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The Backwardness of Nations: Development challenges in the theories of Evgeny Preobrazhensky and Raúl Prebisch

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Abstract

This article surveys the views on economic development of two protagonists of developmental policy in the former Union of Soviet Socialist Republics (USSR) and Latin America: Russian economist Evgeny Preobrazhensky (1886-1937) and Argentine economist Raúl Prebisch (1901-1986). Although the two thinkers started from different analytical premises and developed their theories in diverse social and political settings, there is a basic commonality between the two since the examination of the nature and causes of economic backwardness became the mainstay for stepping up their own economic policies to trigger a developmental process. Each in his own way advanced the idea that backwardness is not a necessary first step of economic development, to be overcome only through economic policies that encourage thriftiness and entrepreneurship and avoid excessive state interference in the economy. To the contrary, for them, backwardness is a result of the dependence of a capital-poor economy on the world economic system. Their studies of backwardness highlighted not only economic, but also political and social obstacles that the peripheral countries must face in their strategies to move toward sustainable development.

Key words: theory of economic development, Prebisch, Preobrazhensky.
JEL **Classification**: B31, B24, O11, O14, O21.

Introduction

The twentieth century was a time when economic development became a predominant idea for governments and national elites across the globe. The history of both Russia and Argentina in the same century provides salient examples of the struggle against economic backwardness and of attempts to secure the

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means to stable and sustainable development. Even taking into account all the well-known failures, one cannot dismiss the fact that these attempts resulted in profound changes in the two countries; and the consequences are still affecting the contemporary situation of both. Naturally, both strategies of developmental policy began from different historical and social starting points and also differed in their political implementation. Still, some general features were not completely dissimilar: 1) the drive to industrialization as a way out of backwardness; 2) the import substitution strategy; and 3) the regulation of foreign trade.

Economics practitioners were not the only contributors to the process of designing modernization strategies; in fact, the drive to development itself affected the shaping of modern economics. To study the interplay between politics and economics, we chose, as case studies, the theories of economic development of two protagonists of industrialization in the USSR and Latin America: Evgeny Preobrazhensky (1886-1937) and Raúl Prebisch (1901-1986). Each in his own way tried to design economic policies to foster development, to react to the developmental challenges, and to influence the actual course of events as policy-makers and economic advisers. Despite the fact that they began with different theoretical approaches (Marxist in the case of Preobrazhensky, and neoclassical, though very aware of Keynes's *General Theory,* in the case of Prebisch),[1] their conclusions were strikingly similar.

For both Preobrazhensky and Prebisch, the diagnosis of their own underdeveloped economies was backwardness: lagging behind the industrially developed countries in technological progress and structural changes as revealed and sustained by their involvement in world trade. Understandably, given the similarity in the diagnosis of these two development economists, both theories offered the same prescription for backward economies: industrialization, that is, putting the priority on developing the industrial sector, accelerated by policy regulations, despite the national and international "natural" obstacles. The two economists were frequently criticized for their alleged neglect of the primary sector. Far from this being true, however, they believed that an increase in productivity in the industrial sector is a condition *sine qua non* for the rise in productivity of the other sectors, especially because, by and large, job creation in industry rises faster than in the primary sectors. Hence, the key to economic development was the industrial sector. Both economists considered this the

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1 In 1947, Prebisch published an *Introducción a Keynes.*

central concern for overcoming the problems of underdevelopment in their respective geographical regions, and, indeed, this constitutes the linkage between them, despite the fact that one of them aimed for it via the socialist path and the other, via a liberal-Keynesian route.[2]

Naturally, it could possibly be argued that an examination attempted here of the two theorists' economic approaches seems a little odd. Indeed, as already mentioned, in terms of their respective theoretical backgrounds, Preobrazhensky was a Marxist, while Prebisch was a liberal-Keynesian, and no doubt they differed regarding which socio-political system was the most appropriate set-up for boosting accumulation, for more progressive distribution, and for social participation.[3] Preobrazhensky was a staunch defender of the socialist state and the planning strategy initiated after the revolution in Russia;[4] but Prebisch, although he showed "a great respect for what has been achieved [in the Soviet Union]" (Prebisch, 2008: 33), sought "a synthesis between socialism

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[2] This term must not be misunderstood. By Liberal-Keynesian we simply mean that Prebisch's ideas welcomed the participation of the state in the economic sphere, and at the same time did not deny the market system as the main regulator of the capitalist system, at least for the period we are presently concerned with (*i.e.*, the late 1940s through the 1960s). For a detailed analysis of Prebisch's ideas concerning economic theories *and* political systems, see Prebisch (2008).

[3] According to a recent biography (Dosman, 2008), Prebisch's concern for social participation and redistribution of social wealth to the lowest strata of society may be traced to his background in his early youth: "Like his father, Raúl [Prebisch] grew up with a middle-class disdain for the Argentine oligarchy, loathing in particular the sugar barons in Tucuman [a province appropriate for cultivation of sugar], whose labor practices made it the most socially backward province of the country" (Dosman, 2008: 17).

[4] Preobrazhensky is one of the handful of internationally renowned Soviet economists. It may be said, in fact, that his writings received much more attention abroad than in Russia, where they had been virtually forgotten since the 1930s. In Russia his ideas were explicitly uncovered for the history of economic thought only at the end of the 1980s, while, abroad, Preobrazhensky's contribution to the studies of economic development had been widely recognized at least since the 1950s.

With the fall of socialism, interest in the problems of non-capitalist development has greatly diminished in economic literature both in Russia and abroad. Today the name of Preobrazhensky appears in the description of clashes between the approaches to industrialization of the 1920s. As usual, a closer consideration of the case reveals some complications. A widespread view that Stalinist industrialization generally followed the lines prescribed by Preobrazhensky and the other left-wingers within the party was subject to criticism (see, for example, Dobb, 1965: 207-8). Preobrazhensky being labeled "a member of the left" hides the evolution of his theory, as well as the diversity within the left. The list of complications may be enlarged, however; Preobrazhensky was deservedly credited by all commentators for posing the problems faced by a backward economy moving toward rapid industrialization. In the second half of the twentieth century, his writings provided an insight not only into the origins of the Soviet socialist economy, but also into the theory of economic development (and underdevelopment).

and liberalism or, if preferred, a version of socialism based on the freedom of the individual and on new patterns of social coexistence" (2008: 32). And yet it is worthy of note that Prebisch saw the Soviet Union system as a "great social experiment" in which "an enormous and deliberate effort has been made in respect of accumulation and equitable distribution" (2008: 33); his concern was that the State ownership of the means of production has had consequences that "are incompatible with the aspirations of democratic liberalism and its inherent values" (2008: 33). It would thus seem that what is at odds between the two thinkers is, in any case, which socio-political system is best for enhancing the living conditions of the masses in their respective countries. No doubt, Prebisch's concern with liberal values has to do, ultimately, with his profound adherence to democratic liberalism: "a legacy which we have inherited from Western civilization, whose full significance is never better felt and understood than when those principles are violated and eclipsed" (2008: 33). But the concern of this article is not to examine the political differences between the two economists. Indeed, our comparison will closely follow a narrower focus, by strictly concentrating on some aspects of the economic thought held by the two thinkers. And, then, when we look at the underlying economic thought and strategies pursued in light of their respective development theories, we will likely find that their economic approaches share many concepts, strategies, and diagnoses of the problems in their respective regions.

In fact, rough affinities between the economic approaches of Prebisch and of some twentieth-century Eastern European Marxists (Preobrazhensky included) have already been noticed in the literature (Love, 1980: 61-2 and 70-1; see also Cooper, 1994: 21-2). This affinity is even more peculiar as there are no indications of any direct influence of the chronologically previous studies of underdevelopment in Eastern Europe during the interwar period on the center-periphery approach developed by Prebisch and his school after World War II. But the history of ideas precisely provides examples of the reverse linkage, when new analytical developments allow us to shed light on previously unnoticed or forgotten names and approaches. For example, we can appreciate the arguments raised by Preobrazhensky (1926) in discussions regarding the choice between importing means of production or making them at home, when he referred to the chance of "improving and cheapening our own products", a clear indication of the old arguments of the infant-industry approach, relying on necessary technological transformations to boost and sustain industrialization

(List, 1885). And, more importantly for our case study, for Prebisch technological transformations, which are the underlying issue involved in developing countries' attempts to change their relationships with the international economy, played a fundamental role in the development of his theory of the deterioration of the terms of trade –as will be seen in this article– and hence in his proposal of industrialization of the so-called *periphery*. Indeed, the center-periphery approach had greatly contributed to the shaping of development discourse since the early 1950s, and, interestingly enough, it was in that context that Preobrazhensky's ideas were discovered in Latin America and elsewhere.[5] Therefore, regardless of their initial assumptions, the two authors came to not dissimilar conclusions and influenced subsequent studies of peripheral capitalism. This is our ultimate motivation for pursuing this research.

By showing similarities and divergences in the approaches to the problem of economic development proposed by Prebisch and Preobrazhensky, our main aim here is to restore an understanding of how these two economists conceived of the obstacles and limits for their regions for attaining an effective level of development, and hopefully, to draw some lessons for present-day policy-making in Latin America as well as in Russia (providing an interesting case study of renascent peripheral capitalism).

Besides this introduction, this article consists of three sections. In the following we examine what backwardness is for both Preobrazhensky and Prebisch. Despite the different economic theories that both thinkers originally endorsed, the analytical role that the concept of backwardness exerts on their own economic diagnoses and policies will become apparent. Subsequently, in the third section, we extend the examination of the role played by the concept of backwardness in each author's theories by linking its self-reproduction in underdeveloped countries with fluctuations in the world economy. In this regard, we also briefly examine in this section the causal relationships between economic and social upheavals in light of both theories of economic development discussed here. The work ends with the presentation of our conclusions.

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[5] As stated above, Preobrazhensky's legacy began to be absorbed into development discourse outside Russia in the 1950s (Erlich, 1950) with subsequent translations of his works into several languages. In the Spanish-speaking world, his *New Economics* was first published in Argentina (Preobrazhensky, 1968) followed by two other editions (Preobrazhensky, 1970; 1971). Some recent examples of references to his ideas in the context of development studies can be found in Zermeño (2004); Gandásegui (2007; 2008); and Miranda Parrondo (2009).

What is backwardness?

At the turn of the twentieth century, the concept of backwardness was by no means a novelty for economic science. Indeed, perceived lags in the levels of economic development (which was basically measured as accumulated wealth) of one region or country, compared to the developed ones, chosen as reference points, were among the most influential factors in the rise of mercantilist literature. Later on, critics of the *mercantile system* did not deny the very phenomenon of backwardness; rather they incorporated it into their broad concept of progress resulting from the free interplay of *economic forces*:

> There seems to be a happy concurrence of causes in human affairs, which checks the growth of trade and riches, and hinders them from being confined entirely to one people; as might naturally at first be dreaded from the advantages of an established commerce. Where one nation has gotten the start of another in trade, it is very difficult for the latter to regain the ground it has lost; because of the superior industry and skill of the former, and the greater stocks, of which its merchants are possessed, and which enable them to trade on so much smaller profits. But these advantages are compensated, in some measure, by the low price of labour in every nation which has not an extensive commerce, and does not much abound in gold and silver. Manufactures, therefore gradually shift their places, leaving those countries and provinces which they have already enriched, and flying to others, whither they are allured by the cheapness of provisions and labour; till they have enriched these also, and are again banished by the same causes. (Hume, 1752: II.III.3)

The idea of the uniformity of a linear pattern of development, in which "the country that is more developed industrially only shows, to the less developed, the image of its own future" (Marx, 1867), was an integral part of the *philosophy of history* shared by the representatives of classical political economy (regardless of all the differences as to the possible final outcomes of the development process, whether it be eternal prosperity, secular stagnation, or proletarian revolution). Basically, the same idea affected the treatment of economic development by a major part of the economics profession.

The concept of backwardness as an initial asset allowing for "latecomers" to catch up rapidly with the leaders in the world economic race did not remain unchallenged, however. Preobrazhensky and Prebisch contributed a great deal to redefining the concept of backwardness and, thus, to the emergence of twentieth-century dependency analysis. However, it was not their initial assumption, but, rather, one of the outcomes of their analysis, as this article attempts to show.

Evgeny Preobrazhensky

Maurice Dobb, one of the first Western economists (if not the first) to comment on the Soviet industrialization debates of the 1920s, noted almost 40 years later that one of the reasons the debates had remained unnoticed by English economists was the "tiresomely unfamiliar concepts" and "a strange jargon" used there: "It did not seem to fit into their categories of thought, still set in a very Victorian mold, from which only a few were emerging" (Dobb, 1965: 198).

But in the 1960s: "[the] study of growth, balanced or unbalanced, development and dynamic equilibria are all the rage; and it is academically fashionable to conduct empirical studies of 'underdevelopment'. In this more realistic context, the relevance of those 40-year-old debates is beginning to be appreciated; they are going through the process of being 'rediscovered' (even if sometimes rather condescendingly) and the extent of their originality is being recognised" (Dobb, 1965: 198).

Preobrazhensky, as well as other Soviet economists, his adversaries and followers alike, had been far from having purely theoretical interests when he seriously started considering the problems of economic development in Russia. He had come to the forefront of Soviet economic studies directly from the battles of the civil war. He clearly understood (and it was broadly acknowledged) that the struggle was going on and that its final outcome would depend on the rate of economic growth the new authorities could achieve. Indeed, the Bolshevik theoreticians had in mind a very practical aim: to preserve the power seized in the revolution and the civil war. They had no doubts that the industrialized sectors, both in industry and agriculture, once established, would easily prove to be a good deal more efficient than the peasant sector (petty bourgeois producers, as they were generally called at that time), retailers, middlemen, and scalpers. Indeed, the agricultural sector was backward, supported with fifteenth-to-seventeenth-century technologies, and characterized by a huge excess population and lack of capital accumulation.

The 1917 revolution brought about a paramount change in the distribution of national income. In 1918, Preobrazhensky pointed out that the revolution would bring significant relief for peasants' incomes as it had abolished the heavy burden of pre-revolutionary taxation (along with Tsarist Russia's huge foreign debts) and boosted the village's purchasing power (Preobrazhensky, 1918: 11). Hand-in-hand with an increase in their purchasing power, the peasants enjoyed a greater independence from markets, which originated from confiscation of the lands from the landlords. Industrial output, on the other hand, did not grow at the same pace during the period of structural change in Russia's economy. In 1923, the phenomena of "price scissors" had been harsh. Industrial commodity prices were growing relatively faster than foodstuffs and agricultural prices. Facing the deficit in industrial commodities, the peasants were inclined to store their marketable surplus, instead of selling it. Consequently industrial goods markets were glutted with huge, unsold stocks. Soviet economists generally agreed to the description of the problem, but they differed in the diagnosis.

Lack of industrial capacities would inevitably lead to a mismatch between demand and supply and, therefore, endanger the accumulation program based on the priority placed on large-scale, state-owned industry. This was the diagnosis Preobrazhensky developed. Objecting to the widely held opinion that the crisis was the result of a lag in development of the planned economy mechanisms (*i.e.*, that it was caused by external factors), Preobrazhensky replied: "Price scissors are based on relations spontaneously generated within the economy itself, which could only partially be changed through planning" (Preobrazhensky, 1924: 49).

Surprisingly for a "left-winger", Preobrazhensky emphasized the need to count on market exchange to effectively develop the socialist economy. For him, backwardness was precisely the problem that caused the need to count on commodity-money relations in both national and international markets. In his view, the effects of the law of value (that is, the distribution of resources and productive forces governed by market forces) on the socialist economy had to be carefully studied in order to curb its negative influence and to use it for capital accumulation. But, essentially, he saw these effects as antagonistic to the task of industrialization. He underlined that the construction of socialism (which was synonymous with the modern industrial sector) was "irrational" from a capitalist point of view: "The task of socialist accumulation requires a different distribution of labor forces than that which would have arisen under the free effect of the law of value" (Preobrazhensky, 1926: 31).

According to Preobrazhensky, in a situation in which both the industrial and agricultural sectors were backward, only the increase in the former would allow positive development in the latter. In order to modernize and intensify the agricultural sector, it was necessary to build up a powerful state-owned socialist industrial sector. Yet 'the law of value' was regarded as one of the chief obstacles to attaining that goal.

Analyses by Preobrazhensky revealed that the underdeveloped structure of the Russian economy would permanently give rise to excessive demand. The mismatch could not be overcome without a proportional increase in supply, which was hardly implausible in the short run. A relative *rise* in agricultural prices, although possible as an immediate solution through state-controlled trading organizations' price policy, was not an appropriate solution at the level of the whole system; it would result only in a redistribution of income: "The peasants would purchase more, while the urban population would purchase less; only the structure of demand […] may change, but not the capacity of demand as a value magnitude, for it presents itself as a fairly stable magnitude in any given period of time" (Preobrazhensky, 1924: 30).

On the contrary, a relative *fall* in agricultural prices would induce the peasants to leave the market for a subsistence economy. Instead, as an effective solution Preobrazhensky initially had proposed encouraging the export of agricultural products to balance their excessive supply: "It is wrong to speak of the sheer rise in grain prices; it is appropriate to speak of the rise in exports that would have allowed increasing the prices automatically and, at the same time, would have expanded the commodity-exchange basis of our economy" (Preobrazhensky, 1924: 27).

Exports through the mechanism of the state monopoly in foreign trade were regarded as one of the principal means for accumulation. It was also commonplace, but, at the same time, Preobrazhensky realized this method's limitations due to the law of value.

In international markets the main constraints were the current prices for exported commodities. The upper limit for the purchase prices of state trading organizations was set there. On the other hand, the lower limit was set on the national level. Extraction of the marketable surpluses was limited by peasant households' low productivity and their tendency to subsistence production. The task of extracting surpluses by means of commodity-money relations required relatively higher prices offered by the state trading organizations.

Increased exports were desirable both for the industrialization program (providing means to import capital goods) and for shrinking the disparity between effective domestic demand and supply, since more exports would bring home more means to be used for providing imported consumer goods. But, as Preobrazhensky pointed out, the very attempt to increase the extraction of surpluses available for export from the primary sector would lead to the shrinkage of the resources available for import. The problem was even more complicated by the existence of the "free" market in commodities. For example, the larger share of grains was traded in the rural sector: in the 1924-1925 fiscal year the total volume of traded grains was 833.7 million *poods*,[6] and those consumed by city markets and exported by the state, comprised only 305.7 million *poods* (36.7%). The rest (528 million poods) was traded in the countryside through private dealers, usually wealthy peasants (Preobrazhensky, 1926: 199). Thus, the degree of freedom for the government's price policy, and for the use of export as a means of accumulation, was limited by the forces of international and national markets. The state monopoly in foreign trade allowed only the preservation of a margin, but had little effect on expanding its limits. Moreover, a rise in agricultural prices, the only effective tool for extracting marketable surpluses from the peasants, would have given rise to an additional increase in both the peasants' income and effective demand.

The root of the imbalance between supply and demand (seen as real magnitudes as in classical political economy, and not as theoretical functions, as in neoclassical theory) was in the demand excess originated in the agricultural sector (an excess *vis-à-vis* the capacity of domestic industry to meet it). Preobrazhensky believed that breaking the state monopoly on foreign trade would promptly establish the "normal" terms of trade, that is, the importation of foreign consumer goods in exchange for agricultural products. The existing imbalance favoring the large scale importation of consumer goods endangered the program of industrial importation and, in the long run, the continued state monopoly in foreign trade. The effect of the law of value on the national level tacitly leads to dependency on the world market, a theme on which Preobrazhensky (1926: 178) voiced his opinion by straightforwardly pointing to US capitalism as exerting the role of the world economy's "price lawmaker". Therefore, export could not serve in the long run as a key instrument for both accumulation and the equilibrium of the mismatch between demand and supply. The clue to success was to be found in the inward development of the socialist industrial sector. Therefore, Preobrazhensky had founded the principal mechanism for securing

[6] The *poods* is a Russian unit of weight equal to 16.38 kg.

economic development in industrialization, implemented, contrary to the effect of the law of value, by such tools of forced accumulation as the non-equivalent exchange of the socialist sector with the non-socialist sector, and the peasants and workers being deprived of consumption.

In short, *original socialist accumulation* was needed in order to launch the socialist industrial sector to the stage of self-sustained growth. It had to be done by the mechanisms provided by planning, by *socialist protectionism*, by means of fiscal, credit, budget, trade, and monetary policies (unfortunately, the second volume of *New Economics*, dedicated to the practical implementation of Preobrazhensky's theory, remained incomplete due to his political opposition to the official course of action).

Preobrazhensky did not present his program as something radically new. He insisted that the majority of tools for fulfilling the strategy of original accumulation had already been launched, at least up to a certain degree, albeit not always consciously. What he argued for was precisely a more rational, purposeful implementation of the strategy to fight backwardness.

Raúl Prebisch

Evgeny Preobrazhensky began his study of backwardness from within the framework of the domestic economy, characterized by the huge backward agricultural sector (around 80-85% of the population were peasants), and little (if any) incentive to dynamic capital accumulation and growth. From the very beginning of his intellectual biography, he took into consideration the impact of the world market on the perpetuation of backwardness. But he developed his approach to the world economy only in the latest stage of his scholarly activity. The last book he managed to complete and publish was on the essence and consequences of the world economic crisis that broke out in 1929 (Preobrazhensky, 1931).

By contrast, Raúl Prebisch drew his theory of economic development from within the framework of the international order shaken by the world wars and the Great Depression of the 1930s. Only later, in the mature stage of his long intellectual life, "the somber Prebisch of *Capitalismo periférico* (1981)" (Love, 1990: 147) elaborated on the internal problems and the fate of peripheral capitalism fully. Indeed, Raúl Prebisch's economic thought was not uniform over his intellectual life, which started in the 1920s and ended in the early 1980s, as Prebisch himself acknowledged in 1983 (see Prebisch, 1983). Since we are chiefly concerned here with the mature Prebisch from 1949 on, especially during his tenure in the Economic Commission for Latin America and the Caribbean, ECLAC),[7] it seems worthwhile to briefly review the evolution in his economic thinking.

His first stage was chiefly characterized by his firm belief in neoclassical theories (Prebisch, 1983: 175), which was only shaken by the great crisis of the 1930s. During these hectic years, Prebisch had been teaching economics in the University of Buenos Aires and was first appointed under-secretary of finance and later Central Bank deputy. As he himself acknowledged, it seems that he was so imbued with orthodox thinking that, time and again, he prescribed orthodox, anti-inflationary plans to stabilize fiscal deficits (Prebisch, 1983: 175). However, Prebisch started recognizing that Argentina, like the rest of the Latin American countries, had to face recurring balance of payment constraints, which, sooner rather than later, would prompt him to formulate his first serious qualms about orthodox economics. Indeed, after his work in the Central Bank, he began a period of theorizing about his actual experience in Argentina. He thus began to consider that the recurrent balance of payments crisis could only be overcome by state intervention (for instance, through compensatory monetary policies and exchange rate management) and industrialization. Yet a recurring doubt surrounded his new thoughts: Why is it that the economic policies formulated in the *center* could not be followed in the *periphery*? (see below for definitions of these concepts.)

This early thought led Prebisch to his second stage in economic thinking upon his entry into ECLAC in 1949, where he remained for more than a decade. In the 1940s, he was already well acquainted with Keynes' *General Theory* (see Prebisch, 1947); in particular, Prebisch thought that anti-cyclical fiscal policies were needed to mitigate the consequences of the depression. It was not only this aspect of economic prescriptions that strongly countered his former neoclassical thought, but also, and more importantly, his increasing awareness that capitalist markets are not self-adjusting, a point Keynes had also raised, although

[7] As Prebisch stated, "My entry into ECLAC in 1949 took place when my ideas were already reaching maturity, and I was therefore able to crystallize them in various studies published in the early 1950s" (Prebisch, 1983: 176).

at the same time retaining some neoclassical elements in his analysis.[8] Since in the second stage of his economic thought, we will find the key elements for understanding Prebisch's views on backwardness and development, we shall here go over the details of the so-called Prebisch *Manifesto* (Prebisch, 1949), written at that stage.

Meanwhile, for the sake of completeness, it is worthwhile to point out that his third stage of economic thought was one of criticisms, which extended between the late 1950s and early 1960s. In this stage, Prebisch was critical of some policies and ideas regarding the processes of development, problems of industrialization, and of inflation.

According to Prebisch (1949), the slow, irregular spread of technological progress through countries has caused the emergence of two different kinds of economies in the world: the most developed countries, the center, and the less developed ones, the periphery. The center mainly exports manufactured goods to the periphery, which in turn exports primary goods (raw materials, foodstuffs, etc.) to the former. From the point of view of economic theory, this is nothing new, because it can be theoretically shown that countries specialize according to relative advantages in the sector accruing high productivity levels. The point so greatly stressed by Prebisch was the fact that international configuration gave rise not only to trade specialization, and eventually gains from trade, but also to the formation of radically different productive structures in different countries. This point, according to Prebisch, seems to have been overlooked by traditional trade theory, because the latter assumes homogeneity in the economic and social structures of all countries independent of their economic position in international trade relationships.

Instead, according to standard neoclassical economics, international trade can always be advantageous both for buyers and sellers, independently of whether one or another belongs to the center or the periphery. Indeed, this

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8 Indeed, despite the fact that Keynes (1936) raised very serious doubts about orthodox economics, in particular regarding the validity of Say's law that full-employment savings determine investments, Keynes retained important marginalist elements in his thinking, like for instance the downward sloping demand for factors of production, based as it is on the principle of (scarce) factor substitution. Indeed Keynes's critique of the neoclassical tenets of full employment and self-adjusting markets was quite pointed, and it shook orthodox thinking so deeply that it reached the point that neoclassical scholars like Samuelson, Hicks, and Modigliani tried to somehow incorporate Keynes into neoclassical thinking, thus giving rise to the so-called neoclassical synthesis, in which the Keynesian elements of sticky prices, wages, and unemployment are phenomena considered to be valid only for a short period, while in the long run, orthodox mechanisms are postulated to fully work.

theory assumes that it will be always possible for every country to find the most efficient production techniques for making goods in which the economy ends up specializing, determined by the relative scarcity of productive factors the economy is endowed with under free competition and perfect information. For neoclassical international trade theory (see Leamer, 1995), as expressed by the Heckscher-Ohlin model, a capital-abundant country will then export capital-intensive products, whereas a capital-scarce country will export labor-intensive products. However, besides the assumptions concerning free competition, perfect information, and free mobility of resources, this neoclassical model would be plausible if, and only if, a further key assumption is established: that all countries are *identical* except for different resource endowments. Indeed, such an economic approach to international trade as is championed by neoclassical theorists (*e.g.*, Stolper and Samuelson, 1941) is based entirely on this assumption of structural homogeneity. Accordingly, capital-abundant countries will end up specializing in capital-intensive goods, establishing a lower price relative to another capital-scarce country. By the same token, a labor-abundant country will produce labor-intensive goods whose prices will be cheaper relative to the same products produced in the capital-abundant country. Thus, international trade between the parties would prove profitable for all.

On the other hand, Prebisch noted that such structural homogeneity could only be the case for the most developed countries, but not in the periphery. Moreover, the structural homogeneity in center countries would prove to be one of the elements through which increases in labor productivity would translate into better social conditions for most of their population. Indeed, these productivity increases had given rise to a considerable improvement in the wealth of the people. These improvements involved social, historical, and political reasons; in fact, not only did capitalist profits rise, but so did wages. The existence of powerful trade unions, in comparison with weak labor organizations in backward economies, might be of help in understanding this fact. This process eventually led to a better living standard for people in the center, giving rise to homogenous economic and social structures with high productivity levels and broad dissemination of technological progress, both in industrial and agricultural sectors; the rise in productivity of the latter allowed for additional resources for developing the former.

Prebisch argued, however, that the economic structure of the peripheral countries is radically different from that of the center. It is important to note that he was looking at Latin American countries, which overall enjoyed relatively better conditions than the other underdeveloped countries in Africa or Asia. Yet, the existence of backward agricultural sectors in the Andean countries (Bolivia, Ecuador, and Peru), or in the marginal regions of Argentina (northwest and northeast), or Brazil (northeast) is worth noting. One of the most salient features was, indeed, the markedly *heterogeneous structure*, the existence of two sectors in the economy: one accounted for technical progress and high productivity (concentrated mainly in primary commodities, raw materials, and food for export), while the other sector (a traditional subsistence sector) accounted for very low levels of technical development and productivity, especially in subsistence agricultural activities, where there is a huge surplus population.

According to the traditional approach to international trade, the difference in productivity would be sufficient for a spill-over of the technology. And indeed, Prebisch saw technological progress as one of the main driving forces for development. From his observations of historical statistics of prices (see, United Nations Economic and Social Council, 1949), it followed that: "As a general rule, technological progress seems to have been greater in industry than in primary production [...] Consequently, if prices had been reduced in accordance with rising productivity, the reduction should have been less in the case of the primary products than that of the manufactures" (Prebisch, 1949: 13).

Had it been the case, Prebisch believed, the specialization in primary goods exports by the periphery would have been sufficient to guarantee the dissemination of technology, increased productivity, and the improvement of the living standards of the people in that part of the world via consumption of low-priced imported commodities. Put differently, peripheral countries would have benefited from international trade by boosting production efforts in the export of primary commodities to the center. However, is it a plausible hypothesis, in the long run, that primary goods prices fall more slowly than manufactured goods prices? Let us look at Prebisch's answer:

> From the 1870s until the Second World War, the price relation has turned *consistently against* primary production. With the same amount of primary products only 63.5 per cent of the finished manufactures which could be bought in the 1860s were bought in the 1930s; in other words, an average of 58.6 per cent more primary products than in the 1870s *are needed to buy the same amount of finished manufactures* (Prebisch, 1949: 14). [Emphasis added.]

Prebisch pointed to a phenomenon quite unnoticed at that time at the center of economic theory: the terms of trade had been changing toward being unfavorable to primary exports, which is the main means by which foreign currency could be obtained by the periphery in the world market. Therefore, based on empirical grounds provided by the historical price series, Prebisch denied the reliability of traditional trade theory. Moreover, any "spill-over" from the dynamic, export-oriented sector is doomed to further intensify the outward orientation of development strategies chosen by many peripheral countries, the result being that: "The economies in the periphery start from an *initial backwardness* and after a period called 'outward-oriented development' […] the new techniques are implemented only in those sectors that export primary goods and in some economic activities directly related to exports […] (Rodriguez, 2001: 105). [Emphasis added.]

Economic cycles and backwardness

The other important element of Preobrazhensky's and Prebisch's economic development theories, often unnoticed in the history of economic thought, involves the relationship established *via* international trade and capital flows between the perpetuation of backwardness and fluctuations in the world economy.

Evgeny Preobrazhensky

As noted above, Preobrazhensky had always regarded the impact of the world economy as an influential factor affecting Russian economic development. Indeed, the idea of a breakdown of countries into *price-setters* and *price-takers* was neither a novelty for Preobrazhensky himself or for Marxist literature in general. As early as 1912, while in Siberian exile, upon observing the perspectives of Russian agriculture, he wrote that despite huge grain exports from Russia, world grain prices were determined in the Americas: "Nowadays, the question of the reasons for a given price level for grain could be fully resolved only if the question of reasons for the increase or decrease of prices in the United States and in Argentina are also resolved" (Preobrazhensky, 1912: 80).

Almost two decades later, amidst the Great Depression, he was planning to prepare a comprehensive study of *modern imperialism*, of which he was able to present only a part (Preobrazhensky, 1931). He believed that this study chiefly required broadening the scope of analysis: it could not be successfully carried out by focusing on a closed national economy. He insisted that monopolistic capitalism, as an economic basis for imperialism, could be studied only as a global phenomenon: "The monopolistic system […] is intrinsically connected, we would even say *structurally* connected, with a high [level of] development of the world economy as a single economic entity" (Preobrazhensky, 1931: 520). [Emphasis added.]

For Preobrazhensky, monopolistic capitalism was characterized by the transformation of the economic cycle, based on the crucial role of monopolies in production and distribution. Another important characteristic was uneven cyclical development, where crisis, recession, and stagnation in several countries enabled the redistribution of resources and capital on a global scale, allowing for the perpetuation of growth without the due economic basis in other countries. In this regard, Preobrazhensky singled out the main trend in the period preceding the Great Depression: "The process of the transfer of the world economic and financial center from Europe across the ocean" (1931: 556). This process was dramatically reinforced by World War I, and a new configuration of forces resulted in a situation in which post-war economic growth:

> […] could only be started across the ocean. In Europe, only France, which received strong impetus for development as a result of the defeat of Germany and Austria and at their expense, was an exception. The one-sided character of world economic development after the war and as a result of the war determined not only the character of the economic upturn, but also the heart of the crisis to come. Of necessity, this core was bound to be situated in the United States and its closest economic periphery of North and South America, which the US economy had involved in the upturn (Preobrazhensky,1931: 553-4).

Preobrazhensky's analysis of the world economy's uneven development revealed that during the upswing phase, some peripheral economies were able to increase their gains due to the nature of their connection with the center economies. But during the downswing, the situation was to change radically:

> If under free competition the most powerful enterprises adjusted to the low prices by improving production techniques, under monopolism the most economically powerful countries, while making a certain rationalization and revising the tariffs in order to raise them, will strive for rip from the more backward countries their share of world trade. In this case the post-crisis depression is to bring in a certain improvement in the economic situation of the most powerful capitalist countries (as compared to the period of crisis) and a good deal more rapid regress for the [backward] countries (Preobrazhensky, 1931: 550).

Raúl Prebisch

Prebisch would agree with Preobrazhensky's analysis, but arrived at a somewhat similar conclusion by a very different route. According to Prebisch, economic cycles follow different paths depending on whether the center or the periphery is being analyzed. Prebisch saw the economic cycles in the center and the periphery as a unified phenomenon, not as two separate economic developments. In the center, during the upswing phase of the cycle, effective demand tends to rise more rapidly than production and the incomes of economic factors (*e.g.*, wages) since trade union pressure tends to grow more rapidly than the increase in productivity from technological progress. In the downswing, on the other hand, demand rarely rises. Production drops, but the incomes of the economic factors cannot fall due to the socio-historical as well as political factors; then, manufacturers' prices do not tend to fall as technological progress improves productivity, because of the rigidities present in the downswing of the center's business cycles. However, Prebisch linked the evolution of the cycle in the center to the economic situation and perspectives of the periphery. He affirmed that: "If this is so, how can it be explained that over the cycles the income of the centers has increased more than that of the periphery?" (Prebisch, 1949: 19).

Prebisch connects the deterioration of the terms of trade with both the upswing and the downswing of the center's economic cycle. In his view, the failure of traditional theory has been to not consider the movements of primary prices in connection with phases of the cycle: "The prices of primary products rise more rapidly in the upswing, *but they also fall more in the downswing*, in such a way that the gap between the two is progressively widened [against the terms of trade in the peripheral economies]" (Prebisch, 1949: 19). [Emphasis added.]

Even from a strictly traditional point of view, one might be puzzled by Prebisch's explanations: if profits fall during the downturn of economic cycles in the proportion in which they rise during the upswing, there would apparently be no reason for unequal movements in trade between the center and the periphery. On the contrary, Prebisch highlights that:

> During the upswing, part of the profits are absorbed by wages rises through the competition between entrepreneurs and the pressure of the trade unions. When in the centers profits have to be reduced in the downswing, the part absorbed by wages increases loses its fluidity […] The pressure exerted upon the periphery is therefore

> greater than if wages and profits in the centers had not been rigid, the latter as a result of the imperfect competition (Prebisch, 1949: 19).

At the core of Prebisch's analysis lie the conflicting forces of the parties,[9] but on a global scale: "the *smaller* the reduction capacity of profits and wages in the centers, the *greater* it will have to be in the periphery" (Prebisch, 1949: 19). [Emphasis added.]

Income distribution rigidities at the center, Prebisch says, appear to be one of the explanations as to why there is such a deterioration of the terms of trade for peripheral countries. So, since "the reduction of income –either profits or wages–, is less difficult" in the periphery than in the center, and since "the agricultural workers employed in primary production of the peripheral countries [are unorganized]" (Prebisch, 1949: 20), then the drop in profits in the center during the downswing is, partially or totally, dealt with by simply passing those losses over in export prices to the peripheral countries, which, in turn, import industrial goods manufactured in the center. Prebisch envisages that the root of such a phenomenon must be sought in the economic structures of the heterogeneous countries, and provides further explanation of the tendency of a secular deterioration of the terms of trade for Latin American economies:

> The *greater* ability of the masses in the center to obtain wage rises in the upswing and to *maintain their level in the downswing*; and *the ability* of these centers, by reason of their role in the process of production, *to divert cyclical pressure to the periphery*, thereby causing a greater reduction in the profits of the latter than in those of the centers, explains why income at the center tends to rise consistently more than in the periphery, as has been the case in Latin America (Prebisch, 1949: 20). [Emphasis added.]

Both economists' theories of economic development established a causal relationship between backwardness, economic cycles, and social upheavals. By observing the contemporary situation in peripheral countries, Preobrazhensky wrote: "The crisis in the countries producing raw materials and consumer goods, many of which are either colonies –like India– or countries dependent

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[9] Note, however, that Prebisch *at this time* envisages conflicting interest as a conflict between the center and periphery, not as a conflicting relationship between capital and labor (or profits and wages). However, in a later stage of his economic thinking, Prebisch would acknowledge that, in order to grasp development processes, it is paramount to regard the production of *surplus* as essential, whereby the distribution of such *surplus* may be conflicting with the different social classes (Prebisch, 1981: 185-6).

on powerful capitalist nations –like those in South America–, leads to the sharpening of the struggle for national independence [and] to incessant 'revolts' in the countries of South America. The periphery of European and US capitalism in its entirety is in intense ferment now […] (Preobrazhensky, 1931: 601).

But such was the depth of the crisis that it affected the center, too:

> The atmosphere in Europe is filled with the smell of gunpowder and poison gas. General disappointment with capitalism is growing even among the non-proletarian classes, even among its former apologists. Capitalists themselves do not know what to expect tomorrow. The situation is so unstable, especially at the weakest link of the capitalist chain –Germany– that the most crucial events and the most severe shocks may appear at any moment. Nobody would be surprised; psychologically everyone is ready for this. (Preobrazhensky, 1931: 601).

Preobrazhensky's studies were forcefully terminated at the time when, at the opposite corner of the world, Prebisch had just begun his long intellectual journey. Standing on Bolshevik ground and based on his evaluation of the world economic crisis, Preobrazhensky predicted that the capitalist system was doomed to fail soon, unless either a new technological revolution or a new world war temporarily postponed its demise. This was not, surely, a prediction that Prebisch would have subscribed to. On the contrary, his initial proposal for the development policy in the peripheral countries, first outlined at the end of 1940s, was based on the idea that, by means of a sound economic policy, the peripheral countries would have been able to overcome backwardness. Later on, upon observing the uneasy fate of development policy, he highlighted that the interrelationship of political and economic processes along the path of economic development would be a severe challenge.

> I am deeply concerned that the system, due to the great failures it involved, might lead to a succession of political cycles, with democratic periods followed by periods of political repression and the deepening of social inequality.
>
> In view of this dangerous perspective, those involved in the study of peripheral capitalism have a very serious task, although we are still far from accomplishing it. For, what options were we able to offer to the political forces to overcome the crisis of the system? Only two extreme alternatives: economic liberalism, which inexorably requires the sacrifice of liberal democracy, or the option to transfer the means of production to state control and to concentrate its management in those men at the top of the pyramid of political power […] In the first case the democratic process is cut off. In the second, the democracy is replaced with an entirely different concept of the political regime and human rights (Prebisch, 1981: 32).

But it may follow from this that the only way to curb negative political and social consequences of the peripheral pattern of development is to curb backwardness itself. Each political regime in peripheral countries, regardless of its origins, especially in times of upheaval, would tend to pursue the policy to fight backwardness in order to legitimize itself and to secure power. There is a bitter irony (in Preobrazhensky's case, a tragic irony) that the names of the two protagonists of economic development are widely associated nowadays with policies they were not responsible for: Stalinist industrialization, begun in 1928-1929, and the industrialization efforts in Argentina culminating during the Peron era.[10]

We thus argue that the most important contribution of both economists to development studies lies not in the substantiation of a specific industrialization strategy (and the options here are not many, as the history of economic development has shown), but in an indication of the obstacles to any strategy implemented. That is why the results of their analysis are still relevant today.

They understood that policy (even the "right" policy) is not enough: backwardness reproduces itself through cycles, and the political cycle, about which "the somber Prebisch" wrote, with repeated attempts to fight backwardness, is nothing but a by-product of this reproduction process. A policy could be

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[10] Both economists were, in fact, regarded as opponents (even as enemies) by the highest authorities in their respective periods. Preobrazhensky's case is quite remarkable in this respect. There is a widely held opinion that Stalin, upon defeating first the "left" then the "right" opposition, implemented the industrialization policy that had been proposed by the "left", Preobrazhensky included. This generalization, convenient as it is from a bird's eye view, turns out to be overly simplified when we look at the details. Firstly, this very distinction was aptly invented and used by Stalin and his apparatus in the line of the old divide-and-rule principle. This is not to say that there were no differences of opinion concerning economic policy among the Bolsheviks, but they were not so sharp and homogenized. Secondly, Preobrazhensky and other Soviet economists of the 1920s did not discuss the need for industrialization as such, but the most suitable and effective means to extract resources for industrialization from the agricultural sector in a given institutional setting (as described at the beginning of this work). Preobrazhensky underlined the necessity of counting on the market mechanism and curbing its effect (by means of *socialist protectionism*, redistribution of resources between industry and agriculture through the "State-driven" inflation, etc.) On the contrary, the Stalinist forced industrialization was based on the abrupt, unprecedented and tragic change in institutional settings: the collectivization that allowed the extraction of resources by means of a centralized administrative mechanism, regardless of any consideration for peasants' demand, will, and even minimum subsistence.

Prebisch's case is more complicated. Even though he became *persona non grata* after Peron's rise to power (1946), he did influence the Import Substitution Industrialization (ISI) strategy implementation beginning in the 1950s, but it was he (and not neoclassical economists) who started to criticize *the way* that strategy was implemented in Latin American countries in the late 1960s.

harmful, whichever agenda it follows and whatever pressure it exerts on the citizens, if it is unattainable within the reality of the economy as it is. To fight backwardness, we need to carefully follow the same laws that generate and perpetuate backwardness, the laws that govern the world economic system. A tough task indeed.

Conclusions

A substantial degree of affinity in the two economists' conclusions stemmed from the nature of the problems they analyzed and tried to solve. But, if in the case of Preobrazhensky the emphasis on industrialization was quite understandable considering the situation in post-revolutionary Russia, Prebisch indeed was the first Latin American economist to theoretically elaborate on the need for that region to deal with backwardness by following a path to industrialization. In both cases, the notion of backwardness was a starting point for analysis; this notion itself largely contributed to the theories' novelty.

The traditional economic development approach regarded this stage as an "initial asset", allowing for capital inflows and technology coming from most developed countries under the free trade regime. Preobrazhensky and Prebisch, each in his own way, advanced the idea that backwardness is not a necessary first stage of economic development to be overcome by the conditions created by an economic policy that encourages thriftiness and entrepreneurship and avoids excessive state interference. In their view, backwardness is the result of a capital-poor economy's dependence on the world economic system, characterized by the supremacy of the most developed industrial countries and their financial centers. Under these circumstances, backwardness is bound to reproduce itself on an ever-expanding basis throughout cycles of development. In this sense, the analysis by Prebisch (who started initially from traditional free-trade premises but later criticized them on the grounds of empirical evidence) is rather remarkable.

Certainly, they were not the first scholars to approach the problem of backwardness. Indeed, the industrialization drive, of which the notion of backwardness was an indispensable part:

> Is a recurring phenomenon that can be structurally explained as the ideology of latecomers in development […] It goes back to F. List and the German reaction to Britain as the workshop of the world, subsequently emerging in other industrializing coun-

> tries: the United States in the mid-nineteenth century, Russia in the late nineteenth century, Eastern and Southeastern Europe in the inter-war period, and Brazil, Chile, Argentina, and Mexico in the 1930s and 1940s (Hettne, 1983: 253).

But in a modern context, ideology needs theory in order to be persuasive. Both economists contributed a great deal to the formation of the theories that structured the discourse and the policy of industrialization. Grasping the paramount importance of the notion of backwardness in developing countries played a major part in the works of these two economists.

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