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Development Economics: Coping With New Challenges, Especially Globalization

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Introduction

As is well-known, development economics fell into disrepute in the West, especially in the USA, with the rise of neo-liberalism from the late seventies (Toye, 1987). This coincided with the denunciation of Keynesian economics with the simultaneous occurrence of inflation and slow growth, seemingly contradicting the Philips' curve trade-off associated with the 'neoclassical synthesis' or cooptation of Keynes.

The eighties began with Carter appointee US Federal Reserve chief Paul Volcker's sharp reversal of developing country growth of the seventies, with the UN promise of a New International Economic Order, following the 1973-5 oil price hike, subsequent commodity price booms and low real interest rates, thanks to Anglo-American commercial bank recycling of petroleum revenue to lend to developing country governments and high inflation.

Thus, the Reagan-Thatcher decade began with the debt crises of Latin America , Africa, Eastern Europe, Korea and the Philippines, enabling the post-Bretton Woods International Monetary Fund (IMF) to take over macroeconomic policy with its stabilization policies and the World Bank to require indebted governments to abandon development policies in favour of economic liberalization through structural adjustment policies.

In the World Bank, the McNamara era associated with the intellectual leadership of Hollis Chenery gave way to the appointment of Anne Krueger as Chief Economist and Deepak Lal as head of research soon after the publication of his *Poverty of Development Economics* (1983).

Although the end of the Reagan (and Bush) years and temporary Japanese ascendance eventually saw some easing up of the counter-revolution against development economics, the damage was irreversible and unlikely to be rectified by the Third Way of Clinton and his later European imitators with their continued neo-liberal commitments.

The appointment of Joe Stiglitz to Mrs Krueger's previous position seemed to promise a critical reconsideration of the now hegemonic Washington

Consensus if not more, but the circumstances leading to his forced resignation soon put a stop to such hopes.

The East Asian crises of 1997-8 had rather mixed consequences. Despite the facts, the neo-liberal lobby continues to portray the episode as one due to East Asian dirigisme rather than inappropriate financial liberalization. For a brief period from around mid-1998, it seemed to promise serious consideration of a new international financial architecture, but with the containment of the Russian and LTCM crises, changes are likely to be limited to the plumbing and wiring at most.

Coping With Globalization

Meanwhile, however, the protests at Seattle and since have continued to remind the world that all is not well with liberalization, with its international manifestation in the form of globalization. It is therefore useful to begin our reconsideration of development economics by the some issues exacerbated by the current phase of globalization.

It seems necessary to begin with two rather obvious points. First, globalization is not inevitable. Second, globalization means different things to different people, like the proverbial elephant and the blind men.

At least five aspects of economic globalization pose serious challenges to the developing world, so much so that many in the South now think of globalization as inimical to development. These aspects include:

1) international trade;
2) foreign direct investment (FDI);
3) international finance;
4) strengthened intellectual property rights and technological access;
5) the new institutional economic governance.

International Trade

Although there is more controversy around international trade theory than commonly acknowledged, it seems likely that there are potential gains from trade due to international specialization, and that much existing protection is more burdensome than advantageous.

Nevertheless, however, advocates of trade liberalization need to consider so-called 'transitional costs' (e.g. employment and income losses due to trade liberalization, including the destruction of existing industries, jobs, etc.) and that there is no guarantee that better new jobs will replace lost jobs.

Besides such theoretical objections, experience reminds us that the consequences of trade liberalization are generally far more severe than in make-believe worlds of constrained economic analysis with its convenient, but unrealistic assumptions about the real world.

Developing countries have much reason to be continue to be concerned about a variety of observed long-run trends including:

1) deteriorating terms of trade for primary products compared to manufactures, as first studied by Raul Prebisch and Hans Singer.
2) deteriorating terms of trade for tropical primary products compared to temperate primary products, as observed by the Jamaican Nobel economics laureate, W. Arthur Lewis.
3) more recent price deflation of generic manufactures produced by newly industrializing countries' industries with relatively low entry barriers.

Perhaps most importantly from a development perspective, trade liberalization undermines the possibility of developing temporarily protected 'infant industries'. While import substituting industrialization has undoubtedly had a mixed record for a variety of reasons, the East Asian miracle was undoubtedly principally due to *effective protection conditional on export promotion*, rather than trade liberalization or open economies, as claimed by neo-liberal 'spin-doctors'.

Foreign Direct Investment

The debate on the pros and cons of foreign direct investment (FDI) continues without any consensus, though there has been greater appreciation of the gains from 'green-field' FDI compared to other types of capital inflows.

However, it is important to recognize that the role of such FDI in the East Asian miracle was modest, accounting for less than two per cent of gross domestic capital formation during the high growth periods in Japan, South Korea and Taiwan compared to the developing country average of around five per cent.

In the aftermath of the 1997-8 Southeast Asian economic crises, it is now generally acknowledged that the region's industrial capacities and capabilities had been much weaker because of greater reliance on and domination by FDI. Foreign industrial domination also meant that public policy in the region tended to be dominated by financial rentier interests, which contributed to its greater financial vulnerability.

The 1999 UNCTAD World Investment Report shows that most FDI in the 1990s has been for mergers and acquisitions (M&As), not 'green-field' FDI which would create new productive or economic capacities. In developing countries, M&As have mainly involved acquisitions, particularly during periods of distress, especially after the ever more frequent currency and financial crises of recent times.

As Paul Krugman has shown, such 'fire-sale FDI' has further undermined the likelihood of superior management due to M&As, already considered dubious in business management theory.

International Financial Liberalization

Three expected gains touted by advocates of international financial liberalization have simply not materialized. First, there have not been net flows of funds from capital rich countries to the capital poor, except to East Asia during the early and mid-1990s until the massive and sudden capital flight of 1997-8, associated with the currency crises. In fact, capital flight from other developing and transitional countries has increased with the pressure for capital account liberalization.

Second, the expected lower cost of funds has not materialized especially when compared with the real interest rates of the second half of the seventies, associated with 'financial repression'. While some margins have declined, financial deepening has increased the variety of rentier claims.

Third, while financial deepening has undoubtedly reduced some of the old sources of financial volatility and vulnerability, it has also introduced new sources, resulting in the greater frequency and magnitude of currency and financial crises with international financial liberalization.

Also, the policy influence of financial interests has grown (e.g. with greater central bank independence), resulting in greater deflationary macroeconomic policy bias throughout the world, whereas the post-war record suggests that moderate inflation has contributed to growth.

Financial liberalization has also undermined the deployment of financial policy instruments to accelerate development, which even the World Bank's 1993 East Asian Miracle study acknowledged was successful in promoting growth and structural change in the region.

Technology

While the pace of technological change and innovation has undoubtedly accelerated in recent years, strengthened intellectual property rights in recent years have raised the costs of acquiring technology, reduced the likelihood of technology transfers and strengthened transnational corporations' monopoly powers and abuses, with adverse consequences for development and industrialization in the developing countries.

New International Economic Governance

The Bretton Woods institutions – the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development or World Bank -- have been increasingly seen as obstacles to development because of their role in promoting economic liberalization, especially since the 1980s, despite dubious empirical and theoretical support for the claims of the proponents of the Washington Consensus.