# Raúl Prebisch

RAÚL PREBISCH was born in 1901 in Tucuman, Argentina. He was educated at the University of Buenos Aires and has received honorary degrees from universities in several countries.

His posts have included Under Secretary of Finance, Argentina, 1930–32; Executive Secretary to the U.N. Commission for Latin America, 1948–62; Director-General for the Latin American Institute for Economic and Social Planning, 1962–64; Secretary-General to the U.N. Conference on Trade and Development (UNCTAD), 1964–69; and Advisor to the Secretary-General of the United Nations on development problems. He is currently Director of the *CEPAL Review* of the U.N. Economic Commission for Latin America in Santiago, Chile.

In 1974 he was honored with the Jawaharlal Nehru award for International Understanding; in 1977, with the Dag Hammarskjold honorary medal of the German U.N. Association; and in 1981, with the Third World Prize by the Third World Foundation.

His books include *Introducción a Keynes* (Mexico City: Fondo de Cultura Económica, 1947); *Una Neuva Politica Commercial para el Desarrollo* (Mexico City: Fondo de Cultura Económica, 1964); *Transformación y Desarrollo* (Mexico City: Fondo de Cultura Económica, 1965); *Interpretación del Proceso de Desarrollo Latino-Americano en 1949*, U.N. Serie Commemorativa del XXV Aniversario de la CEPAL (Santiago: United Nations, 1973), which also appeared in *Economic Survey of Latin America, 1949* (New York: United Nations, 1950); and *Capitalismo Periférico: Crisis y Transformación* (Mexico City: Fondo de Cultura Económico, 1981).

Among his articles are "Commercial Policy in the Underdeveloped Countries," *American Economic Review*, Papers and Proceedings (May 1959); and "El Desarrollo Económico della América Latina y Algunos de Sus Principales Problemas," *Boletin Económico América Latina*, vol. 7, no. 1 (February 1962).

His writing and activities have been directed toward an understanding of the development of the countries of the world economic periphery, particularly those of Latin America. His policy proposals have been influential, especially in relation to the creation of a New International Economic Order.

# Five Stages in My Thinking on Development

WHEN I STARTED MY LIFE as a young economist and professor during the 1920s, I was a firm believer in neoclassical theories. However, the first great crisis of capitalism—the world Depression—prompted in me serious doubts regarding these beliefs. It was the beginning of a long period of heresies, as I tried to explore new views on development matters. The second great crisis of capitalism, which we are all suffering now, has strengthened my attitude.

In the long lapse of time between these two great crises, my thinking on development has gone through five successive stages under the influence of a changing reality and the broadening of my own experience.

During those hectic years of the Depression I had some influence on the economic policy of my country, Argentina, first as under secretary of finance and later with the Central Bank. During the 1930s I recommended orthodox anti-inflationary measures to eliminate the fiscal deficit and suppress inflationary tendencies, but at the same time I departed from orthodoxy when I had to face a serious balance of payments disequilibrium and advocated a resolute industrialization policy as well as other measures to this end.

My duties during this period did not permit me to devote time to theoretical activities. But after I left these responsibilities in the early 1940s, I spent some years trying to derive some theoretical views from my experience. This was the first stage, before my association with the Comisión Económica para América Latina (CEPAL, the United Nations Economic Commission for Latin America). The second and third stages evolved thereafter, during my cooperation with CEPAL, and the fourth relates to my work in the United Nations Conference on Trade and Development (UNCTAD). The fifth stage corresponds to a final period when, free from executive responsibilities for the first time in many years, I have been able to revise and advance systematically in my thinking.

## The First Stage

The first stage evolved after 1943 when, having been forced to leave my public responsibilities, I was able to devote some years to reflection on the meaning of my previous experience. Important theoretical problems emerged in my mind. Why must I depart suddenly from well-entrenched beliefs? Why was it necessary for the state to play an active role in development? Why was it that policies formulated at the center could not be followed at the periphery?

These and other reflections paved the way for the next stage.

## The Second Stage

My entry into CEPAL in 1949 took place when my ideas were already reaching maturity, and I was therefore able to crystallize them in various studies published in the early 1950s. In these studies I tried both to diagnose the problems and to suggest policies which would serve as alternatives to those proposed by orthodox thinking. Thanks to the broader horizon which my new responsibilities permitted me, these studies concerned not only Argentina but Latin America as a whole.

In formulating my point of view I mentioned from the beginning the role of technological progress. In particular, my interest was attracted by the question of the international dissemination of technology and the distribution of its fruits, since the empirical evidence revealed considerable inequality between the producers and exporters of manufactured goods on the one hand and the producers and exporters of primary commodities on the other. I tried to understand the nature, causes, and dynamics of this inequality and studied some of its manifestations, such as disparity in demand elasticity and the tendency toward deterioration of the terms of trade for primary commodity exports, which industrialization as well as other policy measures could counteract.

In trying to find an explanation for these phenomena in those years, I put special emphasis on the fact that the countries of Latin America formed part of a system of international economic relations which I named the "center-periphery" system.[1] In reality, this concept had been turning over in my mind for some time. At first I gave it a cyclical character, considering that it reflected the active role of the industrial centers and the passivity of the periphery, where the consequences of the economic fluctuations of the centers were intensified. There was in effect an "economic constellation," at the center of which were the industrialized countries. Favored by this position and by their early technical progress, the industrialized countries organized the system as a whole to serve their own interests. The countries producing and exporting raw materials were thus linked with the center as a function of their natural resources, thereby

1. See, in particular, *The Economic Development of Latin America and Its Principal Problems* (New York: United Nations, 1950); and *Economic Survey of Latin America, 1949* (New York: United Nations, 1950).

forming a vast and heterogeneous periphery incorporated in the system in different ways and to different extents.

For each peripheral country, the type and extent of its linkage with the center depended largely on its resources and its economic and political capacity for mobilizing them. In my view, this fact was of the greatest importance, since it conditioned the economic structure and dynamism of each country—that is the rate at which technical progress could penetrate and the economic activities such progress would engender. Similarly, this system of international economic relations exaggerated the degree to which income in the periphery was siphoned off by the centers. Moreover, the penetration and propagation of technical progress in the countries of the periphery was too slow to absorb the entire labor force in a productive manner. Thus, the concentration of technical progress and its fruits in economic activities oriented toward exports became characteristic of a heterogeneous social structure in which a large part of the population remained on the sidelines of development.

My diagnosis of the situation of the countries of Latin America was constructed on the basis of my criticism of the pattern of outward-oriented development, which I considered to be incapable of permitting the full development of those countries. My proposed development policy was oriented toward the establishment of a new pattern of development which would make it possible to overcome the limitations of the previous pattern. This new form of development would have industrialization as its main objective. In reality, my policy proposal sought to provide theoretical justification for the industrialization policy which was already being followed (especially by the large countries of Latin America), to encourage the others to follow it too, and to provide all of them with an orderly strategy for carrying this out. This task was by no means easy, because the recovery of the international economic order after the Second World War and the expansion of exports caused a resurgence of the champions of outward-oriented development and the criticism of industrialization of the periphery.

I should like to underline some aspects of my policy proposals which seem to me to be of particular importance.

### *Industrialization*

The technology of the centers had penetrated mainly into activities connected with primary exports, which responded to the needs of the industrial countries, but not into other activities of peripheral countries where the productivity of a very large proportion of the labor force was very low. The basic problem of development therefore involved raising the level of productivity of the entire labor force. However, export activities suffered from serious limitations from this point of view, for the possibilities of increasing commodity exports were restricted by the relatively slow growth of demand in the centers because of the generally low demand elasticity for primary products and their protectionist policies. Consequently, industrialization had a very important role to play in the employment of these large masses of manpower of very low productivity as well as the manpower released by further technological progress not only in export activities but also in the production of agricultural goods for domestic consumption.

But could industry be developed when costs of production were much higher than in the centers?

Let me repeat that, as a young economist, I was a neoclassicist and fought against protection. But during the world Depression, throwing overboard a substantial part of my former beliefs, I was converted to protectionism.

Theoretically, the problem was put in the following dynamic terms. What is to be done with productive resources when further expansion of primary exports would bring a fall in prices? Should these resources be used to generate additional exports, or should they be allocated to industrial production for domestic consumption?

The most economically advantageous solution depends on the proper combination between these two compatible options. Additional primary exports would be more advantageous provided the export income lost through the fall in prices was not greater than the income lost because of the higher cost of domestic industrial production in relation to imported industrial goods. Once beyond the point where such income losses were the same, the option in favor of industrialization was quite obvious.

This was essentially my reasoning. I underlined that this cost was necessary to accelerate the rate of productive employment and consequently the rate of development. The net economic result was quite positive insofar as the global product could grow faster than the rate of primary exports. But every effort must be made to intensify these exports without overstepping the limits just referred to.

No emphasis was put at this stage on exports of manufactures to the centers, because suitable industrial infrastructure was lacking and conditions in the centers were unfavorable. To spark the beginning of this process I strongly recommended the stimulation of exports of manufactures—as well as primary goods—among Latin American countries. I envisaged preferential arrangements by regions or subregions that would lead in the course of time to a common market.

Conventional economists both in the centers and in the periphery have always attacked (and continue to attack) protection as a form of intervention violating the laws of the market. Industrialization, they claimed, should be spontaneous. If costs of production were higher than in the centers, wages should be adjusted to become competitive. And exchange devaluation was the best instrument to promote both exports and import-substitution. My position, however, was that once the limit already referred to was passed, additional primary exports that were already competitive would bring a loss of income through the deterioration of the terms of trade.[2]

From this analysis emerged the conclusion that import substitution stimulated by a moderate and selective protection policy was an economically sound way to achieve certain desirable effects. Such a policy would help correct the tendency toward a foreign constraint on development resulting from the low income elasticity of demand for imports of primary product by the centers, compared with the high income elasticity of demand at the periphery for manufactures from the centers. Import substitution by protection counteracts the tendency toward the deterioration of the terms of trade, by avoiding the allocation of additional productive resources to primary export activities and diverting them instead to industrial production. (I also recognized other possibilities of counteracting that tendency by various ways of limiting competition.) Industrialization, in addition to assisting the overall penetration of technology and creating employment, promotes changes in the structure of production in response to this high demand elasticity for manufactures. Therefore, industrialization and increased productivity in primary production are complementary. The more intense the latter, the greater the need for industrialization.

### *Relations with the Centers*

I strongly criticized the insistence of the centers on the outworn idea of the international division of labor. First they opposed industrialization, and later they exalted the dominant role of the transnationals in an efficient process of import substitution. I recognized the importance of these corporations for introducing technical progress, but at the same time I emphasized the need for a selective policy in order to avoid the excessive pressure of profits on the balance of payments, to check their role in the diffusion of forms of consumption contrary to the accumulation of reproductive capital, and to orient development toward a sense of national autonomy. I strongly advocated important changes in the trade policy of the centers, and stressed the need for an enlightened transfer of financial and technological resources.

Generally speaking, my attack on protectionism at the centers and my defense of protectionism at the periphery has been misinterpreted. I envisaged the latter type of protection as necessary during a rather long transition period in which these disparities in demand elasticity should be corrected. Protection at the centers aggravates these disparities, while at the periphery it tends to correct them, provided they do not exceed certain

2. See my first works in CEPAL already cited, and also "Commercial Policy in the Underdeveloped Countries," *American Economic Review* (May 1959).

limits. The wider the disparity, the greater the need for import substitution (as well as the promotion of exports of manufactures), especially if the rate of growth of peripheral countries is higher than in the centers.

An important policy consideration emerged from this assertion. The insistence of the centers on reciprocity in trade concessions was generally detrimental to peripheral growth. An increase in exports to the centers by virtue of concessions from the periphery implicitly brings with it an element of reciprocity. Why is this? Because given the high income elasticity, that increase in peripheral exports to the centers is followed by a corresponding expansion in peripheral imports from them. Quite apart from this, I considered that the rationalization of protectionism in Latin American countries was in any case a requirement for sound development.

### *Planning and the Market*

The structural changes inherent in industrialization require rationality and foresight in government policy and investment in infrastructure to accelerate growth, to obtain the proper relation of industry with agriculture and other activities, and to reduce the external vulnerability of the economy. These were strong reasons for planning.[3] Another important one was the need to intensify the rate of internal capital accumulation through proper incentives and other policy measures.

International financial resources were to complement and enhance a country's capacity to save, while changes in the structure of trade were necessary to use these savings for capital goods imports. Planning should help obtain these resources and accomplish the latter objective.

Planning was compatible with the market and private initiative. It was needed to establish certain basic conditions for the adequate functioning of the market in the context of a dynamic economy. But it did not necessarily require detailed state investment, except in infrastructure and development promotion. However, there were other reasons for this.

## The Third Stage

The third stage was mainly one of criticism in the late 1950s and early 1960s. I was critical of policy and of ideas, in response to changes occurring in the process of development and my better understanding of problems.

3. I advocated planning in particular in *Theoretical and Practical Problems of Economic Growth* (Mexico City: United Nations, 1950); and "Los Principales Problemas de la Técnica Preliminar de Programación," chap. 1 of *Introducción a la Técnica de Programación* (Mexico City: United Nations, 1955).

### *The Flaws of Industrialization*

On the one hand, it was clear that the process of industrialization (at least in the most advanced peripheral countries) had nearly exhausted the possibilities of further import substitution for the internal market of nondurable consumer goods. It was therefore necessary to enter into more complex and difficult forms of industrialization in intermediary products as well as capital goods and durables requiring larger markets. Consequently I advocated suitable measures conducive to a Latin American Common Market.[4]

On the other hand, the reconstruction of the world economy had been completed with the reorganization of the international system of trade and payments to improve its efficiency. New trade possibilities were visualized for the periphery, and I advocated a policy to stimulate exports of manufactures to the centers and to strengthen trade relations within the periphery. My reasoning was that industrialization had been asymmetrical, since it was based on import substitution through protection without corresponding promotion of exports of manufactures. Protection should be matched with selective export subsidies in order to face cost differentials with the centers. Furthermore, industrial policy had been improvised, principally to counteract the effects of a cyclical fall in exports. It was necessary to introduce rationality and correct exaggerations and abuses by reducing duties. Excessive duties not only distorted industrial production but also had adverse effects on exports of primary products.

### *Income Disparities*

Up to this stage I had not paid sufficient attention to the problem of income disparities, except in the case of the outdated land tenure system. Nor had I paid enough attention in the early CEPAL years to the fact that growth had not benefited large masses of the low-income population, while at the other extreme of the social structure high incomes flourished. Perhaps this attitude of mine was a remnant of my former neoclassicism, which assumed that growth in itself would eventually correct great income disparities through the play of market forces.

At the beginning of the 1960s I changed fundamentally, for some estimates made by CEPAL economists about the dimensions of this problem were appalling indeed. What had caused these great disparities? In the light of the theoretical interpretation that I elaborated years later, I confess

4. The idea of a Latin American Common Market was present in my works from the late 1940s. See especially *El Mercado Común Latinoamericano*, pt. 1 (New York: United Nations, 1959).

that I fell into conventional explanations: the concentration of land, excessive protection, and inflation.[5]

Earlier I had frequently emphasized the need to enhance the rate of capital accumulation both in material goods and in the formation of human resources. At this stage I presented a series of projections to show the possibility of achieving this objective at the expense of privileged consumption of the high income strata in order to employ productively those large masses of the population which had not shared in the fruits of development.

### *Inflation*

I frequently dealt with inflation in my writings. Inflation aggravated social disparities but did not help to increase accumulation, as some would expect. On the contrary, it promoted conspicuous consumption. My treatment of this matter was rather conventional, however, with some occasional incursions into structural factors and external vulnerability. I was far from being sympathetic to the views and prescriptions of the International Monetary Fund, but notwithstanding my previous experience at the Central Bank in noninflationary times, I was not able to recommend policies different from those I criticized.

Be that as it may, it took me some years to understand the real meaning of inflation and the process of income distribution. I was intrigued by these phenomena but I could not undertake further efforts at theoretical elucidation, for I had to leave CEPAL to take charge of the establishment and initial years of UNCTAD. That was the fourth stage.

## The Fourth Stage

The fourth stage related to my work at UNCTAD (from 1963 to the end of the 1960s) and was oriented toward matters of international cooperation. This new responsibility was a very heavy one, but extremely challenging. I had no time for theoretical pursuits, and I had to have recourse to my previous CEPAL thinking.

Despite the great differences between the countries of the world periphery, there were many common denominators. This enabled me to present a full body of policy recommendations that constituted the starting point for discussion by member governments—or rather discussion and confrontation, for there was no meeting of minds. This was the beginning of the North-South dialogue, although it was and continues to be more a

5. See in particular *El Falso Dilema entre Desarrollo Económico y Estabilidad Monetaria* (Santiago de Chile, 1961); and *Towards a Dynamic Development Policy for Latin America* (New York: United Nations, 1963).

series of parallel monologues, not conducive to concrete action, on the most fundamental problems of international cooperation in trade, finance, and technology.

One of the main arguments prevailing in the developed countries was that the developing countries should take adequate measures to deal with their own internal development problems. Far from dissenting from this view, I underlined the need for a global strategy on the basis of joint responsibilities, common objectives, and convergent measures to achieve them.[6]

However, I did not succeed: clear proof that the North was not willing to act nor was the South inclined to engage in the very serious structural transformations needed to pave the way for development and social equity. The problems continue to be essentially the same, but seriously aggravated by the present crisis of the centers.

Although my endeavors at UNCTAD interrupted my theoretical activities, I had the benefit of broadening my field of knowledge and gaining a better insight into the workings of the system, both at the center and at the periphery, and into the complexities of their relationship. This contributed to the fifth stage of my thinking.

## The Fifth Stage

The fifth stage really started when, after many years of rewarding international service, I was able to free myself of executive responsibilities. CEPAL put me in charge of its *Review*, where I resumed my theoretical pursuits in a series of articles that formed the basis for my *Capitalismo Periférico* (Peripheral Capitalism).[7] This was the fifth and probably last stage of my thinking in development matters.

### *The Search for New Answers*

From the start, I asked myself some questions of paramount importance which had previously been left without convincing answers. Why was the

6. *Towards a New Trade Policy for Development: Report by the Secretary-General of UNCTAD* (New York: UNCTAD, 1964); *Towards a New Global Strategy for Development: Report by the Secretary-General of UNCTAD* (New York: UNCTAD, 1968); and *Change and Development: Latin America's Great Task* (Washington D.C.: Inter-American Development Bank, 1970).

7. "A Critique of Peripheral Capitalism," *CEPAL Review*, no. 1 (First half of 1976); "Socioeconomic Structure and Crisis of Peripheral Capitalism," *CEPAL Review*, no. 6 (Second half of 1978); "Towards a Theory of Change," *CEPAL Review*, no. 10 (April 1980); "The Latin American Periphery in the Global System of Capitalism," *CEPAL Review*, no. 13 (April 1981); "Dialogue on Friedman and Hayek from the Standpoint of the Periphery," *CEPAL Review*, no. 15 (December 1981); and *Capitalismo Periférico: Crisis y Transformación* (Mexico City: Fondo de Cultura Económica, 1981).

development process accompanied by growing disparities in income and wealth? Why was inflation so persistent, and why could it not yield to the use of conventional means? What were the reasons for some important contradictions in the development process at the periphery which had not occurred in the historical development of the centers, at least not with comparable intensity? Why had the periphery been left behind?

These and other questions dominated my mind and prompted new efforts to find consistent answers. For this purpose I went over my previous ideas very critically. Although it is true that there were some valid elements in them, they were very far from constituting a theoretical system. I arrived at the conclusion that to start building a system it was necessary to enlarge the scope beyond purely economic theory. Indeed, economic factors could not be isolated from the social structure. This was of paramount importance. It would be hopeless to seek a proper answer to these and other important questions within the narrow framework of a purely economic theory.

### *The Center-Periphery Concept Once Again*

My old concept of center and periphery was still valid, but it had to be enriched by introducing some very important consequences of the hegemony of the centers. Obviously it was not my purpose to deal theoretically with the centers. Some facts had to be clarified, however, in order to understand the other side, the periphery.

Technological progress started at the centers and its fruits remained basically there. For better or worse, they did not spread to the periphery through a general fall in prices in relation to increases in productivity. Historically, the role of the periphery had been mainly restricted to the supply of primary products. This explains why the growth of income stimulated demand and continuous technological innovations at the centers and gave great impetus to industrialization. The periphery was left behind not because of malicious design but because of the dynamics of the system.

It so happened that peripheral industrialization had been greatly delayed and took place during successive crises at the centers. This accentuated the tendency of the periphery to imitate the centers—to grow in their image and likeness. We tried to adopt their technologies and life styles, to follow their ideas and ideologies, to reproduce their institutions.

All this penetrated the social structure of the periphery, which lagged considerably behind the most advanced structure of the centers, and brought significant mutations and contradictions that it is of the utmost importance to clarify. This is in fact the clue to understanding why the system tends to exclude socially those at the bottom, why it becomes more and more conflictive in the course of its evolution, and finally why it eventually tends toward a serious crisis.

### *The Dynamic Importance of the Economic Surplus*

I shall try to explain these phenomena in a rather summary fashion. The essence of my interpretation turns around the concept of the economic surplus, that considerable portion of successive increments of productivity that is appropriated by the owners of the means of production, especially those concentrated in the high social strata.

The surplus is a structural phenomenon. In the heterogeneous social structure of the periphery a great proportion of the labor force is employed in activities of very low productivity. By virtue of the process of capital accumulation, this labor force is gradually absorbed into occupations of greater productivity. However, their remunerations do not increase correspondingly because of the regressive competition of those who have remained in occupations of much lower productivity and income (or are unemployed). Only a relatively small fraction of the labor force qualified to respond to the growing requirements of technological advance is in a position to share spontaneously in the fruits of productivity (thanks mainly to its social power).

I attach to the surplus paramount dynamic importance. Indeed, it is the main source of reproductive capital that multiplies employment and productivity. At the same time, however, it is also the means of enhancing privileged consumption by the high social strata which imitate more and more the consumption patterns of the centers.

The privileged consumer society is detrimental to reproductive capital accumulation. It promotes a premature diversification of demand with adverse social effects. To this should be added the disproportionate siphoning-off of income by the centers, specially through transnational corporations, which are closely geared to the privileged consumer society. Here lies the main explanation of the tendency of the system to exclude a sizable proportion of the labor force.

Let us understand clearly the nature of the surplus. It is based fundamentally on sheer economic, political, and social inequality. *And to fulfill its dynamic role it has to grow* in the course of time. There is a dynamic sequence in this process. Increase in reproductive capital accumulation, increase in employment and productivity, further increase in capital accumulation, and so on.

Thus, the continuous growth of the surplus, the rate at which it grows, and the use made of it depend on the successive increments of productivity added to it. In the course of development, however, other forces emerge that try to share in these increases in productivity, and in the long run they tend to weaken the rate of growth of the surplus for a given rate of increase in productivity.

These forces result from changes in the social structure in the course of development when, mainly through industrialization, technology penetrates a broader area. There are then changes in occupation and income, accompanied by changes in the power structure as an integral part of the social structure. This opens the way for the advance of the labor union and the political power of the labor force. This emerging power tends to counteract the power of appropriation of the surplus by the upper strata.

### *Changes in the Power Structure*

The intensity of these changes in power relations depends largely upon the evolution of the process of democratization. When this process is hampered or manipulated by the top strata, the redistributive power of the labor force is limited. When the democratic process advances genuinely, however, that redistributive power augments the effectiveness of democratization.

But that is not all. To this redistributive power of the labor force is added the growing power of the state to share in the fruits of productivity. Part of the growth of the state is due to the spurious absorption of manpower that does not find employment because of the insufficient accumulation of reproductive capital—a situation that thus aggravates this problem of growing state power.

Let me clarify another point. I have been speaking about the behavior of the labor force. This behavior is due to the efforts of workers not only to improve their real earnings, but also to recuperate their losses from taxes that fall directly or indirectly upon them. From this point of view, the labor force is an intermediary in the pressure of the state on the surplus. No wonder, therefore, that when the labor force has that power, taxes falling on them become inflationary.

There are also taxes which are not inflationary, since they fall in one way or another upon the surplus. Even so, by weakening the growth of the surplus, they aggravate the effects of the pressure of the labor force and the state.

What are the results of this dual redistributive pressure? Obviously it tends to increase consumption: private and social consumption by the labor force, and consumption by the state, including military consumption. However, these different forms of consumption do not evolve at the expense of consumption by the high-income groups which enjoy the surplus; instead, each form is superimposed on the others.

Here we are arriving at the gist of our problem. These various forms of consumption cannot continue to increase indefinitely, for they encroach upon the rate of reproductive capital accumulation and thereby impair the dynamic sequence of accumulation, employment, productivity, and accumulation. How long can business enterprises resist the dual pressure of the labor force and the state without transferring this pressure to prices?

### *The Role of Money*

Monetary policy has a great influence on this. Let us look in a very simplified way at its role in the appropriation of the surplus.

The different stages in the productive process, from primary production to the sale of the final product in the market, take a certain amount of time. To increase the production of these final goods it is necessary to begin at the primary stage with an increase in employment.

This is where the role of the monetary authority comes in: to supply the larger amount of money needed to pay the growing wage and salary bill. This increase in money should be just enough to match the growth of final production owing to the growth of employment. If it is less, the increase in productivity will be accompanied by a fall in prices.

This monetary expansion constitutes an integral part of the productive process, a mechanism whereby the surplus is appropriated by the owners of the means of production. The surplus tends to grow continually, whether it is allocated to consumption or to capital accumulation.

What happens, then, when business enterprises demand more money to pay higher remunerations? If the monetary authority follows a restrictive policy to avoid inflation, it can press enterprises to absorb these higher remunerations at the expense of the rate of growth of the surplus. But there is a limit to this policy. Enterprises under pressure of labor power can indeed be constrained to use the increments of productivity and even a part of the surplus that has been growing. This, however, has obvious detrimental effects, not only because it reduces the earning capacity of business, but also because it restricts the dynamic role of the surplus in relation to the rate of capital accumulation and the rate of increase in employment.

### *The Tendency toward the Inflationary Crisis of the Economic Process*

It is understandable that these tensions in the system cannot continue for long, and the monetary authority finally has to yield to the growing pressure of enterprises, labor, and government. Additional money is created to match higher remunerations, and prices go up. It is the beginning of a new type of structural inflation. As the labor force reacts with a new increase in remunerations, the inflationary spiral gathers momentum. Enterprises increase prices expecting to restore the surplus. But this does not last long, because the labor force reacts by pushing up remunerations correspondingly, when they have sufficient power to do so. Therefore capital accumulation suffers to the detriment of development, and the whole process is utterly distorted when the inflationary spiral gathers momentum.

What is to be done, then? In the Latin American experience there are two ways out. One is through monetary policy, that is to say, credit restriction. But this type of inflation cannot be attacked in this conventional fashion, because it turns out to be counterproductive. Enterprises need *more* credit to face the increase in wages and salaries, and if they do not get more, they are obliged to use available credit at the expense of the increase of production in process, that is to say, of working capital. Recession or contraction follows.

The other way to stop the spiral is to control wages and salaries by government intervention and let prices attain their "proper" level. In other terms, this involves restoring the surplus to the detriment of the labor force. The workers must then not only retreat from what they have gained previously but also bear the weight of taxes that they can no longer transfer by readjusting their remunerations.

The state is then required to use force to overcome the political strength of the labor unions and the masses. Consider the paradox: the use of force by the state is justified by invoking the principle that the state should not intervene in the economy! Economic liberalism is strongly proclaimed at the tremendous social and political cost of destroying political liberalism, if we interpret these concepts in their original philosophic unity.

I cannot deny that the restoration of the surplus through implacable control of wages and salaries could raise the rate of accumulation. But at the same time it would give further impetus to the privileged consumer society, and the latter prevails over the former.

I cannot deny, either, that control could reduce, if not eliminate, inflation of internal origin. If this phenomenon nevertheless continues, it is due to external or fiscal inflation or to the abusive expansion of private credit. But in fact this does not worry the dominant groups, provided the growth of the surplus is fully restored and respected.

### *The Limits of Redistributive Power*

The surplus and its dynamic role are based on inequity—technical, economic, and political. Democratic processes have been very effective in improving real earnings and in the evolution of the state. In the present system, however, there is a limit that must not be overstepped by redistributive power, a limit reached when the dynamics of the system is jeopardized. At this limit the surplus and the privileged consumer society have reached their maximum levels, and the redistributive process to improve income distribution cannot proceed further.

I am not implying that the whole surplus could be redistributed and at the same time a larger share given to the state, which generally grows at an exaggerated pace. Indeed, one of the main flaws of the process is to yield to disproportionate consumption of what should be allocated for capital accumulation.

However, there is nothing in the play of the laws of the market or in monetary policy to correct this flaw. Nor is there any safeguard against the use of the democratic process to improve income distribution beyond the aforesaid limit. On the contrary, if this is done the redistributive pressure leads to the crisis of the system. The democratic process tends to devour itself. In the light of what I have said, I must regretfully conclude that in the advanced course of peripheral development the process of democratization tends to become incompatible with the regular functioning of the system. This is not due so much to the failure of that process on account of the political immaturity that prevails in the periphery, but rather to the serious socioeconomic bias of the mechanism for income distribution and capital accumulation in favor of the high social strata.

Let me emphasize, in order to avoid frequent confusion, that the market is far from being the supreme regulator of the economy. Nonetheless, it has considerable economic and political importance. What really matters is the structure behind the market and the arbitrary play of power relations. Let us change the structures, preserve the market, and respect income disparities emerging from different individual contributions to the productive process.

### *The Market at the International Level*

A similar reflection could be made in relation to international market forces. I fully recognize the value of competition, notwithstanding the well-known fact that it is far from being prevalent. For the correct functioning of the international market, however, it is necessary to deal with the consequences of the great structural disparities between the centers and the periphery. I noted earlier that the fruits of productivity are retained mainly in the centers. This increases demand and promotes technological innovations and capital accumulation in the centers, with only appendicular effects on the periphery in the historical development of capitalism.

This pattern of development has left the periphery on the margin of industrialization. When industrialization has started there (typically with a great lag), it has been necessary to resort to protection and subsidies to compensate for the economic and technological superiority of the centers, as I have explained when dealing with the second and third stages. This applies to those industrial activities in which the periphery could compete with the centers. However, the centers are reluctant to admit this competition even when there are no export subsidies.

How can this be explained in the light of the two successful trade rounds (Kennedy and Tokyo)? They have achieved an impressive reduction of duties and restrictions. But these have been mainly for technologically advanced goods resulting from incessant innovations, where the transnationals have made great progress. It is quite understandable that for the time being the periphery has no access to these innovations, nor can it participate (except marginally) in the extraordinary flow of international trade in these goods. This liberal trade policy in the centers is applied to those goods in which the periphery lags behind technologically. In goods where it can compete, the centers are very far from following a liberal policy.

The centers, principally the United States, have emphasized the role of the transnational corporations in the periphery. These corporations are supposed to internationalize production. Primarily, however, they have internationalized consumption by giving impetus to the privileged consumption society.

There is an aspect of paramount importance to which governments of developing countries have not paid sufficient attention. We have not yet been able to break the pattern of isolation these countries inherited from the old framework of the international division of trade. Indeed, most of world trade has been between the centers themselves. Trade of the developing countries has converged on the centers, and the enormous potential for reciprocal trade has been overlooked. From the earliest days of CEPAL I have strongly preached the need for this structural trade reform.[8]

### *The Historical Hegemony of the Centers*

The pattern of trade has been, and continues to be, a factor in the survival of the historical hegemony of the centers over the periphery. This hegemony is changing, but is very strongly buttressed by the fragmentation of the developing world and the economic and technological superiority of the centers. Colleagues of mine, both within and outside of CEPAL, have dealt much better than I with the political and strategic significance of this hegemony. The concept of "dependence" emerged from them. As generally happens, however, the pendulum of controversy went to the other extreme, so that some writers have tried to explain all the flaws of peripheral development as being due to "dependence." No wonder that in their zeal some of them recommend a radical "delinking" from the centers. In my latest book I have tried to present a balanced view of these phenomena of hegemony.[9]

One of the manifestations of hegemony is the resistance of the centers to change in the status quo. I am referring not only to the center-periphery relationship but also to important structural changes within the periphery and within the centers. Immediate interests prevail and when the periphery, rightly or not, hurts these economic or political interests, the centers—especially the principal dynamic center—frequently react with punitive measures; in extreme cases even with military intervention.

8. See, for example, the works already cited in notes 1 and 2.
9. *Capitalismo Periférico*, pt. 4.

*The Need to Transform the System*

The transformation of the system seems to me inevitable if we are to combine development with social equity and political advance. However, the most widely disseminated doctrinal options do not appear to be of much use for guiding this transformation.

The neoclassical option advocates the restoration of the dynamic growth of the surplus in line with the principles of peripheral capitalism, even though in order to do this it is necessary to stifle the process of democratization by imposing authoritarian regimes. Quite apart from its proven ineffectiveness, this neoclassical option should be rejected because of its renunciation of democratic and liberal political values. The various options which have been supported by democratic movements (such as the Social Democrats or Christian Democrats) usually drift toward mere redistribution and the crises associated with this, without having any idea how to get out of these problems. Orthodox socialism, for its part, puts its faith in state ownership of the means of production and also stifles the democratization process. I therefore believe the time has come to search for a synthesis of both socialism and genuine economic liberalism, and thereby restore that essential philosophic unity of economic liberalism with political liberalism. The discussion of this delicate subject constitutes the last part of my recent book.

Socialism is necessary to ensure the "social use" of the surplus. The rate of capital accumulation and the correction of great social disparities should be the subject of collective decisions, and a new political and economic institutional regime should be established for that purpose. Moreover, economic liberalism is necessary insofar as individual decisions to produce and consume should be left to the market.

We need a policy inspired with a long-term vision on both sides. But the long term starts now with regard to enlightened policy action involving a series of agreed convergent measures. The centers and the periphery are losing a great opportunity. Nothing important is being done to meet a tremendous historical responsibility with far-reaching economic, social, and political consequences for the whole world!

# Comment

## Albert Fishlow

RAÚL PREBISCH identifies five stages in the evolution of his approach to economic development during a long and distinguished career. Despite, or perhaps because of, a significant commitment to public service, he excludes his policy role in Argentina in the 1930s and passes over rapidly his period as secretary-general of UNCTAD in the 1960s. It is a measure of the importance he has always attached to the value and influence of ideas.

I follow him here in focusing on his seminal contributions to the problems of Latin American industrialization from the late 1940s to the early 1960s, and to his most recent thinking on peripheral capitalism.

Like many of his fellow pioneers, Raúl Prebisch interpreted lagging economic development and income disparities in the developing world as the result of market failure: private calculations and market incentives did not succeed in directing resources where these long-term social returns would be greatest. Unlike others, such as W. A. Lewis or Paul Rosenstein-Rodan, for example, he formulated his views explicitly within an international economic framework and derived important and immediate policy implications. At the heart of the matter is Prebisch's argument that the gains of technological progress, concentrated at the center, will not be appropriately distributed by the prices of center and periphery tradables.

The issue is actually dealt with at two levels. In asserting the unfair operation of the international economy, Prebisch relied upon market imperfections that caused the terms of trade inadequately to favor the periphery: monopoly in the center and/or segmented capital markets in the periphery. These led to excessively high prices of manufactures and excessive production of low-priced primary exports. This strand of the argument, later to be reinforced by criticism of multinationals and their excessive returns, emphasizes the deviation from perfectly competitive comparative advantage. The consequence is a smaller gain from trade for the periphery. This disparity, however, is not necessarily reflected in the movement of the barter terms of trade, but is related to the double factoral terms of trade—corrected for the technical change in each trading partner.

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Under Prebisch's assumption that productivity increases more rapidly, if not exclusively, in the center, the barter terms could provide the necessary evidence of progressive loss. This line of attack resurfaces later in the guise of unequal exchange. It powerfully condemns the inherent structure of center-peripheral relations and so directly leads on to prescriptions of North-South delinking and radical change rather than to more modest policy intervention.

For all its political sway, the predominant Prebisch emphasis is another: the more mundane behavioral implications of disparate income (and price) elasticities of demand for manufactures and primary products in the center and periphery. These differences predictably guide dynamic comparative advantage and imply a market-signaled, overly large investment in primary production for export in the periphery relative to investment in manufactures. Such a consistent trend in the terms of trade makes present prices an inappropriate signal for accumulation decisions, and justifies public intervention both to limit imports and to promote industrialization. If not, development is eventually checked. Strongly influenced by the experience of the 1930s—both the magnitude of the decline in import capacity and the success of many of the larger Latin American countries in their production of import substitutes—Prebisch also placed great emphasis upon cyclical fluctuations. Balance of payments fluctuations that checked economic growth when export prices fell because of limited domestic flexibility could mean smaller income levels than a less specialized economy might attain. Prebisch, as had other proponents of industrialization before him, had found reason to doubt the wisdom of a division of labor that implied concentration on primary exports.

The timing of his theoretical justification for the import substitution activities of many countries in the region was critical. The postwar period saw actual improvement in the terms of trade for many countries and favorable prospects for exports. Thus it was necessary to invoke long-term and inevitable trends, and normative arguments, to counteract the immediate force of market signals. As Prebisch revealingly comments, "This task was by no means easy, because the recovery of the international economic order after the Second World War and the expansion of exports caused a resurgence of the champions of outward-oriented development . . ." He might have added that the favorable international climate also facilitated the taxing of agricultural exports through overvalued exchange rates without provoking an early balance of payments crisis.

The practical importance of Prebisch's formulation is clear in the sway it held over development policies in the 1950s and 1960s and even subsequently. Despite academic criticism addressed to the persuasiveness of the theoretical case he formulated for protectionism, industrialization, and planning—for those were the critical conclusions—and mounting statistical evidence that the terms of trade had not shown trend deterioration, import substitution dominated. It did so not merely because of the persuasiveness of Prebisch's ideas, but also because of the conditions then prevailing. In the 1950s the terms of trade eroded for many countries from cyclical Korean War highs and discouraged investment in the primary sector because industrialization in many Latin American countries had already reached levels at which national producers represented a significant political voice; increased direct foreign investment made transmission of technology more effective than it had been earlier, and also compensated for increasing deficits on trade account; and national autonomy and increasing state participation were popular political values.

As we all have come to appreciate, and Prebisch among the first, import substitution was not an unmixed blessing. It was a second-best policy imposed to tax agriculture and reallocate resources toward industry that was eventually brought down by the very circumstance it was to avert: a shortage of foreign exchange. Import substitution's bias against exports and its own voracious appetite for imports of intermediate and capital goods created a fundamental disequilibrium. So, too, expanded state activity without concomitant revenues tended to provoke larger deficits and inflationary pressures; when real resource transfer from agriculture to industry became progressively more difficult because of a weaker balance of payments, subsidies to industry were financed by central banks. Finally, the hopes for massive absorption of labor in industry and for a more equitable income distribution were dealt a blow by evidence of widening disparities and privileged, organized urban workers.

Before passing on to Prebisch's responses to such mounting evidence in the late 1950s in his third stage, it is necessary to underline Prebisch's intellectual accomplishment. He had set the terms, not merely for the rich literature in Latin America that followed and would build upon the center-periphery distinction, but also for the subsequent formalization of the foreign exchange constraint in the North American literature. Trade and development themes were subsequently inextricably related, rather than separate compartments.

In his third phase, Prebisch sought to understand what had gone wrong with the import substitution prescription. For one remedy, he encouraged exports of manufactures from the newly emplaced industrial sector as a source of new foreign exchange; subsidies would compensate for overvalued exchange rates. For another, recognizing that scale was a potentially more important constraint as production moved from consumer to intermediate and capital goods, he advocated a Latin American Common Market. That would make a continuing low import coefficient from the outside world compatible with efficiency. For a third, he called attention to the adverse consequences of continuing high levels of protection long after domestic production had begun.

These proposals were within an import substitution framework: they sought to avert the exhaustion of the process, a theme that increasingly figured in the concerns of the Economic Commission for Latin America in the early 1960s. As growth rates decelerated and balance of payments disequilibria proliferated, and as the institutional and structural reforms Prebisch advocated failed to compensate, there was help from an unanticipated source. The Alliance for Progress, embodying many of Prebisch's evaluations of the limits to Latin American development, brought new inputs of official bilateral assistance. Such finance alleviated the constraints many of the countries were facing—but on the whole, only temporarily. Nor was it possible to sustain assistance at the early rate.

In this context of the early 1960s, many of Prebisch's followers advocated more radical solutions. To avert the seeming strangulation of an ever more burdensome foreign exchange constraint, populist options gained in attractiveness. The internal market was posed against the external, the state emphasized at the expense of the private sector, and equity elevated in concern to compete with efficiency. On the other side, the mounting crisis reinforced the desirability of giving more attention to market signals, international and domestic, and of controlling a mounting state sector.

Although Prebisch's inclinations were clearly of the former persuasion, he never went quite so far. Indeed, he candidly tells of his disappointment at the continuing concentration of income, and his dissatisfaction with his treatment of it and the problem of inflation. At this stage he remained an advocate of structural reform. His commitment to the international economy and to reformism is evident in his UNCTAD labors in behalf of generalized preferences and commodity agreements.

More searching revisionism was to await his fifth, and current, phase. Prebisch has now tried to provide more systemic and far-ranging answers to the puzzle of economic development. They have taken the form of a broad assault upon peripheral capitalism as a viable economic form.

The concept of economic surplus is at the core of Prebisch's reformation. The incapacity of peripheral capitalism to sustain the accumulation of this surplus causes the inviability of the form. Accumulation is impossible because it is checked by redistributive claims upon the surplus by the labor force, on the one hand, and the state, on the other. Such a contest over real shares underlies the inflationary process, the conduct—but not the character—of which is influenced by monetary accommodation. Orthodox policy can only provoke decline, an unacceptable and only temporary solution. The eventual inflationary crisis leads to state intervention and repression to destroy the claims of labor. Peripheral capitalism is unable to mediate the conflict between equity and accumulation (and privileged consumption) in a tolerable way.

In this fifth phase, Prebisch brings to center stage the distribution and inflation issues that had earlier been at the margin. He likewise rehearses the center-periphery theme, casting blame on dependency for an imitative consumerism by the upper strata in the periphery, for "the disproportionate siphoning-off of income by the centers," and for a protectionism that inhibits peripheral growth. Above all, the import substitution crisis he had earlier believed avertable now returns as the inevitable collapse of a democratic, capitalist form. It is not difficult to detect the practical source of Prebisch's concern. The frustrations of the last decade in Chile and Argentina are evident.

The alternative Prebisch holds out is a humane, market-oriented socialism. Whereas earlier the genius of his abstraction of import substitution was its ready conversion to practical implementation, his option now is more utopian. From a previous second-best solution, he has now fixed on the *optimum optimorum*.

It may not be readily attainable or fully necessary. One can accept the reality and the force of tensions he describes without concluding that a self-destructive crisis is the only possible outcome. The gloomy authoritarianism of the Southern Cone is not generalizable. There are too many other cases, in Latin America and elsewhere in the periphery, to suggest that public policy is uniformly inadequate to the task of making equity and efficiency compatible. Nor can one speak of authoritarian processes as if they were completely irreversible.

There is, as always, much to ponder and to learn from this fifth, and one hopes not final, phase of Raúl Prebisch's thinking—not least, his own self-critical capacity. I hope he will pardon others of us our less comprehensive and more policy-oriented visions in the pursuit of the better world to which he has dedicated his own life and work.

# Comment

## Jagdish N. Bhagwati

To PLACE RAÚL PREBISCH among a *large* field of "pioneers" or "fathers" of development economics is to lose perspective. For those of us who grew up through the 1950s, it is immediately apparent that Prebisch (along with Paul Rosenstein-Rodan, Ragnar Nurkse, and W. A. Lewis, to mention several of the important figures that influenced my generation) belongs to a most distinguished *small* group of pioneers—if "pioneers" refers to Columbus rather than the Mayflower immigrants, Vasco de Gama rather than Robert Clive, or Adam Smith rather than Milton Friedman. Indeed, the innovative entrepreneurs of this volume should have started with a "grandfathers" volume, to be followed by "fathers," "sons," and "grandsons" where I and my distinguished fellow commentator might aspire to be included (despite the reminder from *Buddenbrooks* of the perils that await the third and fourth generations)!

I should also add that, for my generation of economists in the developing countries, preeminence of Raúl Prebisch in a field of obvious importance was a major source of inspiration. To see that one's own can be innovative, ingenious, and important is always, and was then especially, a matter of considerable psychological significance. For, among the colonial attitudes which afflicted our societies in those days was the belief that fundamental thinking required that one belong to the center, not the periphery, in Raúl Prebisch's splendid terminology. Prebisch and Lewis, among a few key figures, helped to shatter that myth decisively. I note this, especially for the "great-grandsons" from the periphery in development economics today who are otherwise likely to pass it by. For, within development economics, the situation has now turned decidedly on its head. The intellectual strength of the periphery, with its economists located both in the center and in the periphery, has now grown to a point of dramatic change: in the 1950s development economists traveled in numbers to the periphery to "advise the natives"; now the same flow is substantially to collaborate with them in dispensing the research funds of the center on the problems of the periphery!

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Turning to Raul Prebisch's paper, I am struck by two things. First, it is remarkable how he has interacted with his economic and political environment and has therefore grown as an economist. Second, if one is interested in the origins of development economics at the end of the Second World War, the similarities and contrasts among Prebisch and some of the other major figures cry out for comment. Let me begin with the latter, rather more general question and then turn to the evolution of Prebisch's own thoughts.

[1]

The second stage that Prebisch describes in his paper is, of course, the one that is best known to economists outside Latin America. It relates to the period when he developed the thesis that the prospect of declining terms of trade for Latin American primary products implied the desirability of import substituting (IS) industrialization. Interestingly, he argues that "as a young economist, I was a neoclassicist and fought against protection. But during the world Depression, throwing overboard a substantial part of my former beliefs, I was converted to protectionism. Theoretically, the problem was put in the following dynamic terms. What is to be done with productive resources when further expansion of primary exports would bring a fall in prices?"

From this and subsequent argumentation in Prebisch's present paper, it is clear that Prebisch was converted to elasticity pessimism by the experience of the Depression and the growth of beggar-my-neighbor exchange restrictions and other inward-looking policies that came in its aftermath. A distinction has to be made, however, between falling terms of trade when the country facing this phenomenon is small in Paul Samuelson's sense, and a similar-sounding but altogether different phenomenon where the country is large and the fall in the terms of trade arises from expanding exports. In the latter case protection could be rational; in the former it could not. Prebisch today writes as if he had made the correct latter assumption (elasticity pessimism) in his writings, whereas many have interpreted his writings to imply the former. Indeed, the secular decline in the terms of trade hypothesis is compatible with either interpretation, since it may come about from growth in the periphery in relation to a stagnant or quota-protectionist center. I am therefore happy to assume now that Prebisch indeed had such elasticity pessimism argumentation in mind and that IS-inducing protection followed appropriately from this understanding of the reality.

Taking this interpretation, I am then struck by the similarity of views in regard to elasticity pessimism that many of the major developmental economists shared at the end of the Second World War. I like to distinguish three different types of elasticity pessimists among these early writers.

First, I must recall Ragnar Nurkse whose celebrated Wicksell Lectures, delivered just before his untimely death, developed a theme of balanced growth that was predicated on a carefully stated belief in elasticity pessimism.[1] Nurkse, who must have been clearly influenced like Prebisch by the post-Depression experience on which he wrote so elegantly, felt that the developing countries were faced by the prospect that trade could no longer serve as an "engine of growth" in Dennis Robertson's graphic phrase. He therefore proposed an inward-looking, balanced growth which meant IS industrialization, since without the benefit of constant terms of trade, growth would have to reflect internal demands. This prescription was not spelled out carefully to argue that the IS industrialization would have to go beyond what a decentralized, functioning market economy would generate, since the elasticity pessimism would *additionally* call for an optimal level and structure of protection (which could well be a set of optimal export tariffs reflecting the foreign elasticities of demand for one's primary exports). But this protectionist implication, spelled out today by Prebisch, was definitely there.

Second, the elasticity pessimism was implicit in the classic 1943 *Economic Journal* paper of Paul Rosenstein-Rodan.[2] Like Nurkse, he argued for balanced growth, but felt the need to have investments coordinated and interlocked in a balanced-growth pattern. The underdeveloped economy was trapped in a low-level equilibrium with no effective inducement to invest: for example, the entrepreneur investing in shoes was not sure about selling shoes unless others invested simultaneously in textiles. This dilemma would, of course, disappear if the country faced constant terms of trade at which these entrepreneurs could atomistically sell what they wished. A necessary condition for Rosenstein-Rodan's analysis and prescription is, therefore, elasticity pessimism. And, in Rosenstein-Rodan's version, the balanced, coordinated growth *explicitly* requires a planning framework, whereas Nurkse's does not.

Third, this planning approach also comes naturally—and from quite another perspective than the inducement-to-invest problem of Rosenstein-Rodan—from the "structuralist" models of Fel'dman in the U.S.S.R. and Mahalanobis in India.[3] These planners also implicitly assumed an extreme

1. *Patterns of Trade and Development* (Stockholm: Almqvist and Wiksell, 1959).

2. "Problems of the Industrialization of Eastern and South-Eastern Europe," reprinted in Amar N. Agarwala and S. P. Singh, eds., *The Economics of Underdevelopment* (New York: Oxford University Press, 1963).

3. G. A. Fel'dman, "A Soviet Model of Growth," in Evsey Domar, *Essays in the Theory of Economic Growth* (New York: Oxford University Press, 1957), pp. 223–61; and Prasanta C. Mahalanobis, "Some Observations on the Process of Growth of National Income," *Sankya*, vol. 12 (September 1953), pp. 307–12.

form of elasticity pessimism since they worked with closed-economy models so that, at the margin, transformation of what was produced into what was needed was shut off. In the two-sector version of their models, these planners developed the case for heavy-sector IS industrialization.[4]

The preceding three forms of elasticity-pessimism-based arguments for IS strategies nonetheless implied alternative versions of policymaking to implement the IS program: (1) In the planning-oriented IS strategy, reading Nurkse somewhat liberally and Rosenstein-Rodan, Feldman, Mahalanobis, and others more literally, the planners proceeded to build up consistent, and then "optimal,"[5] plans, with targets of investments and outputs in different activities, often buttressed by licensing mechanisms. (2) In the more market-oriented IS strategy, the protection implied by elasticity pessimism was conceived to be exactly that and no more. The second approach was, in fact, utilized in the writings of international economists such as Gottfried Haberler, who argued that if one must have protection, one should do it by across-the-board tariffs or promotional measures, eschewing the impulse to plan the IS activities in detail, and by planned and regulated investments.[6]

4. In this tradition of "structural" models, I should also include the two-gap models associated with the work of Hollis Chenery, in particular. These were *computable* planning models and were also built on the assumption of elasticity pessimism; the two gaps referred to the ex ante savings and the foreign exchange bottlenecks to increasing the value of the specified objective function. See in particular Jagdish N. Bhagwati, "The Nature of Balance of Payments Difficulties in Developing Countries," in *Measures for Trade Expansion of Developing Countries*, Japan Economic Research Center Paper no. 5 (Tokyo, October 1966), to be reprinted in Jagdish N. Bhagwati, *Wealth and Poverty: Essays in Development Economics*, Gene Grossman, ed. (Cambridge, Mass.: MIT Press, forthcoming); Ronald Findlay, "The Foreign Exchange Gap and Growth in Developing Economies," in Jagdish N. Bhagwati and others, eds., *Trade, Balance of Payments and Growth* (Amsterdam: North-Holland, 1971); Ronald McKinnon, "Foreign Exchange Constraints in Economic Development and Efficient Aid Allocation," *Economic Journal*, vol. 74 (1964), pp. 388–409; and Padma Desai and Jagdish N. Bhagwati, "Three Alternative Concepts of Foreign Exchange Difficulties in Centrally Planned Economies," *Oxford Economic Papers* (November 1979). The best example of the Chenery literature is Hollis Chenery and Michael Bruno, "Development Alternatives for an Open Economy: The Case of Israel," *Economic Journal*, vol. 72 (1962).

5. Nurkse had mentioned that the balanced-growth strategy would require tailoring domestic investments to the income elasticity of demand for different goods. Of course, the logical next step would be to include the entire "final demands" vector and also, in accordance with material-balances and the more sophisticated Leontief input-output procedures, the indirect demands. But all this implies only *consistency*, whereas economists eventually will always maximize. So the consistency models soon gave way to optimizing models, with intertemporal objective functions specified. This latter development in planning models was reinforced by the independent theoretical advances coming in from the work—such as on the turnpike theorem—which stemmed from the capital-theoretic work on heterogeneous-capital models by Samuelson and Solow, among others.

6. *International Trade and Economic Development*, National Bank of Egypt Lectures (Cairo, 1959).

These two IS strategies, one planning oriented and the other market reliant, must be contrasted with yet a third: the approach of Albert Hirschman, who also advocated IS as a strategy for development.[7] In his case, the problem for development was again one of inducing investment, as in Rosenstein-Rodan's classic formulation of many years earlier. Hirschman's solution was very simple: cut off imports and get a ready-made market, so domestic entrepreneurs will jump in.[8] Drawing on the agricultural strategy of "slash and burn," I like to call this the "slash (imports) and grow" IS strategy. It runs against the grain of an economist, for it denies the economic essence of the issue by consigning the notion of costs and benefits to the side! Since many developing countries did wind up in the postwar period with an IS strategy simply as a result of overvalued exchange rates (now understood to imply an inward-looking IS bias), and since we now know that these exchange control regimes were often administered without attention to costs and benefits at any level,[9] many of these developing countries were on a de facto Hirschman strategy of "anarchic" IS industrialization!

The enormous waste that attended the IS strategy has been documented in several empirical studies by the Organisation for Economic Co-operation and Development (OECD) and the National Bureau of Economic Research (NBER). In retrospect, one wonders whether this waste was really essential and not simply a result of the IS strategy pursued in what I have called here the planning-oriented approach, on the one hand, or the anarchic Hirschmanesque approach implied by overvalued exchange rates, on the other hand. Indeed, my own judgment is that many of the costs associated with the IS strategy were the unforeseen results of these two special versions of the strategy.[10] If only the third version—what I

7. *The Strategy of Economic Development* (New Haven, Conn.: Yale University Press, 1958).

8. I am taking the essence of the Hirschman strategy here. He does also advocate attention to "linkages" so as to maximize the investment-inducing effects of any import slashing. This is a nonoperational concept, however, since linkages cannot be defined independently of the decision on which imports to slash and not merely with the aid of information such as income elasticities of demand, and input-output coefficients.

9. For the results of a National Bureau of Economic Research project directed by Anne Krueger and myself on this issue, see Jagdish N. Bhagwati, *The Anatomy and Consequences of Exchange Control Regimes* (Cambridge, Mass.: Ballinger, 1978).

10. I myself have long researched and documented these costs: with Padma Desai in *India: Planning for Industrialization*, for the OECD Development Center (London: Oxford University Press, 1970); with T. N. Srinivasan in *India*, for the NBER (New York: Columbia University Press, 1975); and in my own *Anatomy and Consequences of Exchange Control Regimes*, which synthesizes the results of the NBER project. On the whole, I would say that the planning-oriented IS strategy was followed by the Indian subcontinent, Ghana, and Egypt, whereas the bulk of Latin America followed the anarchic Hirschmanesque approach as a result of consistently and dramatically overvalued exchange rates there. For this reason, the IS strategy has given way rather rapidly in Latin America, as reluctance in adjusting exchange rates has largely disappeared,

called the market-reliant strategy of IS industrialization—had been followed, the results would have been dramatically better.[11]

The different forms of IS strategy are almost never differentiated in the literature that downgrades the IS and romanticizes the export-promotion strategies. I note these important distinctions simply because I believe, reading Prebisch directly today and in derivative writings earlier, that Prebisch was closer to an optimal IS program than the way IS strategy turned out to be mostly implemented. A clarification from Prebisch on this important issue would be most helpful to historians of thought. To restate, while he did urge protectionism, what precisely was the manner in which this protectionism was to be implemented? Only by getting a firm answer from Presbisch to this question can we determine whether his prescription of an IS strategy was wise or not.

Indeed, to determine this fully, we also need to evaluate elasticity pessimism itself. Here history would seem to have come out on the side of those who did not share this pessimism. We need not be too upset by this, since even the nonpessimists did not foresee the dramatic rise in world trade that followed the postwar liberalization of trade and payments. The pessimists lost, but the optimists were rewarded by fortuitous circumstances and the kind of good luck that comes when the gods smile on one. The fact remains, however, that the pessimists were wrong. And it also remains true that the countries, such as those now called the Gang of Four, which saw and seized the opportunity implied by the phenomenal growth of world trade, also participated in it and shared in the affluence it brought. In consequence, the engine of growth did operate for them, but it passed by most of the elasticity-pessimistic periphery in a self-fulfilling prophecy! Prebisch today suggests that he changed his views as this engine in the center chugged away noisily. But it seems as if his increasing skepticism toward continued IS strategy in Latin America was prompted more by what he, in a typically Latin American fashion, calls the exhaustion of the easy first phase of IS in consumer goods industries and the need to have larger markets for the costly second phase IS in heavy industry,[12]

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whereas in India the IS, inward-looking thrust still continues because of its planning-oriented, intellectual basis.

11. The across-the-board protection, which would be uniform on balance, has many advantages which can be argued both on strictly economic and on political grounds. Unlike Prebisch, Nurkse, and others who were elasticity pessimists and therefore were essentially arguing for IS strategy on optimal-tariff grounds, Haberler appears to have been arguing for IS strategy on grounds we would today call "noneconomic" (and taking them as specified by others rather than himself).

12. I call this a particularly Latin American viewpoint since, in India, we have always thought this sequencing notion to be an invalid inference from empirical observation of how countries have invested to a planning prescription of how a country ought to invest. The so-called second phase of heavy industrialization in fact occurred in India simultaneously with the first phase because India had excellent iron ore, an abundance of skills, entrepreneurship, and a program for increasing investments that required an

rather than by any significant awareness that the IS strategy should yield definitely, in the light of newly demonstrated possibilities of expanding world trade, to a far greater outward-looking industrialization than before.

[2]

Let me turn to the second issue I noted earlier: the evolution of Prebisch's thoughts on developmental problems.

Prebisch glides very hastily over his fourth stage, with UNCTAD. I would urge him to enlarge that simply because the creation of UNCTAD was one of his crowning achievements, despite the deplorable tendency on the part of several developed-country economists to treat it as if it was UNWASHED and UNKEMPT. Indeed, the North-South dialogue is currently stalled, though the post-Cancun situation seems a trifle more promising, as argued by me elsewhere.[13] But in the long sweep, UNCTAD will indeed be seen as an important contribution of Prebisch.

What does intrigue me, however, is Prebisch's fifth, and final, stage where he frontally brings political economy onto the center of the stage. I have always felt that this cannot be avoided if we are to take policymaking seriously; and if development is to be explained, we indeed have to take politics seriously. Thus, if we discuss multinationals, it is misleading to consider them as if they merely augment the opportunities open to the host country, and it is also misleading for economists simply to describe the policies that an ominiscient and benign government should implement to utilize to advantage the augmented capital and technical inflows implied by the multinationals' entry. The policymaker must rather take into account the fact that the entry of multinationals may itself constrain the policy choices that can be made; for example, the entry of politically powerful multinationals may carry with it the threat of destabilization if "radical" policies are sought to be imposed by the host country in the national interest, as indeed was the case in Chile.

But while I applaud Prebisch's entry into this wider realm of political economy, I must confess that I have serious misgivings about the thesis that he develops. I have problems with the precise elements of his scenario of the oncoming, inevitable crisis of capitalism in the periphery, but I shall resist the temptation to restate arguments I developed at some length

increasing domestic availability of capital goods—which, given the elasticity pessimism, the planners assumed they could not import in required quantities except at high social cost.

13. "The Significance of Cancun," *Third World Quarterly* (July 1982). My latest thoughts on these issues are in chapters 1 and 2 in Jagdish N. Bhagwati and John G. Ruggie, eds., *Power, Passions, and Purpose: Prospects for North-South Negotiations* (Cambridge, Mass.: MIT Press, forthcoming).

elsewhere.[14] I shall rather express reservations of a very different order that reflect the difficulties attending any attempt to treat political economy seriously. As soon as we endogenize politics and therefore policymaking, we have to worry that there may be no degree of freedom left to say what ought to be done from the policy viewpoint. For policy, having been endogenized, cannot be arbitrarily set at any level. Thus, consider the standard analysis of the effects of import competition on domestic income. In the orthodox $2 \times 2 \times 2$ model with two factors, two traded goods, and two countries, we know that free trade is the best policy for a small country without domestic distortions. Therefore, the "optimal" response to import competition—that is, terms of trade improvement—is to retain free trade and to profit from the improved terms of trade. But this standard economic policy prescription ceases to be relevant if we endogenize policy. Thus, if we were to model a two-party political system, so that the standard model is now a $2 \times 2 \times 2 \times 2$ model and there are cost functions for the political process of lobbying for and against a tariff, the model can be solved for an endogenous tariff.[15] But as soon as we do this, the result of import competition is yet another endogenous tariff. To ask, in this model of endogenous policymaking, what free trade implies is to ask an unrealistic question, for who shall bring this free trade policy about?

I am afraid that Prebisch is caught in this dilemma and does not fully realize it. He transits from his second and third stages, where his analysis of what the periphery should do (implement the IS strategy) is very much in the old tradition of asking what an omniscient and benign periphery government ought to do, to his fifth stage, where the analysis shifts gear to how the capitalist system in the periphery is "deterministically" locked into a developing and unavoidable crisis. Then he still hopes that somehow market socialism will solve this crisis. But, even if it can, who will bring it into being? Perhaps the smart thing to do is to prognosticate, not advocate, and let history judge who is right.

14. "Comment on Raúl Prebisch, 'The Latin American Periphery in the Global System of Capitalism,'" in *Proceedings of the Congress of the International Economic Association, Mexico City, 1980*, vol. 1, Shigeto Tsuru, ed. (London: Macmillan, forthcoming).

15. See the tariff-making models of Robert Feenstra and Jagdish N. Bhagwati, "Tariff Seeking and the Efficient Tariff," and of Ronald Findlay and Stanislaw Wellisz, "Endogenous Tariffs, the Political Economy of Trade Restrictions, and Welfare," both in Jagdish N. Bhagwati, ed., *Import Competition and Response* (Chicago: University of Chicago Press, 1982).