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Foreword

This year marks the hundredth anniversary of the birth of Raúl Prebisch.

ECLAC –the organization Prebisch endowed with its first basic ideas and set in motion in its beginnings– has celebrated this centenary with various events. *CEPAL Review*, which Prebisch set up and directed for its first ten years of life, pays tribute to him in this issue by collecting together in a special section a set of articles by distinguished personalities in the field of social sciences who have helped to shape Latin American thinking.

Raúl Prebisch's vigorous personality left its mark on his own country in critical stages of its development, decisively influenced development ideas and lines of action in Latin America and the Caribbean, and helped in the United Nations' efforts to achieve a more equitable international economic order. There are therefore any number of different ways of honouring his memory. Here, however, we have chosen in particular to follow the evolution of his ideas and the contexts in which they developed, together with their continuing importance for dealing with the current dilemmas of Latin American development.

This set of tributes opens with an unpublished interview which Prebisch gave to his friend and colleague David Pollock in 1985 on his ideas and actions during the period when he was with ECLAC (1948-1963). Professors Kerner and Love edited the material obtained in this interview for its publication among these tributes.

In the contribution by José Antonio Ocampo, the Executive Secretary of ECLAC proposes that the current Latin American development agenda should be enriched by projecting three central elements of Prebisch's thinking –the asymmetrical relations of the centre-periphery system, the need for active endogenous development strategies to overcome structural heterogeneity, and the critically important role of regional integration- onto the present development scenario of the region, and by making an interactive comparison between those elements, the more recent proposals put forward by ECLAC, and the contributions offered by other schools of thought.

Octavio Rodríguez analyses the elements making up Prebisch's structuralist view of Latin American

development –or underdevelopment– and their significance for dealing with the problems of employment and the external bottleneck today.

Arturo O'Connell describes the characteristics of the Argentine economy that Prebisch had before him as an example when he was developing his ideas on peripheral economies, analyses the early stages of the development of those ideas in the late 1920s and early 1930s, and argues that the similarity of the present problems of Latin America to those of that period has given those ideas renewed validity.

Adolfo Gurrieri also deals in particular with the work of the young Prebisch. He shows how, from his earliest work, Prebisch already began to shape the overall scheme of ideas that he was to develop in ECLAC, and he argues that this scheme stems from a perception of the shortcomings of the development pattern that was already in existence before the 1929 crisis.

Roberto Cortés Conde, for his part, highlights the economic circumstances in which Prebisch developed his ideas and applied his actions in the Argentina of the 1920s to 1940s, concentrating on the years when he was in the Government and the role he played in the design and execution of policies which were to be of momentous importance for that country.

Edgar Dosman's article deals with the period between Raul Prebisch's exit from the Argentine Government and his drafting of the "Manifiesto" in ECLAC. He provides new material –together with many biographical details– which documents the evolution of Prebisch's ideas during that period, thus helping to enrich the academic literature on the origins of ECLAC's theories.

Finally, Norberto González proposes that the ideas of Prebisch and ECLAC on Latin American industrialization in the period following the war should be compared with the literature analysing the ideas behind the policies applied in two great industrialization processes of the past: those of the United States and Germany.

Oscar Altimir
Director of CEPAL Review

(Original: Spanish)

Raúl Prebisch on ECLAC's *achievements and deficiencies:* an unpublished interview

David Pollock, Daniel Kerner
and Joseph L. Love*

Introduction

This issue of *CEPAL Review* attests to the lasting influence of Raúl Prebisch's ideas and policies on development in Latin America and the Third World in general. Prebisch's thesis of unequal exchange and his conception of the world economy as organized in a Centre-Periphery relationship, however controversial, has earned him a recognized place in the history of development thought. Through ECLAC and later UNCTAD, Prebisch's ideas affected governments and institutions throughout Latin America and around the world. The theoretical origins and evolution of Prebisch's thought have received extensive treatment by economists and historians.¹ Yet how Prebisch built his team at ECLAC and how he conveyed his theses at the regional and international levels have not been widely treated. The following interview given by Prebisch to his longtime assistant and friend, David

Pollock, goes a long way toward filling that gap. In this conversation, conducted in 1985—a year before his death—Prebisch reviews some of the key moments in his life and that of ECLAC. The material covers the period from 1948 to 1963, from Prebisch's incorporation into the organization up to the early sixties, when he left ECLAC to become the first director of the United Nations Conference on Trade and Development (UNCTAD).

In this interview, Prebisch discusses the politics as well as personal aspects of his entry into ECLAC, as well as providing an account of how he wrote the agency's manifesto, *The Economic Development of Latin America and its Principal Problems* (first published in Spanish, in 1949). Prebisch's international role is also treated in the interview. For instance, he explains the part he played in the creation of the Alliance for Progress in 1961, making it clear that although he was involved, he was not the originator of the programme. His relations with the United States government, the Organization of American States, and the Bretton Woods agencies (the IMF and the World Bank) also receive attention. Prebisch's passion for advancing the economic integration of Latin America, and his candid estimate of the success of that endeavour, are both presented here.

Readers may be surprised by the frankness of the views expressed by Prebisch, famous for his discretion and diplomatic skills. In addition, Prebisch treats the personalities of the early ECLAC team, as well as those

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¹ See for example the bibliographical essay in Love, "Economic Ideas and Ideologies in Latin America since 1930" in Leslie Bethell, ed., *The Cambridge History of Latin America*, Cambridge, U.K., Cambridge University Press, 1994, vol. 6, part 1, pp. 595-601.

of actors in U.S. and international agencies. One gets a clear view of Prebisch's style of leadership, and the political possibilities and constraints ECLAC faced in a region subject to the enormous influence of the United States.

The following interview was conducted by David Pollock in Washington, D.C., in May 1985, a year before Prebisch's death. Pollock, a Canadian, was Prebisch's assistant and close collaborator in both ECLAC and UNCTAD, and knew intimately his interviewee, the issues Prebisch faced, and the milieu in which he moved. Pollock held important posts in ECLAC between 1950 and 1963 (in Santiago, Mexico City, and Washington), and moved with Prebisch to UNCTAD in the latter year, remaining in that organization until 1967. Later, Pollock was head of the Washington Office of ECLAC. He had long intended to record Prebisch's reminiscences on tape, but the opportunity to do so only arose when Prebisch underwent eye surgery in Washington and was temporarily unable to work. At that moment, he invited Pollock to interview him at length. Pollock recorded twelve hours of conversation, of which this material is an excerpt.

In the following text, the words are those used by Raúl Prebisch and his interlocutor, David Pollock, except for a few connecting words and phrases, indicated by square brackets. The conversations were edited by Joseph L. Love and Daniel Kerner to eliminate digressions and repetitions, and the ellipses (...) were removed in order to facilitate the flow of the text. Footnotes have been supplied to identify persons and institutions mentioned in the conversations.

The interview

David Pollock (D.P.) *What brought you into ECLA in 1948?*

Raúl Prebisch (R.P.) I read in a newspaper that there was a meeting in the United Nations whereby they had created an Economic Commission for Latin America. I read that with indifference. However, a few days later, members of the French delegation to the United Nations approached me in Buenos Aires, telling me that the French government would wish me to present my name as a candidate [for the post of Executive Secretary] in the United Nations. After I'd been the head of the Central Bank of Argentina, it appeared to me as a demotion². They would not explain to me the meaning

of the words "Executive Secretary." In my view it was just to make reports of meetings and so forth. So I wasn't interested. I was rather attracted by what the President of the Academy of Economic Science in Buenos Aires had then offered me, to start a Review. Then, sometime afterwards, a few weeks after, I had a call from Benjamín Cohen. [He was] a distinguished Chilean, whom I had met at student meetings in Buenos Aires. He was Under-Secretary for Public Information and he said to me, "I am sent by Trygve Lie³ to formally offer you the post of Executive Secretary of ECLA."

At that time, I still had the illusion to continue being a Professor at the University of Buenos Aires. The salary was rather small, but I had reduced my standard of living to fit it. I had sold my Cadillac and rented my house on the Barranca de San Isidro. Adelita⁴ was willing to accompany me on this type of life. I had decided to devote some years to research, so I said to Benjamín, "I am not tempted." On the other hand, I had seen the League of Nations as a young consultant for the World Economic Conference of 1933 and I saw that we—members of developing countries—had nothing to do in that atmosphere. We were at the margin. So I said, on the phone, "I'm not interested. I'm very thankful, but not interested. On the other hand, I am leaving tomorrow morning to Venezuela because the Minister of Finance there, whom I do not know, has invited me to write a report on two projects of law: reforming the Central Bank and the Banking Laws." "Well," he said, "I'm a very close friend of Pérez Guerrero, the Minister. So I will go there and try to persuade you to accept." I said, "Benjamín, you will lose your time. My determination is very firm." Well, I went to Venezuela and I did what I had to do. Anyhow, when [Gustavo] Martínez Cabañas was appointed [as ECLA's first Executive Secretary], he and [Eugenio] Castillo, a Cuban who was at that time the third man in ECLA, went to Buenos Aires to ask me to spend a few months in Santiago, to write the introduction to the first *Economic Survey of Latin America*. I accepted for two reasons. First, because I said, "Well, let us try." Second, it coincided with a resolution of the University of Buenos Aires to dismiss me as a Professor. I was not a man looked at with sympathy by some highly nationalist groups who were trying to get room for themselves.

² Prebisch was Director-General of the Central Bank of Argentina between 1935 and 1943.

³ Trygve Halvdan Lie (1896-1968), a Norwegian who was the first Secretary-General of the United Nations (1946 to 1952).

⁴ Prebisch's first wife, née Adela Moll.

D.P. So the consultancy came at just the right moment.

R.P. And I went to Santiago. I never had lived in Santiago. I had spent a night there en route to Mexico. I was impressed by this nice city, with the beautiful view of the mountains, the friendship of the people, the running water in the street, the nice atmosphere.

D.P. And good wine.

R.P. Good wine. And last but not least, Louis Swenson. Louis, as you well know, was a man who inspired sympathy.

D.P. Yes.

R.P. And we used to talk and walk, and I started thinking about the nature of this Introduction. As usually happens, I sat down for days without taking any notes. This helps me to speak without notes, because of the sequence of the ideas, and during the month I did not write a word (*laughs*). Castillo would visit me saying, "Raúl, how is your writing going?" "Nothing yet. Nothing yet" I would say. And Louis, "Raúl, you know you have two girls who are excellent typists and who can take dictation." I don't dictate these important things, you know. And I saw their great concern. They probably said to themselves: "Well, this man is a failure."

D.P. Wasting their money.

R.P. A good Central Banker [perhaps they thought], but we need this report. Finally I decided to write, and in three or four days I wrote the whole Introduction to the first *Economic Survey*. It contained our view of the problems at that moment, international as well as Latin American problems, and the close interrelationship between them. These were the result of all my readings and reflections in those three, four, or five years of meditations. They sent the Introduction to Headquarters in New York. I signed the report. Nobody had told me I should not sign. A few days later, New York sent the longest cable that I have ever seen in my life and that, regrettably, does not exist in New York or in Santiago (according to regulations these things are destroyed after 30 years). It's a pity, because in this cable they made a series of considerations that ended in the following form: "The report is a document with a great content. But it speaks about development, industrialization, terms of trade, and many other matters that ECLA is not supposed to deal with. ECLA

has no instructions to deal with these problems. But as the document is a serious and responsible document, we suggest to you (Martínez Cabañas), to present the document as an Introduction signed by the author, so that you will attribute the responsibility to him and not to the organization." I remember that Martínez Cabañas came to see me with great concern, believing that I would react furiously. I said, "Gustavo, I never supposed that I would not sign the document. I put my personal ideas there. I have not diluted these ideas. So I agree fully." Believe me, in the ECLA Conference in Havana the reception of the document by Latin American countries, including Argentina, was inconceivable. Words of praise everywhere. On the other hand there were conventional minds on the part of the U.S., the same on the part of the U.K., a little better from the French.

David Owen, whom I met for the first time in Havana, was so impressed that he took me aside before the end of the Conference and said "Raúl, I cannot offer you any more [the] Executive Secretary [post] because it is in the hands of Martínez Cabañas. But I can [make] you Director of Research with a salary as a consultant at least equal to his salary and with full intellectual independence." I said, "David, are you willing to accept the following three conditions? *First*, what is the meaning of intellectual independence for me? Not to receive instructions from Headquarters nor from Cabañas about what ideas I should put on paper. Instead I should follow my own responsibility. I think that now, no longer being a consultant as I was before, but a man integrated into the body of ECLA, I would have to follow certain rules. With a sense of responsibility, but at the same time with the possibility of presenting problems that the developed countries would not receive with pleasure." He said, "Raúl, this is what we wish in the United Nations; to open new paths." "*Second*," I said to him, "I understand that you should approve the appointments that I would like to make. But every appointment should be the result of my proposal. You can reject or accept but it has to be my proposal. Being a man in the field, I know the people. I know the requirements, and if you act at a great distance, we will incur great mistakes. *Third*, I would want freedom to travel. Not to ask for authorization. Give me an amount of money and I will use it to the best of my judgment." "I accept your conditions," he said. These were the bases of my incorporation as a regular staff member.

D.P. *How did you become Executive Secretary so quickly?*

R.P. Well, it was obvious that the situation existing at that time would not last for long. Martínez Cabañas was an excellent fellow. But he was a young man who never before had that type of responsibility. Our personal relations were good. But everybody understood that the real authority was mine. Then, in a trip of mine to New York, to Lake Success⁵, David Owen said to me, “We are going to create a new entity in the United Nations for technical assistance. The Secretary General offers this to you, or the post of ECLA Executive Secretary, in which case we will accommodate Martínez Cabañas in the new organization. Which do you prefer?” I said, “tell Trygve Lie that I would accept whatever he likes. If he wants me to come to New York, to this new institution, I would go. If he likes me to stay as ECLA Executive Secretary, I will accept because I like this organization and I see the problems and challenges as I could not see them before.” That afternoon, he said: “Trygve Lie said you should be Executive Secretary.”

D.P. *Why did you reorganize ECLA the way you did? The Development Division was very large and powerful.*

R.P. Due to the role of development in Latin America.

D.P. *Describe some of your key early staff, some of the important beginners. You had Ahumada, Urquidi, Furtado, Melnik, Santa Cruz, Boti, Noyola, Vuscovic. Did you pick them all or were they there when you came?*

R.P. When I came there were Furtado, Boti, García and Rey Alvarez. They were consultants, the last two. Urquidi, Ahumada, Melnik, Noyola, and Vuscovic came later. How did [Pedro] Vuscovic come? A Peruvian professor was hired as a consultant in statistical matters and brought a young man, Vuscovic. I remember that Vuscovic was working in a small room at the entrance of Calle Providencia with a calculating machine. He showed intellectual abilities and he made a good career.

[Jorge] Ahumada entered later and Melnik too. We took Melnik from the Corporación de Fomento. He was a very effective man, very effective, a great man and a nice person. Different from Ahumada. Ahumada, at the

beginning, entered with a great arrogance. But gradually he was integrated. And once in Brazil, five years later, in a cocktail party that was prolonged until late, he said, “Don Raúl, I don’t know, I cannot understand how you have tolerated me for such a long time because everything that you said, I disagreed with. And you were patient enough not to say, Jorge, why do you disagree?” And we became good friends. He was a very intelligent man, a good writer, and full of force.

D.P. *Did your staff write papers and give them to you to read? How did you work with them? Did you ask them questions? I wasn’t in ECLA really until 1953, but I had the impression that you did most of the key writing in the first 3 or 4 years. What was the way in which you worked? Did you invite papers, read them, and absorb what they said? Or did people write on their own?*

R.P. Well as you said, there were different sections. Indeed they produced papers, a series of reports, many of which were published in the pre-[CEPAL] *Review*, the *Bulletin*, or printed in mimeograph and distributed. I took advantage of some of their ideas, I used to discuss with them, [but] was not very fond of big staff meetings, rather meetings with one, or two, or three people.

D.P. *You used to keep your office closed for certain hours each day?*

R.P. Yes, in order to produce my own papers. I didn’t have open doors. But most of what I wrote was after everybody went to their homes, on Saturdays, and on holidays. The final decision was made by me, but always after listening. I would not try to present papers with the style of presenting compromises saying: “There are some who believe this and others who believe that.” I would only put what I believe, and I would not eliminate the presentation of other papers with different views, but my personal ideas, my personal papers, would not be compromise papers.

D.P. *You had a few key U.S. staff members: Louis Swenson, Alex Ganz and Richard Mallon come to mind. Did you pick them to have a U.S. presence or was that part of the game? In other words, there was always a gulf between you and the U.S. government. Did you pick some staff to make a showing to the U.S. government that you wanted Americans or were they picked for you?*

R.P. Not at all. I promoted Louis Swenson because he was very able, intellectually very open, and morally a

⁵ Lake Success, New York, was the first site of the United Nations headquarters, while permanent facilities were being constructed in New York City.

superb man. He would be in charge of ECLA for a month or two while I was outside, and neither one of us would be suspicious of the other. It was a perfect team. Louis had a great critical mind. This is one of the reasons why I did not prefer to have a collegium office. Rather, I'd give a paper of mine to Louis, to let him make the criticism. He was free to criticize everything and he had a sharp mind.

D.P. *Yes. I remember he wrote that first paper on European-Latin American economic relations, which was very solid. And Alex Ganz? How come you picked him? You wanted somebody on national income and Alex had worked in Puerto Rico?*

R.P. Alex Ganz was a very good example of the cooperation of an American economist. He worked strenuously. He introduced new techniques.

D.P. *National income techniques especially.*

R.P. He was integrated personally with the boys, and was not eager to go back to the U.S. and publish on the basis of what he'd learned from us. He tried to live for ECLA. This is something that I always remember as one of the great merits of Alex Ganz. Others went there with the idea of taking easy fruits. Of publishing articles, not always paying tribute to ECLA. On the contrary, transforming ideas of ECLA in technical terms.

D.P. *Into political documents?*

R.P. Yes, and reaping the merit of the work for themselves.

D.P. *I want to talk now about your initial relations with the U.S. government. You said that I knew more about this than you because I wrote an article in 1978⁶, but obviously I don't. Relations were often very strained between ECLAC and the U.S. government, and between you and the U.S. government from the very beginning. Why?*

R.P. When Hernán Santa Cruz presented to the Economic and Social Council [ECOSOC] his project for the creation of ECLA, naturally he encountered much opposition from the great powers, and especially from

the U.S. He persuaded Mendès-France⁷ and some others to support ECLA. And finally the U.S. had to accept. Especially taking into consideration that the Commission was initially established for only three years, and perhaps with the idea in the back of their minds of merging ECLA with the Organization of American States. Indeed, when I was appointed Executive Secretary, an ambassador who was representing the United States at the O.A.S., a very nice gentleman, invited me for a cocktail party in his house. And he said to me, "My government does not like two organizations dealing with the same problems. So we have elaborated a project of merging the two. I may say, first of all, that you are our candidate for being the Director of the two organizations. And you will have more resources than before. Here is the text: two pages." I read the text carefully, and I said the following, "Mr. Ambassador, I fully understand your position. But I have to speak very frankly with you. The basis of our new organization, ECLA, is intellectual independence. This is the first opportunity for Latin Americans to start thinking with their own minds on economic problems. This has not been the case up to now." I was persuaded of that, after years of meditation when I had to leave the University of Buenos Aires. I added "I have to tell you frankly that you would be the dominating power in the new organization, as you dominate the Organization of American States. The Economic Department of that Organization is dominated by the State Department. I understand this quite well. But understand my point of view. If I would have yielded my intellectual independence, perhaps I could have continued to serve the Argentine government. But I didn't. And I'm not going to change at this age. And if I had the weakness to accept your offer, not one of the young men who are accompanying me would continue in ECLA. Believe me, it is an exceptional group of brilliant young men who never before happened to work together in Latin America. Not for the salary, but for the idea of a Latin America working in the right direction. So I'm sorry to say to you that I cannot accept." Well, it was a nice drinking party. We changed the subject, and the matter ended as a civilized parting. This was a few weeks before the third meeting of ECLA, which in turn was my first meeting as ECLA Executive Secretary.

⁶ David Pollock. "Some changes in the United States attitude towards ECLA over the past 30 years" in *CEPAL Review*, No. 6, second half of 1978, pp. 57-80.

⁷ Pierre Mendès-France (1907-1982), subsequently Prime Minister of France, 1954-1955.

D.P. *In Mexico?*

R.P. In Mexico. First the constituting meeting in Santiago. The second in Havana, when I spoke as Director of Research, and this one in Mexico was my first as Executive Secretary. Immediately before the meeting, Antonio Carrillo Flores, the Mexican Secretary of Finance, invited me for dinner with Alberto Baltra, Minister of Economy in Chile, with another member of the Chilean delegation, with Merwin Bohan,⁸ and with a high official of the Department of Finance. The second Chilean was Oscar Schnake who was an old friend. We had a nice dinner. [This was] in Mexico City. Right away Antonio Carrillo Flores said at the table, “Don Raúl, how do you like this Mexican wine?” (*laughs*). I replied, “Dear Mr. Minister, this is not Mexican wine.” (*laughs*). He was a man of good humor. Well, after dinner, there were two sofas, with the difference that there was room between the second sofa and the wall. Carrillo was there with Merwin Bohan and Baltra. I was on the side, facing them, with Schnake. The high Mexican official was standing behind the sofa. Then Carrillo said to Merwin, “Will you please read your project, your draft project for the merging of the O.A.S. with ECLA?” Merwin read it. Then Carrillo said to me, “What do you think about it?” I told him, “I do not need to reflect on it because this is precisely what they consulted me [about] in Washington and I reacted absolutely against it, on the following grounds.” And I repeated those grounds. You know what Carrillo did? There are gestures in life one never forgets! “Give me this paper,” [he] tore it up and threw it away. The matter was settled. And poor Merwin Bohan was silent. The U.S. had expected Mexico to support it, and Mexico was silent. This was known, naturally. President Vargas sent a cable to his delegation, the Brazilian delegation, supporting ECLA. Chile was hesitating. It gathered force. And the impetus was such that I had to help Merwin Bohan soften a draft resolution that was extreme (*laughs*). The man who established peace was Philippe de Seynes, a member of the French delegation.

D.P. *Were there any Latin American countries that did not support you in ECLA?*

⁸ Member of the United States delegation to the GATT conference in 1949-1950 and United States Ambassador to the Inter-American Economic and Social Council in the early 1950s. He knew Prebisch when the latter was Director of the Central Bank of the Argentine Republic in 1941-1943.

R.P. All, including Argentina [supported me]. Argentina never put me in a difficult situation, I have to recognize this.

D.P. *Tell me one small footnote, Don Raúl. Why was the Washington Office set up in the first place? Was it because one of the aspects of the agreement was, “All right, if you Latin Americans are going to have a regional commission, and we already have the O.A.S., then let us at least co-ordinate our work programmes so that there will not be duplication and overlap.” Was that why it was set up?*

R.P. I could see the extraordinary importance of being in Washington. First, as a source—as you subsequently developed the office—of contacts between Latin Americans and [North] Americans. As a source of collecting information and papers.

D.P. *In addition to coordinating with the O.A.S.?*

R.P. That was just an excuse. The real idea was to have a foothold there.

D.P. *I see. Tell me a bit about the relationship between Santiago and New York. You always had very good contacts with the Secretary-General, as I understood it. Tell me about the Secretary-General, about ECOSOC, and about the Headquarters Administration. Three different levels. Start with the Secretary-General. You were always on good terms with Hammarskjöld⁹, with Trygve Lie, with U Thant¹⁰. You never had any trouble with the Secretary-General?*

R.P. Absolutely none.

D.P. *What about the ECOSOC and the Economic Department? Did they try sometimes to edit your output?*

R.P. No. I may say that I had the most cordial and soft relationship with the Department. There were several personalities the first year, David Weintraub and Harold Kostin. David was sacrificed by Trygve Lie in the time of McCarthy.

David Weintraub was a man who saw the problem of development and was enthusiastic about the work of ECLA. The same for Harold Kostin, a Briton. But under

⁹ Dag Hammarskjöld (1905-1961). Secretary-General of the United Nations, 1953-1961.

¹⁰ U Thant (1909-1974.) Secretary-General of the United Nations, 1962-1972.

the circumstances, David Weintraub had to resign. Harold Kostin was transferred to other functions and new men came. David Owen came a little later.

D.P. *What about the Secretaries-General? Tell me a little bit about your personal relations with Hammarskjöld, Trygve Lie and U Thant. You knew them all personally?*

R.P. Trygve Lie, only when I went to see him, on accepting to be Executive Secretary. When he was in Santiago for the ECOSOC he visited ECLAC. He visited my office and said to me, “Well, I’m very happy with you –because you don’t give me any political problems.” Period! (*laughs*). He never interfered at all. With Hammarskjöld I established a very cordial relationship. To such an extent that he made an exception: Never before had an Under-Secretary accompanied him on a trip. He asked me to travel with him in Latin America and we had very extensive talks on many matters. The man was intellectually brilliant, and he supported me in every sense.

D.P. *When I was in Santiago in 1955, I worked with José Antonio Mayobre¹¹ and Alex Ganz on an early ECLA document called An Introduction to the Techniques of Planning. When that report went to New York, a cable came back to you that got Mayobre very excited. He showed it to me. It said, “The report is all right, but every place where you say “planning”, delete it and insert the word “programming”, because here in New York we cannot have anything that supports planning.” And you said, “O.K.” Explain to me how come, with all this support you had—from the Secretary-General and all those people at Headquarters—the United Nations decided that “planning” was a bad word and “programming” was a good word?*

R.P. Not in New York. I was not concerned about heads in New York. It was in the State Department and in the World Bank. The Bank would not speak of “planning”, but of “programming”. By the way, [for] many years after, I never used the word “planning”. It was a slip of José Antonio Mayobre to speak of “planning”. I was speaking of “programming”.

D.P. *Why has ECOSOC, which in theory is ECLA’s parent body, never been influential? Why was it always a weak instrument? How did ECLA manage to be so powerful when ECOSOC itself—the parent body—was so weak?*

¹¹ Executive Secretary of ECLA, 1963-1966.

There’s something odd about that. In many ways, ECLA transformed Latin American economic thought and action, for better or for worse. Import substitution, industrialization, the whole concept of Centre and Periphery, terms of trade, regional integration, planning, and so on. ECLA went ahead, wrote, did things, and influenced reality whether ECOSOC listened to it or not. ECOSOC almost seemed irrelevant. Somehow, there’s an anachronism to ECOSOC which I don’t understand.

R.P. After Gunnar [Myrdal]¹² left the ECE [Economic Commission for Europe], I could captivate attention by speaking without reading from notes, by speaking forcefully, by affirming my convictions. And people like that. It is an element of persuasion. If they do not always act in that sense, at least they respect what you do and the organization that you are representing. But if you go and read your speech, or speak in a monotonous voice and present many figures, you lose influence. You have to go and discuss, as an actor. I think this is an important element and Gunnar would do that. He was a powerful man, and I think this was an element. Remember, in a body like this, there are always three or four persons with intellectual ability. They shape the opinion about the intellectual quality of the man who is speaking. I never have seen a face of a man who was sleeping while I was talking. And that is important.

D.P. *[Returning to ECLA itself,] let’s begin with three main initial contributions of ECLA to Latin American development. One was theory. The second was let us say technical assistance, training, and advisory activities. And the third was political: ECLA provided a forum for Latin Americans to meet. ECLA also provided statistical and other such services. But, fundamentally, the main contribution of ECLA and yourself in those early years was in theory. You began by identifying the dichotomy of the centre and the periphery. From 1948 until 1963, you focused fundamentally on the external sector. Your terms-of-trade approach, your emphasis on the need to industrialize through import substitution, your stress on more buoyant exports. Why did you focus so heavily on external vulnerability?*

¹² Gunnar Myrdal (1898-1987). Swedish economist. He became Executive Secretary of the United Nations Economic Commission for Europe in 1947. Author of *The Asian Drama* (1968), Myrdal shared the Nobel Prize for economics with Friedrich von Hayek in 1973.

R.P. Because the external bottleneck was the most important obstacle to development at that time.

D.P. *Early in your life in Argentina, you were very impressed by the vulnerability of the Argentine economy to international shocks. But in the ECLA thesis, there was very little emphasis on domestic phenomena. You looked fundamentally at the problem of the foreign exchange constraint. True, Latin America was enormously vulnerable then. But presumably your emphasis was also partly because you and ECLA wanted to get political support, in those early years, from the Latin American governments?*

R.P. And because we were not prepared to extend our thinking, suddenly, to every aspect of the economy. We took those parts that were more important at the moment. And gradually we extended our ideas to other subjects.

D.P. *Did your theory evolve over time? Your thesis was very intricate. Everything was linked to everything else. Did that evolve slowly between 1948 and 1963, or did you have it in mind from the beginning? That is to say, the tendency toward a secular deterioration in the terms of trade; therefore, an effort to reduce dependency on primary production for exports; therefore, accelerated internal industrialization.*

R.P. It was a gradual evolution. We had to industrialize in Argentina without previously building a theory, because we needed to supply more goods to the population. But we could not pay for all the imported goods, due to the fall of our exports and the deterioration in our terms of trade. That's the simple fact. Without any theory, the whole of Latin America did the same. From Mexico all the way down. Then, in my years of quiet thinking, after I left the Central Bank, I started theorizing. The concept of centre and periphery emerged, and the concept of industrialization.

Let us deal with the latter and then with the former. There was and there still is a great deal of confusion about deterioration in the terms of trade. I was accused many times of projecting into the future a tendency to deteriorating terms of trade. I never said so. What I said is, it is necessary to introduce technological progress into agriculture. The more you increase productivity, the less manpower you need per unit of product. It is true you can increase production and exports, but here comes the external part. If external markets are open, and you can sell in them whatever you produce, all right, that would be the most

economical way of employing manpower. But it so happens that the laws of income elasticity are very narrow. Very low income elasticity for primary products; very high income elasticity for manufactured products. How to deal with this? It is a very simple arithmetic problem.

D.P. *I remember, when I was in Santiago in 1955, that Alex Ganz had calculated the overall U.S. income elasticity of import demand for Latin American primary products at 0.6, and Latin America's income elasticity of import demand for U.S. manufactured goods at 1.6. So there was the gap.*

R.P. And if you extend this reasoning to all the centres of the world, given the very low price elasticity of our exports, there is a certain moment when the attempt to export more gives you less foreign exchange. What is the role of industrialization and protection? Reasonable protection gives an incentive to establish industries and to divert factors of production to industry from agriculture. Not to displace, but to divide the increments of factors of production; one part to continue increasing agriculture and one part for industrialization. This was one of the reasons for the programming that we advocated, to try and keep a dynamic balance between the two activities.

D.P. *One of the odd criticisms of you and ECLA was that you were "against agriculture" because you favoured industry.*

R.P. Well, that's absolutely nonsensical. Anyone reading our literature will see that we put emphasis on both things. One of the first things I did in 1955 when I was consulted by the new Argentine government was the establishment of an Institute for Technological Research in Agriculture –INTA– with financial independence. What I was trying to convey to people was the idea of a dynamic balance between the two sectors. I said, if there is no industrialization in the developing countries, in the periphery, and if there is technical progress in agriculture, then there will be a tendency to deterioration in the terms of trade. The only way to stop that is through industrialization. This was my simple argument. I did not make any forecast about the future. I presented my thesis as an argument in favor of industrialization. Against agriculture? How could I be? A man born and educated in Argentina, who recognizes that the high standard of living in Argentina by the beginning of the century was due to agriculture? And I said in Brazil (in reply to the arguments of Jacob

Viner¹³, who said “Prebisch ignored agriculture”) that agriculture can be the source of wealth. Now, the thesis of the orthodox economists was: If you need to stimulate industry, then devalue. Devaluation would increase the price of imports and would stimulate exports, without any intervention in the free play of the market. My reply was: Devaluation made for that purpose, and not as a response to a previous process of inflation, will promote inflation. It will be a socially costly way of protecting. And those exports (and this was the case of exports of primary products in Argentina, that were already competitive) will see their prices increase, and therefore production will increase, and therefore prices will finally fall. Then Viner said, “Put a tax on exports”. “But my dear [sir],” I replied, “This is intervention into the market. What is the difference between a tax on exports to prevent a fall in prices of exports, and a selective tax on imports?” Nonsensical. This is all. Even when I qualified these points, when I explained these points, still I was accused of incredible things in this matter.

D.P. *Why do you think that happened?*

R.P. Because of second- and third-hand reading. And because there is a prejudice that probably you have seen, [as] a member of a northern university. Really, David, there is a certain arrogance and disparagement. They don’t take us seriously. I’m sure that in Harvard they don’t take us seriously. We are second-class economists, or even third class. We are underdeveloped economists.

D.P. *But could it also be because you represented a challenge to U.S. exports, through your import substitution measures? And also because of your criticisms of transnational corporations? The U.S. private sector and the U.S. government were worried that your theories would have a doubly adverse effect on them.*

R.P. You are right. Let us take it bit by bit. I went to see Frank Southard¹⁴ about the Latin American Common Market. He was an open-minded man. I put as a case that we were thinking of producing cars. “But would you deprive us of our export market?” “Yes,” I replied, “but as a result we could import more.”

¹³ Jacob Viner (1892-1970), the leading trade theorist of his generation in the United States.

¹⁴ United States representative to the IMF, 1948-1950.

D.P. *Import more capital goods?*

R.P. “Well,” he said, “the immediate effects would be this. In the longer run something else may or may not happen.” He saw the immediate effects. There was no long-term policy conception. It was a plea of immediate interests. But I was thinking not only of immediate measures, but in longer run development terms. Don’t forget that the long term starts now. You have to build the short-term programmes within the framework of your conception of long-term programming.

D.P. *[What about] transnational [corporations]?*

R.P. As always happens, the pendulum went too far. We have seen transnationals everywhere. We have built a theory of transnationalization. I think that it is necessary, here again, to try to build a policy. Let me take the case of oil. In 1955, during the short period when I was advising the Argentine government, I opposed with great firmness a policy of “open-door” to oil companies. Argentina, for several reasons had to increase its production of oil. So it was necessary to have the cooperation of the oil companies. I said to the President [Aramburu]¹⁵, “Don’t give concessions. Try to get service contracts from the companies.” The attitude of the companies was against this. Do you remember Mr. Vance, who was head of the Export-Import Bank? He went to Santiago. He said to me: “I am a Republican. I consider that oil companies should be free to invest without conditions. And I may tell you that I’m willing to recommend to my government (he was a very influential man) a different policy; a policy of negotiations, joint ventures and service-contracts, as you had preached.” I took the first plane, at 12 o’clock precisely. I went immediately to see the Minister of Finance. Unfortunately, the day before, President Aramburu made an ambiguous declaration that was to change our policy. When this was known in New York and Washington, they retreated. And the country would have to wait for many years. Now the companies are prepared. They have learned. We need the transnationals, but with very clear rules of the game: duties, obligations and rights. We have to find new policies. First, a selective policy, we have to define where we need them and on what basis. The danger is that, in this very difficult situation, they would try to force the governments to give very favourable conditions.

¹⁵ Pedro Eugenio Aramburu (1903-1970), President of Argentina 1955-1958.

D.P. *This all leaves me with the feeling that the ECLA thesis or the Prebisch thesis of 1950-1960 continues to have considerable relevance for Latin America today.*

R.P. [For instance,] import-substitution, not as a theoretical preference, but insofar as we cannot find sufficient markets for our exports. That's all. We need to increase our income. We need to import more. Insofar as we cannot import more by paying with exports, then we have to pay with our own production.

D.P. *What's interesting to me is how the analytical rationale still goes back to the writings of 30 years ago. There are really very few new thoughts today on "what to do" about the external constraint that were not contained in the ECLA thesis of the early 1950s.*

R.P. I regret to say so, but the Centre-Periphery concept has not changed very much.

D.P. *Nor has the terms of trade theoretical rationale; nor has the import substitution industrialization concept; nor has the concept underlying regional cooperation.*

R.P. I would like to see –really, David– a revolutionary presentation of new ideas.

D.P. *You were in ECLA from 1950 to 1963 as Executive Secretary. I want to go back to some things that happened during that period. I'm going to start with the Alliance for Progress¹⁶. That was, for its time, a noble experiment. Tell me how you got involved in the Alliance.*

R.P. I would say that for me there were two different episodes. Adlai Stevenson¹⁷ visited Buenos Aires with Senator Benson, who was a very sympathetic man. Both of them asked to see me. Stevenson put some very pertinent questions. This was before the Alliance. At the end, after thanking me for the hospitality, [Stevenson] asked me to write a memorandum to him. I did so. And he used this memorandum as a basis for an article that he published soon afterwards in *Foreign Affairs*. I don't know if he was influential or not with John Kennedy.

¹⁶ The Alliance for Progress, a Latin America-wide development programme, was announced by President John F. Kennedy in March 1961. Through it, US\$20 billion in foreign aid was to be channeled into the region over a 10-year period.

¹⁷ Adlai Stevenson (1913-1965). President Kennedy appointed him U.S. Ambassador to the United Nations, with cabinet rank.

Now, let's turn to the Alliance for Progress. I was not the promoter of the Alliance for Progress, but I jumped on the wagon when the train was starting to move. Not because I was against, but it so happened. I underline this because many people believe that I was the intellectual author of it. The Organization of American States, during Kennedy's early years, attempted to introduce new life into itself, and formed a committee of some 15 or 20 people, the majority of whom were Latin Americans.

D.P. *The OAS asked ECLA to send some people to Washington to help?*

R.P. Yes. The papers of ECLA were the basis, and our presence contributed further. The OAS saw the opportunity to get new force. Some weeks later, after the presentation of this document by the OAS to the State Department, I had a meeting with José Antonio Mayobre (the Venezuelan Ambassador [to the U.S.]) plus Felipe Pazos¹⁸ and Felipe Herrera, who was already President of the Inter-American Bank. Alfonso Santa Cruz was in Washington and Jorge Sol was very active. He was the head of the Department. [I drafted a letter for the group to President Kennedy, saying] "This is the moment to act: to have a hemispheric policy toward Latin America." And Mayobre, as the most important man, being Ambassador, delivered this letter personally to the President. And the President received it so well that, a few days later, he said that the fundamental ideas were ideas of the Economic Commission for Latin America of the United Nations. Imagine how we felt, how excited! Well, this is the positive part. What is the negative part? That Richard Goodwin,¹⁹ without consulting us, gave to this document the name "Alliance for Progress." This title sounded to me [like] a "Holy Alliance!" It was not an Alliance: a mistaken and an unfortunate name. I was supposed to be Chairman of a Committee for coordinating the activities. But the Argentine delegation opposed me.

D.P. *Why? I thought you said earlier that they supported you?*

R.P. They did in ECLA. But I was acquiring too much power and importance, and this is very serious in

¹⁸ Felipe Pazos (1913-2001). Cuban economist, IMF staff member from 1946 to 1949.

¹⁹ Richard N. Goodwin was special adviser and speechwriter for President Kennedy (1961), Assistant Under-Secretary of State for Inter-American Affairs (1961-1962), and Director of the International Secretariat of the Peace Corps.

Argentina, I'm sorry to say. So I had to help on this Committee as a consultant, without any power. The Alliance, as you know, was attacked both in the U.S. and in Latin America. In [the] U.S., business interests had the following thesis: "Why think in terms of social reform? First stimulate growth, and then afterwards take measures for better distribution of income." And in Latin America the landowners resisted the idea of agrarian reform. Only the personality of President Kennedy, and his personal influence on government, could have saved the Alliance. But he died.

D.P. *The U.S. business community was against the Alliance because of what?*

R.P. For them Latin America was a source of profit. Anything that could adversely affect those profits was bad. Land reform in itself was convenient. But wait until the country is prosperous, very prosperous, before introducing all these types of reform.

In some countries the landowners said they would raise the flag against foreign companies. In Chile for example. This was utterly unfortunate. Then came CIAP [the Inter-American Committee for the Alliance for Progress]. The World Bank did not pay any attention to it, it continued taking its independent decisions. At the beginning, Latin American countries sent good delegations. When the group of "Nine Wise Men" was replaced by the representatives of governments in Washington, Embassy Secretaries were sent, people without any qualifications. I always remember that, due to the efforts of [Carlos] Sanz de Santa Maria, the American government went there. [He] made a great effort to get the presence of high-level representation from the U.S., and he obtained that. The Latin American representation was disastrous. No questions from them. So that Carlos Sanz, Walter Sedwitz²⁰ and myself had to put the questions. This persuaded me that all this experiment was condemned to failure.

D.P. *One of the implicit criticisms that you are making of the Alliance for Progress is that there never was a boss.*

R.P. That's it.

D.P. *I'd also like to talk briefly about ECLA and you on the one hand, and the IMF and the World Bank on the*

other. There has been a long-standing history of an adversarial relationship, at the intellectual and analytical level. During the 1950s and the early 1960s (until you went to UNCTAD), ECLA and the IMF saw the problems and therefore the solutions of Latin American development from very different lights.

R.P. Yes. The theory of the Fund was based on the conception that a balance of payments deficit was the result of internal mismanagement. ECLA would not deny internal mismanagement. I would have been the last man to do that, because of my long experiences in Argentina and my reading and writing of Argentine monetary history. But to attribute to internal factors what very frequently was the result of external factors was a real calamity, a real theoretical calamity. For instance, a favourable balance of payments during a boom in the centres would increase imports that were the source (the sole source or the greatest part) of taxes. And the Treasury was worried as expenditures would increase. And when the slump came, the deficit in the balance of payments was unavoidable. The thesis of the IMF was always "restrict credit to decrease imports." And we said, "Yes. But the way to decrease imports is through a selective policy, that would at the same time give impetus to new import substitutions." Because, in the long run, import substitution is essential. The Fund would not link the two things, import substitution (because it too was against the laws of the market), and selectivity of imports (because it was an unacceptable interference in the market). This was from the point of view of monetary policy, the most important element in our disputes with the Fund. Years later, many years later, when Pierre-Paul Schweitzer²¹ became head of the Fund, we got along personally very well. And I remember that in one of the dinners of the Fund he told me, "You know, Raúl, when I joined the Fund you were presented to me as the Devil. I was told to be cautious with you." Then there was de Larosière,²² [I remember] once, in the middle of his first period, he said in a speech in Switzerland, "the Fund has always considered that balance of payments disequilibrium in developing countries is due only to internal factors. That is not so. We have to give importance to external factors also."

²⁰ Senior official of the OAS and Secretary of the Inter-American Economic and Social Council responsible for supervising the Alliance for Progress.

²¹ Head of the IMF, 1963-1973.

²² Jacques de Larosière, Managing Director of the IMF from 1978 to 1987; Governor of the Banque de France from 1987 to 1993, and President of the European Bank for Reconstruction and Development from 1993 to 1998.

D.P. *He was the first one to say that publicly?*

R.P. [He was] the first one to say that out loud and clearly. A few days later, I was at a cocktail party at the Fund when they said goodbye to one of the high officials, I said, “Monsieur de Larosière, I congratulate you. You were an innovator when you said what you said in Switzerland.” And he replied, “Yes, but I would like to innovate much more. However I have resistances.” “Well,” I said, “Pope John XXIII had the same resistances!”

D.P. *I want to talk to you about the IBRD, the other Bretton Woods twin²³. You and ECLAC had intellectual difficulties with the Bank. Not quite so strongly adversarial [as with the IMF], but adversarial nonetheless. Was that because the World Bank was not so important? They were equally orthodox for a long time.*

R.P. I will tell you an anecdote that will give you a glimpse of this. In my Argentine report in 1955, I was preaching industrialization, and the need to promote private initiative in industrialization. [First, use] macro intervention of the State to create the broad lines, and then let private initiative take advantage of this. Some weeks after, I had to visit the Vice-President of the World Bank, Burke Knapp, a very cordial and sympathetic man. And Demuth²⁴ was there. Demuth said, “Why are you opposing private initiative in industrialization, and promoting the growth of State enterprise? Why are you recommending this?” “What?” I said to Burke Knapp, “That’s utterly disconcerting to me. I was attacked in my own country (as well as in other countries of Latin America) for the way I was speaking in favour of private initiative in industry as well as in agriculture and other activities. How is it that the Bank, that should be well informed, ignores this and instead presents me as a man promoting the growth of State enterprises? I never did, because I never believed in that.” Well, that shows you how—even in institutions and circles where they should know better—they hear something but they do not take pains to see what is the degree of truth. And this is built up as a consistent theory against you and against your own thinking. This is the unfortunate part.

²³ International Bank for Reconstruction and Development, the original name of the World Bank.

²⁴ Richard Demuth, a World Bank economist, who worked on agricultural matters, among others.

D.P. *So ECLA was a gadfly to the Bank and Fund. You were considered as not paying sufficient attention to neoclassical theory?*

R.P. Yes. Because I was not a neoclassical in the sense that I considered that, even if it is true that private initiative was absolutely important, it also had to be combined with planning, with the broad lines of planning, and this is what they did not accept.

D.P. *All right. But after Eugene Black left [the World Bank] and Robert MacNamara²⁵ came in with Hollis Chenery,²⁶ the attitude wasn’t quite the same. It began to be a little better.*

R.P. Yes, with MacNamara and with George Woods.

D.P. *Yes, he was in between.*

R.P. MacNamara was always very cordial with me, but that’s all. Chenery knew ECLA. Once before, we [had] invited Chenery to spend a few months with ECLA.

D.P. *So with Hollis Chenery, Mahbub Ul Haq²⁷, Drag [Avramovic]²⁸ and MacNamara, there was a different intellectual atmosphere in the Bank. [But in general] in Washington, even our little ECLA Washington office was considered somehow a beachhead of intellectual opposition. Not only to the U.S. government, but also to some of the specialized agencies of the United Nations. In other words, ECLA had the reputation of being a potential threat to the policies of the U.S. government, of the Bank and [the] Fund, and GATT.²⁹*

R.P. Well, there are two sides in this picture. One thing is the intellectual power that was one of our objectives, with political implications. Not the transfer of power from these institutions to UNCTAD; the most that it could get (and this could have been very important), was to be the centre of elaboration of new ideas, and the transformation of these new ideas into political forces. Not to try to manage the Bank or the Fund, but rather

²⁵ Robert MacNamara, U.S. Secretary of Defense, 1961-1968. President of the World Bank, 1968-1981.

²⁶ Professor of Economics at Harvard University and Chief Economist of the World Bank under MacNamara.

²⁷ Mahbub Ul Haq (1934-1998), Pakistani economist and Vice-President of the World Bank under MacNamara.

²⁸ Deputy Director of Economic Development of the World Bank in the early 1960s and subsequently a member of the Board of Governors of the Bank.

²⁹ General Agreement on Tariffs and Trade.

to examine what they were doing, to criticize, for instance in the case of the Fund, its policy of conditionality. One of the most important roles of UNCTAD could have been a severe criticism of the policy of conditionality. Not to say “We do not like conditionality,” but [rather] “how conditionality could be applied.”

D.P. *Don Raúl, I want to ask you about why you created ILPES?*³⁰

R.P. I did not create ILPES. The first idea about creating the Institute came from David Owen. He said, “Raúl, when you retire, you should have a research centre as part of ECLA.” I said, “Fine idea.” This was a conversation perhaps at the end of the 1950s. Once, I was asked by Paul Hoffman to go to New York and visit him. I did. “I will [allocate] resources for you to create a planning institute for Latin America,” he said. Probably David Owen explained this idea to Paul Hoffman, and Hoffman—who established the International Development Institute—was a businessman with a very broad view of the world. We became good friends and he gave me the idea, but I did not ask anybody [to create] ILPES.

D.P. *Now that we’ve mentioned ILPES, how do you feel about it now?*

R.P. Not enthusiastic, ILPES is lacking in resources. It has been living a very precarious life. It doesn’t have a research staff with continuity. And Latin America needs a research staff as a complement to ECLA.

D.P. *Let me go to regional integration. One of the great achievements of ECLA was to expand the concept of import-substitution industrialization from the national level to the regional and sub-regional level. And then to actually do the staff work for the creation of LAFTA,³¹ the Central American Common Market, the Andean Group, and in some ways too, CARICOM.³² So that was one of the specific practical and pragmatic achievements of ECLA. You were a father of regional integration in Latin America. How do you feel on looking back? What should have been done differently? How do you assess ECLA’s contribution to Latin American regional cooperation?*

³⁰ Latin American Institute of Economic and Social Planning, now Latin American and Caribbean Institute of Economic and Social Planning.

³¹ Latin American Free Trade Association.

³² Caribbean Community.

R.P. This is a matter very close to my heart. I consider one of the most vital interests of Latin America [is] to give a strong impulse to this idea. Why has it not advanced beyond a certain point? It was not a failure. It was not a success. It was a mediocrity, a typical Latin American mediocrity. Let us start by saying that during the long years of prosperity of the centres, when Latin America was finally persuaded about the need and the possibility of exporting manufactured goods, the pendulum went the other way. First, the pendulum was in favour of import substitution, forgetting about the export of manufactures. We were the first to say (and I wrote this report at the beginning of the 1960s) that industrialization in Latin America was asymmetrical. We gave impetus to import substitution but we did not give symmetrical treatment to the export of manufactures. Duties on the one hand and subsidies on the other, we were the first, and I underline this because we were accused of being responsible for import substitution and against exports. That was not the case.

The Latin American countries took advantage of the boom years. Some of them were highly successful, following a very intelligent policy (like Brazil) and a consistent policy. Argentina started too, but then came the disaster of lowering import duties, believing that other countries would follow and we would liberalize the trade of the world. An overvaluation of the currency and plenty of money to pay for imports of manufactures destroyed a great part of the industry in Argentina, and therefore of the exports that had started in Argentina. Now we have to rebuild all this. Lack of consistency, David, was the main sin. And wrong ideas. I put in a parallel way Brazil and Argentina. We have to learn from the past, we cannot repeat ideas that we conceived 25 years ago. I was personally under the neoclassical conception of free trade (“Let us assure a growing free trade area in Latin America. Give time for industry to adapt to a lowering of duties. Give as much time as necessary”). In the light of experience, I think that was a mistake. Let us see what is the real problem. It is our deficit with the centres, for well known reasons. To this you must add oil imports. Let us concentrate on import substitution of those goods that are responsible for our deficit with the centres (insofar as we cannot export in sufficient amounts to pay for these imports).

D.P. *Imports of capital goods and intermediate products?*

R.P. Yes. And the new goods produced by technology, all these gadgets that you take enthusiastically. It so

happens that these are the goods that generally need broader markets. The old idea, this is the positive part of our preaching of a quarter of a century ago. Not the rest. But what is the lesson of this experience? Countries such as Brazil, Argentina and Mexico (not so many others) that are in [a] condition to export capital goods, but not at international prices, according to their own schemes, could do that via a system of trade preferences by the other countries. Let us say by Uruguay or Ecuador giving preferences to Brazil, Argentina and Mexico. But who pays the cost of this? Not Brazil. Not Argentina. The cost is paid by Uruguay and Ecuador. Why would they pay this cost? The idea was that they would receive –that they would be able to export– manufactures or other products to Brazil, Argentina and Mexico, receiving preferences from them. That may happen. My present idea is the following. Countries interested in exports should give a subsidy, according to certain established rules, in order to offer prices equivalent to international prices. So that the less developed countries of the area would be tempted to import from them. Even so, this could create a surplus in favour of the great markets. Part of the surplus should be used in a fund [created by Brazil, Argentina, and Mexico] to promote the establishment and development of industries that could export at competitive prices, with subsidies if necessary. [This scheme would not require] from Brazil the full opening of markets, but at prices competitive with internal prices. Not cutthroat competition.

D.P. *If this Fund was created and Brazil had an export surplus, and was going to give part of the Fund to Uruguay (to produce industrial goods that Brazil wanted to import), who would own the industry in Uruguay: the Brazilians or the Uruguayans?*

R.P. Both. I would like to see Brazil, Argentina and Uruguay working together. Not only for developing these industries but also for export purposes. So that, if they established one plant in Brazil, another plant would be established in Argentina. They would divide the work. In Brazil for certain types of capital goods; in Argentina for other types of capital goods. But the same enterprise, if possible. To merge interests.

D.P. *It makes sense for Brazil and Argentina. But does it make sense for Uruguay and Ecuador?*

R.P. If they will receive imports at international prices or close to international prices, at the same time they will have resources for developing their own industries.

D.P. *From this new fund?*

R.P. Yes. And if this could be matched by the Inter-American Bank or the World Bank—if they recognized the need for import substitution on broader lines— this would be perfect.

D.P. *So what you're really saying is a scheme like LAFTA or the Central American Common Market, but one that could be implemented at the level of two countries or more. It could be very practical.*

R.P. Yes, and another advantage is that, at present, according to the new ALADI³³ system, Brazil (let us say) obtains from Uruguay a preference, giving Uruguay a concession. Then Mexico comes and says, "I am willing to give a concession to Uruguay. Give me a preference similar to that of Brazil." Brazil may say, "But I gave it this concession on the basis of having this advantage. Now let us renegotiate." On the contrary, in this system, it is open. Brazil is given a subsidy for the export of machinery to any Latin American country entering into the system. If Mexico or Argentina would like to export the same goods, all right. There's more competition. All of them would have to contribute to the fund and follow certain rules. Subsidies could not be given on wild terms. Some rules would have to be established. It's not easy. We would have to abandon preferences.

D.P. *You mean abandon GSP³⁴?*

R.P. No, preferences inside the area. This deserves careful consideration. I may be wrong –I accept that possibility– but also I may be right.

(Original: English)

³³ Latin American Integration Association.

³⁴ Generalized System of Preferences, established by UNCTAD under Prebisch's leadership.

Raúl Prebisch

and the development agenda

at the dawn of the

twenty-first century

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The hundredth anniversary of the birth of Raúl Prebisch is an invaluable opportunity for us to take another look at the ideas of this great Latin American, one of the thinkers from the developing world who has had the strongest influence in world economic debates. His ideas have been the subject of heavy criticism, but much of this has been based on distorted versions of his thinking or of its practical application, rather than his true intellectual work. Taking his proposals out of their historical context has also been a frequent practice, even by some of his own followers. It should be remembered, in particular, that many of his proposals were made in the light of the collapse of the international trade and financial system in the 1930s, whose reconstruction had barely begun when he published his most influential works (Prebisch, 1949, 1951 and 1952).

This essay tries to show that some of the basic ideas in Prebisch's thinking remain valid, and it reformulates them as a function of ECLAC's most recent proposals and the contributions of other schools of economic thought.

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1. Three main elements in Prebisch's thinking

"The spread of technical progress from the countries where it had its source to the rest of the world has been ... relatively slow and irregular" (Prebisch, 1951, p. 3). This assertion, which forms the opening words of what is perhaps his best-known work, has two fundamental methodological implications. The first is the recognition of the key role of technical progress in economic growth and, hence, the importance for the developing countries of the channels through which that progress is transmitted from the "countries of origin": the derived demand for raw materials; technology transfer proper, including technology embodied in production equipment; the transfer to the developing countries of branches of production which are already "mature" in the industrialized countries, and the participation of developing countries in sectors of rapid technological progress. The second is the impossibility of analysing the dynamics of developing countries independently of their position within the world economy. Their development processes are qualitatively different from those of the most advanced nations. This means that there are no uniform "stages of development" and that "late development" –or "peripheral capitalism", to use Prebisch's own term– has a dynamic which is quite different from that of nations which developed earlier and became the "centre" of the world economy.¹

¹ The best analysis of these points of view is undoubtedly that of Furtado (1961).

This is the view which underlies the idea of an inherently hierarchical “centre-periphery” world economic system (or “North-South”, if we prefer the terminology which gained currency in the debates of the 1970s). The essence of this view is its emphasis on the basic asymmetries characterizing the world economy, and their persistence over time, in contrast with the perception of the world economy as a place of relations between equals, or a “level playing field”, to use a concept which has been in vogue in recent years. In terms of the recent controversies on economic growth, this alternative view of the world economy means that these asymmetries give rise to “divergence” in levels of development, or at the very least represent a serious obstacle to the “convergence” assumed in orthodox economic growth theory.²

These asymmetries are reflected primarily in the structure of production. According to a version which is very close to Prebisch’s thinking, “unlike the production structure of the periphery, which is *specialized and heterogeneous*, that of the centres is *diversified and homogeneous*” (Rodríguez, 2001, p. 105). As technical change originates in the centre countries and they also have higher consumption capacity, at any given moment they tend to have a concentration of the branches of production which are most dynamic at the world level. In Prebisch’s view, this gives rise to a tendency towards specialization by the industrialized countries in products of high income elasticity, while the countries on the periphery tend to concentrate on the production of goods of low income elasticity (raw materials and, increasingly, the manufacture of mature goods), which in turn reflects a trend towards divergence of growth rates and /or the rise of balance of payments problems in the latter countries, i.e., an external gap or bottleneck. These problems are particularly severe at times of crisis, reflecting the high cyclical vulnerability of the developing countries to shocks coming from the centre of the world economy.

In Prebisch’s view, overcoming the basic asymmetries of the international system requires not only a change in the international economic structure, but also an effort to transform the structures of the

² In this formulation we are leaving aside the controversy over the terms of trade, which has been given an excessive amount of attention in the analysis of Prebisch’s work. We therefore concentrate on the divergence in levels of development or—in terms of the controversy in question—the role played by the deterioration in the factorial terms of trade. See, in this respect, Ocampo (1991).

peripheral countries themselves —“development from within”, to use Prebisch’s original terminology, as recovered by Sunkel (ed., 1991). In terms of the more recent debates, this “development from within” is essential because the accumulation of national human capital and technological capacity (“knowledge capital”) and institutional development are essentially endogenous processes. This explains the decisive importance of “programming development”, which was a term used in the first stages of ECLAC’s work and, in general, designing explicit State strategies to change the internal structures of the country, in order to break down the obstacles to development and make possible new forms of integration into the world economy.

Industrialization was initially seen as the main way of changing the production structure —“spreading technical progress”—and import substitution as its main instrument. This view was in keeping with the characteristics of the period when these ideas were formulated: the absence of a dynamic international market for manufactures;³ the “empirical” way in which the import substitution strategy had arisen, as a response to the collapse of the international economy in the 1930s; and the protectionist past which many Latin American countries had shared with the United States and various countries on the European continent, even during the stage of primary-export development.⁴ The possibilities of inefficiency in import substitution, especially in highly fragmented markets, as well as the need to ensure that industrialization was not carried out at the expense of agriculture or export development, were evident to Prebisch even in his earliest publications in ECLAC (Prebisch, 1949, sections I and VI). Therefore, from the late 1950s on, Prebisch and ECLAC began to advocate a “mixed model”⁵ which combined import substitution with the promotion of new exports, especially of industrial origin.⁶ Over time, ECLAC’s view became increasingly pro-export, although it never

³ “No emphasis was placed on exports of manufactures to the centres in this stage, in view of the unfavourable conditions prevailing in those countries and the absence of a suitable industrial infrastructure for this” (Prebisch, 1987, p. 17).

⁴ For more details of Latin American protectionism during the export stage, see Cárdenas, Ocampo and Thorp (eds., 2000a, chap. 1). For a comparison of Latin American tariffs with those of a number of Western European countries and the United States, see Maddison (1989, pp. 45-47).

⁵ This is the term used in a recent study on economic history (Cárdenas, Ocampo and Thorp, eds., 2000b, chap. 1).

⁶ This coincides with what Prebisch called the third stage in his thinking (Prebisch, 1987, pp. 9-21). One of its clearest expressions is to be found in Prebisch, 1963.

favoured the abrupt elimination of protection arrangements.⁷

For Prebisch, the industrialization of the peripheral countries also involved a further problem: modern industry was less able to absorb the surplus labour made available by the rural sector. This fact was further aggravated by technological dependence, which meant that “best practices” corresponded to patterns of labour use dictated by the levels of development of the industrialized countries. One way or another, patterns of development came to be marked by greater “structural heterogeneity” of the productive sectors, to use the term coined later by Pinto (1970): while some workers were absorbed by the high-productivity sectors, a generally much large proportion were relegated to low-productivity sectors. This high level of domestic heterogeneity was one of the basic forces exerting adverse pressures on income distribution, and moreover, in the case of Latin America, this took place in countries which had already inherited a high degree of inequality and marked social segmentation from their previous stages of development.

Under the mixed development strategy, integration processes were seen, from the early 1950s on, as key elements for rationalizing the costs of import substitution: both those associated with the absence of competition and those due to the inefficiency deriving from the sub-optimal scale of the industrial plants. A decade later, when the possibilities of exporting manufactures to the industrialized countries began to be perceived, they were likewise seen as a means of building up export experience, as a prelude to winning other markets. Regional integration –the various subregional processes, LAFTA/LAIA, and the Latin American common market, which was the most ambitious project– thus became a decisive element in the “mixed model” advocated by Prebisch and ECLAC

⁷ See, in this respect, three recent versions of the history of ECLAC thinking: Bielschowsky (1998), ECLAC (1998) and Rosenthal (2001). The reasons for this view (now mainly of historical interest) were based on three considerations: i) the transmission costs that the elimination of protection arrangements would cause; ii) the idea that the structure of export incentives could be rationalized to offset the costs of protection, and iii) the belief that there was some degree of complementarity between protection and export development; in particular, where economies of scale existed, the local market served as a “base” for winning foreign markets (an argument that Krugman, 1990, chap. 12, subsequently called “import substitution as export promotion”). Prebisch and ECLAC always acknowledged, however, that high levels of protection could give rise to inefficiency and insoluble anti-export biases.

from the late 1950s (ECLAC, 1959). Thus, it was seen as a way of expanding the spaces within which “development from within” could take place, in order to make it more efficient.

The asymmetrical features characteristic of the “centre-periphery” system, the need to adopt active “development from within” strategies (including those designed to deal with the special problems caused by “structural heterogeneity”) and the critically important role of regional integration are thus three central elements in Prebisch’s thinking. In the rest of this paper I shall seek to show their ongoing importance in the development agenda of this dawning twenty-first century.

2. International asymmetries

The tendency towards the further expansion of inequalities has been a persistent feature of the world economy for the last two centuries. Empirical studies show that convergence of per capita income levels has been a relatively rare occurrence and has been limited in fact to the most highly industrialized countries in the period after the Second World War and, in particular, during the 1950-1973 “Golden Age”. It was not a feature of the industrialized countries before that war (Maddison, 1991), nor has it been a feature of the developing countries since then (Ros, 2000, chap. 1). There have been episodes of rapid growth in the developing world in certain periods, however. In fact, Latin America was the fastest-growing region in the world between the two world wars, and some Asian countries have led the world in growth in some periods after the Second World War: the oil-producing countries of the Middle East, the “Asian Tigers”, and China and India in different sub-periods (Maddison, 1995). Except in the case of Japan, however, these processes have not brought about convergence with the patterns of development of the industrialized world, and in most cases they have now been interrupted. It may be added that even within Latin America there is no clear tendency towards convergence: the inequalities which grew up a century or so ago have tended to persist over time (Cárdenas, Ocampo and Thorp, eds., 2000a, chap. 1, and 2000b, chap. 1).

The persistence and even accentuation of these international inequalities has occurred despite the impressive industrialization process registered by the developing countries in the last half-century (and even earlier in Latin America). This process has been reflected in greater diversification of the structure of

production of the developing world, except in the most backward areas. Serious imbalances have persisted, however, in the structure of production at the world level: there is a high degree of concentration of technical progress in the centre countries, which has determined their sources of competitiveness; they have continued to dominate the world in the production of machinery and equipment, and they also continue to predominate in the make-up of the great transnational corporations.

The most important consequence of the imbalances in the world economy is that the economic opportunities of the developing countries continue to be largely determined by their place within this international hierarchy. There has undoubtedly been some “spread of technical progress” from the centre, through the channels already mentioned. In the words of Prebisch, however, this spread has continued to be “relatively slow and irregular”, and its benefits have been distributed unequally among the developing countries, thus maintaining or even accentuating their “structural heterogeneity”. Within the context of the “moving target” represented by the world technological frontier (Pérez, 2001), only a few countries –and few sectors and enterprises within them– manage to move faster and thus reduce their technology lag; many others only manage to more or less keep up with the advance of the frontier, and quite a few fall back.⁸

Furthermore, the vulnerability of the developing countries to external shocks continues to be very high and has even tended to worsen with the growing integration of the world economy. The nature of this vulnerability has been changing over the last half-century, however. Although the transmission of external shocks through trade –both directly, through lower sales, and indirectly, through the cyclical deterioration in the terms of trade– has continued to be important, financial shocks have now taken on the leading role, repeating patterns which had already been observed in the past in many Latin American countries, especially during the financial boom and bust of the 1920s and 1930s.

This vulnerability is the result of basic imbalances in the financial structures and in macroeconomic dynamics, especially the depth of financial development and the degree of macroeconomic autonomy of the countries (Ocampo, 2001c). There are four basic financial asymmetries: i) the disparity between the size

of the financial markets of the developing countries and the speculative pressures they face;⁹ ii) the nature of the currencies in which the external debt is denominated; iii) the structures of maturities provided by the financial markets, and iv) the scope of the secondary markets. These last three characteristics mean that in developing countries, those agents who have access to international markets (the government and large firms) are subject to currency mismatches, while those who do not have such access (small firms) are subject to maturity mismatches, but it is generally impossible to secure a financial structure which simultaneously obviates both these risks. All in all, this means that the financial markets of developing countries are much more “incomplete” than the international markets, so that part of the financial intermediation must necessarily take place through the international market. It also means that international financial integration is integration between unequal partners.¹⁰

The macroeconomic asymmetries, for their part, are associated with the fact that the international currencies are those of the industrialized countries and with the nature of capital flows: whereas the capital flows among developed countries are of a counter-cyclical nature (Eatwell and Taylor, 2000), those between developed and developing countries are clearly pro-cyclical. This behaviour is connected with the residual nature of capital flows to developing countries or, to use the terms coined by Palma (2001), the fact that the latter countries are “debtors of last resort”.

The overall result of these factors is that whereas the industrialized countries have more leeway for adopting counter-cyclical macroeconomic policies –and this leeway is even greater in the case of the United States than in the other industrialized economies, since the U.S. dollar is the main international currency–, which thus gives rise to a stabilizing response from the financial markets, in contrast the economies of the developing countries largely lack such leeway, since the financial markets tend to accentuate the cycles and the market actors expect the authorities to behave in a pro-cyclical manner. Looking back over the past, this has meant that whereas the industrialized countries were largely able to free themselves from the rules of the gold standard, those rules continue to determine the macroeconomic behaviour of the developing countries and have even become increasingly influential in this

⁸ For recent information on this topic, with regard to Latin America, see Katz (2000) and ECLAC (2001a).

⁹ See, for example, Council on Foreign Relations, 1999, chap. III.

¹⁰ ECLAC, 2000, chap. 8, and Studart, 1996.

respect. Thus, the macroeconomic imbalances between the centre and the periphery which were characteristic of the gold standard era (Triffin, 1968; Aceña and Reis, eds., 2000) have been further aggravated. Although multilateral arrangements –especially the intervention of the International Monetary Fund– provide short-term relief, they are aimed at ensuring the adoption of austerity measures during crises: a “depression (macro)economics”, to use the expression of Krugman (1999). To be more specific, the characteristic feature of the economies of the developing countries is the alternation of boom and depression macroeconomics (ECLAC, 2000, chap. 8, and 2001b).

There is also a further asymmetry in the international economy which is associated with the contrast between the growing mobility of capital and the restrictions on the international mobility of labour, especially less-skilled labour. As Rodrik (1997) has indicated, asymmetries in the international mobility of the different factors of production give rise to pressures in income distribution which favour the most mobile factors and adversely affect the less mobile ones. These imbalances have a “centre-periphery” component in that the developing countries have a relative abundance of the least mobile factors of production: unskilled labour and natural resources. Indeed, the absence of international mobility of labour was seen by Prebisch (1951) as a basic flaw in the international economy which played an essential role in the tendency towards the deterioration of the terms of trade of the developing countries.

Finally, it should be added that the international economy is also marked by basic imperfections which are of a “systemic” rather than a “centre-periphery” nature. The first of these is the contrast between the rapid development of markets and the lag in building global governance, which has led to a sub-optimal supply of “global public goods” (Kaul, Grunberg and Stern, eds., 1999). The second is the enormous difference between the rapid globalization of some markets and the flagrant absence of a true international social agenda or, more precisely, the lack of effective international instruments to ensure the fulfillment of the development goals which are periodically reiterated, most recently in the United Nations Millennium Declaration. The third is the incompleteness of the international agenda, which also has, to some extent, “centre-periphery” dimensions, in view of the absence of issues of great interest to the developing countries, such as international mobility of labour or the more rapid opening-up by the developed countries of markets

which are of great interest to the developing nations (Ocampo, 2001a).

The analysis thus indicates that the global agenda should include “systemic” issues, connected with the supply of “global public goods”, as well as those connected with the correction of the existing international asymmetries. These “centre-periphery” issues fundamentally involve correction of the asymmetries in the fields of production and technology, the financial and macroeconomic asymmetries which are responsible for the high degree of cyclical vulnerability of the developing countries, and those associated with the different degrees of international mobility of the factors of production.

After the establishment of UNCTAD, under the direct influence of Prebisch,¹¹ there was explicit recognition of the need to correct the imbalances which marked, and continue to mark, the international economic system. The pledges with regard to official development assistance and “special and differentiated treatment” for the developing countries in trade were among the partial, albeit relatively frustrating, results of this effort to construct a “new international economic order”. In recent decades, however, this approach has been seriously eroded (ECLAC, 2001c, chap. VIII) and has been replaced with an alternative model whereby the basic goal in reordering the international economy should be to ensure a “level playing field” to guarantee the efficient functioning of the free market forces. In this new scheme, the main benefits for the developing countries lie in the eventual dismantling of the industrialized countries’ protection of “sensitive” sectors, the guarantees offered for export development by an international trade framework with clear and stable rules, and the design of preventive macroeconomic policies which will serve as automatic protection against international financial volatility. In this approach, the aim of correcting international imbalances is only maintained in terms of the acknowledgement of international responsibility vis-à-vis the least developed countries, thus repeating at the international level the idea that social policy should be a strategy designed to target State action on the poorest sectors.

Although all these actions are desirable, will they be sufficient in themselves to give rise to greater convergence of development levels? In view of the foregoing considerations, the answer may be no. This

¹¹ See, for example, his first report to UNCTAD (Prebisch, 1964).

agenda does not address the asymmetries which tend to generate divergences in development patterns. Moreover, ensuring a “level playing field” implies imposing restrictions on the developing countries, especially the middle-income ones, which the industrialized countries themselves never faced in earlier periods of their history: standards of intellectual property protection typical of countries that generate technology, and limitations on the adoption of policies designed to promote new sectors of production, whether for the domestic market or for export (Chang, 2001). Finally, the problems generated by a manifestly incomplete set of international financial institutions, together with the policy of less intervention in financial markets in order to avoid “moral hazard” and the measures designed to reduce the risks run by large financial agents (the higher risk weighting proposed in the new Basle Committee bank regulation criteria), may end up by helping to “solve” the problem of capital account volatility in the most undesirable way: by bringing about an excessive rise in the cost of external indebtedness for the developing countries and thus possibly leading to a permanent reduction in capital flows to them.

In these circumstances, the design of a balanced international agenda inevitably calls for the correction of the imperfections in the international economic system through action in three areas: i) the application of mechanisms to speed up the “spread of technical progress” from the centre by different forms of “special and differentiated treatment”; ii) efforts by the international financial institutions to increase the developing countries’ leeway for adopting counter-cyclical macroeconomic policies, to check the concentration of credit by placing resources at the disposal of countries and agents which do not have access to credit on private international markets, and to speed up the financial development of the developing countries, as the only way of offsetting in the long term the imbalances that mark the international financial system, and iii) to ensure that international mobility of labour receives the same attention on the global agenda as the international mobility of capital.

3. Development from within

In Prebisch’s view, the importance of action to correct the imbalances characterizing the international economic system necessarily involved recognition of the equally important role of the policies adopted by the developing countries themselves to transform their

economic and social structures. Correcting those imbalances would help to establish an “enabling environment” for the efforts to generate “development from within”.

It is now generally recognized, at the institutional level, that a development strategy must help to generate solid social compacts which will ensure political stability; non-discretionary legal systems and forms of behaviour of the agents which will make contracts secure; and an impartial and sufficiently efficient State bureaucracy. Although these institutional frameworks serve as the backdrop for the development process, however, they do not explain the concrete growth impulses that economies receive, nor their exhaustion.¹² These impulses are related more directly with the matters mentioned in the previous sections: the reduction of macroeconomic and financial vulnerability, the rate of change of the structure of production, and the connections between growth patterns and equity, especially the “structural heterogeneity” of the productive sectors.

a) *Reducing macroeconomic and financial vulnerability*

As already noted, the emphasis in the first of these fields has been shifting from trade-related matters, on which Prebisch largely concentrated his attention, to those of financial origin. In this respect, Latin America’s experience in recent decades makes it possible to deduce some “stylized facts” which should be borne in mind for designing better macroeconomic policies (ECLAC, 2000 and 2001b; Ffrench-Davis, 1999; Ocampo, 2000):

- i) There is no simple definition of macroeconomic stability. The return to fiscal discipline and low rates of inflation has not been reflected in greater stability in real terms, that is to say, in GDP growth and greater employment. Nor has it been reflected in better results in the external accounts, since private deficits have not been kept under control. Consequently, concern for the soundness of the fiscal accounts must be accompanied by measures to prevent the accumulation of unsustainable private deficits.
- ii) Real stability is also costly. It gives rise to defensive strategies by firms, which put off their investment

¹² In the terminology used by Maddison (1991), they refer to the ultimate causes rather than the immediate causes of economic growth. See also Ocampo (2001b).

decisions, thus causing adverse effects on economic growth. In downward phases of the cycle there are also irreversible losses of both tangible and intangible business assets (“tacit” technological and organizational know-how, trade contacts, reputation of the firm), especially when those phases are accompanied by financial crises. For these reasons, there is an inverse relation between economic growth and real instability. As we shall see below, serious social imbalances are also generated during the cycle.

- iii) In financial matters, balance sheets are just as important as flows. Financial crises have been originated not only by unsustainable current account deficits, but also by unsuitable financial structures in the public and especially the private sectors: that is to say, structures which have an excessive proportion of short-term liabilities or are open to risks from higher interest rates or rates of devaluation.
- iv) In the absence of a fiscal policy with a medium- or long-term horizon, backed up by suitable institutions (stabilization funds), keeping fiscal deficits low is really a pro-cyclical policy approach. It encourages expansion of spending during boom periods on the basis of transitory public revenue. Subsequently, however, the cuts made due to short-term falls in revenue aggravate crises and thus lead to further reduction of public sector revenues.
- v) In the developing countries, monetary policy autonomy is limited under all exchange-rate regimes. This fact has always been recognized in connection with fixed or semi-fixed exchange-rate systems, but in fact the same thing occurs when interest rates are managed in a pro-cyclical manner in flexible exchange-rate regimes in order to avoid exchange rate fluctuations. In view of the vital role played by the exchange rate in open economies –it is a determinant both of competitiveness and of price levels– some degree of intervention in foreign exchange markets may be necessary, but pro-cyclical management of interest rates is undoubtedly the wrong road to follow. For this reason, in spite of its limitations prudential regulation of capital flows can do a lot to increase the autonomy of monetary policy.
- vi) Credibility is not necessarily attained by the use of “automatic pilots”. If capital flows are pro-cyclical, explicit renunciation of monetary policy autonomy (as for example by adopting systems based on a currency board or the use of a foreign

currency as an anchor) can result in more severe economic cycles. In that case, it is quite possible that the market may not validate the hypothetical increase in “credibility” by reducing the country risk accordingly. Furthermore, the country loses some degree of freedom to cope with external or domestic shocks. In both cases, the private agents may question the sustainability of the rules themselves and the high costs of breaking them. Prudent management of macroeconomic flexibility may therefore be a better way, in the long run, to build up greater policy credibility than the adoption of excessively rigid rules.

These lessons indicate that the concept of macroeconomic stability should be expanded to include not only price stability and the maintenance of low fiscal deficits, but also stability of economic growth rates, employment, the external accounts and the national financial systems, as well as the use of pluriannual horizons in fiscal policy design. They also mean that it must be recognized that the authorities are faced with complex dilemmas in seeking to ensure macroeconomic stability in this broad sense of the term, since there is no simple, straightforward association between its different components.

The most promising approach in order to achieve this result would appear to be to pragmatically combine three sets of policies. The first of these is made up of consistent but flexible macroeconomic policies –fiscal, monetary and exchange-rate– designed to prevent the public and private agents from building up heavy debts, to avoid the generation of imbalances in the most important macroeconomic prices (the exchange rate and interest rates) and in the prices of fixed assets and securities in boom periods, and to facilitate reactivation in the event of crises. The second is a stringent system of prudential regulation and supervision of financial systems, with a clear counter-cyclical orientation, which provides for stricter rules in periods of financial euphoria in order to counteract the increasing risks run by intermediaries at such times. The third element is a “liability policy” designed to ensure that a suitable profile of internal and external debt maturities is maintained in the public and private sectors (ECLAC, 2000, chap. 8; Ocampo, 2000).

Prudential regulation of the capital account, applied in periods of euphoria in order to prevent over-indebtedness, can play a vital role as a “liability policy”, promoting an external finance structure in which long-term liabilities predominate, but also, as already noted,

as an instrument designed to give monetary policy more leeway to adopt counter-cyclical policies. In the long term, however, the main instrument for breaking the asymmetries typical of the international financial system, which are accompanied by the pro-cyclical macroeconomic performance of the developing countries, is deeper financial development in those countries which will ensure suitable development of the long-term segments of the market and of the corresponding secondary securities markets.

Applying counter-cyclical macroeconomic policies is no easy task, since the international financial markets generate strong incentives to over-spend during periods of financial euphoria and over-adjust during crises. For this reason, counter-cyclical macroeconomic policies of the developing countries must be backed up by suitable international institutions. In particular, international financial institutions must take on the essential function of offsetting the pro-cyclical effect of the financial markets, damping down financial cycles from their source by suitable regulation in the industrialized countries, and must also give the countries more leeway to adopt counter-cyclical policies, both through suitable surveillance and incentives to reduce macroeconomic and financial risks at times of euphoria, and through mechanisms to soften adjustments when there are sudden interruptions in capital flows (Eatwell and Taylor, 2000; Ocampo, 2001c).

b) *Dynamic changes in production patterns*

Greater macroeconomic stability, even in the broad sense in which we have defined this term, is a necessary but not of itself sufficient condition for rapid economic growth. This is precisely what the various historical variants of structuralist economic thinking, to which Prebisch belongs, are trying to get across when they emphasize that different economic sectors have very different capacities to “spread technical progress” and, ultimately, boost the economy, generating a strong interaction between structural change, investment and economic growth. In this view, the leading role played by some sectors and companies, which form the “dynamic nucleus” at any given point in time, is the essential element in economic growth.

Many schools of thought have analysed the features of these structural dynamics. Some of them have noted that, because of the complementarity (linkages) between production firms and sectors, the macroeconomic and distributional effects of the growth

of a sector can give a strong boost to the growth process or, alternatively, halt it (Rosenstein-Rodan, 1943; Taylor, 1991; Ros, 2000). These sectoral dynamics can give rise to successive phases of imbalance, as noted by Hirschman (1961). Technological dynamics can also give rise to processes of “creative destruction”, to use the terminology of Schumpeter (1962, chap. VIII). Since technical knowledge, and indeed knowledge in general, is not transmitted through detailed manuals, the growth path of firms involves an intense adaptation and learning process which is intrinsically linked with the experience acquired in the production process and largely determines the capacity for the accumulation of technical, commercial and organizational know-how (Katz, 1976; Amsden, 2001).

Although other formulations could be used, one which captures the essence of structural dynamics centres on two fundamental concepts: i) innovations and the associated learning processes, and ii) the development of production linkages (ECLAC, 2000, chap. 9; Ocampo, 2001b). In this context, “innovation” must be considered to cover every new way of doing things: not only new technologies, but also the development of new sectors or products, new marketing strategies, and the opening of new markets. In the developing countries, many of these “innovations” are associated with the successful adaptation of technologies and activities developed earlier in the industrialized world, in this case through import substitution and/or export promotion. All innovations, in this broad sense of the term, involve learning and dissemination processes, many of them marked by the generation of dynamic economies of scale. This also applies to technological innovation and the development of new productive sectors, as well as new marketing networks, in which such economies are associated with the reduction of transaction costs over time. The second concept highlights the role of the externalities which the economic agents and sectors generate among themselves (Hirschman, 1961) and which determine the degree of “systemic competitiveness” of the relevant production structures (ECLAC, 1990).

These ideas have been used recently by a number of authors to bring out the need for a production development strategy as a fundamental ingredient of a dynamic developing economy, a long-standing subject in the literature on “late industrialization”. In line with an old tradition in industrial policy, Chang (1994) has highlighted the importance of lowering the “coordination costs” associated with the development of new sectors subject to substantial complementarities.

Rodrik (1999) has pointed out the importance of a “national investment strategy” which would make it possible to give an initial boost to growth, while ECLAC (2000) refers to the need to adopt a structural change strategy. Amsden (2001), for his part, has emphasized the crucial importance of close collaboration between the State and the business sector and the need for “mutual control mechanisms” which establish a link between incentives and results, so that incentives do not simply become a source of “rent-seeking”.

This interpretation brings out one of the most important characteristics of successful cases of development in the past: a strong industrialization drive based on firm and close collaboration between the State and the private sector. Can it be that the opening-up of markets will do away with the need for active production development policies?

The results obtained so far in Latin America are not very encouraging in this regard as in the last decade of the twentieth century, the fastest export growth in the economic history of the region was accompanied by only mediocre economic growth. The “destructive” elements deriving from the disintegration of domestic production linkages and national innovation systems have been stronger than the opportunities generated by the expansion of transnational corporations or export development patterns which make highly intensive use of imported inputs or natural resources (ECLAC, 2001a). Figure 1 sums up this situation, showing that the economic growth rate in the 1990s was over two percentage points lower than that of the 1950s to 1970s, but gave rise to a trade deficit similar to that of the 1970s and higher than that of the two earlier decades. Furthermore, as noted in UNCTAD (1999, chap. IV), this adverse shift in the relation between economic growth

and the trade balance is virtually universal in the developing world.

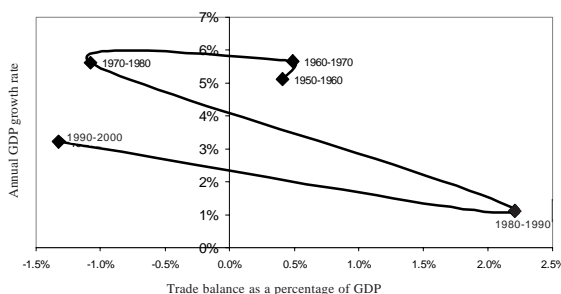
All this emphasizes the importance of combining macroeconomic stability, in the broad sense, with an active production development strategy. According to the foregoing considerations, the two essential elements of such a strategy are: i) to speed up the rate of innovation, including the transfer of technology, the development of new production sectors and the conquest of new markets, and to support the learning processes involved in all these processes; and ii) to promote the reduction of coordination costs in order to exploit the synergies between enterprises and production sectors which help to generate “systemic competitiveness”. This policy requires a considerable institutional and organizational effort in order to develop the right instruments for today’s open economies, with a view to playing an active part in international markets. These efforts will have to be all the greater to the extent that the old intervention arrangements have been dismantled or significantly weakened during the liberalization phase of the economies in question.

A policy of this type also requires that the international community should recognize that such strategies are an essential component for dynamic growth of the developing countries. In the light of the problems currently being faced by those countries in seeking to bring about a dynamic change in production patterns, this means that “special and differentiated treatment” must be given in three areas: i) intellectual property protection schemes which help to promote the transfer of technology; ii) temporary promotional arrangements for import substitution industries; and iii) especially in the present conditions, temporary promotional arrangements for new exports (“infant export industries”), through the use of incentives designed to diversify the exportable supply and mechanisms to make it possible to increase the national content of exports (for example, through sectoral agreements backed up by agreements on export performance). All this obviously means seeking the right instruments to ensure that these mechanisms do not give rise to sterile competition among countries to attract industries that are candidates for relocation.

c) *The effects of economic changes on equity*

The deep significance of Prebisch’s observations on the difficulties that industrialization has faced in the developing countries in general, and in Latin America in particular, in

FIGURE 1
The trade balance and GDP growth rates



Source: ECLAC.

absorbing labour is shown in figure 2. Both at the beginning (1950) and the end (1980) of the most rapid industrialization phase, the share of industrial employment in total employment in Latin America was nearly ten percentage points smaller than that which had been displayed by the countries of the Organization for Economic Cooperation and Development (OECD) when (about half a century earlier) they were at the same levels of per capita GDP. Excess labour was absorbed first by the rural sector, but by 1980 the majority of the labour force was employed in urban services. In the light of the form of absorption of excess labour that characterized the mid twentieth century, Prebisch (1951) associated that phenomenon with the deterioration of commodity prices. Three decades later, it had become a source of pressure on urban income distribution in Latin America.

The concept of “structural heterogeneity” developed by Pinto (1970) to take account of this phenomenon is undoubtedly preferable to the traditional concept of “dualism”, because the heterogeneity characteristic of developing countries and societies cannot be described simply in terms of the contrast between a “modern sector” and a “traditional sector”, since low-productivity sectors are constantly arising and changing, and only a few segments that lag behind can be defined as “traditional”. This is what happened in Latin America in the 1990s: the region generated more “world-class” firms (many of them subsidiaries of transnational corporations) capable of successfully integrating into the world economy, but at the same time there was an increase in low-productivity activities, which absorbed seven out of every ten urban workers (ECLAC, 2001a and 2001d).

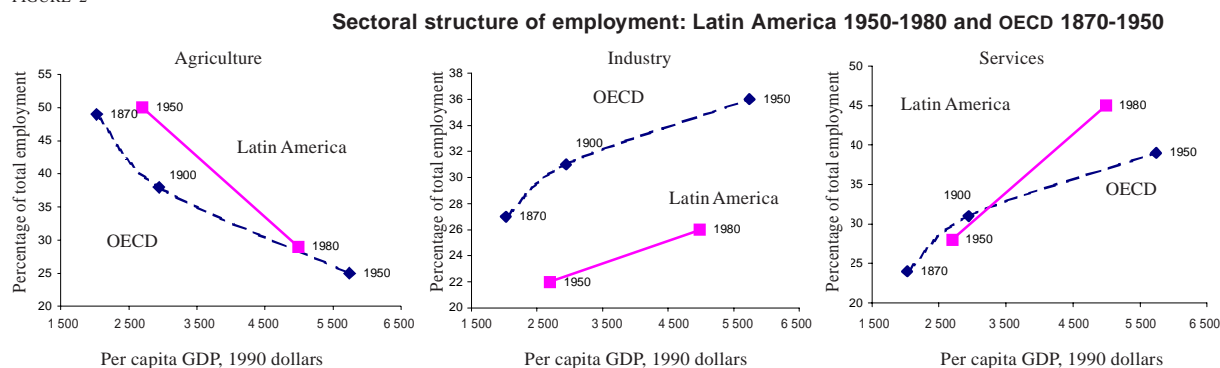
Structural heterogeneity means that there are no automatic mechanisms which will ensure that rapid

technological innovation in dynamic sectors will promote general economic growth. In the absence of suitable internal linkages, or when the “destructive” effects of production restructuring and the defensive microeconomic strategies that accompany them are predominant, structural heterogeneity can even become more pronounced. If this happens, the effects on economic growth will only be weak and there will be still further pressures on employment and equity (see for example Taylor and Vos, 2001).

The linkages between the modernized dynamic sectors and the rest of the economy are therefore important not only for growth but also for equity. Production development strategies can play a fundamental role in promoting such linkages. The evidence also shows that good distribution of assets which gives rise to a universe of solid small enterprises is associated with better income distribution and less concentration of power in general. Policies designed to democratize the access of small urban and rural producers to production assets –capital, technology, training and land– are therefore of the greatest importance, both in terms of growth and of equity.

In addition to these linkages of a structural nature, there are also others associated with macroeconomic volatility: the serious asymmetries in the social effects of business cycles. Thus, in the downward phases of cycles jobs are destroyed and there is an increase in poverty, but when the economy returns to the pre-crisis level of per capita GDP, this does not necessarily mean that there is a return to the previous levels of unemployment or poverty. This is certainly what Latin American history of the last two decades shows: although in the mid-1990s per capita GDP returned to the levels of before the debt crisis, even by the end of

FIGURE 2



Source: Maddison (1989, 1995).

the decade the pre-crisis levels of poverty had still not been restored. It may be added that at the level of the individual, unemployment has a permanent effect on workers' careers: the loss of working experience, reputation and connections means that when workers find employment again they earn significantly lower wages or else are only able to enter the labour market again through self-employment activities (ECLAC, 2001d). The problems are obviously even more serious when the need to contribute to the family's income forces young people to abandon their studies, thus permanently affecting their future careers. Furthermore, when there are no institutions to protect workers against unemployment, unstable demand for labour is in itself costly in social terms.

These interconnections of economic growth patterns with equity highlight a basic fact: equity undoubtedly depends on very active social policy, but it does not depend solely on that. The rate and stability of economic growth are also important, and so too in particular is the way in which patterns of change in the production sector help to reduce or increase "structural heterogeneity". For this reason, even ambitious efforts in the field of education will be futile unless there is dynamic generation of good-quality jobs. When this is absent, the hypothetical connections between human capital accumulation and growth do not materialize, and instead there is still greater "educational devaluation" (occupation of the same jobs by persons of a higher educational level) or emigration of well-educated labour abroad.

The persistent and even increasing levels of urban informal employment and the increase in non-permanent jobs clearly show the importance of universal, solidary and integral social security policies which include measures to incorporate informal-sector workers and (depending on the degree of development of the countries concerned) to advance towards the provision of unemployment insurance. It is also important to initiate arrangements to promote greater adaptation of the labour force to technological change and to business cycles, so that unemployment will not be the basic means of adjustment: especially arrangements that combine aggressive labour training policies with a "social dialogue" at the national, sectoral or enterprise level in order to restructure production sectors within a framework of stable employment (ECLAC, 2000, chap. 5). Social safety nets and permanent schemes for the timely initiation of emergency employment programmes should be viewed, in this context, as intermediate arrangements that should

develop, in the long term, into integral social security systems.

The above-mentioned interconnections also show the importance of designing integrated policy frameworks. One of the weakest points in this respect is the lack of institutions that facilitate this. In the last two decades there has even been a tendency to strengthen the macroeconomic institutions disproportionately, not only over the social institutions but also over those responsible for production development policies. It is therefore necessary to radically reorient the institutional schemes in order to build up systems which make possible coordination between the economic and social authorities, in which social priorities are incorporated as a central part of economic policy design, and which make visible both the immediate and the structural social effects of economic policies.

It should be noted that the foregoing considerations do not of course cover all the positive linkages that can exist between equity and development: apart from the interactions between human capital and good-quality employment and the beneficial effects of better distribution of production assets, there are also favourable economic policy linkages, positive effects on the capital market, and links between social cohesion, investment and productivity. The relations between equity and development were one of the favourite subjects of the development literature of the 1960s, and fortunately they have also come to occupy a leading place in recent economic debate (see for example Ros, 2000, chap. 10). It may be noted, however, that not all connections are positive. Thus, Prebisch's later work (Prebisch, 1976, 1981 and 1987) is full of reflections, based on the Latin American experience of those years, on the way in which pressure on wage levels and public expenditure can generate forms of macroeconomic instability which end up by interrupting economic growth.

4. Regional integration

In the classical views of integration associated with Prebisch's thinking, the history of Latin American integration holds a double paradox. On the one hand, the protectionist forces which prevailed in the region in the 1960s and 1970s gave rise to integration processes which fundamentally restricted their scope to non-competitive sectors. Thus, one of the fundamental virtues of integration, the rationalization of import substitution (ECLAC, 1959), was only achieved to a very

limited extent. Moreover, during the debt crisis of the 1980s the regional integration schemes were on the point of collapsing because of the generalized use of protection and competitive devaluation as means of adjusting the economies.

The vigour displayed by the regional integration process from the late 1980s on was likewise paradoxical, for in the most orthodox views that dominated development concepts at that time integration was seen as a source of distortion of trade flows. The fact that unilateral trade openness coincided with the revitalization of regional integration was therefore a belated concession to the views which had served to justify regional integration in previous periods and, in particular, to the idea that integration was a source of creation rather than diversion of trade and, moreover, a source of trade flows with a greater content of technology than those resulting from unilateral openness.

These virtues have in fact materialized in practice. Thus, the growth of intra-regional trade was extremely vigorous between 1990 and 1997, especially in the two South American integration agreements –MERCOSUR and the Andean Community– where such trade grew by a factor of 5 and 4.2, respectively, during those years. As a result, there was a reversal of the historical situation whereby the intensity of intra-regional trade was greater for the smaller economies. By 1997, the greatest relative intra-regional trade flows were in MERCOSUR. All the regional integration agreements still have a long way to go, however, if the yardstick is the European Union, where intra-regional trade has represented around 60% of total trade in recent decades. It should also be noted that intra-regional trade suffered a pronounced drop with the Asian crisis. The hardest-hit flows were those among South American countries, but these recovered strongly in the year 2000. This indicates that the elasticity of such trade to economic activity is now very high (ECLAC, 2001c).

Furthermore, the intra-regional trade flows consist to a substantial extent of manufacturing goods, especially those of higher technological content. This pattern is particularly evident if we exclude Mexico, whose sales of manufactures to the United States have grown rapidly since the signing of the North American Free Trade Agreement. In 1999, for example, 81% of intra-regional exports corresponded to manufactures, compared with 65% of total external sales (excluding Mexico). The contrast is even greater when only non-traditional products are included. In this case, intra-regional trade then absorbed 35% of exports of

manufactures, concentrated in products with the highest content of technology.

The view that there is a relation of complementarity between general trade openness processes and integration was branded by ECLAC (1994) as “open regionalism”. This complementarity indicates that, in spite of the advances made in information and communications, external economies and economies of scale (including economies of specialization) and the transaction costs associated with geographical distance continue to be substantial. The latter include not only transport costs, but also those associated with the establishment of trade networks, especially those involving small and medium-sized firms. Regional processes also make it possible to advance further in the harmonization of the rules affecting economic activity and to promote deeper economic relations which also have effects on trade. This is why regional networks create additional trade, over and above that created through unilateral trade openness.

It should be noted, however, that the new regionalism differs from similar efforts made in the past because of the increased number of areas of action involved and the scope of tariff liberalization. Nevertheless, efforts to secure convergence of the existing agreements in order to form areas of larger relative scale and measures to build up customs unions continue to be pending issues, and the existing institutions are still somewhat fragile.

In addition to trade itself, the future of regional integration also clearly depends on the “depth” of the corresponding agreements. In this era of globalization, the space available for regional-level arrangements depends on two different forces. The first of these is the tendency towards the weakening of national autonomy, which means that the efficacy of policies is shifting to the regional or global levels. The second is the relative weight, in these processes, of two factors: i) the regional (rather than the global) scope of the “public goods” that it is sought to promote; if they are not of truly global scope, the principle of subsidiarity would indicate that they should be handled at an intermediate (regional) level; ii) the capacity of the different institutions to generate a sense of “ownership”; from this point of view, the subregional and regional levels are at a marked advantage.

In macroeconomic and financial matters, the loss of autonomy is obviously an ongoing process, so that, as we already noted, there is a need not only for global action, but also for arrangements at the regional level. Possible coordination of macroeconomic policies could

be a first area for action. Indeed, the demand for action of this type has been heightened by the great vulnerability of intra-regional trade to the recent business cycles. However, the difficulties involved in this process have been brought out clearly in the three decades of experience accumulated by the European countries in this field. In the short term, therefore, the objectives in this respect should be relatively modest.

A measure which is highly complementary to the foregoing would be the establishment of mechanisms to coordinate policies for the prudential regulation and supervision of financial systems. A desirable objective in this field would be the development of mechanisms for the mutual supervision of such policies and, perhaps, the design of minimum standards which are more specific than those of the Basle Rules. The fact that some of the main international banks are operating in a number of countries of the region further emphasizes the importance of coordination in this area, in order to secure more suitable regulation and supervision and to avoid arbitrage by these banks between different regulatory systems.

As emphasized in ECLAC (2001b), similar attention should be given to the development of regional and subregional financial institutions. In this respect, Latin America and the Caribbean already possess important assets in the form of a network of multilateral development banks comprising the Inter-American Development Bank, the Andean Development Corporation, the Central American Bank for Economic Integration, and the Caribbean Development Bank. Furthermore, the experience already built up by the Latin American Reserve Fund (FLAR, formerly the Andean Reserve Fund) opens up the possibility of giving support to countries in crisis with extraordinary resources of regional origin, either through significant expansion of the membership and resources of FLAR, or through mutual support arrangements (through swaps) between Central Banks.

The advance of trade itself also creates a demand for harmonization of the different regulatory schemes. This includes harmonization of technical regulations (including phytosanitary regulations), customs codes, government purchasing standards, and those governing the supply of services. Some progress has already been made in some of these fields in the region. It is also important to make similar progress in other fields, especially as regards rules on competition and the regulation of public utilities. With respect to the first-named of these, it may be noted that there are reasons for believing, on the basis of the experience of Europe,

that as common markets and an active process of intra-regional investment become more firmly established, regional agreements on competition, and the eventual adoption of a common policy on competition, have obvious advantages over rules on unfair competition which apply solely to foreign trade. Among other things, a framework of this type would also make it possible to cope more effectively with possible anti-competitive practices by big transnational corporations.

Furthermore, the considerable proportion of goods with a high technological content in intra-regional trade points to the possibility of joint action to develop the corresponding sectors, but of course without the rigidities of the old (and mostly unsuccessful) sectoral complementation agreements. Such action should rather form part of broader schemes to complement the efforts being made in the field of technological research and development, which should also serve as a means for the transfer of technology to the relatively less developed countries.

In the area of physical infrastructure, in addition to developing harmonized rules on transport, energy and telecommunications it is extremely important to develop infrastructural networks conceived with a view to regional and not solely national integration. The development of infrastructure with this aim in view also highlights the need to visualize spaces as common rather than purely national. An interesting case in this respect was the establishment in 1994 of the Association of Caribbean States, in order to promote greater cooperation in that subregion. Steps have also been taken towards this type of objective in the case of sustainable development, specifically of shared ecosystems (the Amazon and Andean areas, or the Mesoamerican Corridor) or river basins. The establishment of various plans for border area development is another example of the change caused by integration.

Going beyond all this, there are also the immense possibilities opened up by social and political integration. The agreements on cultural matters and education—some of them associated with the first stages of integration—are only the first small step towards an integration agenda centered on social development. The “democratic clauses” of integration agreements and the various forums in which the Heads of State of the region now meet, together with the incipient subregional and Latin American parliaments, are further examples of promising initiatives on the broad agenda of political integration.

These considerations show that regional integration, based on the principles of open regionalism, has a

promising future whose actual materialization will depend on the political will of the parties concerned. Indeed, their ability to survive within a hemispheric free trade area or within the process of globalization will depend on their capacity to deepen their achievements by further developing the agenda outlined above.

At all events, Prebisch's categorical admonition continues to be fully valid, not only in relation to trade but also to the international economic (and political) system as a whole: "There is an aspect of fundamental importance to which the governments of the developing countries have not paid sufficient attention. We have

not yet managed to break out of the isolation these countries inherited from the old pattern of the international division of labour. Thus, the greater part of world trade has been among the centres themselves. The trade of the developing countries has converged on those centres, overlooking the enormous potential of mutual trade, although it should be recalled that, ever since its earliest days, ECLAC has vigorously advocated such a structural reform of world trade" (Prebisch, 1987, p. 29).

(Original: Spanish)

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Prebisch: the continuing *validity of his basic ideas*

Octavio Rodríguez*

1. Introduction

Prebisch's analytical contributions, which are particularly valuable and numerous in the fields of development theory and policy, have sometimes been called "pre-economics". This term is used to denote those points of view which seem to be based on and justified by common sense—for example, the desirability of industrialization and of the application of protection in order to achieve this—but which are at variance with conclusions backed up by economic science.

The present article takes an opposite view to this. It begins by briefly presenting Prebisch's seminal ideas—that is to say, the so-called "centre-periphery concept"—, going on to show succinctly that those ideas are reshaped and formalized in both economic theory and policy analyses based on the patterns of coherence of conventional economics (section 2). His basic ideas and their subsequent formal expression thus form a special field of economic theory which may be termed a "theory of underdevelopment".

This latter theory forms the main basis of Latin American structuralism. In reality, however, the true importance of that theory—that is to say, of the set of contributions by Prebisch which make it up—becomes

"manifest" in its appropriateness for analysing some of the priority issues of recent Latin American development (section 3). In the light of certain notable aspects of the current technological revolution and the globalization process that accompanies it, these contributions are useful for addressing problems which seem to be getting worse, such as unemployment and underemployment, and others which repeatedly arise in the external sector. Furthermore, these conceptual bases are also useful as a framework for the debate on the conditions of viability and efficiency needed to renew the development effort.

The application of Prebisch's ideas and contributions to the present situation highlights their key (and also general) substrate: the perception of development as a dynamic of the structures of production of goods and services and of labour force employment: that is to say, as a set of changes in the sectoral and subsectoral composition of those structures which are inherent to their expansion and growing complexity.

If we go along with Prebisch's view that the market is not capable of inducing these changes alone, this means that the structural perception of development referred to earlier is hence "non-reductionist": that is to say, it is a perception whereby the analysis of economic phenomena must fit within a broader framework of social and political phenomena. This methodological implication means that we must reconsider the whole matter of the State and question

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certain quasi-minimalist positions on its role, which seem to be compromising the development of various Latin American countries and adversely affecting the already serious levels of inequality prevailing in the region.

2. Main contributions

The concept of the centre-periphery system was originally expressed in the essay entitled “The economic development of Latin America and its principal problems”, which was republished a little later in the first five chapters of the *Economic Survey of Latin America, 1949*.¹

It will be seen below that this concept consists of a set of ideas of a general nature expressed at a pre-analytical level and thus not representing a fully formalized theory. They are clearly harmonious and complementary to each other, however, and form a new view of underdevelopment or, rather, of the characteristics and long-term evolution of the so-called underdeveloped economies in the period immediately after the war.

Prebisch refused to consider as an anomaly what he saw, in his experience, as a way of being.² He understood that underdevelopment cannot be identified with a mere state of backwardness, often attributed to the burden of non-economic factors supposedly connected with the social structure. Rather, he saw it as a pattern of operation and evolution specific to certain economies and thus deserving of a likewise specific effort to develop a corresponding theory.

This effort hinges fundamentally upon the identification of a basic content –that is to say, of a general view of the object of investigation– and takes this as its starting point.³ This view –or the basic concept mentioned earlier, which amounts to the same thing– may be briefly described through three key concepts:

¹ The first of these publications dates from late 1949 and the second from early 1950. Hereafter, however, the quotations from them will refer to the publications listed in the bibliography as Prebisch (1962) and Prebisch (1973a).

² This experience is directly and specially related to the important functions he was called upon to discharge in the management of the Argentine economy during the 1930s crisis and the Second World War: especially putting into operation the Central Bank of that country and acting for a long period as its Director. For a short description of this see Rodríguez, 2001, pp. 100-104.

³ The term “view” is used here in the sense given to it by Schumpeter (1971, p. 78) in his *History of Economic Analysis*. This term expresses and sums up the point of view that every new theory, or every renovation in depth of an existing theory, begins when a set

heterogeneity, specialization and unequal development.⁴

a) *Structural heterogeneity*

Structural heterogeneity refers to a prime characteristic of peripheral economies: the simultaneous existence in them, on the one hand, of activities and/or branches of production in which the average productivity of labour is normal, in that it is relatively close to that permitted by the available techniques, together with others in which productivity is quite high, in that it is relatively similar to that prevailing in the main industrial centres, but also, on the other hand, substantial numbers of technologically backward activities in which the levels of productivity are very limited: well below those of the other, “modern” activities.

Of these two broad classes of activities, the former generate true employment, while the latter are responsible for underemployment. This simultaneous existence of true employment and underemployment –of one labour force where productivity is high, side by side with another where it is low– is a directly visible expression of structural heterogeneity.⁵

The basic concept also accepts the fact that underemployment tends to persist over time. In essence, underemployment reflects a huge supply of redundant labour whose dimensions seriously compromise the possibility of rapid absorption of the labour force as a whole into activities with normal or high levels of productivity. Continuing to view this from the supply

of key hypotheses is assembled which express the fundamental content of the new ideas. It is from such a basic content that different formal expressions are developed –different formal theories structured with academic rigour– in whose construction the original content is reshaped and refined.

⁴ Using these concepts, sections 2a, 2b and 2c below refer briefly to the content of Prebisch’s basic concept. Section 2d, for its part, refers to various works by Prebisch himself in which this content was progressively formalized. These works are mentioned in order to “manifest” the decisive importance of his contribution to Latin American structuralism. There is no intention, of course, of belittling the great contribution made to this approach by ECLAC and various authors associated with it.

⁵ The underemployed, employed and openly unemployed make up the economically active population (EAP). It should be noted that the first of these three categories is defined solely and strictly on the basis of the physical productivity of labour, so that although it may come close, the notion of underemployment does not coincide with “informality” or “marginality”. This differentiation does not mean denying that they all seek to take account of phenomena related with social exclusion in peripheral economies such as those of Latin America.

side, this redundancy is also seen to be associated with demographic variables, that is to say, the increase observed in the growth rates of the population as a whole and the active population of peripheral countries when their mortality rates go down, while their birth rates take longer to decline. From the point of view of demand, it may be noted that the labour-saving nature of the technical progress originating in the main centres and the relatively small rates of accumulation and growth that can be reached on the periphery also make it more difficult for underemployment to be converted into employment there.⁶

Underemployment persists in the stage in which the development of the periphery comes to be led by expansion of the industrial sector. Although it persists, however, there are significant changes in its composition in this stage. The attraction exerted by the cities, or the straightforward expulsion of labour from backward agricultural activities, mean that in urban areas the percentage of the labour force which is underemployed (employed in low-productivity occupations) is higher than nationwide underemployment, while in rural areas it is correspondingly lower. In other words, over time structural underemployment shifts from rural to urban areas, while nevertheless remaining a key expression of heterogeneity.⁷

⁶ The persistence of structural underemployment is referred to in Prebisch, 1973a, pp. 69-70.

⁷ For an early overall reference to the problems of the periphery connected with the agricultural sector, see Prebisch, 1973b, pp. 47-51 (the first version appeared in 1951). This document contains the following telling assertions: "This is a very important aspect of the problem of the spread of technical progress in Latin America, but has not yet been given all the attention it deserves. It is possible that, because of the shortage of capital to absorb the surplus labour force caused by agricultural mechanization, the saving of labour may have led to poor employment in rural areas or big concentrations of city-dwellers". "Not much can be done to raise the standard of living of the masses tilling the soil (especially the poor soil of traditional agriculture) unless the redundant rural population due to technical progress is eliminated and that part of it which is not needed for working the new land opened up for cultivation is reabsorbed into activities with satisfactory levels of productivity". It may be inferred from such assertions that the process of structural change that makes up development is linked with the transformation of the peripheral economies from rural to urban and from agricultural to industrial. The employment problems of those economies are likewise seen to be linked with such changes. By way of example, it may be noted that in Brazil in 1960, underemployment affected nearly 50% of the working population and about three-quarters of it still corresponded to agricultural underemployment.

b) *Production specialization*

The specialization of the production structure of the periphery was originally connected with the long period in which its growth depended on the export of foodstuffs and raw materials. Later, when industry spontaneously became the main source of growth, the initial primary export specialization conditioned the new pattern of development. This specialization at the starting point (in extreme cases, the almost exclusive production of primary exports and almost complete absence of exports of manufactures) means that industrialization progresses from simple to more complex levels. In other words, a country begins by producing simple consumer goods and only gradually progresses to the production of more technologically complex goods: consumer durables, intermediate goods, and certain capital goods.

Precisely because countries begin with simple goods and then gradually embark on the production of other goods located "further back" in the production chain, the pattern of industrial development peculiar to the peripheral countries means that the specialized nature of their production structure is maintained, because in view of the initial specialization of the export sector in primary commodities and the need to progress from simple to more complex levels typical of that pattern, the degrees of intersectoral complementation and vertical integration of production achieved by the periphery are only small or incipient.

The foregoing basic argument is clarified and complemented if we take into account Prebisch's assumptions on technical progress, which he perceived as a variable exogenous to the economy. He also accepted that such progress is more rapid in industry than in primary production, and also more rapid in industrial activities situated "further back" in the production chain, especially in the production of capital goods, in which it is embodied. This acceptance means that the industrialization of the periphery repeatedly has to progress from simple to more complex levels, since it is obliged to embark on activities in branches where technical progress is slower. This means, in turn, that the specialization of the periphery persists, while its possibilities of achieving greater intersectoral complementation and vertical integration of production are repeatedly limited.⁸

In addition to the low level of initial development of industry, the new specialization aspect just mentioned

⁸ With regard to these views on technical progress, see Prebisch, 1962, pp. 1 and 4.

has some other noteworthy connotations. On the one hand, there is repeated difficulty in exporting manufactures and thus achieving successive increases in the value of total exports.⁹ On the other, there tends to be ever-increasing growth of imports, because of the low level of complementarity of domestic production and/or the demand for imports of goods located “further back” in the production chain, because of the low level of vertical integration. These implications of specialization, regarding the behaviour of exports and imports, lie of course at the root of the persistent tendency of the peripheral countries to register trade deficits, which are repeatedly observed during the process of spontaneous industrialization. This tendency is also responsible for the fact that external saving –i.e., the inflow of foreign capital– can only make a limited and supplementary contribution to the development of the periphery.¹⁰

c) *Unequal development*

The unequal (bipolar) nature of development in the centre-periphery system is related primarily with the special structural features described in previous sections. These features mean that the production structures of the peripheral economies keep on changing over time, especially during the stage in which the expansion of industry spontaneously acts as their leading source of growth.¹¹ As pointed out in the

⁹ The difficulty in achieving such increases is also connected with the decline in primary commodity prices that would result from a major increase in their volume, because of the low income-elasticity of the demand for them in the main centres.

¹⁰ A growth pattern (the most simple in analytical terms) in which no effort is made to export manufactures would mean that industrialization would have to progress with a gradual decline in the export coefficient and the degree of openness to the exterior. It can be demonstrated that reduction of the share of foreign ownership in the total assets of the periphery (defined as the percentage ratio between the total value of that property and the value of the external debt regarding that total) is a logical requisite for continued growth, in the growth pattern in question. Such a requisite must also be satisfied in analytically more complex cases where both coefficients increase, where it is a case of peripheral economies structurally conditioned by external constraints. In the final analysis, the argument is based on the accentuation of that restriction because of the effects produced in the long term on the balance of payments current account by the remuneration of foreign capital. With regard to this argument, which is taking on renewed importance nowadays, see ECLAC, 1953, pp. 52-54.

¹¹ The documents by Prebisch and ECLAC maintain that problems of employment and those caused by the tendency towards external imbalances are connected with the patterns of change in the structures of production and employment due to the “spontaneous

previous observations, however, even after they have been changed these structures continue to be heterogeneous and specialized. Those characteristics and their persistence are in marked contrast with those of the great industrial centres: the latter also go through ongoing changes and become more complex, but they maintain or even further increase their already comparatively high degrees of homogeneity and diversification.

Development in the centre-periphery system is also unequal in a second respect: average income (per employed person and/or per capita) tends to differ considerably between its two poles. The reason for this difference is the disparity between the growth rates of the productivity of labour, which is higher in the centres because technical progress is faster in them. Another factor which operates in the same direction in peripheral economies is the persistence of heterogeneity in them: that is to say, the existence of great masses of workers employed in very low-productivity activities, which adversely affect average productivity. A further factor which causes average incomes to be lower is the deterioration in the terms of trade,¹² for the decline in the relative prices of the peripheral countries’ exports means that in the sectors producing those goods the workers’ income increases less than the productivity of labour. The opposite is the case, however, in the export sectors of the central economies.

It is easy to see that the differences in incomes and the inequalities of the production structures are related with each other. The differences in incomes, like the unequal performance of labour productivity levels and the deterioration in the underlying terms of trade, mean that the peripheral economies are weak in terms of their capacity to achieve and maintain high rates of accumulation. It will likewise be readily understood that this weakness makes it harder for those economies to overcome their structural backwardness or, more precisely, adversely affects their possibilities of gradually reducing their prevailing heterogeneity and specialization. In turn, the persistence of such structural conditions means that there will also be a tendency for the inequality of average incomes to persist between the two poles of the system.

industrialization” which gained pace in various Latin American economies as a result of the Great Depression and the Second World War. In contrast is the “planned industrialization” approach which forms the essential basis for a development policy capable of ensuring that the changes in those structures follow a proper path.

¹² This question is referred to briefly again in the following section.

d) *Formalizing the initial content*

In order to gain a fuller perception of the significance and importance of Prebisch's basic concept, we should also associate it with another of his contributions and briefly consider its different formal expressions.

The first documents in which this concept was put forward contain the first two formal expressions of the theory of deterioration of the terms of trade. An "accounts version" (using only ratios of definition) describes it accurately and brings out its hidden significance: that is to say, its influence on the differentiation of average incomes between the centre and the periphery.¹³ A second formal expression, known as the "cycles version", was designed to explain the phenomenon of such deterioration on the basis of cyclic movements in the central economies and the way those cycles spread from those economies to the periphery.¹⁴ In the first half of the 1950s, various equally precise formal expressions were developed of another two theories, one designed to explain the tendency towards an over-abundance of labour, and the other the tendency towards an external imbalance.¹⁵ In 1959 a third formal

version of the theory of deterioration of the terms of trade was published, seeking to explain this as the natural result of the industrialization process or, more exactly, the forms and characteristics of spontaneous industrialization in peripheral economies.¹⁶

Thus, in the course of the 1950s suitable formal expressions were being made of those key aspects of the initial content needed in order to make the interpretation of the long-term development of those economies intelligible and coherent. In other words, what may be termed a "theory of underdevelopment" was worked out, made up of the combination of the basic content and of the various theories which replicate, in abstract form, the phenomena of external imbalance, deterioration of the terms of trade, and structural underemployment.

The mere fact that this set of theories comply with the logical requirements usually demanded in conventional economics entitles them to be considered as forming a "theory of underdevelopment". It should also be borne in mind, however, that they were prepared in close connection with economic policy analyses which were also carried out with precision, so that they too complied with the same requisites of logic and internal coherence.

Only brief reference needs to be made to the economic policy proposals. The first field which may be mentioned is that of resource allocation, for which criteria aimed at optimizing the accumulation effort are established, both with regard to the form of distribution between production for the domestic market and production for export and with regard to the impact of that effort on agriculture and the possible effects of agricultural modernization on employment problems. The second field concerns "international cooperation" and covers such key issues as protection, Latin American integration and external finance. Policy bases are established for all of these which are compatible both with each other and with the resource allocation criteria, with the aim of achieving a pattern of reinsertion in the international economy which is compatible with sustainable growth and is also efficient.¹⁷ The third field revolves around the *idée-force*

¹³ The significance of the deterioration in the terms of trade and its perception as a long-term trend typical of centre-periphery relations was already recognized in the study *Postwar Price Relation between Underdeveloped and Industrialized Countries*, prepared in February 1949 under the direction of Professor Hans Singer.

¹⁴ Everything seems to indicate that the terms centre and periphery were used for the first time in 1946. The following assertions by Prebisch illustrate the meaning then given to them: "Why do I call the United States the cyclic centre? Because that country, because of its size and economic characteristics, is the starting point of the impulses resulting in the expansion and contraction of world economic activity, and especially that of the Latin American periphery. I believe that the cyclic movement is universal, that there is only a single movement which spreads from country to country but with markedly different characteristics, depending on whether it is a question of the cyclic centre or the periphery" (Prebisch, 1946, pp. 25-26). Later on, the centre and the periphery came to be conceived in the light of the nature of their production structures and to be related not so much with cyclic movements as with the long-term development of those structures, within the system that they formed. The "cycles version" of the theory of deterioration corresponds to one of these concepts, while the "industrialization version" mentioned below corresponds to the other.

¹⁵ Both of these were already outlined in the initial documents mentioned earlier but were expressed more precisely in other documents during this half of the decade. Of these, special mention may be made of two documents: *Problemas teóricos y prácticos del crecimiento económico* (Prebisch, 1973b; first version: 1951), and *La cooperación internacional en la política de desarrollo latinoamericano* (Prebisch, 1973c; first version: 1954).

¹⁶ The "industrialization version" forms part of the article by Prebisch (1959) entitled *Commercial policy in the under-developed countries*. The basic arguments of this theory are set out in Rodríguez, 1980, pp. 108-122.

¹⁷ The resource allocation criteria and international cooperation policies are referred to respectively in the two documents mentioned in footnote 15 above. Both these documents maintain that "planned industrialization" is the essential path for the development of the

of planning, as reflected in the development of instruments designed to help the State to design and implement long-term development policies capable of attaining the objectives of continuity and efficiency.¹⁸

The above-mentioned theory of underdevelopment, or, if preferred, the existence of a systematic appraisal of the characteristics and tendencies of “peripheral status” in economic matters, serves as an explicit or implicit point of reference for many of the Latin American approaches to development. This is why they display common features which differentiate them from the theories in this respect that come within the framework of conventional economics.¹⁹ This special quality clearly imbues the works in which Prebisch tries to make an interpretation of Latin American development which transcends a purely economic approach: that is to say, a long-term interpretation which is both economic and socio-political.²⁰

peripheral economies, and seek to outline ways of following that path without setbacks. It should be borne in mind that neither these nor other documents advocate industrialization at all costs or excessive and unlimited closure of the peripheral economies to the exterior: positions which have often been insistently attributed to ECLAC. On the contrary, these documents emphasize the need to expand different types of activities only for reasons of relative economic gain and to keep them exposed to the stimulus of external competition through moderate and decreasing levels of protection. Temporary financial support, together with what Prebisch called “asymmetrical protection” –i.e., more rapid reduction of protection in the centres than on the periphery–, are elements of international cooperation which will lead to a scheme of international division of labour that will gradually extend to the industrial sector. This new scheme of production and trade, which is seen to be beneficial for both poles of the system, may be termed “joint industrialization”.¹⁸ In this field, an early work by ECLAC (1953) bore the title *Estudio preliminar sobre la técnica de programación del desarrollo económico*. Planning naturally means that the State must actively participate in the process of industrialization and development, leading it forward in a deliberate and determined manner. This position must not be identified with over-intervention, however, as the documents of that institution fully recognize the importance of the market and advocate different degrees and types of intervention, according to each particular case.

¹⁹ The book *Cincuenta años de pensamiento de la CEPAL: textos seleccionados* (ECLAC, 1998) covers a broad range of such approaches, and the foreword by Ricardo Bielschowsky contains a useful summary of them.

²⁰ These efforts were mainly reflected in three of his books: *Hacia una dinámica del desarrollo latinoamericano* (Prebisch, 1963), *Transformación y desarrollo: la gran tarea de América Latina* (Prebisch, 1970), and *Capitalismo periférico. Crisis y transformación* (Prebisch, 1981). They also contain various other undoubtedly important contributions by Prebisch to Latin American structuralism which will not be dealt with in this essay, which is limited to the subjects enumerated in the Introduction.

3. The continuing validity of structuralism

Everything indicates that the technological revolution which is under way and the accompanying process of globalization are responsible for the efforts to reformulate the theory of technical progress which have been made in the last fifteen or twenty years. The new approaches depart from neoclassical usage (and that of Prebisch himself), which sees such progress as exogenous and embodied in capital goods. These new approaches now consider technical progress as accumulative and as endogenous to enterprises and economic systems.²¹

It is considered that the revolution in question –or, if preferred, the installation and rapid spread of a new techno-economic model–²² is also accompanied by a difference between the capability of the great centres to generate and incorporate technology and the corresponding capability of the peripheral countries. At the beginning of a period in which technical progress is taking on renewed dynamism, the peripheral pole lags behind or is at a disadvantage. It is held that this lag at the starting point means that this pole will have less capability to make successive technological advances in the future. In other words, it is accepted that the initial disadvantage –since it involves a smaller accumulation of scientific and technical knowledge and research and development experience– tends to bring about its own reproduction: i.e., it tends to persist over time. There is yet another factor, however: the size of the enterprises and economies of the centres –so much greater than those of the periphery– represents another decisive element that further increases the latter’s disadvantage in coping with the speed of technological change, together with their smaller capacity to cover the costs and risks that such change involves.

These are the basic reasons why it is recognized in the specialized literature²³ that the new model brings with it differentiation of the rates of technical progress

²¹ For different versions of the new “endogenism”, see Burgueño and Pittaluga, 1994. The same subject is dealt with at length in Malerba and Orsenigo, 2000.

²² With regard to the concept of techno-economic model, see Freeman and Pérez, 1988.

²³ Various authors (such as Verspagen, 1993) refer to the role of technological disparity in competitiveness and, hence, its influence on the performance of countries which are lagging behind. A number of recent analyses on the impact of the technological revolution on the development of such countries are summarized and compared with ECLAC approaches from different periods in Hounie and others, 1999.

between the centre and the periphery or, to put it in a nutshell, “technological disparity” between them.

As we shall see in the following sections, this disparity has important connotations for the analysis of employment and external sector problems, and such analysis, for its part, backs up the views on the need for certain basic requisites for the viability and efficiency of the development of the periphery.

a) *Employment problems*

Consideration of the employment problems of a typical economy over a very long period of time backs up certain hypotheses on the subsequent evolution of such problems when this is left to the play of the market forces.²⁴

The first hypothesis concerns open unemployment. It is generally recognized that it is tending to increase in both the centres and the periphery and that this trend is connected with the saving of labour due to rapid technological progress. It is also recognized in many cases, however, that this tendency is more marked in the periphery, and especially in the Latin American economies. It is noted in this respect that in these economies the new model began to be applied within a context of extremely rapid external openness, in economies which already registered unfavourable levels of productivity and competitiveness, thus endangering the survival of various industrial and other production activities.

This phenomenon, however, which was noticeable in the 1990s, is considered to be less important than the long-term effects of the new model and the accompanying technological disparity. In view of this disparity and the external openness which continues to be maintained, it may be expected that while many activities producing goods and services will be viable in the peripheral economies, many others will be out of their reach. Thus, the slow and difficult process of trying to catch up on technologies which are constantly being renewed will tend to be reflected in problems of high and persistent open unemployment, even if

relatively high rates of GDP growth are recovered and/or maintained.

The second hypothesis concerns the already existing underemployment or, more exactly, the difficulties now being faced in trying to absorb this labour. In the past, under the model known as “Fordism”, rapid growth was accompanied by negligible levels of open unemployment, and there were clear tendencies towards a fall in structural unemployment, that is to say, the absorption of the labour force in question in high-productivity activities.²⁵ Under the new model, however, this possibility is limited, if not completely prevented, by the presence and persistence of openly unemployed workers who compete with the existing body of underemployed workers for jobs which are relatively scarce because of the technological disparity.

The third hypothesis concerns the possible incidence of the new model on the expansion of urban underemployment. The information on the previous model reveals that, under it, slow growth gave way to an outright increase in that form of underemployment, in both relative and absolute terms. This increase may be considered to be the result of successful survival strategies in which the material wherewithal for survival is obtained through jobs which are of low productivity but are nevertheless capable of averting the still greater problem of open unemployment and thus preventing its excessive expansion.

Recent experience, however, reveals that the high levels of open unemployment have been accompanied by a reduction in urban underemployment in both relative and absolute terms. Although the available information is scanty, it thus gives grounds for thinking that the introduction of the new model does not only cause difficulties in terms of open unemployment but also gives rise to obstacles to the expansion of underemployment, thus preventing the success of the underlying survival strategies.²⁶

²⁴ The case studied is that of Brazil, for which structural underemployment was estimated at various points during the period from 1960 to 1996. It may be noted that in this case underemployment displays similar trends in all six of the different forms of calculation used for its estimation. One of these estimates is summarized and commented upon in Rodríguez, 1998. For reasons of brevity, no detailed reference will be made here to the quantitative information on which the hypotheses described in the following paragraphs are based.

²⁵ It should be noted that the absorption of underemployed labour does not merely mean the hiring of labour in high-productivity activities, on a wage-earning basis. Its definition is broader: absorption is considered to mean raising the productivity of labour from the low levels typical of underemployment to higher levels corresponding to true employment. In this sense, employment is considered to comprise various forms of labour relations and/or “occupational status” (employer, own-account worker, unpaid family worker) and not just those involving wage labour.

²⁶ A good illustration of this is the very widespread reorganization of the sale of consumer staples. This is now carried out by big oligopolistic firms which not only compete advantageously with small shopkeepers but may well also be affecting the

All in all, the foregoing considerations reflect a sort of impasse. On the one hand, the rate of growth alone no longer holds out hope of a gradual albeit slow solution of employment problems, through the creation of jobs of high or moderate productivity. On the other hand, nor do there seem to be any possibilities of relieving these problems through the lesser evil of underemployment. Thus, in the new model, the problems referred to earlier would appear to be at the root of lasting situations of social exclusion whose persistence may lead to the emergence and repetition of extremely critical conflicts.

b) *The external bottleneck*

“Technological disparity” is associated with a trend towards trade deficits which seems to be taking a similar form –similar in more than one sense– to that which existed in the stage of industrial expansion carried out in the context of the old “Fordist” model. The arguments regarding this trend are also similar to those used by Prebisch and ECLAC, as briefly described earlier, and may be viewed as a renewed version of the latter which seek to take into account the change in the techno-economic model and the technological disparity this has caused.

As already noted, technological disparity means that while certain activities and branches will be accessible to the periphery, access to others will repeatedly be inhibited by the faster technical progress of the centres. Likewise because of the different rates of technical progress, there will be difficulties in expanding the periphery’s exports away from activities where that rate is comparatively low and hence increasing their global value. Furthermore, in conditions of strong and/or growing external openness, this same technological lag will make it difficult to undertake or maintain the domestic production of tradeable goods where the peripheral countries do not possess levels of productivity and competitiveness close to those of the centres, so that they will have to resort to repeated significant increases in imports of goods whose domestic production is not viable.²⁷

underemployment reflected in the activities of sidewalk vendors or its expansion.

²⁷ In early analyses on this subject (for example, Prebisch, 1973b, pp. 33-34 (first version: 1951)), the typical tendency of the periphery to register external imbalances was explained on the basis of the disparity between the income-elasticities of their export and import demands. A similar argument may now be put forward on the basis of “Thirlwall’s Law” (see McCombie and Thirlwall, 1994),

The tendency towards a trade imbalance has a further connotation applicable to the periphery considered in abstraction or to the periphery as a whole and/or large underdeveloped economies: the impossibility of export-led growth based on the outright liberalization of those countries’ markets. We will return to the importance of this further implication later.

The foregoing comments are connected with this trend, which is associated with the disparity of technical progress: this disparity adversely affects the possibility of increasing exports, while it also causes an increase in imports of goods whose domestic production is not feasible because of their technological complexity.

Underlying the foregoing argument is another more abstract argument of a structural nature. It is argued that in order to achieve sustained expansion of the production of goods and services it is necessary to comply with certain “laws of proportionality” between the activities, branches and sectors responsible for such production, or, if preferred, between the growth rates of the different components of global output. It is also argued that as production operates as a whole, these laws must also be complied with in respect of export production, production for the domestic market, and the production of the imports coming from the other pole of the system (i.e., these laws must be reflected in compatible patterns of insertion in the world economy). Thus, the explanation of the external imbalance rests on an analytical referent indicating the changes in the production structure required by its own expansion and increased complexity.²⁸ Later on in this essay we will

which may be summed up through the expression $\gamma = \varepsilon\omega/\pi$, where ε is the income-elasticity of exports; π that of imports; γ is the growth rate of the periphery, and ω is the growth rate of the centres. The rate of technical progress tends to be higher in the latter, and this tendency underlies the disparity of elasticities ($\pi > \varepsilon$) and limits the growth of the periphery ($\gamma < \omega$). As noted below, overcoming this limitation requires deliberate development policies designed to raise the periphery’s domestic and external competitiveness so as to increase the elasticity of its exports (ε) and reduce that of its imports (π).

²⁸ This perception of development as a dynamic involving and requiring certain patterns of change in the production structure represents a key substrate (and at the same time a synthesis) of Prebisch’s basic ideas. The presence of this perception in his work is clear from the following statements: “Economic development and the recent events are not only considered in themselves, in their episodic significance, but also as a sequence of dynamic phenomena, as living manifestations of a complex which is constantly growing and diversifying”. “Economic growth is not just a question of increasing what already exists. It is a process of intense structural changes ...” (*El trimestre económico*, 1953, p. 46).

return to Prebisch's views on the inability of the market to bring on these structural changes.

c) *Conditions for viability and efficiency*

It will be gathered from the previous section that, in order to achieve such continuity, or even to achieve high and steady growth of the product, it is necessary to impede the action of the external constraint deriving from the disparity of technical progress, by designing and implementing deliberate policies in the fields of technology and production. In essence, these policies should aim to achieve, in successive activities, the levels of productivity and competitiveness required in order to expand exports and avoid non-essential imports, so as to be able to make other imports of greater technological content that are made necessary by the disparity itself.

This deliberate guidance of external trade is considered to be a condition for the viability of development, since its aim is precisely to prevent its blockage by impeding the emergence of an external bottleneck. Such guidance is also perceived as a condition for efficiency, however, since it assumes that the process of catching up on new techniques will be carried out in a planned and orderly manner, beginning with those where it is easiest to attain the levels of productivity of the great centres and subsequently going on to those of increasing complexity, so as to reduce to a minimum the differences in productivity of the activities undertaken.²⁹

The external constraints in the field of trade also give rise to conditionalities in the area of financial relations, the main one of these being the need to adapt the flow of external resources to the country's needs, bearing in mind that those constraints impose limits on the possibilities for remunerating those resources. In

²⁹ A formal long-term growth model which takes account of the intensity of technical progress and the income-elasticities of export and import demand may be found in Cimoli, 1988. It shows that speeding up technical progress on the periphery would enable it to diversify its efficient activities, thus transforming its production structure and avoiding an external bottleneck. It should be noted that such a transformation does not mean that the domestic and external markets should be associated with "protected" and "competitive" activities, respectively, but should instead represent two areas expressing the technological capabilities that the periphery is gradually acquiring. It may also be deduced from the model that such acquisition of capabilities favours the growth of the system as a whole and hence benefits both its poles (like the "joint industrialization" advocated by Prebisch and referred to in footnote 17 above).

other words, financing the development of the periphery cannot be based to a discretionary or unlimited extent on foreign direct investment and external indebtedness. This means that ultimately significant levels of domestic saving are needed to ensure viable growth, although this also depends, in the final analysis, on the degree of technological disparity.³⁰

The above recognition and brief analysis of the importance of underemployment show that it is the basis for the tendency towards income concentration and the enormous magnitude of rural and urban poverty: phenomena which express the social exclusion typical of the periphery. At the same time, however, it can also be adduced that in spite of these perverse effects underemployment nevertheless represents an available resource, and indeed a resource whose better use is a requisite for the viability and efficiency of the peripheral countries' development.

It was noted earlier that the existence of the external constraints rules out any possibility of achieving high and sustained growth rates with the export sector acting as a spearhead sector capable of inducing global economic growth. Instead, in order to keep the average growth rate at a high level it must include a substantial component of increased production for the domestic market, but this means that the domestic market must expand accordingly, so that it can absorb that proportion of rapidly increasing production targeted at it.

A stylized and extremely simplified view of this expansion of the domestic market could be expressed as an increase in employment which could gradually absorb the increases in the economically active population in modern activities and also a sustained increase in the levels of productivity of the existing underemployed workforce and the achievement of high levels of productivity among new members of the underemployed economically active population.

Such increases form the basis for the growth in domestic demand needed for strong growth: i.e., they are necessary conditions for the viability of that growth. At the same time, however, these same increases—especially the absorption of the underemployed—are a necessary condition for efficient development.

This is directly visible from a static perspective. Such absorption of itself means making better use of

³⁰ This implication of the trade imbalance is similar to the concepts contained in Prebisch's basic ideas and the subsequent more precise formulation of them referred to in footnote 10 above. Similar arguments may also be formulated on the basis of "Thirlwall's Law" referred to earlier.

the available labour and gaining fuller access to the available range of technologies. It is important, however, to approach this matter from a dynamic perspective. The fact is that over time the absorption of underemployed labour is reflected in the generation of potential economic surpluses which are of vital importance for stimulating domestic saving and capital accumulation. Furthermore, as they are a source of domestic saving, the surpluses generated by this absorption of labour help to make development viable from the standpoint of the limitations on external finance and also from the angle of the balance of payments restrictions ultimately due to the technological disparity.

Alongside the arguments put forward in the previous section, it can also be argued that there is an analysis of a structural nature underlying the foregoing considerations. The laws of proportionality governing the changes in the composition of output by branches and sectors (and even between production for the domestic and external markets) which are needed for the continuity of growth also call for corresponding changes in the occupational structure of the labour force, as well as concomitant increases in the productivity of the latter, associated in turn with the generation of surpluses that make it possible to expand production and the creation of demand conditions permitting this.³¹ The following section goes on to explore some aspects of such an analysis, addressing the question of the State and its role in development.

4. The question of the State

In his last work, Prebisch repeats and emphasizes his views on the importance of the market, but not without drawing attention to its lack of a social (equity) dimension and a proper time horizon.³²

³¹ In order to simplify the arguments still further, they were set forth earlier as a straightforward dichotomy (between employment and underemployment). Somewhat more complex forms of reasoning, however, indicate that the viability and efficiency of peripheral development do not simply depend on expanding the former and absorbing the latter. They also call for a pattern of changes in production which, by overcoming the external constraints, will bring about increases in employment and productivity in successive "technical strata" in order to increase the levels of the surplus and domestic saving in them and thus keep up high rates of accumulation and growth. It may be noted that the expression "technical strata" is taken from Prebisch's last work (1981), where it is used in the same way as in this essay.

³² See Prebisch, 1981, p. 257.

These views may be linked with the foregoing considerations and serve to sum them up. On the one hand, the lack of a social horizon is reflected in the continuing existence of heterogeneity or, in other terms, in the employment problems which the present technological model makes still worse and which are becoming a permanent element. On the other hand, the lack of a time horizon expresses a likewise continuing tendency towards production specialization which tends to limit or impede economic expansion, through the external bottleneck.

It is considered, then, that overcoming the market shortcomings referred to by Prebisch is equivalent to overcoming heterogeneity and specialization. As we saw in the previous section, this means seeking certain patterns of change in the production structure of the periphery, leading to corresponding changes in the periphery's international linkages, as well as similarly corresponding changes in the employment structure, with successive increases in labour productivity in the different "technical strata" making up that structure.

The structuralist approach holds that the market alone is incapable of effecting this set of changes. It has been asserted in this respect that "the ECLAC theory ... (which represents it) ... may be interpreted as an early attempt to adapt orthodox economics to conditions of systemic market failure".³³ Here, it is maintained that the proposals of Latin American structuralism are of a different nature: they do not refer to such imperfections, but rather to the need to fulfill certain laws of proportionality which the market is incapable of doing, even if its imperfections are corrected.

This approach, then, is "non-reductionist",³⁴ in the sense that it does not limit the types, functions and behaviour of the agents in question to those involving supposed economic rationality, connected essentially with the guidelines given by the markets, and in this respect it recognizes that the analysis of economic phenomena (although it initially considered them in abstraction) must in the long run be carried out within a broader framework of social and political phenomena.

From this standpoint, the question of the State becomes particularly important. It directly concerns the role that the State should play in running the economy and, in more general terms, in the design and achievement of objectives which are both economic and social. This key question of the role of the State is closely linked with two others: the socio-political

³³ These assertions may be found in Fitzgerald, 1998, p. 60.

³⁴ See, in this respect, Vercelli, 1991 and 1994.

relations that serve as its basis, and the geopolitical relations within which it exists.³⁵

Consideration of these matters, whose complexity has been further increased by the recent globalization process, is well beyond the scope of these notes but – subject to this reservation – brief reference will be made to some points of view which seem to coincide in the present discussions on the crisis of Latin American development.

It is often noted that, in conjunction with the globalization process, a renewed and stronger presence of foreign capital and interests has been growing up in the countries of the region, and this presence is observed in more branches and sectors (especially the financial sector), with much higher levels of concentration than before. In view of its nature and magnitude, this presence has been accompanied by a reshaping of socio-political relations not only between internal classes and groups but also between them and foreign groups and interests. For example, there has been a change in the relative weight and connection patterns between production and/or financial interests linked with the big transnational corporations and those of an essentially local nature. Likewise, the new technological patterns –and also the bargaining power acquired by highly concentrated capital, even in its relations with the weakened public agents– affect the relations between capital and labour, reducing the capacity of the trade unions to exert pressures and the effectiveness of the latter.³⁶

To put it another way, when a certain basic external structural relationship (mentioned in footnote 35 above) is changed, this changes the whole bases of the previous

political power structure. This upset in the bases of political power, however, cannot be divorced from its surrounding geopolitical relations. The great powers usually present their own positions as the rational basis for geopolitics. On the basis of these positions, they promote changes in world trade regulations which are implemented with the intermediation and support of the main international organizations.

It is also recognized that the implementation of these changes is having profound repercussions on the countries of the periphery. On the one hand, they continue to be subject to “enormous imbalances in the conditions prevailing in international trade”, yet little or no progress has been made in “building a new architecture for the global financial system”.³⁷

Those countries are therefore subjected to loose and diluted forms of control over foreign direct investment and financial capital movements. The consequent heightening of their external vulnerability is accompanied by a reduction in the leeway open to States, which are particularly restricted in various areas of short-term macroeconomic policy.³⁸

In short, socio-political relations have been significantly changed in line with the recent globalization process, making the possibilities for their future modification and improvement more obscure and complex. In the view of the peripheral countries, the resulting changes in geopolitical relations are unfavourable for them, giving rise to a new correlation of forces which makes it harder for them to agree on an international negotiation strategy of their own. These two changes are also associated with a third change: in contrast with the recognized need for decisive State intervention, the role of the State has been reformulated in line with positions of a more or less minimalist nature, with unfavourable effects for economic management and development, as well as for the improvement of the prevailing conditions of severe social inequality.³⁹

The previous paragraph mentions a number of negative aspects. In contrast, however, some possible alternative paths to follow may be mentioned, although they involve serious difficulties. Nowadays, any effort

³⁵ This dual perspective evokes the more frequent concept of dependence, which defines it as an external-internal structural relationship. According to this concept, “the action of the social groups, whose behaviour in effect links together the economic and political spheres ... (concerns both the nation and) ... its links of all types with the world political and economic system. Dependence thus finds not only its internal expression but also its true nature as a particular form of structural relations: a specific kind of relationship between classes and groups which involves a situation that structurally determines the links with the exterior” (Cardoso and Faletto, 1969, p. 29).

³⁶ It is surprising how far the flexibilization of labour markets has been promoted in different countries of the region, all at the same time. Leaving aside the different features of the efforts made in this direction, it seems clear that –albeit with differing results and to different degrees– this has been due to the weakening of trade union power. With differences of detail, various aspects of the proposals for flexibilization are dealt with in *World Development Report 1995: Workers in an Integrating World* (World Bank, 1995).

³⁷ According to Faria and others (2000, p. 18).

³⁸ Ffrench-Davis (1999) gives a review of these policies in recent Latin American experience.

³⁹ Among the approaches which redefine the role of the State in line with the promotion of market-oriented development strategies, mention may be made of *World Development Report 1997: The State in a Changing World* (World Bank, 1997). Evans (1996) offers a review of recent approaches to the role of the State in development.

to reformulate development strategies must begin with the explicit consideration of political and geopolitical equations: that is to say, with the search for broad and inclusive internal agreements and, in that connection, with the building of consensuses among countries which will reduce their weakness and help them to defend their positions in international negotiations. These agreements and consensuses form the basis for

redefining guidelines on the role of the State, which, however, should also provide for proper use of its own relative autonomy. This is also important for outlining the new legal and institutional frameworks that its action requires, which in turn are related with the consolidation and deepening of democracy.

(Original: Spanish)

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The return of “vulnerability” and Raul Prebisch’s early thinking on the “Argentine business cycle”

Arturo O’Connell*

There is something paradoxical about the rise and fall –maybe we could speak about a renewed rise– of Raul Prebisch’s thinking on what in the early years of his intellectual life would have been called primary producer economies. In parallel with what had happened with development economics at large, by the early 1960s or so his thinking was being progressively dismissed both in public and academic discourse.¹

In their more generous forms, the criticisms levelled against Prebisch’s theories described them as plainly out of date. From such a point of view they might have been all right as an interpretation of events in the pathological 1930s Depression years or the immediate post-Second World War period, dominated by scarcities and controls. But in the fast-growing world economy of the 1960s, with a progressive opening-up to international transactions, what was thought –in an exaggerated way– to represent Prebisch’s teachings on import substitution and State interventionism was supposed to be no longer applicable.

Protagonists of those criticisms were basically the advocates of liberalization of what were by then called

the developing economies. Import barriers had to come down, foreign exchange controls eliminated, and countries should stake all their fortunes on a fast expansion of exports that would supposedly result from the increased efficiency achieved through those measures. Their success, which was perhaps not only based on their capacity for intellectual argument, has been phenomenal. The following decades have witnessed the adoption, first gradual and reluctant in most cases but turning into a stampede in the last decade, of precisely those policies. And what have been the consequences of all those reforms? An extraordinary degree of instability, with repeated crises hitting what are now termed “emerging economies”, highly vulnerable to international economic shocks.

Those questioning Prebisch’s ideas, after having been successful in reinstating a world economy quite similar to that of the early twentieth century or the late 1920s, have ended up doing him the greatest possible intellectual favour. Prebisch’s thinking on the difficulties of a “peripheral” open economy under financial globalization has now become highly topical.

In this paper, therefore, an attempt will be made to show that Latin American economic problems mirror the circumstances of the late 1920s, to say nothing of the following depression decade. And, thus, all of a sudden Prebisch’s thinking regains its relevance for the present day. It is, in fact, to an early Prebisch that reference will be made in this article: the Prebisch of the late 1920s and early 1930s. At that time he was

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¹ See, for example, Paul Krugman’s comments in his article entitled “The fall and rise of development economics” (Krugman, 1994).

more worried with what could be termed short-run macroeconomic problems than with what were later to be called development issues, to which his ECLA years were devoted.

This paper is organized in the following way. First, the progressively more unstable character of the world economy in the last quarter of a century and its impact on our region will be surveyed. Second, some parallels will be drawn with the Argentine economy in the period between the wars. Third, the early development of Prebisch's thinking in the late 1920s, as related to the study of that economy, will be examined. And, fourth, his first reactions to the Depression years will be studied.

What will emerge from this analysis is an awareness of how clear and true even to present-day realities were Prebisch's views about the problems of an early "emerging market" economy, even though there may not be unanimous agreement on his specific economic policy proposals.

1. The instability of the world economy and the renewed vulnerability of the Latin American economies

Beginning in 1975 –and as acknowledged for instance in several of the last issues of the IMF's *World Economic Outlook*– the world economy has undergone several slumps. According to that publication, up to recently there were four of these, although a fifth one in the mid-1990s can also be detected.² And right now –in 2001– another one which we could easily rate as a sixth slump is taking place (figure 1).

The frequency of crises seems to be increasing, since there have been six crises in about 25 years, but four of them have taken place in the last 10 years, three in the last five years, and two in the last three. Such a casual perusal of the frequency of crises is confirmed in, for instance, a recent study by Bordo, Eichengreen and others (forthcoming). In their examination of 120 years of financial history, crisis frequency after 1973 turns out to have been double that of either the Classical Gold Standard Period or the post-Bretton Woods one. Interestingly enough for the argument we are trying to develop in this paper, such frequency has been similar to that of the period between the wars. Furthermore,

² See, for example, IMF (1999, pp.2-5). In the graph on world industrial production –figure 1.2. on page 5– of that same report, a clear fifth slowdown may be detected in 1995, and not only in Latin America.

FIGURE 1

World: Real gross domestic product
(Percentage annual rate of change)

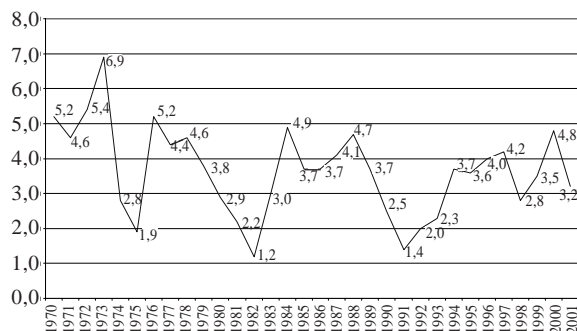
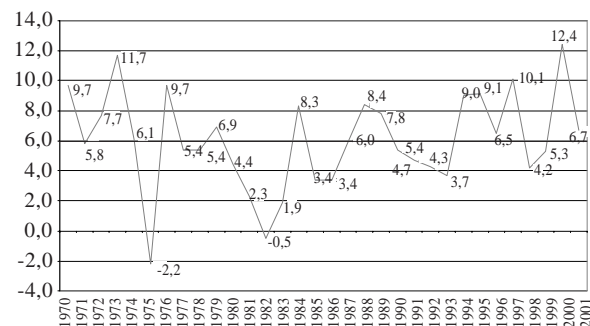


FIGURE 2

World: Volume of goods and services trade
(Percentage annual rate of growth)



the last 25 years show a higher frequency of twin crises (currency cum banking); these crises are known and have been shown to be particularly severe and have resulted in high output losses.

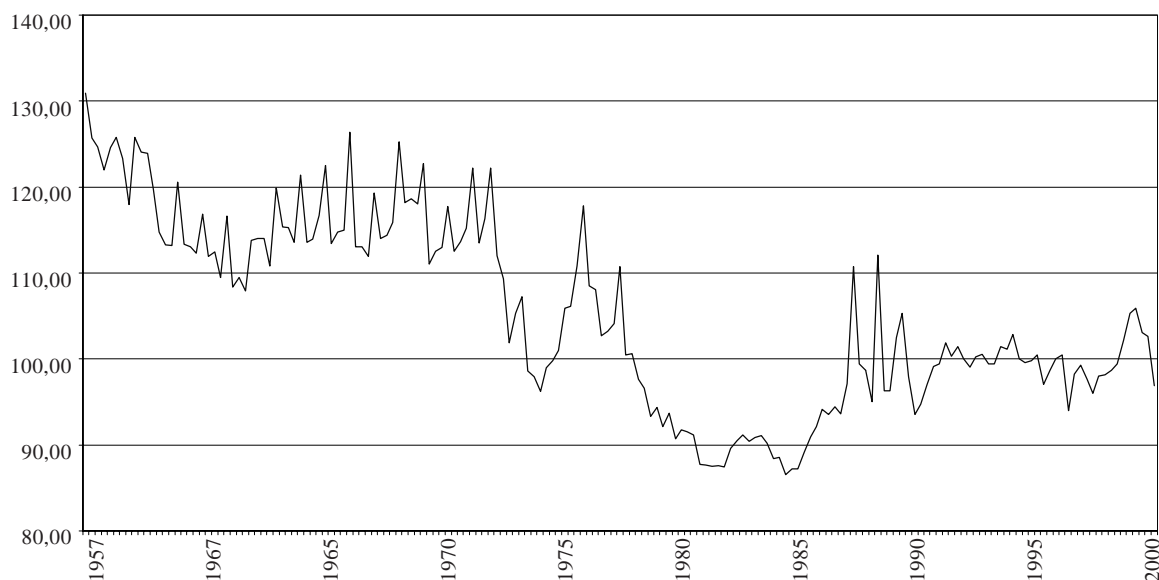
And, of course, as further background on the instability in the world economy, we have also had the extreme volatility of interest rates and exchange rates among the major currencies, which some authors make responsible for the behaviour of commodity prices: a matter to which we will refer below.

Besides frequent slowdowns in economic activity amplified by strong variations in international trade volume (figure 2) and volatility of interest and exchange rates, this last quarter of a century has shown extraordinary variability in two other aspects of great significance for developing countries, i.e., commodity prices and capital flows.

As for real commodity prices, on the one hand, recent studies have vindicated at least the facts of the Prebisch-Singer hypothesis, i.e., that there is a long-run trend –over a 140-year span– towards a decline in

FIGURE 3

Terms of trade: Non-oil developing countries 1957-2000
(1995=100)



these prices (at the rate of 1.3% per year). Moreover, there is a break around 1917 after which the decline accelerates to 2.3% per year and in the 1990s to 6.9% per year.³ Not only there is such a declining trend, but also volatility has significantly increased in the later period, with larger swings in prices and cycles of higher frequency.⁴

It is also useful to remind ourselves that by the beginning of the year 2000, real commodity prices were fully 40% below their level at the beginning of the 1970s. The result of this on the terms of trade of developing countries could not be more obvious, as may be gathered from figure 3, on non-oil developing countries.

A very similar story could be told with regard to capital flows. Since the beginning of the 1970s, two distinct boom and bust cycles may be detected. The first one was the well-known cycle relating to bank loans in the 1970s, which led to the “sudden stop” of the early 1980s and to debt crises spanning the whole decade. The second was the more recent boom of the early 1990s, which was followed by the collapse which began with the Asian crisis of 1997.

³ See Cashin and McDermott, 2001.

⁴ “...rapid, unexpected and often large movements in commodity prices are an important feature of the behavior of commodity prices.” (Cashin and McDermott, 2001, p. 25).

Quarterly figures for the last several years, when superimposed on those long cycles, make it easy to detect an extreme variability in the behaviour of private capital flows. Most specifically, bank lending –and also bond issues, although less so– displays extreme volatility moderated by a more stable performance of foreign direct investment. In fact, as may be seen from figure 4, net non-equity capital flows have not only been much more unstable but indeed in the last few years have been nil or even negative.

Summing up, as should be well known –although not always thoroughly recollected– the world economy has shown an extraordinary degree of instability in the post-Bretton Woods era and most specifically in the last decade.

Latin America, of course, by “opening-up” both to trade and financial relations with the world economy, could hardly avoid being subject to that instability. Growth rates of GDP and of international trade volume played their part, as well as the behaviour of interest rates, real commodity prices and capital flows.

Net transfers of resources, which on the whole were positive in the 1990s (compared with the negative figures of the 1980s) ended up the century by being negative again, after having likewise shown a slump in the mid-1990s (figure 5).

As it is well known, exports increased at a faster rate than in previous decades, but imports increased

FIGURE 4
Net non-equity private capital flows to emerging markets
(In US\$ billion)

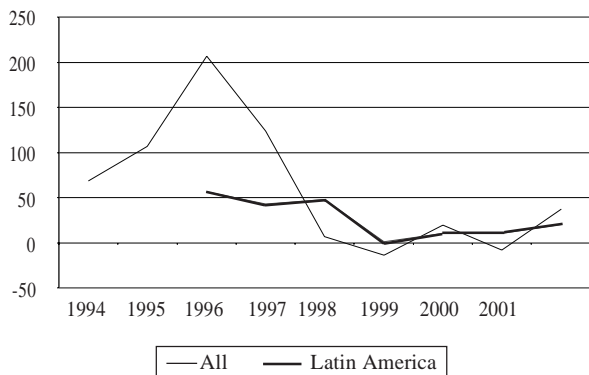


FIGURE 6
Latin America and the Caribbean: Balance of trade
(In US\$ million)

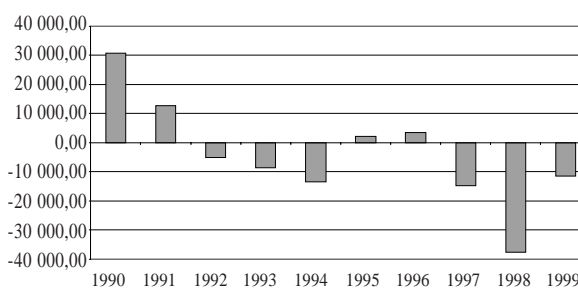


FIGURE 5
Latin America and the Caribbean: Net transfer of resources, 1980-2000
(As a percentage of GDP and exports)

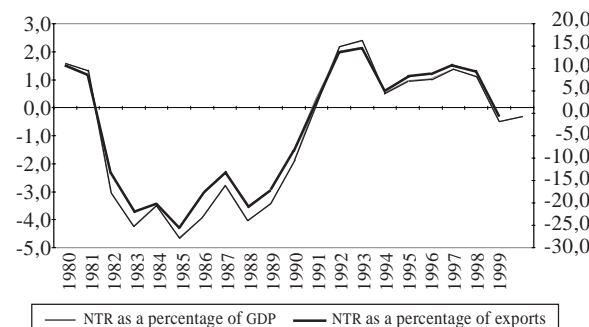


FIGURE 7
Latin America and the Caribbean: Current account balance as a percentage of GNP
(Percentages)

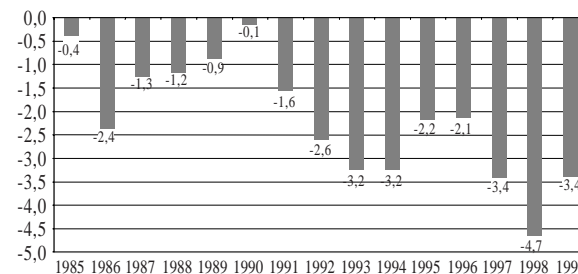
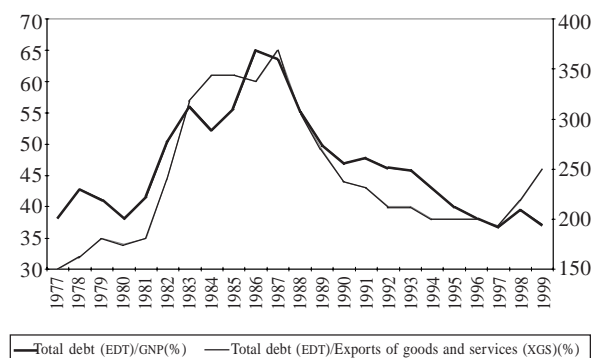


FIGURE 8
Latin America and the Caribbean: External debt ratios
(In percentages)



even faster. The result was the emergence of sizeable trade deficits, only moderated or turned positive under recessionary conditions (figure 6).

Coupled with a negative balance on real and financial services, current accounts became increasingly negative, even in terms of a larger GDP (figure 7).

Furthermore, by the end of the decade external debt ratios –with respect to exports and to GDP– had started to climb again and were standing at levels similar to those that had prevailed at the beginning of the 1980s crisis. It was of course precisely the renewed accumulation of foreign indebtedness that led to the expansion in outflows on account of financial services.

And although short-term debt –as a percentage of foreign exchange reserves– was low and falling towards the end of the 1990s, financing requirements –short-term debt plus service on long-term debt coming due within a year– were building up as a consequence of the sheer growth of the external debt (figure 9).

Rapidly growing imports plus large external financing requirements (figure 10) have made the region extremely vulnerable to the vagaries of the world economy. Country-risk spreads reveal the volatile evolution over time of the creditworthiness ratings of

FIGURE 9
Latin America and the Caribbean: Short-term debt as a percentage of foreign exchange reserves, 1971-1999

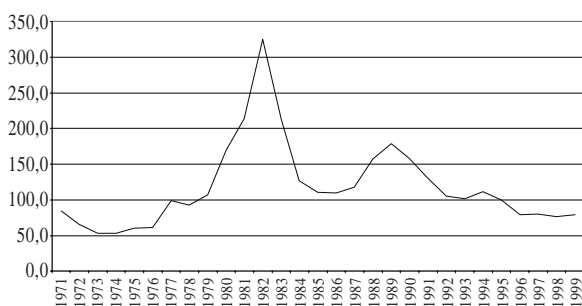


FIGURE 10
Latin America and the Caribbean: Financing requirements (As a percentage of GDP)

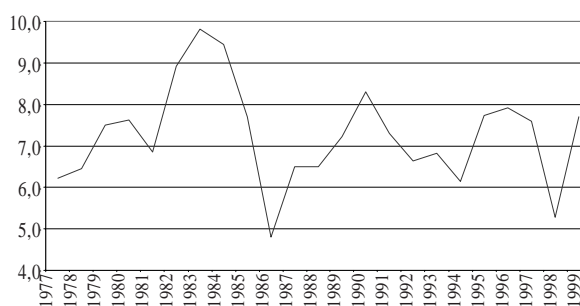
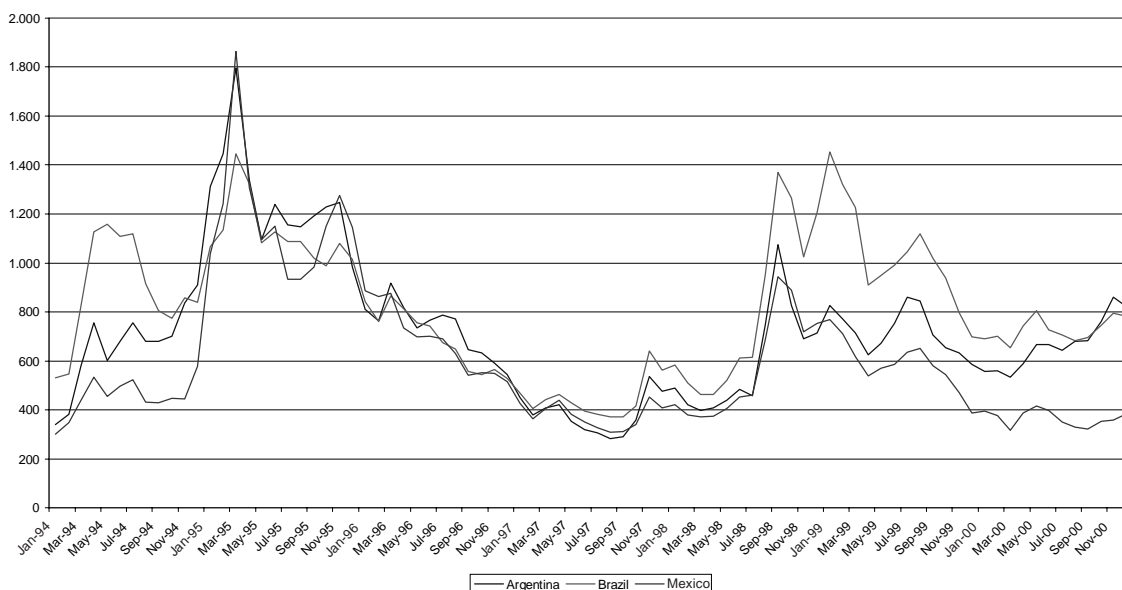


FIGURE 11
Argentina, Brazil and Mexico: Country-risk ratios, 1994-2000



the countries in the region in the eyes of the international financial markets, and the resultant instability of their access to resources.

No wonder, therefore, that under those various pressures crises have repeatedly visited the region and a number of countries –including all the major ones– have been placed at risk of a collapse in their exchange rate pegs and/or their debt service (figure 11).

Not surprisingly, vulnerability to an unstable international economy and most specifically to volatile financial flows has resulted in high “real instability” for Latin American economies, even if the much-praised price stability has basically been achieved. But what also must be recalled is that the last decade’s average

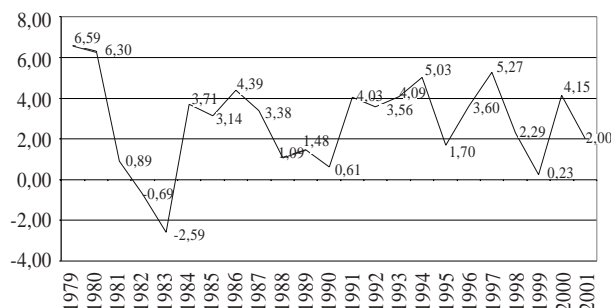
rate of growth on the whole was only marginally greater than that of the “lost decade” of the 1980s (3.0% compared with 2.1% per annum).⁵ Thus, if the 1980s was the “lost decade”, then the 1990s may well be baptised the “roller-coaster decade” (figure 12).

2. The Argentine economy in the late 1920s

Parallels with the Argentine economy in the late 1920s –the period when Raúl Prebisch started developing his ideas about the “peripheral economy”– are many. We have already noted that in terms of frequency of crises

⁵ See IMF, 2001.

FIGURE 12
Latin American and the Caribbean: Real GDP growth rates, 1979-2001
(In percentage per year)



as well as of the behaviour of commodity prices, the period between the wars was that –out of all the periods in the last 120-odd years– which was most similar to the post-Bretton Woods era and most specifically to the last decade.

Let us take a look at the Argentine economy of those years. Crises and fluctuations did not first visit the country only after 1929. The idyllic version of an exclusively prosperous 1920s is far from the facts. A clear pattern of economic fluctuations had previously emerged, to the point of being christened by Prebisch and his team as the “ciclo económico argentino” (“Argentine business cycle”). Unlike, for instance, the U.S. business cycle that was being analysed by Mitchell and the NBER in those same years, that of Argentina, Prebisch and his team posited, was dominated by the instability of exports and capital inflows rather than by that of domestic investment.⁶

The reasons for export instability were several. First, exports were overwhelmingly agricultural exports. In the period from 1923 to 1927, on average, 96% of exports originated in the agricultural sector.⁷

⁶ For an examination of the Argentine economy of those years, see *Revista Económica* (there is an English version published as *Economic Review*) of the Banco de la Nación Argentina (BNA, various issues), which was continued for a brief period after 1935 –as a new series– by the newly created Central Bank of Argentina. An Economic Research Department, which published that review, had been organized at the Bank under the direction of Raúl Prebisch. For a survey of its studies see the first section –“The Argentine Business Cycle”– of O’Connell, 1984.

⁷ Fifty-five per cent were agricultural products and 41% produce from stockbreeding activity. See Dirección Nacional de Estadística y Censos (DNEC, 1921, 1922, 1923, 1924, 1926, 1927, 1928, 1929).

Moreover just four products (wheat, maize, linseed and beef) made up two-thirds of the total.⁸

Some studies published at that time or immediately afterwards would show a chronic trend, beginning by the end of the 19th century, for instance, for wheat prices to decline in real terms.⁹ Additionally, Argentina was far from being a marginal supplier in some of these markets so that, as conditions of over-supply worsened after the First World War, her exports were bound to encounter barriers.¹⁰

As mentioned above, recent studies of long-run trends have confirmed that a declining trend in real primary product prices was taking place. No wonder, therefore, that when he observed the late 1920s situation, Prebisch started placing emphasis on the “trend towards a deterioration of the terms of trade between primary products and manufactured products”.

Going back to fluctuations, however, a second characteristic of Argentine exports to which Prebisch’s attention was drawn and was confirmed again later was

⁸ Wheat made up 22% of total exports, maize 19%, linseed 12% and beef 11%. Those exports had another very special characteristic distinguishing them from those of other primary producers, such as for instance Brazil, which exported coffee: i.e., those Argentine exports –being temperate-zone agricultural products– entered into competition with the domestic output of the more advanced Western European and North American countries.

⁹ Mandelbaum (1953) shows that wheat prices had been falling –in real terms– since the early 1880s. For V. P. Timoshenko (1933), the prices of fifteen important agricultural products were already falling by the mid-1920s, not to speak to what happened later in the early years of the Depression. In Argentina, wheat prices fell from an average of 15.13 pesos per quintal (100 kg) in the 1920/1924 period to 10.50 pesos in 1927/1928 and 9.68 in 1928/1929, well before the Wall Street crisis.

¹⁰ Argentina was the second world exporter of wheat –22% of the total– and the leading exporter of maize, with more than two-thirds of the total. Its shares of world exports of beef (61%) and linseed (80%) was also very high. See Taylor and Taylor (1943) for the shares of Argentine exports in world markets. By the 1920s, agriculture in the industrialized countries had become a sector in crisis, where protectionism and measures of direct support to domestic producers were becoming rampant. In fact the First World War had thrown the whole world agricultural sector out of balance. As output fell in continental Europe due to the ravages of trench warfare, the overseas producers had experienced a boom in output. The return to normal of European agriculture by the mid-1920s –under a panoply of support measures– produced a situation of chronic oversupply, however. For an account of the mounting tide of protectionism, whose roots lay in the late nineteenth century, see O’Connell, 1986 (this volume, by the way, was dedicated to “Raúl Prebisch - Elder Statesman of the Emerging Nations”, Prebisch having attended the seminar at St. Antony’s College, Oxford, at which most of the contributions for that volume were first presented).

their extraordinary price volatility, further compounded in those years by an instability in volumes (figure 13) due to weather factors and a cobweb-type cattle cycle. As domestic consumption showed a steady trend, volatility in output translated into volatility of exports.¹¹

In spite of some inverse relation between export prices and export volumes—to be expected of a country which was not a price-taker for quite a few products—export values also showed a high degree of instability. In fact, in the period from 1917 to 1929 this was much higher than in any other period of Argentine economic history and well above that experienced by developing countries in the Bretton Woods era.¹²

Had import prices fluctuated in the same direction and magnitude as export prices, the volatility would have been neutral for the country as a whole, although it would have had significant income redistribution consequences. But that was far from being the case. Thus, the terms of trade experienced wide swings before 1930 and only recovered the level prior to the First World War by 1946-1950.¹³

Not only did the terms of trade experience strong fluctuations but also, on average, over the 1920s they were at the same level as over the 1930s and in both cases 27% below that of 1913. Once again, a picture of the 1920s prior to the October 1929 Wall Street crash emerges which is anything but idyllic.

Imports, on the other hand, were quite a high share of GDP, almost 25% in 1925-1929. In this same period imports supplied 13% of consumption, while those of machinery and equipment represented 35% of domestic investment.¹⁴

Furthermore, as analysed by Prebisch's team, imports also displayed a high income-elasticity and a ratchet effect, as there was some inertia in their adaptation to lower levels of national income.

¹¹ For an analysis of export volume instability, see BNA (1930) and also BCRA (1937a and 1937b). For an instability index following MacBean see Diéguez (1972). Prices were normally less unstable than volumes, but in the period from 1917 to 1929 the instability of prices was slightly higher than that of volumes (12.5% versus 12.2% respectively).

¹² The instability index –à la MacBean– for export values in the 1917-1929 period was 16.8%, while that estimated by MacBean for developing countries in the 1948-1958 period was only 9.06% (Diéguez, 1972).

¹³ For a terms of trade index see Ministerio de Finanzas de la Nación/BCRA, 1952.

¹⁴ The years of the First World War had shown how essential imports were for the performance of the economy, when a dearth of supplies –plus, admittedly, a crisis of the building sector due to financial difficulties– resulted in the worst slump of the whole century.

FIGURE 13

Argentina: Exports-volume and prices, 1919-1939
(1913 = 100)

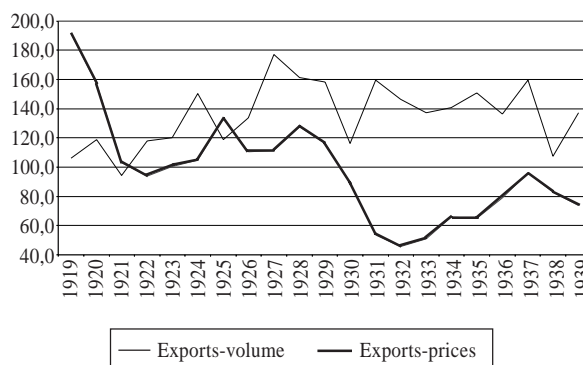
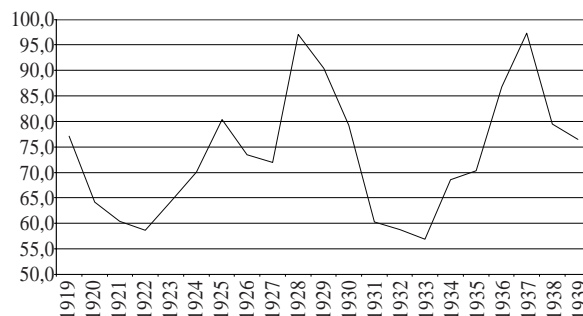


FIGURE 14

Argentina: Terms of trade, 1919-1939
(1913 = 100)



Consequently, when an export downturn –or a drop in capital inflows– hit the country, leading first to a scarcity of foreign exchange and second to a drop in GDP, the preservation for a time of high levels of imports resulted in further pressure on the availability of foreign exchange. In fact, wide swings in trade balances were experienced as may be visualized in figure 15.¹⁵

The second element of instability identified by Prebisch was that originating in capital inflows. Gross capital inflows amounted to the equivalent of 10% of exports, making them a significant supplier of foreign exchange. Contrary to what is habitually asserted as

¹⁵ For figures on the share of imports in GDP, consumption and investment, see ECLAC, 1958, tables 24 and 25. In the 1996-1998 period, when Argentina was recovering from the “tequila” crisis, the import elasticity of the country was between 3 and 4. That is very similar to the levels of most present-day “emerging market economies”, consequently putting their external position in danger.

FIGURE 15

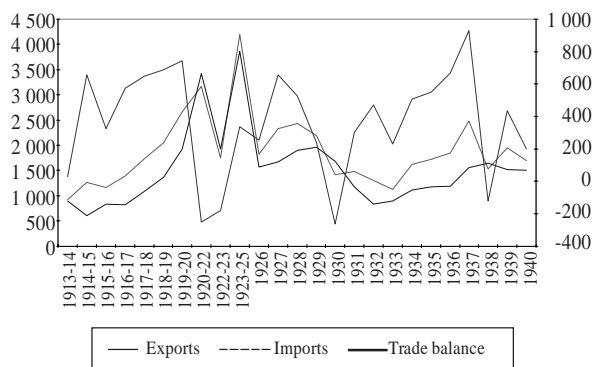
Argentina: Exports, imports and balance of trade, 1913-1940*(In million pesos m/n)*

FIGURE 16

Argentina: Gross capital inflows, 1919-1939*(In million pesos m/n)*

being different in that world compared with the present-day one, on average in the 1920s fully 53% of those inflows went to the private sector and only the remainder to the public debt.¹⁶

Capital inflows to the private sector were largely made up of foreign direct investment, which however, as it is today, was to a significant extent financed by debt issues. In stock terms, foreign direct investment (FDI) accounted for 32% of the estimated total capital invested in Argentina, and gross inflows were 10% of fixed capital formation.¹⁷

Capital inflows were notoriously unstable, however, as may be gathered from figure 16, concerning the period between the wars, which shows that this instability was already clearly present in the 1920s.

The instability of exports and capital inflows was transmitted to the economy through various mechanisms.

On the income side, exports in the period 1925-1929 represented 24% of GDP and more than two-thirds of the final demand for “Pampa” produce. Agriculture, for its part, accounted for between 25% and 30% of

GDP at 1950 prices, which were admittedly extremely low for these sectors, so that its true weight was surely much larger.¹⁸ The upturns and downturns of exports, therefore, were bound to have a strong impact on GDP. As to capital inflows, both private and public sector expenditure levels had to accommodate themselves to their availability, as they were an important source of finance.

Shocks were also transmitted via the fiscal and monetary systems. Three-fourths of government current revenue came from customs duties and other taxes on foreign trade. Therefore, to a great extent, they oscillated with what we have seen were highly volatile exports and imports. The availability of resources for government expenditure was also determined by the capacity to acquire further indebtedness. But, as may be gathered from figure 17, showing strong variations in the stock of public debt, such capacity underwent significant instability.

It is in relation to the monetary mechanism, however, that the parallels with present-day preoccupations are more striking. The monetary system of Argentina in those years was called a “sporadic gold standard” by Mr. Hueyo, a Minister of Finance in the early 1930s.¹⁹ In fact, Argentina had adopted a Currency

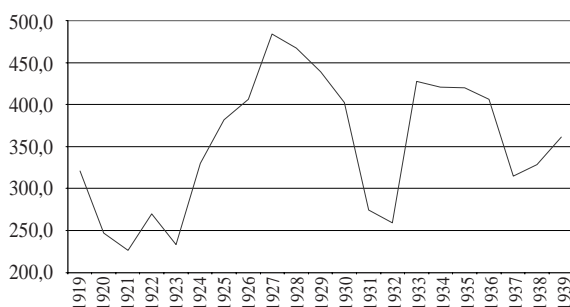
¹⁶ See Ministerio de Finanzas de la Nación/BCRA, 1952.

¹⁷ For these figures see ECLAC, 1958. Fully 60% of FDI originated in the United Kingdom; in turn, in 1929 Argentina accounted for 27% of all the UK’s FDI and 42% of that in “foreign countries”, i.e., in countries other than those of what was still the British Empire (see United Nations, 1949, table 7). For the United States, Argentina was much less important as a recipient of FDI—only 8% of the total—and ranked behind other countries in Latin America (see United Nations, 1949, table 6). However, many United States firms started to establish themselves in the Argentine market, manufacturing motor vehicles, electrical home appliances, cosmetics, and other things (see Phelps, 1936, and Whyte, 1945).

¹⁸ See ECLAC, 1958.

¹⁹ Mr. Hueyo’s pronouncements on the Argentine monetary system may be found in Ministerio de Hacienda y Obras y Servicios Públicos, Secretaría de Hacienda, 1932. Hueyo—following orthodox teaching and as Mr. Hoover did in the United States—tried in 1932-1933 to stabilize the economy through the reduction of fiscal deficits: a feat he almost succeeded in, but with less than favourable consequences for economic recovery.

FIGURE 17

Argentina: Foreign public debt
(In US\$ million)

Board system early in the twentieth century but had abandoned “convertibility” –to use modern Argentine parlance– at the beginning of the First World War, only resuming the operation of the Currency Board in August 1927.²⁰

As with many other cases of premature resumption of the Gold Standard in the 1920s, the experiment failed by late 1929 and the country only returned to a Currency Board system in early 1931, this time on a U.S. dollar standard.

Of course, under the Currency Board system credit and money supply had to accommodate to the vagaries of the trade balance and of net capital inflows. The Central Bank was only created in 1935, so that some of the functions of “lender of last resort” were fulfilled by the Banco de la Nación Argentina, echoes of which may be detected under the “tequila” crisis and under today’s –what we should call it?– “tango” crisis.²¹

Instability of exports and capital inflows, therefore, not only directly hit the balance of payments position

but was also transmitted to the rest of the economy through the workings of income and monetary links.

The experience of the 1920s had shown, in fact, that a cycle based on the instability of exports and capital inflows, amplified by income and fiscal/monetary mechanisms, had become clearly established.

A slump in incomes of various sections of the population –remember again the significance of price deflation– had inaugurated the decade. The sharp reduction in agricultural prices after the end of the war had a special impact on Argentina, which was dependent on those products. After deflation had run its course, there was a recovery which was followed, in the 1922 to 1924 period, with good harvests and the beginnings of large capital inflows originating in the United States. A bad harvest in the 1924-1925 season, however, caused a new decline in economic activity (accentuated by renewed deflation), which extended into 1926.²²

Beginning in that latter year, a new phase of expansion set in, but this time prices showed a slight downward trend. Due to a rise in exports and capital inflows, the peso started appreciating, leading to the reinstatement of the Currency Board system –a return to the Gold Standard– in August 1927. Government borrowing abroad expanded even faster, and gold entered the country, resulting in a big increase in reserves. This expansion found support in the policy of the U.S. Federal Reserve, which had cut interest rates by that time, resulting in an outflow of capital from the United States.²³

During that expansive period, currency and deposits increased. Lending, however, did not expand at an equivalent rate as banks tried to rebuild reserves and cancel old credits: a hangover from the previous downturn. The Banco de la Nación Argentina –which in the absence of a Central Bank proper was half-playing that role and had extended credit to other banks during the previous period of stress– started recovering those loans.²⁴

²⁰ The opening of the Currency Board, in 1927, pitted the politically powerful agricultural exporters against foreign investors. Exporters asked for a return to “convertibility” because the peso was appreciating too much, even beyond parity, while foreign investors were happy to see their earnings in pesos translated into larger amounts of pounds sterling and other foreign currencies.

²¹ In 1932, an “Empréstito Patriótico” was launched –like those in 1995 and now in 2001– but for lack of demand it ended up being purchased by the Banco de la Nación Argentina (a publicly-owned bank created after the crisis of 1890), using for the first time a Rediscount Law that had been passed back in 1914 to counter the crisis unleashed by the war in Europe. Mr. Hueyo asked for the advice of the Bank of England in setting up a Central Bank. As “money doctor” the Bank of England sent down a high-ranking official, Sir Otto Niemeyer, who was extremely critical of the Gold Standard. See his opinions in *Revista económica* (BNA, 1934).

²² See BNA (1929c) for an account of the early and mid-1920s cycles.

²³ For an analysis of the impact –not only on Argentina but on the world economy– of Federal Reserve Policy in the late 1920s, see BNA, 1929a. In August 1927, the Fed had lowered interest rates to 3 ½ % from 4% and engaged in an active “open market” policy of credit expansion. But beginning in early 1928 that policy was reversed because of increasing concern about the “irrational exuberance” of Wall Street; bonds were sold, and after successive increases interest rates stood at 5% by July 1928. Argentina’s international reserves increased from US\$ 466.5 million in January 1927 to a peak of US\$ 680.1 million in July 1928

²⁴ From the high point of June 1927, interest rates fell from an average of 6.75% to 5.75% by July 1928. See BNA, 1929b.

The 1928-1929 period is extremely interesting for our attempt at drawing parallels with the most recent decade and the present-day situation. As might be gathered from the previous figures, exports increased less and imports kept growing at a faster pace than in the previous expansion. On top of this, capital inflows started declining and some funds left the country as the tightening up by the Fed, plus the Wall Street boom, attracted them towards New York. Beginning in the second half of 1928 –way before the Wall Street crash– gold started leaving the country, mainly as a consequence of its boom rather than of the later crash. By the end of 1929 –when the Currency Board was closed down again– all the gold –or even slightly more– which had entered Argentina after the return to the Gold Standard had been lost.²⁵ Bank reserves started declining after September 1928, reaching a point lower than that prior to the 1927-1928 boom. Once again the Banco de la Nación Argentina was playing a compensatory role by lending to the government and other banks.²⁶

A drastic fall in export prices was the reason for lagging exports, which added to the crisis unleashed by the financial movements. Wheat harvests in the main producing countries in 1928/29 were much larger than in previous years and led to further accumulation of already heavy unsold stocks. Between May 1928 and May 1929 –again well before the Wall Street crash– wheat prices in Argentina fell 30%. Although not all agricultural prices fell so heavily, the general index dropped 7% between 1928 and 1929. Land prices fell in sympathy with these movements.²⁷

The stage was set for a significant slump in economic activity, even before the Wall Street crash of October 1929 signalled the beginning of the Depression that would dominate the following decade.

3. The early development of Prebisch's thinking about the "Argentine business cycle"

Surveying that experience, Prebisch coined the expression "Argentine business cycle" to describe it.

²⁵ See BNA, 1929d. Between September 1928 and December 17, 1929 –when the Currency Board was closed down– gold outflows amounted to 187.6 million gold pesos (roughly equivalent to pre-1933 dollars), which was slightly more than the 179.4 million that had entered Argentina since the opening of the Currency Board back in August 1927.

²⁶ Thus, in spite of the outflows to New York, bank lending increased 15% between September 1928 and December 1929 (BNA, 1929d).

²⁷ For the behaviour of land prices see Sociedad Rural Argentina, 1979.

Economic policy and the conduct of private as well as public affairs, he insisted, had better take it for granted that a new downturn would always be just around the corner, even during what could look like the most solid of booms. This seems a very prescient outlook compared with that of the advocates of the "new economy" and of the endless indebtedness of the emerging market countries.²⁸

Leaving aside the impact of weather on the volume of produce available for export, the other factors determining that cycle –prices and demand for agricultural goods and capital inflows– were intimately connected with international economic behaviour. In the case of Argentina, which did not have a domestic machinery-producing sector, the "accelerator" mechanism that Prebisch considered to be behind the cyclical behaviour of advanced countries was not applicable. In his opinion, therefore, all the instability originated abroad.

Furthermore, when analysing the instability of capital inflows, Prebisch came to a very up-to-date conclusion widely accepted nowadays: i.e., that capital flows are negatively connected with activity levels in what he was later to label the "monetary centres". As New York was almost the only such centre in the 1920s, capital inflows would be threatened when, as happened in 1928-1929, a boom in the United States economy and in the stock markets –accompanied by an attempt by the Federal Reserve to stop the "irrational exuberance"– would determine a capital drain from Argentina. The cycle in Argentina, therefore, tended to be the reverse of the United States one: something reinforced by the fact that sales to that country represented only a tiny fraction of total exports.²⁹

In his view, the contrast between the high instability of exports and capital inflows and some rigid elements of the economic structure made Argentina extremely "vulnerable" to that instability.

²⁸ In a later pronouncement, Prebisch said: "Even though there may be no idea of how, in what form, or at what particular moment the cyclic reaction will take place after boom periods, the fact that we know of its inevitability is sufficient to justify the timely adoption of measures to moderate the size of the fluctuation or reduce its economic and social consequences". See BCRA, 1938.

²⁹ In 1925, only 8% of Argentine exports were directed to the United States market. Imports from that country, on the other hand, had come to account for 23% of total Argentine imports, and the United States had become Argentina's largest supplier, displacing the United Kingdom (see Dirección Nacional de Comercio Exterior, 1941).

To begin with, mention has already been made of the behaviour of imports: their rapid expansion resulting in trade imbalances in booms and temporary downward rigidity in slumps, thus making those imbalances even worse. Government finances, also, tended to behave in an asymmetrical manner. When funds were easily available, expenditure –which was also supported by the higher revenues fed by the ensuing expansion of the economy– would increase at a fast pace. But in a downturn, the reduction of such expenditure became more difficult because of the rigidity of commitments previously entered into. Consequently, in slumps there was a tendency for fiscal deficits to explode, thus preventing the economy from adapting to the new level of availability of foreign exchange.

Additionally, service on foreign debt in the 1920s, on average, absorbed 20% of export proceeds (this proportion shot up to 35% in the first few years of the Depression). Current account deficits plus amortization on private and public lending resulted in high financing requirements, so that although it normally registered trade surpluses, year after year the country had to find large new resources to finance service on foreign debt and investment.³⁰

There were therefore two almost fixed charges against foreign exchange proceeds: somewhat rigid imports, and service payments on the foreign debt and capital invested in the country. In contrast, both exports and capital inflows were extremely volatile. According to Prebisch those were the circumstances that made the Argentine economy “vulnerable” to an unstable international economy.

Out of those observations on the sources of instability and the rigidity of some elements in the economy, in the late 1920s Prebisch developed his model of the “Argentine business cycle”. In this model the mechanics of the cycle hinged upon credit and monetary expansion and contraction and their impact on import levels. Only later, in the 1930s, did the Keynesian –or Khanian– income multiplier enter into his analysis.

In Prebisch’s scheme, expansion of exports –due to a bigger harvest but mainly to better market

conditions abroad– or larger capital inflows leads to the creation of “high-powered money”. Banks expand through the “monetary base” multiplier, creating purchasing power additional to that originally produced by the inflow from abroad. Trade and industry expand and imports –remember that they form a high proportion of GDP– surge up and the expanded availability of foreign exchange is rapidly exhausted. Either gold –under the “Currency Board” system– or “foreign exchange” start leaving the country or, under the floating exchange regime that predominated in Argentina for some time after the closing of the “Currency Board”, the national currency will experience a depreciation. A cyclical downturn in either export proceeds or capital inflows may add an additional recessionary force on top of all this. In the meantime, foreign obligations also have increased.

The scene is now set for the descending phase of the cycle. The outflow of gold and foreign exchange contracts the monetary base and the expansion of credit not only comes to a halt but in fact reverses itself. For that to happen smoothly, Prebisch insists, credit should have been granted only for short-term purposes, meaning that its repayment would be almost automatic, its purpose of financing merchandise trade having been fulfilled. If that had been the case, no financial crisis should necessarily happen. If expectations of sales had been too optimistic, some difficulty could arise in the repayment of credit, but then it would be the responsibility of the commercial banks and the Central Bank to resort to their reserves and rediscounting operations to fix the problem. Thus what Prebisch would criticize as an unwarranted contraction of credit could be avoided.

On the other hand, Prebisch took a strong stance vis à vis those advocating the use of bank credit to finance long-run investment. In his opinion, a confusion between credit and savings is the reason for advocating this, and banks should refrain from granting credit for such purposes unless funds from the public have been collected specifically for that purpose. Again the main reason for his opposition is based on the impact of such operations on imports, and consequently on foreign imbalances.

If the cycle has followed its course and the whole country has been subject to its ups and downs, however, the government’s financial position also suffers because of the impact on revenues. And, then, the rigidity of fiscal expenditure coupled with that of imports would only worsen the imbalances that the economy has run into. Prebisch also points out the pernicious character

³⁰ Financing requirements were around 25% to 30% of exports in the 1920s, increasing to almost 60% in the 1930s. On the whole, the net transfer of resources was clearly negative; in the 1925-1929 period it came to almost 5% of GDP. For figures on the debt burden and financing requirements in relation to export proceeds, see Ministerio de Finanzas de la Nación/BCRA (1952), and for the net negative transfer of resources, see ECLAC (1958), tables 24 and 28.

of short-run capital inflows: what he labels as “floating funds”. In his vision, these funds “...tend to duplicate foreign exchange demand; once to pay for imports that result from their inflow and (twice) for the need to support their later outflow”.³¹

Prebisch also introduced another element in his analysis of the short-run behaviour of an “emerging market economy”. Businessmen’s expectations are brought in as a motive force that could lead to the expansion or contraction of output and the consequent demand for credit. In the case of a rural country, however, he made those expectations dependent on the state of the rural sector, thus returning to the idea that weather and external prices are the main determinants of the cycle, coupled with the vagaries of capital inflows.

In all his writings and analyses, dependence on imports –with its high income elasticity to increases in GDP and its asymmetric downward rigidity– is the factor that plays the main role in erecting an insurmountable obstacle to expansion and also to any attempt at a counter-cyclical policy –such as an expansive monetary policy– in conditions of a balance of payments crisis.

Economic policy therefore had very limited autonomy for coping with the “Argentine business cycle”. With such a primitive fiscal and monetary system as the one described above, many instruments for such counter-cyclical policies simply did not exist. The only possible course was one of extreme prudence during expansionary periods so that excessive credit and government expenditure based on further indebtedness could be avoided. That would make what Prebisch considered to be the inevitable downturn more manageable.

4. The Depression and further developments in Prebisch’s thinking

It was under such circumstances that a new downturn in the international economy –beginning in late 1929– hit the country. Export prices continued to fall until 1932, and import prices also fell, although less so. As a result, the terms of trade deteriorated over that four-year period.³² Price levels were also important, and not

only their relative decline. Thus, in 1932 export prices stood at half their pre-First World War level, placing an enormous burden on the indebtedness of producers and their creditors.

For their part, capital inflows almost dried up, only partially recovering in 1933.³³

The Argentine economy only began to recover in 1934 (and even more firmly afterwards) due to a prolonged serious drought in North America that later extended to Australia. On the one hand, this drought generated the famous “dust bowl” that brought misfortune to poor farmers in the United States, but on the other hand it brought prosperity to Argentina, which saw its export prices climbing by the second quarter of 1934 to unexpected levels. The country experienced a balance of payments bonanza fed by exports at those high prices, and on top of this a return of capital inflows partly due to political instability in Central Europe. This time, however, these inflows were mainly short-term and started leaving the country as soon as the situation began to deteriorate in 1937 (with the recovery of harvests in the main competing countries).

Argentina, which almost alone had not defaulted on its foreign debt service, actually repatriated part of it, besides engaging in major domestic sterilization operations.³⁴

The consequences of the abundance of foreign exchange were obvious: imports shot up –by 74% between 1932 and 1937– and GDP expanded by 27% in that same period.³⁵

³³ Some short-run “compensatory finance” (in reality, it was used to repay a previous loan from Phoenix Corp.) was provided –in the absence of a body like the IMF– by Brown-Harriman of New York, and the British railway companies managed to issue some debentures in both 1930 and 1931.

³⁴ Perusal of the minutes of the discussions for the Anglo-Argentine Treaty of 1933 reveals that the Argentine delegation was insistent in complying with full debt service, even under pressure from the British side to leave some resources for British exports and, above all, for profit remittances by British-owned firms –especially the railways– in Argentina. By the way, Raúl Prebisch was a member of that Argentine delegation as financial expert; in 1933 he was formally still an official of the Research Department of the Banco de la Nación Argentina, in which capacity he had been invited to attend the preparatory meetings (in Geneva) for that year’s World Economic Conference and had gained the appreciation of the head of the British delegation, Sir Frederick Leith-Ross. Later in the 1930s the newly created Central Bank and its General Manager, Raúl Prebisch, were widely praised, for instance by the League of Nations economic and financial section, for the debt repatriation and sterilization measures adopted.

³⁵ Export prices increased by 43% in 1933-34, 21% in 1935-36 and 22% in 1936-37. By 1937 the terms of trade were at their highest

³¹ See BCRA, 1937c, chapter II for this sentence (my translation) and, more generally, for a succinct later account of Prebisch’s thinking about the “Argentine business cycle”.

³² Export prices fell 64% between 1928 and 1932, while the terms of trade dropped 40% over the same period. For figures on foreign trade prices and terms of trade, see Ministerio de Finanzas de la Nación/BCRA (1952).

In opposition to both traditional and some modern scholarship, Prebisch himself, however, was careful not to claim that the recovery was mainly due to the policies followed. In the *Economic Review*, published since the mid-1930s by the Central Bank, Prebisch –speaking again about the cycle the country had been going through– said: “From 1934 up to the present there has been... a gradual improvement (of the economic situation in Argentina), partly brought about by the adoption of measures tending to facilitate readjustment of international accounts and revive internal economic activity, but mainly as the result of the gradual rise in the world prices of the country’s export products”.³⁶

The way in which Argentina overcame the Depression, therefore, was more related to “exogenous” events –a prolonged and serious drought that hit foreign competitors– than to any shift in economic policy-making. At the same time, however, it is true that the crisis forced some changes both in economic policy and in economic structure.

In terms of shifts in economic policy “régime”, perhaps the most important event was the introduction of exchange controls right after the pound sterling went off the gold standard in September 1931. Priority was given to essential imports and the service of the foreign debt, with other imports and remittances of profits being relegated to a second order of importance.

Once again, rather than fed by a visionary policy of “import substitution”, rationing of foreign exchange became a necessity because of the balance of payments crisis. Exchange controls were to remain in place for decades, although undergoing significant changes, the first one inspired by Prebisch himself at the end of 1933.³⁷ Rationing of foreign exchange, in fact, took the place of a true real devaluation like those undergone by other countries in South America.³⁸

level in the century up to that moment. Export values rose explosively by 128% between 1932 and 1937. For an account of how the drought in North America determined the recovery of the Argentine economy, see O’Connell (1984).

³⁶ See BCRA, 1937c, page 1.

³⁷ Under the new régime instituted in November 1933, a “free market” was established, separated from the “official” market. In the free market exchange would be sold by the authorities by auction. That was thought to introduce an element of flexibility that would lead to the gradual fading away of the controls. The official market, in its turn, was divided between a buying and a selling rate, with some margin in between. This margin was to pay for the increased cost of foreign public debt service –after a devaluation of around 20% was introduced– plus a price support scheme for wheat, maize and linseed.

³⁸ In Argentina, the peso had become overvalued against the pound

Almost as soon as the new scheme was introduced in late November 1933, foreign exchange –boosted by good market conditions for Argentine exports– became abundant for reasons already mentioned. The market-determined “free rate” tended to fall towards the pegged “official” rate, at which point the authorities decided to fix the margin between the two. In this sense –as Prebisch acknowledged later in life– it was confirmed that the system was being used mainly as an element of discrimination in favour of Great Britain and some of the European countries and against the United States. Investors and exporters from those countries were to benefit from the official rate, while United States exporters and firms established in Argentina had to resort to the “free” market. Such a policy, of course, had to do with the extreme triangularity of Argentine trade, that worsened the sterling area deficit with the U.S. dollar area, and the leverage Great Britain had to force the country into a bilateral exchange agreement.

The other decisive innovation in the economic policy régime was the institution of a Central Bank, beginning in 1935. This move consolidated and reinforced the role that the Banco de la Nación Argentina had been playing in shoring up banks –and the government– and represented a further step away from the “Currency Board” system.

As already noted, Sir Otto Niemeyer –our British “money doctor”– was extremely critical of the workings of the Gold Standard, and although Prebisch disagreed with Sir Otto about some of his recommendations for the Central Bank, he did share those criticisms.

The Gold Standard –or the “Currency Board” system based on gold– was deemed to be too rigid a mechanism both in the upswing and in the downswing for a country whose economy was dominated by frequent movements in export values and capital inflows. It would lead to easy over-expansion in an era of abundant foreign exchange and to excessive contraction in a moment of slump.

Thus, Prebisch –who always had thought of himself as an orthodox economist– ended up defending the exchange control system. In his view, exchange controls were absolutely necessary in order to be able to introduce a “national monetary policy” that would gain some autonomy for the country from world forces beyond its control. He thought of exchange controls only as a mechanism in the financial sphere and not

sterling over the 1929-1933 period, and this was not fully corrected by the devaluation of November 1933.

—at least in his writings— as an element of protectionism for the country's produce. For that, he said, Argentina must have its own customs policy; otherwise this would be imposed by the great powers.

The other novel element in Prebisch's thinking was that relating to the role of industry. Industrialization —a larger share of GDP originating in manufacturing activities— was reckoned as a further way to regain autonomy, as this sector would be less connected with developments abroad. At that time, however, his writings did not contain any of the other arguments in favour of industrialization that would make him and ECLA famous in the late 1940s.

For the rest, both in his writings, speeches and lectures and in economic policy making Prebisch resorted to consecrated orthodox solutions, i.e., a restrictive monetary policy and sound government finance as well as a banking system based on short-term credit and under strong supervision by the Central

Bank, and of course the honouring of debts. No wonder, then, that if a comparison is made between the availability of foreign exchange and the rate of growth of GDP or of manufacturing in Argentina and in other "emerging market" economies of the era —Brazil and Chile in South America as well as India or the Danube basin countries in Europe— the performance of Argentina was decidedly slower.³⁹

In the present new era of financial globalization, however, Prebisch's vision of the problems of an "emerging market economy" in an unstable international system has regained significance and it stands as a source of insights about its mechanics. "Vulnerability" is back with us. From that point of view his enemies —advocating the reinstatement of "free" international trade and capital movements— have ended up paying him the greatest homage of them all.

(Original: English)

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³⁹ For such a comparison with Brazil see Abreu (1984), and for a comparison with other countries see O'Connell (1984).

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The ideas of *young Prebisch*

Adolfo Gurrieri*

1. Introduction

Prebisch arrived at ECLA for the first time in 1949, to write a report in which he set out his views on the main problems then facing the economic development of Latin America (Prebisch, 1949). As he had been hired as an outside consultant, he did not receive the support of other members of the institution in its preparation, nor did he have much time at his disposal, so that the report was a reflection of the ideas he already held prior to joining ECLA. As the content of that work made a great impact on academic and political circles in the region and came to be considered one of the basic pillars of structuralist thinking, it has often been wondered when and why Prebisch incorporated those ideas into his thinking.¹

In 1949 Prebisch already had a lengthy career as an academic and public official behind him and was, according to Furtado, “the only Latin American economist with an international reputation” (Furtado, 1985, p. 58). His first works date from the 1920s, and

the general opinion is that in those years he was a firm supporter of neoclassical ideas, but there is very little in them that could have served as a basis for the 1949 report, and only as a result of the crisis that began in 1929 does he appear to have begun to abandon his neoclassical views and to look for new interpretations of the economic process and heterodox policies for reshaping it.² The fact that Prebisch often confirmed this simple division of his thinking into two periods must have been one of the main reasons why this was accepted without question and a deeper study was not made of his thinking in the 1920s (Prebisch, 1983).

Attentive reading of the material he wrote during those years, however, shows that the continuity of his ideas was much greater than has been assumed, so that it would be very simplistic to divide the evolution of his thinking into two periods—orthodox and heterodox—separated by the 1929 crisis. Prebisch himself, when going into greater detail, recognized that the 1920s had not been a period of pure orthodoxy for him. For example, when referring in an interview to the first articles he had written, he said “In those articles I tried to interpret actual phenomena with my own eyes, and not with economic theories from outside. I attached

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¹ This question is different from another one which is also important but is not considered in this article: whether those were original ideas of Prebisch or not, and what sources they came from. See in this respect Love (1994 and 1999).

² “When Prebisch began his career as an economist and professor, in the late 1920s, he was an ardent supporter of neoclassical theories. The Great Depression of the 1930s—the first great crisis of capitalism—was the prime cause of Prebisch’s conversion” (Sprout, 1992, p. 188). Similar opinions may be found in many other authors.

great importance to the balance of payments... I began to understand Argentina's external vulnerability at that moment. This was between 1921 and 1923" (González and Pollock, 1991, p. 458). The fact that Prebisch often confirmed this simple division into two clearly opposed periods must have led those who have studied his thinking to take this for granted, with the already mentioned result that they did not study his thinking during the 1920s in greater depth.

The aim of this article, therefore, is to show that even from his first works, written in 1920, Prebisch began to shape the body of ideas that he formulated as a whole when he arrived at ECLA in 1949, and also that he did not need to go through the experience of the 1929 crisis in order to become aware of the defects of the primary export pattern, since these had already been clear to him even in the early 1920s, when the Argentine economic process was considered a shining example of successful growth. The brutal impact of the crisis merely served to confirm to him that he had not been mistaken about those defects and to lead him to definitively abandon his confidence in the Gold Standard as a basic criterion for economic policy management and seek new ways that would permit an improvement in the standard of living of the population.

2. The main ideas put forward in the 1949 report

The origin of the main ideas put forward in the 1949 report could hardly be traced back without first of all recalling them here, albeit in an extremely summary manner. In that report, Prebisch laid down the main lines of a strategy for promoting the economic development of Latin America, understood as a process designed to raise the standard of living of the population through a systematic increase in productivity.³ His main thesis with regard to the orientation of that strategy is that it could not be successful if economic activity were concentrated around the production of primary commodities and their export to the industrial centres, so that it was essential to promote industrialization. The primary export pattern had of course lost its dynamism as a result of the difficulties caused to international trade by the great crisis and the Second World War, and although the most negative effects of those events were

coming to an end, Prebisch did not think it likely that that dynamism could be recovered, because of the protectionist policies applied by the United States since 1930, which had reduced external demand and the flow of capital. In view of that country's importance as the main cyclical centre, he concluded that those policies imposed conditions which ruled out the restoration of a world economy compatible with the primary export pattern. In any case, even if the United States were to change its policies with regard to the rest of the world and international trade and capital movements expanded once again, it would not be a good idea for the Latin American countries to return to the primary export pattern, because this had three negative aspects. Firstly, as primary exporting countries, their economic processes were a reflection of those of the industrial countries, so that they were subject to the fluctuations of the latter and to considerable external vulnerability. Secondly, when the world economic system has been made up of industrial countries and primary exporting countries, the income generated by the system as a whole through increases in productivity has tended to be concentrated in the industrial countries because historically the terms of trade between industrial and primary goods have evolved in favour of the former, due primarily to the subordinate role played by primary commodities compared with industrial goods in the production process of the system as a whole. Thirdly, in most of the countries of the region, primary export activities have not been and will not be capable of absorbing the growing labour force and systematically raising its productivity.

These are the basic reasons why Prebisch maintained that the Latin American countries should not base their economic development on the primary export pattern but should adopt a strategy in which industrialization plays a decisive role. He made it clear, however, that while his criticisms were directed against a type of development centered on the production and export of primary commodities, they were not directed against those activities as such, since they must form an important part of the new strategy. He noted in that respect that industrialization would not do away with external constraints, so that in order to grow without upsetting the balance of payments it would be necessary to give a decided boost to primary commodity exports. In view of the diversity of national situations, he emphasized that each country must choose the sectoral mix most appropriate to the main objective, which was to raise the standard of living of the population. He was concerned that approaches based on the primary

³ The 1949 report can also be analysed as the basis for the structuralist theory of underdevelopment. Both these approaches are of course equally valid and mutually supportive. The work of Octavio Rodríguez represents the greatest contribution in this direction. See for example Rodríguez, 2001a and 2001b.

export sector should not be replaced outright with others based on industry, for selective sectoral development was a means rather than an end in itself. Yet although he expressed his ideas very clearly on repeated occasions, they have often been misrepresented either through ignorance or in order to serve particular interests, presenting them as though they advocated out and out industrialization and underrated or even despised primary activities.⁴

In his 1949 report, Prebisch also put forward several ideas on the means and conditions needed to promote this new development strategy. Two of these stood out above the rest. On the one hand, he stressed the need to combine the pursuit of development with the maintenance of monetary, fiscal and external sector balances. He rejected the idea that macroeconomic policy management should be guided by the automatic criteria of the Gold Standard, because these had shown themselves to be procyclical, when what was needed was to reduce fluctuations; deliberate intervention by the public authorities was essential in order to ensure that such management was both orderly and in keeping with the needs of development. On the other hand, he emphasized that development called for an enormous domestic saving effort and a considerable increase in the proportion of that saving used for productive investment. He explicitly rejected the idea of using inflation as a way of raising capital, because it put pressure on the balance of payments and was regressive in terms of income distribution: it was a kind of forced saving imposed on the mass of the population for the benefit of just a few, and there was no guarantee that the latter would use their growing income productively. At the same time, although he believed that it would be essential to use external saving in view of the shortage of domestic saving in many countries, he suggested that it should be employed with caution, because it too caused pressure on the balance of payments. It therefore seemed to him to be essential that most of the capital formation effort should be based on the domestic resources of each country, so that it was necessary to find “forms of (spontaneous or collectively determined) saving which... would make possible more appropriate use of resources for collective purposes”, including in particular the reduction of unproductive fiscal spending

⁴ See for example Viner, 1952. In contrast, Furtado understood very well the “limits” that Prebisch placed on industrial development, though he did not agree with them (Furtado, 1985, p. 62). Cattáneo (1991) gives an analysis of the relationship Prebisch envisaged between industry and agriculture.

and of the conspicuous consumption of the highest income groups.⁵

Finally, this summary review cannot fail to mention that Prebisch fully acknowledged that his proposals were only tentative and that a great deal remained to be done in terms of research and practical action in order to improve our knowledge of Latin American development. In the pursuit of this greater knowledge, he recommended that we should avoid over-academic approaches, ensure that all ideas had a scientific basis, and not accept ideas formulated in the centres without first of all making sure that they take account of the special nature of our problems. He therefore advised us “not to confuse analytical knowledge of outside ideas with slavish mental subjection to them: something from which we are very slowly learning to free ourselves” (Prebisch, 1949, p. 107).

3. Inequality, vulnerability and the Gold Standard

Prebisch came up against the question of economic development right at the beginning of his intellectual career, but with reference to Europe. Thus, in 1921 he commented on the International Economic Conference which had been held at Brussels in 1920 in order to analyse and find solutions for the great economic and social problems caused by the 1914-1918 war, which affected millions of people all over that continent (Prebisch, 1921a). The central issue was the economic “reconstruction” of Europe, and Prebisch summarized the views of some of the economists invited to that Conference, who had made their diagnoses and prescribed the measures that should be taken. He did not share the views of Pantaleoni, who, as “champion of the old economic gospel”, proposed the restoration of laissez-faire as the sole solution. Instead, he identified himself more with Gide, Bruins and Pigou (and indeed most of the other participants), who considered that it was not sufficient merely to balance the public finances and control inflation: those efforts would be no use unless the forces of production were reconstructed and developed through better use of the factors of

⁵ Prebisch, 1949, p. 136 (the page numbers of the quotations from Prebisch correspond to the editions mentioned in the bibliography). Despite the emphasis placed by many governments and international agencies in recent years on the so-called first –and second– generation structural reforms as necessary conditions for economic development, a recent study concluded that the countries which grew most quickly from the mid-1970s to the end of the twentieth century were those which invested a high proportion of their GDP and maintained macroeconomic stability (Rodrik, 1998).

production, reduction of consumption in order to increase capital accumulation, removal of hindrances to trade, increased international cooperation, and the integration of efforts within each nation in order to tackle those great economic, social and political difficulties more effectively. These proposals are remarkably similar to those which Prebisch made when he arrived at ECLA thirty years later, so it may be held that they were turning over in his head right from the start of his intellectual evolution. It was also obvious that he was greatly attracted by the ambience of the Conference, where leading economists and politicians were discussing solutions that would affect the lives of millions of persons: it was a situation in which he would have loved to take part, as in fact he was to do so many times in later years.⁶ Prebisch did not take the ideas of the Conference as the starting point for his own thinking, because his main interest was in the Argentine economy, which did not need reconstruction or development at that time; on the contrary, its growth had been so successful that—for example—the value of its exports had increased fivefold in the first two decades of the century. That growth had its problems, however, and Prebisch drew attention to them, clearly showing that, as already noted, he was well aware of the shortcomings of the primary export-based growth pattern, even in an economy like that of Argentina which was growing at a rapid rate. He perceived two main problems: inequality and external vulnerability.

He referred to the economic inequality of Argentina above all in a lecture he delivered during a visit to Australia (Prebisch, 1924a). Very briefly, his view was that the benefits of the rapid growth attained in Argentina on the basis of the export of primary commodities were not equitably shared, mainly because land ownership was concentrated in a handful of big landowners. In order to change that situation, he maintained, it would be necessary to break up land holdings so that land ceased to be an instrument of privilege and became a means of efficient production in the hands of an extensive and more highly developed

rural population. The great landowners have been able to use their political power to avoid any actions which could weaken their position, however.⁷

This situation has impeded the settlement of a greater proportion of foreign immigrants in rural areas, has favoured extensive land use, and has given rise to an extraordinary degree of inequality between the living conditions of the rich and those of the middle and working classes. In other words, the concentration of land ownership, together with an oligarchic political power structure, has formed the basis, in conjunction with its external components, for a primary export pattern which has made possible a high rate of growth but has concentrated the benefits of that growth in only a few hands and given rise to great economic and social inequality. Prebisch did not return to the question of land distribution for many years, only doing so in the early 1960s (Prebisch, 1963), around the time when José Medina Echavarría was publishing in ECLA his analyses on the economic, social and political effects of the persistence of oligarchic power (Medina Echavarría, 1963).

With regard to the external vulnerability of the Argentine economy, he considered that this was due to the elementary fact that the dynamism of primary export activities depended on external demand and external capital, so that fluctuations in those two factors led to cycles of growth and crisis.

“Although Argentine monetary history appears to be confusing, it does in fact reflect a series of periods of boundless confidence and prosperity, of expansion of transactions, real estate speculation and financial bubbles, followed by more or less serious collapses causing outbreaks of panic which lead to the forced liquidation of operations, a slump in confidence, economic prostration and stagnation of business activities. Of course, these cycles are not exactly similar to each other in terms of their underlying conditions or their nature, but taken as a whole there are fundamental elements in them which are repeated and whose analysis can serve as the basis for theories on their evolution. In making this apparently *a priori* assertion, we have not

⁶ At the Conference, the participants talked about “reconstruction” rather than “development”, but there are many similarities between these two concepts, as noted by the Latin American delegates who promoted the establishment of ECLA at the United Nations Assembly after the Second World War. They emphasized the many common features between the reconstruction of Europe and the development of Latin America: if an Economic Commission for Europe had been set up to aid in the reconstruction of that continent, then a similar Commission should be set up in Latin America to aid in its development (see Santa Cruz, 1995).

⁷ In his comments on a government land settlement project he notes that “Every time an attempt to carry out agrarian reform is made in our country, the literature on these matters is copiously enriched by a flood of ideas and comments on foreign laws of this type. This great flood of words, however, contrasts vividly with the absence of effective action, which is smothered under lackadaisical legislative actions and washed out by the influence of the interests of the great landowners” (Prebisch, 1924b, p. 393).

been influenced by the description of the classical process of crises formulated by some economists: on the contrary, we will seek to demonstrate that in our crises –apart from some other minor differences– there is a fundamental factor which is lacking from the European crises and is peculiar to the country’s degree of historical formation” (Prebisch, 1921d, p. 95).

Although his concern over inequality was only to re-surface a good many years later, his preoccupation with cyclical fluctuations was present in almost all his thinking throughout the next three decades, up to the time when he joined ECLA, when it was absorbed by the broader phenomenon of economic development. Prebisch embarked upon the historical study of the cyclical fluctuations of the Argentine economy because of his interest in finding the cause of the depreciation of the national currency, which had a highly negative impact on real wages: a very important matter in the Argentine socialist thinking of the period in which Prebisch was immersed.⁸ Encouraged by his professor, Augusto Bunge, he studied the various proposals for stabilizing the purchasing power of the currency (Prebisch, 1921e) and criticised the approach taken by Juan B. Justo, the main Argentine socialist leader of the time, who considered that the determining factor in depreciation was excessive currency issue, overlooking the decisive role played by the balance of payments fluctuations caused by the external factors already mentioned (Prebisch, 1921b).⁹

In his analysis of the various cycles which had taken place in the Argentine economy he highlighted the importance of external factors, which represented the main “objective” elements originally promoting periods of upward growth. In schematic terms, and taking into account the existence of strong external demand, he considered that it was the inflow of foreign loans and investments, especially from 1865 onwards, which made possible the convertibility of the peso and

served as a basis for the increase in currency and credit which stimulated economic activity through the increase in opportunities for investment and gain and for the expansion of government expenditure, culminating in “excessive” expansion of the money supply –both with respect to the reserves and the volume of business– reflected in “artificial” growth marked especially by private speculation and fiscal irresponsibility. At that moment, he considered, the economic agents are full of “confidence” in the performance of the economy: a “subjective” factor of great importance in speeding up the cycles. The productive impulse is overtaken by an urge for speculation, however, which contains within it the seeds of its own failure: the balance of payments begins to register a deficit because of the disproportionate growth of imports and the increase in outlays on services, interest and other liabilities, so that reserves begin to flow out and the peso begins to depreciate, the bank reserves fall, credit becomes tighter, economic activity slows down, and the country finds itself in the midst of a downward phase, which normally makes it harder to obtain fresh external capital. At this point, the public and private actors who were originally responsible for the monetary and banking “excesses” that caused the “artificial” expansion of the economy try to check the downward trend through measures such as rediscounting and non-convertibility: these are the social forces which defend policies based on excessive currency issue or inflation. The crisis cannot be contained, however, and the fall in the reserves finally leads to a reduction in the money supply and credit, with consequent liquidation of assets and reduction of imports. The reduction of the latter makes it possible to obtain favourable trade balances which permit the payment of debts and reactivation of the economy, thus giving rise to a renewed climate of confidence which attracts foreign capital, setting off a new upward phase.

In those days, Prebisch supported the idea that the liquidation of assets promoted by the application of the Gold Standard would make it possible to “cleanse” the economy of the excesses of “artificial” expansion and defeat the forces advocating currency issue and practising speculation, but the economic history of Argentina shows that this is only a transitory defeat, since these tendencies will reappear in the next upward phase. The inflow of external capital, of course, depends both on its availability and on the expectations of confidence and profitability that the investors perceive in the borrowing country. Prebisch notes that there have been occasions when the abundance of capital and the

⁸ The first article on this matter seems to have been that which he published in the newspaper *La Vanguardia* (Prebisch, 1920). I should like to thank José Besa for providing me with a copy of that article, from the documentary records of Mrs. Adela Mol de Prebisch.

⁹ In criticising Justo he based his arguments on the study by Williams (1920) on monetary fluctuations in Argentina, which had a lasting influence on him, since it served as a guide both for his ideas and the method of investigation he used. At all events, he acknowledged a little later that his criticisms of Justo had been somewhat too harsh, because currency issues in the period studied had in fact been greater than Williams and he himself had stated (Prebisch, 1921d).

feeling of confidence prevailing in the lending countries have sometimes allowed Argentina to keep on receiving capital and putting off the start of the downward phase in spite of the existence of appreciable trade deficits, but such postponements have never succeeded in preventing the crisis from occurring eventually.

Although the foregoing outline of Prebisch's view of the formation of cycles has been extremely brief, it nevertheless shows the significance of that view for the ideas which he put forward in 1949.

Above all, as he himself acknowledged, that view of cycles is the origin of his conviction that the primary export pattern is intrinsically vulnerable to variations in external demand and in the flow of capital, which thus become one of the main elements explaining economic fluctuations. In other words, he asserts that the Argentine economy has established a form of relationship with the industrial countries in which its functioning depends on the demand and capital of those countries, which has brought considerable growth, but growth subject to fluctuations which it has not been possible to control. Prebisch's schematic view is a dichotomy: on one side are the industrial and creditor countries, and on the other is Argentina, as a primary exporting country and debtor. Between these two there is a difference in the degree of "historical formation" which is equivalent not so much to inequality of living conditions as to inequality of social and institutional solidity; at any rate, that is what emerges from the comparison he makes between the Argentine banks and the Bank of England. The concept which comes closest to this is the development-underdevelopment contrast, if understood in a manner which does not take account only of economic dimensions. In addition, however, there is not only a difference of degree between the members of that dichotomy, in the sense that they have unequal degrees of historical formation, but also a functional relation, in that they carry out functions and maintain relations of interdependence within the same structure, and furthermore that functional relation involves a relation of domination within the structure of the world market.¹⁰

Decidedly, Prebisch does not like the fact that Argentina forms part of a structure in which it obtains benefits, but at the cost of loss of control. Obviously, there is only a single step separating this view from the centre-periphery scheme: all that is needed is to extend

the approach to cover all primary exporting debtor countries. It will be recalled that external vulnerability is one of the defects attributed to the primary export pattern in the 1949 Report, although at that time Prebisch paid more attention to trade vulnerability than to financial vulnerability, because in those days the Latin American countries had very little access to international capital after the cessations of payment that followed the crisis. In recent decades, however, the financial vulnerability associated with the condition of debtor countries has recovered all its importance in Latin America.

Secondly, Prebisch placed great emphasis in his initial works on the importance of external factors in the cycle dynamics of Argentina, because he considered that they were not being given their due importance compared with internal factors. This did not mean, however, that he ignored the latter; on the contrary, his analytical approach is much more complex than one based on mere dependence on external stimuli, because it incorporates internal sociological and psychosocial stimuli. Both the feelings of the actors (especially their greater or lesser confidence in the economic outlook) and the "social forces" play a significant role in cycle dynamics.¹¹

In his view, the most suitable approach for the study of cycles was one similar to that which ECLA sociologists were to propose forty years later for studying the historical development process in Latin America: to pay considerable attention to external factors, but to remain constantly aware that their impact on peripheral society is not manifested directly, because it is affected by the attitudes and behaviour of the domestic social forces. Prebisch summed up his view by stating that the dynamics of an economy are the consequence of "a series of mutual actions and reactions between the two types of factors" (Prebisch, 1921d). Although he appreciated the importance of domestic factors, however, he regretted that he could not study them, perhaps because he felt that he lacked the sociological knowledge for doing so; apparently no such study was made by any sociologist of the time either, thus losing the opportunity to lay the bases for a sociological theory of the Argentine business cycles.¹²

¹⁰ This latter aspect concerns what Max Weber calls "domination based on a constellation of interests", which must be differentiated from domination based on authority (Weber, 1964, vol. II).

¹¹ The incorporation of subjective factors into the analysis of cycles shows the influence of Pareto. For that author, social phenomena take the form of cyclic fluctuations, and in them the feelings of the actors –the basis for non-logical actions– play a decisive role (see Prebisch, 1923b).

¹² This gap was filled for a time during the 1960s in ECLA studies by a number of sociologists, notably José Medina Echavarría and

Thirdly, and paradoxically, in those years Prebisch combined his critical view of the primary export pattern with a conviction that the rules of the Gold Standard would make it possible to “cleanse” the economy of monetary and fiscal excesses and external sector imbalances, thus recovering macroeconomic balance, disciplining the social forces and resuming growth. This was the orthodox dimension which remained in his thinking and only disappeared with the 1929 crisis, although there are some indications that he had already begun to have his doubts about it before that date. His confidence in the Gold Standard led him to reject the initiatives for the creation of some kind of institution designed to regulate the economic cycle. He called Norberto Piñero’s idea of setting up a bank to regulate cycles “banking orthopaedics” (Prebisch, 1921c) and likewise criticised Emilio Frers’ proposal to set up an International Convertibility Board. “All the countries with depreciated currencies long to get back to the Gold Standard. So why interfere with it? And some of them, through drastic disinflation of the money supply, through savings on public expenditure and through a determined effort to improve their international balance of payments position, are on the point of doing so. Such is the case of Great Britain. Noted economists are already pointing to it as an example to follow” (Prebisch, 1923a, p. 359).

The paradoxical aspect of this is that at the same time that he was drawing attention to the importance of external factors in the dynamics of cycles, he accepted that economic policy should be based on a mechanism which asserted that domestic factors were responsible for external imbalances. At all events, Prebisch believed that the policy of “liquidation” needed to restore order after the “excesses” should be used to ensure that they were not repeated, by reorienting the economy towards a more genuine form of growth. This meant that production and financial activities should be based preferentially on domestic saving (since external saving was a source of vulnerability and instability, because it always ended up by disappearing) and the money supply and credit should be adapted to the existing reserves and the real needs of the economy. In other words, he wanted a more productive and less speculative economy, with a solidity coming from within, based on domestic saving and

investment, whose growth is less spasmodic, and with a sound currency and solid banks. He did not say anything about changes in the development pattern and made no mention of industrialization, but it may be presumed that he must have had them in mind, for otherwise how could Argentina raise its degree of “historical formation” and reduce its external vulnerability?

Finally, it is very likely that the scant attention paid by the Argentine economists of that time to the role of external factors in the evolution of Argentine cycles (in keeping with the ideas then prevailing in the centres) brought home very clearly to Prebisch for the first time the danger of accepting out of hand theories developed in other contexts and leaving out of the reckoning the special features of the Argentine situation: a danger he reiterated in 1949. As already noted, this does not mean that he proposed ignoring those theoretical efforts: on the contrary, he considered that their elements of value must be extracted from them to the full, as he himself did in the case of the studies by Harvard economist John Williams, which showed him the importance that should be attached to external factors in Argentina’s cycles. He noted in this respect that the under-estimation of those factors has led to serious policy errors even in the centres, as for example in the case of the international recommendations made to the German Government at that time for tackling its grave monetary problems. Those recommendations, which were based on the classical approach, maintained that those problems were caused by the increase in the money supply, which must be reduced at all costs, and they failed to notice that that increase was due to the demands for the payment of war reparations. Prebisch concluded that it was useless to insist that the German Government must control monetary expansion without first reaching an international agreement to relieve the burden of the reparations (Prebisch, 1922a).

4. The crisis, and the consolidation of his heterodox approach

Prebisch formulated the foregoing ideas between 1921 and 1924. In the following years, he continued to be very interested in studying the cyclic problems of the Argentine economy, but was faced with the problem of the lack of empirical information, so he made a great effort to prepare and compile statistics that would enable him to make a deeper analysis. He first of all occupied the post of Deputy Director of the National Statistical Institute, then of the Statistical Office of the Sociedad

Fernando Henrique Cardoso. This line of analysis has been interrupted in ECLA since the 1970s because an economic approach has prevailed.

Rural Argentina, and subsequently, from 1927, of the Bureau of Research and Information of the Banco de la Nación Argentina. The information collected served as the basis –especially in the last-named post– for the preparation of detailed descriptions of the economic situation; his approach continued to be that which he had developed in previous years, but –as was to be expected from an author working in a government office– he reduced his criticisms and increased the amount of empirical description.

These studies reflect his effort to unravel the significance of the recessive tendencies which he perceived from 1928 on. The first symptoms of what was subsequently to become the great crisis of 1929 allowed him to assert that once again Argentina –as a country which depended on outside demand and capital– was being affected by turbulences originating in the main industrial economies. In mid-1928 the inflow of external capital began to go down because of the increase in interest rates imposed by the Federal Reserve, which was very worried about the expansion in the amount of credit used for stock market speculation, and moreover the prices of Argentina's exports fell because of the lower demand by the industrial countries. This obliged the Argentine Government to cover its growing balance of payments deficit through an outflow of hard money, with its natural consequences for the monetary process (Prebisch, 1929 and 1930a). In those studies he also noted for the first time, however, that the fall in the prices of agricultural commodities was aggravated by the fact that those prices fell more than those of industrial goods. That process of relative deterioration of commodity prices compared with those of industrial goods could be due to various causes, but on that occasion he only argued that it was due to the fact that the inelasticity of agricultural supply had not allowed it to evolve in line with the drop in external demand.

Up to mid-1930, Prebisch (1930a and 1930b) held that those phenomena were merely specific manifestations of yet another cyclic decline, of the many that Argentina had experienced. "It may be considered as a short-term economic phenomenon, a downward period in the up and down movements that normally mark the evolution of any country; as a purely superficial event... which does not in itself affect the structure of the national economy or involve any significant departure from the ongoing upward trend in the country's economic activities" (Prebisch, 1930a, pp. 613-619).

It was in these circumstances that a new stage in Prebisch's life began when, in 1931, he took office as

Undersecretary of Finance and was called upon to make a decisive contribution to the task of formulating and applying policies to deal with the crisis. During that year and the next, government policy combined orthodox measures, such as the reduction of public expenditure, higher taxes and tighter credit, with other measures of a heterodox nature such as authorizing rediscounting operations in order to improve the situation of the banks and their creditors (Prebisch, 1931a), raising tariffs in order to check the balance of payments deficit and reduce the fiscal deficit, controlling the exchange rate in order to defend the value of the peso with respect to gold (Prebisch, 1931b), and introducing income tax in order to improve fiscal revenue (Prebisch, 1932a). These heterodox measures which Prebisch helped to formulate and implement as from 1931 were always presented as transitory and extraordinary, so that they were accepted by the rest of the members of the government and by the economic elite, among whom orthodox economic policy tendencies prevailed. They were always presented as being essential for dealing with an abnormal real situation; when things returned to normal they would be abandoned, and good normal doctrines would prevail once more. In addition, there was a project for the establishment of a Central Bank, which Prebisch drafted in 1931 but which the Executive did not dare to present to Congress because it was afraid it would be considered too interventionist and permanent, which proposed to regulate not only the inflationary tendencies in the upward phases of cycles but also (which was considered an unacceptably heterodox idea) the recessive tendencies in the downward phases (Prebisch, 1972).

Thus, he very quickly abandoned the Gold Standard and turned to heterodoxy, when he still believed that the crisis was merely a cyclic downturn; he no longer accepted that the liquidation of assets was an acceptable way out of the crisis, or that the automatic market mechanisms should be given full freedom to act. The rapidity of this change in his ideas raises the suspicion that he had already begun to doubt the validity of such convictions even before the crisis: indeed, he had already explicitly expressed his doubts about the efficacy of the market mechanisms when, years before the crisis, he supported State intervention in the meat market (Prebisch, 1927). Likewise, in the bill for the authorization of rediscounting operations in 1931, and very emphatically in 1932, he rejected the "liquidation" of assets as a way of putting the economy on a sounder footing and restoring growth: the State, of course, could not be liquidated, and he saw no advantage in

liquidating rural producers who could not pay off their loans because of the fall in the international prices for their products.

In his writings of those years, he returned to his old idea that the dynamics of cycles are affected by both external and internal factors; thus, he asserted that the problems Argentina was suffering were due both to monetary and fiscal excesses and to the external difficulties caused by the drop in export prices and the fall in capital inflows, as well as the country's weak monetary institutions. The proposal he put forward in mid-1932 was therefore to attack all those factors simultaneously through restrictive monetary and fiscal measures, exchange controls and foreign trade control measures, and a Central Bank which would put monetary institutions and policies in order and regulate cyclic fluctuations. At that time he still maintained that the crisis was merely a cyclic downturn, but he was beginning to suspect something worse: for many decades the evolution of the Argentine economy had been one of "growth only interrupted by depressions that were of short duration and low amplitude, in contrast with the severe features of the present recession" (Prebisch, 1932b, p. 86).

In 1933, however, he no longer had any doubt that the crisis was not just a cyclic downturn: between 1929 and 1933 agricultural commodity prices had gone down by almost half in pesos and by over two-thirds in gold; indeed, the prices in gold in 1933 were well below those prevailing in 1900. This reduction was much greater and longer-lasting than those which had occurred in cyclic downturns, and its impact was therefore broader and deeper, to the point of "... violently upsetting the economic structure of the country" (Prebisch, 1933c, p. 135). Because of this, in order to pay the same amount of interest on its debt Argentina needed 200% more agricultural products in 1933 than in 1929 and, because of the deterioration in agricultural commodity prices compared with those of industrial products, Argentina needed 78% more of the former to buy a given amount of the latter in 1933 than in 1929.

This serious diagnosis was accompanied by a pessimistic forecast regarding the possibility of returning to the pre-crisis situation in the short term. This appraisal must have been considerably influenced by two events. First, when he took part in the organization of the 1932/1933 World Economic Conference he became aware of the enormous political, trade and financial difficulties hindering the evolution of the international economy, including the persistence of the problems connected with war debts, the obstacles

standing in the way of tariff reduction, the dislocation of exchange rates, and the protectionist and reserve-building policy followed by the United States. This latter issue, which was to be given considerable prominence in Prebisch (1949), was a source of special concern to him in view of the central position of that country in the international economy. Some of those problems (such as the war debts and protectionist tendencies) already existed before 1929, but the crisis made them worse and also created other new problems (Prebisch, 1933a). His pessimism must have been further heightened by the conditions that Argentina had to accept in its negotiations with Great Britain, which culminated in the 1933 Roca-Runciman agreement. Prebisch formed part of the Argentine negotiating team and knew at first hand the force with which Great Britain (the main buyer of Argentine products) took advantage of its economic power in order to regulate trade with Argentina in line with its own interests (Prebisch, 1933b).¹³

In such circumstances, three ideas must have come together in Prebisch's mind: i) full confirmation of his long-standing criticisms of the Argentine economy's external vulnerability as an agricultural commodity exporting and debtor country, along with the more recent idea of the deterioration of the terms of trade; ii) the conviction that the crisis was much broader and deeper than a mere cyclic downturn, and that it shook the very foundations of the economy; and iii) the improbability that Argentina would be able to return to the situation existing before the crisis, because of the problems affecting the international economy at both the multilateral and bilateral levels. Those ideas must have convinced him that it was necessary to make an even deeper search for new ways of bringing his country out of its present situation.

He had already become convinced that the automatic mechanisms of the Gold Standard were not appropriate to the Argentine situation, since they were procyclical and attacked the external imbalance only indirectly, through restrictive fiscal and monetary measures, which led to an economic and social cost which was unacceptable to him; instead, that imbalance should be tackled through direct measures designed to regulate the exchange market and foreign trade. This was an advance in his heterodox thinking, but it only

¹³ The article by González and Pollock (1991) gives a very good analysis of the influence of these events on Prebisch's thinking –and state of mind.

referred to the manner –interventionist rather than automatic– of achieving balanced external accounts. A further decisive step was needed in terms of the application of active policies to bring the Argentine economy out of recession, and it was necessary to decide to what extent that called for the establishment of a new development pattern, now that it was clear to him that the primary export model would not be capable –at least for a long time to come– of playing the dynamic role that it had had before the crisis. In this aspect, Prebisch was influenced both by the ideas being formulated in those years in the industrial countries (especially the contribution of Keynes) and the policies being applied in them, especially in Great Britain and the United States. An analysis of this aspect is outside the scope of this article, however.¹⁴

He began to take this step with the National Economic Plan of Action which he prepared together with a number of colleagues in late 1933, with the explicit aim of “lightening the burden of the economic depression on the country” (Prebisch, 1934a, p. 146). After having put the monetary and fiscal situation in order, the Plan provided for a first set of measures to tackle the balance of payments deficit problem that Argentina suffered as an agricultural-exporting and debtor country, through devaluation and exchange and import controls. In defending these measures he explicitly and definitively broke with the Gold Standard system, since that only served to correct price and balance of payments upsets caused by an excessive increase in the money supply, but in 1933 no-one doubted that such upsets had not been caused by “excesses” or faults in the calculations of the economic agents, but rather by an unusually great and unforeseeable drop in international prices. Applying the Gold Standard mechanism, while ignoring the fundamental importance of external factors, would merely make the crisis still worse by causing an extraordinarily severe liquidation of assets.¹⁵ He had already set forth these ideas earlier, but in this Plan it was noteworthy that, as well as seeking to balance the external sector, these measures were also designed to reactivate the economy; exchange and import controls would protect industrial activities from outside competition, and the devaluation would have a beneficial effect on rural producers. Without

devaluation, the domestic prices of agricultural products would drop in line with international prices, and producers would not be able to pay their debts contracted at higher price levels, thus causing enormous successive liquidations of assets; in contrast, devaluation would reduce the impact of the drop in international prices on those producers.

A second set of measures was designed to promote reactivation of industrial production directly through a recovery in domestic demand. He argued that the reduction in the purchasing power of the population had reduced economic activity and increased unemployment, giving rise to a situation which needed to be corrected by the government through a large-scale public works plan designed to reduce unemployment and increase the purchasing power and consumption of the population, thus stimulating the reactivation of domestic industrial production, which would be further protected by the inability to import goods from abroad. He noted that in recent years tariff protection and the higher cost of foreign exchange had favoured domestic consumption and production, giving rise to an extremely important process: “local industries have managed to expand their production, while foreign trade has declined” (Prebisch, 1934b, p. 201). In short, “... it is very unlikely that the stimulus so desperately needed by the Argentine economy can come from outside; solutions must be sought within the country itself” (*Ibid.*, p. 144).

The Plan also has many other aspects worthy of interest, such as for example its attention to the redistributive effects of the economic policy measures on the different social groups, as already hinted in his early studies. This in turn leads the way to another issue of great importance: the social consequences of economic policies, for when redistributive effects are caused by the hidden hand of the market, as under the Gold Standard system, economists are not obliged to take complex ethical decisions, but when such effects are caused by their own interventions they have no alternative but to take them into account and analyse them carefully. Thus, for example, devaluation favours rural producers by improving the domestic prices of their products, which seemed fair to Prebisch because they had been one of the groups most seriously affected by the crisis. But this can encourage some of them to sell their products abroad at knockdown prices, thus adversely affecting the rest, so the government prevented this by setting up an institution to control this process (the National Cereals Board). Or other producers may try to derive excessive benefits by selling

¹⁴ See, in this respect, the articles by Love (1994 and 1999), González and Pollock (1991), and Rodríguez (2001a and 2001b).

¹⁵ His criticism of the Gold Standard appears in various studies of the time. See in particular Prebisch, 1934c.

the foreign exchange they obtain on the black market, so the government took steps to oblige them to change it on the official market. This shows that the Plan is important not only for its heterodoxy and its expansionary nature but also for its concern for the distributive effects of the measures taken.

How far did this Plan seek to reorient economic activity towards a development pattern in which industrial development played a decisive role, or was it only concerned with stimulating economic activity? Bearing in mind what we said earlier about the previous evolution of his ideas, there can be no doubt that the Plan was Prebisch's first answer to the question of how Argentina could cease to be an agricultural exporting debtor country: a question that Prebisch must have posed himself right from the start of his intellectual life, when he saw the problems that those problems brought with them. At that time he would have said that Argentina's situation as a debtor country could be overcome through a big domestic saving effort, but up to 1933 he had not written anything about how that country could overcome its dependence on agricultural exports. The idea of industrialization must have passed through his mind, however, for how otherwise could Argentina overcome that situation and raise its "degree of historical formation" to a level comparable with that of the important countries of the world? It would have been difficult to defend such ideas, as long as Argentina was registering high growth rates as an agricultural exporting country and the economic power was in the hands of an elite whose core consisted of great landowners. The situation changed in 1933, however, when it was clear that agricultural export activities had sunk into a deep crisis because of the serious drop in export prices, the deterioration of the terms of trade and the dislocation of international trade due to the crisis and United States protectionism, whereas industrialization had shown its capacity for increasing the supply of goods and improving employment and incomes.

Finally, some comments are called for on Prebisch's views in his early years about State intervention in the economy: a matter he never dealt with explicitly.¹⁶ Above all, Prebisch was always a fervent defender of disciplined and austere economic processes and he rejected all "excesses", be they monetary, fiscal, or in the fields of external trade,

consumption or other areas. This attitude was always present in his thinking, right from the start of his personal and intellectual life, and is the reason why he always believed that countries must maintain well-ordered accounts, avoid conspicuous consumption, and base their growth on domestic saving, without resorting to the easy but spurious "solutions" of external indebtedness and inflation. At first, he believed that the free play of the market forces would be sufficient to achieve this, but between the late 1920s and the early 1930s he gradually realized that this was not the way to go, and he began to advocate State intervention. He had no doubt that it was necessary to guide and discipline the private economic actors: for example, he scornfully referred to landowners who were not capable of seeing where their real interests lay,¹⁷ and in the decree serving as the basis for exchange controls he argues flatly that "the harmful anarchy prevailing in the market must be replaced with a centralized approach run by the most capable elements" (Prebisch, 1931b, p. 4). It was increasingly clear to him that the economic process must be regulated by an enlightened State elite capable of avoiding the pressures of powerful economic agents and also of governments themselves, which, as he showed in his first analyses on cycles, usually handle their economic affairs in an improvident, electoralist and often corrupt manner.

5. Conclusions

Prebisch's work on development began in 1921, when he became aware that the Argentine economy was highly vulnerable to the fluctuations caused by the industrial countries because of the position they occupied in the world economic system. This was the foundation-stone of the body of theories he built up over the years, which took its final shape in the centre-periphery scheme. As the most important exponent of Latin American structuralist thinking, he did not need to wait for the impact of the 1929 crisis in order to be aware of the intrinsically vulnerable and unequal nature of a development pattern whose functioning depended on foreign demand and capital and which was based on the concentration of land ownership; the crisis confirmed his diagnosis and made it urgently necessary

¹⁶ With regard to ECLAC's thinking on the role of the State, see Gurrieri, 1987.

¹⁷ "...the stock-raising crisis has shaken the great Argentine landowners out of their lethargy and may be a powerful element in turning their class instincts –mostly incoherent, disoriented and negative– into a clear awareness of their economic interests" (Prebisch, 1922b, p. 349).

to seek solutions, but it was not itself the prime cause of the problems. There is therefore a marked continuity in the evolution of Prebisch's ideas from his first youthful studies to the 1949 Report in which he presented his developmentalist "manifesto": those early studies already contain, to a greater or lesser extent, almost all the ideas he put forward when he joined ECLA, so it would be a mistake to overlook them as if they were merely another expression of neoclassical thinking.

Ever since 1921 Prebisch was concerned with the question of finding a less vulnerable and unequal way of organizing economic activity in Argentina. With regard to the dependence on external capital, his answer was immediate: much greater emphasis should be placed on domestic saving. The answers to the problem of dependence on external demand and the reduction of inequality were much more complicated, however, because they involved profound restructuring of the economy and came into conflict with the dominant interests. As already noted, he only returned to the question of inequality due to the concentration of ownership in the early 1960s, but he already gave a first response to the problem of external demand in the 1933 Plan, although he had probably been turning it over in his mind much earlier. What we can say for sure on the basis of his works is that in seeking new ways of reducing external vulnerability he had to abandon above all his support for the Gold Standard. This occurred when he became convinced that that standard was unsuitable because it subjected monetary and exchange policies to a criterion which took no account of the interests of the Argentine economy, since it expanded the cyclic fluctuations instead of reducing them and involved the application of restrictive monetary and fiscal measures which gave rise to high social costs. It was at this point that he proposed direct intervention on the exchange rate and foreign trade, and he began to apply measures in that direction when he took up a government post in 1931. Those measures not only helped to balance the balance of payments, however, but also helped to reactivate the economy, because they fostered domestic production, with beneficial effects on employment and income. In other

words they showed –if such a demonstration were needed– that industrialization should be an essential component of policies designed to reduce the dependence on external demand, so that in late 1933 he helped draft a Plan which combined control measures for the external sector with others expressly aimed at stimulating domestic supply and demand. This was his first consistent response on how to change the Argentine economy's situation of external vulnerability. The industrial development which took place in those years, however, revealed to him that industrialization also brings its own external vulnerability with it, so he insisted on the need to make such development compatible with the expansion of exports: a matter to which he devoted much attention in the 1949 Report.

Many other ideas put forward in that Report had already been present in his early works: the aggravation of external vulnerability through the deterioration in the terms of trade; the difficulties caused by the protectionist policies of the United States, and the error of accepting out of hand diagnoses and proposals prepared in the industrial countries, because they could well refer to different situations, so that economists must exercise a considerable degree of independent creation and critical judgement if they want to understand and successfully cope with the problems of their own national situations. He was also already convinced even as a young man that a combination of the market and State intervention was required in order to reorient the economy in the desired direction and promote its growth. As he was mistrustful of the political elites, he considered that such intervention should be carried out by an institution with a high degree of autonomy, staffed by technicians capable of disciplining and guiding the private and public agents in line with a technical and substantive rationale aimed at the benefit of the community as a whole. This perfectly expresses the way he then conceived the role of technicians in the decision-making process, and this is the line he took in ECLA and in the Central Bank of Argentina, which he helped to set up and of which he became General Manager in 1935.

(Original: Spanish)

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Raúl Prebisch:

his years in government

Roberto Cortés Conde*

1. The early years

The Prebisch that most people remember nowadays was a distinguished figure in international circles, with only sporadic interventions (1955 and 1984) in the economic affairs of Argentina, but this Prebisch who lived outside Argentina in the second half of the twentieth century played an extremely important role when he was a young man in the design and implementation of policies that brought about notable changes in that country.

He had graduated from the Faculty of Economic Sciences in 1923, and twenty years later, when he was still only 42 years old, he was forced to put an end to his work as General Manager of the Central Bank of the Argentine Republic, after eight years in that post and after having occupied high posts in the government.

When he was still a student he translated the study that J.H. Williams presented at the seminars of the school.¹ That work, and through it Taussig's ideas on economic cycles and balance of payments adjustments with capital movements, gave him the idea of analysing the Argentine cycles and mechanisms not envisaged in current international trade theory.

In 1922 Alejandro Bunge put forward his name to occupy the post of Director of Statistics of the Sociedad Rural Argentina. There he headed a team which in 1928 published a yearbook with the fullest historico-statistical information on the country to date.

In that same year he was entrusted with the organization of an economic research department in the Banco de la Nación Argentina, where he was to carry out important work on the compilation of statistics and short-term economic analysis, published in the Bank's *Revista económica* (BNA, 1928).

When Argentina was faced with new problems in the 1930s, the theoretical and statistical knowledge thus acquired allowed him to meet a challenge to which few intellectuals of that country have been able to respond. The circumstances he had to live in: the end of one world, that of the belle époque, and the appearance of a new one, that of closed economies and nationalist reactions, were hard for anyone to understand.

It was necessary to adapt or construct theories to explain phenomena which were previously unknown and hence had never been studied before. His visit to Australia in the 1920s and his stay in the United States –including his friendship with Williams– helped him in this task and allowed him to keep abreast of the newest intellectual developments.

Under the influence of Williams' study on balance of payments adjustment mechanisms in a country with inconvertible paper money and the theories on economic cycles (Taussig, 1915; Hawtrey, 1919;

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¹ See Williams, 1969.

Kondratieff, 1946), he began to work out new interpretations on the characteristics of the Argentine cycle. Argentina had an economy which depended on its exports of cereals, and this gave it a seasonal nature and also made it very vulnerable, since it was affected both by weather conditions and by the big fluctuations in international markets. There was also a monetary system which further accentuated such fluctuations. The seasonal cycle –which had come to be called the Argentine cycle– meant that when the harvests were sold in the summer months there was an inflow of gold and the banks expanded their supply of credit, whereas in winter, when there were no export proceeds, there was a shrinkage in national income and the banks reduced their credit. This gave rise to the idea of taking counter-cyclical measures.

In 1921, while he was still a student in the school of Economic Sciences, Prebisch published his “Notas para la historia monetaria de la Argentina” (Prebisch, 1921), in which he went back all the way to colonial monetary antecedents, noting that it was paradoxical that in a colony producing silver there was a shortage of currency. It was not that there was a shortage of silver, he said, but that as the Mint received currency at a lower price than it had as a commodity, it hoarded it and only circulated bad money: the “macuquina”, a feeble currency which was considered to be of little value because of its low content of silver, or local substitutes. In his “Notas” he studied the experience of issuing banks and inconvertible paper currency, as well as the crises of 1876, 1885 and 1890, maintaining that they were the result of over-expansion of credit in the upward phases of the cycle, in which purchasing power was created through money issue, whereas this situation was reversed when a deficit appeared in the balance of payments and the money supply had to be reduced. In the last part of the article in question he dealt with the 1913 crisis and began to outline a theory on monetary disturbances in the phases of cycles with a Currency Board system: a theory which he later developed in the Central Bank, in that institution’s *Memoria* for 1938 (BCRA, 1939). He said in that respect that whereas in issuing banks the money issue is based on commercial credit, in a Currency Board system money can only be issued on the basis of the balance of payments surplus (gold reserves). He noted however that even under the latter system inflows of gold produce not only an increase in the money supply but also an increase in the reserves of the banks, which, because they have more reserves, likewise expand credit. Hence, in an upward phase of the cycle there is over-expansion of

credit (a procyclical tendency), whereas when the opposite takes place there is an outflow of gold, the reserves go down, and credit shrinks still further. This is what happened in the upward phase of the cycle in 1913, he said, causing a chain reaction and giving rise to generalized pessimism on the economic outlook which made the recession still worse through its effects on consumption and investment.

2. His years in government and in the Central Bank

The 1930s was a period of enormous difficulties, but also of new experiences in the formulation and implementation of economic policies, under the new roles taken on by the government.

The 1930 world crisis made it necessary for Argentina to place itself in a totally different international context and find answers to situations which were previously unknown.

In 1933 Prebisch had read the four articles by Keynes published in *The Times*, after which, he said, “I began to think about an expansionary policy”.² Later on, he was to play a leading part in disseminating Keynes’s ideas in Spanish (Prebisch, 1947).

After the enormous upsets in the international goods and capital markets during the period following the First World War, the rigidity of the Gold Standard had become obvious. Argentina had been one of the few countries which, following the lead of Great Britain, had returned to a Currency Board system in 1927, at the parity which had prevailed before the war. It may be noted that during the time that that system had been closed down, currency issue had continued under the rules of the Gold Standard. In 1914 a law had been adopted permitting the issue of money on the basis of the discounting of paper of the Banco de la Nación Argentina, provided that 40% of the reserves were kept in gold. This law had not been used, however. In 1929, after the collapse of the New York Stock Exchange, and fearing a run on the banks, the government decided to close down the Currency Board, but it did not prevent remittances abroad and, after the first devaluation, it tried to maintain an overvalued exchange rate for the peso by selling gold. After the 1930 revolution, and finding itself in a difficult situation because the outflow of gold to pay debts and imports continued and delays were building up in the delivery of foreign exchange, it decided –in line with the 1914 law– that the Currency Board would issue money on the basis of paper

² Quoted in Fernández López, 1996.

discounted by the Banco de la Nación Argentina. As Prebisch (who had been Under-Secretary of Finance up to 1932) noted, that measure did not yet represent a change from the orthodox policy with which the government aimed to face the crisis (i.e., reducing expenditure and increasing taxes), but was taken because it was urgently necessary to replenish the assets of the banking system, which had been exhausted with the outflow of gold. At all events, however, the Gold Standard system was made more flexible. Taxes were established on remittances and government expenditure was reduced by lowering the wages of public employees. Rather than because of the closing down of the Currency Board and the application of the 1914 law, 1932 was important because it was then that money was issued on the basis of public securities in order to finance the Treasury deficit and a new conception of the monetary system came into being.

In 1933, with the entry of Pinedo into the Cabinet as Minister of Finance and the return of Prebisch as Under-Secretary, measures were applied which formed part of a plan guided by a new conception of economic policy. At the request of ministers Pinedo and Duhau, certain economic measures were formulated which were reflected in the National Economic Plan of Action of November 1933.

In that year the peso was devalued, not only in order to balance the balance of payments but also in order to support the agricultural sector. There was, said Prebisch, a true redistribution of profits; it was not just a mere exchange rate measure but was combined with the purchase of the harvest surpluses which it had not been possible to sell, in order to give the population greater purchasing power. It also aimed to stimulate economic activity through public works programmes and aid for industry.

Exchange controls were also established, with two markets: one official, on which the foreign exchange corresponding to the official prices of regular exports was sold, and the other a free market on which the excess over the official prices and the income from non-traditional exports to neighbouring countries could be changed. Two exchange rates were established: a buying rate at 15 pesos per pound sterling, and a selling rate which was finally set at 17 pesos. Since at these rates the demand for foreign exchange was greater than the supply, foreign exchange was rationed through prior import licences granted according to criteria fixed by the government. As Prebisch said: "Now, for the first time, we are putting into effect a monetary and financial plan which is above the old traditional influences" (BCRA, 1986, p. 50).

It was the understanding of everyone that these measures were of an extraordinary nature, as were the situations they sought to correct, and that when the Central Bank was set up in 1935 and exchange controls were allowed to continue, there was nevertheless the intention of getting rid of the latter and returning to a free market. In the message accompanying the bill proposing the establishment of the Central Bank – noted Prebisch – it was clearly stated that the aim was to establish a bank which would maintain the stability of the currency and make it possible to return to normal in monetary matters, but only provided that the main nations of the world did the same and that international trade was restored. But "if a system of closed economies prevails" – added the message – "the country will have, in its Central Bank, the means for adapting its policies to this de facto situation, in defence of the national interests" (BCRA, 1986, p. 51). These measures were adopted, then, in response to the closure of the economies of the most highly developed countries.

3. The Central Bank

Prebisch was a member of the first commission responsible for drafting a project for a central bank, but this was rejected in favour of a project by Otto Niemeyer, who had already prepared a similar project for Brazil. The 1935 law, however, differed from the Niemeyer project and incorporated modifications which bore the stamp of Prebisch.

The creation of the Central Bank was designed to achieve monetary stability and reduce the disturbances of the economic cycle. Prebisch maintained that in view of the characteristics of the cycle in Argentina, the Central Bank should intervene to smooth out the fluctuations by using absorption instruments. He considered that rediscounting, in contrast, would play only a transitory role.

"Thus, although the Bank was along classical lines ... the actual situation would not allow it to act in that manner" and "the possibility of applying another type of policy" should be envisaged. Here, he reiterated the concepts which he had already put forward in the early 1930s in "La acción de emergencia en el problema monetario" (Prebisch, 1991, p. 51). He went on to say "The strict Gold Standard system had an intrinsic flaw: during the upward phase the banks' assets grow, and this leads them to lend more money, because of the natural competition among them, so that they create more purchasing power than would be warranted by

the balance of payments position. This creation of purchasing power expands the effects of the upward phase but makes necessary a more violent contraction in the downward phase. But this is not the case if, instead of creating money, the compulsory reserves of the banks are increased during the upward phase, this extra cash is collected and sterilized so that it cannot serve to expand credit, and it is then returned when the situation is reversed, in order to avoid a contraction” (*Ibid.*, p. 52).

Rediscounting would be used only in limited cases: when a harvest failed or exports went down and there was an outflow of hard money. In those circumstances, rediscounting was in order in order to take pressure off the economy and prevent a contraction in agricultural activity and all the other activities connected with it.

The first intervention by the Central Bank took place from 1935 to mid-1937, in the upward phase, and involved the creation of absorption certificates which made it possible to sterilize purchasing power (saving), as well as buying back part of the external debt in dollars. When it was observed, in mid-1937, that the cycle was turning round and a downward phase was beginning, the reserves were used to give back purchasing power to the public in order to prevent a recession from spreading. The idea was to soften the cyclic curve and this, said Prebisch, was the second stage in “our monetary ideas”. Up to then, purchasing power was taken away in the upward phase and returned in the downward phase, but money was not created.

In the next intervention, during the early years of the Second World War, the authorities went much further. In view of the severe contraction in the early years of the war, when traditional markets disappeared, it was decided to try to give a more active role to the policy of regulating the means of payment, by creating purchasing power in order to promote industry and construction work; that is to say, it was decided to apply very active market policies in order to promote the development of the economy, but within a monetary circuit controlled through the exchange control system.

This idea had been at the centre of the proposal made by minister Pinedo in his 1940 economic reactivation plan (BCRA,1986), which consisted of mobilizing the enormous amount of idle deposits invested in the short term in the financial system, so that through the intervention of the Central Bank –which would purchase those deposits– the commercial banks would be able to make long-term loans, primarily for promoting construction (which was the most dynamic engine of growth in Prebisch’s view) and local

industry. This would have to be done with extreme caution, and only as long as there was not full employment of the factors of production, because otherwise it would lead to inflation.

These measures –said Prebisch– finally turned out to be unnecessary, because from 1941 on, with the entry of the United States into the war, exports increased, the supply of imports was reduced, and purchasing power rose within the country. This instrument was, however, to be used later in very different circumstances with highly inflationary consequences, which he criticized in his 1955 report to the Argentine government (BCRA,1956).

4. Conclusions

In his years in government, Prebisch played a leading part in the formulation of new ideas and economic policies which had a profound influence in following decades. Many of them were put forward in response to exceptional circumstances, and were to be abandoned if those circumstances disappeared. In the final analysis, they were responses to a world in which economies had closed and there were no international capital markets.

The starting point for these ideas was the conviction that the Gold Standard could avoid monetary crises, but not banking crises, which had serious consequences for the whole economy because of the pro-cyclical nature of bank credit. Prebisch proposed that compulsory reserves should be increased in the expansion phase and reduced in the contraction phase, and that a reserve fund should be established which would withdraw purchasing power from the public (through absorption certificates) and return it to them (by buying back those certificates) in the downward phase, while rediscounting should be only a transitory measure. In order for that purchasing power not to be diverted towards imports, there should be an exchange control system with selective exchange permits.

Although Prebisch does not actually say this in as many words, the idea was that counter-cyclical policies should be applied in the upward phase, when it is possible to build up reserves, for if it is not possible to restore purchasing power in the downward phase, this can only be expanded by creating money, which he does not recommend as it would produce inflation. All this, however –and this is an aspect which Prebisch does not mention because it seems so obvious– requires a thoroughly solvent and credible State.

In reality, this is rather similar to smoothing of taxes. But why use a monetary instrument instead of a fiscal one, then? In fact, fiscal instruments were not ruled out, since in the upward phase in 1935-1937 external debt was bought back with part of the surplus, but apparently it was politically easier to restrict credit by increasing the reserves in an upward phase than to increase taxes or reduce expenditure, when this had already been done earlier in order to balance the budget.

Finally, the last stage in what Prebisch called his thinking on economic management has to do with the reactivation plan prepared by minister Pinedo and the Central Bank policies designed to use the surplus of short-term deposits for long-term loans in order to promote construction and industrial activity. The Central Bank was to take those short-term deposits and then lend them to the banks on a long-term basis, the justification for that measure being the upsets caused by the war in agricultural production, which had no outlet for its goods, and the need to orient activities

toward the domestic market. The entry of the United States into the conflict in 1941 changed the situation, however, as exports of wool and hides to that country increased, while imports went down, thus balancing the balance of payments and, in Prebisch's view, making it unnecessary to apply the measure.

At all events, however, new policy instruments had now been created.

After Prebisch had been removed from the Central Bank, in 1943, that institution made repeated widespread use of rediscounting, with very adverse consequences for the economy, as he himself emphasized in his 1955 report to the Argentine government (BCRA, 1956). By then, after more than a decade in the government, his economic ideas had reached maturity, and since that time they have had an undeniable influence on numerous aspects of the economic thinking and history of Argentina.

(Original: Spanish)

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Markets and the State

in the evolution of the

“Prebisch manifesto”

Edgar Dosman*

1. Introduction

When Raúl Prebisch died in 1986 his ideas were out of fashion in Ronald Reagan’s Washington and Latin American capitals, dismissed by most Western economists as *passé* –or even dangerously misguided in the new crusade for globalization. Only United Nations circles and a narrowing band of supporters insisted on his permanent contribution. It was as if his life had merely reflected the turbulence of the “short, violent century” (as Hobsbawm termed it); now that it was over, with the Cold War consigned to history, so too (it appeared) was Prebisch’s legacy.¹

Exactly the reverse has occurred. Prebisch’s life and work retains a remarkable contemporary significance. Instead of diminishing, his stature as economist and policy-maker has grown, and the recognition of the magnitude of Prebisch’s contribution continues to expand as previously unpublished sources and unpublished manuscripts are assembled by scholars. Prebisch, it turns out, wears very well. The

central theme which preoccupied him from the 1920s to the North-South Dialogue was the relationship between markets and the State; today globalization and its unpopular aspects (or “civilizing globalization” as some authors have termed it) remains the central challenge for both Latin America and most of humanity. For this reason, it is worth revisiting Prebisch’s immense contribution –both the challenges he faced, and the concepts and policy tools he evolved through trial and error to meet the development challenges of Argentina, Latin America and the world.²

No person of his stature has been as neglected or misunderstood in the literature as Raúl Prebisch. This is not to claim that important contributions by senior scholars regarding individual segments of his life are unavailable; indeed a rich bibliography exists and continues to expand.³ Instead, the obstacle which has

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¹ A special note of appreciation is extended to Doña Adelita Prebisch for giving me access to the Prebisch Papers in Santiago, Chile; for her permission to quote from these papers; and for her unlimited personal assistance in researching the life and work of Raúl Prebisch. I wish also to thank Eliana Prebisch and the Prebisch Foundation in Buenos Aires for their kind collaboration; Adolfo Gurrieri and David H. Pollock for their comments on the manuscript; and ECLAC in general for its cooperation over the years.

² For further references to the passions which Prebisch aroused, see Dosman and Pollock, 1993, pp. 11-43. For a telling example of the continuing vilification of Prebisch for allegedly misleading Third World leaders, see Crossette (1999): the ex-Premier of Singapore, Lee Kwan Yew, claimed to have read and heard out all the arguments of writers such as Argentine economist Raúl Prebisch and said they were rubbish, but that other leaders believed them because it was “emotionally satisfying”.

³ The numerous works by Prebisch scholars include the exceptional contributions of Joseph L. Love, Carlos Mallorquín, Ronald Sprout, Octavio Rodríguez, Kathryn Sikkink, Cristobal Kay, Adolfo Gurrieri, Leopoldo Solís, Manuel Fernando López, and many others. For recent assessments see Ocampo (2001) and Rodrik (1997 and 2000).

handicapped Prebisch studies from the beginning has been the persistent inability to integrate the academic and policy dimensions of his life. There is an apparent dichotomy in don Raúl's life and work, with the mainstream historical record projecting a dual image, almost a split personality, between his Argentine and United Nations periods. There is first the international Raúl Prebisch of ECLA, UNCTAD and beyond –radical thinker and founder of structuralism; innovator and institution-builder; tireless fighter for justice in regional and global relations; the *bête noire* of Washington during the ECLA years; vibrant, elegant, with charisma and compassion– a true and rare leader from the moment in 1949 when he presented his Manifesto to ECLA's second conference in Havana. The "other" Prebisch, when he served the Argentine State, is associated with the Argentine oligarchy and Conservative Restoration between 1930-1943, also known as the "infamous decade". Indeed, he was a beneficiary of the September 6, 1930 military coup of General Uriburu which opened this period. He was appointed Under-Secretary of Finance at the age of 29, and his responsibilities continually expanded until 1943, culminating in his designing and running the Central Bank of Argentina as General Manager until his dismissal at the end of the Conservative Restoration.⁴

In reality, there is a fundamental unity to Prebisch's life and work –there is no split personality, dichotomy, or dual image– and the key to understanding his permanent legacy as a thinker lies in linking his Argentine and United Nations periods. The reasons why systematic biographical research has been limited for so long have been the complexity of don Raúl's life as both actor and thinker, on the one hand, and the exceptional turbulence afflicting Argentina and the global system during and after the Second World War on the other. Above all, there has been little attention to his years between his dismissal from office in October 1943 and his presentation of *The economic development of Latin America and its principal problems* at the ECLA conference in Havana in June 1949 (Prebisch, 1949). The Prebisch Papers, now available in Santiago, include a wealth of new material, including many previously unpublished manuscripts and items of correspondence, covering the whole period from his early years up to his time at ECLA, which document the progress of his thinking on markets and the State as he moved forward

from his dismissal in 1943 to the Havana "Manifesto" in 1949. The present paper offers a first step in this broader task of deepening the scholarly literature on the origins of the "ECLA Thesis".⁵

2. Inward-looking development (1943)

There can be no doubt that October 18, 1943, the day he was fired from the Central Bank, was the most painful experience of his life. The Central Bank had been a remarkable achievement, an adaptation of a Niemeyer model in such a way that it could play the role of a central agency in monetary and financial policy, growing in responsibilities and powers after 1935, while remaining autonomous from the political game as a mixed private-public sector enterprise. The manner in which he was sacked –paid only to the day, blackballed for other employment, with the university on strike and in disarray, and with the burden of being an honest man in a corrupt State– added to the sense of rupture. From being the busiest executive in Argentina, he had become an isolated intellectual, condemned to the sidelines in Mar del Plata to observe the post-war transformation of the international system under United States leadership, as well as the political and economic closing of Argentina under Peronism.

Prebisch decided to use this time to write a book on his experiences as General Manager of the Central Bank and also address Argentina's post-war challenges with recommendations on the actions required in order to prepare the country for a successful post-war transition. If he was no longer welcome inside the government, and if no-one else would give him a job, he could at least present his views to the public in a book. For fifteen years, beginning in 1928 in the Banco de la Nación Argentina and then in the Ministry of Finance and Central Bank, he had accumulated important insights in managing the world's leading emerging economy; however small a consolation, his forced resignation certainly gave him the luxury of spare time for reflection. He had managed large institutions without adequate time for academic research; especially since the outbreak of war in 1939 his work had been so overwhelmingly hectic that he was barely in the Faculty of Economics even to direct seminars. He had directed official publications such as the Central Bank *Annual Reports*, or ghost-written articles in *La Nacion* where he was identified as "a senior government official," but he had been a practitioner

⁴ Dosman and Pollock (1993), pp. 16-26. For more recent assessments see Dosman and Pollock (2001) and Lorenzutti (1996).

⁵ See Toye and Toye (forthcoming) for a lucid and valuable contribution to this subject.

rather than a scholar –a technocrat in the governing establishment.⁶ He was now free to think through the lessons of his experience since arriving in Buenos Aires as a student in 1918; essentially it meant integrating his personal experiences between 1928 and 1943 with his writings and lecture material in the Faculty. He knew he could offer an unmatched assessment of Argentina's response to the Great Depression and the successes and failures of policies evolved by trial and error during the 1930s. No detailed publication existed on the origins and workings of the Argentine Central Bank, and he knew that he could provide an unparalleled account of the role it had played as a central agency since its creation in 1935.

It was apparent, however, that the book he proposed to write, entitled "La moneda y el ritmo de la actividad económica" (*Money and the Rate of Economic Activity*), must go beyond the Central Bank experience to address theory as well as practice. By the time he completed his draft on December 13, Prebisch had decided on the need for innovation. "My long involvement with the practice of monetary policy over the last fifteen years," he noted, "has constantly persuaded me of the need to return to the theoretical foundations of the system to improve our understanding and management of concrete problems," and he considered that "a distinctive theoretical explanation" was required to understand and explain Argentina's position within the international economic system. Financial and monetary policy were of fundamental importance to Argentina; the Central Bank had been created because the alternatives had failed. It had initiated "a period of experiments and guesswork, successes and errors" from which "lessons for future policy could and should be extracted." But to be credible the book could not only look backward from past experience: it also had to look to the future. The challenges faced by Argentina in the Great Depression and the war would be followed by new problems after the peace; and solutions would be just as difficult to achieve. Traditional liberal economic theory offered Argentine governments an inadequate framework of analysis from which to draw the relevant policy prescriptions, and an alternative approach was therefore required in order to interpret Argentina's place and role in the international economic system.⁷

⁶ The Prebisch Papers represent an indispensable source for this work, since much of the material in them is not included in the four-volume compilation *Raúl Prebisch: Obras 1919-1949* (Prebisch, 1991a).

⁷ Raúl Prebisch, "La moneda y el ritmo de la actividad económica," unpublished manuscript, December 13, 1943, located in the

Question 1: What were the national purposes of financial and monetary policy? Prebisch saw three: avoiding a boom and bust cycle by controlling the violent ups-and-downs in agricultural prices and other foreign trade impacts on the economy; strengthening development and maintaining full employment; and stimulating the fastest possible rate of economic growth. There was no going back. Industrialization had unleashed national creativity, and growth must continue to harness that "enormous potential."

Question 2: What should be the role of international trade? Raúl underlined the need to restore an open trading system. "It is essential to avoid what happened after the First World War," he noted, when exports of the rest of the world to the United States were blocked, leading to a vicious circle of trade restrictions and controls, and the eventual breakdown of the world economy into "water-tight compartments" during the 1930s. Globalization, therefore, with a soundly-based multilateral trade and credit system, was a precondition for Argentine success after the war –but it was not enough. Harry Dexter White and John M. Keynes were preparing a Conference for July, 1944 to devise a post-war plan to revive trade and stabilize the international economy. White and Keynes's work was vital for all countries, including Argentina, Prebisch concluded, but Argentina's policies had to reflect its own needs within this evolving system.

Question 3: Why must Argentine pursue industrialization? Because neither the doctrine of comparative advantage, nor the workings of the business cycle, automatically work for emerging economies such as Argentina. Raúl concluded from his experience that the terms of trade for agricultural commodity producers like Argentina were in historical decline. He called it a "persistent fall in the international prices for our exports." But declining terms of trade only accentuated a deeper structural imbalance, or embedded equilibrium, in the international system. According to liberal Western economists, the market mechanism automatically benefited all countries, the large industrialized as well as the agricultural economies, and the business cycle regulated the periodic ebbs and flows in the international economy. He disagreed with this, however, arguing instead that the international economic system functioned in permanent disequilibrium because the business cycle operates with

Prebisch Papers. Subsequent quotations in the text are taken from this important document (Prebisch, 1943).

different rules for industrial and agricultural countries like Argentina, which have “such distinct characteristics in our economic life that their explanation requires an alternative theoretical approach.” Prebisch had already concluded in his 1921 “Anotaciones sobre nuestro medio circulante” (*Notes on the Money Supply*) (where he first used “centre” and “periphery,” a metaphor developed locally in the national debate on the concentration of wealth and power in the coastal metropolis of Buenos Aires, which drew wealth from the underpopulated pampas) that the business cycle in Argentina created an atypical boom and bust phenomenon because it lacked the self-correcting mechanisms characteristic of industrial economies (Prebisch, 1991b). Since then he had lived through the post-1918 crash, the boom of the 1920s, the Great Depression, the post-1934 recovery, and now the Second World War.

No country had aspired to trade and monetary orthodoxy more than Argentina in the illusive search for a restoration of “normalcy.” It had suspended the gold standard on August 20, 1914 for 30 days, believing that a return to convertibility was imminent – then again, and repeatedly again for 30 day intervals, until December 1927, when the gold standard was finally restored. After two disastrous years it was suspended again, and remained so in 1943. In 29 years the system hadn’t functioned “normally” at all, and in more than three-quarters of a century convertibility was in place for only 23 years.

Question 4: Why promote development? In practice, Argentina had been forced to abandon free trade and evolve the tools for an activist state led by the Central Bank. Now that the war was coming to an end, the Argentine State would have to retain that role because national development would not happen automatically. According to Prebisch, only an activist State could shield it from a permanent vulnerability relative to the industrial countries, with the primordial role of building on the type of calculated interventions devised by the Central Bank since 1935 to manage turbulence, and thereby ensuring that Argentina would remain a full partner rather than a marginal dependent country in the emerging global economy. A new period had opened because Argentina had to manage itself out of this problem or face marginalization. “To resist subordination of the national economy to foreign movements and contingencies, we must develop inward (“desarrollo hacia adentro”), strengthen our internal structure, and achieve autonomous functioning of our economy”.

Prebisch’s early views on free trade are well-documented. As late as 1927, in a polemic with Spanish visiting professor Luis Olariaga, he rejected protectionism with the argument that Argentina had benefited as much as the United States, Canada or Australia by specializing in commodity trade (Prebisch, 1991c). Nor is there a need to repeat the details of his gradual shift toward interventionism while Under-Secretary of Finance, with the National Recovery Plan of late 1933.⁸ Simply stated, it was experience which changed Prebisch’s approach to markets. In practice, Argentina had been forced to abandon free trade and develop a more activist State in the first National Recovery Plan; the creation of the Central Bank in 1935 had in fact reduced Argentina’s vulnerability during depression and war by taming the business cycle. Major public works had created employment. Raúl was an intuitive economist rather than a typical academic pursuing scholarly debate via learned journals. In the balance between engagement and reflection, he had chosen public service in the 1920s, notwithstanding his commitment to economics and his tenure of a coveted Chair in the Faculty of Economic Sciences since 1925. Fundamentally a man of action, his theory-building derived as much from experience as scholarly research.

Question 5: What should be the role of the State in promoting industrialization? Prebisch called for “an intelligent regime,” or “smart State.” While the State must support industrialization, the economy as a whole must remain private sector-led in order to prosper. Excessive State intervention was therefore as damaging as a naive acceptance of the doctrine of comparative advantage. “Don’t stifle the private sector”, Prebisch warned. A healthy private sector and investment climate were essential for economic success and a wise investment strategy. Argentina required an active State, but within a judicious private-public sector partnership. “Monetary policy is little or no use if it suffocates private initiative and the spirit of enterprise, which absolutely require the profit motive and an overall climate of confidence.”

An example of an industry support initiative in 1941 was the Export Promotion Corporation (also called the Argentine Institute for the Promotion of Trade (IAPI), but quite different from Peron’s 1946 creation), with offices in the United States, for developing new and non-traditional export products to replace European products locked out by the German occupation. Managed by a private-sector board, it was ultimately

⁸ The authoritative work is Love, 1994, pp. 393-601.

accountable to the Central Bank.⁹ But the corollary of openness to the private sector was the latter's responsibility for remaining competitive. From the last Central Bank *Annual Report* prepared under Prebisch's direction, which dealt with the preparations for the post-war period, it is clear that his support for industrialization did not imply the wholesale protection of inefficient and uncompetitive businesses which had sprung up since the Depression.¹⁰

Question 6: What about post-war policy? In Prebisch's view the imperative post-war trade and industrialization policy required a judicious combination of import substitution and export promotion rather than blanket protectionism. "A policy of autarky is as absurd as free trade," Prebisch concluded, "with 'noxious' consequences... This possibility of increasing imports under an intelligent regime, and a policy of prudent monetary stimulation where indispensable, will favour intensive industrial development, with the natural effect of attracting immigration to other economic sectors, as in earlier days of economic and demographic growth." According to Prebisch, a competitive private sector after the war implied sanitizing the economy by building on the viable industrial sectors created during the war while eliminating the inefficient and uncompetitive industries which had emerged during the enforced protectionism of the World War. The same caution applied to State expenditures, which must remain prudent and non-inflationary. "There must be a reasonable equilibrium between the role of the State and the play of individual interests in economic life." Furthermore Prebisch warned against the politics of extremes. A balance had to be ensured between productivity and social policy to maintain growth, rather than engaging in excessive public expenditure. Inflation was a constant danger. The Argentine economy already had full employment and was in danger of overheating, and the government should

therefore resist political pressures for inflationary expenditures. Although Argentina had to improve conditions among the poor, Prebisch appealed for a social policy coordinated with national economic productivity in order to prevent deficits and inflation. "One must bear in mind that the common denominator of social policy is the increase in production. Without this a stable increase in the level of income of the masses cannot be sustained." Argentina could only maintain its high prestige if the government adopted the correct policy mix; domestic policy must encourage sustained growth because Argentina depended as much on the State as on industrial activity to shape the conditions for prosperity. Despite the many uncertainties, Prebisch forecast a positive future for Argentina. Obviously its prosperity was not automatically guaranteed by its relative success during the last decade, but Argentina had the policy tools needed to achieve stability and growth. Argentina's success in handling the Great Depression and the war experience had given it new confidence and international ranking; it had made great strides since 1930 and could look forward to the post-war era with confidence, rather than with fear, as a powerful young New World actor on the international scene.

Question 7: What defines Prebisch's theoretical challenge? Prebisch's approach promised a unique and prophetic blend of theoretical radicalism and Keynesian State activism, but within a banker's concern for sound money and the private sector. At the theoretical level, he challenged conventional Western liberal economists on holy ground by reversing the assumptions of equilibrium and comparative advantage in the international economy; since they had failed the empirical test he proposed developing a theoretical approach more in line with intuition, observation and Argentina's experience. But Prebisch was anything but a revolutionary critic of Western capitalism. He rejected communism, and was confident that Argentina could develop the tools it needed to meet the post-war challenge. Instead, Prebisch's book advocated an approach which could be called "civilizing globalization"; he felt that Argentina had no choice but to embrace globalization, strengthen trade links with its neighbours, recognize the decline of Britain, and accept that United States leadership was inevitable in the emerging international system. But he insisted that the Argentine State, private sector and society both could and should assume responsibility for policy choices to guarantee sustainable development.

⁹ *United States, Department of State*, Memorandum from the United States Embassy in Argentina to Washington, November 29, 1940, which outlines the objectives and structure of the new IAPI, as well as Prebisch's discussions with Embassy and State Department officials. Under-Secretary of State Sumner Wells noted on January 7, 1941 (during Prebisch's extended visit to the United States capital) that the project "involves both policy and practical questions of some importance."

¹⁰ This is also clear from the text Prebisch wrote for General Agustín P. Justo's Address to the British Chamber of Commerce on November 22, 1942 (Source: the Prebisch Papers).

3. Towards the “Manifesto”

One can only speculate on the impact of this book, had it been written and published. Prebisch’s tantalizing outline in December 1943 regarding the decline in the global terms of trade; his hypothesis of structural disequilibrium in the international economic system and the projection of a new theoretical framework for development; his call for industrialization and an export mix going beyond commodities; and his notion of the “smart State” with administrative coherence to combine open markets with calculated interventions and deliberate processes, were of extraordinary scholarly promise. Already by 1943 Prebisch had proposed his conceptual leap forward that would challenge Western economists on their own ground. The manuscript is an essential reference point indicating his thinking in 1943 at the immediate close of his Central Bank career, demonstrating that he had elaborated his concept of “inward development” long before the formation of ECLAC, and that his theoretical development was more advanced than anticipated.

But his proposal was rejected by Argentine publishers, and he therefore had no option but to continue the project while teaching in the Faculty in order to make a living. He hoped to get it out quickly – friends like Robert Triffin were already asking for it in 1945 – but as it turned out, the Havana “manifesto” was still some distance away in 1943. Life in Buenos Aires was depressing for him as Peronism took hold in 1946 and he observed Argentina’s growing isolation and cultural decline. He also had to act as a consultant in order to survive, and this also hampered his work, although his discovery of the wealth, beauty and potential of Latin America beyond the Southern Cone in his visits to Mexico, Colombia and Peru in 1944 and his subsequent travels in Paraguay, Venezuela, Guatemala and other countries were fundamental to the evolution of his regional vision. The lack of resources for research, and above all the problem of working in isolation without associates, also slowed down his work. On many occasions he envied scholars in North American and European universities who could devote themselves fully to their academic work.¹¹

After 1946 it became increasingly difficult for Prebisch to continue teaching in the Faculty, and he

was finally forced out of the university on 15 November 1948 with his book project still incomplete.¹² After 1943 he had travelled and worked extensively throughout Latin America, but he had always resisted opportunities to move abroad to the United States or Mexico. Now he had to reconsider, and the options came down to heading ECLAC in Santiago as its first Executive Secretary, or taking up a senior position with the IMF in Washington. Of the two, Prebisch infinitely preferred the latter. Camille Gutt, the IMF Managing Director, accompanied by his deputy, Edward M. Bernstein, had visited Buenos Aires on November 25, ten days after Prebisch’s departure from the university, and made an offer which Raúl accepted. An actual contract had not been signed, pending approval by the Fund’s Executive Board, but Mr. Gutt had dismissed this as a formality. However a disturbing silence from Washington after this visit suggested problems, and Prebisch’s humiliating and painful rejection by the IMF provided the essential personal backdrop for the emergence of the Havana “manifesto”.

A first sign of internal opposition appeared early, on December 23, when Gutt cabled to announce that the terms of his appointment would have to be changed. “I have reviewed our recent talks with department heads. They feel that an adviser outside departmental lines is not feasible. Prepared to recommend appointment in Operations Department at proposed salary.”¹³ But Prebisch was assured that the change was simply to avoid setting a precedent within the Fund and that the offer would soon be confirmed. M. H. Parsons of the Operations Department told him that the delay in approval was merely technical – the January flu in Washington had decimated the Executive Board; he expected a meeting before the end of January. “We are looking forward to having you here and taking advantage of your great experience, particularly in our dealings with Latin America.”¹⁴

¹¹ For example, in a letter to Eugenio Castillo dated 23 November 1948 (The Prebisch Papers, Correspondence), he described his situation in Argentina as “the thankless position of a solitary researcher”.

¹² Prebisch eventually declined an offer in 1945, brokered by Robert Triffin, to visit Harvard and teach in the United States; both the Guggenheim and Rockefeller Foundations became involved, and Assistant Secretary of State Nelson Rockefeller noted that he was “very interested in Raúl Prebisch’s proposed trip to Harvard...I am delighted to hear that plans are progressing and as soon as you have definite word, I would appreciate your letting me know when he is coming” (Memorandum, United States Department of State, February 9, 1945). Prebisch also turned down an offer of a senior appointment in the Bank of Mexico after the election of Perón in 1946.

¹³ The Prebisch Papers: Correspondence, June Eckard to Raúl Prebisch, March 22, 1949.

¹⁴ The Prebisch Papers: Correspondence, M.H. Parsons to Raúl Prebisch, January 19, 1949.

So, strongly reassured, Raúl and Adelita Prebisch continued preparations for their departure, with Urquidí and other friends combing the real estate market in and around the United States capital. Farewells were held, and Raúl prepared his lectures to be given in Mexico from February 16 on. Just before his departure Raúl received more good news from the IMF: Parsons suggested that they meet in Mexico during Prebisch's seminar at the National Autonomous University of Mexico (UNAM) to discuss a work plan. Executive Board approval was now imminent, he said. It was a busy month which augured well for the future, despite the emotional let-down of leaving Buenos Aires.¹⁵ However, Adelita was confined to bed in Mar del Plata and unable to accompany him to Mexico when he left on February 15; on his arrival at the *Hotel Reforma* he cabled his affection.

But when Prebisch opened his seminar on February 16, it was clear that the hold-up of his much-discussed appointment at the IMF had little to do with illness on the Executive Board. Parsons failed to arrive; he heard nothing from Washington. To his mortification, rumours of United States Treasury opposition to his appointment became corridor gossip in Mexico. After the Mexican seminar ended, Prebisch decided to force the issue with the IMF and sent a cable to Gutt on March 6 demanding a definitive response. The Managing Director first procrastinated with a message asking for more time, but then confirmed that the Executive Board had indeed rejected his appointment. Parsons wrote a personal letter of apology on March 11. "We have behaved intolerably... I am not sure which is worse –to feel ashamed of oneself, or to feel ashamed of the organization for which one works. We shall pay heavily for our folly in losing your services and the prestige which you would have brought to the Fund in its relations with Latin America. I don't ask you to be tolerant with us because I think we have behaved intolerably, but I do ask that you pity us that we should add this kind of folly to what is already a heavy enough burden. Whom the gods wish to destroy they first make mad."¹⁶ He signed it with "Keenest regrets." Raúl shared his disappointment by telephone with Adelita, who was now recovering. She said that she was happy not to go to Washington and have to deal with such dishonorable people. Some day, she predicted, the tables would be

turned.¹⁷ Robert Triffin and other friends in Washington provided the inside story of his rejection by the IMF.¹⁸ The issue had developed into an internal *cause célèbre* because the United States had reversed its position and now opposed his candidacy even though the Treasury had originally supported Prebisch. It was embarrassing and unpleasant; the Fund had sought him out in Buenos Aires, rather than the other way around, and so firm a commitment would never have been given had the United States not been on board. Moreover Prebisch was Latin America's best-known economist and central banker; there was no way the sudden rejection could be explained by questioning his competence. The fight over Prebisch in the Fund was therefore lengthy and bitter.

A complex set of factors lay behind Washington's refusal to accept his appointment in early 1949, and it had nothing to do with a rumor that old Washington hands remembered Raúl's toughness during the 1930's in bilateral negotiations with the United States and were getting back at him now for favouring Britain after the Roca-Runciman Treaty. Instead the United States decision reflected the new opening in US-Argentine diplomatic relations, Brazilian opposition to Prebisch's appointment, and the changing political climate in Washington. Perón vigorously opposed Prebisch for any influential position in the IMF, even though Argentina was not a member of the Fund; while he had agreed six months earlier to support him for ECLA (presumably to ease him out of Buenos Aires into a marginal position in Santiago), the Argentine President did not want a domestic opponent in a key position in Washington. Considering the deep-freeze in US-Argentine relations since Pearl Harbour, however, such expected opposition should not have concerned Washington –quite the reverse. The United States Embassy had campaigned openly against Perón in 1946, who later had denounced the Marshall Plan as a scourge and disaster for Argentina.¹⁹ On January 19, 1949, however, Perón fired the economic team led by Miguel Miranda and Washington saw an opening to improve bilateral relations. A bilateral Joint Committee was established to review economic issues, including the potential opening of United States petroleum investment; Washington sought to restore its pre-war position in

¹⁵ The Prebisch Papers: Correspondence, M.H. Parsons to Raúl Prebisch, February 10, 1949.

¹⁶ The Prebisch Papers: Correspondence, M.H. Parsons to Raúl Prebisch, March 11, 1949.

¹⁷ The Prebisch Papers: Correspondence, Adela Prebisch to Raúl Prebisch, March 13, and March 30, 1949.

¹⁸ The Prebisch Papers: Correspondence, June Eckard to Raúl Prebisch, March 22, 1949.

¹⁹ Lewis, 1990, pp. 191-192.

Argentina, then the most important market in Latin America, with assets in 1943 greater than all other countries except Cuba and Canada, and “now threatened by European expansion of bilateral trade and the dollar shortage.”²⁰ The Prebisch appointment was thus caught up in a bilateral diplomatic reorientation, with the State Department arguing that United States support for Prebisch in the IMF could preempt this promising development with Perón. Thrown out of the Central Bank by the Perón-backed military government in 1943 against United States protests, a man who had risked and lost his career for the allied cause and who had continued to work closely with the Federal Reserve after 1945 was thus sacrificed six years later on the altar of US-Perón rapprochement.

There was another, less tangible factor at play in the United States rejection of Prebisch. Raúl not only lacked the support of his country, but he was also vulnerable in Washington’s changing political climate, now unrecognizably different from the circumstances surrounding his exit from the Central Bank in 1943. He had worked with the United States Federal Reserve throughout Latin America, and still knew some of its officials such as David Grove, Chief of its Latin American Section in the Research Department. In those years he could also have picked his job among United States banks: the Chase Manhattan Bank referred to him as “almost a member of the family”; Joseph C. Ravensky commented in his retirement letter to Raúl in 1945 that “you are so at home in the Chase that you will not miss me much.”²¹ But times had changed. Prebisch was no longer very well-known in Washington, and the friends who still regarded him highly, such as Triffin and Wallich, were increasingly out of step with the gathering Cold War ideology in the Beltway. They represented the war-time generosity and innovation of United States Latin American policy; a new and tougher approach rendered Prebisch an outsider in Truman’s Washington. The United States opening to Latin America terminated after 1945 and gave way to a different era in Washington. The many invitations from leading United States universities terminated abruptly; Triffin, Williams and Hansen gave way to Gottfried Haberler, Jacob Viner and the narrowest view of markets. While not yet hysteria, a groundswell of anti-

communism in the United States capital demanded the greatest care in choosing senior people for the IMF and World Bank; while no one could possibly argue that Prebisch was pro-communist, he was a Latin American who used terms such as “centre” and “periphery.” With the revival of orthodox economics organized principally around the concept of equilibrium and rejection of the need to correct the market mechanism, he stood out like a sore thumb: by recognizing the embedded imbalances in the system and proposing an active role for the State in the economy, he challenged the dominant post-war paradigm. Prebisch, in short, was not automatically “safe.” This new caution seeping into the IMF selection process was transmitted directly from the United States Treasury, but also internally by United States officials who followed the flag. E.M. Bernstein, for example, who had made the approach to Prebisch in Buenos Aires and whose support might have made the difference in Raúl’s approval, remained silent during the affair. Even Ravndahl, who might also have influenced the State Department, chose to stand aside. In the end the IMF was an inter-governmental organization led by the great powers, and its politics could not escape the changing ideological alignment of the Washington foreign policy community. Raúl had been used by Washington while he was powerful and to their advantage; now that he was weak he could be discarded and made a laughing-stock from one end of the Americas to the other without fear of retribution. Recently-hired Latins in the Fund could do nothing but watch the spectacle in frustration and anger.

Finally, Brazilian opposition to Prebisch fortified Washington’s determination to press its veto on Prebisch’s appointment, and the diplomatic weight of Brazil in South America also made this a factor of considerable importance in the region. In this case, however, the issue was not so much politics as envy. Although Octavio Bulhões had sent Raúl a congratulatory letter from the Ministry of Finance in Rio on February 5, he also convinced the Cabinet to veto the appointment at the level of the Fund’s Executive Board.²² Eugenio Gudín, who genuinely respected and supported the Prebisch appointment, was away from Rio undergoing surgery in the United States and was therefore not in a position to prevent a betrayal. Confronted by the United States and Brazil, other members of the IMF Executive Board eventually fell into line.

²⁰ United States State Department (1949), Internal Memorandum 835.5151/7-149. For background see Escudé, 1981.

²¹ The Prebisch Papers: Correspondence, Joseph C. Ravensky to Raúl Prebisch, December 28, 1945.

²² The Prebisch Papers: Correspondence, Octavio Bulhões to Raúl Prebisch, February 11, 1949.

Rejection by the IMF on top of the end of his university career in Buenos Aires meant that Prebisch was down to his last chance: ECLA. He had been approached in late 1948 by the United Nations for the position of Executive Secretary, but had turned down the offer, and Gustavo Martínez-Cabañas had eventually been selected to begin work on January 1, 1949. Nevertheless ECLA persisted, offering Raúl a consultancy to help the new organization prepare for its Second Session in Havana, scheduled to open on May 26. The problem facing Martínez Cabañas and his deputy, Eugenio Castillo, was to fulfill ECLA's main task at its First Session in June, 1948 –namely, producing the first *Economic Survey of Latin America*: a huge task never before attempted– in less than one year, and with a brand new team in Santiago which lacked depth and experience. They pleaded with Prebisch for help, even for a leave of absence from the IMF (expecting that he would be in Washington); but Prebisch did not respond until the IMF debacle was evident, finally agreeing to a short-term consultancy for the duration of the Havana conference.²³

In New York, David Owen and senior officials in the United Nations Department of Economic and Social Affairs were also increasingly anxious about the future of ECLA, realizing that they too could not afford a failure at Havana. The *Economic Survey* promised for Havana had to be presentable, and they hired Francisco Croire, another former employee in the Argentine Central Bank whom Raúl had sent to Harvard for graduate training, to head the Latin American section of the Stability and Development Section and provide a New York anchor for the *Economic Survey*. Arriving in December, 1948 he found that little had been done during the preceding six months and that the two staff members he inherited were of doubtful quality and acculturated to permanent paid holidays. United Nations morale and staff competence in New York contrasted badly with the old Central Bank in Buenos Aires, Croire sniffed.²⁴

Croire poured out his concerns to Prebisch in a stream of long personal letters.²⁵ He discovered that the *Economic Survey* had taken on a heavy symbolic value for the United Nations system as a whole –or at least for Latin America within the United Nations. There was, he reported, a growing *Schadenfreude* among the skeptics in New York who doubted that Latin economists were competent enough to deliver unless supervised by United States and European superiors. Since the *Economic Survey* was the single most important work of ECOSOC relating to Latin America, it had therefore become a test of Latin American economists themselves. The *Economic Survey* was unique in that Latin Americans themselves were in charge; it was the first major international report on the region to be directed and written by Latin Americans rather than foreign consultants, for in the IMF or World Bank Latin Americans were members of teams led by senior North American or European economists. Croire and other Latin Americans like himself in New York therefore felt on trial; failure in Havana would confirm a New York perception that they were second-raters. This situation made Prebisch's role doubly important. New York would mobilize all available resources to pull together the individual components into an acceptable document, including sending headquarters staff to Santiago on short assignments. A great deal of data were being collected; a more realistic work-plan and *Economic Survey* outline were now accepted in Santiago. Other agencies such as the FAO and the IMF were being helpful, and the World Bank had just completed a study *The Pattern of Latin American Trade Payments with ERP Europe and the US*, which was helpful for ECLA's own report on "Prospects for Trade Expansion" being prepared for Havana. Dorfman and Alfonso Santa Cruz were working overtime on it; Louis Shapiro from New York Headquarters arrived in Santiago on December 17 to work with Regino Boti on regional foreign trade statistics. The problem, however, was overall leadership: although the *Economic Survey* had to be a team effort, one person, finally, had to draft a framework document laying out a theoretical approach and rationale. Croire was relieved by Prebisch's acceptance of this role; had he not agreed to write the report, the United Nations would have gone outside Latin America, probably to Sweden's Gunnar Myrdal, thereby demonstrating to the world the bankruptcy of

²³ United Nations, Correspondence: Eugenio Gudín to Harold Caustin, New York, July 13, 1948, reviewing the efforts to attract Prebisch, including Juan Perón's approval for the United Nations to approach him. Also in the Prebisch Papers, Correspondence: Eugenio Castillo to Raúl Prebisch, November 19, 1948 and February 5, 1949; Raúl Prebisch to Eugenio Castillo, January 10, 1949; and Martínez-Cabañas to Raúl Prebisch, February 3, 1949.

²⁴ The Prebisch Papers: Correspondence, Francisco Croire to Raúl Prebisch, December 24, 1948.

²⁵ The Prebisch Papers: Correspondence, Francisco Croire to Raúl Prebisch, February 28 and April 8, 1949.

Latin economists and spelling the certain demise of ECLA.²⁶

Even more, Havana was unexpectedly emerging as an important meeting in US-Latin American relations. In part this reflected the old theme of dashed expectations of United States recognition and post-war cooperation. By 1949 and the beginning of Truman's second Administration, a sense of injustice was boiling up again as Washington's priorities focused on Europe and Asia. During the Second World War, Latin countries had sold their commodities to the United States at prices fixed by the OPA (Office of Price Administration), but they had been unable to convert their dollar earnings into goods during the war, with consequent inflation. Now they found that when United States goods were finally available for purchase, there were no price controls on these industrial exports, even though the prices for their own primary and agricultural products had declined.²⁷ With the end of the war, single-commodity countries such as Venezuela, Cuba, Chile and Bolivia faced an inevitable downturn in trade, and were on the verge of serious economic crisis. Yet the Truman Administration had failed to implement most of its war-time promises of economic partnership made during the war. Washington now opposed the creation of an Inter-American Development Bank, continued to postpone a much-heralded Inter-American Economic Conference, and rejected multilateral efforts to stabilize commodity prices. Worst of all, the United States Congress had killed the proposal for the ITO (International Trade Organization) put forward in 1948, also in Havana, placing an additional strain on US-Latin American relations. Conceived during the Second World War, Keynes had seen the ITO as the trade counterpart to the IMF and World Bank; its failure left Latin Americans disappointed and frustrated. The sequence of the Great Depression, the Second World War and the post-war challenge of adjustment to *Pax Americana* had created an incipient regionalism in Latin America—a consciousness of shared experiences, and even greater needs, carried by a new generation of better-trained and travelled professionals. Young Latins ached for recognition, for leadership and for definition

all in one; there was an opening for new ideas and change. *Does Latin America exist?* Mexican author Luis Alberto Sánchez had asked a few years earlier in the 1940s. Latin America was a region ready to be created, and this idea and opportunity built on perceived grievances to give the 1949 ECLA Conference in Havana a symbolic significance out of all proportion to the actual agenda of the meeting.²⁸

The additional burden of evident ECLA, United Nations and Latin American anxiety and expectations added to Raúl's agony as he began his work in an upstairs office at the end of a corridor somewhat apart from the rest of the ECLA staff, pausing only for his daily lunch with Adelita in Providencia. He needed a breakthrough, but he felt flat—as flat as during his last lectures in the Faculty in 1948 and a set of seminars he had recently completed in Mexico. He now fully understood the cost of his years in the wilderness. When he left the Central Bank in 1943 and drafted his outline for “La moneda y el ritmo de la actividad económica” he had been well ahead of the pack in his theoretical development. His central concept of a structural rift in the international economy between industrial and agricultural countries in which market forces tended to accentuate inequalities had been novel and exciting. But that was more than five years ago. He had seemed on the verge of major innovation; so much had seemed possible, but he had not been able to deliver. He had certainly made progress; since 1945 he had grafted the centre-periphery terminology, first used in 1921, into his analysis to accent the dualism present in the international economy, and this was now a permanent fixture in his writing. Work on the business cycle had also advanced significantly. But the discipline was not standing still either, and younger economists were moving into development economics; the argument, for example, that agricultural exporters were at a disadvantage compared with industrialized exporters in international trade was becoming commonplace (Love, 1994). While no other scholar had yet presented an answer to Prebisch's hypothesis set out in “La moneda y el ritmo de la actividad económica” in 1943, it was only a matter of time before he would lose this race as well to scholars in Europe and North America.

Raúl felt close to a new synthesis, but the days went by in Santiago and his frustration grew as the Havana deadline approached. In early April he circulated some

²⁶ The Prebisch Papers: Correspondence, Francisco Croire to Raúl Prebisch, December 24, 1948. See also United Nations, Memorandum from W.R. Malinowski to Harold Caustin, November 12, 1948.

²⁷ United States State Department, “Latin American Policy Statement,” Memorandum from E. Miller to Louis J. Halle, November 14, 1950.

²⁸ The Prebisch Papers, Correspondence: Francisco Croire to Raúl Prebisch, February 24, 1949.

draft text to ECLA colleagues for comments. Furtado read the manuscript and was disappointed. The style was academic and defensive, dealing with familiar topics such as the declining United States import coefficient, capital controls, foreign trade, savings and inflation, and the importance of industrialization.²⁹ The paper seemed more a digest of his lectures in the Faculty and in Mexico than a policy document, and while it was enlivened by his “centre-periphery” terminology, his explanation for this lop-sided capitalism was not complete, and unlike his 1943 study “La moneda y el ritmo de la actividad económica” it apparently did not refer to declining terms of trade. Prebisch was clearly struggling as he faced the approaching deadline, aware that his work fell short of what he knew he could achieve.³⁰

What happened next has been masterfully related by Furtado in his autobiography (Furtado, 1985, p. 60). While Prebisch struggled in Santiago, Croire in New York received a copy of a draft report which Dr. Hans Singer had written for the United Nations Sub-Commission on Economic Development entitled *Post-war Price Relations Between Under-developed and Industrialized Countries*.³¹ Incredibly, Castillo had also received an advance copy of Singer’s document as early as December 17 when United Nations statistician Louis Shapiro arrived from New York to work on the *Economic Survey*, but he had not shared it with Prebisch.³² Croire noted a reluctance by senior staff to allow its circulation, because Singer’s report challenged conventional wisdom and would therefore likely be rejected by the United Nations Sub-Commission, but he sent it immediately to Raúl in Mexico along with another IMF paper on foreign trade.

Prebisch had never met Singer, a German-born scholar who left Germany in 1933 and obtained a PhD

at Cambridge University. Recruited by David Owen to work in the Department of Economic and Social Affairs at the United Nations, he had arrived in New York in April 1947 on a two-year leave of absence from the University of Glasgow. He began his work in the trade section of the Department of Economic and Social Affairs with an interesting group of economists who quickly drew his attention to the terms of trade issue (Singer, 1984, pp. 275-311). Singer argued that historical statistics demonstrated a decline in the terms of trade of developing countries. “From the latter part of the nineteenth century to the eve of the Second World War, a period of over half a century, there was a secular downward trend in the prices of primary goods relative to the prices of manufactured goods” (Toye and Toye (forthcoming), p. 25). Such a decline provided an “added incentive towards industrialization” in developing countries, since they would otherwise lose resources for development relative to their industrialized counterparts (United Nations, 1949, pp. 16-17).

But Singer’s paper was the stimulus Prebisch needed to escape his mounting frustration and fear of failure. In his 1943 draft “La moneda y el ritmo de la actividad económica”, Raúl had already assumed a secular decline in the international terms of trade for agricultural countries, and both Kindleberger and Samuelson had written articles based on this hypothesis.³³ But Singer not only demonstrated it statistically within a rigorous historical study; he also articulated the ethical implications of declining terms of trade in the global economy, which created a divide between rich and poor countries. Prebisch therefore recognized a kindred spirit in the British economist; Singer’s work not only corroborated his assumptions on trade, but also gave him the confidence to recast his work with a new structure and style.³⁴ Raúl’s energy returned, and he began again, ensuring that all copies of his earlier text were collected and discarded. Then in three days and nights he wrote *The economic development of Latin America and its principal problems* (Prebisch, 1949), in which the laboured prose

²⁹ Both Furtado (1985) and Toye and Toye (forthcoming) are important sources of information on this episode. The author’s extensive interview with Celso Furtado in 1990 provided additional insights for writing the present paper.

³⁰ Prebisch himself never referred in subsequent interviews to this transition towards the Santiago “manifesto”. Furtado (1985), Toye and Toye (forthcoming) and the present author’s works note that early in 1949 there was an important turning point in don Raúl’s work.

³¹ Subsequently retitled as *Relative Prices of Exports and Imports of Under-Developed Countries* (United Nations, 1949).

³² The Prebisch Papers, Correspondence: Gustavo Martínez Cabañas to Raúl Prebisch, March 5, 1949 and Francisco Croire to Raúl Prebisch, April 8, 1949. This matter is also discussed at length in Toye and Toye (forthcoming).

³³ Kindleberger (1943) and Samuelson (1948). The Prebisch Papers (particularly Prebisch’s correspondence with Victor Urquidí, such as that of June 2, 1944, which takes up Kindleberger’s work in detail) provide important insights into the evolution of Prebisch’s reflections on emerging economic theories during the 1943-1949 period.

³⁴ Prebisch’s life-long respect for Hans Singer never wavered during the long personal friendship subsequent to Singer’s visit to Santiago in 1950. The feeling was entirely mutual.

of his earlier work disappeared in an essay which recalled the power and simplicity of Keynes. The new document may not have been scholarly, as defined by refereed journals; nor was it replete with mathematical formulas, explicit hypotheses or reams of footnotes. None of the individual components or his argument was entirely novel – it would be more correct, for example, to identify the terms of trade break-through as the “Prebisch-Singer Theory” – but the genius of Raúl’s “Manifiesto” was that it moulded these disparate components into a unique and compelling synthesis. It succeeded in re-examining the determinants of economic activity in developing countries, and represented a key event which changed the vocabulary of international development and marked a new period in Latin America.

The 1949 “manifiesto” began with an appeal to reason, paraphrasing Aristotle’s dictum that “the facts have not yet been sufficiently established. If ever they are, the credit must be given to observation rather than to theories, and to theories only in so far as they are confirmed by the observed facts.” Latin Americans must have the courage to confront their own reality to find solutions, and this meant subjecting inherited wisdom to the ultimate questions: Does it work? Who gains and loses? To understand is to be free and able to take control of one’s destiny, the *Manifiesto* implied, and Prebisch articulated an unforgettable, if deceptively simple, framework to explain why the system was not working in the mutual interests of rich and poor nations, why the industrial countries reaped the major gains, and what had to be done to restore equality for Latin America in the international economy. The 1949 study *The economic development of Latin America and its principal problems* owed much to Prebisch’s 1943 study “La moneda y el ritmo de la actividad económica”. There is the same confident tone, the same stepping back from his data to highlight the key points, and the same assurance that the dilemma facing the countries of the region could be successfully overcome.

But the “manifiesto” was different in its regional vision and call to action. The “center-periphery” conception of the world economy was much more explicitly focused on the dynamics and structure of global inequality. It began with the claim for a unified world economy in which all States, industrial and developing, were linked in a single system of exchange and affected by a common business cycle. Within this system, however, he counterposed the quite different roles of the rich industrial versus the developing agricultural countries: the latter produced primary

products for the industrial countries in return for manufactured goods, while the business cycle began in the core countries and spread to the periphery. Prebisch then argued that the distribution of benefits was unequal because the dynamics of foreign trade and the business cycle favoured the industrial countries. This was not due to the ill-will of governments, but rather the inherent functioning of the system: the fact that gains in productivity were greater in industrial than in primary goods could be documented by the declining terms of trade which he had assumed in 1943 and which Singer had now documented. This factor in turn was aggravated by the international trade cycle, in which the agricultural countries were more vulnerable than the core economies during recessions because organized labour in Europe or North America was strong enough to prevent an equivalent collapse of prices. The result of both factors – a secular decline in the terms of trade and business cycle vulnerability – explained the fundamental flaw of neo-classical trade theory, which assumed equal benefits for industrial and agricultural exporters and which was assumed to have the same validity in Latin America as in the United States or Britain. There was, in short, an inherent asymmetry in the system, understanding of which was a necessary step towards understanding Latin America’s insertion in the international economy and thereby designing a new approach appropriate to the region’s needs in the future.³⁵

The attraction of the “manifiesto” lay in its dual thrust: not only did it offer a powerful diagnosis, but it also contained a vision which promised agricultural countries a way out of their dilemma. To be peripheral was not necessarily to be dependent; just as in “La moneda y el ritmo de la actividad económica”, he proposed that industrialization, with due care to avoid inflation and distortions, offered Latin America the prospect of reversing the dynamic of unequal exchange which otherwise doomed it to constantly diminishing benefits in the global economy. Here was a non-revolutionary, non-communist prescription for change which all governments in the region, regardless of ideological orientation, could applaud. It was a call to action which Prebisch based directly on his experience in Argentina, where import substitution had already

³⁵ Within the vast literature on this subject, note the recent work of Love (1996); Rodríguez (1998); Gurreri (1983); Mallorquín (1994) or Sprout (1992). All the articles in Iglesias, ed., (1994) are also useful. See also Spraos (1980) and Tanzi and Chu (1989).

advanced considerable even before 1914, and where the Central Bank had pursued precisely this role, to the point where industrial production equalled that of agriculture in the national economy by 1943. From a regional perspective, where most economies were less developed than Argentina, it was a truly bold departure. But once out of the bottle, his challenge to peripheral economies to move from commodity production to a more diversified economy proved durable and irresistible—so much so that today it is taken for granted to such an extent that the originality of the Prebisch “manifesto” has been obscured by its success.

The “manifesto” contained other elements which lurked below its extraordinarily elegant and flowing prose. For all its appeal to reason and measured arguments, there is an almost imperceptible but unmistakable undertone of indignation in the text. Development economics, Prebisch implied, meant taking a stand. The treatment he had just received in Washington may explain part of this tone, as well as the trade pessimism of 1949 in which the outlook for increasing Latin exports was gloomy. The United States—the region’s dominant supplier since the Second World War—had fallen into recession, with Latin America’s imports from it rising 168% while those from Western Europe fell by 15%. “Formerly, prior to the Great Depression, the Latin American countries developed outwardly, stimulated by the constant increase in exports. There is no reason to suppose, at least at present, that this will occur again to the same extent, except in very particular cases.”³⁶ Given this grim prospect, the international economic system was even less likely to stimulate development and technical progress in Latin America, and it was therefore urgent to get moving without delay.³⁷

Prebisch’s report transformed the Havana meeting and created a sensation in the media throughout Latin America; instead of debating an important but dull *Economic Survey*, ECLA found itself with a great idea

and a potential cause. No one could possibly doubt that Prebisch had been the centerpiece of the Havana triumph, the great victor. Everyone, including he himself, realized that Havana had launched him as a regional personality, and a formal resolution of appreciation was unanimously approved on June 14 at the close of the conference. But in New York and Washington the reaction was different, and there was consternation among senior United Nations and United States officials who understood the power of the “manifesto”: Prebisch’s framework of structuralism offered a new approach to international development; he had spoken out in favour of an activist State and industrialization in a new language which challenged the old doctrine of comparative advantage. The notion that agricultural countries in Latin America could thrive in the future by remaining commodity producers was undermined, and all development experts—whether from the industrial or developing countries—knew that a new debate had been launched. The immediate and harsh reaction of mainstream economists, including Gottfried Haberler, Gerald Baldwin, Charles Kindleberger, and Gerald Meier, to *The economic development of Latin America and its principal problems* underlined the seriousness of Prebisch’s challenge to traditional economic theory.³⁸ Jacob Viner of Princeton University set the tone by dismissing the “manifesto” as a set of “malignant fantasies, distorted historical conjecture and simplistic hypotheses.” During his lectures in Brazil at the National University during July and August 1950, Viner’s arrogance astonished his audience as much as his advice: stay with free trade; don’t be wooed away from neoclassic verities by sirens promoting economic diversification; devote yourselves to agriculture and birth control.³⁹ Prebisch was a heretic—even a “grand heretic”—, to be avoided at all costs. Other United States economists were less ideological, with criticisms of aspects ranging from the empirical data underpinning the Prebisch-Singer terms of trade theory, to the neglect of shipping costs, the impact of technological innovation, and so forth.⁴⁰

³⁶ Prebisch (1949), pp. 9 and 37-38. The outlook for Latin American exports was gloomy in the United States and Europe as well as in Latin America itself. Moreover, the recession in the United States coincided with a transformation in US-Latin American-European trade relations between 1937 and 1949, over which period European exports to the region had fallen 15%, compared with a 168% increase for the United States, while Latin American exports to Europe had fallen by 39% and those to the United States had increased by 38%.

³⁷ Furtado (1985, pp. 60-61) underlined this point, noting that Prebisch had moved from a critique of economic theory to international “realities”.

³⁸ See Solis (1989) for a preliminary examination of the scholarly controversies surrounding the “Prebisch Thesis”.

³⁹ Prebisch was invited to Brazil for a lengthy visit, from August 19 to September 1, 1951, much of which was spent answering the criticisms Viner had made of Prebisch a year earlier, which had been published in the *Revista Brasileira de Economia* of the Getulio Vargas Foundation.

⁴⁰ “El Gran Heresiarca” was the expression Furtado coined for Prebisch and ECLA at the height of his fame.

But Prebisch's critics missed the point. The "manifesto" was not a fully-developed theory of economic development, and Raúl made no claim in this direction. Indeed, the report repeatedly appeals for more research. It was not anti-trade ("The more active Latin America's foreign trade, the greater the possibilities of increasing productivity by means of intensive capital formation"). It was not anti-agriculture ("The industrialization of Latin America is not incompatible with the efficient development of primary production"). Nor was it blindly pro-industrialization (chapter VI of the report was entitled "The Limits of Industrialization" and said "Industrialization is not an end in itself, but is the only means at their disposal of obtaining a share of the benefits of technical progress and of progressively raising the standard of living of the masses").⁴¹ Prebisch also believed in the market, but demanded answers to the question of "What else? What about the inequities and asymmetry in the system?". He challenged the market by itself as the great equalizer, and called for purposeful action to share the benefits of international trade. This was the cognitive leap which identified him as the father of development: he had presented a new paradigm of development within a fundamentally novel approach. Indeed the most serious –and resented– of Raúl's criticisms of neo-classical economists in American and European universities was their presumption of wisdom: "One of the conspicuous deficiencies of general economic theory, from the point of view of the periphery," he maintained, "is its false sense of universality". Viner (who once acknowledged that he was an "old-fashioned free trader") and his colleagues had no difficulty attacking the "manifesto" on specific points because it was not a fully-developed theory, and therefore vulnerable to academic criticism. But on the central issue of asymmetry, they could only fall back on the old "truths" –such as the fairness of the system if developing countries created a suitably hospitable business climate for investment.

4. Conclusion: The essential Prebisch

It can be argued that Prebisch changed less than Washington and Argentina: between 1943 and 1949 the Cold War reversed policy in Washington, and Peronism transformed Argentina. The many criticisms of Prebisch –that he was a blind protectionist, or that he was anti-American, for example– obscure the record of his actual

life and work before 1943.⁴² The ultimate irony is that he is often blamed for deforming Latin American development by advocating excessive import substitution. In fact the ethical imperative which drove him all his life derived from his boyhood years in Tucumán, where a handful of sugar barons maintained a colonial-style system of exploitation over migrant Indian labourers, because their power in the national capital could keep out cheaper Brazilian imports. Like his father, an immigrant from Saxony in Germany who married into a poorer branch of one of Argentina's most famous colonial families, he disliked the oligarchy and military; he was a charter member of Argentina's "golden generation," and he arrived in the capital committed to reform. His decision to study economics –at that time a new and non-prestigious discipline in Argentina promising few rewards– reflected a desire to understand markets to improve society in the original Adam Smith conception of the discipline. This same idealism infused his choice of a career in the Argentine public service when he recognized the modernization of the State as his future path, and he moved up quickly to become a leading technocrat by 1928. The autonomous Central Bank model he developed in 1935 was his crowning achievement in his Argentine years, capturing his vision of a modernizing elite in Argentina to oversee a coherent development process protected from political uncertainty –just as he built ECLA (and later UNCTAD) as instruments to champion equity in North-South relations. Ironically, after some 54 years, the World Bank's *World Development Report 1997* accepted Raúl's vision of a strong but "smart" State to correct market externalities, safeguard public goods, and seek competitive advantages instead of comparative advantages in trade.

In 1943, six years before the "manifesto", when Prebisch outlined his thoughts on the challenge facing Argentina, his ideas sound familiar in the current discourse on coping with globalization: especially the need to harness the market in the social interest by locating a compromise between the benefits of liberalization on the one hand and the political choices required to protect national values and public goods on the other. As we already noted, we would now view

⁴¹ Prebisch, 1949, p. 52.

⁴² See Prebisch, 1949, p. 11, for his assault on the "false universality" of general economic theory. The widespread notion that he was anti-American, which became prevalent in Washington during the 1950s, is entirely belied by his life and work. This issue is discussed at very considerable length in the author's forthcoming biography of don Raúl.

Prebisch's approach as "civilizing globalization" to ensure sustainable growth and social development. Some assumptions of the "manifesto" (such as the pessimism about exports) proved incorrect, but his enduring contribution does not lie in time-bound details. Rather its greatness lies in projecting a paradigm which restores the power factor to international economics and in demanding that theory be linked with experience in interpreting Latin America's peculiar regional insertion in the international economy. This vocation reflected

the constant interaction between the practitioner and the academic in his life, which by 1943 had abundantly demonstrated the false universality of neo-classical economic theory. The short and undistinguished trajectory of the Washington Consensus serves as a salutary reminder of ideological excess and the need for new approaches that reflect the contemporary Latin American context.

(Original: English)

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The motive ideas *behind three* industrialization processes

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In its most orthodox version, neoclassical economic theory has occupied a leading place in Latin American economic policy discussions in recent years. According to this doctrine, the market mechanisms –if allowed to operate in complete freedom– allocate production resources in the most efficient manner possible. Any interference by State policy with this allocation will lead to loss of efficiency and a reduction in the growth rate of the economy compared with the optimum level that could be obtained through the free play of the market forces. The virtues of the main body of this economic theory for interpreting reality have been proved over more than two centuries. But this does not justify overlooking the serious limitations affecting the operation of the market or the differences observed in that operation in the different stages of countries' development. In the historical period in which they began their industrialization processes, the countries which are now developed applied policies of active State participation in combination with the free functioning of the market, and formulated theories which gave technical backing to those policies.

Although these facts have been studied and are well known in academic circles, very little reference is made to them in economic policy discussion in our region. I therefore propose in this essay to recall the ideas which

guided the evolution of two important economic policies: those of the United States and of Germany. Due to lack of space, I shall not deal with the case of Japan, which also applied policies in the last century which combined State and private action. The first two cases will be used in this essay as the background for analysing the ideas of Prebisch and ECLAC applied to the case of Latin America.

1. The case of the United States. Alexander Hamilton

These ideas on the industrialization of the United States were set forth by Alexander Hamilton in 1791 (see Hamilton, 1934). This author questioned the validity of the objections against policies for the promotion of manufactures and the assertion that –without government aid– industry would grow as quickly as the natural state of things and the interests of the community required. According to Hamilton, this assertion is not always true. Inertia and a tendency to imitate are reflected in fears about failing in new ventures, the obstacles inseparable from first experiments in competing with nations which have already perfected a particular branch of industry, and the artificial incentives with which foreign countries support their citizens (Hamilton, 1934).

Hamilton goes on to say that “Experience teaches ... that the simplest and most obvious improvements, in the most ordinary occupations, are adopted with hesitation, reluctance and by slow gradations. The

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spontaneous transition to new pursuits ... may be expected to be attended with proportionably greater difficulty. ... these changes would be likely to be more tardy than might consist with the interest either of individuals or of the Society ... and ... in many cases they would not happen. ... To produce the desirable changes, as early as may be expedient, may therefore require the incitement and patronage of government. The apprehension of failing in new attempts is perhaps a more serious impediment ... it is essential that [those embarking on such new ventures] should be made to see ... the prospect of such a degree of countenance and support from government, as may be capable of overcoming the obstacles, inseparable from first experiments". "The superiority antecedently enjoyed by nations, who have preoccupied and perfected a branch of industry, constitutes a more formidable obstacle ... to the introduction of the same branch into a country, in which it did not before exist. To maintain between the recent establishments of one country and the long matured establishments of another country, a competition upon equal terms, both as to quality and price, is in most cases impracticable ... without the extraordinary aid and protection of government". Thus, government aid for infant industry in a new country may be essential in order to offset inequalities of competition in the initial period.

Thanks to the reports by Hamilton and by some of his followers, such as H.B. Carey, who advocated these ideas in 1865, these concepts spread and strongly influenced the trade and industrial policy applied by the United States during its industrialization process (see Mill, 1987).

2. The case of Germany. Frederick List

The industrialization policy for Germany was set forth in similar, albeit broader, terms by Frederick List in the nineteenth century (List, 1856). List claims that, during the initial period of development of an industry in a new country, government aid for the infant industry may be essential in order to equalize the conditions of competition. He maintains "The protective system is the only means by which nations less advanced can be raised to the level of that nation which enjoys a supremacy in manufacturing industry. A monopoly not conferred by nature, but seized by being first on the ground; the protective system, regarded from this point of view, will be most effective promoter of universal association among nations, and consequently free trade" (List, 1856, p. 201). Although he recognizes that in the

beginning customs protection increases the price of manufactures, he maintains "that in course of time, in a nation capable of large industrial development, such articles can be produced at a cheaper rate than they can be imported from abroad" (List, 1856, p. 224). The initial sacrifice "is amply compensated by the acquisition of a productive power, which ensures not only a larger product of wealth in future, but also a greater industrial independence" (List, 1856, p. 224).

Citing Say, he accepts that the State may protect national industry provided that within a few years that industry can survive unaided, just like "... a shoemaker's apprentice, to whom a few years' teaching and support is accorded that he may learn his trade to live without further help from his parents" (List, 1856, p. 262).

List's proposals go further than those of Hamilton. He not only refers to the greater independence in industrial matters that this policy gives to a country, but also notes that the progress of industry in a predominantly agricultural country has more general consequences for development. It stimulates urban growth and has a positive influence on social and political development, on intellectual and cultural progress, and on creative capacity. Industrial development makes possible increased productivity throughout the economy and development of the means of transport.

He highlights the interdependence between industrial and agricultural development, noting that industrial development stimulates and diversifies demand for agricultural products (List, 1856, p. 295). During the process of industrial development, each new industry supports the development of others (List, 1856, p. 377). This assertion brings out the intersectoral and not merely individual nature of industrial policies.

List hints at the structural nature of the economic development process when he asserts that the development of manufacturing is only attained slowly and gradually. It takes a long time to improve equipment, production processes and distribution systems. It is easier to perfect and expand an existing enterprise than to start up a new one. Old industries, which have been developed over generations, can be promoted more easily than new ones. It is more difficult to make an enterprise progress when there have been few or no such enterprises in the country in the past, since in new enterprises the managers and workers have to be trained or brought in from outside, and the prospects are not promising enough to give capitalists the degree of confidence needed to ensure their participation. Over generations, it is possible to improve

the price, quality and quantity of the production (List, 1856, pp. 373-374).

These ideas open up a broader horizon than that of the industrial sector itself and are forerunners of later, technical proposals. The manufactures of a newly industrialized country, List says, “can be compared with a youth struggling with a fully grown man. The manufactures of the chief industrial and commercial power possess a thousand advantages over those of new or as yet not fully mature nations. They have ... skilful and experienced workmen in great numbers and at low wages, men of special skills and experience in management, ... financial institutions, ... transport facilities, ... efficient storage and distribution systems, ... a domestic market which provides them with support for conquering outside markets”. In those conditions, it would be useless for a new country to trust exclusively in the natural evolution of the economy to develop an industry in free competition with the most highly developed nations (List, 1856, pp. 378-379). List, like Hamilton and other classical authors, considered that there must be limits on policies for the promotion and protection of industry: protection and support should not have excessive levels, should be kept in being only for a reasonable length of time, and should be applied to activities in which the country had the possibility of being competitive (List, 1856, pp. 390-393). Customs duties should be considered and applied only for the benefit of sectors which offered basic advantages for the country.

3. More general cases: John Stuart Mill and neoclassical theory

Mill acknowledged the legitimacy of industrialization policy by incorporating the infant industry argument into classical theory. His ideas (Mill, 1987) were based on the more pragmatic and limited version of Hamilton rather than that of List.¹

Pages 922 and 923 of Mill (1987) contain the following well-known paragraph: “The only case in which, on mere principles of political economy, protecting duties can be defensible, is when they are imposed temporarily (especially in a young and rising nation) in hopes of naturalizing a foreign industry, in

itself perfectly suitable to the circumstances of the country. The superiority of one country over another in a branch of production, often arises only from having begun it sooner. There may be no inherent advantage on one part, or disadvantage on the other, but only a present superiority of acquired skill and experience. A country which has this skill and experience yet to acquire, may in other respects be better adapted to the production than those which were earlier in the field: and besides, it is a just remark of Mr. Rae, that nothing has a greater tendency to promote improvements in any branch of production, than its trial under a new set of conditions. But it cannot be expected that individuals should, at their own risk, or rather to their certain loss, introduce a new manufacture, and bear the burthen of carrying it on until the producers have been educated up to the level of those with whom the processes are traditional. A protecting duty, continued for a reasonable time, might sometimes be the least inconvenient mode in which the nation can tax itself for the support of such an experiment. But it is essential that the protection should be confined to cases in which there is good ground of assurance that the industry which it fosters will after a time be able to dispense with it” (Mill, 1987, pp. 922-923).

Neoclassical theory has refined the infant industry argument and clarified its validity. But at the same time it has helped to limit its application. It analyses the case of external economies, where the company making the investment does not capture all the resulting benefits, part of which may be diverted to other firms through the transfer of skilled labour, or through firms which supply the company which made the investment with non-tradeable goods, or through acquisition of its products (Corden, 1974, pp. 256-257). In these cases, it might be necessary to compensate that company for the benefits of the investment that it does not capture.

Neoclassical theory also takes account of the case where there are reciprocal external economies and none of the companies involved captures the total result of the investment (Corden, 1974, p. 260).

In the neoclassical school, there is some skepticism about the application of industrialization policies. Although the validity of the infant industry argument is usually accepted, it is considered that such policies are not the best alternative, but rather second- or third-best options. It is maintained that rather than applying active industrial policies it would be more efficient to improve the information available to entrepreneurs for taking their decisions or to try to improve the capital markets, leaving it to the market, free of all outside

¹ List showed himself to be a capable and far-sighted economist, but he advocated nationalist views which shocked other authors of his time, as described in the essay by G. A. Matile, who edited List's works.

interference, to allocate resources. This would give industrial policies less leeway than was allowed to them by the classical authors who influenced the industrialization processes of the United States and Germany.

Two main positions may be observed in the recent application of neoclassical theory to economic policy for the developing world in general and Latin America in particular:

On the one hand, there is the more orthodox point of view, which gives public policies a much-reduced role and leaves the allocation of production resources to the unfettered functioning of the market. It attaches decisive importance to maintaining fiscal and monetary balance, and advocates the reduction of the public sector to a minimum, the privatization of State activities, and deregulation. The supporters of this approach are openly hostile to active production development policies and attempts to change the economic structure, such as promotion of industry, policies designed to support technological progress, and trade policies based on protection and export promotion.

During the Reagan administration in the United States, this line of thinking, promoted by a supply-side economy, was very much in vogue. Even after the end of that administration, however, it has continued to enjoy strong support, especially among conservative groups, Latin America's private international creditors, and domestic sectors in Latin American countries associated with those financial circles. In the words of Feinberg (1990): "On one side are those who favor the restrictive Reaganite model: provide for national defense, set the appropriate macro conditions, and walk away".

On the other hand, there is also a less rigid neoclassical position which accepts some degree of active policies to promote industrial and technological development and support new exports. This position sets quite strict limits for such policies, however, both as regards the instruments used and the intensity with which they are applied in particular sectors, and also the length of time they are applied to each sector of production. Generally, though not always, it accepts one exception to the ideal of free trade, namely, infant industries, which may warrant substantial protection, but only on a temporary basis (Williamson, 1990, p. 15).

In another paragraph, Williamson refers to his own position on subsidies: "... for my taste, the hostility toward subsidies tends to be too general. I fully sympathize with the hostility toward indiscriminate subsidies, but I also believe that there are circumstances

in which carefully targeted subsidies can be a useful instrument ... for improving either resource allocation or income distribution" (Williamson, 1990, p. 12). Stiglitz (1998) also takes a broader view on economic policies which can be applied without distorting the operation of the markets.

4. The case of Latin American industrialization: the Prebisch and ECLAC approach

Prebisch and ECLAC also opted for an approach involving deliberate industrialization, with State participation, in support of the private sector. They took a broad-based approach which, although centering mainly on economic matters in its operational aspects, also covered social issues, especially for the interpretation of the process. Changes in economic structures, industrialization, agricultural development, international economic relations, saving and investment, employment and income distribution were other issues analysed extensively and in depth.

Prebisch had been brought up in the classical economic tradition, and in the first years of his professional life he was an orthodox economist. As he himself said: "I believed in the universal validity of the theories developed in the centres" (González and Pollock, 1991). As a young Under-Secretary of Finance of his country, in the early 1930s, he recommended the government to apply orthodox policies in monetary, fiscal, trade and exchange matters. Soon, however, his ideas began to change, as a result of his experience in government which began in that period and continued later in the Central Bank of the Argentine Republic. There were two main aspects of that change: i) he came to the conclusion that, in the light of the world crisis, the Argentine economy would not recover using orthodox policies, in view of the ongoing deterioration in exports, which contrasted with the tendency towards strong growth in import needs; and ii) the failure of the 1933 World Economic Conference and the fact that Keynes's ideas on international cooperation found almost no acceptance among the European countries convinced him that Argentina could not hope for a solution through the reactivation of world demand. The tough bilateral negotiations for the Roca-Runciman treaty with Great Britain clearly revealed to him the limits imposed by a high degree of dependence on the export of primary commodities to a few foreign markets (González and Pollock, 1991).

As a result of this experience, he became convinced that it was essential to change the country's structure

of production and of exports through industrialization, and that to secure this objective it was necessary to combine the play of the market forces with State action designed to promote and guide private sector action. Prebisch had become clearly aware of the profound repercussions on developing countries caused by crises originating in the developed countries, and knew that little could be done to avoid such crises.

His experience in Argentina served as the ground in which Prebisch's ideas initially germinated, to be subsequently developed in ECLAC and later still in the United Nations Conference on Trade and Development (UNCTAD).

According to Prebisch, the developing countries –which were on the periphery– specialized in the production of primary commodities. This resulted in an asymmetrical structure of their trade and financial relations with the developed countries. They exported low-technology goods and imported high-technology ones. Their exports were produced by unskilled labour, with a weak level of trade union organization, and the demand for them was marked by low income elasticity. As a result, this demand grew only sluggishly, and the exports provided low and unstable wages and profit margins. Their imports, in contrast, contained skilled, highly unionized labour, and their income elasticity was high, meaning higher wages and profit margins and faster growth for the supplier countries.

This asymmetrical structure of the external relations of the developing countries limited their growth potential, while their structural economic and social heterogeneity was reflected in unequal income distribution whose most evident –though not its only– features were poverty and marginality.

The cornerstone of the recommendations he made on the basis of this diagnosis was the industrialization process, which would make it possible to change the domestic production structure and external relations. This process could not be induced fast enough solely through the unaided effect of the free market forces, but required active public protection and promotion policies in the fields of trade, taxation and credit.

This policy varied with time, changing its emphasis according to the variations in the international economic situation and the development of industry in the region. In the post-war period, the markets of the developed countries were closed by high protectionist barriers, so that policy was aimed preferentially at the domestic market, through import substitution. Prebisch and ECLAC, however, considered that in view of the small size of that market import substitution meant

inefficiency, so they recommended integration among the Latin American countries in order to create bigger markets and greater competition, and ECLAC gave strong support to the Central American integration process, the Latin American Free Trade Association (LAFTA)/ Latin American Integration Association (ALADI) and the Andean Group. From the 1960s on, as the markets of the developed countries showed themselves to be somewhat more receptive to Latin American manufactures, ECLAC maintained a programme to provide technical support for policies to promote the export of manufactures.

There was also an ongoing evolution of the priority production sectors in the industrialization process, from sectors producing non-durable and durable consumer goods at the start, to intermediate and capital goods with greater requirements in terms of investment and technology later on. The production of consumer goods created the subsequent demand for intermediate and capital goods: a form of evolution endorsed by ECLAC studies on industrial sectors and policies.

In order for progress to be made in policies to support the production of manufactures, two complementary elements were required:

- i) A technology policy whereby the State provided support for the creative adaptation of outside technology to the special conditions of the Latin American countries and helped to speed up the innovation process. This increased efficiency, reduced costs, and improved the quality of the goods produced, so that they were better adapted to the demand on external markets. A project was carried out in collaboration with the Inter-American Development Bank (IDB) in this field.
- ii) As well as the efforts of the developing countries themselves, the export of manufactures required the active collaboration of the developed countries, which should open up their markets. One of the main objectives of Prebisch's work at UNCTAD –ably seconded by ECLAC in the Latin American area– was the creation of a generalized system of preferences, with unilateral opening of the markets of the developed countries in favour of the developing countries, through specific lists of goods that the developing countries were interested in exporting.

Although industrialization was the hub of the policies advocated by Prebisch and ECLAC, its success would call for the simultaneous application of other policies too.

Thus, an international cooperation policy was required, in order to secure a substantial increase in the

flow of medium- and long-term capital from the developed countries to the region. Domestic saving capable of being turned into foreign exchange was not sufficient to finance an acceptable growth rate, as was reflected in the saving and trade deficits. International cooperation was possible, thanks to the political climate prevailing at the end of World War II and the political competition between the capitalist developed countries and the socialist countries. The World Bank, which was set up soon after the war, was complemented with the establishment of the Inter-American Development Bank (IDB), in whose creation ECLAC played a leading role. Mechanisms were also established in the countries of the region to ensure that medium- and long-term capital of public origin was invested efficiently, with the highest possible yield in terms of its contribution to economic development and employment and with guaranteed payment capacity. These mechanisms operated efficaciously until the abundance of international funds created by the oil price rises from the 1970s on and the surplus savings being accumulated by the developed countries turned the shortage of international funds into a glut. This led to the slackening of the discipline which had prevailed up to then and encouraged unproductive or imprudent use of the funds, culminating in the 1980s in the Latin American external debt crisis.

It was also necessary to pay special attention to two interrelated social issues: income distribution and employment. Income distribution was a matter of growing concern for Prebisch and ECLAC from the 1950s on, unlike conventional theory, which paid little attention to this issue because it based its ideas on the principle that, in an equilibrium situation, redistribution could not improve one person's income without adversely affecting that of another person. ECLAC, however, considered that Latin American industrialization received substantial

support from the domestic market, so that better income distribution – quite apart from its importance for equity – was of great economic significance because it promoted the broadening of the domestic market and the incorporation into it of a high proportion of the previously marginalized population. With regard to employment – the other aspect of marginality – specific objectives and forms of development were proposed which would make it possible to progress towards the solution of structural unemployment and underemployment within a reasonable length of time.

Another two methodological aspects were given a great deal of attention by ECLAC: the investment projects manual, and planning – two technical instruments which were placed at the disposition of countries in order to help them to ensure the most efficient possible use of their resources. In the projects manual, a project preparation technique was described which increased projects' contributions to development and employment to the maximum, thus offering a means of relieving external constraints. This technique was very useful for submitting projects to financing bodies and evaluating their effects from the point of view of the entrepreneur and society. Planning, for its part, was put forward as a means for designing medium- and long-term policies and following up their implementation in order to ensure, as far as possible, that the structural changes pursued were effectively obtained. It aimed to secure coherence of the objectives proposed in development policies and compatibility of those policies with the restricted resources available, especially savings and foreign exchange. ECLAC therefore made the institutionalization of development planning one of the main objectives.

(Original: Spanish)

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