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**Technology, Finance and Dependency:  
Latin American Radical Political Economy in Retrospect**

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## **Technology, Finance and Dependency: Latin American Radical Political Economy in Retrospect**

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### **Abstract**

The surge in academic work on globalization has made several of the topics dear to authors of the dependency school relevant once again. Therefore a reconsideration of dependency theory seems to be appropriate. There are at least two approaches to dependency. This paper analyzes critically their similarities, differences and limitations, in particular regarding the role of technology, and international finance in the explanation of center and periphery interactions. The evolutions of the ideas on dependency in Latin America are evaluated. The reduced relevance of strict definitions of the technological division of labor, and the theoretical problems caused by the effective industrialization of several countries in the periphery, the debt crisis, and the failure of the neoliberal agenda are also discussed. In the era of globalization and great transformations in the international economy the 'new' dependency seems to be financial in nature.

**Keywords:** Dependency, Structuralism, Development

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## INTRODUCTION

Dependency theory has almost disappeared from the academic curricula – in the US at least.<sup>1</sup> The reasons are varied and beyond the scope of this paper, although it is clear that the demise of the Soviet Union and the subsequent enthusiasm for market friendly development strategies are prominent causes of the disappearance of dependency from academic programs of study. On the other hand, the surge in academic work on globalization has made several of the topics dear to authors of the dependency school relevant once again. Therefore a reconsideration of dependency theory seems to be appropriate.

There are two dependency theory traditions, namely: the American-Marxist developed by Baran, Sweezy and Gunder Frank, with important ramifications in the works of Dos Santos, Marini, Quijano and Bamberger; and the Latin American-Structuralist that builds on the work of Prebisch, Furtado and Anibal Pinto at the Economic Commission for Latin America and the Caribbean (ECLAC),<sup>2</sup> and also on Marxist historians such as Bagú and Caio Prado and is best represented by

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<sup>1</sup> For example, although prominently discussed in Gilpin (1987) dependency authors disappeared from his recent survey of international political economy (see Gilpin, 2001). Velasco (2002) wrote a short obituary of dependency theory for *Foreign Policy Magazine*, in a section called the Dustbin of History. The obituary, as Mark Twain's one, maybe exaggerated. The interesting point, however, is Velasco's description of a talk by Fernando Henrique Cardoso – a key author in dependency theory, and Brazilian president from 1995 to 2002 – in the early 1980s. Cardoso shocked the audience, and Velasco himself, by telling them that perfecting capitalism, and not socialism, was the task ahead. That had been the aim of Cardoso's brand of dependency since its inception. The lack of knowledge by a 'well trained' economist like Velasco speaks volumes about the consumption of dependency in America, to use Cardoso's apt expression. In contrast, Topik (1998) argues that dependency is alive and well in other guises, for example in the world-systems theory.

<sup>2</sup> At the time of those developments ECLAC was simple ECLA. I will use the Spanish and Portuguese acronym CEPAL in the text.

Cardoso and Faletto, Conceição Tavares, José Serra, Cardoso de Mello, Sunkel and Francisco Oliveira.<sup>3</sup> One should note that the dichotomy American-Marxist and Latin American-Structuralist does not mean that only American Marxists contributed to the first, since as it is clear Latin Americans did too, or that only Latin American Structuralists contributed to the latter, since Marxists also participated. However, the main influences are relatively well described by these two labels.<sup>4</sup>

The objective differences between the two groups – and the sometimes bitter debates – conceal the similarities between the two groups. In fact, both groups would agree that at the core of the dependency relation between center and periphery lays the inability of the periphery to develop an autonomous and dynamic process of technological innovation. Technology – the Promethean force unleashed by the Industrial Revolution – is at the center of stage. The Center countries controlled technology and the systems for generating technology. Foreign capital could not solve the problem, since it only led to

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<sup>3</sup> It is important to note that Lustig's (1980) claim that Furtado uses neoclassical categories, while Tavares uses for the most part Marxist categories is incorrect. Furtado clearly uses Keynesian categories – as he admittedly was highly influenced by Cambridge Keynesians such as Nicky Kaldor. However, his *magnus opus* on the Brazilian economy (Furtado, 1959) was highly influenced by Caio Prado, the foremost Marxist historian in Brazil. Further, the concept of surplus is an integral part of Furtado's discussion of development in all his work, a concept that is alien to neoclassical economics, but not to Marxism.

<sup>4</sup> Palma (1978, p. 23) distinguishes three approaches to dependency. The first one corresponds to what was referred here to as the American Marxists, while the other two were here conflated into one. Within our Latin American Structuralist Palma distinguishes between those that wanted to extend (Furtado and Sunkel) and those did not want to extend (Cardoso) CEPAL's analysis. While for the most part correct the distinction obscures the fact that both approaches take CEPAL as their starting point. The same arguments stand for Blomström and Hettne (1984) who distinguish four groups, namely: Structuralists, neo-Marxists, Cardoso, and Frank. Dos Santos (2002) also offers an alternative taxonomy. Finally, the contributions to dependency school outside Latin America (e.g. Amin, Emmanuel, and the world systems approach) will not be directly discussed.

limited transmission of technology, but not the process of innovation itself.<sup>5</sup> This paper argues that in that respect both versions of dependency resemble neoclassical economics, which sees technical progress, i.e. supply side forces, as the main limitation to economic growth (and development).<sup>6</sup>

The paper is divided in three sections. The following section describes the differences between the two dependency theory traditions, in particular regarding the importance of external and internal forces in the dependency relation. Then, the similarities between the two traditions and their limitations are discussed in light of the process of globalization. In particular the supply side view of the development process, that has technology as its focal point, is criticized. The role of financial dependency and its importance in the process of development is emphasized. Financial liberalization and the poor performance in the 1990s have highlighted the role of the balance of payments as the main constraint to growth. An alternative interpretation of dependency relations, one in which the role of international financial markets rather than technological change, is considered.

### **THE NEO-MARXIST APPROACH**

Traditional Marxist authors – and Marx himself – argued that the developed Nation showed the underdeveloped one the path to be followed. In Rostowian fashion underdeveloped countries would pass the same stages of development and eventually become fully industrialized. Albert Hirschman referred to this view

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<sup>5</sup> Not surprisingly several dependency authors see Schumpeter and the Schumpeterian literature in positive light. The process of development is related then to the role of the entrepreneur. Cardoso (1964) for example argues that the weakness of a dynamic national entrepreneurial class – a national bourgeoisie – is part of the explanation for Brazilian backwardness.

<sup>6</sup> We will not discuss distinctions between growth and development, but it should be clear that GDP per capita growth is only one component of development. The Brazilian economic miracle (1968-73) with high rates of GDP growth (more than 10 percent per year) and increasing income inequality comes to mind as an example of growth that does not translate into development.

as mono-economism, that is, the idea that only one path of development exists. Paul Baran (1957) was certainly a break with that tradition.<sup>7</sup> Baran divided the world into advanced capitalist economies and underdeveloped economies, emphasizing, as much as Latin American structuralists had before, the interrelation between development and underdevelopment processes in a world-centered approach.<sup>8</sup> The origins of the center-periphery relation are strictly technological and determined by the international division of labor. In other words, the center produces manufactured goods for itself and the periphery and the periphery produces commodities mainly for the center, while maintaining a relatively big subsistence system.

Baran explained the lack of dynamism in the underdeveloped world as being a result of the particular insertion in the world economy. The process of development for Baran depends on capital accumulation, which, in turn, hinges on surplus extraction.<sup>9</sup> A higher surplus leads to higher accumulation of capital and growth. According to Baran (1957, p. 164) it is in the uses of the surplus that the differences between developed and underdeveloped regions are more

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<sup>7</sup> Palma (1978, p. 1) suggests “Marxist interest in the problems of capitalism development in peripheral countries and areas of the world only began in 1957, with the publication of Baran’s *The Political Economy of Growth*.” Palma (1978), one should note, emphasizes the role of the American Marxist tradition – or more simply the Marxist tradition – rather than the Latin American Structuralist one. Emphasis on the latter would make Mariátegui (1928), Caio Prado (1942), or Bagú (1949) the starting points of original Marxist thinking on development. Ignacio Rangel and Juan Noyola are other examples of original Latin American Marxist thought that precede Baran’s book.

<sup>8</sup> There is, one should note, no reference to Prebisch, CEPAL or his followers in Baran’s book. He does quote Hans Singer, and some other structuralist authors, in passing.

<sup>9</sup> Surplus is defined as the difference of output and necessary consumption. The difference between actual and potential surplus is here ignored. It should also be noted that Baran’s heuristic model presupposes that investment depends on surplus (profits). This assumption is markedly different than the Keynesian and Kaleckian notion of autonomous spending determining income. It also, one might add, quite different from the underconsumptionist approach to Marx of Baran and Sweezy (1966).

evident. In the most backward countries, where the process of industrialization did not take a hold, and agriculture is still dominant, Baran suggests that underdevelopment results from the patterns of land tenure.

The predominance of large states in plantation systems implies that a great part of the surplus ends with landowners, which emulates the patterns of consumption of developed countries. Excessive and superfluous consumption on luxuries would then reduce the potential for investment and capital accumulation.<sup>10</sup> Hence, conspicuous consumption would be the culprit of stagnation in the periphery.<sup>11</sup> The international division of labor that promoted the export oriented plantation system in a good part of the developing world, and reinforced the need for luxury imports is then at the core of the dependency relation. However, industrial development is quite possible in the periphery as Baran clearly knew, and in that case a new pattern of dependency would emerge.

Baran (1957, p. 175) believes that industrial development in the periphery is usually founded by foreigners often in conjunction with local interests, and under the protection of tariffs and other State concessions, in a description that fits better the Latin American than the East Asian experience. Foreign capital brings the technical know-how that is lacking in the developing world. Baran admits that industrialization brought some good to the periphery, but the advantages are rather limited.<sup>12</sup> Foreign capital tends to control domestic markets, and the

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<sup>10</sup> Baran (1957, p. 168) was, however, rather strikingly against agrarian reform, since in his view a Nation constituted of small agricultural unities would be unproductive. See also Brewer (1980, p. 155).

<sup>11</sup> A similar argument was put forward by Furtado (1972). Furtado argued that while the dynamic element in the center was technical progress, in the periphery the dynamic role was taken by the consumer demand patterns. The imitation of patterns of consumption from the center that could not be sustained by the level of technological development in the periphery was the main cause of stagnation in the latter.

<sup>12</sup> Baran's discussion on foreign capital precedes and to some extent foreshadows Hymer and Kindleberger's discussion of the multinational corporation.

periphery then jumps into the monopolistic phase of capitalistic development. However, the surplus extracted by the monopolistic capital is not reinvested in productive activities in the host country.<sup>13</sup> Part of it is simply sent abroad to the parent company as profit remittances to placate their foreign stockholders, while the other part is spent on conspicuous consumption in the manner of the landed aristocracy.<sup>14</sup> Baran concluded then that the only way to break with the circle of dependency would be a political revolution.

André Gunder Frank (1967) extended the ideas of Baran to explain the historical development of Latin American – Brazil and Chile in particular – since the sixteenth century. In essence Frank's notion of the development of underdevelopment reproduces Baran's thesis that the center extraction of surplus from the periphery limits the latter ability to grow. Theotônio dos Santos (1970), in what is probably the most popular version of dependency, put forward similar ideas. Their conclusion as much as that of Baran was that only a political solution – that is, a revolution – would allow to break the circle of dependency and permit true development in the periphery.<sup>15</sup>

Two basic criticisms of the American-Marxist tradition should be noted. The first set of criticism came from classical Marxists. For them – Ernesto Laclau and Robert Brenner being the most prominent – the dependency school erroneously defined capitalism as system of world exchange, hence, for them the relations of production played a secondary role. In their view, a truly Marxist perspective

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<sup>13</sup> For recent theoretical discussions and empirical estimates of surplus extraction in the periphery and the limits to development see Yeldan (1995) and Somel (2003).

<sup>14</sup> An additional cause of stagnation in the periphery is related to the nature of monopoly capital, in similar fashion to stagnation in the core. Baran believes – in contradistinction to Schumpeter – that oligopolistic market structures tend to slow down the innovative efforts of corporations, and reduce the incentives to invest. For a discussion of Baran and surplus theorizing in general see Lippit (1985).

<sup>15</sup> Palma (1978, pp. 24-25) correctly points out that Frank and dos Santos refer to a Socialist revolution, and not a democratic bourgeois revolution.



would put the question of the ownership of the means of production and the resultant social relations in the productive sphere (i.e. the wage contract), that were essential in the Marxist definition of mode of production, at the center of stage. In that respect, the critique resembles the debate on transition to capitalism by Dobb and Sweezy in the 1950s. In both cases the emphasis on external conditions, in particular external demand (dependency and Sweezy) is seen by orthodox Marxists as a violation of the received doctrine.<sup>16</sup>

The second criticism, and the more important one for our purposes, came from what was referred to as the Latin American-Structuralist camp of dependency, and was directed towards the notion of the impossibility of industrial development in the periphery. The stagnationist thesis – initially defended, but later recanted, by Furtado (1969) too – presumed that the process of import substitution industrialization had reached its limits. Cardoso and Faletto (1967) and more emphatically Tavares and Serra (1970) would produce a definite refutation, and facts would prove them right, to a certain extent.<sup>17</sup> The effective industrial development of the periphery implied that the extreme pessimistic view of the American-Marxist approach was, at best, exaggerated.

### **THE STRUCTURALIST APPROACH**

Cardoso and Faletto (1967), although critical of Cepalist generalizations, and for that reasons defenders of the analysis of concrete experiences, were, in fact, revising and extending the Cepalist approach to development; not the least because their work was written at CEPAL. Not only is capitalism development in the periphery possible, according to Cardoso and Faletto, but also foreign capital

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<sup>16</sup> Dos Santos (2002, p. 30) notes that Frank correctly follows Bagú and Caio Prado against orthodox Marxists in arguing that there was no feudal past in Latin America. Dos Santos (2002, pp. 53-58) also notes the connection between the neo-Marxist approach to dependency and the world systems literature emphasis on external forces.

<sup>17</sup> For the stagnationist debate see Lustig (1980) and more recently Goldenstein (1994).

has a tendency to re-investment in the host country so that foreign investment may in fact crowd in domestic investment.<sup>18</sup> Hence, the nature of dependency is such that partial or dependent development is viable.

As result, dependency is not a relationship between commodity exporters and industrialized countries, but one between countries with different degrees of industrialization. Furthermore, Cardoso and Faletto brand of dependency distinguishes two dichotomies that allow classifying the political and economic situation of a given country. Development and underdevelopment remain an economic category essentially related to the degree of development of the productive structure, and, hence, to its level of technological development. On the other hand, dependency and autonomy refer to the degree of development of the political structure, and the ability or not of local political elites to take economic decision making into its own hands. As a result, dependent development in association with foreign capital was possible and did occur, according to Cardoso, in countries like Argentina, Brazil and Mexico, and in a good part of East Asia, one might add.<sup>19</sup> Arguably, these would be the countries that correspond to what Wallerstein (1979) refers to as the semi-periphery.

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<sup>18</sup> Cardoso and Faletto (1967, p. 41) talk of solidarity between foreign investment and domestic expansion. In modern terms one would refer to crowding in, that is, the idea that linkages promoted by foreign investment lead to increasing domestic capital formation. For measures of crowding in Brazil see Vernengo (2003b), for a more broad empirical coverage see Agosin and Mayer (2000), who found crowding in Asia, and crowding out in Latin America.

<sup>19</sup> Halliday (2002, p. 83) argues that critics of the American Marxists tradition like Cardoso got it right, since “industrialization, and economic growth in general, have been possible in a range of peripheral countries and on a scale that dependency theory did not envisage.” Sutcliffe (2002, pp. 50-51) also criticizes the rigidity of the American Marxist tradition, in particular “its inability to account for those developments which have not simply been a continuation of North-South polarization, for instance the extraordinarily rapid capitalist industrialization of a number of Asian countries during the last forty years.”

Cardoso and Faletto emphasized the importance of domestic internal developments, in contrast to the external forces of the world economy, as the main determinant of the situation of dependency. It is the internal political process that leads to outcomes that favor foreign actors in the process of development. Further, national capitalist development is not incompatible with the absorption of technological knowledge from multinational firms. Arguably if the goal is to achieve development, dependent development is a reasonable road to it, even if autonomous development is politically more interesting.<sup>20</sup>

For that reason, Cardoso and Faletto were among the first to note that stagnation was not inevitable for Latin America, and that growth could in fact resume after the cyclical crisis of accumulation that followed the wave of investments of the developmentalist policies of the 1950s.<sup>21</sup> Tavares and Serra (1970) formalized the idea and showed that income redistribution to the higher income groups – de facto creating an upper middle-income class in Brazil – had allowed the so-called Brazilian Miracle. Tavares and Serra also argued that chronic instability would come together with the recovery as a result of the lack of capacity to generate domestically endogenous technical progress. In that respect, they hint that more than mere transfer of technology from the center, Latin American countries should be able to generate their own dynamics of technological innovation, what later neo-Schumpeterian authors would refer to as a National System of Innovation.

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<sup>20</sup> In that sense, one may interpret Cardoso's administration (1995-2002) alignment with the liberalizing policies of the Washington Consensus as the recognition that autonomous development was not possible for Brazil, and that dependent development was the only alternative. See Fiori (1997) and Rocha (2003) for arguments along those lines, and for similar early critiques of the Lula administration see Oliveira (2003), and Vernengo (2003a).

<sup>21</sup> O'Donnell (1982) argued that the political constraints to dependent development were lifted by the military coups in Latin America that came to promote development in authoritarian guise. Bureaucratic authoritarian rule would do what liberal democracy was unable to accomplish.

The importance of technology, the role of multinationals in the process of technology transfer, and the role of the State in promoting technological innovation through industrial policy then became the focus of the Latin American Structuralists. The specific historical conditions of development of different stiles of capitalism in the periphery become part of the agenda of research.<sup>22</sup> The main difficulty as seen by the Latin American approach to dependency was taken from the old structuralists, and was associated to the hard phase of import substitution, that is, the implementation of a domestic capital goods sector. In particular, the need for import of capital goods would imply that the balance of payments could impose a serious constraint to economic growth.<sup>23</sup>

Policies that would enhance systemic competitiveness in international markets were seen as the main tool to promote development.<sup>24</sup> The preoccupation shifts from the technological gap with the center to the clear gap between Latin America and the more successful industrialization of East Asian economies. The study *Transformación Productiva con Equidad* (CEPAL, 1990) is preoccupied with the successful integration of Latin America into the world economy. The changing structure of international markets, where the Fordist paradigm is

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<sup>22</sup> For example, Cardoso de Mello (1975) and Evans (1979) discuss the specificities of dependent capitalist in Brazil. For a more general analysis of Latin America see Fajnzylber (1983).

<sup>23</sup> An idea that was also dear to Cambridge Keynesians and that is alive in the post-Keynesian tradition (e.g. Davidson, 1990). Intellectual cross-fertilization resulted from the fact that Michael Kalecki and Nicky Kaldor taught at CEPAL in the 1950s. Furtado, Sunkel and other Cepalists also spent sabbatical periods or were educated in the British academia.

<sup>24</sup> Systemic or authentic competitiveness reflects the ability to compete based on higher productivity, in contrast to what Fajnzylber referred to as spurious competitiveness based on lower wages. Fajnzylber is arguably the most relevant author of this new phase of CEPAL's thinking on development, which might be named neo-structuralist even though it moved considerably in the direction of the liberal views on development, in particular, its emphasis on liberalization as a strategy to avoid technological isolation in an era of technological innovations in the information technology and biotechnological sectors. For a thorough discussion of the evolution of Cepalist ideas see Bielschowsky (1998).

transformed by flexible specialization techniques or Toyotism is crucial in this view. Export orientation and a greater degree of openness were then seen as part of a strategy to reduce technological dependence.<sup>25</sup>

The implicit diagnostic is that although development had been possible, import substitution was unable to eliminate the structural heterogeneity of the productive structure, or to diversify the exports in the region. The lack of a proper export insertion and bad macroeconomic management (i.e. excessive fiscal deficits) is then seen as the cause of the debt crisis. The solution, for neo-structuralists, lies in a stable macroeconomy and microeconomic (industrial) policies that stimulate niches of technological innovation that may include foreign capital participation (CEPAL, 1990).

However, the Latin American Structuralist version of dependency, in refuting the American Marxist emphasis on the relevance of external factors, went to the other extreme and claimed that internal forces were the almost exclusive determinant of development. The inability to generate a domestic dynamic of technical progress incorporation, the domestic patterns of consumption, and the limitations of the domestic elites were to blame. If the successful industrialization of the periphery showed the weakness of the American Marxist tradition, then the debt crisis and the failure to renovate the process of development in the 1990s proved that the optimism of the Latin American Structuralist approach was not guaranteed. If rates of growth before the debt crisis had been spectacular, and

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<sup>25</sup> It should be noted that Raúl Prebisch – who shaped CEPAL’s thinking in its Import Substitution Industrialization (ISI) phase – had moved in the early 1960s, before he became Secretary General to the United Nations Conference on Trade and Development (UNCTAD), to defend a more important role for export promotion in the process of development (Bielschowsky, 1998). Also, countries like Brazil had moved by the late 1960s towards an export oriented strategy. Hence, the idea that ISI was still the dominant strategy on the verge of the debt crisis seems inaccurate to say the least.

Latin America had caught up with the central countries, the region stagnated in the two decades that followed.<sup>26</sup>

More than the lack of technological dynamism of the import substitution industrialization, or the perverse composition of demand, or the lack of dynamism of its elites, all of which are emphasized by neo-structuralists, what the debt crisis revealed was a considerable degree of financial dependence.<sup>27</sup> It was the hike in interest rates in the United States that forced the reversion of capital flows, led to massive capital flight and the Mexican default of August 1982, and through contagion effects to the rest of the region. The crucial difference between Latin America and the more successful industrialization experiences in the periphery was the higher degree of financial openness of the former and the more financially repressed structure of the later. Hence, the real solution for the stagnation of peripheral countries – as defended by the Latin American Structuralist approach to dependency – based on dependent and associate (to foreign capital) industrialization proved to be short lived.

## **FINANCIAL DEPENDENCY**

Financial deregulation in Latin American resulted from American pressures, which were made more effective after the end of the Bretton Woods system. The collapse of Bretton Woods in the early 1970s foreshadowed an era of more open and deregulated global financial markets. In fact, the pursuit of such open financial markets by American authorities is one of the reasons for the collapse of

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<sup>26</sup> Chile would be the exception that proves the rule. Some other Latin American countries experienced a growth bubble in the immediate post-liberalization period. However, it is painfully clear by now that the Washington Consensus policies were not effective and that low growth equilibrium still prevails in the region.

<sup>27</sup> In fact, Dani Rodrik (1999, p. 71) argues that “contrary to received wisdom, ISI-driven growth did not produce tremendous inefficiencies on an economywide scale. In fact, the productivity performance of many Latin American and Middle Eastern countries was, in comparative perspective, exemplary.”

Bretton Woods. The oil shocks and the cost pressures that followed implied that initially real interest rates were negative. However, that was but a short-term accident. Overall interest rates have been on average higher in the post-Bretton Woods period than during the so-called Golden Age period, that is, the post-World War II period up to 1973.

In the late 1970s Paul Volcker, the then chairman of the Federal Reserve Board, hiked interest rates. Real interest rate became strongly positive, and remained so for a long period. Smithin (1996) refers to the interest rate shock as the revenge of the rentier. That is, the rentier class that was under attack during the Bretton Woods period – which ultimately had imposed Keynes' euthanasia of the rentier – was able to impose higher rates of remuneration at the expense of the rest of society. Interest rates increased in the rest of the world, in tandem with the American rates. Higher interest rates were the inevitable outcome of the collapse of Bretton Woods and the more open international financial system that followed. The elimination of capital controls in several developed and developing markets meant that central banks around the world could compete for speculative capital flows. Also, more volatile exchange rates meant that international speculators would pursue arbitrage possibilities from perceived or real exchange rate misalignments.

The golden age of growth during the ISI period in Latin America resulted not only from the strategies of the developmental State, but also from the favorable environment of restricted capital flows and stable but relatively devalued currencies.<sup>28</sup> Lower rates of interest were particularly important in allowing government expenses to increase without leading to explosive public debt accumulation. Capital controls and managed exchange rates allowed to keep foreign debt under control. In fact, Latin America's foreign debt explodes in the

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<sup>28</sup> In fact, capital controls allowed for preferential systems, which promoted devalued currencies for exporters, and effectively appreciated currencies for importers. Multiple exchange rate systems were fairly common during the Bretton Woods era.

1970s as a result of the recycling of the petro-dollars, at a time when the ISI strategies were out of the agenda in most countries, and when some countries had already switched to the neoliberal agenda (e.g. Argentina, Chile and Uruguay).

If financial deregulation had negative consequences for Latin America, the holders of the international reserve currency – the U.S. – would benefit, or at least some groups within that country. For that reason, the U.S. has been a promoter of financial deregulation directly and through its international agents – the International Monetary Fund and the World Bank. Some post-Keynesians emphasize the role of financial liberalization in the collapse of the Bretton Woods regime. Paul Davidson (1982) argues that the U.S. dollar represents the asset of ultimate redemption, and hence is used as the measure of international liquidity. As a result the U.S. benefits from a more liberal financial system, since the centrality of U.S. financial market allows it to attract funds to finance persistent current account deficits.<sup>29</sup>

Before discussing whether the American foreign debt is sustainable or not – a question that has been fiercely debated during the last twenty five years – let me emphasize the main point, namely: the existence of an international monetary hegemon that controls the international reserve currency implies that the global dependency relations do not suppose international disparities in technology or the ability to produce technology or a monopolistic international market structure, even if those conditions actually exist.<sup>30</sup>

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<sup>29</sup> The liberal newspaper *The Economist* has recently singled out Paul Davidson and Ronald McKinnon as the two most prominent defenders of the idea that a dollar crisis is unlikely.

<sup>30</sup> A different criticism of dependency is raised by Grosfoguel (2000), emphasizing the underestimation of culture and the over emphasis on economics and politics within the dependency tradition. The exception would be Anibal Quijano that used the concept of 'coloniality of power' to emphasize the continuity of power relations from colonial to modern times.



An economy whose currency is used in international transactions as unit of account, means of payment and as international reserve, and that provides its currency to satisfy the international needs of trade is in an exceptionally advantageous position. In particular, the currency that acts as international money is well positioned to dominate the debit and credit relations at the heart of the capitalist world system (Rochon and Vernengo, 2003). These debit and credit transactions are organically connected to the process of capital accumulation.

Keynes presented in his *Treatise on Money* the definition of money that most post-Keynesians would still accept as accurate. For him, money-of-account, the money in which debts and general purchasing power are expressed is the primary concept of a theory of money. That is, money comes into existence along with debts, which are nothing more than contracts for deferred payment. Contracts are essential to the phenomenon of money, and the existence of institutions which can enforce the discharge of contractual commitments for future action are essential in providing confidence in the future of the capitalist system.

Also, world systems authors have emphasized the importance of international financial hegemony. Giovanni Arrighi (1994) starts his discussion of the long twentieth century by analyzing the four cycles of accumulation that constitute the succession of hegemonic cycles from the inception of capitalism to modern times. The Genoese, Dutch, British and American cycles of accumulation are marked by the financial hegemonic power rather than territorial domination, even if colonial domination was in some cases part of the cycle. The so-called territorial cycles associated to Venice and the Iberian countries are relegated to a secondary role. The point is exactly that financial dominance rather than territorial domination is the essential feature of the hegemonic cycles.<sup>31</sup>

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<sup>31</sup> Clearly by relegating territorial dominance as the essential feature of hegemonic power to a minor role in the process of accumulation, then it follows that the role of the technological division

Financial domination implied that persistence balance of payments imbalances could be maintained for long periods. The American trade deficit that persists since 1981 is only the last of a long series of persistent imbalances. Arrighi (1994, p. 249) refers to it as “the age-old problem of a structural imbalance in West-East trade.” The current accumulation of dollars by the Chinese and the Japanese reproduces the old Chinese accumulation of American silver during the colonial times.

Tavares (1985) was the first to recognize that the old structuralist – as well as the more recent neo-structuralists – got it wrong, and that the end of Bretton Woods did not represent the end of American hegemonic cycle, but quite the opposite, and that the diplomacy of the dollar was the real instrument of power, the technology of power so to speak.<sup>32</sup> Tavares (2000, p. 133) notes that dollar diplomacy forced Latin America into a *longue dureé* crisis, whose end is still not in sight.<sup>33</sup> In particular, Tavares notes that the technological division of labor in which the periphery concentrates in the production of commodities for the center, while the latter produces manufacturing goods for the former is of very limited historical relevance. Industrialization and technical progress in the periphery was not sufficient to break the dependency ties with the center. The financial dependency reflected in the inability of peripheral countries to borrow in

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of labor, and the surplus extraction from the periphery is greatly reduced in explaining dependency. Arrighi (1994, p. 33), in fact, seems to consider that territorialist rulers are not capitalist. For him, “territorialist rulers tend to increase power by expanding the size of the container [while] capitalist rulers, in contrast, tend to increase their power by piling up wealth within a small container and increase the size of the container only if it is justified by the requirements of the accumulation of capital.”

<sup>32</sup> Several authors have claimed that American hegemonic power is waning. Arrighi (1994) and Wallerstein (2003) are among the most forceful.

<sup>33</sup> This view that emphasizes financial, rather than technological, dependency is associated to Tavares and her followers at the Universidade Federal do Rio de Janeiro and Unicamp. The collection of essays edited by Fiori (1999) is representative of this tradition.

international markets in its own currency, present since the first debt crisis in the late 1820s until the most recent Argentinean default in 2001, is the real obstacle to development.<sup>34</sup>

In that respect, the external debt crises of peripheral countries are a recurrent phenomenon, a characteristic of the center-periphery interaction. Suter (1989) compares the debt-cycles to the long waves of technological innovation often referred to as Kondratieff or Kuznets cycles. Technological dependency – the inability to generate autonomous technological innovations – although important, is subsidiary and financial dependency – the inability to borrow in its own currency – is central.

Further, one should note that the reverse position, that of the international hegemon is not without risks. Arrighi (1994, pp. 27-28) notes that hegemony implies the power of a state to exercise functions of leadership over a system of sovereign states. Hegemony, following Gramsci, implies a mix of coercion and consent. The role of the dollar since the end of Bretton Woods has given, in fact, more rather than less coercive power to the U.S. in the sense that manipulations of the interest rate by the Federal Reserve Board have great power over capital flows, at the same time that the gold requirements of the Bretton Woods system, that ultimately restricted American policy choices are gone.<sup>35</sup> However, the role of the dollar as international reserve currency depends on the consent, i.e. the willingness to hold dollars, mainly of Japanese and Chinese authorities and investors. In a world without alternatives, the risks are relatively limited, and in

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<sup>34</sup> The inability to borrow in its own currency has been dubbed the 'original sin' in more conservative circles (Hausmann, 1999).

<sup>35</sup> In fact, the U.S. has basically followed a monetary policy that privileges domestic issues. In a recession interest rates are drastically reduced, and then raised as recovery goes on. The dollar has then fluctuated over medium term cycles, associated to interest rate variations at home. On the other hand, countries in the periphery are generally forced to hike interest rates in the midst of a recession. In other words, center countries can pursue counter-cyclical policies, while peripheral countries in general cannot.

that respect the appearance of the Euro in 1999 increases the dangers of the American foreign exposure.

However, one must note that transitions from one hegemonic international currency to another are slow processes, and there are several reasons to believe that the relatively short-lived run of the dollar is not near the end. Serrano (2003) notes about a third of the American current account deficit with foreign residents is in fact due to imports from subsidiaries of American multinationals. Foreign debt to GDP – which is denominated in domestic currency for the U.S. – is still at low levels by international standards. Given the incredible relevance of the dollar as vehicle currency in international trade and the inertia implicit in those institutional arrangements it will certainly not have any difficulty in finding sellers in international markets willing to accept dollars as payment for its imports. More importantly, for the purposes of understanding dependency theory, even if at some point in the near (or distant) future there is a switch towards the Euro, or any other contender, it is clear that financial dependency in the periphery will not disappear with the fall of the dollar.

### **CONCLUDING REMARKS**

Financial hegemony eliminates the balance of payments constraint and allows the dominant country to grow foreign exchange limitations. In fact, the hegemonic country not only provides the international reserve currency, but also is the main provider of global effective demand. This would suggest that if the balance of payments is the main constraint on growth for the periphery, then restrictions on domestic demand growth are the main limitation to growth in the hegemonic country.<sup>36</sup> This view contrasts with mainstream authors – and several

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<sup>36</sup> This was exactly the point of Baran and Sweezy (1966) stagnation thesis. In fact, Baran and Sweezy shift the focus of the limits to capitalism from the supply side, the falling rate of profit, to the demand side, the realization crises. In that respect, they are in line with the demand-oriented approach first raised by Sweezy in his debate with Dobb on the transition to capitalism. Their

heterodox ones too – that consider that supply side constraints are the main limitation on growth not only for the periphery, but also for developed countries.

In the alternative view, then, demand-led growth is possible because it does also affect the supply side restriction. Demand expansion by forcing the economy to work at near full capacity promotes technical progress. As the saying goes “necessity is the mother of invention.” That is, economies that are under pressure of increasing demand need to create new processes of production, new forms of organization and new products to be ahead of demand. The technical developments in turn generate higher levels of output and income, which translate in a new expansion of the demand, and a cumulative process of accumulation follows.<sup>37</sup>

According to this view policies that promote full employment and demand growth are desirable, since they are self-reinforcing. In the case of the hegemonic country the balance of payments does not impose a limit on demand expansion. In the case of the periphery, export-led growth is the only source of demand growth that does not lead to recurrent balance of payments problems. Not surprisingly several authors have described the East Asian experience as a case of the Smithian vent for surplus theory, in which foreign markets provide an outlet for domestic production, promoting demand-expansion and higher levels of productivity growth.<sup>38</sup>

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work, hence, is an underconsumptionists approach of Marx based on Kaleckian dynamics. See Rowthorn (1981) for a formalization of Baran and Sweezy’s arguments.

<sup>37</sup> The theoretical origins of cumulative causation are to be found in the work of Gunnar Myrdal, Nicky Kaldor, and have been formalized, in the context of open economies, by Anthony Thirlwall (see Davidson, 1990). Verdoorn’s Law underscores the idea that growth promotes technical progress. For a discussion of the Cambridge origins of cumulative causation see Vernengo and Rochon (2001).

<sup>38</sup> Brenner (1977) noted the neo-Smithian elements of those that emphasized the role of demand, and world markets in the process of development, albeit in a critical perspective.

A caveat though is important at this point. Export-led expansion as a development strategy for the periphery is not a panacea. If the neo-Marxist 'dependencistas' exaggerated the tendency to stagnation, and the structuralists saw the possibilities of growth associated with integration with world markets, then the limitations of the latter perspective are worth noticing. Export-led growth is limited by the growth of world markets, which is ultimately highly dependent on the expansion of central countries. Also, in a world with relative open capital accounts, peripheral countries would be forced to keep interest rates too high, in order to attract capital flows, and/or avoid capital flight. High interest rates then lead to contractionary forces that may very well overwhelm any expansionary force from external markets. For that reason export-led strategies would be more successful in 'Bretton Woods' like environments, in which capital controls are widespread.

In that respect, many Latin American structuralists have moved to emphasize the need to reform the international financial system to provide the conditions for demand-led growth to flourish in the region once again (e.g. Ocampo, 2000). The financial turmoil of the 1990s generated a deep sense that reforms on the structure of the international financial system were needed.<sup>39</sup> This contrasts with the positions from the extreme right and the extreme left that would prefer a complete revolution in the international financial system, eliminating the IMF, and other multilateral institutions. Reform of international financial institutions, rather than a complete overhaul is a necessary (but not sufficient) precondition for the renovation of the process of development in the periphery. In that respect, the reformist tendencies of the structuralist version of dependency rather than the

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<sup>39</sup> Although Ocampo was the Secretary General of CEPAL, there is no official document that shows that the institution is committed to reforming international finance, which would represent an important break with the long term emphasis on trade and technology issues privileged by CEPAL. Bresser Pereira (2000, p. 20) points out that at this point there is no clear consensus on development strategies, but everybody would agree that the growth with foreign debt strategy is a very dangerous one. Bresser, however, does not take the next step in arguing for a more closed international financial environment.

revolutionary element of the neo-Marxist approach seems to be dominant in Latin American radical political economy. On the other hand, the structuralist optimism in the internal ability to break with dependency, has given place to the more pessimistic neo-Marxist emphasis on external factors, financial dependency in particular, in perpetuating the cycle of dependency.

In sum, the reduced relevance of strict definitions of the technological division of labor, and the theoretical problems caused by the effective industrialization of several countries in the periphery, shows that trade and technological dependency are less important. In the era of globalization and great transformations in the international economy the 'new' dependency seems to be financial in nature.

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