



DEVELOPMENT STRATEGY

Crisis, Ideology, Options

*The Yusif A. Sayigh Development Lecture 2009
Palestine Economic Policy Research Institute-MAS
at Kamal Nasser Hall, Bir Zeit University
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Postwar Golden Age



- Post-WW2 'Golden Age': high growth in both North + South
- Divergence reduced following:
 - Decolonization
 - M-substituting industrialization
 - Rural development

Divergence again from 70s



1970s' transition

- End of Bretton Woods system, 1971
- Oil price hike → petrodollars recycling
→ low real interest rates + high
commodity prices → N/S divergence
- 'Stagflation' in North
- high growth + inflation in Latin America
- high growth in East Asia
- African regression until 2003-2008

Ideological counter-revolution

- 1970s' stagflation → Thatcher, Reagan → *decline* of Keynesian economic influence
- Conservative revolution against post-war Keynesian consensus
- 1980s' debt crisis → 'counter-revolution' against development economics
- World Bank history: mid-1980s → 'Washington Consensus'

Slower growth because of structural adjustment reforms



Structural adjustment reforms despite *dubious theoretical justification and weak empirical support* (Washington Consensus) including:

- global economic governance
- loan policy conditionalities
- reduced 'policy space'
- trade liberalization
- financial liberalization
- deflationary macroeconomics
- pro-cyclical macroeconomics
- privatization
- strengthened intellectual property rights (IPRs)
- 'good governance', esp. property rights

Changed role of state



- Stabilization + structural adjustment programs
- Reduced growth, development + redistribution roles
- Less taxes + less progressive taxation
- Reduced role of government in most countries, especially social spending
- Privatization, contracting out

Trade Liberalization



*International terms of trade moving
against developing countries*

1. Primary commodities vs.
manufactures

Hans Singer, Raul Prebisch

Grilli & Yang (IMF)

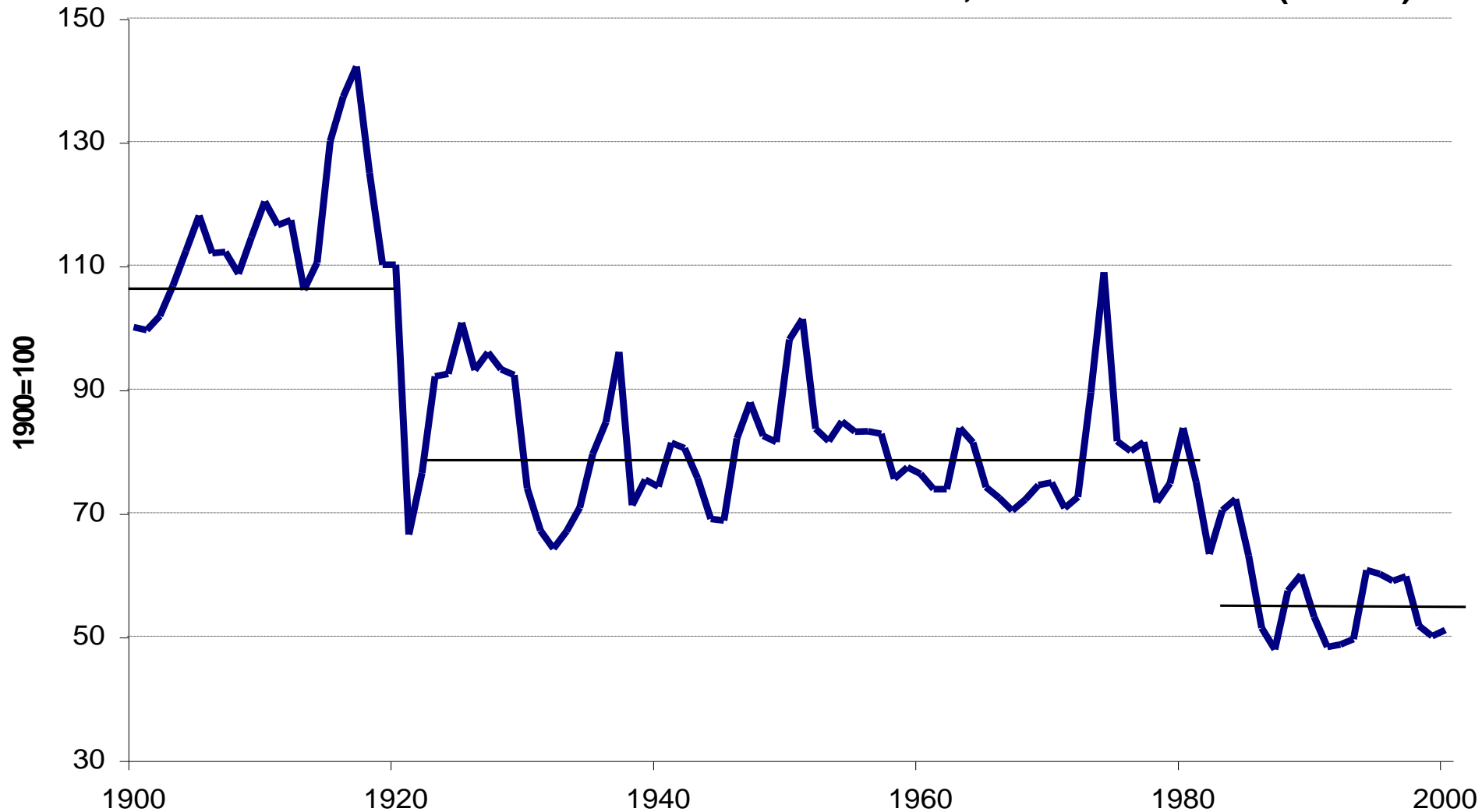
Ocampo & Parra in Jomo (2005)

Commodity Price Index, 200C



Figure 1

AGGREGATE REAL COMMODITY PRICE INDEX, EXCLUDING OIL (GYCPI)



Trade Liberalization



International terms of trade have moved against developing countries

1. Primary commodities vs. manufactures
2. Tropical vs. temperate agriculture
3. South vs North manufactured Xs

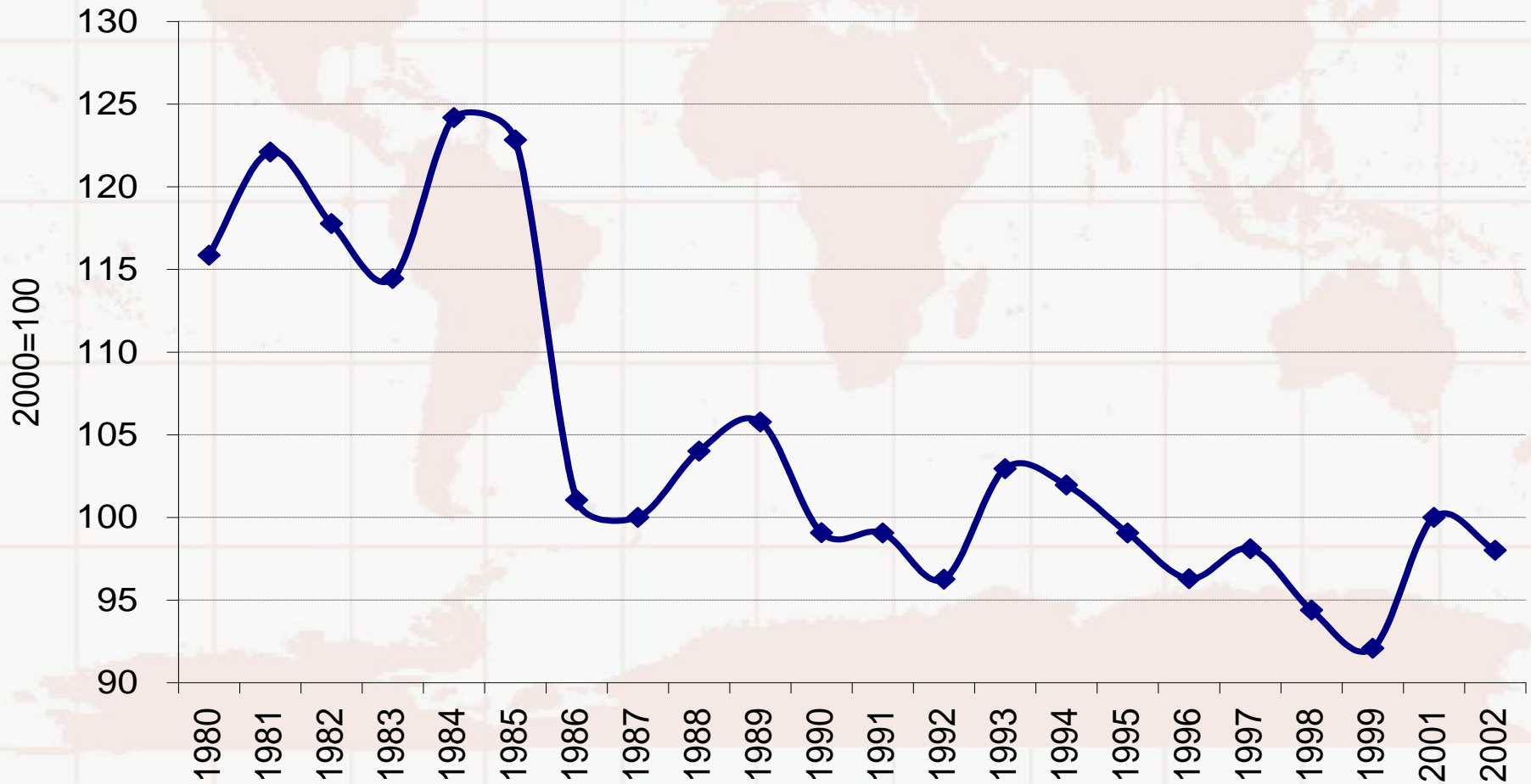
Generic manufactures vs monopolistic manufactures protected by IPRs?

→ Immiserizing growth?

South vs North Manufactured Exports' Terms of Trade



Unit value of manufactures exported by developing countries relative to manufactures exported by developed countries



'Aid for Trade' rationale



Loss of *tariff revenue*

Loss of *production + export capacities*

Cost of building *new* internationally competitive productive + export *capacities + capabilities*

[Above obscured by comparative statics of international trade theory, CGE models]

International financial liberalization



Converse of advocates' claims:

1. **K flows** *not* from K rich to K poor

Except E Asia early + mid-1990s

2. **Costs of funds** *not* lower

3. Some old **sources of volatility + instability** reduced, but **new sources** introduced

Old Warnings Ignored

- Keynes: **beauty contests** → **casino capitalism**
- Tobin: **sand in wheels** of finance
- Drucker: changed world economy
1985: 89% X-border flows not related to real economy → 1996: >97%
- McKinnon: **Sequencing** economic liberalization
- K account liberalization should be **last**

Asian crisis *mea culpa*



- IMF: opposed AMF → no productivity growth, currency crisis theories, cronyism
- Krugman Plan B
- Bhagwati: Wall St-US Treasury nexus
- Fischer: Controls on inflows [not outflows]
- IMF 2003: 'Financial globalization' flawed
- Koehler, IMF Article 6
- Rajan, *et al.*: no direct growth contribution

Effects of liberalized capital flows



- Exchange rate appreciation → high sterilization costs
negate supposed benefits

Also:

- asset market bubbles
- consumer binges
- over-investment

Foreign capital inflows not really developmental



- Most short-term K flows not developmental
- Most to other advanced economies
- Only significant for about 12 countries
- >80% FDI in 1990s for M&As
- ‘Green-field FDI’ often crowds out domestic investment; limited linkages
- Most to others for mineral extraction
- Investment incentives reduce net benefits
- Weakness of domestic industrial K → dominance of financial sector in SEA

Domestic financial liberalization versus development



- 1. Deflationary** macroeconomic influences
- 2. Counter-cyclical** financial instruments + institutions eliminated
- 3. Developmental** financial instruments + institutions eliminated
- 4. Inclusive finance** initiatives undermined

Crisis unexpected?



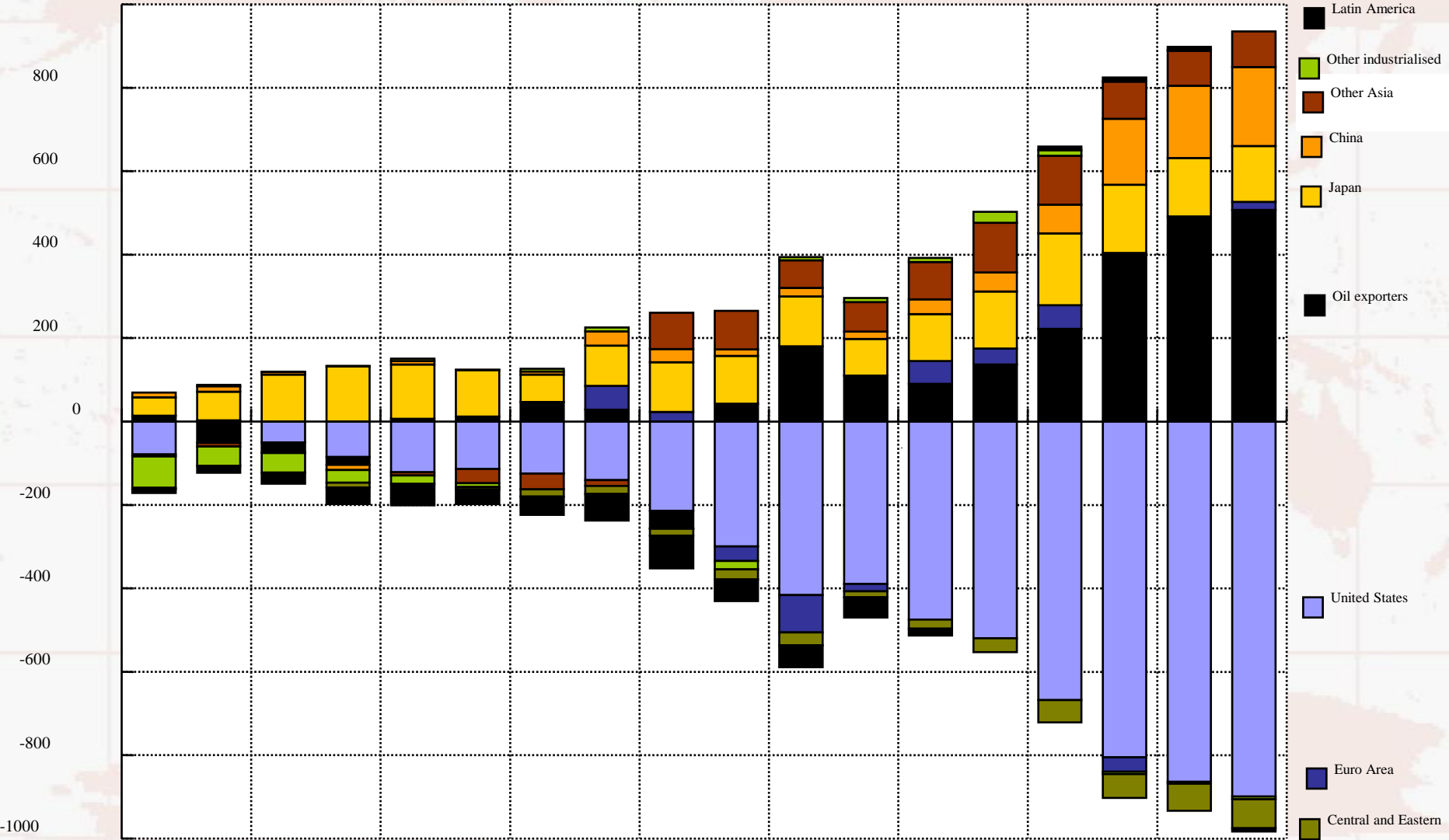
- *A **crisis foretold**: BIS, UN, UNCTAD*
- *Unsustainable global **imbalances***
- *International fin. **architecture**: **non-system***
- *Ideology: **deregulation**, self-regulation,
inadequate + inappropriate regulation
capital account liberalization*
- ***Financial** globalization: growth, stability?*
- *Globalization → crisis **hit all**, unlike 1970s*

Global imbalances grow

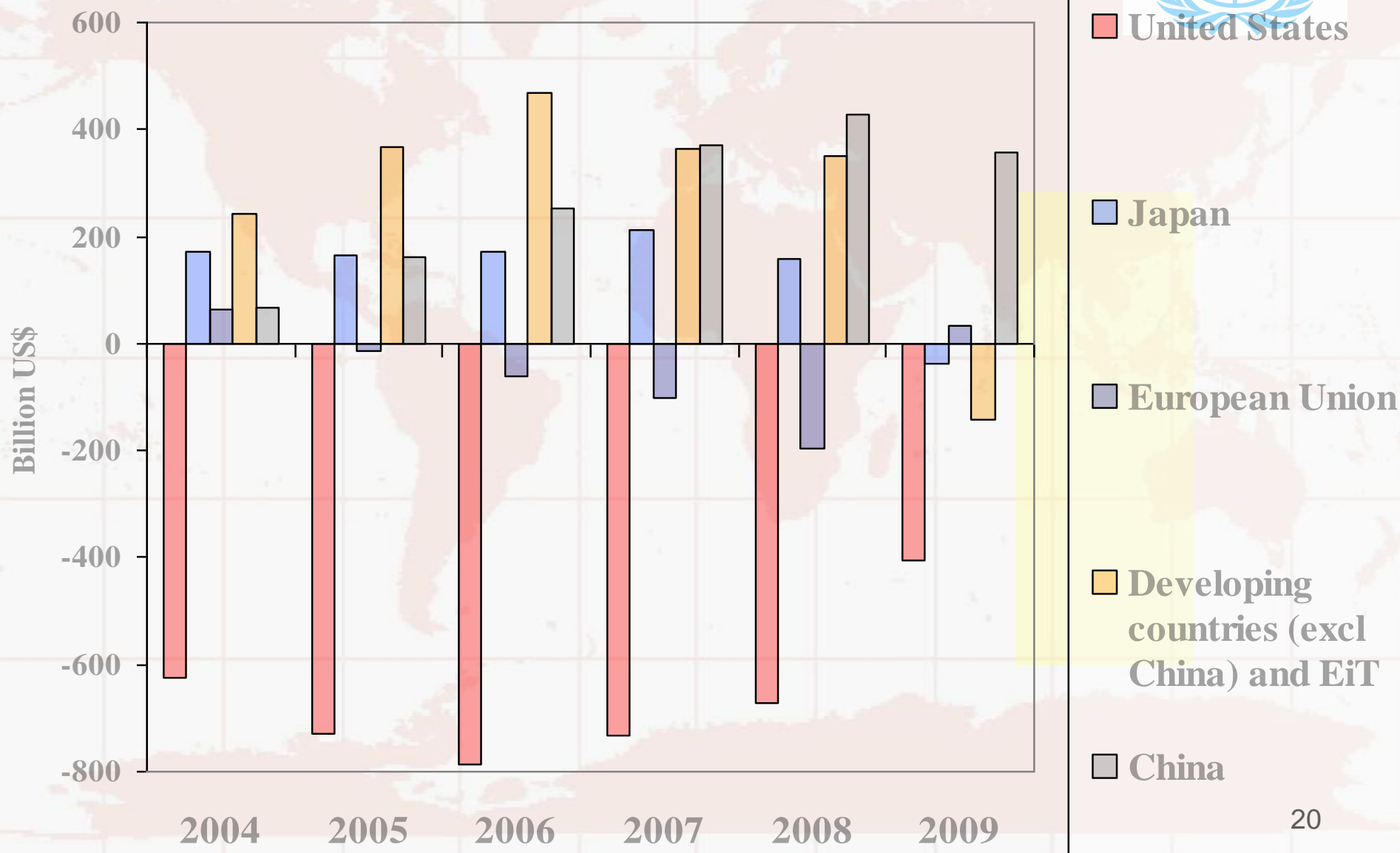


USD bn

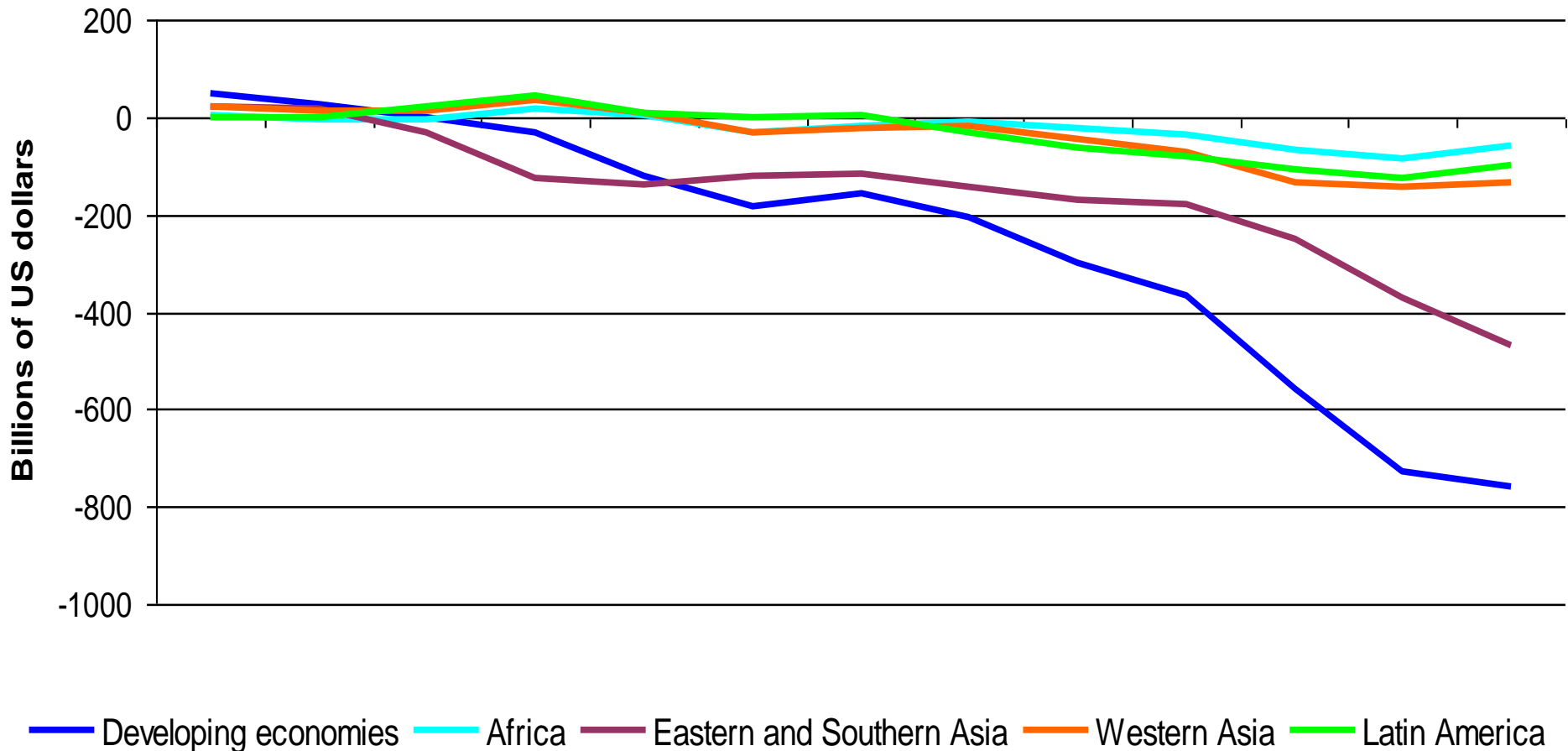
1000



Disorderly unwinding



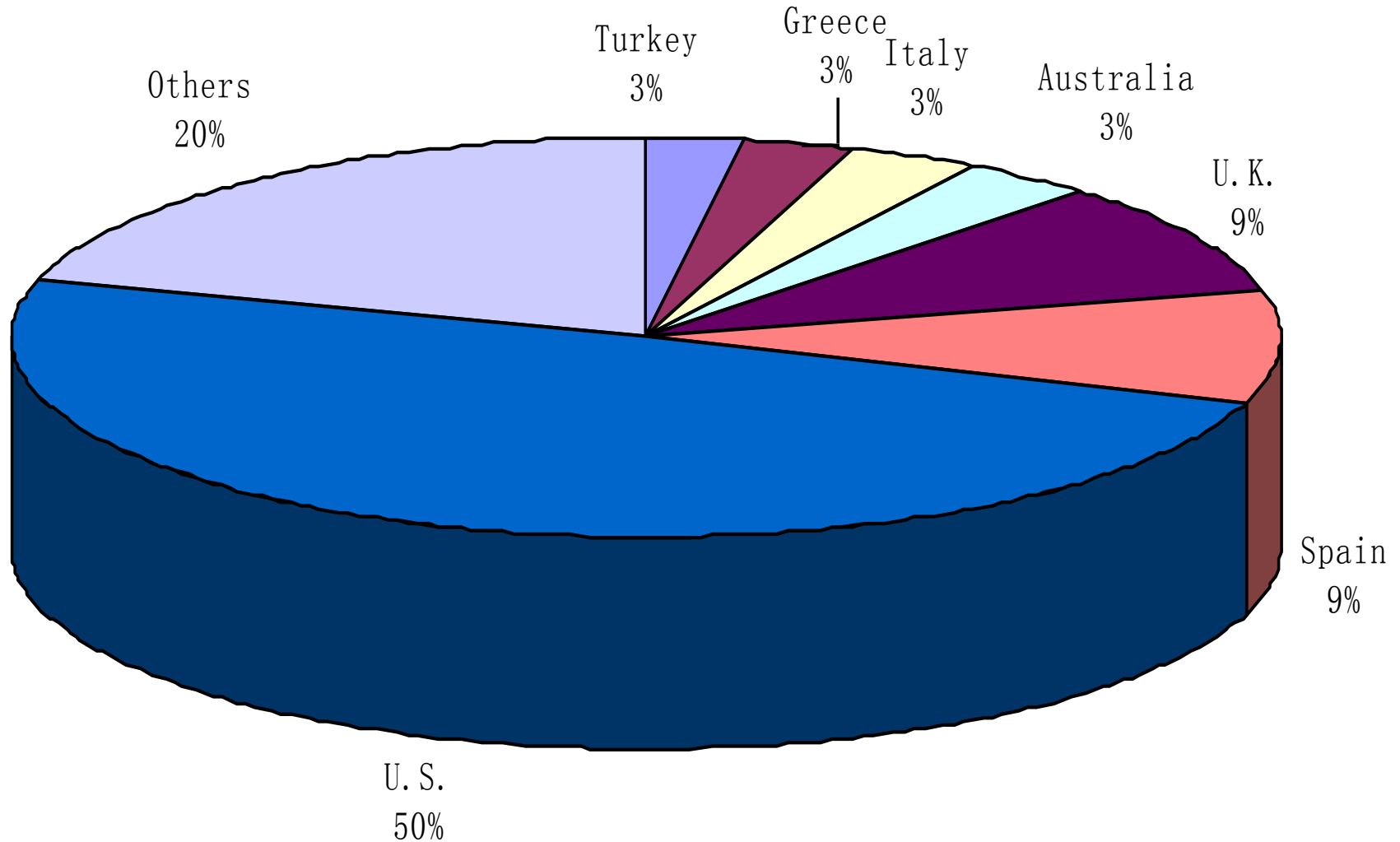
Net transfer of financial resources from South to North



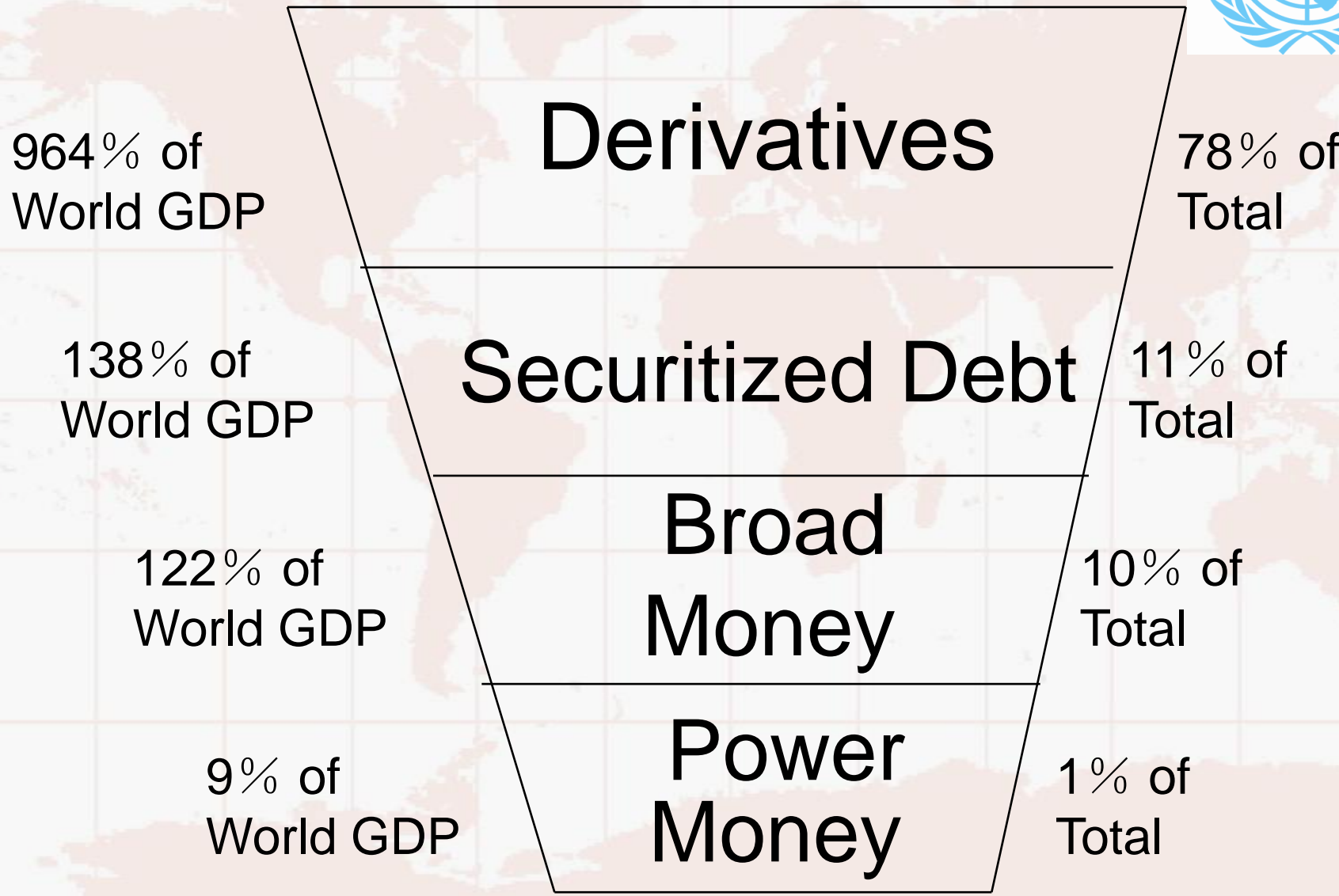
Net capital importers



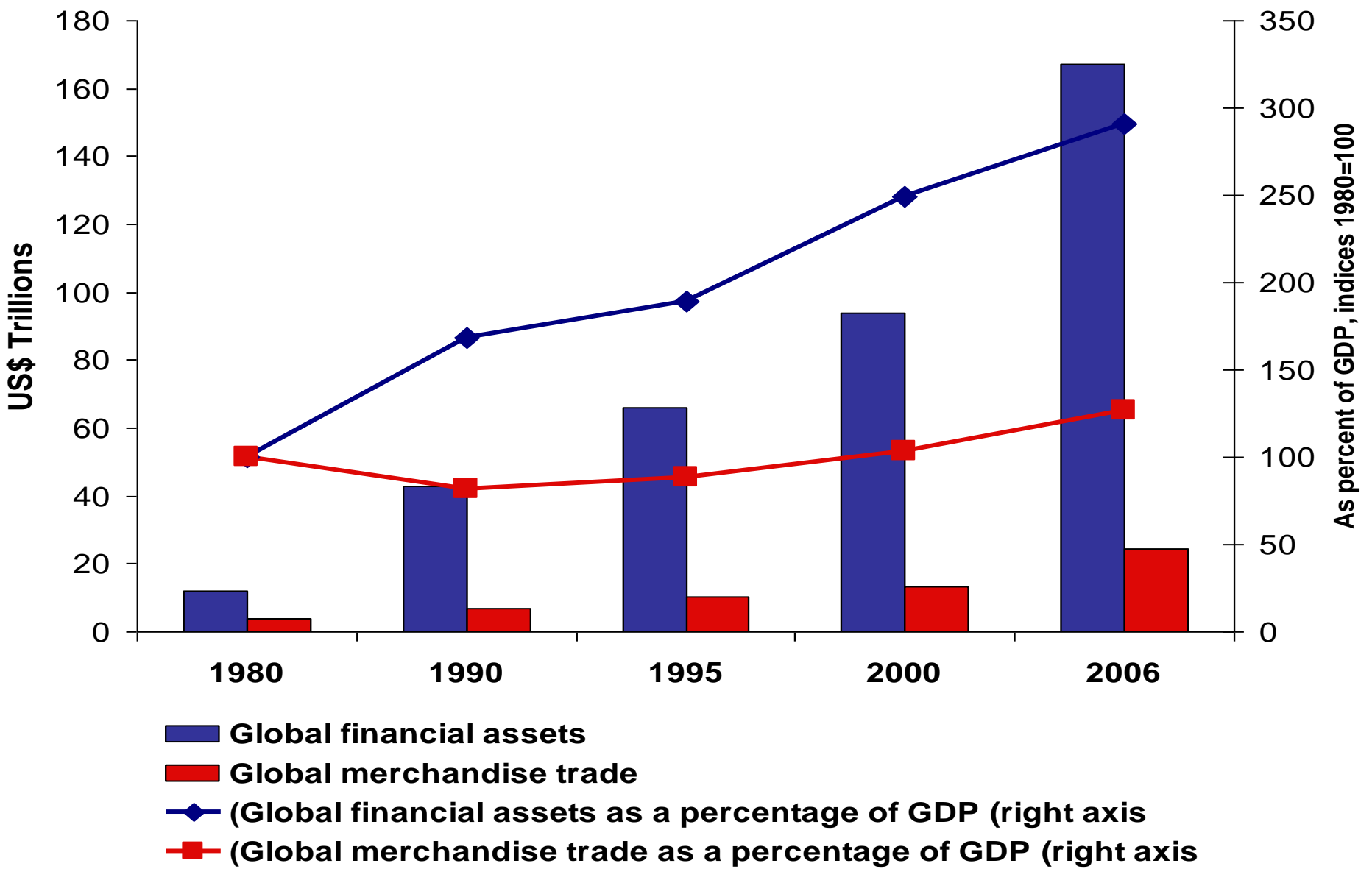
Capital Importers



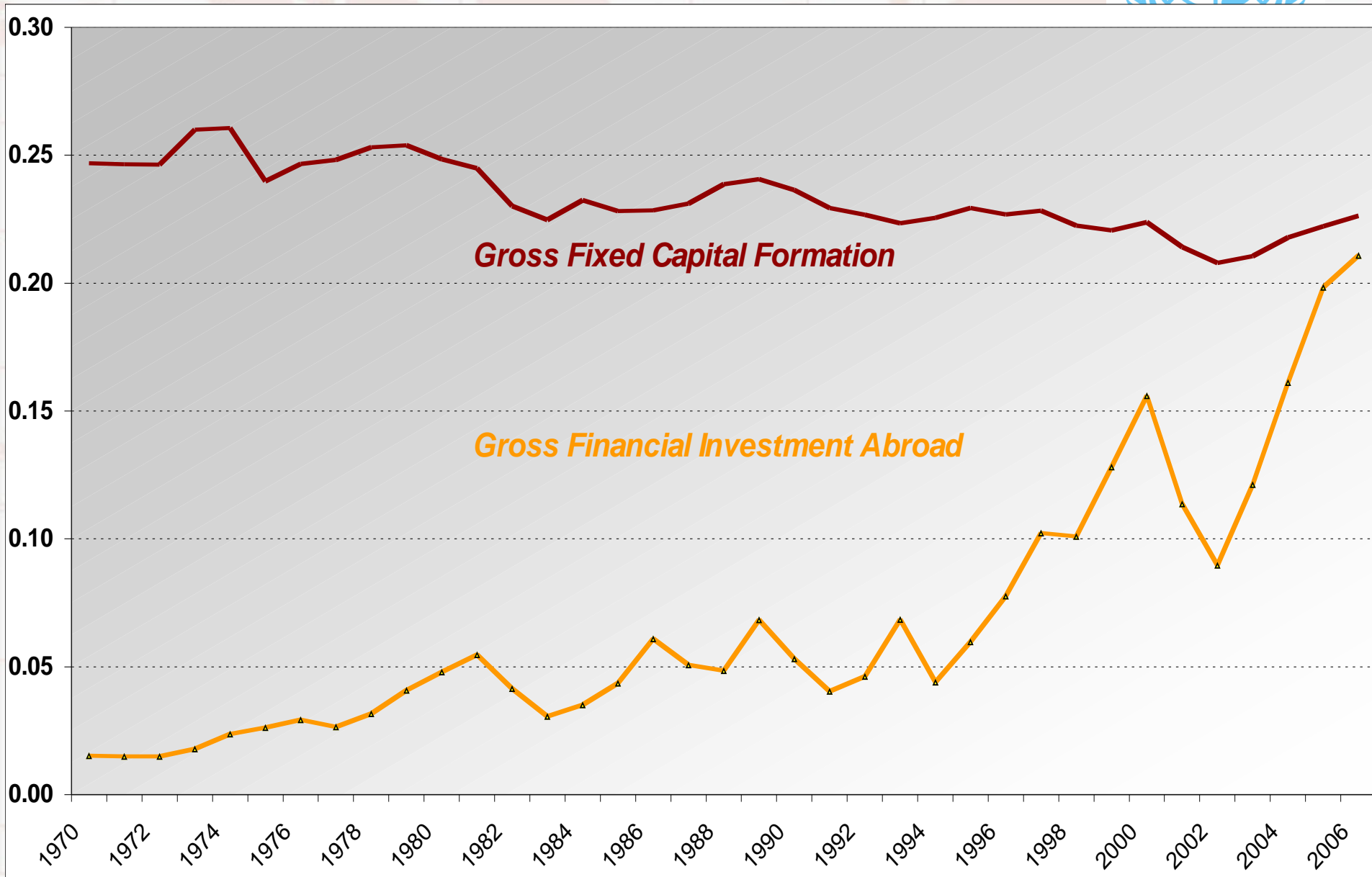
Inverted pyramid unstable



Globalization: finance > trade



Finance-investment nexus?



Financial impacts on developing countries



- Despite non-involvement in sub-prime debacle:
 - Emerging *stock markets* collapse greater
 - Reversal of *capital flows*, FDI also down
 - Spreads rise, much higher *borrowing costs*
- But *financial positions stronger* than during Asian + LA crises (more foreign reserves, better fiscal balances)

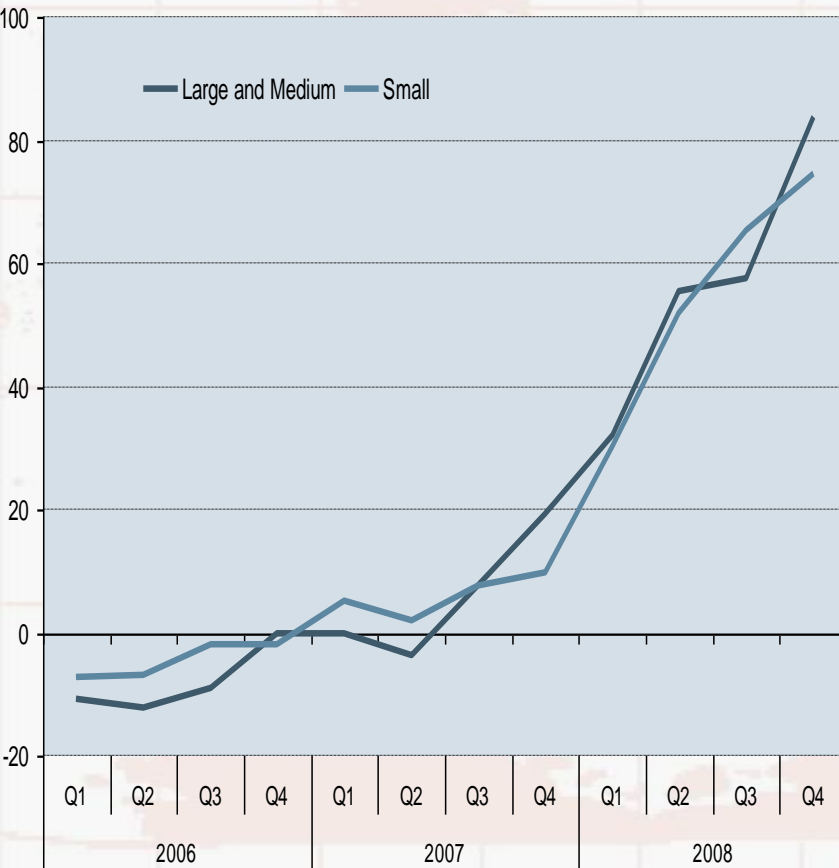
But reserves rapidly evaporating with export collapse; fiscal space also disappearing

Credit crunch: US, EU

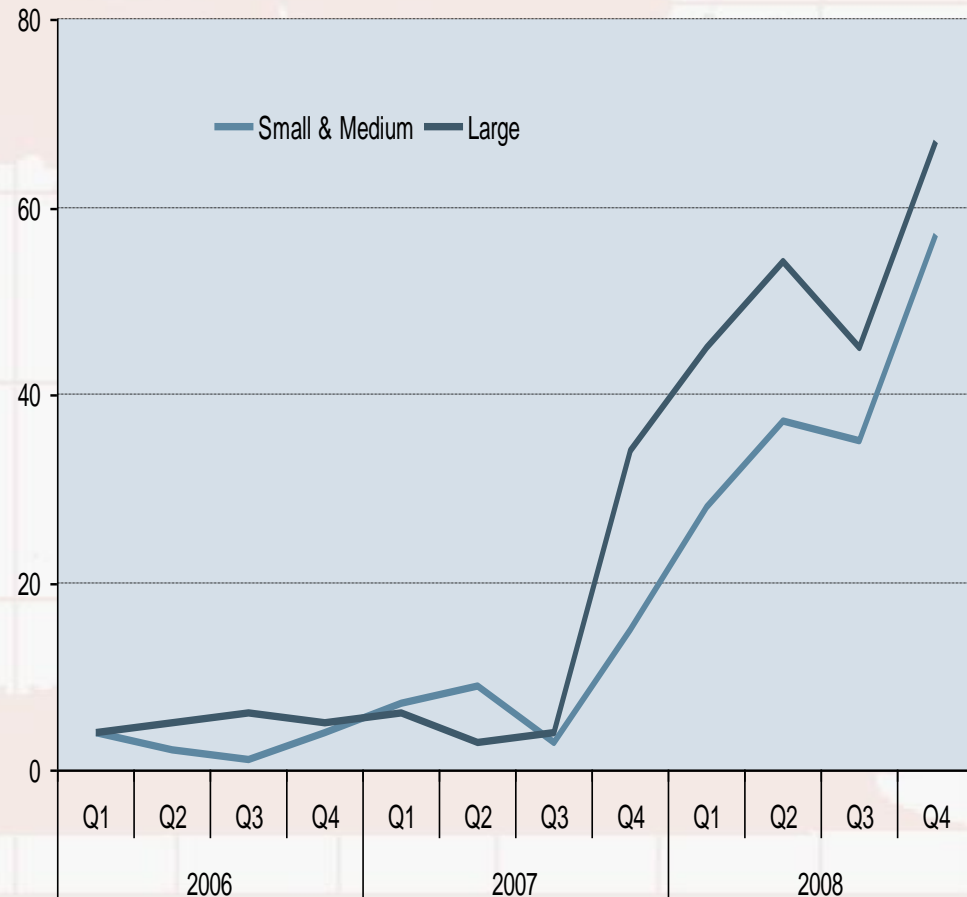


Percentage of lenders tightening standards, by size of enterprise seeking loans

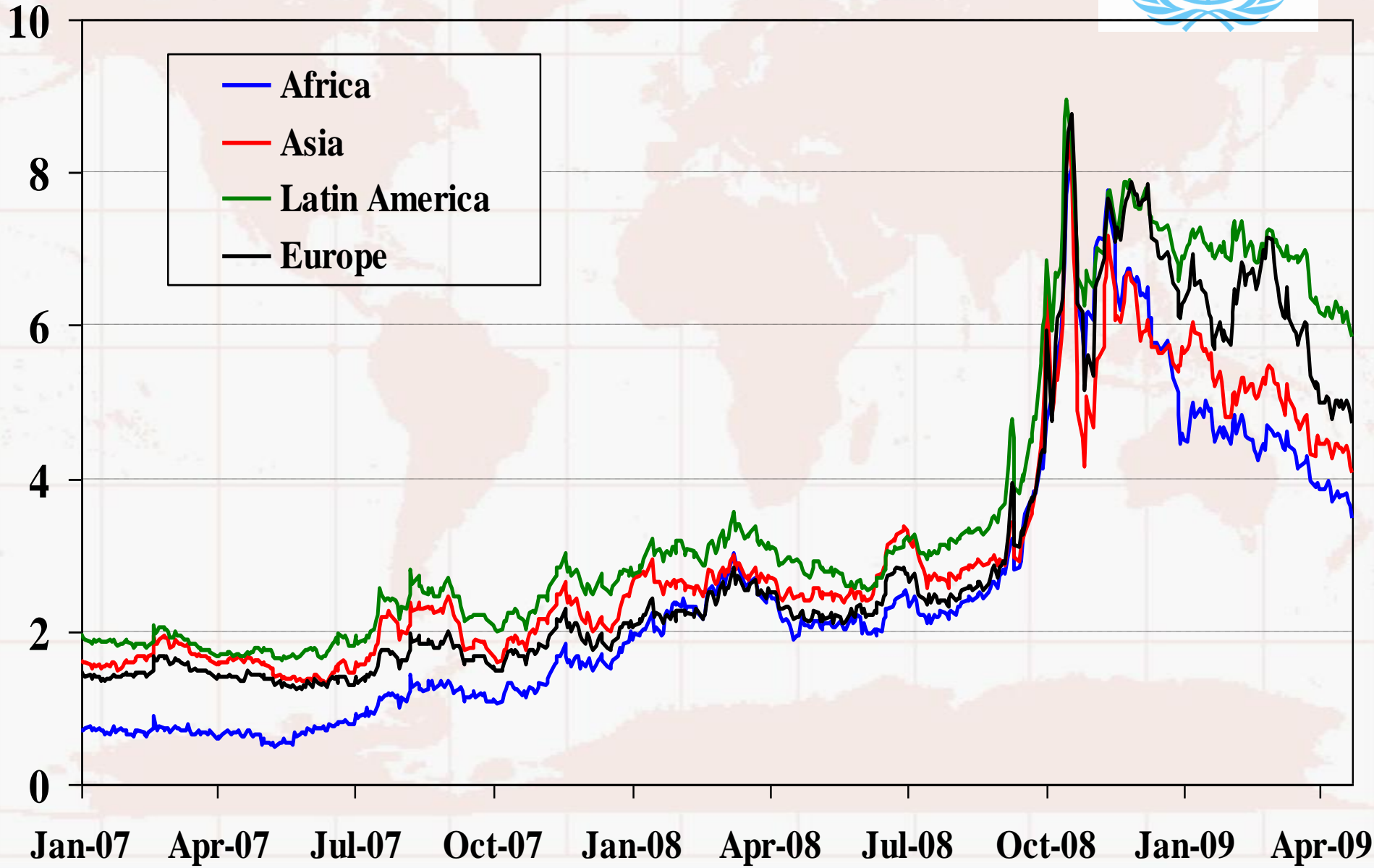
Panel A: United States



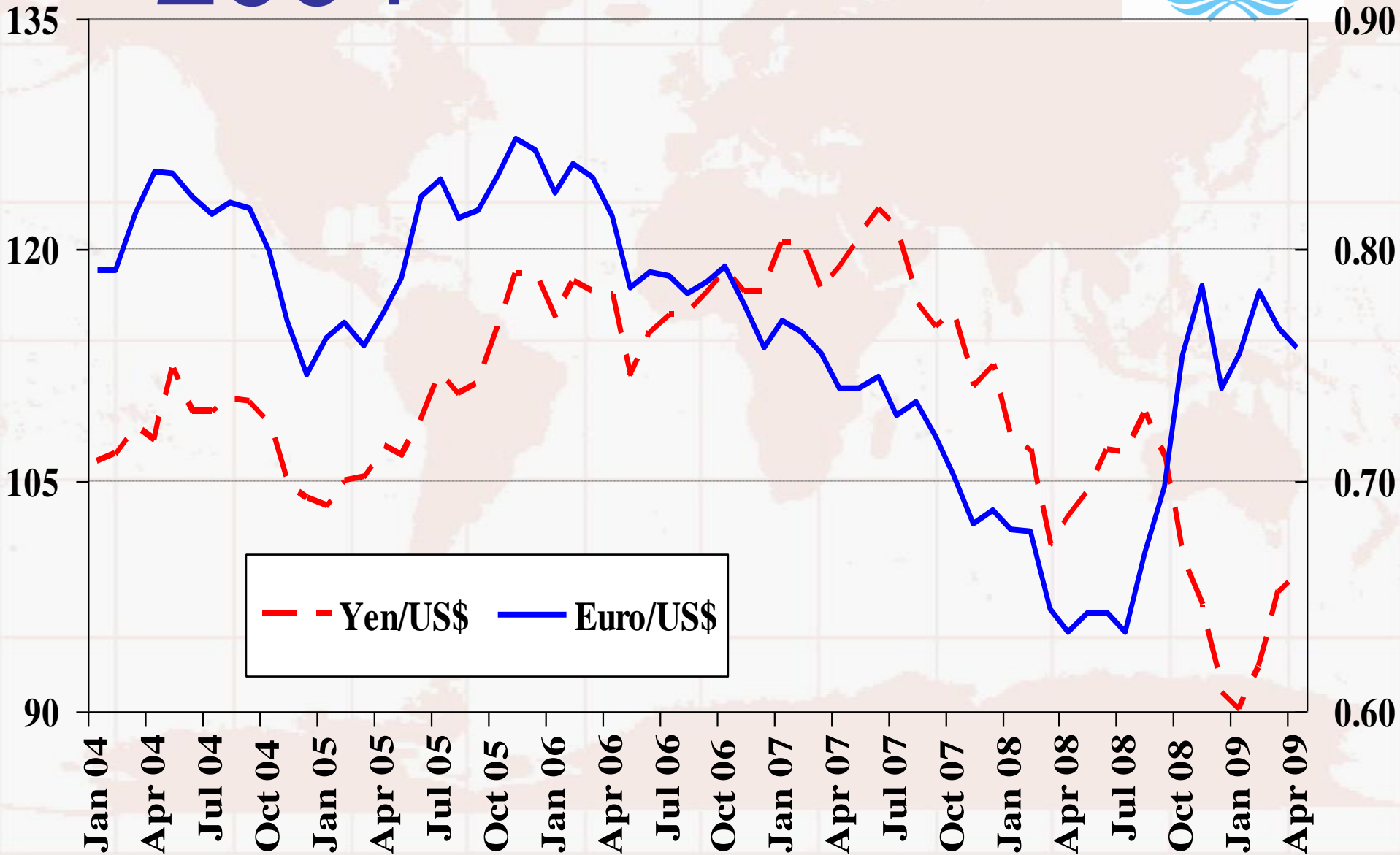
Panel B: European Union



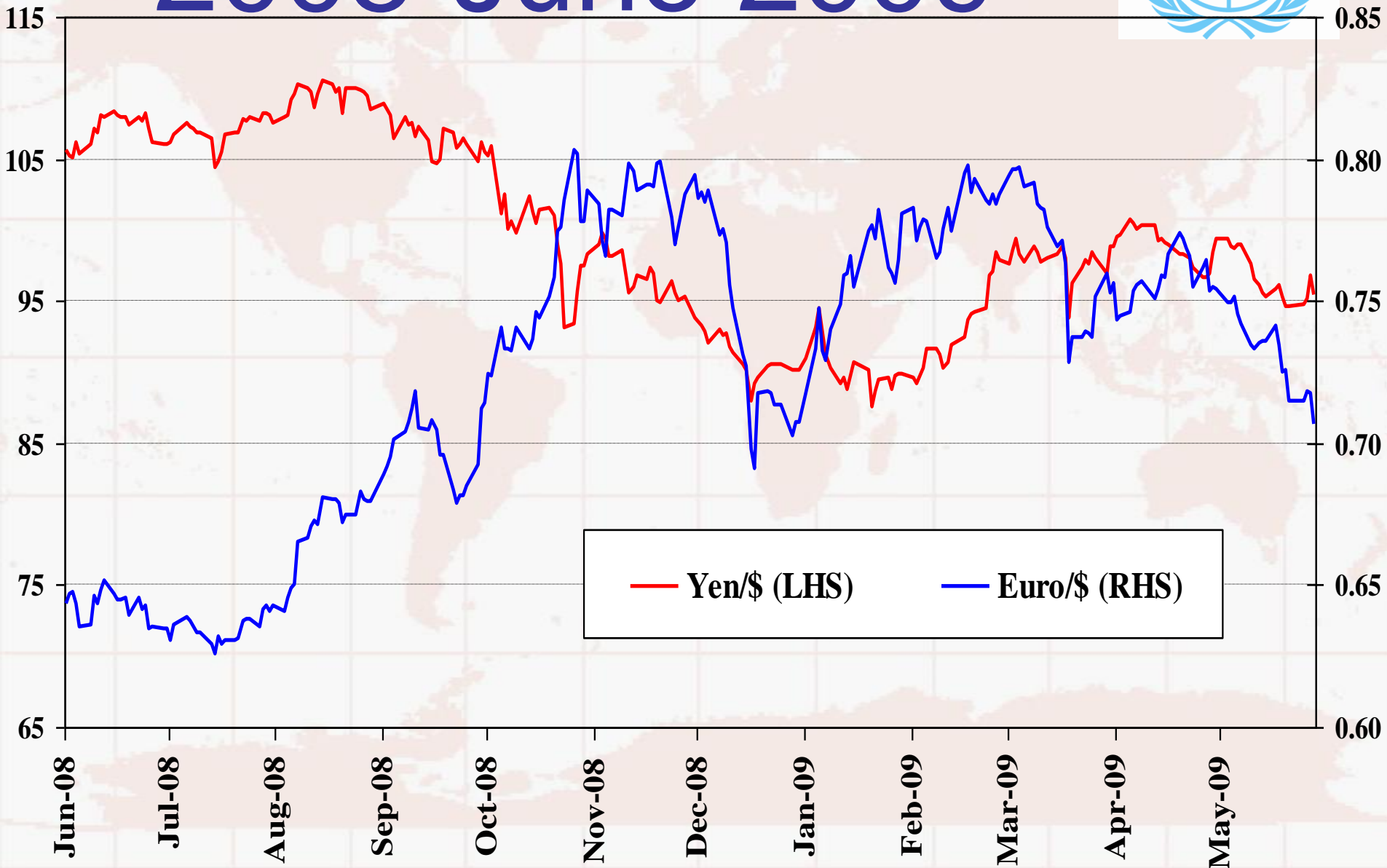
Borrowing costs high



Dollar volatility continues 2004-



Dollar volatility, June 2008-June 2009



Contagion: crisis spreads



Financial sector contagion (incl. vicious circles):

Sub-prime crisis → financial crisis

→ asset price deflation → liquidity/credit crunch

Financial crisis → Economic recession

(including feedback loops)

Real economy contagion (incl. vicious circles):

→ Less investment, especially abroad (FDI)

→ Less consumption

→ Reduced demand for imports, i.e. others' Xs

→ Prices, output declines globally

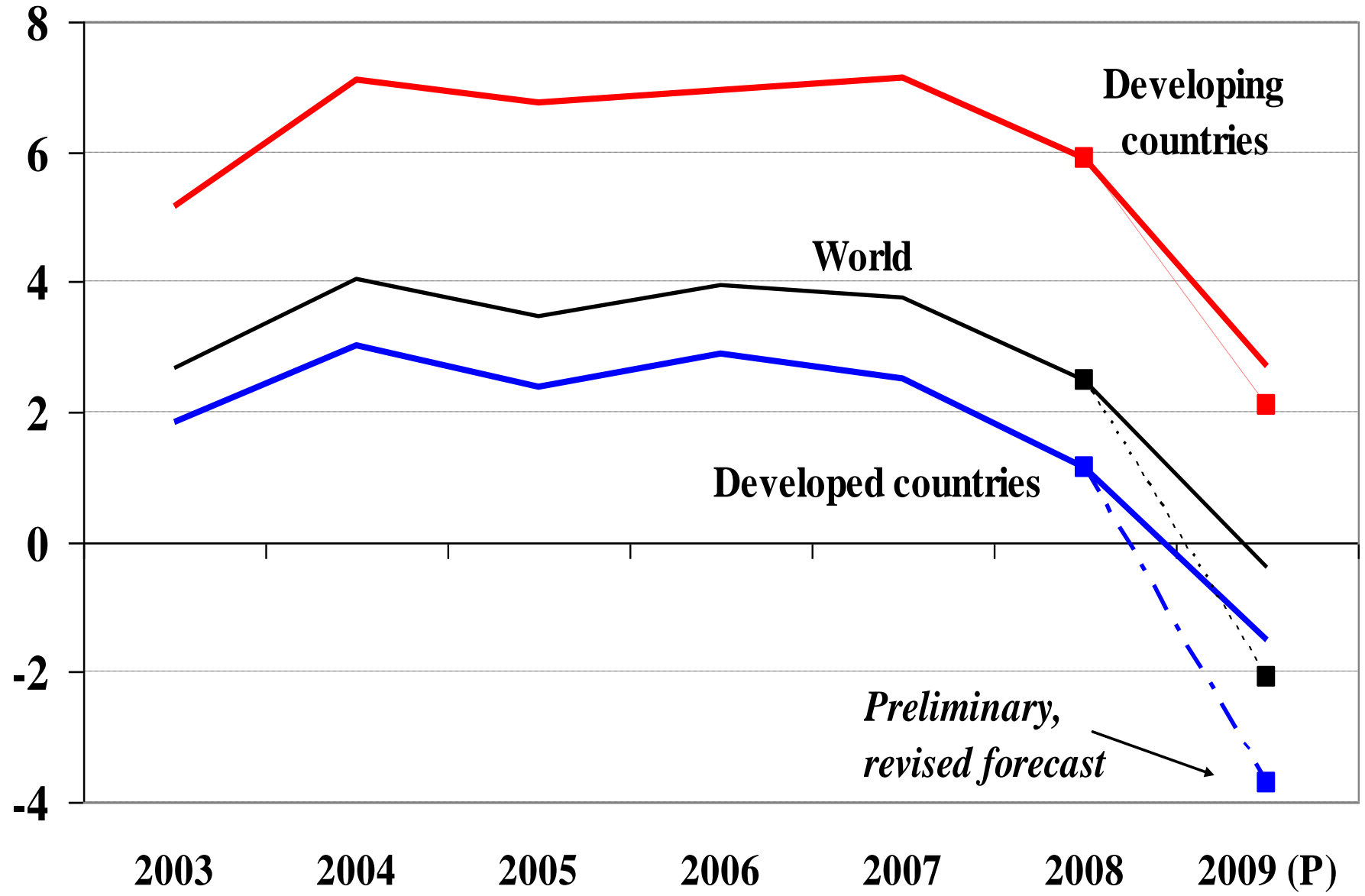
→ Growth, employment declines globally

Deflationary spiral



- Asset (stock, property) markets deflating
 - negative wealth effect
 - more bank insolvency
 - generalized credit squeeze
- Lower external demand, world trade
 - excess capacity
 - investment slowdown
- Depressed domestic demand
 - lower prices, output
 - lower employment, incomes

Globalization: Parallel fates

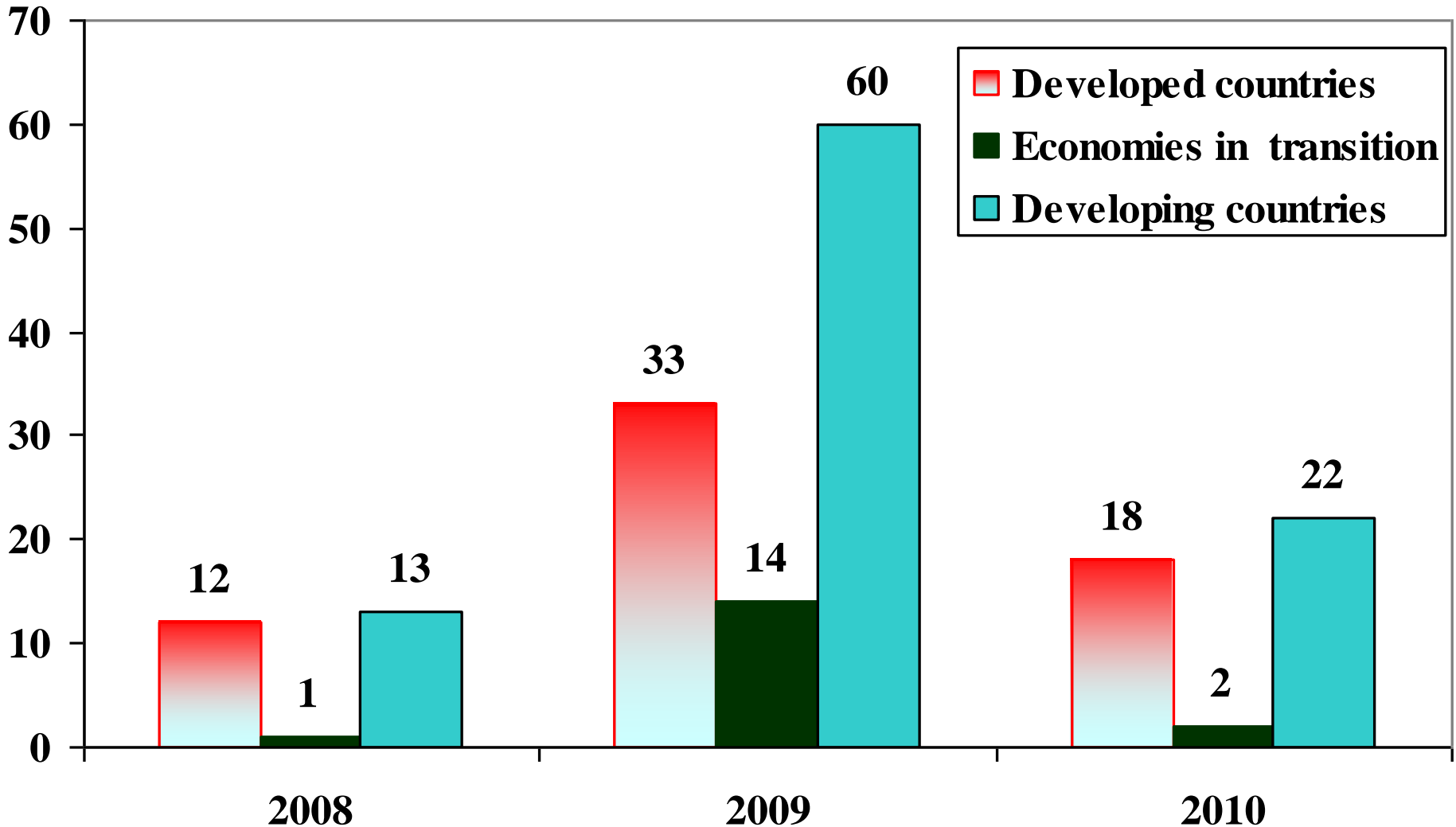


Growth by main country groups



	Per capita GDP growth rate			Change in growth rate	
	<i>2004-07</i>	<i>2008</i>	<i>2009</i>	<i>2009/2008</i>	<i>2009/2004-7</i>
World	2.6	0.9	-3.4	-4.3	-6.0
Developed economies	2.1	0.3	-4.1	-4.4	-6.1
Economies in transition	7.7	5.5	-2.6	-8.1	-10.2
Developing economies	5.7	4.0	0.1	-3.9	-5.6
LDCs	5.2	3.6	0.3	-3.3	-4.9

60 developing countries will see declining incomes in 2009

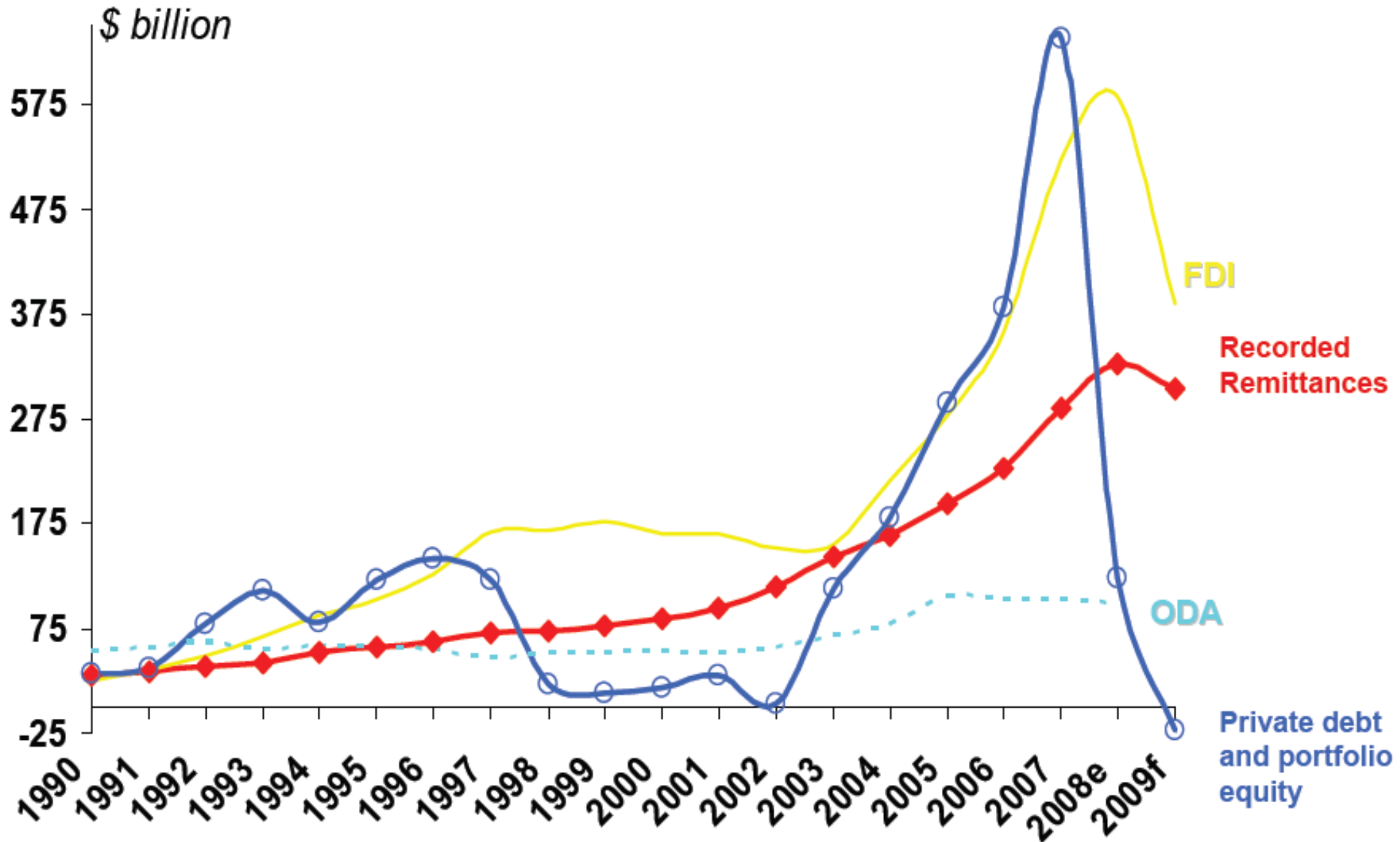


Trade impacts: summary

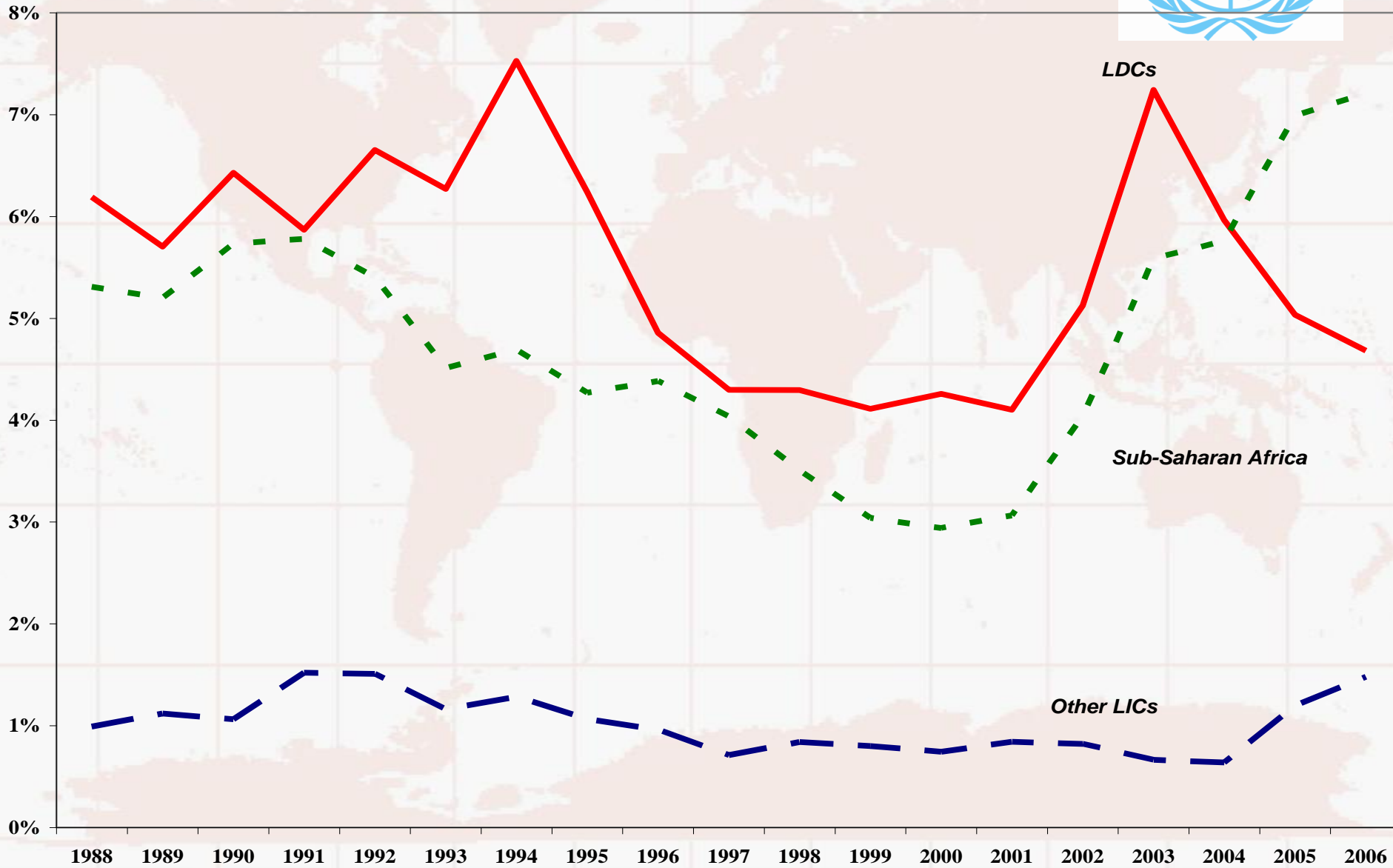


- Exports decline →
all developing countries
- Terms of trade → **primary exporters**
- **Trade surpluses,**
reserves run down quickly
- **But lower energy, food prices helped net food and oil importers**

All capital inflows down

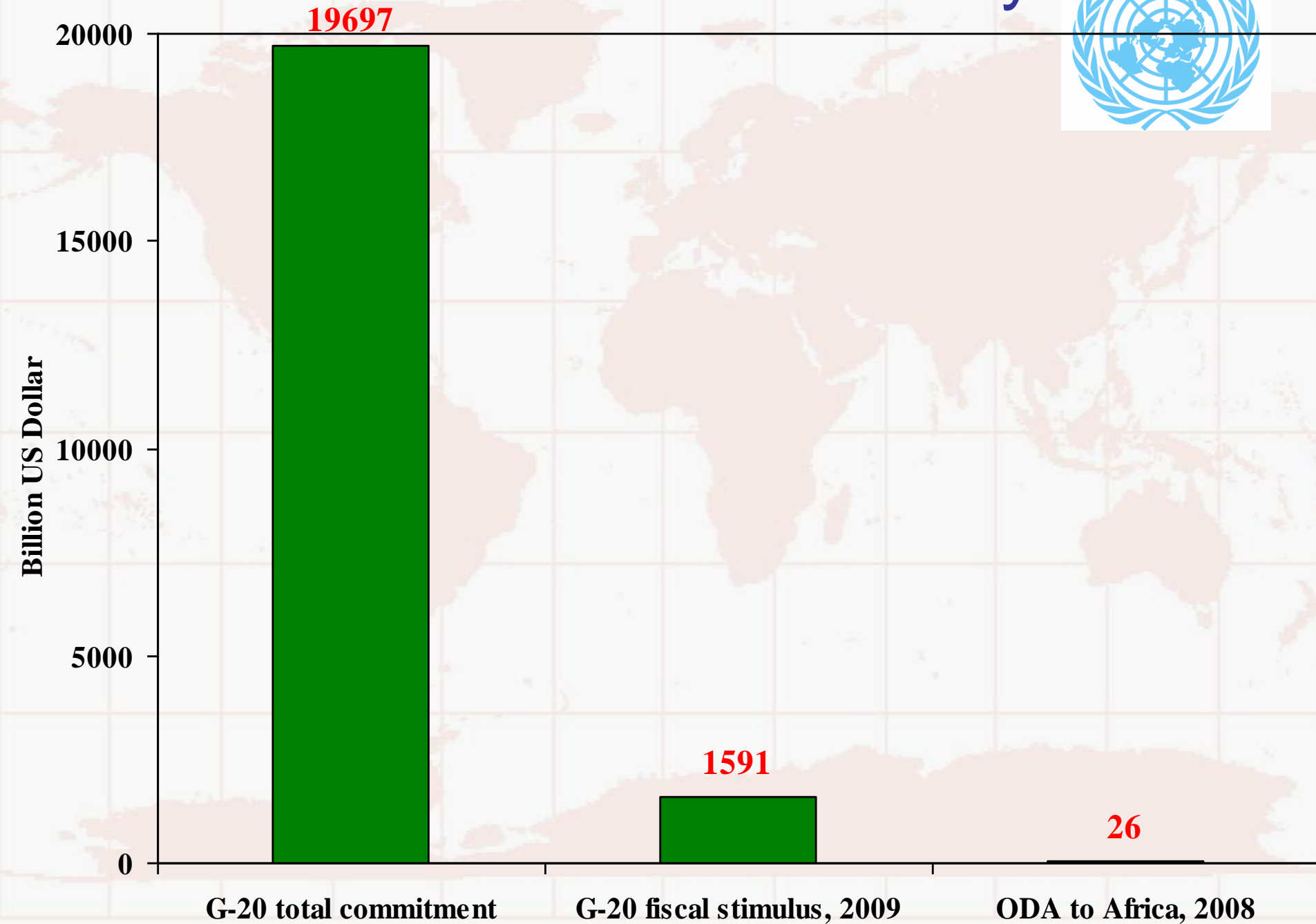


Aid flows unreliable





ODA for Africa vs G20 recovery efforts



Net aid transfers?



- Net ODA is net of principal payments, *but not of interest received on such loans*
- Net Aid Transfers (NAT) are *net of both*
- Japan recently received >\$2bn/year in interest on ODA loans
- NAT excludes cancellation of old non-ODA loans, e.g. a 2003 Paris Club deal cancelled some \$5bn in non-ODA official debt owed
- That cancellation is ODA, but generated little additional net transfers, i.e. NAT
- Hence, e.g. **DRC received \$5.4bn in ODA in 2003, but only \$400m. in NAT**

Remittances?

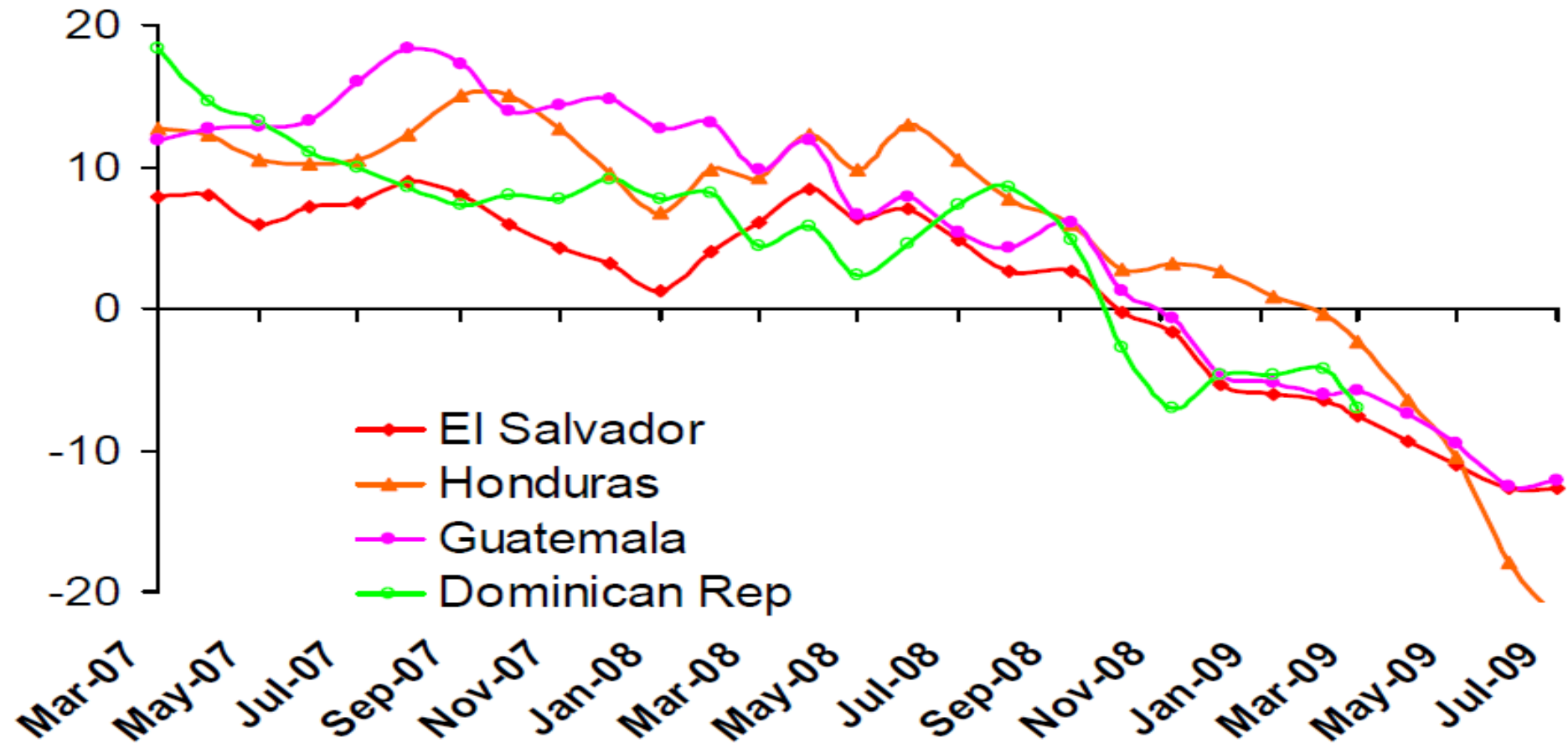


- Historically, remittances to home countries rise in crisis
- However, migrant workers in host countries now most adversely hit by job losses, lower incomes
- Evidence uneven for different migrant workers by home country, host country, crisis impact
- Debt sustainability redefined to include remittances, allowing greater debt

LA remittances down



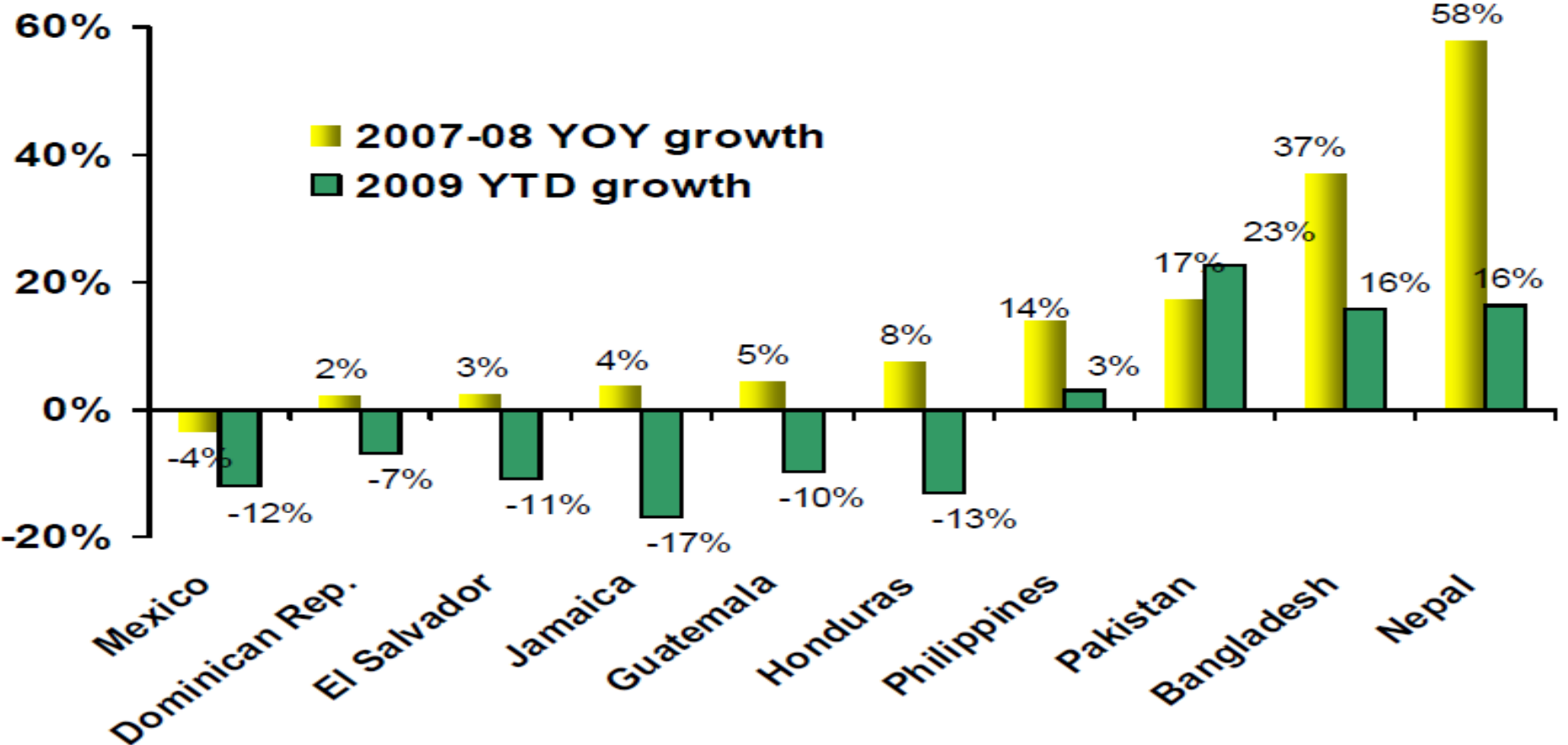
Remittance to other Latin American countries started declining in the first half of 2009



But up in Asia (X rate effect)



Remittances are falling in Latin America, but are still growing in South and East Asia



Social impacts



- ILO: >200 m. more working poor
- ILO: Unemployment to rise by 51m
- ILO projections based on IMF Nov 08
- MDGs, IADGs, social spending at risk
- Rising social, political unrest
- US intelligence report, February 2009:
crisis -- greatest security risk



Growth and welfare

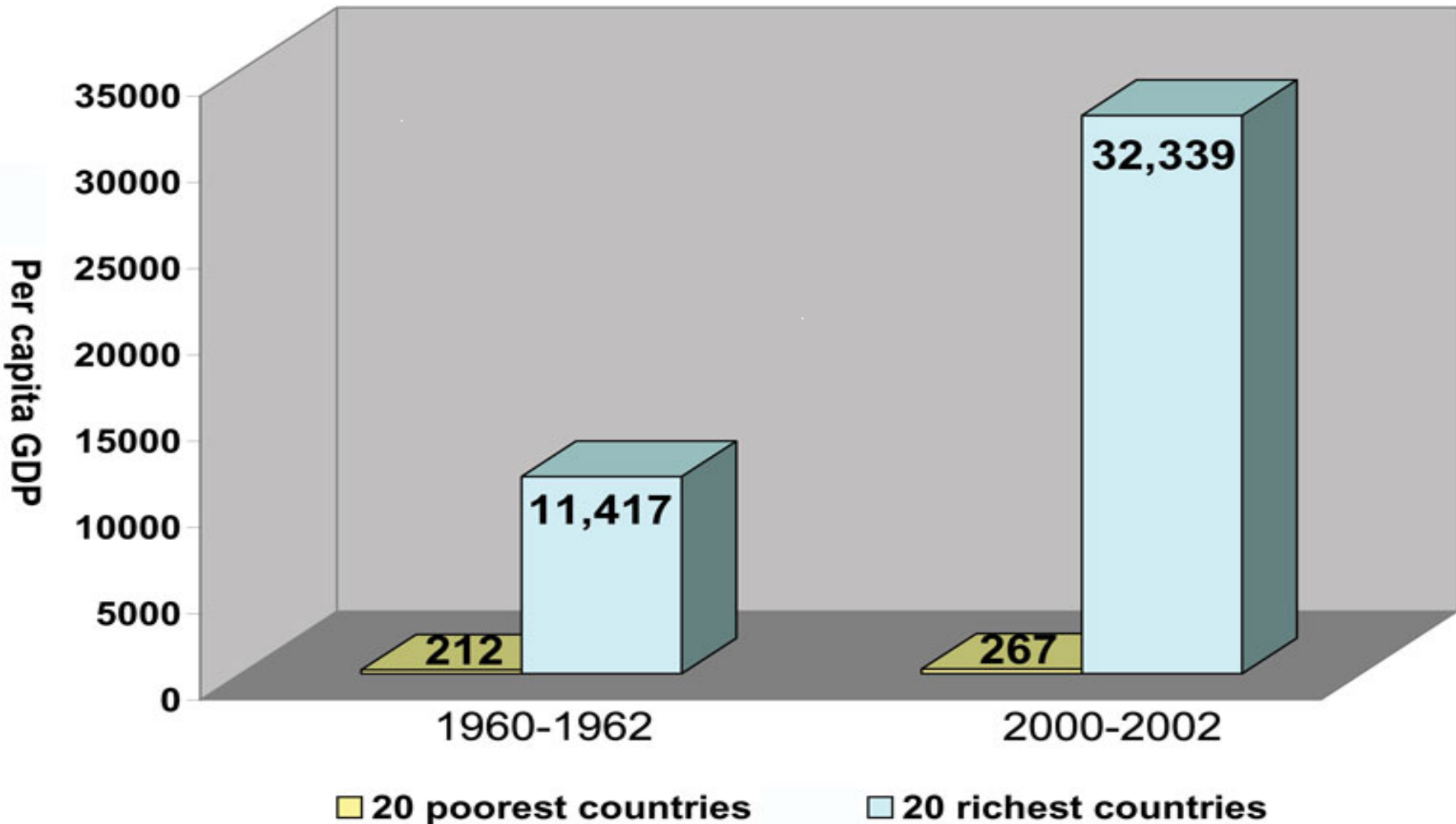


- Growth slower 1980-2002, compared to 1960-80
- Welfare improvements more modest since 1980s
- Therefore, poverty reduction slower with less growth, worse distribution

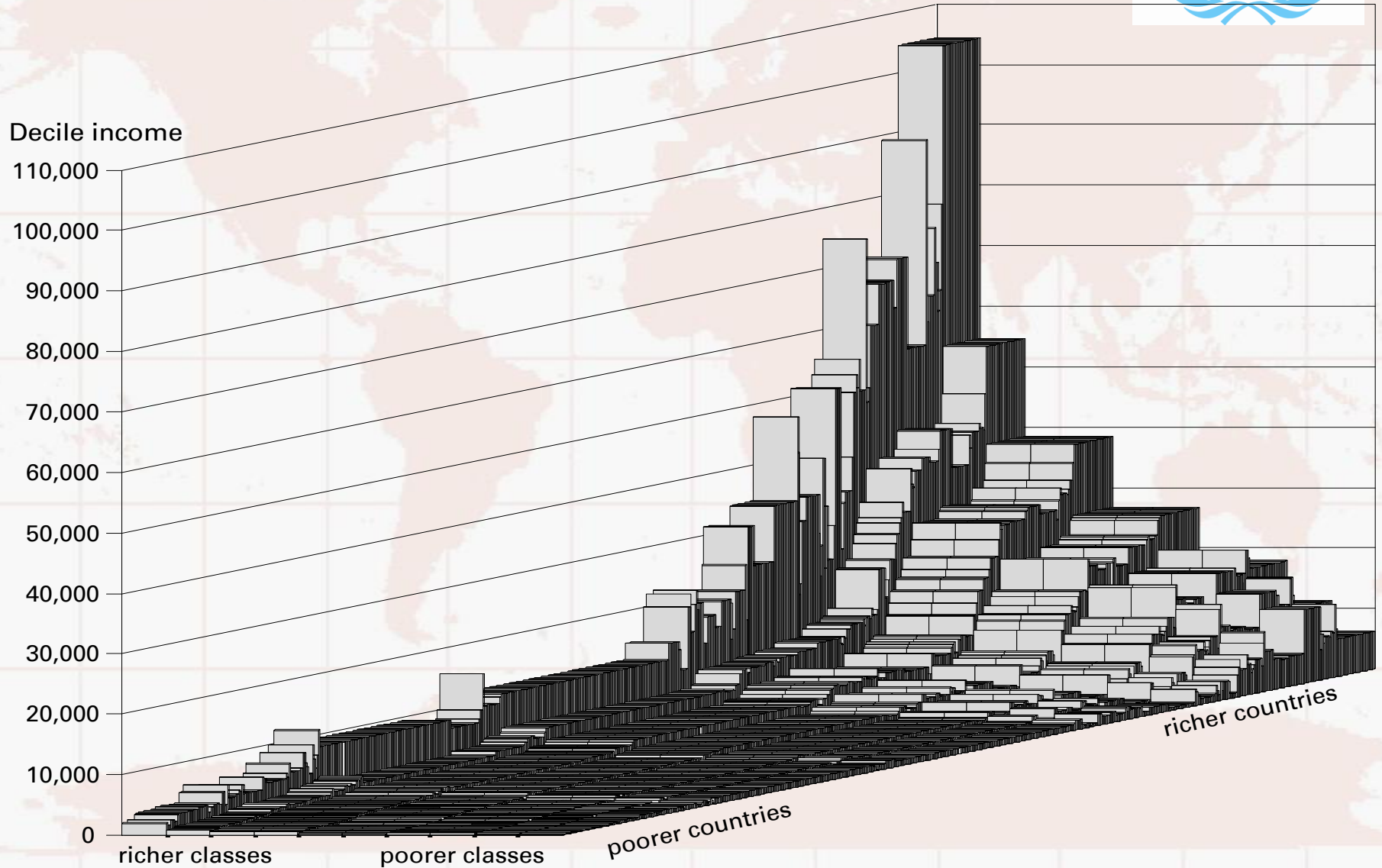
Recent growth after 2003

- Higher growth in South, inequality persists
- Jobless growth spreads; No poverty reduction without employment growth

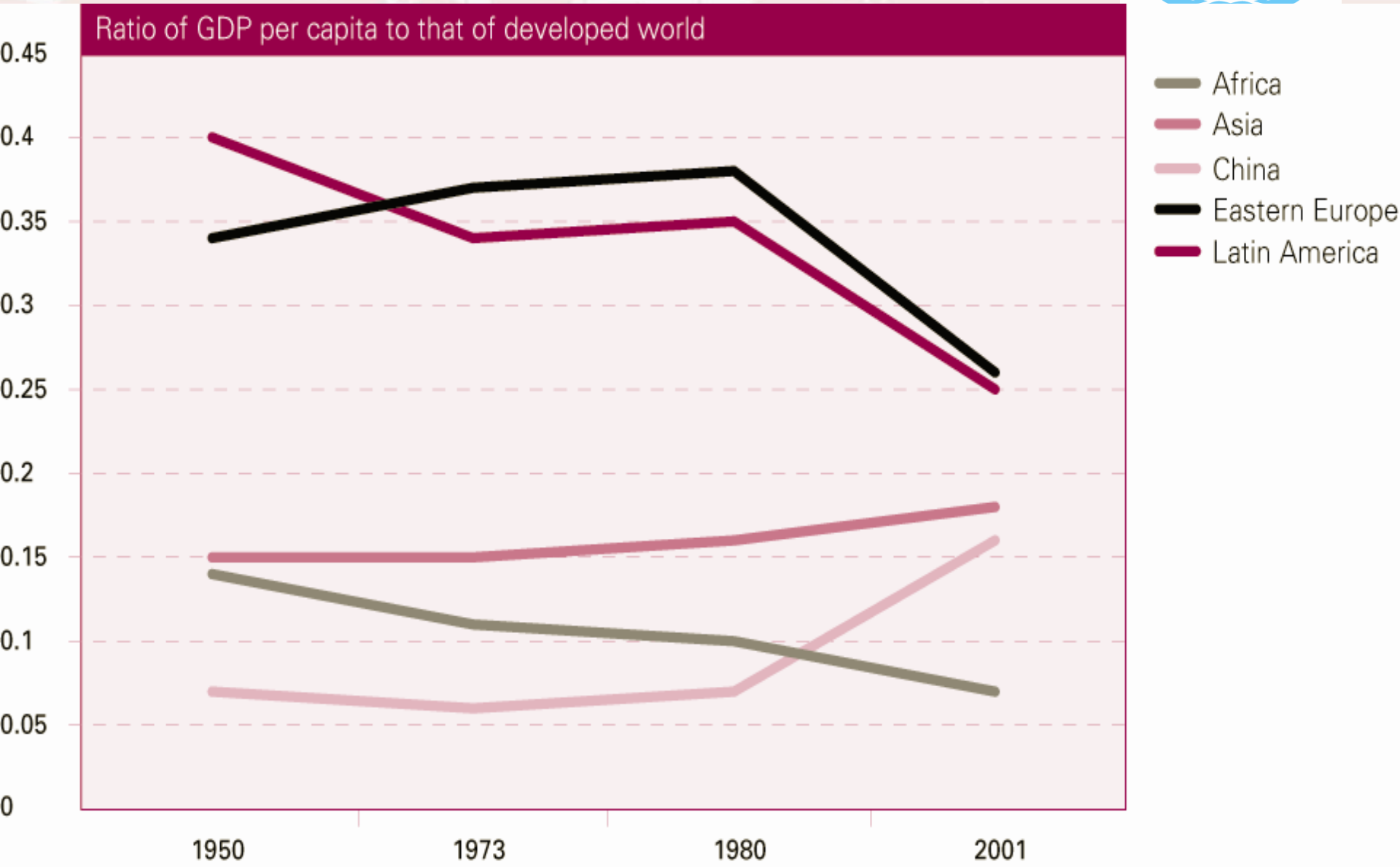
Huge inequalities! Per capita GDP in 20 poorest + 20 richest countries



Global income distribution



Ratio of GDP per capita to developed countries'



Development State



Selective industrial policy
involves incentives, e.g.

1: EPconEP, not ISI vs EOI

2: financial restraint/directed
credit, not 'financial
repression'

Research: Bases for policy?



- Critical research rejected (e.g. Kapur, Lewis, Webb: WB history)
- Inconvenient research irrelevant for operations, e.g. Winters, Grilli & Yang on trade, Rogoff *et al.*, Rajan, *et al.* on 'financial globalization'
- Deaton, *et al.* 2006 report on WB research during 1998-2005 found *policy legitimation*, e.g. Collier, Dollar

Conditionality, advice



- ‘Do as we say, not as we did’:
‘kicking away the ladder’
- ‘Double standards’, e.g. counter-cyclical policies for North, but not South in response to crisis
- BWIs’ macro framework, e.g.
<25% of PRSPs have employment strategy

World Trade Organization



- ITO (1948 Havana Charter) → GATT → Uruguay Rd, Marrakech → WTO
- Consensus decisions, but green rooms, etc
- ‘single commitment’ → no more choice
- broader scope: agriculture, services
- ‘trade-related’ issues (e.g. TRIPs)
- dispute settlement mechanism
- financial services liberalization
- Singapore issues

Doha Round not developmental



- Modest concessions (e.g. 97% market access for LDCs in HK)
- Doha Round gains:
 - more for developed economies;
 - most for 5 developing countries
- India's gains from international agricultural trade liberalization?!
- Divide and rule
- Non-Agricultural Market Access (NAMA)
- *Modest, unequal, 1 time* gains

Learning from experience



- Palliative vs developmental approaches
- No single model; one size does not fit all
- Eschew mainstream orthodoxy; common sense, cautious experimentation → pragmatism
- Growth necessary, but not sufficient
- Distribution + accountability important
- National ownership + 'policy space' crucial
- Unfortunately, power + economic governance, national + international, in the way

Israel-Palestine relations



- No economic borders with Israel since 1967-68 occupation
- Israel's anti-development/anti-competition policy in Occupied Territories:
there will be no development initiated by the Israeli Government, and no permits will be given for expanding agriculture or industry (there), which may compete with the State of Israel
(Defence Minister Yitzhak Rabin in 1986)
- Paris Protocol (PER) legitimized skewed integration under a single (Israeli) currency, VAT, customs regime, and open economic borders, i.e. a customs union (CU)

A bantustan economy?

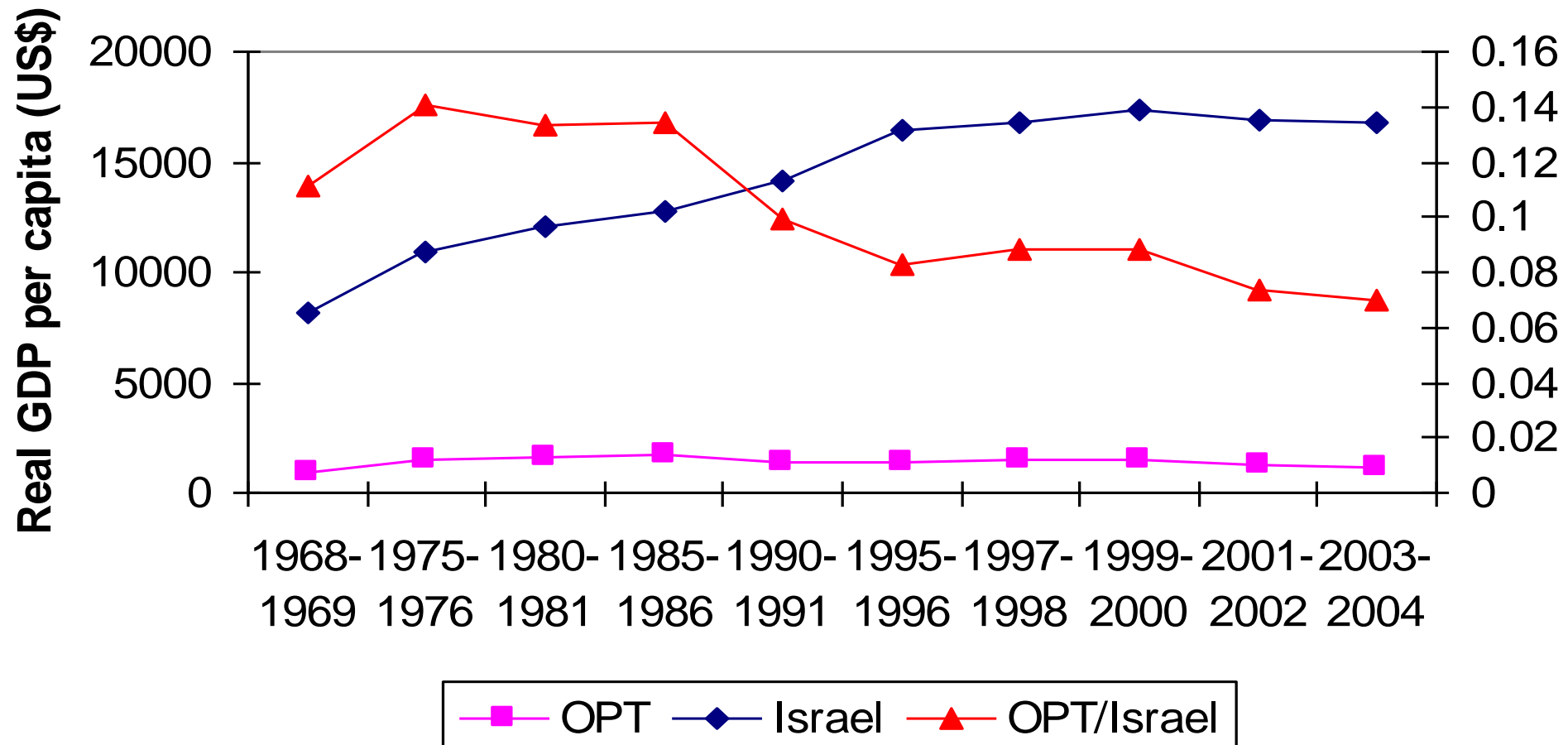


- No national currency → no seigniorage revenue
- Suffers from worst of both polar exchange rate regimes
- No control over capital flows
- Very limited fiscal capacity
- Exposed to globalization with no protection
- Israel remains Occupied Territories' main trading partner, receiving 90+% of exports
- Faces arbitrary border closures and restrictions on economic activities

Divergence big time



Pattern of divergence: Real GDP per capita (1995 US\$) - Israel and OPT



A state of siege?



<i>Year</i>	<i>Days closed</i>	<i>% of potential</i>
1993	26	6.1%
1994	89	23.1%
1995	112	29.9%
1996	121	31.9%
1997	79	20.5%
1998	26	5.2%
1999	16	2.5%
2000	75	18.8%
2001	210	70.6%
2002	260	
2003	130	
2004	220	
2005	180	

New economic relations?



- Agreed 'economic borders'
- Emphasis on domestic job creation & less dependence on employment in Israel
- Negotiate new economic relations with Israel with recourse to arbitration under WTO framework
- Integrate with region's economies

PA development policies?



- Expansionary fiscal policy for developing economic & social infrastructure, including to attract private investment
- SOE employment (better than public service jobs); also serves as social protection
- Industrial (investment + technology) policy
- Supportive measures, including development bank, to finance development process
- Effective protection conditional on export promotion
- Gain seigniorage revenue from issue of national currency

NDS Policy Notes



Reviewed by Prof. Joseph Stiglitz (Nobel, 2001)

- Macroeconomics & Growth (Shari Spiegel, Jayati Ghosh)
- Finance (C. P. Chandrasekhar)
- Trade (Murray Gibbs)
- Investment & Technology (Mushtaq Khan)
- State Owned Enterprise Reform (Chang HJ)
- Social Policy (Isabel Ortiz)

Thank you



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- Research papers
- Policy briefs
- Other documents

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