



## POWER RELATIONS AND MARKET LAWS

Raúl Prebisch

Working Paper #35 – September 1984

Raúl Prebisch is currently Director of the CEPAL Review and Special Advisor to the Executive Secretary of the Economic Commission for Latin America. He graduated with a degree in Economics from the University of Buenos Aires, and soon held a professorship in Political Economy at the same University. Dr. Prebisch served as Under-Secretary of the Argentine Ministry of Finance, Director-General of the Latin American Institute for Economic and Social Planning, Secretary-General of the United Nations Conference on Trade and Development, and Special Representative of the Secretary General for the United Nations Emergency Operation. His particular concerns, as evidenced by his career work related to UNCTAD activities and his extensive publications, have been in the areas of trade and development problems for Third World countries, and North-South relations.



## Abstract

According to neo-classical economic theory, the free play of market forces ensures that resources are allocated in the best possible way and that the fruits of technological progress are disseminated throughout society, leading to the steadily rising productivity of the system. This paper contends, however, that the concept of economic equilibrium is not adequate to deal with the structural phenomenon of the economic surplus nor, at the international level, with the structural imbalance between the periphery and the center. Conventional theories of development and income distribution fail to take into account social change and consequent changes in power relations. The author examines the various effects of appropriation of the surplus, power sharing by the labor force, and contractionary monetary policies, and concludes that at this stage in world history we have to recognize the need for economic regulation.

## Resumen

De acuerdo con la teoría económica neoclásica, el libre juego de las fuerzas del mercado asegura que los recursos sean utilizados en la mejor forma posible y que los frutos del progreso tecnológico sean diseminados en la sociedad, así fomentando el aumento de la productividad del sistema. Este ensayo afirma, en cambio, que el concepto de equilibrio económico no es adecuado para tratar con el fenómeno estructural del superávit ni, a nivel internacional, con el balance estructural entre la periferia y el centro. Las teorías convencionales de desarrollo y distribución de ingresos no toman en consideración el cambio social y los cambios resultantes en las relaciones de poder. El autor examina los varios efectos de la apropiación del superávit, la distribución del poder por la fuerza de trabajo y las políticas monetarias restrictivas, y concluye que en esta fase de la historia mundial tenemos que reconocer la necesidad de la regulación económica.



## Introduction

In my younger years, I was a neo-classicist. I strongly believed in the Walras-Pareto theory of general equilibrium and was fascinated by its mathematical elegance. Under the free play of economic forces, according to that theory, resources would be allocated in the best possible way, both at the international and national levels, and the fruits of technological progress would correspond at the equilibrium point to the contribution of every factor to the production process.<sup>1</sup>

The world depression had a tremendous intellectual impact on me. I had to abandon the belief in free trade as well as in the positive results of the international division of labor. However, it took me many years to arrive at the conclusion that the free play of market forces was not conducive to the pattern of distribution supposed by the equilibrium theories.<sup>2</sup>

Let me first consider the problem of distribution in order to pave the way for explaining the question of the international division of labor between industrial centers and peripheral countries engaged in primary production.<sup>3</sup>

I am persuaded that conventional theories of development and income distribution have a great flaw due to the fact that they do not explicitly include in their reasoning the structure of society and its mutations, as well as the changing power relations emerging from these.<sup>4</sup>

### 1. Internal Dynamic Disequilibrium and Inflation

The concept of economic equilibrium in conventional theories is totally out of touch with reality, inasmuch as it overlooks the structural phenomenon of the economic surplus. I maintain that, however fully the rule of free

market competition be observed, only part of the productivity increment attributable to technical progress is transferred to the labor force, while the rest is appropriated and retained as an economic surplus by the holders of the means of production, especially by the upper strata of society where the ownership and control of those means are concentrated.

The economic surplus plays a vital role in the dynamics of the system: it is the primordial source of reproductive investment which multiplies employment and productivity and continuously augments the surplus itself. It is also a source of the considerable expansion of consumption by the upper strata, increasingly stimulated by the techniques for the diversification of goods and services, which, it is true, also tend to augment the consumption by the lower strata as income increases.

During the past history of capitalism, it has been possible for the upper strata to appropriate the surplus by virtue of the passiveness of the labor force and the laissez-faire attitude of the State. The surplus is an historical category which is based essentially on social inequality; it corresponds to a specific power structure. In the course of structural change the labor force progressively, although unequally, develops its trade-union and political power, and struggles to obtain a larger share of the growth of productivity; the State does the same, in order to cover both its increasing social expenditure on behalf of the labor force and the outlays deriving from its own dynamics, which, in their turn, reflect the changes that have occurred in the power structure.

Insofar as the State, in order to cover the social services referred to as well as the expansion of other expenditures, resorts to taxation of which the burden has to be borne by the labor force, the latter tries to recuperate itself by means of wage increases. This tends to push wages up faster than

productivity increases, thus weakening the growth rate of the surplus and therefore that of capital accumulation. Some of the taxes also fall on the surplus and adversely affect the development of reproductive investment and, consequently, of productivity, at least as long as State investment and expenditures do not counteract these effects.

Thus, as the passiveness of the labor force and the laissez-faire policy of the State are modified, the tendency for wages to increase faster than productivity and the slackening of the latter's rate of growth have consequences that are more and more disturbing, given the nature of the system.

Every increase in wages above the rate of productivity has the two-fold effect of raising costs and boosting demand in such a way that the higher costs can be transferred to prices, at least insofar as the rate of increase of wages outstrips that of productivity. And hard upon this rise in prices follows a fresh wage increase, if the labor force has enough power to obtain it. This is an important source of the inflationary spiral, deriving from the pressure of costs and intensified by the upswing in rates of interest that succeeds the rise in prices.

The upward movement of prices is really due to the endeavors of enterprises to defend the appropriation and retention of the surplus. And there is no spontaneous mechanism whatsoever whereby the increase in costs can be absorbed at the expense of the consumption of the groups benefitting by the surplus so as not to weaken the rate of accumulation. This is not how the system functions. It tries to protect the appropriation of the surplus by the groups in question where both their consumption and their investment are concerned.

It should be taken into account, however, that if the real remunerations of the labor force are improved, a portion of them may be used for

accumulation, thus offsetting, to some extent at least, the weakening of capital accumulation on the part of enterprises. But neither is there any mechanism that spontaneously leads to this sort of compensation. What is of essential interest to enterprises is to defend the surplus and use it freely for their own investment rather than to let it be drawn upon for accumulation by the labor force. The same might be said in general of accumulation by the State.

It is not so much a question of resolving the technical problem of accumulation in order to promote the dynamics of the system, as of preserving the appropriation of a large proportion of the fruits of technical progress by the owners of the means of production. The system's need to speed up the rate of accumulation in order to increase employment does not represent a responsibility intrinsically incumbent upon the social groups that appropriate the surplus. It is other elements that determine the rate of accumulation, above all a factor of a cultural nature: the degree of austerity of these social groups, or, in other words, their resistance to the pertinacious incitement to consumption, spurred by the ever-increasing diversification of goods and services. Whatever degree of austerity may have been practiced in the historical development of capitalism, it must be acknowledged that this is not a characteristic of peripheral capitalism.

Let us now revert to the defense of the surplus through price increases, which causes inflation to spiral when the labor force is no longer passive and the monetary authority allows the necessary creation of money. The growing distortions which accompany this amplification of the spiral sooner or later induce the monetary authority to restrict credit. The consequences are common knowledge: a decline or contraction of the growth rate, together with tighter and tighter compression of the surplus and a slump in employment.



It is precisely in the decrease in employment that the key to this monetary policy lies. Sooner or later it leads the labor force to accept a deterioration of its real remunerations until the wage squeeze permits a renewed increase of the surplus and, therefore, its dynamic role in accumulation as well as a rise in the consumption of the advantaged social groups.

Furthermore, a rise in interest rates, accentuated by a restrictive monetary policy, implies a substantial transfer of real income from productive activity (surplus and remuneration of labor force) to financial activity, and slows down the tempo of economic activity, which then contracts.

Such, in a few words, is the way in which a notable success in curbing inflation has been achieved, initially in the main dynamic center of capitalism itself. In a recent commentary on this fact, The Economist noted that this result had been effected by squeezing real wages in order to increase the profits of enterprises (i.e., to reestablish the surplus). This is a very laudable thesis, according to the periodical, which has gained a wide circulation both in the centers and in the periphery, and which supports monetary policy as a means of combating inflation. Here are the terms in which its remarks are couched:

Falling real wages, like falling oil prices, are correcting an imbalance that has harmed the world economy for 10 years. Too-dear oil and too-dear labor both helped to cause stagflation. Their demise could herald a new age of low unemployment and low inflation, especially if too-dear money also ended. When that happens, the world will enjoy many happy New Years.

The economic and social costs of a restrictive monetary policy are tremendous, as we have already pointed out. But according to its defenders, this is a cost that has to be incurred in order to restore the system to health, i.e., in order to correct what they consider to be excesses brought about by the exaggerated demands of the trade unions, as well as by the increasing

social benefits that contribute to the hypertrophy of what is no longer a laissez-faire State. In fact, neoclassical economists generally accept with resignation (and not without a measure of complacency in some cases) the economic and social costs in question for the sake of remedying the consequences of the violation of market laws by the labor force, as well as by abusive exercise of power by the State.

This is a violation of market laws because, according to neoclassical theories, if the market is allowed to operate freely, with no extra-market interference whatsoever, the economic system will tend towards equilibrium. And given this equilibrium, workers, entrepreneurs, and capital will be remunerated in accordance with their contribution to the production process. Whence derives a conclusion of supreme importance in neo-classical theory (although it is not usually explicitly stated): the free play of market forces disseminates throughout society the fruits of technical progress which find expression in the steadily rising productivity of the system, when this is left to its own devices.

These arguments, of course, disregard the structural phenomenon of the surplus; not only does accumulation increase, but so does the privileged consumption of the social groups that benefit more by technical progress. It is precisely this manifest inequality in consumption that causes the twofold pressure for redistribution exerted by the labor force and the State. The system itself, given its modus operandi, precludes efficacious fulfillment of the goal of equitable distribution.

Let some thought be given to the significance of these facts. The labor force finds itself compelled to accept a compression of its real wages so that the system may recover its capacity for accumulation. And for that to happen, unemployment must increase. Can it be supposed that, if a reactivation of the

economy and a rise in employment levels occurs, the labor force will meekly renounce its aspirations in favor of accumulation and more lavish consumption on the part of the advantaged strata? Or will it be necessary to recognize that the system, in the present structural phase, is continually exposed to inflationary pressure, which weakens with unemployment and recrudesces with the reactivation of the economy?

There is nothing surprising, then, in the peculiar thesis of those who maintain that the regular operation of the system entails a certain coefficient of unemployment in order to moderate wage demands.

I believe I have reached a clear and categorical conclusion. It is not feasible to seek the social betterment of the less-favored groups through wage increases that raise enterprise production costs. A historical phase in the evolution of capitalism is coming to an end without a solution having been found for the fundamental problem of synchronizing the distribution of the fruits of technical progress and the accumulation of reproductive capital.

Moreover, to dream of resolving it by market laws would be a fatal illusion. The market, insofar as it operates correctly, is efficacious from the economic standpoint. But its social efficiency is partial and limited, as also is its ecological efficacy. It is not the market in itself that should concern us, but the underlying structure of society and the power relations inherent therein, as well as the ambivalence of technology. Nor must we labor under the delusion--much more dangerous still--that the abolition of the market will resolve these and other problems, since that would invest those who manage the system from the summit with a power which, besides jeopardizing the system's efficiency, would prove incompatible with the progressive democratization of society.

## 2. The Structural Imbalance Between the Periphery and the Centers

In this section I turn to the question of the free play of market forces at the international level, in the relations between the centers and periphery. The centers have always stubbornly refused to recognize their great structural differences from the periphery, which stem from the considerable lag in the latter's development. This lag is itself the consequence of the inherent dynamics of advanced capitalism: a centripetal type of dynamic that has always characterized the latter's development in the past and has not spread spontaneously to the rest of the world. The fruits of the increase in productivity due to their enormous technological progress have remained in the centers and have not spread further through the reduction of prices: a situation which has given impetus to the accumulation of reproductive capital and the unceasing innovations in the centers. For better or for worse, this is how the capitalism of the centers has developed, with the periphery playing only the role of an appendix. This explains the historical lag in the latter's development and its great structural differences from the centers. These differences are manifested in three main points worth mentioning briefly here: the structural disparities in demand; the economic and technological inferiority of the periphery, which makes protection necessary; and the characteristic division of the periphery into relatively small units, which calls for integration measures.

With regard to the first point, in order for a country to develop it is essential for it to change its structure of production in order to cope with the correlative changes in demand. These changes can be oriented mainly towards the interior or towards the outside world, and the attitude of the centers has a dominant influence in this. There can be inward-oriented changes involving import substitution, or outward-oriented changes involving

the export of manufactures. The latter option has become increasingly necessary because of the relative slowness with which exports of primary commodities generally tend to grow.

The obstacles impeding the ability of import substitution to move beyond certain limits are well known. The limits in question depend on the availability of natural resources and on technological considerations, thus making it necessary to combine import substitution with the export of the manufactures.

To what extent can manufactures be exported? Over and above the question of the effort that a peripheral country is willing to make in this direction, this extent depends fundamentally on the receptiveness of the centers, which is influenced in turn by their rate of development and the intensity of their restrictions on imports from the periphery. As a general rule, it can be said that the greater the receptiveness of the centers in the light of these two elements, the less need there will be to substitute imports in the periphery.

This, however, covers only one aspect of the matter. The other aspect concerns the changes in the composition of demand, which, as noted earlier, go hand in hand with development. In view of the well-known disparities in the income-elasticity of the demand for imports, the demand for the latter, which come primarily from the centers, will tend to grow more quickly than the demand for the exports of the periphery by the centers.<sup>5</sup> Such is the effect of the technological innovations in the centers, which increasingly diversify goods and services, in contrast with the technological lag of the periphery. In order for the development of the latter to progress, it is essential that it should develop its exports of manufactures in order thus to correct the tendency towards an external structural imbalance caused by this disparity in elasticities. If it does not manage to do this, it will be forced to engage

in import substitution, in view of the rate of development which it proposes to achieve.

Now, import substitution calls for a certain amount of rational and moderate protection. This is where we encounter a severe obstacle in the form of reciprocity, which is now being put forward once again as a condition for the centers to lower their levels of protection. It is worth going more deeply into this matter.

There is a fundamental difference which should not be overlooked: protection in the periphery is aimed at eliminating the tendency towards structural imbalance, whereas protection in the centers tends to aggravate this tendency, to the detriment of peripheral development. We have set forth our reasoning on this matter many times, but apparently we have not been persuasive enough. Reciprocity has been the most important reason why attempts have been made and continue to be made to extend the scope of GATT (General Agreement on Tariffs and Trade) to the peripheral countries, so that they can participate in the negotiations based on this concept. It is not recognized that there is in fact already implicit reciprocity, since the more the developing countries export to the centers, the more they will be able to import from the latter.

There is also another consideration which is often forgotten. No rational projection puts imports below the amount that is exported to the centers, taking account of financial remittances and other payments abroad: all that is changed is their composition. The difference is that protection is aimed to bring about a deliberate change in the composition of imports in order to promote change in the structure of production in line with the requirements of development. In the absence of such a policy, the composition of imports is determined by international market forces and the transnational

corporations which predominate in them, so that the structure of production is determined from the exterior. This means that a country cannot develop faster than is permitted by the growth of its exports, that is to say, by the receptiveness of the centers.

Is protection really necessary, however, in order to achieve these changes in the structures of production? The original concepts under which GATT was set up, based on the old-fashioned scheme of the international division of labor, did not accept this, nor do the economists who still continue to preach the virtues of the free play of market forces for the periphery. It is true that these economists recommend devaluation of the currency to carry out these changes without breaking these laws. However, in order to simplify the argument, let us pass over the fact that devaluation is also a kind of intervention. We are not talking, of course, about devaluation to bring the external value of currency in line with domestic inflation, which is fully justified; rather, we are referring to it as a tool of economic policy.

Applied with this criterion, devaluation has the virtue of making imports more expensive and thus promoting their substitution, and also stimulating the growth of exports through a reduction in their prices. It does this, of course, for the exports which require this stimulus; however it also affects the exports which were already competitive at the international level. That is to say, from their point of view, this type of change in the structure of production brings about a deterioration in the terms of trade when the growth of exports goes beyond certain limits. Thus, it would be counterproductive from the point of view of development. It is true that a tax on exports is also advocated in order to avoid this, but would not this represent interference by the State with the market laws?

Furthermore, devaluation means altering all prices and costs in order to achieve effects only on a relatively small part of the global product of the economy. This is not all, however. It is well known that when the labor force has sufficient power to gain compensation for price rises it will demand a rise in wages, which will eventually wipe out the effects of devaluation. Consequently, while protection and the corresponding subsidies seem to us to be inevitable, they must be rational and not arbitrary or excessive, as often happens.

In order to undermine the idea of protection, the old argument continues to be put forward that it is necessary to pay more for import-substitution products than imports would cost. This reasoning fails to take account of two points of decisive importance. First of all, there is the low income-elasticity of exports. If their volume is increased, their prices will go down, and after a certain point the periphery would experience a deterioration in the terms of trade, thus suffering heavier losses than the higher cost involved in the promotion of import-substitution activities. Second, these activities make it possible, within certain limits, to achieve a higher growth rate of the global product which more than outweighs the higher cost involved. Protection is thus an economically sound solution, provided it is applied in a rational manner, as it is always necessary to insist.

Of course, it is quite true that protection on the part of the periphery has infringed from the very beginning on the free play of the international market forces on which the original concept of GATT was based.

All the foregoing concerns the periphery, but it would seem that the most difficult problems lie with the centers. It is hardly surprising that these should resort to restrictions outside the ambit of GATT when they are suffering from serious unemployment. As already noted, however, they were very



reluctant to liberalize their own trade, even during the years of prolonged prosperity and even in the case of countries suffering from a shortage of labor which threw wide their doors to immigrants. Nothing seems to indicate as yet that in the future, even when the current difficulties are overcome, the centers will be willing to make any really significant changes in their attitudes. I think that this is a fundamental problem whose true significance has not been made fully clear. Yet it is essential that this should be done if we are to find solutions capable of reconciling the interests of the centers and the periphery in increasing growth. It is therefore worth going into more detail on this subject.

As already noted, in the past development of the centers the fabulous increase in productivity has not been reflected in a steady decline in prices, but has been retained internally. This is a structural phenomenon which has constituted a very important factor in the accumulation of capital and in the carrying out of technological innovations. The periphery has only participated to a marginal extent in this process, except insofar as it has produced raw materials which the centers needed. It is doubtful whether capitalism would have been able to develop so vigorously if it had not been for this form of retention of the fruits of technical progress, especially in the upper strata.

The industrialization of the periphery was not a spontaneous consequence of this capitalist expansion, for the centers were only interested in investing in the periphery in order to obtain from it the primary commodities they needed: they had no intention of establishing industries there which could export anything other than primary products. For a number of reasons, they preferred to carry on industrial production in their own part of the world, and consequently the industrialization of the periphery was the result of its

own decision in response to the severe crises in the centers: two great World Wars and a Great Depression between them.

Be that as it may, the periphery, which had first been forced to industrialize through import substitution because of these critical conditions in the centers, gradually leaned afterwards to export manufactures, thanks to the prosperity reigning in the centers and through the use of deliberate promotional measures. If this prosperity were to return in a few years, although not necessarily at the same level as before, the question would arise of whether the centers would be willing to follow a liberalization policy such as they have put into effect among themselves. Let us examine this very important aspect for a moment.

Up to now, the exports of manufactures from the periphery have been carried out only by a few countries and have accounted for a relatively small part of its potential. Would the centers be willing to liberalize their imports if this export effort reached large dimensions?

Let us reflect on the following fact. If success was achieved in the export of manufactures, this was because the exporting countries were capable of adopting techniques similar to those of the centers (although corresponding to less advanced phases of the latters' development) to produce goods for which the demand tends to grow less rapidly than the demand for the increasingly technologically advanced goods coming from the innovations made in the centers. It is hardly surprising that the possibility of access to advanced technologies and the lower level of wages have enabled the exporting countries to compete successfully with similar goods produced in the centers.

This fact could signify the beginning of a process of reversal of what has been occurring in the past development of the centers. It should be recalled that the fruits of technical progress have not been reflected in a

corresponding reduction in prices, and that generally speaking the ability of the centers to open up external markets has not been due as much to lower prices as to the unceasing diversification of goods deriving from their technological innovations. It would appear, however, that this is not the way in which the exports of the periphery have been competing in the centers; instead, they have been exploiting their lower prices.

Although this reaction of the periphery to this historical process has still not reached large proportions, in view of the growing export possibilities it is necessary to think seriously about the possible consequences of the accentuation of this phenomenon which has now begun.<sup>6</sup> What will the centers do in the face of this process? Will they continue to maintain and increase their restrictions, as they have been doing so far outside GATT, or will they resort to the use of devaluation as an instrument, as the periphery has been recommended to do so many times?

As well as containing imports, devaluation would reduce the external prices of exports, even those which were already fully competitive. The reason we mention this is not because we believe that it is likely to occur, but merely in order to emphasize the difficult choice which the centers have to face. On the one hand, they would continue to violate the principle of GATT which they have defended so much; on the other hand, they would have to resign themselves to losing, through the lower prices of their exports, part of the fruits of their technical progress, with all the great disturbances that that would imply.

In the meantime, a comment is called for which is not without importance. The centers have always proclaimed to the periphery the advantages of the international division of labor within the system of market laws. This attitude was completely in line with their interests, although it prejudiced the

development of the periphery. Now that the periphery has begun to export, however, the centers are departing from those principles on which the existence of GATT is based.

To tell the truth, those principles, although they continue to be of great validity in the centers and in spite of the conjunctural phenomena mentioned elsewhere, have not been in keeping with the requirements of peripheral development in the past. Moreover, at present they actually militate against such development because they outlaw protection.

On the other hand, it cannot be denied that the centers will be exposed to growing adverse effects if, in this new stage of industrialization of the periphery, those principles continue to be fully valid. Let us recall the nature of the accumulation process, whose source lies in the increase in productivity which is not passed on in the form of reduced prices but is reflected in the displacement of demand to increasingly diversified goods and services. Obviously, increased competition from imports through a reduction in their prices, far from generating investment resources in the enterprises, reduces their surplus to the prejudice of accumulation. This competition thus generates unemployment and weakens accumulation. In contrast, when the unemployment is due to increased productivity, this increase produces an accumulation potential which, if utilized, enables the unemployment to be offset. This is the serious problem which is causing so much concern and which must be faced immediately if we are to find mutually advantageous solutions.

Clearly, it would suit the periphery much better to be able gradually to take advantage of the market of the centers without the need to resort to an exaggerated reduction of prices at the expense of the fruits of their technical progress. This would not suit the centers either. Up to now, without referring to the exports of the latter, we can say that they have tried to

defend themselves through arrangements such as the Multifibers Agreement and so-called voluntary accords in order to limit exports from the periphery. As well as constituting discriminatory actions--since they affect only the periphery and not the centers--these measures are not in line with the contractual system of GATT and are always subject to the threat of further unilateral decisions by the centers. Of course, the principles of GATT are not fundamentally applicable to these new tensions, which call for a new institutional system, as the UNCTAD (United Nations Commission on Trade and Development) Secretariat has suggested.

It is necessary, then, to explore other avenues which suit both the interests of the centers and those of the periphery. New ways of recognizing comparative advantages in practice are required. There can be no doubt that it is in the interests of the periphery to gain access to the markets of the centers for goods which are in line with their technological capacity. They would then be able to import the other technologically advanced goods produced by the centers, goods that would be very costly for them to substitute at the present stage of their technological development. This would also mean clear advantages for the centers, because of the ever wider field thus offered for the exploitation of their technological innovations. In other words, it would suit the centers to export goods with a high technological content in exchange for imports of goods with a lower technological content from the periphery. This would also be advantageous for the periphery itself.

Of course, I am not making concrete proposals, but simply stressing the need to explore these issues. What is needed is to reach formulas which gradually and progressively open up the markets of the centers without the risks of unlimited competition.

Clearly, the formulas should not be static but eminently dynamic. Exports of manufactures by the countries of the periphery, together with import substitution, will enable their industrialization to be made increasingly efficient and, at the same time, promote their technological development. It will therefore be understood that this advance would make it possible to increase the exports of goods which are at present not technologically accessible to the periphery. This has already happened in the case of countries which, although once peripheral, have finally attained technological homogeneity and become integrated into trade with the centers.

The peripheral countries which are advancing in their industrialization are passing through a transitional period which is more or less prolonged, in line with the big differences existing among them. If this process continues, there will be a steady expansion in actual fact, and not just in a formal manner, in the scope of the international division of labor within GATT and the mutually advantageous observance of its principles, including eventually that of reciprocity.

The role of the centers will be of considerable importance during this transitional period: up to what point will they be able to open themselves up substantially to the periphery? In the light of what has been said before, there would appear to be serious doubts about this: there is nothing to indicate that, even in the best of cases, the periphery could dispatch to the centers all the exports it would need to make in order to acquire the enormous amounts of goods required for this development.

There is no justification for placing exaggerated emphasis on exports to the centers while failing to give sufficient importance to exports of manufactures within the periphery itself. The main obstacle continues to be the economic division of the periphery, which is a clear manifestation of the way

in which the centers, through the very dynamics of their own development, have left the periphery on the sidelines of industrialization.

According to the past system of the international division of labor, each peripheral country converged separately towards the centers, with very little intra-peripheral mutual trade. Import substitution used protection in a general manner, without establishing preferences among the developing countries. This is however, on top of the violation of conventional principles represented by protection in itself, such preferences would have added something which the centers would have rejected as open discrimination. Thus, import substitution was carried out in water-tight compartments and not much progress has been made in the arrangements arrived at over the course of time in order to try to do away gradually with these compartments.

One of the main reasons (although not the only one) why this division has lasted was the illusion, during the long years of prosperity in the centers, that the indefinite expansion of exports of manufactures made it unnecessary to continue with an active import-substitution policy combined with mutual exports within the periphery itself. Furthermore, the centers either actively opposed measures aimed at correcting the fragmentation of the periphery or, even in the best of circumstances, were indifferent to them and failed to give them the support which would have been of great significance in this respect. This was yet another of the consequences of the centripetal growth pattern which first of all prevented the periphery from industrializing and subsequently kept it on the sidelines of trade in industrial products.

It is worth repeating once again that this centripetal growth pattern is a primary factor in the centers' lack of any real interest in the development of the periphery, except inasmuch as it is important to their own development. I refer to the development of the periphery in all its social depth, that is

to say, the process whereby the advantages of technical progress are spread throughout the structure of society and are not limited to a relatively small part of the labor force.

This assertion may seem surprising in view of the active role which the transnational corporations have played in the industrialization of the periphery in recent decades. At first, the centers opposed this development. However, once the process was well under way and appeared to be irreversible, they stimulated the participation of these transnationals, which thus took advantage of import substitution after having previously opposed it. It was claimed that the transnationals would be agents of the internationalization of production. Their most important role, however, has been to internationalize forms of consumption rather than those of production, since they have been an important factor in opening up the markets for the centers. In other words, without ignoring their technological contribution, the transnational corporations have nevertheless taken advantage of the industrialization of the periphery without making any serious contribution towards offering it international horizons.

Very important changes are now taking place in the world economy. Thus, we are at present witnessing, among other events which cause profound concern, the decline of productivity in the centers. The increase in productivity no longer seems to be a process which occurs automatically in the capitalist growth pattern. It must now be the result of a deliberate policy, in both the domestic and the international fields. It is therefore to be expected that new criteria should now be adopted in tackling the problem of relations with the periphery, including the question of comparative trade advantages. This problem must be approached, however, not in the previous ways, but in response to a situation which is very different from that which existed when the



periphery began its industrialization. There is now no longer any doubt about the periphery's increasing capacity to achieve this, and it must therefore be allowed to participate in the sustained and growing process of comparative advantages, where it would make a notable contribution to increased productivity in the world economy.

### 3. The Appropriation and Retention of the Fruits of Technical Progress and the Distribution Struggle

Since we attached so much importance to the structural phenomenon of the surplus, the time has now come to explain, firstly how it comes about, next how it is retained, and lastly how the social struggle to share in the fruits of technical progress triggers the trend towards dynamic disequilibrium between the rate of expenditure and that of reproductive capital accumulation. This trend inevitably leads to inflation and cannot be contained by means of the monetary instrument without those huge economic and social costs which we stress above.

Let us begin, then, with a simple schematic explanation of the economic surplus. The surplus is closely linked to technical progress, which finds expression, thanks to capital accumulation, in a continuous superimposition of new technical layers of increasing productivity on layers of lesser productivity. This is a process which is incessantly renewed.

It happens that when a technical layer is added in which productivity is higher than in those preceding it, the wages and salaries of the labor force thus employed do not improve correlatively with the increment in productivity. Within the play of market laws, an improvement will be obtained only by that part of the labor force which possesses the increasing skills that technical progress demands. The increase in productivity is the result of these skills plus capital accumulation in and through which technological innovations take

shape. The wages of the rest of the labor force employed in new technical layers do not increase correlatively with productivity for a very simple reason: competition on the part of the labor force which is left behind in lower-productivity layers where income is less, and on the part of the labor force entering the market, prevents wages from rising at a rate equal to the increased productivity of the new technical layer.

I have applied the term surplus to the productivity increment which, not being transferred to the labor force, remains in enterprises and is appropriated by the owners of the means of production. A clear distinction must be drawn, moreover between the surplus and the remuneration of those who organize the actual productive activity, whether they are the owners of the means of production or not.

The surplus has its origin, then, in structural heterogeneity, that is, in the diversity of technical layers, levels of productivity, and incomes of the labor force. It is conceivable that capital accumulation and the skills necessary to meet its requirements may tend to lead progressively to homogeneity, with similar levels of productivity, and equal pay for equal skills. In that case, the surplus would peter out, as would likewise its dynamic role in accumulation, and other forms of capital accumulation would have to be put in its place. In any event, the process would be a relatively slow one, and would be threatened by the incessant diversification of goods and services which militates against reproductive capital accumulation, as well as by population growth, especially in the periphery.

Meanwhile, the redistributive power of the labor force and of the State gradually achieves what market laws are slow to accomplish. And as redistribution takes place, the expansion of expenditure which it involves is added to the ever-increasing expenditure of the social groups benefitting from the

surplus. Thus, the system tends towards that dynamic disequilibrium between the rate of expenditure and the rate of reproductive capital accumulation which was mentioned above.

This tendency towards disequilibrium cannot be explained, however, without showing--likewise briefly--how the surplus is retained in enterprises, instead of being socially disseminated as the neo-classical theories assume, and how, in the course of structural changes in society, the redistributive power of the labor force and the State weakens the growth rate of the surplus, to the detriment of the rate of reproductive capital accumulation.

My interpretation is based on study of the dynamics of the production process and the various phases that occur during the period of time between the primary phase and the stage when the final goods (both consumer and capital goods, between which there is no difference where the production process as such is concerned) are launched on the market.

This introduction of the time factor is essential, as is likewise the growth of production. Otherwise, it would be impossible to explain how the increase in productivity which has been achieved in the various phases can be absorbed without a fall in prices. If enterprises do not transfer the whole of the productivity increment to wages, the demand stemming from their expenditures will be insufficient in relation to the growth in productivity.

Herein lies the significance of the time factor in the dynamics of the production process. In order to understand it, the various phases of production under way must be clearly distinguished from the final stage of output of final goods. Demand for the latter does not derive from the income that the enterprises have paid out formerly in the course of their production but from income earned during the process of producing new final goods, goods that will be offered on the market later on.

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Such, in the dynamics of production, is the effect of the time factor. Because of it, the amount of goods in process of production, during a given period of time, is larger than the quantity of final goods in the same period. In other words, final goods lag behind current production. Thus, the increase in final goods in any period in relation to the one before it could not be absorbed without the expansion of demand deriving from the income paid out by enterprises in the course of the production underway between those same periods.

The additional amount of final goods results both from the increase in employment and the rise in productivity. And if demand expands enough, the productivity increment stays in the enterprises in the form of a larger surplus (or an increase in profits, in a first approximation).

It should be explained that this larger surplus is not obtained in its entirety when the final goods are sold on the market; step by step it appears in each phase of the production process, in accordance with the demand expected by the enterprises concerned. Thus, partial surpluses emerge. If the demand for final goods is sufficient and confirms expectations, it can continue at the same rate for the whole of the production under way. Otherwise, adjustments in one or another direction will be necessary, according to whether the demand for final goods does or does not expand sufficiently to absorb the increase in those goods.

We are now in a position to introduce the creation of money into our argument. We were saying that the income paid out in the course of production generated the demand for final goods. If this demand is sufficient, enterprises in the final phase recover the income they paid out in due course and obtain their partial surplus. If production were static, the money thus obtained by enterprises would suffice for the purchase of goods produced

during the preceding phase and for payment of their own labor force. And the same thing would happen in every phase. In the course of increasing production, on the contrary, the money obtained by enterprises in the various phases would not be enough both to step up their own employment and to purchase the in process of production in the preceding phase, the corresponding partial surplus included.

Thus, as production under way increases, enterprises have to resort to the creation of money by the bank system, except to the limited extent that they may have stocks of money available (for simplicity's sake, we shall eliminate this possible increase in the circulation of money, which makes no difference to our argument).

The role of the monetary authority then, is to permit the creation of the money required for the growth of income in production under way, so that the increment in demand thus generated may be equivalent to the increase in output of final goods.<sup>7</sup> In this way, monetary stability can be maintained.

There are two principal sources of an increase in demand, namely, the growth of ongoing production, as has been explained, or the expenditure of the State, when its income does not suffice to cover its disbursements and recourse has to be taken to the creation of money. Inflation likewise has its origin in these two main sources.

We will now consider the inflation stemming from ongoing production. The additional income paid out by enterprises in the course of production corresponds to the increase both in employment and in salaries and wages. According to the playing out of market laws, wage increases are related in part to the rise in productivity that enterprises expect to achieve. However, it should be recalled that another part of productivity, that which is not transferred to the labor force, contributes to the growth of the surplus.

What happens when the labor force is no longer passive, and acquires the necessary power to increase its wages at a rate higher than the growth rate of productivity, whether in quest of a genuine improvement or in order to recover losses incurred through taxation?

Obviously, in such a case the expansion of demand originating in production under way outstrips the increase in productivity, with a corresponding increase in the level of prices. Under these circumstances, what can the monetary authority do in order to maintain price stability? Here a restrictive monetary policy comes into the picture. If this policy is applied with firmness and continuity, it produces results that we all know. The rate of economic activity falls and unemployment appears or increases. The philosophy behind contractionary monetary policy is just to compel the labor force to accept lower wages and salaries. This philosophy is part and parcel of conventional neo-classical theories according to which the union and political power of the labor forces constitutes a departure from market laws; in this type of reasoning, unemployment is seen as a way of restoring not only the laws of the market but also the growth of the surplus. However, what these theories do not take into consideration is the sheer fact that, even under the full play of market forces, the fruits of productivity growth are not socially disseminated but are appropriated by the high social strata in the form of economic surplus.

In practice, while unemployment is seen as a way of reinstating the play of market forces, the success in the use of this instrument depends initially on the intensity of the trade union and political power of the labor force. If this power is weak, it can be eliminated by unemployment. If, on the contrary, it is strong, the labor force will resist the decreases in their earnings. The result of the latter case is simply that enterprises, being

deprived of an additional amount of money creation, have to divert their funds from capital accumulation to pay for higher wages and salaries. Naturally, this is detrimental to employment and gives rise to the phenomenon of stagflation, with which we are all familiar. In sum, in peripheral societies where the labor force has strong power, the monetary instrument tends to lose its efficacy. Its use often becomes counterproductive. Sooner or later, both enterprises and the unemployed exercise growing political pressures on the monetary authority, which finally has to yield and expand its credit creation in order to increase employment again. This not only enhances the political power of the labor force but also brings a new inflationary spiral with all its well-known adverse consequences.

Let us consider this phenomenon from another perspective. To the consumption of the high income strata, one should add the consumption obtained by the labor force through its union and political power as well as the civil and military consumption of the State. Generally, in peripheral societies, these additional forms of consumption are not detrimental to the privileged consumption of high income groups but are superimposed on it. As a result, a tendency to disequilibrium between the rate of expenditure and the rate of capital accumulation emerges, the final outcome of which is a new type of social inflation, one that cannot be attacked with the monetary instrument. The monetary authority in this situation is really dethroned.

It is true that if monetary restrictions are applied with great energy, even the best organized labor movement can be forced to yield, and correspondingly the rate of inflation may fall. But the economic and social costs of this type of policy are of such magnitude that eventually a monetary expansion will be called forth. With it, the power of the labor force will be restored and a new inflationary wave will be set into motion.

Those familiar with events in Latin America have witnessed the use of another instrument--other than monetary policy--in counteracting inflation. I refer to the instrument of force. One of the arguments given to justify the interruption or suppression of democratic processes has been the need to stop the inflationary spiral by eliminating the union and the political power of the labor force, so that the free play of market forces is restored and prices are allowed to attain their "own level." In this way, it is argued, the surplus will recuperate its dynamic. It so happens, however, that the instrument of force, instead of substantially stimulating reproductive capital accumulation, yields a greater impulse to the privileged consumption of the high income strata of society. Furthermore, notwithstanding the control of remunerations and the freedom of prices, inflation generally continues due to external as well as internal factors. The latter correspond frequently to a budget deficit that is not corrected by orthodox fiscal policies, because its correction would require an increase in taxes falling on those groups which generally support the use of force by the State.

May I say in passing that the democratic process is sooner or later bound to be restored in those countries of Latin America where the use of force has suppressed it. It is all for the good. However, I have a great concern. I am afraid that in countries undergoing redemocratization the attempt to counteract inflationary forces will be utterly defeated, unless there is a transformation in the process of capital accumulation and income distribution. Indeed, given the existing pattern of capital accumulation and income distribution, the democratic process tends to devour itself. The enduring success of democratic processes crucially depends on a very serious change in the structure of political power. We cannot retreat to the past in order to assure the free play of economic forces in a social structure that is quite



different. Nor can we continue with the disruptive process of appropriation and redistribution of the fruits of productivity. I do not see any other solution than the macroeconomic regulation by the State of the process of accumulation and distribution, and this implies very important institutional changes. If you wish to call this "socialism," I accept it, but it is a form of socialism combined with the play of the market forces. For economic as well as for political reasons, the market has to be preserved and purified. What is important is to deal with the structures and institutions that are behind the market. The time has arrived for a synthesis between socialism and liberalism.

#### 4. Summary and Conclusions

Let me summarize now the main points elaborated in previous sections and offer some final reflections.

I do not deny the logical validity of neo-classical theories. However, they do not adequately explain the real phenomena of capitalist development in the periphery. Indeed, they omit from their reasoning the structure of society, its mutations, and the changes in power relations resulting from them. I have stressed that there is no tendency in peripheral capitalism to disseminate socially the fruits of development. This is due to the structural factors that lead to the appropriation of a large part of the fruits of productivity increases by the high social strata in the form of economic surplus.

This system of appropriation of the surplus could function well during the stage of development in which the power of appropriation prevailed, unchallenged by counteracting forces. Thus, under the full play of market forces, the dynamics of the system were based on a marked social inequality.

This stage was, however, temporary. The mutations of the social structure in the course of development have been accompanied by the appearance and strengthening of power-sharing by the labor force, which has interfered with the laws of the market. Furthermore, with the emergence of strong unions and the expansion and diversification of the functions of the State, the monetary instrument has tended to lose its efficacy. Why? Because under these new circumstances, the increment of global income paid to the labor force has the tendency to surpass the increment in productivity--a situation that is detrimental to capital accumulation and usually results in inflationary spirals. True, a sufficiently energetic contractionary monetary policy can correct the deviation of labor income growth from productivity growth, but it does so at the cost of unemployment and economic contraction, so much so that the pressure of labor and business finally prevails and the monetary authority is forced to expand credit. As this happens, the sharing of power by labor and the State is restored, and so is the danger of a new inflationary wave. The monetary authority thus becomes dethroned.

In the context of this struggle for sharing in the surplus, there is indeed no regulatory mechanism that assumes an adequate relationship between the increase in global nominal income and the increase in productivity. My firm conclusion is that the mutations in the structure of society and the corresponding changes in power relations make it impossible for the system to function satisfactorily and to avoid constant disequilibria. A macroeconomic regulatory mechanism compatible with the market system is required.

A regulatory mechanism is also indispensable in the relations of the periphery with the centres. The laws of the market were relevant during a stage of development when the centers and the dominant social groups in the

periphery could reap the advantages of the international division of labor, to the detriment of peripheral industrialization and employment.

Industrialization came with a great historical delay. In the course of time, the periphery has been able to export manufactures with a lower technological content (in comparison with manufactures exported from the centers). But this is proving to have some disruptive effects that could be aggravated by further industrialization in the periphery. Here, again, we have to recognize the need to regulate. The free play of the market forces at the international level will not solve the problem, nor will it promote the vigorous reciprocal trade inside the periphery that is needed to correct its economic fragmentation.

These regulations in trade or in internal peripheral development are far from being easy, either politically or economically. But there are no alternatives. It is regrettable that the free play of the market forces cannot eliminate the external and internal constraints on development, as expected in the light of conventional theories. Although the market is of paramount economic and political importance, there is really no magic in the workings of the market.

## NOTES

<sup>1</sup>Extensive statements of Dr. Prebisch's critical assessment of neoclassical theories of development are found in various of his recent writings. In particular, "The Neoclassical Theories of Economic Liberalism," Cepal Review No. 7, 1979; and "Dialogue on Friedman and Hayek. From the Standpoint of the Periphery," Cepal Review No. 15, 1981. (editors' note)

<sup>2</sup>Dr. Prebisch has retraced in more detail the stages in his intellectual journey in "Five States in my Thinking of Development," IBRD/The World Bank, Washington, 1982. (editors' note)

<sup>3</sup>The central ideas outlined in this paper have been developed more fully by Dr. Prebisch in a series of articles published in the Cepal Review since 1976. In particular, the reader is referred to "A Critique of Peripheral Capitalism," Cepal Review No. 1, 1976; "Socio-Economic Structure and the Crisis of Peripheral Capitalism," Cepal Review No. 6, 1978; "Towards a Theory of Social Change," ibid., No. 10, 1980. (editors' note)

<sup>4</sup>For a recent article reviewing the sociological aspects in Prebisch's work see Adolfo Gurrieri, "La Dimension Sociologica en la Obra de Prebisch," Pensamiento Iberoramericano No. 2, 1982. (editors' note)

<sup>5</sup>Dr. Prebisch articulated this thesis in his "The Economic Development of Latin America and Its Principal Problems" which made its appearance in mimeographed form, in 1949, and which was fully reprinted subsequently in the Economic Bulletin for Latin America, vol. VII, No. 1, Santiago, Chile, 1962.

<sup>6</sup>On Prebisch's interpretation of the economic crisis of the early 1980s, its effects and historical meaning for the periphery, see his article "A Historical Turning Point for the Latin American Periphery," Cepal Review No. 18, 1982. (editors' note.)

This essay was baptized by Albert Hirschman as 'the CEPAL manifesto.' See A. Hirschman, "Ideologies of Economic Development in Latin America," in A Bias for Hope, Yale University Press, 1971, pp. 280-281. Prebisch's 1949 article along with his classic "Commercial Policy in the Underdeveloped Countries," American Economic Review, 49, No. 2, 1959, constitute central building blocks to what came to be known as the 'Prebisch-Cepal Doctrine.' Prebisch's writings of the 1950s produced an uproar of critical responses among 'orthodox' economists who focused principally on one aspect of those writings, namely, the question of the deterioration of the terms of trade. The most notable example was that of Gottfried Haberler (see his "The Terms of Trade and Economic Development," in H.S. Ellis, El Desarrollo Economico y America Latina, Mexico City, Fondo de Cultura Economica, 1957, pp. 325-351). For a discussion of the sense in which Haberler misunderstood Prebisch, as well as for an insightful examination of the ideas of Prebisch and of CEPAL, their evolution and their enduring contribution, see F.H. Cardoso, "The Originality of a Copy: CEPAL and the Idea of Development," Cepal Review, Second Half of 1977. A rather comprehensive bibliography of Prebisch's writings can be found in O. Rodriguez, La Teoria del Subdesarrollo de la CEPAL, Siglo XXI Editores, Mexico, 1980. (editors' note).

<sup>7</sup>The role played by the monetary authority in peripheral societies in connection with the process of appropriation and defense of the surplus has been discussed more extensively by Dr. Prebisch in his article "Monetarism, Open-Economy Policies and Ideological Crisis," Cepal Review No. 17, 1982. (editors' note)

