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Monetarism, open-economy policies and the ideological crisis

*Raúl Prebisch**

In his recent articles, and especially in his latest book (*Capitalismo periférico. Crisis y transformación*, Fondo de Cultura Económica, Mexico City, 1981), the author pays special attention to the role played by monetary mechanisms in peripheral capitalism and to the meaning and limits of their use by the monetary authority. The ideas he expressed generated various critical comments which have led him to present, in the first part of this article, a new version of his views which, while respecting the original structure, incorporates some additional reflections. Thus, after reaffirming the essence of his thesis on the role of monetary mechanisms in the appropriation of the surplus, he examines how these instruments also play a decisive role in the defence of this surplus. On the basis of this theoretical clarification, he criticizes the way in which monetary mechanisms have been applied in recent 'monetarist' experiments in Latin America, and sounds a warning about their effectiveness and consequences.

In the second part he deals especially with trade and financial 'openness' policies and the form and effects they have had in Latin America, in the light of the centre periphery relationship and the interests dominating this. Both monetarism and economic openness are theoretical manifestations which originated in the centres and have shown that they do not serve the fundamental interests of peripheral development, which can only be satisfied by a tenacious effort towards intellectual emancipation.

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Introduction

Attempts to interpret peripheral development within the framework of neoclassical theories are pointless if they do not take into account the structure of society and the phenomena which occur as technology from the centres penetrates into it.

These are extremely important phenomena which, impelled by the internal logic of peripheral capitalism, tend in time to lead the system into an inflation-fuelled crisis of a social nature which is impossible to explain by using such theories. Monetary measures can neither explain nor effectively attack such a problem.

From the ranks of the neoclassicists —not all of them, of course— have arisen the monetarists, who try to apply these measures while ignoring the true nature of the phenomena responsible for social inflation.

The inflationary crisis of the system is, in the last analysis, the outcome of a distributive struggle characterized by the interplay of power relations in the course of the structural changes which accompany the progressive penetration of technology from the centres; and this distributive struggle has its origin in the great social inequality of peripheral capitalism. Few will dispute the persistence of this phenomenon. Efforts have been made to correct it through various redistributive measures, which have undoubtedly had some positive effects. But in the long run they themselves have helped to provoke the serious upheavals of social inflation.

One may seek all kinds of explanations for this. In my opinion, however, there is one basic explanation: *the dynamic of the system is based on social inequality* whose origin lies in the structural phenomenon of the economic surplus which is appropriated by the upper strata of society, where most of the means of production are concentrated. As explained in previous studies, the existence of a large mass of people with lower productivity and lower income prevents that part of the labour force which is employed at growing levels of productivity thanks to the accumulation of capital from raising its wages in a corresponding fashion. There is a regressive competition within the labour force when the market forces are fully in play, and the portion of the increase in produc-

tivity which is not transferred to the labour force is the economic surplus.

The *growth of the economic surplus is a dynamic necessity of the system*, since it is the source of most of the reproductive capital whose accumulation multiplies productivity and employment. But at the same time a considerable part of this surplus is used for the privileged consumption of the upper strata, and this consumption expands as the surplus grows, to the detriment of accumulation.

In the course of development, the middle and eventually the lower social strata naturally try to raise their own private and social consumption by placing pressure on the distribution scheme, either directly, through their trade union power, or through the government, while the latter also increases its civil and military consumption.

What happens, however, is that *this expansion of consumption in the distributive struggle does not occur at the expense of privileged consumption, but rather is superimposed on it*. And this is the origin of the social inflation upheavals, for if the rate of all these forms of consumption exceeds the rate of productivity, slowing down the growth of the surplus, the system reacts with an inflationary rise in prices: it cannot continue regularly to fulfil this dynamic requirement.

As already noted, the surplus is explained by the heterogeneity of the social structure, where there is a great variety of levels of technology and productivity. It is thus a structural phenomenon, but monetary mechanisms play a prime role in its appropriation.

Monetary mechanisms are far from neutral. They not only allow the upper strata to appropriate the surplus, but are also a factor in its defence. It is a serious theoretical as well as practical error to consider money independently of the productive process, to which monetary mechanisms are closely linked.

I mentioned above the relations of power. The development of the redistributive power of the labour force and the State accompanies the process of democratization as the latter progresses and begins to overcome the obstacles in its path. This is one of the important consequences of the changes in the societal structure

which occur as technology penetrates the society.

The distributive struggle attempts to correct social inequality, and manages to do so up to a certain limit without entering into conflict with the growth of the surplus, thanks to successive increases in productivity. Beyond this critical limit, however, the dynamic of the surplus becomes involved.

When this limit has been reached, monetary mechanisms play their defensive role. The incompatibility between the different forms of consumption referred to above and accumulation shows up in the rise in prices. By using monetary mechanisms, it is possible to counteract this rise through credit restrictions, which lead to a recession or contraction of economic activity and resulting unemployment. This unemployment then causes a decline in wages *if the redistributive power of the labour force and its ability to pass on the burden of taxes which falls on its shoulders are weak or non-existent*.

The labour force thus has to give way in its redistributive effort, if government expenditures are not reduced and the upper strata, by using their political power, evade the tax burden.

There is thus an indispensable condition if the monetary mechanisms are to be able to effectively defend the surplus and hence accumulation and the privileged consumption of the upper strata: the non-existence or weakness of the trade union and political power of labour. But when this power becomes stronger in the course of structural changes, the labour force, and especially its middle strata, resists the drop in wages. When this happens, the tightening of credit brings with it recession or contraction in the economy, with consequent unemployment, while the companies transfer to prices the higher wages of the labour still employed. *Thus, the inflationary spiral and unemployment coexist*. Sooner or later, however, the intensity of these phenomena and their adverse effects on the companies themselves and on the government force the monetary authorities to relax credit in order to stimulate the economy. There is thus a new impulse which tends to accelerate inflation. *The monetary mechanisms are left powerless; they have become*

obsolete in the later stages of structural changes and the progress of the democratization process.

The Latin American periphery is not characterized by the solidity of its democratic institutions. When the redistributive power has gained strength and unemployment cannot bring it back in line, an attempt is made to do so by means of the military power of the State, thus restoring the dynamic of the surplus and privileged consumption. It would also be possible to raise the rate of accumulation at the expense of such consumption, but there is no spontaneous way of doing so. It would be necessary to take deliberate measures to reduce privileged consumption, and this is hard to reconcile with the euphoria which usually prevails in the dominant groups when resort is had to the use of military force.

There is a huge social and political cost in restoring the surplus, and if, in the course of time, the process of democratization is renewed, there is a risk of a new inflationary cycle if the system of appropriation and distribution of the fruits of technical progress is not tackled at its roots. *It would be a tremendous error to try to go back in time without effecting such a transformation.*

This is what I now propose to demonstrate. It is not a question of going back to the situation of a decade or two ago, nor to some remote past. Anyone who believes that neoclassicism is a great theoretical innovation seems not to have noticed that this theory prevailed in the periods of the outward-oriented growth of the periphery, before the Great Depression of the 1930s.

This study is based on ideas set forth in other previous studies published in *CEPAL Review* and in *Capitalismo Periférico*,¹ a book which systematizes and condenses them. In writing this article the criticisms and suggestions received and my own clarification of previous ideas have been very useful. I should also cite two works published after this book, namely, "La crisis inflacionaria del capitalismo", published in *El Trimestre Económico*, Mexico City, Vol. XLIX, No. 193, January-March 1982, and a recent monograph, *Teoría y práctica de la ortodoxia*, presented at the international seminar on economic policies and the prospects for democracy in Latin America of the 1980s, organized by the Latin American Institute for Social Research (ILDIS) and held in Quito, Ecuador, in April 1982.

I

Monetary mechanisms in the appropriation and defence of the surplus

1. *The role of monetary mechanisms in social inequality*

Monetary mechanisms play a dual role which is closely linked to the societal structure and its changes. Above all, they must create enough money for total demand to coincide with the total supply of final goods, which has grown bigger because of the increases in both employment and productivity. Thanks to such mechanisms, this productivity can be exploited by the companies in the form of a surplus for the owners of the means of production, without

lowering prices. Monetary mechanisms *thus fulfil their role of sustaining social inequality.*

Monetary mechanisms also have to defend the surplus from the distributive struggle, in such a way that its growth allows more capital to be accumulated while at the same time permitting the privileged consumption of the upper strata to rise. These mechanisms thus place a limit on the redistribution of the fruits of

¹*Capitalismo periférico. Crisis y transformación*, Mexico City, Fondo de Cultura Económica, 1981.

technical progress, or on the progressive correction of structural inequalities. Let us first examine the role of monetary mechanisms in the appropriation of these fruits.

2. *The appropriation of the surplus*

To understand this, we must answer the following simple question. If in the course of the production process the wages of the labour force only rise in accordance with *part* of the increase in productivity, since much of this is appropriated in the form of a surplus by the owners of the means of production, then how do we explain the fact that the total demand originating in this labour income can absorb the *entire increase in productivity* which augments the total supply of final goods?

The answer is also very simple. If the demand came from the wages paid to obtain the corresponding supply, it would be insufficient to absorb the latter and the prices would fall as productivity rose. This would occur *if production were stationary*; but this is not the case in the dynamics of development, because *the income from which this demand arises does not come from present supply but from a greater supply in course of production*, from which the corresponding final goods will come after a certain time. *The growth in demand thus anticipates the future supply by directing itself towards the present supply* and thus absorbing in the form of a surplus the increase in productivity.

To understand this phenomenon we must take into account *the time that the production process takes*. A certain time passes between the primary stages of production and the output of the final goods. In all the stages of this process the companies pay income to the labour force, from which total demand arises. But this income does not wait to be spent until the corresponding final goods are produced at the end of a certain time; instead, it becomes a demand for goods which already exist in the market and whose production process began some time back.²

If we look at a given period over the growing course of production, the demand for final goods comes from the income which, during the same period, is paid to the labour force in the different stages of the productive processes in progress during this period. Now, this income being paid by the companies is greater than the income which was paid before in order to obtain the supply entering the market in the period under consideration. Present demand thus exceeds the demand which would have been recorded if present demand had come from the income paid previously to obtain the present supply. This is indispensable in order that the increase in productivity reflected in this final supply, plus the growth in production resulting from higher employment, may be absorbed without prices falling.

If the demand is sufficient to absorb all the supply without a drop in prices, this is the market's signal for production to continue to increase. This signal is transmitted back to all the stages of the process in progress. Thus, the companies which have sold more final goods than before increase the demand for goods in process produced by the companies of the preceding stage; and the latter in turn augment the demand for goods from the previous stage, all the way back to the primary goods stage.

This demand between companies, which has thus been moving backward, causes partial surpluses to arise in the course of the production process. It cannot therefore be expected that the total surplus will appear when the final goods enter the market, as if a single company were handling all the production processes: on the contrary, the surplus also appears *in advance* in the different stages.

In order to pay the growing wages corresponding to the greater employment of labour and the increase in partial surpluses, the companies have to increase their availability of money correspondingly by resorting to the banking system. The money which they pay out in this way comes back to them when they sell the goods at the various stages up until the

²The famous Say's law said that supply creates its own demand. Expressing ourselves in the same language, we

would say that *today's supply does not create its own demand, but this demand is created by the supply which is in process* and from which final goods will later emerge.

final goods stage. In this way the companies obtain from each stage the corresponding surplus and recover the money they have already paid to labour. And these funds thus recovered, plus and additional creation of money, allow them to continue to increase the production in progress.

Let us follow this same reasoning by successive approximations. Not all the money used by the companies is immediately transformed into demand for final goods; part is directed towards demand for services, which absorb quite a large portion of the money created in order to increase the production in progress, and *this money gradually returns to the companies in the form of demand for final goods.*

Let us consider the nature of this demand which is diverted to services. It means that a part of the money corresponding to the wages paid by the companies, and the partial surpluses they obtain, temporarily stops being spent on goods and takes the form of demand for services. Any formation of capital requires corresponding saving; thus, the production in progress which has to increase in order for the supply of final goods to grow in its turn *represents the circulating capital or working capital of the companies and is thus covered by the temporary saving in question, which should not be confused with the saving required for the accumulation of fixed capital.*

Before finishing this section we should briefly recall the mechanism which allows the monetary authority to fulfil its regulatory function as a stabilizer of prices. It is guided by symptoms. If the creation of money is excessive in relation to the growth of supply, due to the increase in employment and productivity, prices will tend to rise, with the resulting external imbalance, and this will slow down the expansion of money until a new equilibrium is reached, provided the monetary authority does nothing to counteract the initial expansion. One of the most important factors in the rise in prices is the increase in labour wages, whose significance we will now consider.

In order to simplify our explanation, we had not yet introduced this factor. We do so now so that we can examine the other important role of the monetary mechanisms, for, as we have said, besides being an instrument of ap-

propriation they are also an instrument for the defence of the surplus against the attacks it suffers in the distributive struggle.

3. *The defence of the surplus*

Let us now introduce the *notion of rates* in order to clarify our reasoning.

For the system to function normally, the rate of growth of labour pay must maintain a close relationship with the rate of increase in productivity.

The rate of pay rises either when the labour force attempts to augment its share in the increase in productivity at the expense of the growth of the surplus, or when compensation is given, through an increase in wages, for a rise in prices resulting from higher government taxes which affect it in one way or another. It also tries to secure compensation for other price increases such as those resulting from imports or from inelasticity of the domestic supply of certain goods, that is to say, from factors which do not originate in the distributive struggle.

At all events, we must make a clear distinction between the pressure of distribution and that of compensation in order to understand *the bias of the system in favour of the upper strata through the monetary defence mechanism.*

When the wage rate rises above the rate of productivity, no matter how this occurs, the companies will demand a rise in the rate of money creation in order to pay the higher wages.

If they manage to obtain this greater quantity of money, the wage increases will inevitably be transferred to prices to the extent that the rate of increase in productivity has been exceeded.

There is thus an inflationary increase in prices which the monetary authority will try to correct if it fulfils its stabilizing function. This is the role of monetary mechanisms. Their corrective effectiveness depends on the flexibility of wages. *In view of the nature of the system, wages must fall; whether they do this or not depends on the strength of the trade unions and the political power of the labour force.*

In both cases this phenomenon could be schematically explained as follows. Once the

rise in prices has occurred, if the monetary authority refuses to continue to provide additional money to keep paying the higher wages the companies are obliged (insofar as they cannot directly force a reduction in wages) to use part of the flow of money available to them before the increase in wages to pay for this increase. As a result, they will not have enough money to keep on increasing the level of employment and of the production in progress.

The extent to which the rate of growth of employment begins to slow down in this way will depend on the intensity of the restrictive monetary policy. Such is the direct effect on employment and future supply. But there is also an immediate impact on total demand for finished goods. As the money flow destined for production in progress diminishes, the rate of total demand is insufficient to match the rate at which the supply of final goods had been growing, and this insufficiency in demand is transferred back to the different stages of the production process. The initial restriction on the creation of money thus causes a recession in productive activity, with resulting unemployment, and this unemployment allows the companies to cut back wages if the trade union and political power of labour is weak or non-existent.

This is the social cost of restoring the dynamic of the surplus through monetary mechanisms.

It is true that the total surplus also shrinks insofar as the reduced demand among the companies at the different stages of the process brings along with it a decrease in the partial surpluses. This is only a temporary phenomenon, however, since when the economy later recovers, these partial surpluses begin to rise once more, inasmuch as labour does not have the power to win an increase in wages again, or the companies refuse to grant such an increase in the face of the threat of a firm, stabilizing attitude on the part of the monetary authority.

For the neoclassical economists, this readjustment in wages is one of the great virtues of the system, since to them the trade union and political pressure of labour represents an arbitrary interference in the laws of the market. This would be a reasonable criticism if under these laws the fruits of technological progress

were passed on to all levels of society through decreases in prices, as they assume. We know, however, that the system does not work like this, since only a part of these fruits is transferred to the labour force; another more or less large part is retained in the form of the surplus by the owners of the means of production.

This is what leads to the social inequity of the so-called 'virtues' of the system. Consumption on the part of the labour force must be reduced in order to re-establish the surplus and permit not only accumulation but also privileged consumption by the favoured social strata.

It is true that the growth of accumulation is an inevitable requirement—in whatever system—for increasing employment with growing productivity. However, peripheral capitalism suffers from severe asymmetry in this respect. *If the limiting of consumption on the part of the labour force is imposed in order to fulfil this dynamic requirement, the fact remains that there is no provision in the system for limiting the privileged consumption of the favoured strata.* On the contrary, increasing imitation of the forms of consumption of the centres is occurring, to the clear detriment of vigorous development. And there is nothing in the system which imposes a reduction of this privileged consumption in order to favour accumulation. But consumption on the part of the labour force does have to be reduced, by monetary mechanisms, when it threatens privileged consumption.

This is not the only way the *regressive bias of the system* manifests itself, however. We already explained that wage increases, as well as reflecting the efforts on the part of labour to share in the fruits of technological progress, are also explainable by the desire to compensate for the unfavourable effects of price increases resulting from government taxes or external or domestic factors outside the distributive struggle. This action to seek compensation through wage increases is also subject, as in the previous case, to the restrictive policy of the monetary authority, and when the instrument at the latter's disposal is used in this way and causes unemployment, wages have to go down, not only by the amount they had genuinely risen, but by the amount they had managed to gain as

compensation for the effect of these other price increases. Thus, in the last analysis, these increases do not hurt privileged consumption but the consumption on the part of the labour force. Such is the virtue of the readjustment brought about by the monetary mechanisms: *a virtue for some, but downright social inequality for others.*

We have spoken of the effectiveness of monetary mechanisms when the redistributive power of the labour force is non-existent or very weak. This is so in those phases of structural change when the process of democratization is incipient or is manipulated in one way or another by the dominant groups. But when this process advances and the labour force acquires trade union and political strength, the monetary mechanisms again become incapable of slowing down the redistributive power.

How does the system react, then, to an increase in the wage rate beyond the productivity rate? The initial reaction is the same as that of the previous case: the restrictive policy of the monetary authority forces the companies to divert a part of the monetary flow for the payment of higher wages, with a consequent decrease in the rate of the production in progress. The result is unemployment. But unlike what happens in the other case, here the labour force does not accept a cut in its wages, and the companies therefore transfer to prices the increased costs caused by the diversion of the monetary flow, to the detriment of the production in progress. Since the redistributive power is strong, however, the rise in prices is followed by a new compensatory rise in wages, although of only temporary effect, giving rise to the familiar spiral.

Now if the monetary authority continues with its restrictive policy, *the companies will have to further increase the diversion of money to finance the inflationary growth of wages,* and in this way they will deprive the production in progress of the money needed to keep it growing at the previous rate. If the pressure of the employed labour force continues, without the monetary authority attenuating or changing its restrictive policy, the recession will then turn into active contraction. It is at this point that the *dual phenomenon of inflation and unemployment which did not occur in the pre-*

vious phases of the structural evolution appears. The monetary mechanisms have not only become impotent, but actually counter productive, for in addition to the fairly large loss it suffers due to unemployment, the surplus fluctuates continually: it grows when prices rise and shrinks when wages rise in a new turn of the spiral.

Is there any way out of this inflationary crisis, for which the *intrinsic logic of the system* is itself responsible? Neoclassical economists who hold monetaristic beliefs advocate persisting with the restrictive policy until labour resigns itself to accepting a reduction in its real wages and does not insist on being compensated, wholly or partially, for the rise in prices. It is possible that the risk of unemployment spreading to those who are still employed may become a flexibility factor in wage negotiations.

Indeed, when inflation grows serious and unemployment becomes high, labour is usually more disposed to consider social pacts. But this willingness, besides having certain drawbacks, is only temporary, since when the economy recovers and employment increases, the redistributive pressure arises again, and the system is exposed to a new cycle of inflationary spiral and unemployment. I do not believe there is any way to avoid this, except through a new system of appropriation and redistribution of the fruits of technological progress, obviously not along neoclassical principles.

It is not surprising, then, that some proponents of this school of thought are now talking about the advisability of constantly maintaining a minimum unemployment level, like the sword of Damocles, in order to contain the rise in wages during the reactivation of the economy. Does it follow, then, that this waste of factors of production signifies their optimal allocation according to those principles? Far from it, since the potential for accumulation is diminishing, to the clear detriment of the absorption of labour from the lower strata and the general improvement of the productivity of the entire economy.

Before going on to the next point, let us look for a moment at one very important aspect. We have already explained that the upheavals of the system occur when the wage rate rises

above the productivity rate. The latter depends, on the one hand, on the accumulation of reproductive capital and, on the other, on the growing skills which the penetration of technology requires the labour force to possess. Thus, in capitalistic development, there is a clear tendency towards a rise in productivity through a rise in the level of labour skills, even if there has not been a rise in the rate of accumulation of reproductive capital. To the extent that this occurs and the wage rate is not out of line with that of productivity, the system functions normally and wages, as well as the surplus, evolve without any upheavals of a redistributive nature.

This observation is important, since without this increase in the productivity rate (and in that arising from a higher rate of reproductive accumulation) we cannot explain the effective and persistent improvement in labour's standard of living over the course of development.

Another significant observation is the following: we have referred to the social expenditures of the State (social consumption). Undoubtedly this has contributed to the rise in the efficiency of labour. In addition, State investments in infrastructure have formed part of the reproductive capital and thus have effectively participated, along with accumulation by companies, in the rise of employment and productivity.

There is another aspect we should also mention. Remember that the surplus is a phenomenon which results from structural heterogeneity. When the accumulation of capital is very active, so too is the transfer of workers from relatively low technical levels of production to others with growing productivity. The phenomenon of regressive competition is thus weakened, as is the capacity to appropriate the surplus. Wages thus tend to rise more than productivity, independently of the exercise of redistributive power. And no matter how hard the monetary authority tries to contain this rise in wages through the well-known mechanisms at its disposal, the readjustment of the system will not be able to force wages down, since the improvement is a structural one. The economic recovery policy will have to recognize this fact and the resulting rise in prices. However, in view of its nature, this phenomenon occurs

rather slowly and the system gradually adapts itself to it. At all events, this has an adverse effect on the rate of the surplus, the capacity for accumulation and the rate of growth of employment. In this way the system spontaneously slows down the correction of regressive competition. This is one more proof that the dynamics of the system are ultimately based on social inequality.

4. *The use of military power*

I shall not be so foolish as to maintain that the employment of the military power of the State to contain the inflationary increase in wages is a result of neoclassical thinking. It is a complex political phenomenon which, although it may be explained by the increasingly serious upheavals accompanying the inflationary crisis in the system, is also the result of other factors which have occurred in the historical development of the periphery in the past, before the redistributive power of labour and the State became prominent.

There can be no doubt, however, that some neoclassical economists approve of the intervention of military power in order to subdue the trade union and political power of labour and correct its violation of the laws of the market.

How can the continuation of the spiral, which the monetary mechanisms have not been able to contain, be averted? Simply by subjugating the power of labour, in order to apply the formula mentioned earlier in regard to wages: preventing their increase in the spiral while leaving prices free to 'seek their own level'.

The surplus, free from interference, recovers its growth. I have said more than once that the restoration of the surplus provides the opportunity to raise the rate of reproductive accumulation above its previous level. But to do this it would be necessary to contain the evolution of the privileged consumption of the favoured strata. There is no spontaneous mechanism in the system for achieving this positive effect; on the contrary, we have frequently witnessed a veritable orgy of consumption which tends to contaminate part of the middle strata, the usual supporters of military power.

Another very significant fact is the continuation of inflation despite the fact that the wages of most of the labour force have been frozen. This is due to the persistence or recrudescence of traditional forms of inflation, especially of fiscal origin.

Another of the vehement aspirations of the neoclassicists is the dismantling of the State in order to make it subsidiary or dispensable. These efforts, however, are not usually as successful as expected. While some spending, especially of a social nature, is reduced, other spending—generally related to the new political régime—is increased. The State thus fails to observe one of the primary recommendations of fiscal orthodoxy, as well as that of increasing taxes in order to pay the deficit. This latter measure may be effective if the power of labour to seek compensatory wage rises is eliminated. In this case, the tax would no longer be inflationary, even if it fell on the labour force; as for possible burdens on the upper strata, the strengthening of their political power places them out of danger in this respect.

Thus, it is not surprising that fiscal-generated inflation springs up. The truth is that it is a tolerable form of inflation for the dominant groups as long as it does not hurt the dynamic of the surplus. On the contrary, it inflates the surplus and thus offers more scope for the readjustment of wages, as long as the real surplus can continue to grow. In any case, these readjustments represent a certain psychological relief for labour, which has already suffered from shrinking wages.

The consequences of fiscal inflation are thus ultimately felt by labour, since it acts to the detriment of their consumption rather than that of the favoured strata. It is thus compatible with the dynamics of the system.

The same is true of inflation of external origin, as well as that resulting from domestic factors other than the distributive struggle, as mentioned elsewhere in this article. The effects are likewise felt by labour and not by the surplus, insofar as a compensatory increase in wages is not allowed.

At this point in our argument we might ask if there is not some way within the system other than fiscal orthodoxy for eliminating the inflation originating in the State deficit. This way is

certainly not that of monetary orthodoxy, which cannot be a valid substitute for the former, since it is not possible to neutralize the creation of money from fiscal sources by restricting the money available to private activity. Such an opinion would make sense to those who consider that inflation can be corrected simply by controlling the quantity of money. However, paradoxical though it may seem, fiscal inflation, far from requiring a smaller quantity of money for private activity, actually requires greater creation of money than before.

The explanation for this is very simple. Thus, fiscal inflation first causes prices to rise and inflates the surplus at the final goods stage. And this phenomenon moves backwards through all the stages of the production process, inflating the partial surpluses, so that the companies need more money than before for their circulating capital. If the monetary authority refuses to grant it, there will inevitably be a recession or a contraction, depending on the degree of credit restriction, as we explained before when discussing redistributive pressure. Of course these adverse effects tend to expand the fiscal deficit.

There are usually other reasons, however, for resorting to the restriction of credit. To contain the inflationary effect of the deficit, it is also recommended that the savings of the public should be used, and this additional demand for savings causes interest rates to rise in the financial market. Why is it then necessary to raise the interest on bank money? For a very simple reason: without this increase, there would be a risk that part of the money created in response to the growth of production in progress might be diverted to the public sector (or abroad), so that a part of the fiscal deficit would be covered by bank money rather than savings. This is why it is necessary to raise the bank interest rates, confusing them with those of genuine savings. To achieve this purpose the banks are forced to restrict credit to private sector companies, to the detriment of the growth of production in progress, i.e., at the cost of recession or contraction of the economy with the corresponding unemployment and decrease in savings, depending on the intensity of the restrictive policy.

There is no doubt that inflation could be

contained, under this policy, but only by incurring in an economic and social cost at this time which could be very considerable.

A clear distinction would be drawn between this case and the other in which unemployment is unable to contain the inflationary spiral and the trade union and political power of labour prevents wages from being reduced.

Recent examples of fiscal inflation have displayed certain notable consequences. Since domestic saving is not enough to compensate for the fiscal deficit, governments resort to external financing, and in order to make this procedure attractive, the bank interest rates are raised to the maximum through credit restriction.

Around this singular procedure, a new constellation of financial groups springs up which enthusiastically supports the restrictive policy, inasmuch as this extreme raising of rates leads to huge profit margins for the fortunate operators.

But this is not the only result. When genuine domestic saving is used, it is possible to contain fiscal inflation through the displacement of consumption: the demand and consumption of those who are saving is reduced in favour of the demand and consumption of the State (or of those who work in connexion with its investments). In contrast, when foreign funds are used there is no such compensation of demand and consumption. These funds have an inflationary effect similar to that which occurs when domestic expansion of money is used to cover the deficit. There is, in effect, an

inflationary increase in demand. But in this case the external imbalance caused by this increase is covered by the foreign funds which have flowed into the country.

Furthermore, yet another inflationary effect is added. The companies try to transfer the extreme interest rates to prices, thus tending to aggravate the effect of this inflationary demand. And if labour cannot exercise its power to seek compensation because of the military power, the high interest rates will eventually affect its reduced consumption.

It is true that, strictly speaking, it would not be correct to blame this manipulation of the system on neoclassical theories: it is really a manipulation of these theories. But these are still not the only consequences. There is yet another: that of tempering the inflationary demand caused by the inflow of external resources (or other factors) by lowering tariffs so as to slow down the rise in prices in the name of neoclassical theories. And since this is not enough, overvaluation of the currency is resorted to, preventing the exchange rate from adjusting to the domestic price rises.

The consequences of this manipulation are much too well known for us to examine them here. Overvaluation stimulates imports (already stimulated by the drop in tariffs) and discourages exports. But the favoured groups do not worry about this, since the resulting deficit in the balance of payments is covered by new external credit, providing a new stimulus for the financial boom.

II

Theories, self-interest and breaking of the rules

1. *Neoclassical theories and the periphery*

Why have neoclassical theories and their monetarist derivations proved unable to explain the reality of the development of the periphery? Why are their recommendations counter-productive when compared with the facts?

The reason is that these theories ignore the

structure of society. They thus ignore the persistence of the surplus, a structural phenomenon of appropriation of the fruits of technological progress, which lies at the very root of social inequality.

These theories also ignore the primordial role of monetary mechanisms which allow the owners of the means of production to appropri-

ate this surplus. It may thus be useful to summarize what was explained above.

The appropriation of the surplus completely invalidates the neoclassical reasoning about the social diffusion of the fruits of the growing productivity of the system.

This reasoning leads neoclassical economists to abominate the trade union power of labour, since this power interferes with the laws of the marketplace and is alleged to counteract the spontaneous tendency of the system towards distributive equilibrium (an integral part of general equilibrium).

It is the logical conclusion of this reasoning that forms the basis for monetarism. Its virtue is precisely that it causes the contraction of the economy until unemployment allows the trade union's power to be overcome and forces them to accept a lowering of wages. This is not the way to reach distributive equilibrium, however, since the decline in wages makes it possible to fully restore both the surplus and its dynamic, and this is the basic inequality of the system.

When labour has acquired a great deal of trade union and political power, however, the monetary mechanism for defending the surplus becomes obsolete and loses its effectiveness. Even in cases where labour finally has to give in, this is a temporary fact rather than a definitive correction.

Furthermore, according to this thesis, wages have to fall not only because they have progressed beyond the point required by the presumed equilibrium, but also so that the surplus can recover what it had lost owing to the exaggerated growth of the State. This is why it is necessary to dismantle the latter, beginning with the social services.

How could anyone imagine that labour, when it has acquired consciousness and power, will meekly accept the imposition of monetary mechanisms?

The problem thus becomes insoluble, and the system ends in social inflation which tends to become an inherent feature of it.

It is insoluble because of the system of appropriation of the fruits of technological progress and the dynamics of accumulation. This is the great problem which will have to be re-

solved sooner or later by the periphery —and also by the centres...

Whatever the degree of purity of the original theories may have been —and I believe it was very high— the later function of these theories has been to sustain peripheral capitalism, with its exclusive and conflictive tendencies, and for this purpose it has used, among other methods, monetary mechanisms. These mechanisms are first useful for obtaining the surplus and later for defending it from labour and the State: they enshrine the bias of the system in favour of the upper strata, until the mechanisms become obsolete.

These theories thus respond to the dominant interests in the system. This is true not only in domestic development but also in relations between the centres and the periphery. I am referring in this case to the dominant interests which characterize the hegemony of the centres over the periphery. In the period before the world depression of the 1930s, the influence of the previous system of the international division of labour was very great; under its sway, the periphery remained excluded from the industrialization process and was merely an appendix to the centres.

When we thought that this system had been superseded once and for all, it unexpectedly resurfaced in the form of the so-called 'open economy' policies.

These policies are not usually rejected frankly and openly with regard to the industrialization of the periphery, but it is usually held that they must be spontaneous, without protection or subsidies. The supporters of this reappearance of neoclassicism recognize, however, that the costs of peripheral industrialization are high compared with the technological and economic superiority of the centres. In any case, one must not interfere with the laws of the marketplace by using arbitrary expedients. If the costs are higher, they must be reduced. And the most expeditious means, according to them, is to reduce wages as much as is necessary for the industry to become competitive.

There can be no doubt that the past system of the international division of labour fitted in very well with the interests of the centres. The industrialization of the periphery did not really interest them. In this sense it was usually as-

serted that the solution to development did not lie there, but rather in the technification of primary production in order to lower costs and compete better in the international market.

When the countries of the periphery, after the great world depression, began to think about these phenomena with independent judgement, they soon reacted against this thesis held by the centres. They did not deny the need to introduce technological progress in primary activities, but they maintained that this could not be done outside the context of development without leading to serious consequences, for if the productivity of these activities were to increase and the labour thus made redundant were not absorbed, the benefits of technological progress would be transferred to the centres, through the deterioration of the terms of trade.

This was one of the theoretical justifications of industrialization: to contribute to the employment of the redundant labour force in activities of higher productivity. Industrialization and technological progress in primary activities were thus integral and complementary parts of a single development policy. Imagine anything more opposed to the theory of lowering wages in order to industrialize!

Once peripheral industrialization was underway, the centres resolved to take advantage of it. It was claimed that transnational corporations would bring with them a vigorous modernization of industry: the doors should thus be thrown open to them. It was no longer a question of denying industrialization but rather of giving it an international perspective. There was now a new thesis to talk about: the internationalization of production.

In reality, however, it was not the internationalization of production in the periphery which interested the transnationals so much as its internationalization in the centres themselves, under the powerful thrust of technological innovations leading to the ceaseless diversification of goods and services. And the periphery was once again left on the sidelines of this type of industrialization, except in relation to those goods which were no longer new.

There was, moreover, an intense liberalization of trade in which the periphery scarcely participated, for this liberalization did not ap-

ply to a comparable extent to those industrial goods in which the periphery had obtained or might obtain comparative advantages.

As a result, the transnational corporations contributed much more to the internationalization of consumption in the periphery than to the internationalization of production there. Thus, we again see the importance of the self-interest of the centres.

I have been referring to the industrial transnationals which have acquired so much influence in the international field. They now share their enormous power with the financial transnationals, i.e., with a few private banking institutions which have rapidly evolved due to the Eurodollar market, which we will discuss later. These transnationals played a very useful role when the rise in oil prices led to a large deficit in the importing countries. But they later offered credit for the payment of these growing imports, which often included consumer goods. The results are well known: growing indebtedness in order to make payments of capital and interest. The position of some developing countries is a matter of serious concern, not only because of the magnitude of the debt, but also because the recession in the centres makes it impossible to pay it back through corresponding exports.

This is a case of significant lack of foresight, both on the part of the private international banks and of the debtors, which was fostered in the case of the banks by the enormous gains involved.

As for the debtor countries of the periphery, they have often allowed themselves to be seduced by this type of operation because it enabled them to avoid taking indispensable readjustment measures. Moreover, they have more than once been persuaded that they should open their economies on a massive scale to external finance closely linked to trade openness.

Those in favour of 'open economy' policies strongly oppose selective measures in regard to imports such as were adopted in previous periods when there was a trade imbalance: such artificial interference in the laws of the marketplace must be avoided, they say, and the trade balance must be corrected in some other way, either by using credit facilities or by restricting

credit in order to cause contraction and thus reduce imports at the expense of economic activity.

Here too there has been a lamentable theoretical regression, since the public international financial bodies themselves had finally recognized—very late in the game, it is true—that structural imbalances were occurring in the relations with the centres which also required structural readjustments. I very much fear that we are returning to the seriously mistaken theoretical concepts of previous eras. This is a new manifestation of the return to orthodoxy!

However, it would be a grave error always to see behind the theories elaborated in the centres themselves the predominant influence of the interests which weigh so heavily on the periphery. What is occurring now in the central countries is a clear demonstration that some of the theories prevailing there do not fit in either with the profound structural changes which have occurred in the centre.

I am afraid that in making this assertion I may be accused of having the arbitrary attitude of looking at certain phenomena in the centres from the viewpoint of the periphery. I nevertheless maintain that a structural imbalance is occurring there between consumption and accumulation similar to that in the periphery, and it is in fact a structural crisis.

2. *The crisis in the centres*

Advanced capitalism is in the midst of a crisis. It is not surprising that the situation is frequently compared to the Great Depression of the 1930s. However, they are two different phenomena. The crisis of the 1930s was conjunctural, albeit of extraordinary severity. In contrast, the present crisis basically represents *a structural imbalance between consumption and accumulation*, as in the Latin American periphery, which does not appear to have occurred previously, since this imbalance is the result of the evolution of the structure of society and of the power relations arising within it.

This crisis was incubating right through the long years of the boom period in the centres which ended in the first half of the 1970s. It is not the result of the decadence of capitalism,

but rather of its over-vigorous development, which has caused it to overflow its banks without finding a new course. And the result of all this has been social inflation which, as in the periphery, cannot be attacked effectively by using monetary mechanisms.

In order to understand the nature of the structural imbalance between consumption and accumulation, it is worth recalling what was said about the dynamic sequence which characterizes a growing economy, whatever the economic and social system. *The accumulation of reproductive capital is an essential condition for an increase in employment and productivity, which, in turn, is an essential condition for the growth of accumulation; and so on. Thus, if the rate of accumulation drops, productivity will also drop.*

In my opinion, this is what has occurred in the centres, beginning with the United States. Despite the very high level of productivity, this has proved insufficient to meet the growth of various forms of consumption. On top of the growing and increasingly diversified consumption of the upper strata of society, there has been added that of the middle and, finally, the lower strata, while the trade union and political power of labour has been getting stronger as the structural changes in the society occur. Yet this is not happening at the expense of the consumption of the upper strata but is rather being imposed on it, in regard to both the private consumption and the social consumption of labour, especially through the intermediary of the State. The same occurs with the growth of the civil and military consumption of the latter.

It should not surprise us, then, that over time the growth rate of consumption has tended to exceed that of accumulation. Moreover, only a part of the latter corresponds to reproductive capital which augments productivity as well as employment, another part which tends to show relative growth corresponds to forms of accumulation which do not have this virtue, as in the obvious case of capital which is accumulated to respond to the needs of military consumption. In addition, there tends to be an increase in the proportion of capital used for the constant diversification of goods and services rather than for productivity.

All this negatively influences the rate of productivity, although other factors are involved as well.

It should be taken into account, on the other hand, that in the past higher productivity has been due not only to technological innovations but also to the irresponsible use of a non-renewable natural resource —oil. To correct this phenomenon, there would have to be a greater investment of capital per unit of energy, and thus per product unit, unless greater energy efficiency is achieved.

The same is true of measures designed to defend the environment from all the forms of pollution which have been destroying it.

Consequently, serious measures for the readjustment of consumption are called for in order to raise the rate of accumulation of reproductive capital, employment and productivity, and to respond to the various requirements for ecological defence measures in regard to energy and the environment.

How is this to be done? This is the fundamental problem which is still far from being resolved, since there is no mechanism in the system, for regulating consumption and accumulation, nor has any theoretical explanation been offered for these phenomena which might serve as a guide for practical action.

In order to correct the inflationary consequences of the fiscal deficit, recourse is being had, just as in some countries in the periphery, to the procurement of public savings in order to support government consumption, by means of compressing the consumption of those who are saving. Because of the magnitude of the deficit, extremely high interest rates are being used to obtain the necessary saving. Moreover, in order to ensure that these rates do not result in any transfer of bank money to the financial market, the interest rates on money from the latter are also raised by virtue of credit restrictions. These restrictions in turn lead to recession—at the very least—and unemployment, and the latter, besides shrinking savings, expands the fiscal deficit.

I admit that it is possible to sharply reduce or even eliminate inflation in this way, but at great economic and social cost, not only for the United States but also for the rest of the world and most especially the periphery. *It is a policy*

which, in addition to being counterproductive, falls far short of offering a fundamental solution, since sooner or later credit will have to be expanded and interest rates lowered, with the resulting inflationary effects as explained above.

Of course this brief and superficial overview of the situation of the centres was not undertaken out of mere intellectual curiosity, but in order to explain the structural nature of this crisis. It is no longer possible to counteract the crisis, as in the 1930s, with a Keynesian expansive policy, unless this is combined with other fundamental measures which are slow in coming. My conclusion is that there are no grounds for expecting a lasting improvement in the economies of the centres. The periphery should therefore prepare itself for a serious prolongation of this crisis and seek basically to make use of its own potential for development, although this should be done in such a way that if this hypothesis does not come true, the periphery can take advantage of the additional stimulus which the hoped-for economic recovery of the centres would bring with it.

3. *World inflation and peripheral open-economy policies*

There is one very important comment that remains to be made: inflation in the United States has expanded beyond its national borders. This has had the advantage of alleviating the domestic pressure of consumption on accumulation, since the economy has been able to take advantage of part of the product of the rest of the world, paying for this contribution with dollars which ended up being non-convertible.

This was a new blow —added to that suffered during the Great Depression— to what was left of the gold standard, which has now been destroyed without trace.

In reality, the Bretton Woods agreements already marked the demise of the gold standard, whose role was henceforth to be played by the dollar, thus giving the United States an enormous responsibility that it has proved incapable of carrying out.

Together with this responsibility it received a right of seigneurage by which it was able to create for its own advantage the money

required for the expansion of world trade. This arrangement freed the world currency from the shortage of the precious metal, but instead of dollars being created in response to these trade requirements, they were created mainly in response to the redistributive struggle and the fiscal deficit.

Be that as it may, the fact is that inflationary dollars flooded the world. The dollar assumed the role of international as well as national currency, although it was not subject to the strict laws of the gold standard. Quite on the contrary, it was not subject to any monetary discipline whatever.

The inflationary abundance of this currency generated the Eurodollar market. Since the countries receiving them were worried lest they should give rise to an exaggerated domestic expansion of money, they returned part of their holdings to this market, generally in the form of short-term loans. These operations, of course, further accentuated the inflationary pressure: for each unit of money, two or three more have been created, in the same way that the money from bank reserves multiplies domestically. But contrary to what occurs domestically in each country, these Eurodollar operations are not subject to any control.

What happens is that when money is loaned in the Eurodollar market, it does not necessarily represent saving on the part of those who have received dollars for their external transactions—that is, genuine saving—as has always occurred in the case of international long-term loans. Instead, it mainly represents dollars which multiply in an inflationary manner as indicated.

This is another of the paradigms on which monetarist open economy policies are built: the idea that countries should resolutely enter the international market, as if it corresponded to the past image of the gold standard.

In line with this concept of open economy policies, a monetarist theory of the balance of payments has arisen, which rejects any reason for intervention by the monetary authority in regard to fluctuations which originate outside the country. If these cause a surplus, they claim, then the domestic interest rates will drop and the money which is not needed in the country will flow out of it; the opposite will

occur when there is a deficit. This is a very unrealistic picture of what actually happens in the cyclical reality of our countries. When the domestic interest rates drop due to the inflow of external funds, this heightens the tendency to misuse credit, and this makes it more difficult for the cyclical decline to occur. The monetary authority then has to act in various ways, and I believe that I have gained some positive experience in this respect when I had some responsibility for the monetary policy of my country.

It is clear that when there is an abundance of dollars which the big international private banks want to loan, the open economy policy is very attractive. But how long will it continue to be so? The gold standard did not work this way. The interplay of interest rates occurred primarily among the big countries.

Neither does trade openness attract me. It is a well-known fact that the centres either do not follow the rules of the game of the international division of labour, or else the rules they do follow are incompatible with the development of our countries. I will not deal with this subject now. I only want to refer to the serious impact that this second great crisis of capitalism is having. Can we talk about unconditional open economy policies when faced with the decline in the growth rates of the centres and the reappearance of protectionism? It is paradoxical that the return to orthodoxy coincides with this phenomenon which is so contrary to the comparative advantages of the periphery.

We must not confuse trade openness with the rational linking-up of the periphery with the centres. The great error of the open economy policy is not that it proclaims comparative advantages—to deny them would be absurd—but that it assumes that the dismantling of protections and subsidies would allow us to profit from these advantages fully.

I hope that the foregoing reflections will serve to temper the enthusiasm of those who, in their desire to imitate, let themselves be seduced not only by the theories of the centres but also by the manner in which the latter attack their own problems. This observation not only corresponds to the present crisis of capitalism but also to the previous one: the Great Depression of the 1930s.

Let me say a few words about the latter. What appeared in the beginning to be a simple cyclical decline turned into an intense economic contraction; the immediate origin of this phenomenon was, in my opinion, the brutal restriction of credit to which the stock market crash led in the United States. Instead of this policy, it would have been advisable to use a policy of government expansion to deal with it. But the new Keynesian ideas, which were just beginning, took a long time to penetrate, being considered heresies although they were later incorporated into orthodox thinking.

On all this were superimposed the tragic consequences of the sharp increase in import duties. The world contraction, the drop in prices and protectionism all led to a great external imbalance in the rest of the world, in contrast with the impressive accumulation of gold by the United States. The rest of the world had to defend itself through bilateralism, which restricted imports from the United States while trying to maintain imports from countries which could be paid with exports.

The multilateral trade and payments system which appeared to have been built on solid foundations, with a longstanding history interrupted only by the First World War, was thus destroyed, and the gold standard system suffered a hard blow from which it never recovered.

As is well known, the consequences of these crises have lasted a long time; indeed, they have dominated the greater part of the half century which has passed since the Great Depression. But scarcely had the world recovered from the consequences of the latter when the Second World War occurred, followed by the serious difficulties of the post-war era. There then occurred the extraordinary boom which lasted until the first half of the 1970s, only to be followed by the present crisis, which seems to me to be more profound, complex and difficult than the Great Depression.

I have had the rare privilege—in academic terms, of course—of having worked as a young economist during the first great crisis and the Second World War, and of now witnessing the present crisis. In those days we had to improvise defence measures which were the beginning of an autonomous development effort.

And today we are also being forced to defend ourselves from the vicissitudes of the centres and seek new development paths. There is much to be discussed before selecting our course of action.

In my long lifetime, between these two extremes of the great world crises, I have had the opportunity to participate in the initial struggles of UNCTAD to obtain from the centres a more enlightened policy of co-operation with the periphery.

Nothing important was achieved then or later. However, it must be acknowledged that in the long years of prosperity which came to an end in the first half of the 1970s the concern of the Latin American periphery about the negative attitude of the centres began to weaken in view of the positive consequences of the extraordinary rates of development achieved, which had never occurred before so persistently. Thanks to this prosperity, the most industrialized developing countries embarked upon the export of industrial goods. They strove to persuade the centres to liberalize the importation of goods in which they had comparative advantages. But they did not succeed.

Despite this fact, these exports were successful, since the high growth rates of the centres made it possible in many cases to overcome the obstacles in their path.

It is perfectly understandable that this boom should have appeared to be the beginning of a new and very promising era. The periphery allowed itself to be dazzled, and in view of the success of its exports it did not rationally pursue the import substitution required by the symmetry of the process of industrialization. This error was analogous to that which had been committed earlier in the opposite sense, when development was held to be more important than the process of substitution.

These observations are not intended to put on paper what is still fresh in the memory of one who had to act in those tempestuous times, nor merely to explain my serious concerns today. I am writing for another reason, since those of us who were neoclassicists had to deal with phenomena which were outside the field of theory. During the Great Depression, the centres had stopped being an exemplary model of opera-

tion, a paradigm for our countries to identify with. What is equally important, we stopped accepting with reverence the theories developed there, and as a result of passing through so many vicissitudes we began to seek our own developmental path.

Thirty years ago, the periphery had begun a tenacious and difficult attempt to emancipate itself intellectually. It was learning to question those theories developed in the centres which did not fit in with the basic interests of peripheral development. The return to conventional theories in recent years has represented an attempt to counteract this effort aimed at inde-

pendent thinking about development. The seductiveness of these theories is very powerful, and it clouds their new proponents' view of reality so that they are unable to perceive clearly the interplay of internal and external interests behind these new manifestations of conventional thinking.

Now is the time to pursue this effort at intellectual emancipation. We must now advance in broader fields and include in our thinking an examination of the structure of the society, without which both the theory and the practice of development will continue to drift from their proper paths.