment. The lack of opportunities to participate in local, regional or national government stifles the productivity and energy of people. For all these reasons and more, there would appear to be a need to devote increased intellectual energy to the questions of political reform, democratization, equity and popular participation.

Quite apart from these lessons, it is clear that a development strategy which entails macroeconomic policy reforms, trade liberalization, private sector promotion and technological innovation as its main thrusts must include reforms of the state as a serious objective. It is not only reducing the economic role of the state that is required through fiscal reform, financial liberalization, trade policy reform and privatization, but also the reform of the state itself—which is something else altogether—to permit it to play a complementary, facilitative and responsible role in the development process. The national technological capacity component of competitiveness depends upon an intelligent, efficient and agile role for the public sector. The state has a role in education, health, technology support, infrastructure development and ensuring property rights and competition that cannot be played without reforming the state to make it more effective.

As a result, there has been in the last two years increasing discussion of “good government,” governance, participatory development and public economic management as important elements to the development process. There is a growing awareness, as Pierre-Clave Damiba of the UNDP states in an article on “Governance and Economic Development,”<sup>25</sup> that a symbiotic relationship exists “between democratization in

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<sup>25</sup>*Africa Forum*, 1, 1, 1991.

the form of people's participation in the political process, accountability, respect for human rights, freedom of speech, rule of law, tolerance of alternatives, succession of office, etc. and governance in the form of administrative capacity to formulate, implement and monitor socio-economic policies."<sup>26</sup> Arturo Israel found that "practically no country has been able to develop in a sustained way without a political system that functions with a minimum level of effectiveness and ethical standards."<sup>27</sup>

The Development Assistance Committee (DAC) of the OECD, which coordinates policies of national donor aid agencies, holds high-level meetings once a year with Ministers of Development Cooperation and heads of aid agencies. At the 1990 meeting, they concluded that "DAC members reaffirm their conviction that there is a vital connection between open, democratic and accountable political systems, individual rights and the effective and equitable operation of economic systems with substantial reductions in poverty. Participatory development requires strategies which combine effective economic policies, equitable access to basic social and economic services and broader popular participation in decision-making on the orientation of government policies and programs."<sup>28</sup>

Participatory development in the DAC definition includes priority for education, training and health for the masses of people, promoting the private sector including facilitating broad access to productive assets, support for microenterprise and informal sectors, a greater role for local government, association of users with the design and implementation of aid projects, enabling the active participation of women, strengthening institutions, policies and practices leading to good government, respect for human rights and fighting corruption.

Whereas it can be anticipated that bilateral and multilateral aid agencies will be giving greater priority to these issues in the future it is clear that "participatory processes must come from within a country; they cannot be imported."<sup>29</sup> The recently formed Global Coalition for Africa is a high-level political body of African leaders and international agencies which is, among other things, attempting to build broad political support from within for the idea of promoting political and public sector reforms in the region. At the next meeting of Heads of State of the Global Coalition for Africa a document enunciating a specially adopted definition by Africans of "governance" and reforms will be presented.

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<sup>26</sup>Quoted in OECD, "The Role of Development Co-operation in Contributing to Participatory Development," Paris, May 1991, p. 22.

<sup>27</sup>A. Israel, "El cambiante papel del Estado," *Working Papers*, Washington, D.C., World Bank, 1990.

<sup>28</sup>OECD, "The Role of Development Co-operation," p. 2.

<sup>29</sup>*Ibid.*, p. 11.

Given the importance of state reform for Latin America's future, it is worth asking now how this issue can genuinely become a priority policy concern within Latin America and how the intellectual community can help clarify the agenda for action.

### ***Harmonizing the Economic Relationship with the Environment as a Source of Growth***

Environmental concerns, both global and local, have risen in priority on the national and international agenda. Whereas at first, environmental considerations were thought to be constraints on growth, now there is more awareness of the potential for maximizing growth over the long run with environmentally sound economic policies. More attention is now being given to social as opposed to private costs, and the potential for the maximization of growth over the longer term, if appropriate measures of costs and benefits are used. Rather than a trade-off between growth and the environment, they are seen as potentially complementary.

Furthermore, new attention within Latin America is being given to its advantage in natural resources as compared to other regions. ECLAC, in particular, has focused on the nexus between natural resource-based economic activity, including manufacturing, along with technological change, as a vehicle for achieving sustainable development.<sup>30</sup> This interaction of natural resources and technology can be self-reinforcing in a dynamic fashion. As Fernando Fajnzylber has written, "the incorporation of technical progress actually enables production increases and environmental conservation to be compatible." Drawing from the section of this paper on technological innovation, this nexus represents a specific application with positive development results. For the application to work, however, the specifics must be generated internally in a way that fits the national circumstances. "The most successful strategies are based on an analysis of our regional, institutional, economic and social peculiarities and our environmental problems."<sup>31</sup>

### **Conclusions: An OECD Synthesis Framework**

As we look to a development strategy for Latin America in the 1990s, we see a critical need to draw diverse elements of economic policy, techno-

<sup>30</sup>United Nations Economic Commission for Latin America and the Caribbean (ECLAC), *Changing Production Patterns with Social Equity: The Prime Task of Latin American and Caribbean Development in the 1990s*, Santiago, Chile, 1990.

<sup>31</sup>Development and Environmental Commission for Latin America and the Caribbean, *Our Own Agenda*, Washington, D.C. and New York, Inter-American Development Bank and United Nations Development Programme, 1990, p. 3.

logical innovation, political reform and environmental sustainability together to achieve dynamic development.

A strategy for the future would need to represent a synthesis of these diverse elements which could be combined and applied in diverse ways but would each be vital parts of an overall thrust. The broad framework would have to include:

- Macroeconomic policy reforms
- Trade liberalization
- Private sector development
- Innovative policies for technological change
- Reform of the state, focused on greater equity, efficiency and participation
- Environmental sustainability.

A framework containing these elements might be said to constitute an “OECD synthesis” rather than a “Washington Consensus,” both because of its more inclusive character but also because the main elements are widely shared by the industrial democracies of Europe, the Pacific and North America as noted within the OECD itself in numerous documents and meeting programs of the organization.

Its value for the international discussion of development strategies for Latin America is that it carries the discussion into new realms and dimensions which have the possibility of activating the development process rather than simply providing the conditions in which growth can occur. A systemic approach to innovation and technological change is one that increases productivity growth and disseminates growth impulses broadly through the economy. Reform of the state provides the possibility for energizing society in relation to development objectives due to a greater confidence in the capacity, transparency, accountability and responsibility of the state in the development process. Part of political reform entails achieving greater equity through priority to human resource development, education, training, nutrition and health—and more equitable access to productive assets, i.e., land, water, capital, technology, etc. These human development aspects have the quality of improving social balance, income distribution and equality while simultaneously raising productivity and supporting democratic reforms. Environmentally sustainable development based on long-run social costs and benefits and sound technological applications can provide additional sources of growth in natural resource-rich Latin America.

These elements—technological innovation, participatory development and sustainability—are mutually reinforcing and add sources of dynamic development to conditions propitious for macroeconomic sta-

bility, free trade and free enterprise, “in order to avoid that they assure only macroeconomic equilibrium, in a way that the current efforts of the Latin American countries can bear fruit.” (Nohra Rey de Marulanda, IDB, October 1, 1991, letter to conference panelists.)

### **Tasks for the Research Community**

This framework leads to several new tasks for the research and intellectual community involved in Latin American economic policy discussions. The first task is to integrate into the mainstream of policy discussion critical dimensions of the development process which have traditionally been at the margin of the debate—such as technological innovation, political reform and the environment. These elements are now essential pillars for a viable development strategy; they can no longer be treated as afterthoughts.

The second task is to focus on the relationships that exist between the main pillars of development strategy, rather than treating each as an area of specialization unto itself. The integration of the three new elements into the mainstream discussion will not be advanced by convening still more conferences and research within each realm. The crucial questions are how the six elements interact, combine and relate. This reflects the importance of designing a systemic approach as opposed to an approach which is partial, specialized and solely economic or technical. To achieve greater dynamism in the development process and more policy relevance, we need research on the inter-relationship, synergy and interaction of critical elements rather than further clarifying them as isolated areas.

Finally, the research community needs to direct itself to the multiple decision-makers in the more complex societies that are evolving in Latin America with the return of democracy and the regions opening up to the world economy. “When an economy opens and non-governmental actors make decisions, a form of democracy is already instituted...In the case of Latin American economies, where prices and markets rather than officials and governmental regulations increasingly determine actions, decision-making power has been expanded from the center down to thousands, hundreds of thousands, in some cases millions of decision-makers making those decisions for themselves.”<sup>32</sup> This emphasizes well not only the increasing multiplicity of actors in the current context, but also the drift of reform in recent years. We need to recognize, even though more needs to be done, that the role of the state has been indeed reduced in recent

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<sup>32</sup>Weintraub, in National Research Center, “The Transition to Democracy: Proceedings of a Workshop,” Washington, D.C., 1991, pp. 14-15.

years. Much intellectual and reform effort has been spent to fight bad policies, corrupt policymakers and self-interested rent seekers. Now more needs to be done to promote positive policies, and help public-minded policymakers and socially-oriented entrepreneurs. In the next decade a more balanced approach in the focus, the execution and the policy orientation of research would provide richer and more policy-relevant results. Such a refocused research effort would be aimed at enhancing policy effectiveness and the range of policy choices within an agreed development framework in increasingly complex societies where all sectors, including the state, have vital roles to play.

Democracy is enriched when the range of public policy choices is wide and differentiated, rather than narrow and monolithic, and when other actors in the economy have freedom of choice. Policy-oriented research can do more in the future to enlighten decision-makers on the inter-relationship of factors and the variety of combinations, sequences and timing of actions that can ultimately be more effective in spurring development. Our passion for efficiency, stability and market forces needs to be balanced by and integrated with our commitment to innovation, participation, equity and sustainability to provide a vision of Latin America's future which is capable of mobilizing diverse forces for dynamic development rather than simply providing correctives for the excesses and abuses of the past.

## **DEVELOPMENT STRATEGY FOR LATIN AMERICA IN THE 1990s**

John Williamson<sup>1</sup>

While the 1980s were a lost decade to Latin America in terms of the growth of living standards, they were a highly productive decade in terms of the progress of ideas. Not only was this the decade in which democracy became generally established, but it also marked decisive movement toward the acceptance of modern forms of economic organization, involving outward-oriented, liberalized economies practicing prudent macroeconomic policies. The fruits of this modernization are now apparent in some of the countries that made the change first and most decisively, notably Chile and Mexico.

The first order of business has to be to complete and consolidate this change in the policy regime. Completion means two things. First, extending the new regime to those countries where it is not yet implanted, such as Brazil and Peru among the larger countries. Second, perfecting the new regime, notably by constructing the hemispheric free trade area visualized by President Bush in his Enterprise for the Americas Initiative. Consolidation means winning general support for the new regime, so that its irreversibility becomes as taken for granted as it is in Western Europe, North America or Japan.

Fears have sometimes been expressed, notably by Dornbusch,<sup>2</sup> that implementation of the sort of modernizing policy reforms adopted by many Latin American countries in the past few years—what I once termed the “Washington Consensus”<sup>3</sup>—will not suffice to get growth going again. Dornbusch has pointed to Bolivia as a country that early on

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<sup>1</sup>Senior researcher, Institute for International Economics, Washington, D.C.

<sup>2</sup>R. Dornbusch, “From Stabilization to Growth,” a study presented at a conference on Latin American economic reconstruction at Fundação Getulio Vargas, Rio de Janeiro, August 7 and 8, 1989.

<sup>3</sup>I have come to regret the term. One reason is that the “Washington Consensus” does not command that much of a consensus in Washington. But the more important reason is that the term was construed by some to imply that Washington had figured out what needed to be done and then sent missionaries to teach those who live beyond the beltway. In fact, I believe that thought moved in parallel fashion in Washington and Latin America as part of a worldwide intellectual development that had its most dramatic manifestation in the former Council for Mutual Economic Assistance area. See also J. Williamson, “Policy Reform in Latin America in the 1980s,” a study presented at the conference entitled “Structural Adjustment: Retrospect and Prospect” at The American University, Washington, D.C., March 1991.

implemented a brave set of reforms but has still not been rewarded by the return of robust growth. The question arises as to what could be done to accelerate the return of growth once the policy reforms are in place. The problem is that many of the traditional remedies—like Keynesian deficit spending, or easy money, or big foreign loans—are exactly what caused the crisis by being carried to excess in the past, and so a reversion to those practices is more likely to undermine confidence than to stimulate the economy.

The one thing that can clearly help is a definitive resolution of the debt overhang, such as the Brady Plan has succeeded in providing where it has been applied. It is vitally important that Brady agreements not lose their ability to provide a “good housekeeping seal of approval,” in the way that IMF standby arrangements did a decade ago, by being granted before reasonably comprehensive policy reform is in place. But, beyond that, one has to recognize that it may be necessary to hang tough and wait. When confidence has been badly bruised, it may take time to convince entrepreneurs that the new policy regime is permanent. A desperate search for a magic growth potion may delay revival rather than accelerate it.

Crucial as it is to complete and consolidate acceptance of the “Washington Consensus,”<sup>4</sup> it is time to start looking at a broader agenda. Latin America suffers from the world’s worst, i.e., most inegalitarian, income distribution. Implementation of the “Washington agenda” should, of course, tend to improve rather than worsen income distribution. We now realize, as Raúl Prebisch did not, that import substitution increases the demand for scarce factors of production at the expense of abundant factors, notably unskilled labor, and is thus systematically inegalitarian. The left—defined as those who care about equity—was misled by Karl Marx for over a century into believing that the interests of the poor could be advanced by suppressing markets. The collapse of communism in its homeland has disabused everyone except Fidel Castro of that myth. We now understand that the only lasting result of inflation is the inflation tax, which is highly regressive. Indeed, since the first necessity in improving the lot of the disadvantaged is an increasing supply of worthwhile jobs (as can come only from getting sustainable economic growth underway again), full implementation of the “Washington Consensus” should be the starting point for those concerned about equity.

Nevertheless, the policies subsumed under the “Washington Consensus” are not by themselves likely to lead to a substantial or rapid improvement in income distribution. If we worry about equity, we need to be able to count on more than trickle-down benefits. We need a

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<sup>4</sup>A summary of what this covers is provided in an appendix to this chapter.

separate set of policy reforms addressed specifically to that issue. The question that arises is what policies would be capable of improving income distribution without killing the goose that lays the golden egg of growth.

It is now clear that it is unwise to distort resource allocation or monetary policy in pursuit of distributional objectives. Hence the primary instrument available to redress income distribution is the fiscal system. Moreover, it appears to be difficult to construct a significantly progressive tax structure without risking severe disincentive effects. Given the greater resources that the rich can bring to bear to evade or avoid taxes, it takes a lot of effort to maintain even a rough proportionality in the tax structure. The fiscal system can nonetheless be a powerful instrument for aiding the disadvantaged if expenditure is concentrated on those in genuine need (in addition, of course, to the provision of public goods).

Two fields where there is an overwhelming case for increased public expenditure—on grounds of increasing growth as well as equity—are primary education and basic health, especially preventive medicine.<sup>5</sup> However, since the benefits of university education accrue primarily to those who receive it and these are largely in the upper-income groups, equity would suggest that tertiary education should be financed largely by student loans. Similarly, advanced curative medicine is consumed overwhelmingly by the better off, and hence it would be desirable to assign it to the private sector.

A particular priority in the health field should surely be universal availability of contraceptive services. The coexistence of large numbers of unwanted children thrown on the streets at an early age and the absence of access to birth control is a social disgrace. Not only does it lead to human tragedy on a massive scale, but high population growth aggravates environmental threats and constitutes a drag on economic growth.

The work of UNICEF has established that—provided they are carefully directed to the poor—welfare expenditures, including food subsidies and nutritional supplements, can provide cost-effective ways of addressing equity concerns.<sup>6</sup>

<sup>5</sup>Note that increased public spending on education and health were included as a part of the “Washington Consensus.” I deliberately restricted the list of public expenditure priorities to those fields where more spending could be justified primarily by its potential to accelerate economic growth. The improvement in distribution was incidental, because my objective was to describe the extent to which a consensus existed in Washington, and I judged that in 1989 Washington was largely indifferent to equity concerns. Stanley Fischer challenged that judgment, and I am happy to accept that correction, at least so far as the World Bank is concerned; see J. Williamson, *Latin American Adjustment: How Much Has Happened?*, Washington, D.C., Institute for International Economics, 1990, p. 27.

<sup>6</sup>A. Cornia, R. Jolly, and F. Stewart, *Adjustment with a Human Face*, Oxford, Clarendon Press, 1987.

One public good notoriously underprovided is piped water. This is a service for which cost recovery is relatively easy, but is frequently precluded by governments that believe it wrong to charge the poor for such a basic amenity. It is true that user charges for basic services are likely to be regressive; yet no provision at all is even more regressive.

Housing is another field where much can be accomplished “provided...standards of provision are kept down. [A] version...from Chile is simply a plot of land near a road, a bare concrete floor, plus...water, plumbing, sewerage and electricity. The incomers are left to finish the job with walls and roof as best they can.”<sup>7</sup>

Several Latin American countries have already acted to step up cost-effective social expenditures directed at the underprivileged in recent years. Most notable are Mexico with its Solidarity Program, Bolivia with its Emergency Social Fund, and Chile with its Social Solidarity Fund. It is rather conspicuous that these are the same countries that were the pioneers in implementing serious policy reform. In contrast, Brazil continues to pour over a quarter of its education budget into providing a free university education for a privileged elite, while almost two-thirds of its school-age children never finish primary school (eighth grade). Thus there is some evidence that the “Washington Consensus” and cost-effective social expenditures are complementary rather than antithetical.

It is certainly not true, however, that a high level of public expenditure tends to have a systematically egalitarian impact. The need is to redirect expenditure away from politically sensitive areas which typically receive more resources than their economic return can justify (e.g., administration, defense, indiscriminate subsidies and white elephants), and toward neglected fields with high economic returns or major benefits for the underprivileged. The composition of public expenditure matters far more than the issue on which controversy has typically focused, namely its level.

There can be a serious political obstacle to implementation of the advice to concentrate expenditures on the poorest. The fact is that the poorest are not a majority of the electorate, but typically constitute an under-organized minority with disproportionately little political clout.<sup>8</sup> To win political support for a program of social spending it may be necessary to extend the range of beneficiaries, which inevitably means increasing the cost of the program. If that process is carried far it leads to an acute conflict between social spending and fiscal discipline.

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<sup>7</sup>*The Economist*, October 19, 1991, p. 24.

<sup>8</sup>J. Nelson, “The Politics of Pro-poor Adjustment” in J. Nelson (ed.) *Fragile Coalitions: The Politics of Economic Adjustment*, New Brunswick, Transactions Publishers, in collaboration with Consejo de Desarrollo en el Exterior, 1989.

Resolving that dilemma is a challenge we economists have to leave to the politicians.

The other side of fiscal policy concerns the raising of revenue. The “Washington Consensus” also included tax reform, meaning a broadening of the tax base, especially via better tax administration, and a reduction in marginal tax rates. The aim is to sharpen incentives and improve horizontal equity without lowering realized progressivity. From an equity-oriented standpoint one might want to advocate actually increasing progressivity, although—as mentioned previously—it would be unrealistic to entertain any high expectations as to what may be feasible in that direction. Nonetheless, there are two potential sources of tax revenue that merit mention, due to the sums at stake and their positive implications for both efficiency and equity.

The first of these sources is the interest earned on assets held abroad (“flight capital”). Some Latin American countries make no attempt, even in principle, to tax foreign investment income as a result of their fidelity to the “origin principle” of taxation, which says that income should be taxed by the country where the income is generated rather than by the country of residence of the taxpayer (which is known as the “residence principle”). In the days when Latin American countries were major recipients of inward foreign direct investment and held no foreign assets worth mentioning, the origin principle could at least be rationalized on the basis of self-interest, but today even that is doubtful.

Other Latin American countries have laws which say that tax should be paid on foreign investment income, but they have no way of policing compliance with the law. As with most voluntary taxes, evasion is the norm. In effect, the interest income on assets held abroad is tax-free. This provides a tax distortion favoring capital flight and discriminating against domestic investment. Moreover, since only the relatively affluent have sufficient assets to justify the effort of placing funds abroad, the distributional effect is perverse.

It would be necessary to do two things to tax foreign investment income. One is to include such receipts in the definition of taxable income. The other is to sign tax information-sharing agreements with the haven countries, so that the tax authorities will get a chance to catch interest recipients who fail to report their earnings. The U.S. Treasury is now open to the negotiation of such agreements, and concluded the first with Mexico in 1989. The OECD has also negotiated a multilateral tax information-sharing agreement among its members, which is in the process of ratification. If the Latin American countries are serious about improving equity, they should make it a priority to urge that this treaty be opened for signature by nonmembers of the OECD.

The other tax that is conspicuous by its absence is a tax on the value

of land. Since the yield of land is pure rent, this is a tax with no disincentive effects. And since the rents that a piece of land can command depend critically upon public expenditures on infrastructure, social justice would be served by such a tax even if its incidence were not progressive. In fact land ownership is highly concentrated among the wealthy, and hence a tax on land values would be distinctly progressive. These arguments are ancient, familiar, and compelling. The only reason I can think of which might explain why they continue to be ignored is that Henry George and his disciples discredited the cause by arguing that land values should be taxed at 100 percent, that this should be the only tax, and that its imposition would solve every imaginable economic problem. A tax on land values should not be the only tax and it would not be a panacea, but a tax at a reasonable rate would nonetheless be wholly desirable.

In addition to raising revenue from those best placed to pay, a tax on the value of land would tend to undermine the pecuniary interest of landowners in resisting land reform. It thus might pave the way for future progress in an area where pathetically little has been accomplished in most countries despite an apparent massive need, indicated by the coexistence of large areas of underutilized land and the presence of land-hungry peasants, and an excellent record in other countries, notably South Korea and Taiwan. (Outward orientation is not the only policy lesson from the Asian tigers.)

The work of Hernando De Soto and the Instituto de Libertad y Democracia in Peru also seems to have established beyond any doubt that there are major potential gains to both efficiency and equity from the legalization of property rights in the informal sector<sup>9</sup>. Their work has shown that providing title to property need not be expensive and encourages a greater willingness to invest, permits the use of property as collateral for borrowing in order to finance investment, and economizes on the resources used unproductively in defending property rights.

The other recent lesson of grassroots initiative that now seems to be crystal clear comes from Bangladesh. The Grameen Bank established there has shown that it is possible to advance credit to microenterprises (including peasants) with an expectation of repayment, and very low rates of default, under appropriate circumstances. The necessary condition appears to be that potential borrowers who already have some form of close social relationship are organized into a cooperative and take joint responsibility for the loans contracted by a member of the group. Such

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<sup>9</sup>H. De Soto, *The Other Path: The Invisible Revolution in The Third World*, New York, Harper and Row, 1989.

small loans can have exceptionally high productivity, presumably because they enable very small amounts of capital to work with a very large quantity of labor. The discovery of how to make small loans that are not giveaways is a social innovation that offers the possibility of improving efficiency and equity at the same time.

What I have attempted to do above is to construct a list of measures capable of advancing the cause of social equity by building on rather than destroying all that has been achieved by the policy reforms of the last few years. There is nothing startlingly novel about the resulting list of reforms:

- Reorientation of public expenditure to emphasize basic education and health, birth control, targeted welfare, piped water, and low-cost housing.
- Improved tax administration, efforts to include foreign investment income within the tax net, and the introduction of a tax on land values.
- Land reform.
- Legalization of property rights in the informal sector.
- Foundation of banks to provide credit to peasants and microenterprises on the model of the Grameen Bank.

The purpose of offering a list of this type is to try and help crystallize thought, in the same way that my earlier list in the "Washington Consensus" appears to have done. Obviously this list is far more subjective than my previous effort was, for what I did there was simply record my impression of a consensus that had jelled.<sup>10</sup> I do not sense that a comparable consensus has formed on the question of how to promote equity; indeed it probably never will, for questions of distribution are inherently more controversial, and politically more divisive, than those of efficiency. But this does not make it less important to lay out an agenda which demonstrates that emphasis on the importance of efficiency is entirely consistent with a concern to advance equity.

I do not imagine that my agenda will satisfy everyone who boasts an egalitarian bias, for it promises no panaceas and forgoes the sort of populist program that has so often ended up by penalizing rather than benefiting the poor. The implication is that improving income distribution is likely to be a slow process. That is better than the alternative, which is never to improve it. The fact that it will take a long time provides

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<sup>10</sup>I recorded what I sensed had "jelled in" Washington at the time: that was how the term got named.

all the more reason to get the process underway promptly. Perhaps I have missed some proposals that could help to speed up progress, but they will need to pass the test of being capable of buying a substantial improvement in equity without much cost in terms of efficiency before they would find their way onto my agenda.

While I have focused on equity as the next issue that needs to be added to Latin America's agenda, I should add that I am among those who believe that the environment provides a further issue of a comparable order of importance. But that is an issue for another occasion (or perhaps another author).

## Appendix

### *A Summary of the "Washington Consensus"<sup>11</sup>*

*Fiscal Discipline.* Budget deficits, properly measured to include provincial governments, state enterprises, and the central bank, should be small enough to be financed without recourse to the inflation tax. This typically implies a primary surplus (i.e., before adding debt service to expenditure) of several percent of GDP, and an operational deficit (i.e., the deficit disregarding that part of the interest bill that simply compensates for inflation) of no more than about 2 percent of GDP.

*Public Expenditure Priorities.* Policy reform consists of redirecting expenditure from politically sensitive areas which typically receive more resources than their economic return can justify (like administration, defense, indiscriminate subsidies, and white elephants), toward neglected fields with high economic returns and the potential to improve income distribution, like primary health and education, and infrastructure.

*Tax Reform.* Involves broadening the tax base and cutting marginal tax rates. The aim is to sharpen incentives and improve horizontal equity without lowering realized progressivity. Improved tax administration is an important aspect of broadening the base in the Latin American context. Taxing interest earned on assets held abroad ("flight capital") should be another high priority for broadening the tax base in the coming decade.

*Financial Liberalization.* The ultimate objective is market-determined interest rates, but experience has shown that, under conditions of a chronic lack of confidence, market-determined rates can be so high as to threaten the financial solvency of productive enterprises and government. Under that circumstance a sensible interim objective is the abolition of preferential interest rates for privileged borrowers and achievement of a moderately positive real interest rate.

*Exchange Rates.* Countries need a unified (at least for trade transactions) exchange rate set at a level sufficiently competitive to induce a rapid growth in nontraditional exports, and managed so as to assure exporters that this competitiveness will be maintained in the future.

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<sup>11</sup>This summary is taken from J. Williamson, "Policy Reform."

*Trade Liberalization.* Quantitative trade restrictions should be rapidly replaced by tariffs, and these should be progressively reduced until a uniform low tariff in the range of 10 percent (or at most around 20 percent) is achieved. There is, however, some disagreement about the speed with which tariffs should be phased out (with recommendations falling in a band between three and 10 years), and about whether it is advisable to slow down the process of liberalization when macroeconomic conditions are adverse (recession and payments deficit).

*Foreign Direct Investment.* Barriers impeding the entry of foreign firms should be abolished; foreign and domestic firms should be allowed to compete on equal terms.

*Privatization.* State enterprises should be privatized.

*Deregulation.* Governments should abolish regulations that impede the entry of new firms or restrict competition, and ensure that all regulations are justified by such criteria as safety, environmental protection, or prudential supervision of financial institutions.

*Property Rights.* The legal system should provide secure property rights without excessive costs, and make these available to the informal sector.

## **TOWARD A NEW REGIONAL DEVELOPMENT STRATEGY FOR LATIN AMERICA IN THE 1990s**

Gerald K. Helleiner<sup>1</sup>

At the international level, the developing countries have been marginalized as at no time in the past 30 years or more. This is particularly the case in respect to debt-stricken Latin America and Africa. The active North-South debate of the 1970s has long since been forgotten. The world economy is managed by the self-appointed “economic directorate” of the Group of Seven (G-7); and there is no prospect of any change in this scenario, however much the United Nations may be “coming back” in other spheres. Outside their “domestic” concerns, the G-7 countries are preoccupied with growing markets in Asia and dramatic changes in Eastern Europe. At the 1991 World Bank/IMF meetings, the focus was overwhelmingly on Eastern Europe, the impact of U.S.-European squabbles upon the prospects of the GATT, and similar macroeconomic policy debates within the G-7. The problems of Third World debt, now that they do not threaten the global financial system, are already seen to be of tertiary importance. The more general problems of the developing countries are now primarily seen as emanating from their own mistaken policies; they must be encouraged to get their policies right—balancing market and state roles appropriately, and opening themselves to the beneficial influences of the global economy.

I believe that the functioning of the global economy has a profound influence upon the economic prospects of Latin America, and that influence is not always beneficial. But let me accept, for the sake of argument, that domestic policies within Latin America are of critical importance. What should they be? I shall comment upon five issues:

- Appropriate measurement of economic performance.
- Current views of economic growth.
- Consensus in policies on trade, foreign investment and macroeconomics.
- Relations with the United States.
- A suitable monument to Prebisch.

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## Measurement of Economic Performance

Appropriate measurement of economic performance plays an important role in strategizing about and monitoring success. It will be difficult to develop or pursue a new strategy for equitable and sustainable development growth as long as the IDB, ECLAC and the World Bank continue to rely on traditional measures of GNP or GDP growth. I do not speak of the UNDP's human development indicators, but of their measure of economic growth.

Probably nowhere else on the globe is the difference between income-weighted and population-weighted growth measures as great as in Latin America. The growth (or decline) of a poor person's income should carry at least the same weight as that of a rich person. In current growth accounting, if one earns 20 times the income of another, he or she receives 20 times the weight in the growth calculation. There is no harm in this procedure if one seeks to measure the sheer level of economic activity; as a measure of economic "performance," however, it is patently absurd. It was encouraging to see the World Bank again devoting some attention to this issue—after a lapse of over a decade—in its recent document on global macroeconomic projections. Those concerned with Latin America should be leading reforms in this sphere, rather than following them. Similarly, the appropriate treatment of environmental depreciation in the national accounts, and the use of net (rather than gross) growth rates to measure economic performance might well be led by Latin Americans.

## The Roots of Growth—1990s Version

The current Northern mainstream literature on the sources of economic growth plays down the role of capital accumulation or other factor inputs. Growth comes primarily from "technical change." There may be some measured gains in aggregate total factor productivity (or the unexplained residual after the role of factors has been accounted for) arising from reallocation of resources on the margin from low- to high-productivity activities. Syrquin notes that these have accounted for as much as 11 percent of output growth and one-third of total factor productivity improvement.<sup>2</sup> Most economic growth comes, however, from increasing knowledge and thus efficiency in existing broad spheres of economic activity via "learning" (from others or by doing), and scale economies. Increasing productivity at

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<sup>2</sup>M. Syrquin, "Growth and Structural Change in Latin America since 1960: A Comparative Analysis," *Economic Development and Cultural Change* 34, April 1986.

the industry or sector level may also derive from new activities and thus new product mixes. This mainstream wisdom is fully consistent with more radical “structuralist” or nationalistic interpretations of the roots of growth with their focus on the need for indigenous possession of technological mastery (a nontradable if ever there was one).

Before embracing this approach too categorically, it is important to issue some caveats. First, factor inputs—particularly capital goods and skilled labor services—play a relatively much more important role in developing countries’ growth than in the growth of those countries engaged in advancing humanity’s technological frontier. They can, after all, incorporate others’ more advanced knowledge and technology. After observing the impact of reduced investment in the 1980s, most Latin Americans would find it difficult not to continue to place heavy emphasis upon the role of capital formation in macroeconomic performance.

Second, macroeconomic performance itself impacts directly upon measured total factor productivity. Productivity increases in the medium-term are likely to be associated more with increased utilization of capacity (of both labor and capital) than with improved allocation among competing activities or even improved technology. The “fine tuning” required to increase capacity utilization without, at some point, creating more price inflation has proven to be a very tricky, and perhaps an impossible, undertaking. Certainly external resource flows (and favorable terms of trade) improve the prospect.

Third, productivity change can and should occur in agriculture and other primary production as well as in manufacturing. The recent literature’s emphasis on technical change is frequently taken as equivalent to favoring industrial progress, but that is only part of the story. Agriculture still accounts for as much of the labor force as manufacturing in many Latin American countries in the 1990s. Moreover, local adaptive research is typically more necessary in agriculture than in manufacturing in Latin America. There is, therefore, a strong case for expenditure on local agricultural research as part of a general strategy that emphasizes technical change.

Clearly, there is a need for policy that encourages all forms of technical change and productivity improvement. Given resource scarcities, it is likely that governments, consciously or against their will, should find themselves favoring some economic activities more than others. It is difficult for budgets on education, research, science and technology to be totally neutral—to the degree that, for instance, trade policy in principle can be. A critical policy issue is therefore how governments can best deploy their resources (and policy instruments) to encourage technological improvement in their economies. A significant subissue is how Latin American economies can best draw, for this purpose, on external inputs.

## Consensus on Trade Policy?

Central to the “Washington Consensus” on development policy for Latin America, and that of increasing numbers of Latin American policymakers, is openness in economic relationships with the rest of the world. The fresh emphasis on openness, however, bears a closer look. What are its theoretical and practical roots?

International trade has never been an end in itself. It must be functional in terms of expanding production and incomes. In the context of the balance of payments situation—particularly the debt servicing requirements—of Latin America in the 1990s, increased exports are necessary (though, by that logic, no more necessary than increased efficient import substitution). This is not generally at issue.

Appropriate incentives and institutional structures must be created in support of this objective. More is known about the former than about the latter in the Latin American context. Korea and Taiwan, two super performers, for instance, built their export successes on totally different institutional bases. Different Latin American countries will probably also experience different degrees of success with different systems.

The role of generalized import liberalization, however, is one on which agreement is not so widespread. It is not nearly as clear that import liberalization, except to the degree that it relates directly to more efficient exporting, will at present contribute to the agreed objectives. It is worth considering why.

The newly emerging mainstream wisdom on trade policy differs fundamentally from the more traditional one. Rather than focusing upon the static social costs of misallocated resources—which generally do not seem to add up to much in terms of readily calculable values (the areas of little triangles)—the current literature emphasizes instead the “dynamic” role of trade (and openness more generally) in stimulating productivity growth. In this respect, it reflects the current wisdom on the sources of overall growth. Externalities are seen to abound in activities associated with importing of goods and services. In the words of the World Bank’s *World Development Report*, 1991:<sup>3</sup> “Openness—the free flow of goods, capital, people, and knowledge—transmits technology and generates economic growth across nations...First, increasing global competition raises the demand for new technology. Second, the supply of new technology for industrializing countries is determined largely by the degree to which they are integrated with the global economy. New products and processes are transmitted through im-

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<sup>3</sup>World Bank, *World Development Report 1991*, Washington, D.C., pp. 103, 114 and 116.

ported inputs and capital goods, sold directly through licensing agreements, and transmitted through direct foreign investment or export contacts with foreign buyers.

“By affecting the nature of inputs as well as production processes, trade could generate gains which greatly exceed the short-term benefits from improved resource reallocation...The accumulated evidence suggests that the long-run gains from increased competition and the spillover of technology are likely to be much greater than the short-term gains.”

This raises some fairly basic questions. If imports of particular goods and services are so important to development—not, except in particular circumstances, where there are production externalities or opportunities for technological learning exports per se—it would seem to follow that:

- Measures to raise the capacity to import, notably reduced net resource transfers out of Latin America, are of fundamental long-run developmental importance and not just a temporary inconvenience.<sup>4</sup>
- The composition of imports of goods and services may be of at least as fundamental importance as their level.
- Since many of the critical imports are likely to be services, the old verities relating to policies on goods trade may not be as important as those relating to foreign direct investment, intellectual property and trade in services.

Thus, the “neutrality” or uniformity of incentives for goods imports, upon which some “liberalizers” continue to place heavy emphasis, fades away in relative importance.

There is a further practical issue. The evidence on the relationship between the trade regime and productivity change is tenuous at best. Even the World Bank, noting among other things, that “the relation between imports and productivity growth is sometimes positive and sometimes negative” concludes that “the debate is not fully resolved.”<sup>5</sup> One of its authors cannot even find any correlation between the various alternative measures of the “outward orientation” of trade policy.<sup>6</sup>

### **Consensus on Foreign Investment?**

What do we know about the role of foreign direct investment and other external sources in the provision of productivity-enhancing services?

<sup>4</sup>H. Esfahani, “Exports, Imports, and Economic Growth in Semi-Industrialized Countries,” *Journal of Development Economics*, January 1991.

<sup>5</sup>World Bank, *op. cit.*, p. 116.

<sup>6</sup>L. Pritchett, “Measuring Outward Orientation in Developing Countries: Can It Be Done?” World Bank *Working Papers*, PRE, No. 566, 1991.

There is a presumption in the current mainstream literature that openness or *laissez-faire vis-à-vis* foreign business is usually “best.” Yet we know that neither Japan nor Korea used so “open” an approach; that incentives or performance requirements have sometimes stimulated desirable (productivity-enhancing) changes; that external technology can be acquired in different ways; and that intellectual property laws create (indeed are intended to create) rents.

Foreign ownership also calls into question some of the purported benefits of import liberalization. It is often said that import competition will particularly enhance productivity where there is domestic market concentration and this is, in general, correct. Unfortunately, however, more careful scrutiny reveals that when the concentrated firms are foreign-owned these efficiency gains are likely to be fully captured by foreign owners rather than by the liberalizing economy.<sup>7</sup>

We need to know much more about how best Latin American firms and governments should interact with foreign firms so as to achieve the best results for their own growth and development.

### **Consensus on Macroeconomic Policy?**

There is also a renewed agnosticism about the role of the exchange rate (even at the IMF). All agree on the desirability of macroeconomic stability—low price inflation and a real exchange rate that permits sustainable external balance. The route to this agreed objective remains elusive, however, and, apparently, extremely costly. A few years ago, the IMF and World Bank seemed prepared to concentrate on getting the real exchange rate right and keeping it fairly stable, letting anti-inflation objectives take lower priority. As long as problems were seen as those of temporary balance of payments adjustment, some extra inflation could be tolerated in the process. But now that longer-term development is again seen as the objective, the costs of continuing high rates of inflation, inevitably abetted by constant nominal devaluations, have regained their former prominence.

The exchange rate plays a major role in inflationary processes and exchange rate policy can therefore perform an important anti-inflationary function. Using the nominal exchange rate as an anchor with which to defeat inflation appears still, however, to be highly risky. If credibility is in question, this approach will surely fail. Yet the Draconian measures required for credibility and the length of time that must elapse

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<sup>7</sup>T. Hazledine, “Trade Liberalization and Economic Welfare with Endogenous Market Structure,” Department of Agricultural Economy, University of British Columbia, 1990.

before the rewards can be felt may be politically impossible. We do not seem to have learned much about these issues over the past 40 years!

### **Economic Relations with a Larger Partner (the United States)**

The simple-minded presumption of two-country, two-good neoclassical trade theory is that, when a small country “opens” to trade with a large country, the resulting gains flow disproportionately to the small country. This is basically because the large country’s domestic price structure will dominate in the determination of post-trade prices and thus leave it relatively indifferent to the possibility of international exchange which does not significantly alter its incentive structure one way or the other. The small country, on the other hand, can expect a major change from its pre-trade price structure and therefore, always allowing for greater adjustment costs, much greater gains from the reallocations of production and consumption that result from expanded trade opportunities. Where there are scale economies, or other productivity-enhancing effects from which a small autarchic country could not previously significantly benefit, gains also are presumed to flow disproportionately to the smaller country. A more modern version of this basic proposition—often offered with a neomercantilist export-oriented flavor—rests on the presumption that if one country’s market is 10 times as large as the other’s, assuming both initially have roughly equal trade barriers, then reciprocal liberalization will provide (market) gains to the small country that are roughly 10 times those of the larger country.

If the smaller partner in a bilateral trading agreement is expected to derive a disproportionate share of the gains from increased trade, then the obvious question is why the larger (and presumably more powerful) partner should permit this outcome to occur. It is possible that the positive-sum nature of the game leaves the larger country content with its gains even though a larger share of the “increased pie” is claimed by its smaller trading partner. A better a priori hypothesis than that of “positive-sum contentment” is that the larger country will not consent to a game that is disproportionately beneficial to a smaller (weaker) trading partner unless it extracts a “side payment” from this partner that is roughly the size of that partner’s disproportionate gain from trade alone. As has been seen, this may be facilitated via foreign ownership in domestic oligopolistic industries.

There is also the question of how the game is actually played. There must always be anxiety over the degree to which powerful actors will eventually submit to disagreeable developments, whatever they may have agreed, if they do not suffer greatly in consequence of failure to do so.

Can the large country be credible in its commitments to comply

with the terms of an agreement with a much smaller and weaker country? Must there not be a better balance of disadvantage from noncompliance, such as is approached in a multilateral system, or an alliance of small countries, for there to be hope that the large will eventually comply with what was originally agreed? In alliance, there can be greater trading strength.

### **A Proposal to Honor Prebisch**

Prebisch was an intellectual leader. He stimulated and provoked development thinking around the world. Some have been more impressed with the directions of his efforts than others, but few would question the fact of his influence. I have argued that, despite the illusion in some quarters that a consensus on economic policy for development already exists, there is still much to be discovered. There could be no better monument to Prebisch's memory, in my judgment, than the resurrection of an independent Latin American intellectual thrust in the sphere of (development) economics. The building blocks for such a monument are in place—in the form of a new generation of highly skilled and experienced Latin American economists. At least one internationally competitive postgraduate program of economics and public policy could now easily be launched within Latin America. It is possible that, if a new "Latin American Consensus" emerged, it might not today be so different from the Washington one; but then again how will we know if strong alternative intellectual centers do not exist? Is it not time now to launch one? And, should it not bear Prebisch's name?

## NOTES ON A NEW REGIONAL DEVELOPMENT STRATEGY IN THE NINETIES

Gert Rosenthal<sup>1</sup>

### The New Debate over Development Strategies

If this roundtable had been held just two or three years ago, the opinions about the topic “new development strategies” would have fallen into two major groups. The first would have contended that it was absurd to talk about “strategies” when the Latin American technical bureaucracy was focusing almost exclusively on short-term policies for survival to the point where thinking about the medium and long term was out of the question. The second would have asserted that the very concept of “strategy” was passé, reflecting the public sector’s clinging to a determinism out of sync with the new reality. What was needed was to place full trust in the signals of the marketplace, so that development might follow the prompting of the proverbial “invisible hand.” What the two sides would have had in common was the certitude that debating “development strategies” was a waste of time.

Since then, apparently, a consensus has emerged about the general direction development should take. What one might call an implicit strategy. Institutions which in a previous era used to offer markedly divergent interpretations and approaches on development now largely concur, at least in general outline.<sup>2</sup> That consensus has grown out of several factors, chief among them evidence that the production and marketing of goods and services is becoming global, so that no country can isolate itself from this phenomenon.

As a result, the current tendency is to rely more on market signals, and on monetary and credit policy consistent with a reasonable balance between demand and supply. There is a general willingness to eliminate

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<sup>2</sup>See, for example: World Bank, *World Development Report*, 1991, New York, Oxford University Press, 1991, especially Chapter 1; Comisión del Sur, *Desafío para el Sur*, Mexico City, Fondo de Cultura Económica, 1991; United Nations Conference on Trade and Development (UNCTAD), *Report of the Secretary General of UNCTAD to the Eighth UNCTAD*, (TD/354), Geneva, August 1991, especially Chapter 1 of the second part entitled “Market Forces, Official Policy and Good Management.” See also John Williamson, *The Progress of Policy Reform in Latin America*, Washington, D.C., Institute for International Economics, 1990.

price distortions and to correct the key relative prices, especially to prevent anti-export biases, and diligent efforts are made to achieve fiscal equilibrium. Those coherent and stable macroeconomic policies are generally accompanied by a trend toward the liberalization of trade and the privatization of public enterprises.

The importance of human resources is also usually emphasized, given the growing importance of knowledge in the trading of goods and services and of the need to offer incentives for saving and investment. Even one of the formerly more controversial issues, such as the role of the public sector, today tends to find greater consensus. It is difficult to find defenders of all-out interventionism or of pure laissez-faire. The World Bank's *World Development Report* (1991) expresses an opinion fairly representative of this consensus by stating that governments need to reduce their presence in areas where the markets function, or can be made to function, in a reasonably satisfactory fashion, and that at the same time governments should do more in areas where the marketplace alone does not suffice.<sup>3</sup>

Finally, and contrary to the argument supported in some quarters several years ago that it was "easier" to foster development in authoritarian societies, the prevailing belief today is that democracy and respect for individual rights are useful for a type of development based on market mechanisms.

In sum, the extent of the common ground shared by various institutions and individuals is striking, at least with respect to the general framework that should govern the development process. That affirmation is valid for short-term policies and medium-term strategies, as well as for the role of international cooperation.

### **Some Proposals for a New Strategy**

The Economic Commission for Latin America and the Caribbean (ECLAC) has also formulated its own position on Latin American and Caribbean development in the 1990s and thereafter. That position, which in broad outline follows the approach summarized above but with some major original perspectives on regional issues, is set forth in the document entitled *Productive Transformation with Equity*.<sup>4</sup> Accordingly, one way for me to contribute to this roundtable will be to summarize that proposal.

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<sup>3</sup>World Bank, *op. cit.*, p. 9.

<sup>4</sup>ECLAC, *Productive Transformation with Equity. The Principal Task of Latin America and the Caribbean in the Nineties*, Santiago, Chile, March 1990.

The point of departure for the ECLAC position, and the central idea around which all the others revolve, is that the transformation of the productive system should flow from a deliberate and systematic incorporation of technical progress, with a view to achieving rising levels of productivity. That idea appeals to common sense and may appear somewhat timeworn, but it has not always been applied in practice. On the contrary, in the past many of the region's exporters were inclined to maintain the status quo. Others performed less well than they might have, perhaps because of excessive protection. Others, conversely, became internationally competitive, sometimes by the expedient of depressing real wages and depleting natural resources. What is being attempted now, as productivity levels rise, is to couple competitiveness with environmental sustainability, and economic growth with social equity.

The application and dissemination of technical progress includes the strengthening of plant, technological infrastructure and, particularly, worker training and all the incentives and mechanisms that facilitate access to, and the generation of, new knowledge. For that reason the ECLAC proposal puts considerable emphasis on, for example, the role of education and know-how as one of the central elements in productive transformation with equity. I shall return to this subject later.

A second central idea closely linked to the first is that of underscoring the systemic character of competitiveness. To be more exact, although the firm is crucial to the achievement of higher productivity, it is part of a network of linkages that include, among other things, the educational system, the technological, energy and transport infrastructure, employer-employee relations, the public and private institutional apparatus and the financial system. Weakness in any link of this chain can affect an entire socioeconomic system. With this in mind, determined, persistent and, most important, all-embracing effort is required.

A third central idea, related to the preceding ones, is that productive transformation cannot simply be the result of an appropriate and stable macroeconomic climate, or of a policy of "correct prices." Coherent and stable macroeconomic management is necessary but not sufficient: it must be combined with sectoral policies. Short- and long-term policies will have to be integrated as well. In addition, a very wide range of institutional changes will be needed, including improvements in business management, in public and private activity, and in the firms themselves.

In the fourth place, it is postulated that the transformation of the productive system must be consistent with environmental conservation, especially in a region with a record of natural resource depletion and increasing water and other environmental pollution, particularly in the cities. The dovetailing of environmental concerns with the development process goes beyond concerns about natural capital. What is sought is a

dynamic equilibrium between all forms of capital or wealth that share in the development process, including human, natural, physical, financial, institutional and cultural forms thereof.

In the fifth place, the ECLAC proposal assigns equal importance to equity and transformation of the productive system, in the conviction that the two concepts reinforce each other. Thus it is assumed that sustained growth driven by competitiveness is inconsistent with the prolongation of delays in equity, but that such delays cannot be corrected without sustained growth. The starting point for achieving greater equity is certainly situated in growth from greater levels of productivity, which translates into increased employment and a possible rise in the levels of workers' real wages.

Nevertheless, however intense the transformation effort, there is certain to be a long lead time before the poorest sectors can be brought into activities in which productivity is rising. It will therefore be necessary to consider additional redistributive measures, including large-scale training programs for microentrepreneurs, independent workers and farm laborers; reforms of various regulations that prevent microbusiness training; adjustment of social services to the needs of the poorest sectors; organizations which contribute to mutual aid and adequate representation of the needs of the most disadvantaged to the state; and use of the redistributive potential of fiscal policy.

In the sixth place, it is noted that Latin American and Caribbean integration and intraregional cooperation make a vital contribution to the strengthening of the transformation of the productive system. In this regard, concrete actions based on sectoral criteria are required, preferably subregional in scope and gradual, with emphasis on competitiveness and profitability. This has been the case, for example, with the creation of the Southern Cone Common Market made up of Argentina, Brazil, Paraguay and Uruguay, or the system of bilateral, trilateral and multilateral agreements that are being concluded in the region. Such actions are designed to ensure that integration contributes to the proposed development strategy and can enhance it. Its role would not be to oppose a better insertion of the region's productive activities into the world economy but to facilitate it.

In the seventh place, all of the foregoing flows from a recognition that the formulation and application of economic strategies and policies will have to occur in a democratic, pluralist, participatory context. This affects the content and scope of economic policies and strategies, the manner in which they are formulated and applied, and the means of interaction between public and private agents. There is no longer any debate in the region over whether it is easier or more difficult to foster development in participatory versus authoritarian societies. It is a given

that democracy is an intrinsic goal, and that Latin American development must be approached in conjunction with pluralist political systems, all of which has implications with respect to the style of formulating and applying economic policies and strategies.

In that democratic context, strategic policy coordination—understood as a system of explicit and implicit broad agreements between the main actors of the civil society and the state—must acquire decisive importance. An attempt is made thereby to legitimize mechanisms and actions which generate behavior consistent with common purposes while slowing the efforts of interest groups which could compromise the collective purposes. This minimal platform of agreements serves as a basis for consensus regarding the course which economic policy is to follow.

In the eighth place, a rethinking of state intervention is proposed. The argument is made that state initiatives should concentrate on strengthening competitiveness through technical progress and on achieving reasonable levels of equity, although this suggests that the state ought to give up many of the activities it performed in the past in order to focus on essentials. This would have no bearing on the size of the public sector. The purpose is to increase the positive impact of public action on the efficacy of the economic system as a whole. It also emphasizes regulation over direct intervention.

The program described above grows not out of abstract considerations but rather from concrete experiences, within and outside the region, that indicate a course to follow. The general terms of this brief summary are spelled out in the proposal to describe policies and mechanisms with varying degrees of specificity. And although none of the approaches offered is particularly novel in itself, the whole derives a certain originality from its coherence. In any case, as previously noted, it is largely situated within the bounds of the consensus to which I referred in the introductory paragraphs of this essay.

### **Some Areas of Consensus**

In relation to that consensus there are some points which in my judgment should be examined with particular care in order to resolve certain insufficiencies and dilemmas. Despite growing agreement on the broad concepts governing development, much remains to be discussed with respect to the most appropriate policy mix for each concrete situation: that is, the exact content of those policies, the most advisable sequence, the best way to adapt them, the choice of strategies, and the circumstances and needs of each country. This is one of many challenges that the future holds for the region.

A lively debate is in progress over the precise content, scope and

purpose of specific ongoing policies, and over the importance of various instruments in the public policy inventory. The combination of different instruments, the speed with which particular measures will have to be applied, and the relative importance of short-term objectives (stabilization) in comparison with medium- or long-term ones (productive transformation) are only some of the subjects causing controversy.

One issue presenting special difficulties concerns the relative importance of sector policy as opposed to macroeconomic policy. What categories or branches of activity will become engines of growth? "Whichever ones the market determines," the neoliberals would say. "Those that have the potential to become quality pace-setters at the international level," say those who wish to emulate the Japanese. "But who picks them?" the neoliberals would ask (the paradigm in vogue disdains the art of picking winners). However, there is a place for a sector policy that would supplement market signals and spur international competitiveness based on selective public support for activities in which it is assumed, at first sight, that a given country might develop levels of excellence. Examples abound showing that a combination of concrete actions (research, training, infrastructure investment, specific incentives) to support a particular activity (for instance, horticultural exports) is a necessary complement of the "right prices."

No universally valid strategies can be offered. In the final analysis, the precise content and the scope of short- and medium-term policies will depend on the particular circumstances experienced by each country and on the objectives being pursued. It would then be well to introduce a greater degree of tolerance in the concrete application of the implicit strategy deriving from the broad outlines of the argument described above, in order to understand the wide range of conditions found in the region.

### **The Problem of Marginalization**

A second matter worthy of comment is the scant attention given by the paradigm in vogue to the subject of marginalization, the intractable severe poverty that afflicts Latin America. It must be admitted that our own program does not convincingly resolve the longstanding and much-debated growth versus equity dilemma,<sup>5</sup> and this has led us to focus on the relationship between the transformation of the productive system and equity as one of the central concerns of our current work program.

Several recent studies stress the regressive character of adjustment

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<sup>5</sup>See the classic work compiled by the World Bank in the early 1970s: H. Chenery, *et al.*, *Redistribution with Growth*, Madrid, Tecnos, 1976.

and the growth of poverty in Latin America during the 1980s.<sup>6</sup> It is not usually emphasized that the implicit strategy in vogue has an openly regressive bias. There is, already, a widespread realization that social needs are not readily met by the logic of the marketplace, or of the shortage of empirical data establishing a clear cause and effect relationship between levels of growth and changes in distributive structures.<sup>7</sup> The attitude prevalent in the region today puts a premium on efficiency—in contrast to a few decades ago, when it was considered shameful to glory in efficiency's benefits—while tending to accept the falling behind of the majority as a regrettable but inevitable, and surely passing, by-product of the march to modernity.

Nevertheless, one of the great paradoxes of recent times is that the growing incidence of poverty—and probably the growing distance separating the extremes of the distribution structure—is occurring in the context of political systems where the elected authorities feel they are committed to meeting the demands of the lagging majorities.<sup>8</sup> Furthermore the fulfillment of this commitment is periodically subjected to the verdict of the electorate. This means that distributive policies—economic and social—will have to receive more attention in the development strategies of the 1990s.

It is possible that this will be more obviously manifested in connection with worker training, and particularly in the educational system, where the need for a transformation of the productive system backed by rising productivity converges with the requirements of greater social justice. In other words, awareness of the importance of human resources to achieve greater international competitiveness already exists, and it is likely that governments and civil societies will earmark more funds to train them. This would also produce qualitative improvements, which increases the importance of training from the standpoint of development.

It is also inevitable that some actors who do not figure prominently in public policy at the present time will become more interesting to policy-makers. I am referring to small and medium-sized business, including microbusiness, where significant potential for higher productivity exists. Beyond the debate about whether or not it is desirable to

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<sup>6</sup>See, among others, World Bank, *World Development Report 1990*, Washington, D.C., Oxford University Press, 1990; Economic Commission for Latin America and the Caribbean, *Magnitud de la pobreza en América Latina en los años ochenta* (LC/L.533), Santiago, Chile, May 1990; United Nations Development Programme, *Human Development Report 1990*, Bogotá, Tercer Mundo Editores, 1990.

<sup>7</sup>G. S. Fields, "Poverty and Inequality in Latin America: Some New Evidence," paper presented at Symposium on Urban Poverty in Latin America, Woodrow Wilson Center, Washington, D.C., December 1990.

<sup>8</sup>ECLAC, *Panorama social de América Latina*, 1991 edition (LC/G.1688), Santiago, Chile, October 1991.

support enterprises of less than optimal scale from the standpoint of efficiency, this fact cannot be overlooked: in most countries of the region, microbusiness still generates a high percentage of total employment.

Similarly, even if experience in Latin America with the earmarking of public expenditure has not been uniformly positive, the old debate over whether or not to earmark part of that expenditure for the poorest has now narrowed to the question of how to do it. It is likely that development strategies will put considerable stress on qualitative and quantitative changes in the allocation of funds and the way such allocation is combined with any efforts from the private sector.

There is one more item, previously mentioned, that tends to resist the logic of the marketplace. This concerns the imperative need to give future development strategies an environmental dimension, which means that the development effort will have to be qualitatively different from past versions. In that sense, Latin America has discarded the old idea that environmental protection is a luxury that only the industrialized societies can afford, while developing societies must subordinate that concern to the need to raise living standards. Today it is realized that, in a region whose development hinges essentially on the utilization, processing and marketing of its natural resources, the protection and proper management of those resources is imperative. Soil erosion and degradation, desertification and deforestation, and other threats undermine countries' abilities to feed themselves, generate energy and boost exports as required by the development process.

Moreover, in a region where more than 70 percent of the population lives in urban areas, and more than 30 percent in the region's principal cities, the imbalances caused by uncontrolled physical expansion coupled with limited resources give rise to pressures on the supply of services, air pollution, housing shortages and a host of other problems.

These phenomena will have a profound impact on public action in the future. For example, macroeconomic policies, natural resource management, training, legal and institutional regimes, the selection of technologies for production, social and population policy, development finance and many other items all entail environmental protection, reduced polluting emissions and, in general, efforts to improve the quality of life. In a word, future development strategies will have to be environmentally sustainable.<sup>9</sup>

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<sup>9</sup>ECLAC's views on this subject are outlined in ECLAC, *El desarrollo sustentable: transformación productiva, equidad y medio ambiente* (LC/G.1648/Rev.2-P), Santiago, Chile, United Nations, May 1991. Also see the Development and Environment Commission on Latin America and the Caribbean, *Our Own Agenda*, Washington, D.C., Inter-American Development Bank and United Nations Development Programme, August 1990.

## The Evolution of ECLAC Thought

In conclusion, it might be interesting, in the context of this seminar, to draw a brief analogy between the contemporary positions of ECLAC and those set forth during the organization's pioneering years, under the inspired leadership of Raúl Prebisch. In both cases, they grew out of an interpretation of the main constraints, especially of a structural nature, on the development of the countries of the region. During the intervening period, the domestic situation of each country and the external environment having changed dramatically, the content of ECLAC's position has naturally changed as well.

Still, certain basic concerns appear as basic themes throughout ECLAC's history. Prominent among these are the application of technical progress to the production process, the linkage between the countries of the region and their international economic environment, the phenomenon of capital formation, equity, the potential of intraregional cooperation, and the role of public action and its relationship with private activity. The manner of the response to those concerns, and the precise content of the organization's proposals, have adapted to changing circumstances.

But in the past as in the present, both the interpretation of constraints on development and the framing of proposals are approached from a Latin American and Caribbean perspective. That constitutes the organization's most characteristic feature. As I said to our member governments when I became Executive Secretary of ECLAC, "our profound Latin American and Caribbean identity prompts us to approach the development agenda from the viewpoint of the countries that make up our region. Thus, in its simplest terms, ECLAC's mission is, no more and no less, that of seeking avenues to the economic and social development of the nations of Latin America and the Caribbean."<sup>10</sup>

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<sup>10</sup>G. Rosenthal, "La CEPAL en su cuadragésimo aniversario: continuidad y cambio," Address to the Twenty-second meeting of ECLAC, Rio de Janeiro, April 25, 1988, published in *Notas sobre la economía y el desarrollo*, nos. 461/462, Santiago, Chile, ECLAC, April 1988.

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