

PAL REVIEW



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Review

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Notes on trade from the standpoint of the periphery

Innovation and diversification in goods and services and their implications for trade

*Raúl Prebisch**

The necessity of generating foreign exchange in order to pay off interest on the external debt once again brings to the fore the topic of centre/periphery trade relations, of their implicit potential, and of the obstacles that hamper them.

The author begins by reverting to the persistence of the structural causes underlying the trade imbalance of the peripheral countries—causes that are directly linked to the evolution of the income-elasticity of international prices of manufactures and primary products (with the exception of petroleum)—and recapitulating the ways and means by which the countries in question have sought to deal with it. Among these expedients, the substitution of domestic production for imports from the centres and the export of manufactures to the central countries are singled out for particular attention.

The opening-up of the centres' markets to manufactures from the periphery would be a measure with enormous potential for the latter, but the varied range of hindrances and constraints that exists does not incline the writer to optimism. In the circumstances, therefore, he advocates a recrudescence of the old idea of import substitution in a broad framework of regional integration. It is not a matter of newly applying policies devised several decades ago; they can constitute a remedy for the external imbalance, always provided that they are adjusted to the current situation and that the mistakes made in the past are avoided. In face of an increasingly closed world trade, they represent an indispensable ingredient of any reasonable development strategy.

The technological revolution that is taking place in the centres, monetary events in the United States, and the substantial imbalances in international economic relations pose very serious problems for the Latin American region of the periphery.

In earlier articles published in this *Review* we have upheld a number of theses which bear very closely on the subject of the present article.

We have endeavoured to show that in the development of the centres during the past, as at the present time, the substantial increases in productivity which technical progress has brought in its train have not been correlatively reflected in a fall in prices. The reason for so important a discrepancy lies in the continuous diversification introduced by technological innovation in goods and services. As global income rises, owing to the increase in productivity, demand shifts in the main to new types of goods and services in preference to those already being produced. The diversification in question occurs in manufactured goods, not in foodstuffs and other primary products, where change and diversification are very limited.

This circumstance suffices to account for the tendency towards a deterioration of the relation between the prices of primary products and those of manufactured goods. Since its earliest days, ECLAC has explained that this trend in the terms of trade has a very serious effect on centre/periphery relations. What is more, in so far as technical progress gradually penetrates into the periphery and raises income, the aforesaid incessant diversification of demand makes its appearance there as well, generally in a guise accentuated by the great defects in income distribution.

*Director, *O.PAL Review*.

Thus, as the development process advances the periphery becomes exposed to a situation of external disequilibrium which must be rectified if the process in question is to run its proper course. Owing to the impulse given by the diversification of demand, the growth of imports is generally very rapid, while exports of primary products, except those of petroleum, tend to expand at a relatively slow rate. This has been happening for some time back, always subject to cyclical effects transmitted from the centres.

In general, economists in the centres first attacked the industrialization of the periphery, which began during the great world depression, and subsequently execrated import substitution, recommending the periphery to cope with the trend towards disequilibrium by exporting manufactures instead.

There are countries in the Latin American region of the periphery which took this advice seriously and embarked upon a vigorous export effort. It so happened, however, that when these exports began to compete with the production of the centres, the latter lost no time in subjecting them to severe restrictions. To account for these restrictions they adduce the unemployment that has accompanied the dynamic weakening of the centres in recent times. Yet in the long years of prosperity which came to an end in the first half of the 1970s, and during which some countries not only had no unemployment problem but even admitted foreign workers, no manifest effort was made to lower the tariff barriers erected not only against primary products but also against manufactures from the periphery.

Strenuous efforts were made in UNCTAD to change this state of affairs, with little or no success. This leads me to suppose that there are very important factors that discountenance a liberalization policy for imports from the periphery. During the boom years in the major (Kennedy and Tokyo) rounds of GATT negotiations, customs tariffs were brought down to a very low level, but this mainly affected the centres' trade, which largely involves just the very goods in whose case the diversification process is highly intensive, thanks to the continuous technological innovations, and to the impulse given by the transnational corporations. These, in making the innovations, actively intervened in the trade in question, which

reached exceptionally high figures. It is not surprising, then, that the periphery, which had begun to export goods that were not very advanced technologically and whose degree of diversification was extremely slight, should have lagged far behind in this expansion of trade in manufactures.

I have already said that there are factors which account for the unfavourable reaction of the centres to imports of manufactures from the periphery. I think that for a proper understanding of this fact it is indispensable to recall the dynamic role of the economic surplus of enterprises that I have sought to explain in earlier articles.¹ In the surplus is mainly embodied that part of the fruits of the system's increasing productivity which is not transferred to the labour force. This is a matter of profound dynamic significance, since the surplus is the source of a considerable proportion of the capital accumulation of enterprises. Thus, as the evolution of demand calls for more and more diversification, capital investment also shifts towards production of goods that are diversified. Inter-enterprise competition is directed towards capturing markets in the diversification process rather than towards reducing prices, except in the case of those goods that have been surpassed by others deriving from the incessant innovations aforesaid.

Here a point arises which must be stressed: the shift in investment is affected by virtue of the growth of the surplus, and this growth occurs precisely because, in general, and thanks to diversification, prices of manufactures do not fall. If there were no diversification resulting from ceaseless innovations, consumer demand would tend to reach saturation point.

This is a phenomenon characteristic of capitalist development. It happens, however, that when imports from the periphery acquire competitive capacity through the combination of technical progress with relatively low wages, competition in this case is based on price reductions, and adversely affects not only the growth of the surplus but also the ability of industries hard hit by competition to redeploy

¹See, in particular, "The Latin American periphery and the global crisis of capitalism", *CHPAL Review*, No. 26, August 1985.

their forces and invest in the diversification process or step up their productivity. This explains why entrepreneurs and workers are antagonistic to imports from the periphery. Clearly, an additional element today is unemployment, which, as we have said, stems from the sluggishness of the economies of the centres.

The centres have been defending themselves with all sorts of restrictive measures which are adopted unilaterally in disregard of GATT commitments. Thus we are witnessing a phenomenon unprecedented in capitalist development: one which, in my opinion, is of a structural character, and which, although hitherto it has attained only moderate proportions, might become of major importance, as other peripheral countries join the few that have learnt to export manufactures. In view of this, it may well be asked whether the centres, even in the event of their dynamics being re-established, would be willing to liberalize imports from the periphery.

Nevertheless, they continue to proclaim the need for trade liberalization. There has been no backsliding in their adherence to the neo-

classical principles which have regained outstanding importance both internally and in international relations. Perhaps the purity of the doctrine is kept intact because that helps to ease the conscience of those who are violating it in practice. (God helps those who help themselves.)

All this is quite deplorable, because such restrictions deprive both sides of the benefits of trading technologically advanced goods from the centres against less advanced goods from the periphery, with indisputable reciprocal advantages. But what is the solution? Of course it lies neither in maintaining or tightening the restrictions nor in eliminating them completely, but in regulating trade in such a way that the periphery can share in the increase in consumer demand in the centres without disruptive effects. If the periphery wants to combat its tendency towards external disequilibrium, it will have to lower its prices in the corresponding industries, a step which would reduce its capacity for accumulation; the pertinent enterprises in the centres, too, would undergo the disruptive effects of which I have just spoken. Formulas must therefore be sought which will safeguard the advantages of reciprocal trade. '

II

Importance of protection

But the centres have put up opposition, first to the peripheral industrialization and then to import substitution, by means of customs protection. In HCLAC we maintained from the very outset that protection was indispensable as a means of standing up to the centres' technical and economic superiority. Unfortunately, protection has as a general rule been greatly exaggerated, if not abusive and has been kept in force for a very long time, affording industries no incentive to reduce their production costs — a point to which we shall revert later.

Subscribers to the neo-classical doctrines impugn protection. In the end they have

accepted industrialization, always provided that it comes about spontaneously, not as the result of State interference in the play of market forces. The most they have ever recognized as admissible has been recourse to currency devaluation in order to achieve effects similar to those of protection. But perhaps they did not fully realize that in the wake of devaluation would come a fall in the international prices of the competitive primary goods. I remember that measures of this kind were recommended to our countries by technical experts from the International Monetary Fund; when their attention was drawn to this adverse effect on

prices they said that it could be countered by establishing export taxes, a proposal contradictory to their own liberal doctrine, since an export tax implies the same sort of State interference in market forces as import duties represent. If I recall this it is in order to point out that a clear understanding of our phenomena has not always been shown in the centres' thinking.

More than once of late I have wondered why instead of the restrictions which the centres apply to imports from the periphery devaluation is not recommended in order to place industries on the centres that are affected by competition in a position to withstand it, by bringing down real wages in this way. Mention of this fact alone is enough to reveal the nature of the recommendations under discussion since even in cases where such a measure would have been socially or politically viable, a reduction of wages would also have led to a fall in prices in all the competitive industries, i.e., to the deterioration of the centres' terms of trade.

In reality, when economic theories gain prominence, they do so not always on account of their scientific exactitude, but because of the interests they favour, and this consideration brings me to another aspect of the subject under analysis. I have referred elsewhere to the opposition of economists in the centres to the industrialization of the periphery. From its infancy, ECLAC maintained that industrialization was an unavoidable necessity of development. This postulate of ours was commented on in the early 1950s by Professor Viner, one of the most eminent authorities on international trade. As has often been our lot, Professor Viner had read second-hand versions of our ideas, and thus, in seeking to impugn the industrialization thesis, he ascribed to us the idea that agriculture impoverished peoples whereas industry increased their well-being. When a few weeks later I was invited to occupy the same Chair in the Universidade do Brasil, I asked: how could I uphold so fantastic a notion when at the beginning of the present century my own country, Argentina, had attained one of the highest per capita income figures in the world? Professor Viner maintained that, instead of becoming industrialized, the periphery ought to introduce technical progress into agriculture, an irrefutable proposition, of course, but one which was completely at variance with the experience

of every country, irrespective of its economic and social system. What really happened was that as technical progress raised productivity in agriculture, its capacity to absorb labour decreased, and other ways of employing redundant manpower had to be sought. Hence one of the basic dynamic roles of industrialization. Otherwise, the existence of redundant labour would have serious depressive effects on wages and, consequently, on the international prices of agricultural products.

In my belief, this last argument is conclusive; but on talking of it in the centres I became convinced that far from disturbing some of their economists, it helped to back up Viner's thesis, since it suited the centres to pay lower prices for the primary products they purchased from the periphery.

The time has now come to pose this other question: why do the centres look with favour upon a downward movement in the prices of these primary products while they take pains to withstand a fall in the prices of the manufactures they import from the periphery? The answer is very simple. A reduction in the prices of primary products enlarges the economic surplus of the enterprises who purchase them, whereas a decline in industrial prices weakens their surplus and consequently their capacity for accumulation, as I observed before.

Let me now revert to protection in the periphery. I was saying that it was indispensable to introduce technical progress in agriculture and in primary production in general but that without industrialization a risk of deterioration of the terms of trade was incurred. Obviously, however, industrialization fulfils its labour-absorbing function relatively slowly, and what is needed is an attempt to curb the deterioration. It is precisely through protection that this is achieved, since the intensification of industrializing activity helps to shift capital and labour from primary to industrial production. But this does not mean that very grave mistakes have not been made in Latin America in this respect, protection having been applied in so exaggerated a form as to end by adversely affecting primary production; the opponents of industrialization frequently adduce this as an argument against it, instead of referring to an ill-judged policy for carrying it out.

III

The deterioration of the terms of trade

I should now like to pass on to consider the trend towards deterioration with which we were so much and so rightly preoccupied in ECLAC's early writings. Agricultural products, and primary products in general, do not allow of much diversification. It is true that the labour and capital allocated to producing a good whose price tends to decline could be used for producing other primary goods, but these, in their turn, are subject to the risk of a similar saturation problem. In the case of industrial output, on the other hand, such saturation is mitigated or prevented by the shift in demand and the corresponding investment of the surplus and of sinking funds to keep pace with it. Such is the situation of inferiority in which agriculture is placed in this respect, especially when technical progress makes for a rapid increase in productivity unaccompanied by an expansion of demand sufficient to prevent a fall in prices.

This is well-known to be the state of affairs in the industrial centres, where the considerable technical progress made in agriculture in recent decades has brought with it an exceptional increase in output; thus, for example, in the United States limits have been set in various ways to grain production, in order to prevent or moderate a fall in international prices, and this is happening even in times when neo-classical theories are prevalent. Much the same thing has occurred in the countries of the European Economic Community, and it is common knowledge that the trend towards deterioration has been combated by means of certain price subsidies or import bans. I do not fail to recognize the basic phenomena which are conducive to this policy, especially after the experience of two world wars which have taught the advisability of giving due importance to agriculture. There is also the question of the agricultural surplus, in accordance with the observations I have formulated elsewhere. But from thence to producing big surpluses and launching them at any price on the international

market it is a very long way indeed. Yet that has been and still is being done, thanks to internal subsidies, as in the United States under the famous law 280, which in practice implies a subsidy on external sales of grain, especially sales to the developing world.

All this has meant infringing the principles of GATT. And not only that, but the periphery, and ECLAC in particular, were attacked when we described the trend towards deterioration of the terms of trade in primary products. What is more, we have been charged with accusing the centres of deliberately exploiting the periphery through that deterioration. It is true that various ways of siphoning-off peripheral income have been and still are being practised, but ECLAC has never linked the aforesaid deterioration with any concept of exploitation. Such theses generally stem from political considerations.

After clearing up these theoretical issues we come to a problem of the greatest importance, i.e., how are we to combat the trend towards structural imbalance in our relations with the centres? It has already been said that exports to the centres ought to be encouraged and import substitutions undertaken. Now, exports depend basically upon the receptive capacity of the centres in terms of their rate of development and their willingness to find formulas which will allow the periphery a share in the increase in their consumption or ultimately in their consumption itself. In so far as this proves impossible, the only alternative is import substitution. Substitution, therefore, is not a doctrinaire whim but a response to objective conditions implicit in the realities of our relations with the centres.

The problem is distinctly complex, since it is necessary to determine what goods it would be expedient to replace by domestic production. This problem might be stated in the following terms: there are some goods in respect of which substitution has already taken place and we have

acquired competitive capacity. So much for one extreme; at the other extreme, there are other products—both capital goods and inputs, and consumer goods—which correspond to the continual advances of technology in the centres. For the moment, substitution in respect of such goods cannot be thought of, for obvious reasons. Between these two extremes there is a wide range of goods in which we have acquired or easily could acquire technological capacity, and *it* is in relation to these that substitution possibilities will have to be examined in the light

of a selective criterion, so that those most susceptible of being produced in economic conditions can be chosen in preference to others which it is not feasible for us to produce, because of our type of development.

Everyone knows that import substitution for the relatively small domestic markets of our countries, not only because of their population but also because of their relatively low income levels, encounters the obstacle of very high costs. Hence the necessity of expanding domestic markets by means of regional integration.

IV

The need for new integration formulas

It must be recognized, however, that the effort expended over more than two decades has produced very scanty results. Accordingly, the reasons why we have not advanced as much as in the early days might have been thought possible should be subjected to careful scrutiny. A retrospective review leads me to the following conclusion: in ECLAC we allowed ourselves to be seduced by the idea of a Latin American common market, which gradually cleared a way for itself and took shape in the arrangements generally known. What I am saying is not that this idea must be abandoned, but that there should be a change in the form and timing of its materialization. The crux of the matter always has been and still is the trend towards an imbalance with the centres which must necessarily lead us to substitute domestic production for imports from the central countries. It is there, in my opinion, that efforts should be concentrated, leaving other measures, aimed at trade liberalization, for a later stage. Thus, for example, the preferences that our countries could grant one another in respect of importing consumer goods are not going to resolve that basic problem to which we alluded. Nor is this all; I think that import substitution under a preferential regime comes up against major obstacles. The countries whose industrial

development is farthest advanced are in a position to export capital goods or intermediate goods to the relatively less or least advanced countries while the latter cannot participate to the same extent in trade of this kind. It is on their shoulders, however, that the cost of such operations tends to fall, since they are made to pay higher prices than are quoted on the international market for the capital goods and inputs which they import from the more advanced countries. For this and other reasons, I am more inclined to think that the advanced countries should grant their exports subsidies equivalent in significance to their customs protection. Of course the subsidies régime would have to be established by common accord under a new agreement, but it would not suffice in itself to ensure a relatively balanced trade. The least or relatively less advanced countries would still be in an inferior position unless special corrective measures were taken; one of these would be for the countries benefiting most by the trade in question to share with those that gained least the investment required to possibilitate a satisfactorily balanced trade not bilateral but multilateral among all the participant countries.

This would have another very important advantage: under the existing régime, arrangements made by two countries to

specialize their production for the purposes of reciprocal trade could not be left open to the access of other Latin American countries without violating the terms on which such arrangements are based. In contrast, a subsidies regime would permit the incorporation of third countries prepared to observe the general principles governing an agreement of this kind.

It is common knowledge that the centres are opposed to a subsidies régime, notwithstanding the various disguised forms in which subsidies in respect of their exports are granted. But they could not object to arrangements of this nature among countries in the periphery. This idea is not in fact new. I remember that in the early 1960s we said in one of our reports that Latin American industrialization had developed asymmetrically, since the encouragement given

to import substitution was not paralleled by an equivalent incentive to exports of manufactures.

I believe that serious thought must be given to the desirability of reorienting integration policy in the direction I have just described. I am not making a concrete proposal but simply suggesting that it might be as well to diverge from the line of thought we followed more than a quarter of a century ago, when industrialization had barely attained moderate dimensions and we had not the advantage of a stock of experience that we now enjoy. I also want to point out that the relatively less and least advanced countries could participate in these new forms of trade via exports of consumer goods, which could be effected under arrangements or regulatory formulas similar to those I have mentioned in the case of our exports to the centres.

V

Possible co-operation of the centres

In the development of industries to meet the requirements of broader markets the co-operation of the centres might be of great importance. But what interest would they have in supporting our efforts to substitute domestic production for imports from the central countries themselves? The answer is very simple. Substitution would enable us to import technologically advanced rather than less advanced goods, which would clearly be to the benefit of both parties.

Furthermore, this would be a way of opening up a broad field for transfer of technology to the peripheral countries, with obvious advantages for the centres, which, besides making progress in diversification through new technologies, would have the benefit of negotiating with peripheral countries the transfer of technologies that are already being left behind by others which are more advanced, and thus expanding their sphere of action. These two considerations might perhaps lead the World Bank, as well as

IDB, to take an active part in financing the necessary investment. This would make it possible to strengthen the position of Latin American enterprises, whether private or public, in different forms of co-operation with those of the centres.

In the light of what has been said above, it is possible to understand the effort that is being made by the most important countries to clear a way for their advanced-technology exports. The most interesting case that has recently arisen relates to the trade and tariff act that has just been passed in the United States. The different branches of electronics and biotechnology constitute the most outstanding expression of the technological revolution that is taking place at the present time in the developed world, and it is natural that the United States, like other countries, should be anxious to broaden its markets, which are of course subject to keen competition. It would seem that to achieve this

end, the United States is intending to provide incentives which will promote the market for their products in the peripheral countries, and there is even talk of trade concessions which would be extended bilaterally. Should this happen, we should surrender one of the most important conquests that have been made in the international economy, i.e., multilateralism, I am inclined to believe, however, that it would mean bilateral negotiation to obtain advantages rather than a radical change. But apart from that, what, it may be asked, could the United States do to ensure that the peripheral countries' demand for imports of advanced goods can be accompanied by an increase in our exports to the United States? I have previously voiced my doubts as to this possibility, but I will admit to having been mistaken if we are offered concrete opportunities of trade expansion in appropriate conditions. But without disdaining such opportunities, should they arise, I still wish to urge—as I have done before—the advantages that peripheral import substitution would signify for the centres. It would be the most effective way of opening up markets for advanced-technology goods.

The endeavours of the United States are not confined, however, to the goods in question, but are also extended to services. There is a wide range of these which is experiencing the effects of the technological revolution, but what advantages would there be for our countries in accepting, for example, full liberalization of the United States banking system in competition with their own? I feel that in many cases we have already gone too far in this respect and that nothing would be gained by continuing to extend the facilities that have been given in the past. It is true that technological advances in bank operations represent indisputable advantages, but it is no less certain that measures could be adopted to promote technological progress in the national banking systems. There are various arguments in favour of measures of this kind, because the saving on remittances of profits that would be achieved in this way, thanks to the substitution of domestic for imported services, could be more advantageously turned to account in importing advanced-technology products, whether capital goods, inputs or consumer goods, which incessant diversification offers to our countries.

VI

The interest of the centres and the interest of the periphery

In face of these challenges, needs and possibilities must, I think, be carefully reviewed, with no succumbing to the allurements of ideas from the centres. They must be carefully reviewed, they must be sifted through the strict mesh of our own best interests with one essential concept always in mind: the centres have shown concern for peripheral development only in so far as it was in keeping with their economic, political or strategic interests. We cannot reproach any one country with promoting its own interests, but that does not

mean that ideas and suggestions coming from abroad have to be accepted at their surface value without a discerning eye for our countries' own interest. The reproach would be deserved by those who lightly adopt such ideas and suggestions without that prior review of what is and is not desirable.

I am convinced, moreover, that a stage has been reached in relations with the centres at which broad areas of convergence of interests can be found, and therefore I have ventured to make the observations set forth above. Such

broad areas of convergence exist in trade and in external investment. The requisite review must be made in the light of our own experience. I have already recalled the opposition put up first to industrialization and then to import substitution. We were advised to export manufactures instead of substituting domestic production for imports and when we learnt to do so obstacles were placed in our way. Import substitution was long regarded as a monstrosity spawned by ECLAC. But with the passage of time these ideas are changing. Last year Dr. Annie Kruger, an important World Bank official, on passing through Santiago (Chile), severely criticized import substitution; yet Mr. Clausen, President of the World Bank, in his most recent address to the Board of Governors, spoke of the need for exporting manufactures and also for import substitution, kindling the hope that a further mental stride will bring the Bank to recognize the necessity of promoting reciprocal trade in the Latin American periphery as well. What is more, Professor Bela Balassa, consultant to the World Bank, who had been systematically critical of ECLAC's position in this respect, is now likewise speaking of import substitution and exports of manufactures. Mr. Larossiere, Director-General of the International Monetary Fund, also accepts these ideas.

All the foregoing remarks are equally applicable to conditionality. We are now being told that the World Bank will establish a conditionality like that of the IMF in respect of loans for the purpose of structural changes. I believe that loan operations of far-reaching scope must be accompanied by conditionality, but what conditionality? Does a conditionality defined in accordance with the centres' own

concept of development meet the requirements of peripheral development? As far as I know, conditionality has never been discussed with Latin American economists, but has been decreed by the North. Here too an efficacious co-operation policy calls for a significant change. A real effort must be made in this direction, because of course the ideas that correspond exclusively to the interests of the centres are deep-rooted. Perhaps the most striking case in point is afforded by *The Economist* of London, which stated in the headlines of a recent issue (30 November 1985) that the poor countries had donated US\$ 65 billion to the developed countries as a result of the deterioration in the prices of primary products. This, according to *The Economist*, will make it possible for the centres to attenuate the price increases which might be caused by an expansionist policy, an effect that seems highly advisable. Yet no other reference to the periphery is made, such as, for example, the comment that a possible lowering of interest rates would be advantageous for it as well. There is no allusion, of course, to the seriousness of a fact which is severely prejudicial not only to the debtor countries, but to all developing countries, in that it deprives them of resources that are indispensable in order to raise their rates of growth.

Needless to say, the crisis of the centres drastically affects the periphery, accentuating the consequences of its own crisis, which are not only economic but also social and political. The significance of our countries' return to democracy is cried up, but the risks and problems implied by this crisis for the Latin American countries' political and social stability perhaps go unperceived.

VII

Post scriptum

After finishing this article I learnt that three institutions whose prestige stands very high have taken the praiseworthy decision to embark upon formulating a new development strategy

for Latin America. They are the Colegio de México, the Fundação Getulio Vargas and the Washington Institute for International Economics. I have received a copy of two

opening chapters setting forth the initial findings of an analysis in which the development of the Latin American countries is compared unfavourably with that of other developing countries. It is not my intention to go deeply into this analysis, but simply to refer to a statement made in it with respect to ECLAC's share of responsibility for the foreign trade policy of the Latin American countries included in the tripartite study. The following comment appears: "The early post-war years saw a policy shift from export orientation to import substitution in Latin America. The intellectual underpinnings of this shift were provided by the United Nations Economic Commission for Latin America, that saw scant possibilities for rapid economic growth through export expansion. The view was expressed that, due to a secular decline in their import coefficients, the developed industrial countries would not provide a sufficient stimulus for economic growth through primary exports; that Latin American countries were not in a favourable position to develop manufactured exports; and that there was a tendency for the external terms of trade of countries, indicating the relationship between export and import prices, to deteriorate over time."

This is a purely arbitrary assertion founded on imperfect acquaintance with ECLAC's work, as I shall go on to show, in the hope that in a subsequent version of the study the serious misapprehension entertained may be cleared up.

For instance, a report published in 1959² reads as follows:

"Import substitution is not a simple operation with boundless horizons. A persistent substitution policy which is unaccompanied by increases in productivity may be carried so far as to entail a reduction of exports, that is, a net loss of foreign exchange. Indeed, unless it is spontaneously generated, import substitution calls for the adoption of protectionist measures which have to be gradually intensified as possibilities are exhausted in those fields where differences in productivity between the country concerned and the rest of the world are not too marked. As a result of this increasing degree of

protection, internal costs rise, and affect the profitability of exports, which varies from one commodity to another. In the initial stages of the substitution process, the decrease in the profitability of exports may not be enough to cause a contraction in their volume, but it may perfectly well happen that, as further progress is made, marginal exports dwindle, and a point may be reached at which what is saved through substitution is lost on exports. Of course, the wider the margin of profitability of exports and the less the need for protection, the farther can import substitution be carried without the critical point's being reached..

"The analysis has led to the conclusion that the slow growth of demand for traditional export commodities and the maintenance of a rate of growth of the product formerly registered call for a substitution of domestic production for imports so rapid as to seem an impossible task, even if the external financing situation were to be very favourable.

"How, then, can the Latin American countries eliminate the bottleneck created by the shortage of foreign exchange? There are in reality two ways open to them. *One would consist in a considerable expansion of extra-regional exports of goods, other than the traditional commodities;* another would take the form of an expansion of inter-Latin American trade based on an accelerated substitution process in respect of imports from other parts of the world, but carried out at regional level and by means of more intensive trade in traditional commodities.

"The first of these alternatives would require a notable change of direction in the trade policy of the developed countries, in the sense that the tariff and other restrictions which they are in the habit of applying need to give way to a system under which the Latin American countries could exploit the comparative advantages afforded by their natural resources and their geographical position. The second method would entail a gradual reshaping of the bases on which inter-Latin American trade has hitherto developed, in such a way that full advantage could be taken of the potential benefits of a broad regional market, without prejudice to the development prospects of countries with lower income levels.

²See ECLAC, *The Latin American common market*, United Nations publication, Sales No.: 59.II.G.4.

"These two methods are not mutually incompatible, and a wise application of both would redound to the benefit not only of Latin America but also of the more developed countries of the rest of the world. The possible effect of a reform in the trade policy of the great industrial centres merits detailed study. Only the possibilities of eliminating the bottleneck through the organization of a common market will be studied here.

"The establishment of a common market would have the advantage of enabling the substitution process to be carried farther, without detriment to specialization possibilities, than would be possible within the sphere of each country's individual market. When Latin America is considered as a whole, demand for imports from outside the region falls to a level compatible with its supply of foreign exchange; and, at the same time, each of the members of the market could maintain a high coefficient of imports, although the proportion obtained from intra-regional sources would increase, in varying degrees."

Shortly afterwards, in 1961, when I was Executive Secretary of ECLAC, a study of mine was published, entitled "Economic development, planning and international co-operation", in which, to the best of my knowledge for the first time, industrialization policy was severely criticized, a quarter of a century in advance of the study in question on a new strategy. It is worth while to reproduce two or three relevant paragraphs:⁵

"The basic flaws in industrialization.

Although the *volume* of industrial production is not arbitrary, its *composition* has proved to be so in Latin American experience. From this point of view, *the process of industrialization suffers from three main flaws which have weakened its contribution to improving the standard of living. These are: (a) all industrialization activity is directed towards the domestic market; (b) the choice of industries to be established has been based more on circumstantial reasons than on considerations of economic yield; and*

(c) industrialization has failed to overcome the external vulnerability of the Latin American countries.

"The excessive channelling of industry towards the domestic market is a result of the development policy pursued in the Latin American countries and of the *lack of international incentives to exports of industrial goods from the region.*

"Development policies have been discriminatory as regards exports. Assistance has been given —through tariffs or other restrictions— to industrial production for internal consumption but not to industrial production for export. *The production of many industrial goods has thus been developed at a cost far above the international level, when they could have been obtained with a much smaller cost differential in exchange for exports of other industrial products which might have been produced more profitably.* The same could be said of new lines of primary commodities for exports and even of traditional export commodities within certain relatively narrow limits."

And in another study, also published in 1961, and concerned with the false dilemma between economic development and monetary stability, similar concepts were enlarged upon in the following terms:

"Discrimination against exports.

Obviously the development of new exports, in addition to traditional lines, would help considerably to achieve this aim. This brings us to the other fundamental error: an asymmetrical development policy. The need for import substitution and for consequent protection of substitution activities has been unavoidable. But there has been a failure to boost exports to the same extent. There has been discrimination in favour of industrial substitution and against exports, mainly industrial exports. The ideal policy would have been to promote exports in order to place them on an equal footing again with substitution activities, which does not necessarily mean equal incentives.

"This aspect is sufficiently important to merit examination; in a nutshell, it is the following. Limitation of external demand for primary exports makes it necessary to devote part of the *increase* in the factors of production

⁵See A. Giirrieri (compiler), *La obra de Prebisch en la CI.PAL*, Mexico City, Fondo de Cultura Económica, Part Two, pp. 84 and 85. The English version is quoted from *Economic Development. Planning and International Co-operation*, Santiago, Chile, United Nations publication, Sales No.: 61.11.G.6., p. 14.

to substitution activities. As their productivity is lower than in the industrial centres, they need to be given a certain subsidy in the form of tariff protection. Yet there would be possibilities of using a smaller subsidy to develop new industrial export activities, whereby a greater quantity of industrial goods could be obtained through trade than those that could be manufactured by substitution production.

"By subsidizing substitution production rather than production intended for *new* exports (industrial or primary), export opportunities have been lost which, had they been properly used, would have reduced the scope of substitution policy or made more rapid economic growth possible."⁴

The tripartite study on strategy (p. 12) also cites Santiago Macario, an ECLAC economist, who censured the abuses of the Latin American countries' protectionist policy and that of the developed countries too. In the words of Mr. Macario,

"With very few exceptions, the Latin American countries cannot be said to apply a protectionist policy, if by this is to be understood a systematic body of measures deliberately designed to permit and encourage the development of certain industries rationally selected within an overall framework of objectives established under a given economic development policy. What did and still does exist is protectionism, but as the largely indirect result of *ad hoc* measures, often adopted, at least initially or during a first stage, as emergency procedures, either in order to solve balance-of-

payments problems, or under the pressure of other exogenous factors. Such measures, temporary to begin with, became permanent in most cases and more general in their scope, giving rise to a form of protectionism which has been characterized by extemporaneousness, lack of autonomy (since it is primarily motivated by external causes), extremely high levels and indiscriminate application, and whose basic objective is import substitution at any cost, regardless of which industries it is most expedient to develop and how far the process should be carried."⁵

The tripartite study also remarks that "with additional subsidies and low import protection, exports in the manufacturing sector received, on the average, similar incentives as import substitution in the Far Eastern countries" (p. 19). In other words, these latter pursued a policy resembling that which ECLAC had recommended to the Latin American countries in the early 1960s.

In the light of the quotations from our writings, and of others of which mention would be redundant: is it possible to make such charges against ECLAC as are formulated in chapter I of the study in course *oí* preparation?

ECLAC, in its desire to collaborate with the governments of the region, has put forward many suggestions and recommendations. Some have been followed, others have not. That is the fate of every initiative of this kind. If the countries do not heed these recommendations and suggestions, can the responsibility be laid at ECLAC's door?

⁴See A. Gurrieri, *op.cit.*, pp. 18 and 19. The English version is quoted from Raúl Prebisch, "Economic development or monetary stability: the false dilemma", in *Economic Bulletin for Latin America*, Vol. VI, No. 1, March 1961, p. 5.

⁵See Santiago Macario, "Protectionism and industrialization in Latin America", *Economic Bulletin for Latin America*, Vol. IX, No. 1, March 1964, p. 61.