



# 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  
10:00 am, Tuesday, 10 November 2009*

Jomo Kwame Sundaram  
*UN Assistant Secretary-General  
for Economic Development*

# 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)

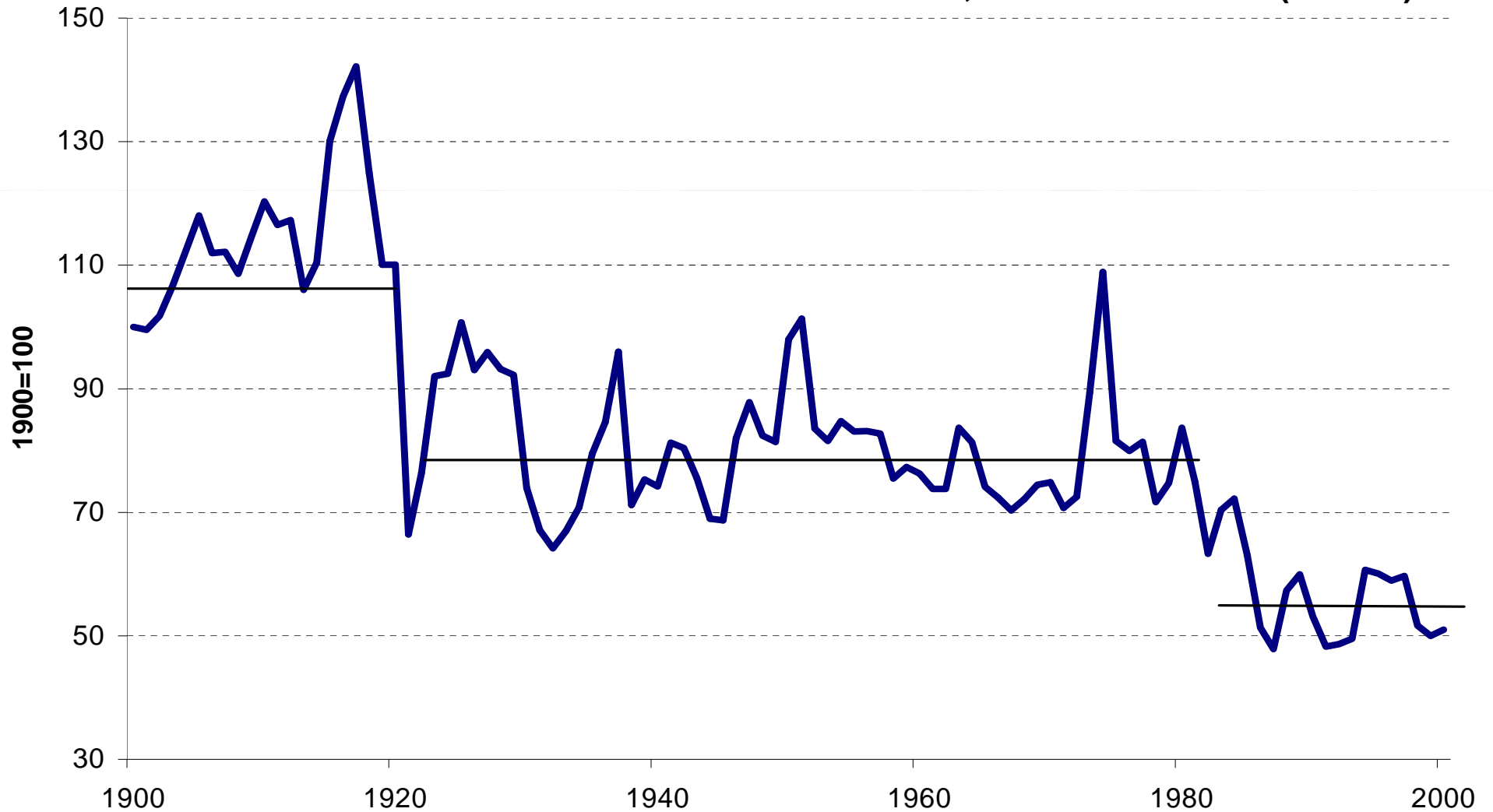
Ocampo & Parra in Jomo (2005)

# Commodity Price Index, 20C



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

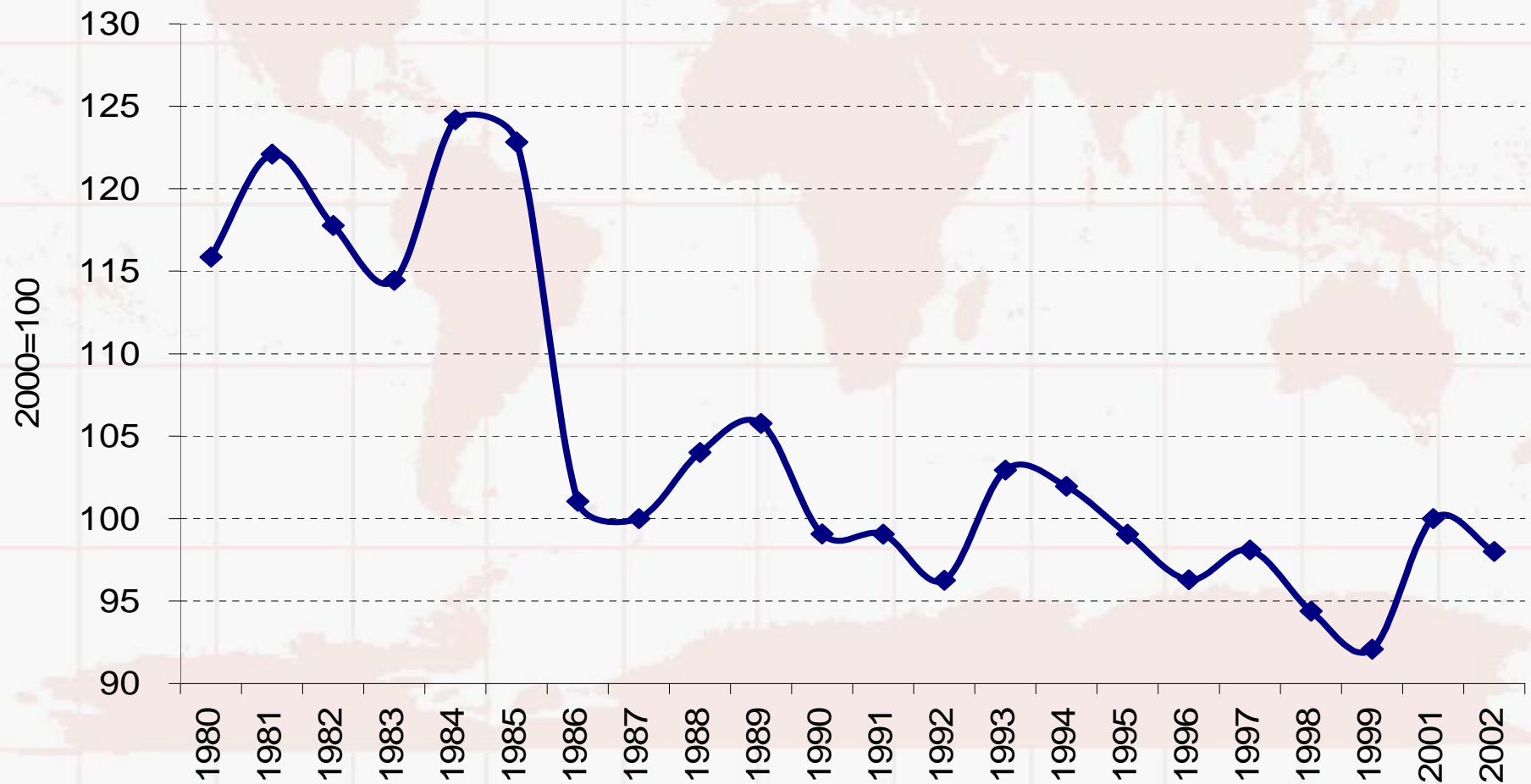
*Generic manufactures vs monopolistic manufactures protected by IPRs?*

**→ 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 culpas*



- 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?



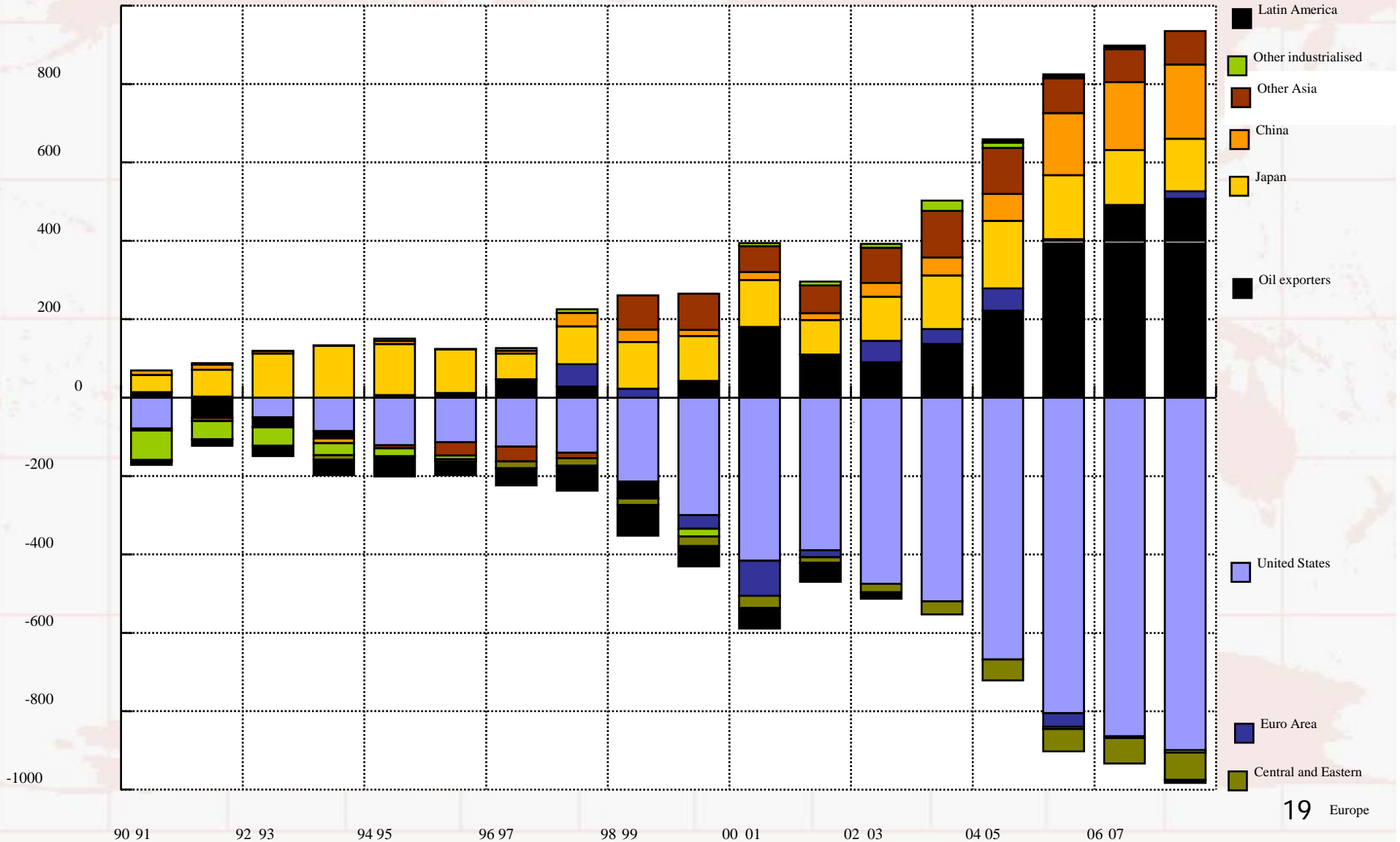
- *A **crisis foretold**: BIS, UN, UNCTAD*
- *Unsustainable global **imbalances***
- International fin. *architecture: **non-system***
- *Ideology: **deregulation**, self-regulation, inadequate + inappropriate regulation  
capital account liberalization*
- ***Financial** globalization: growth, stability?*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

# Global imbalances grow

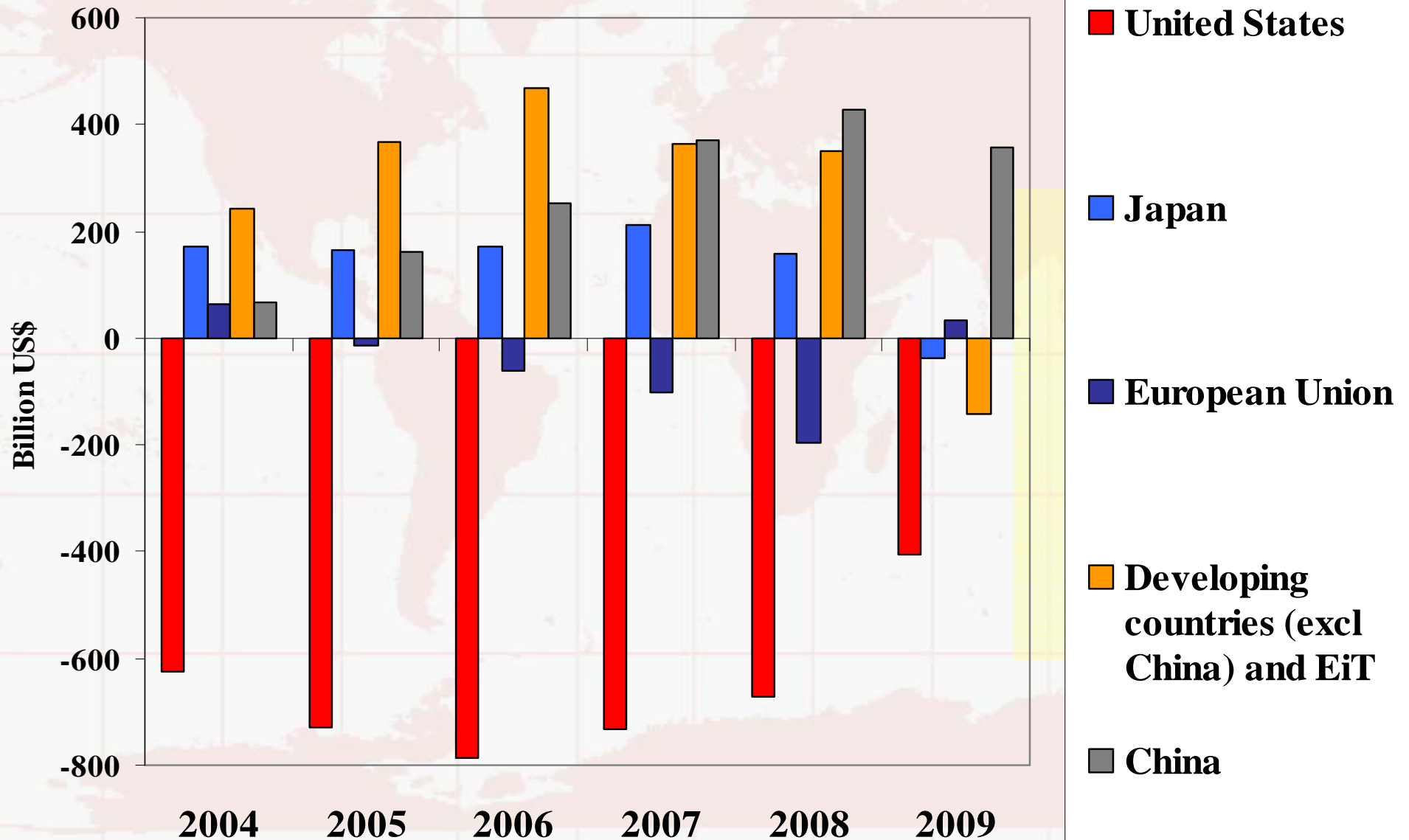


USD bn

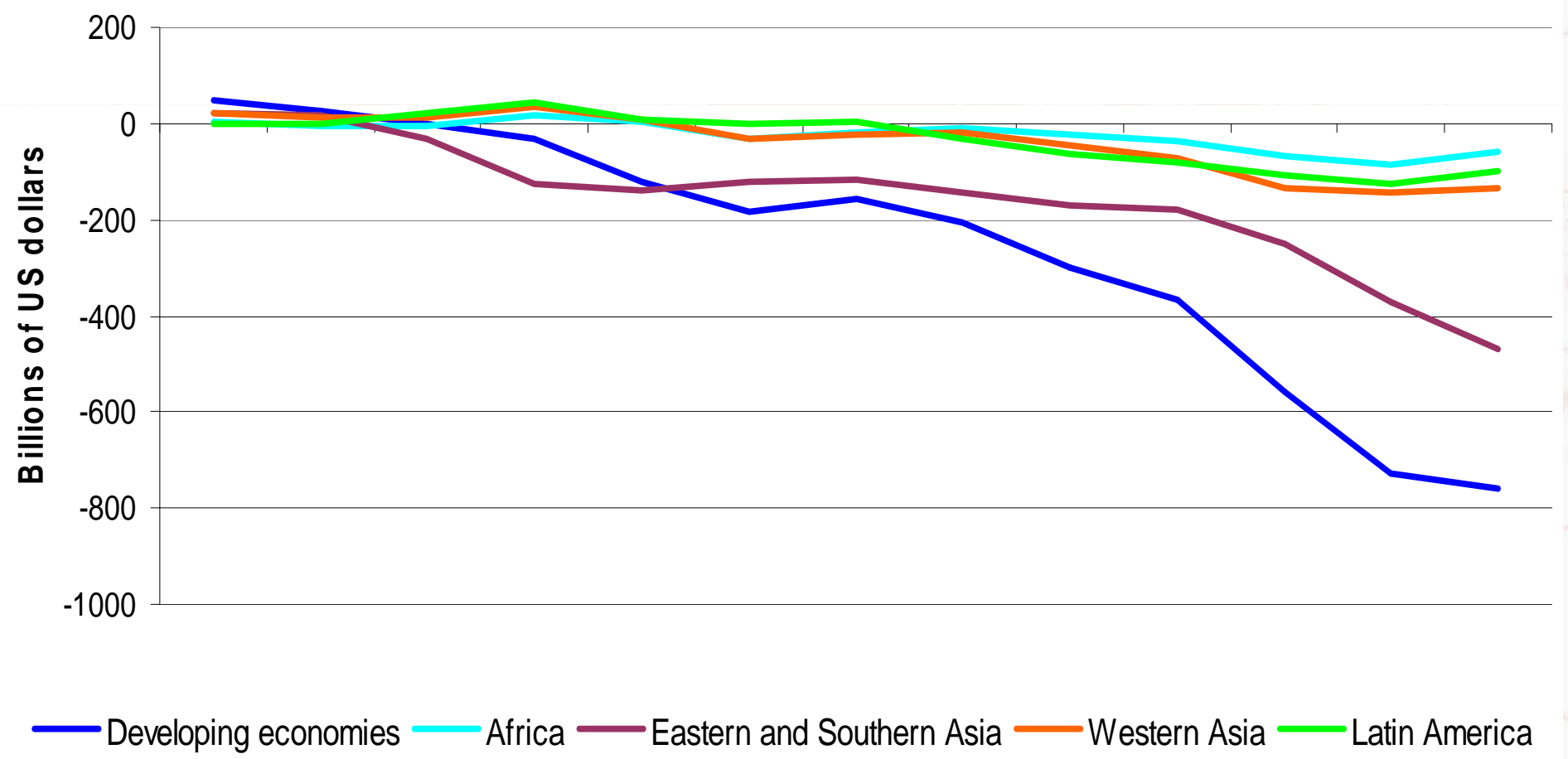
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# Disorderly unwinding



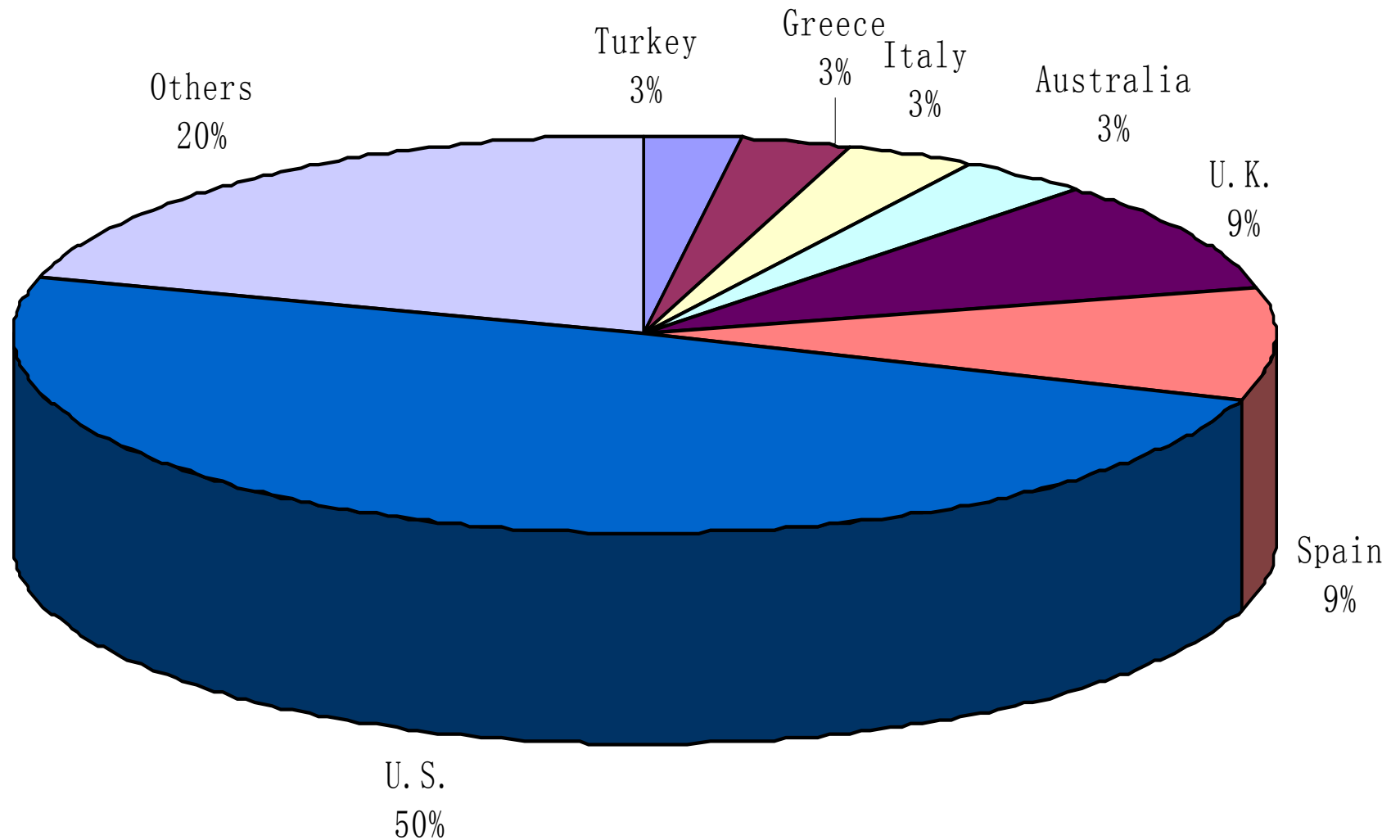
# Net transfer of financial resources from South to North



# Net capital importers



## Capital Importers



# Inverted pyramid unstable



964% of  
World GDP

**Derivatives**

78% of  
Total

138% of  
World GDP

**Securitized Debt**

11% of  
Total

122% of  
World GDP

**Broad  
Money**

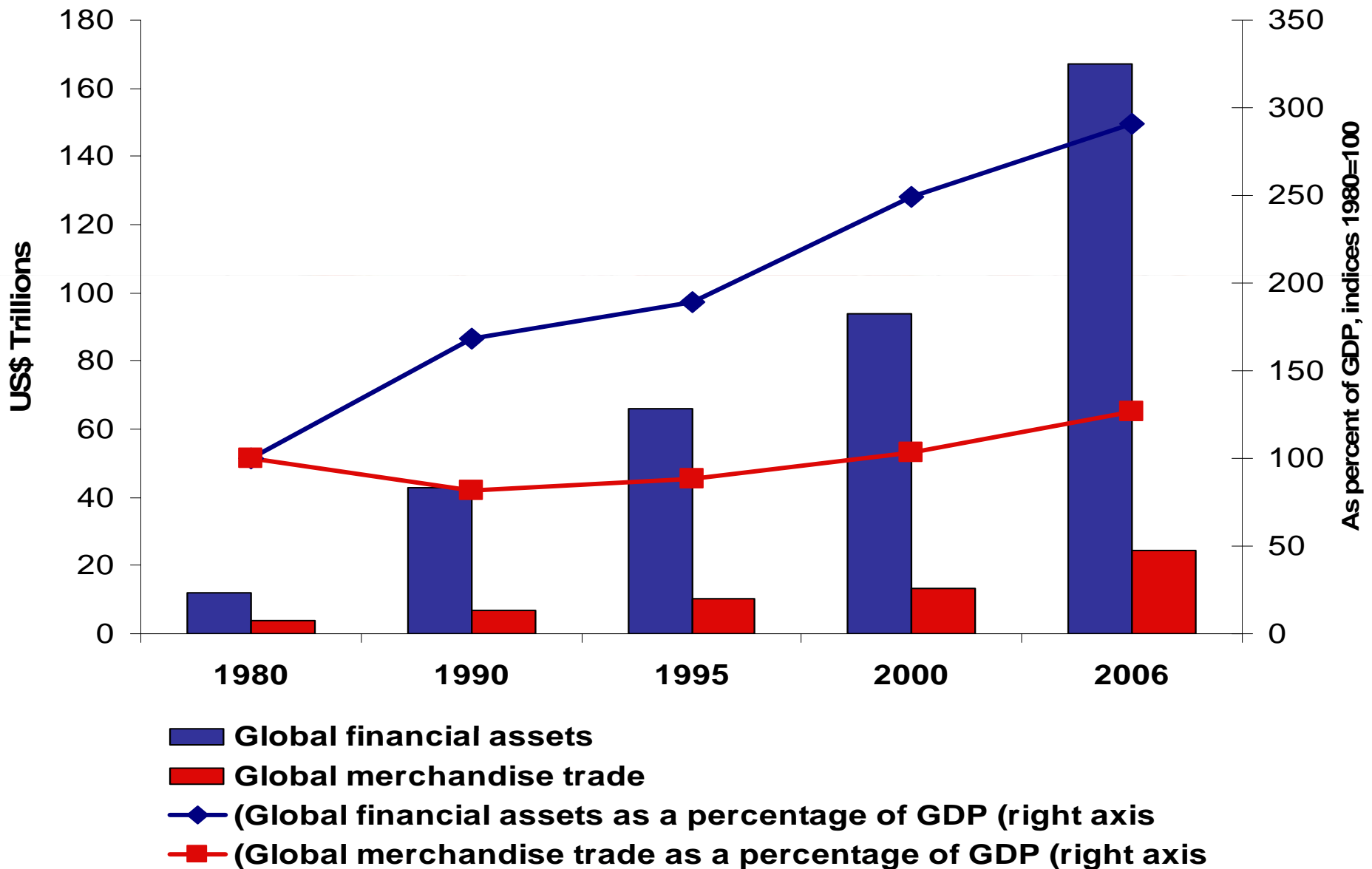
10% of  
Total

9% of  
World GDP

**Power  
Money**

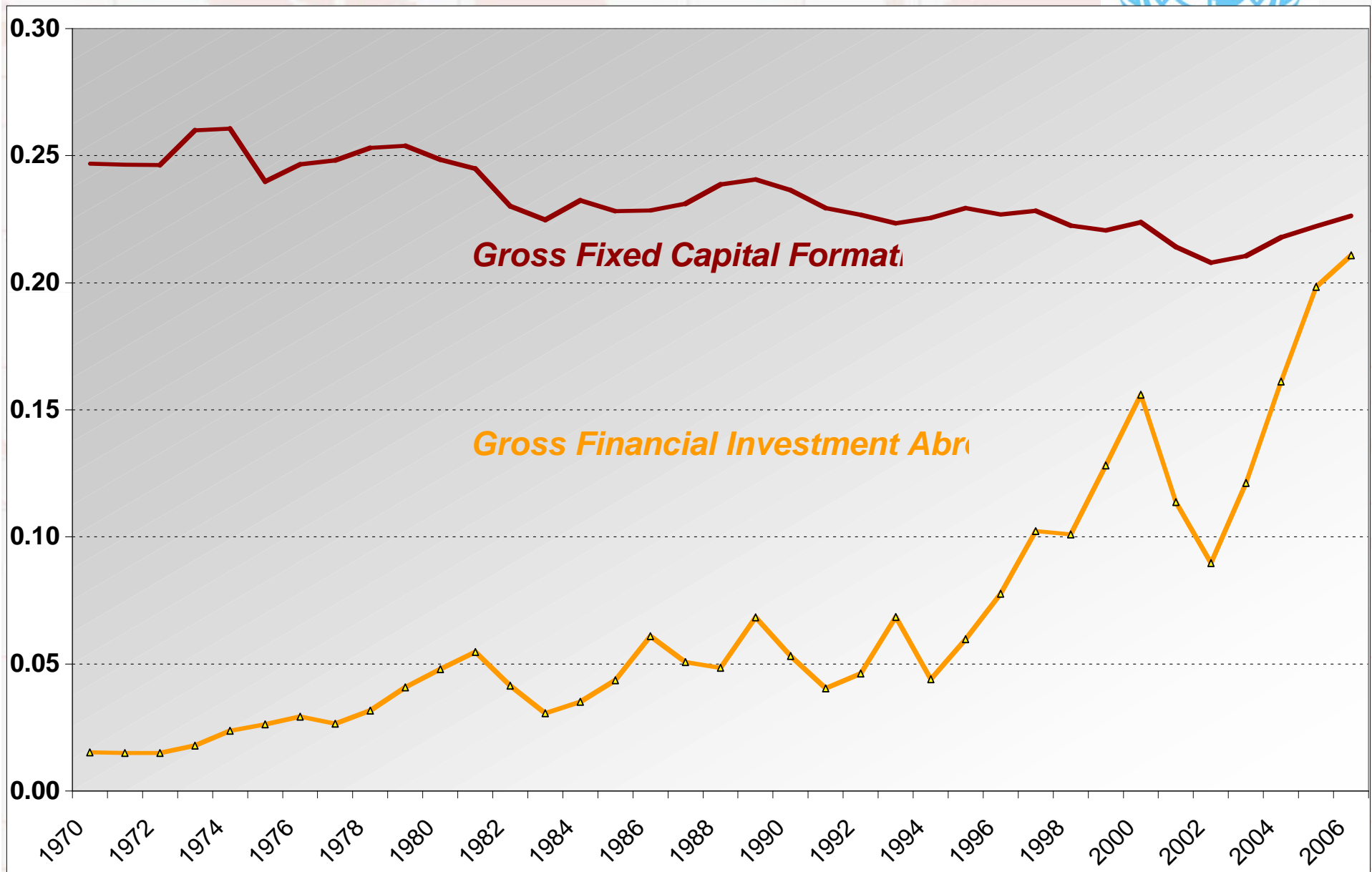
1% of  
Total

# 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

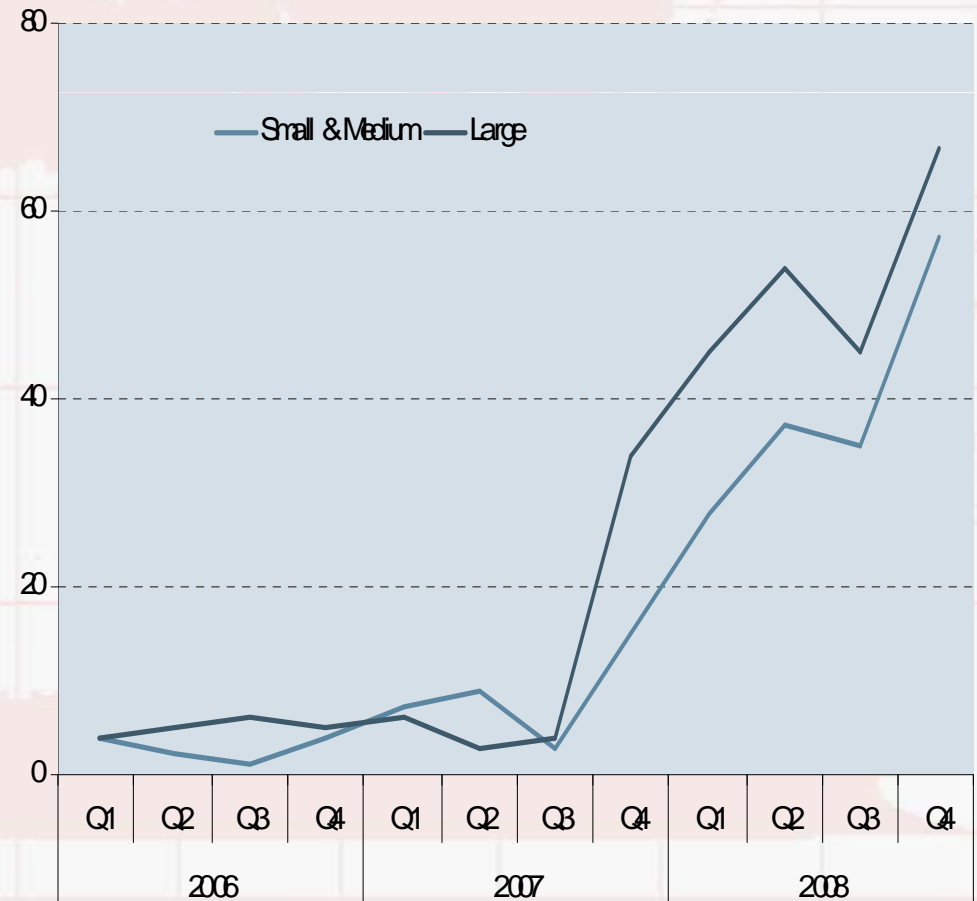
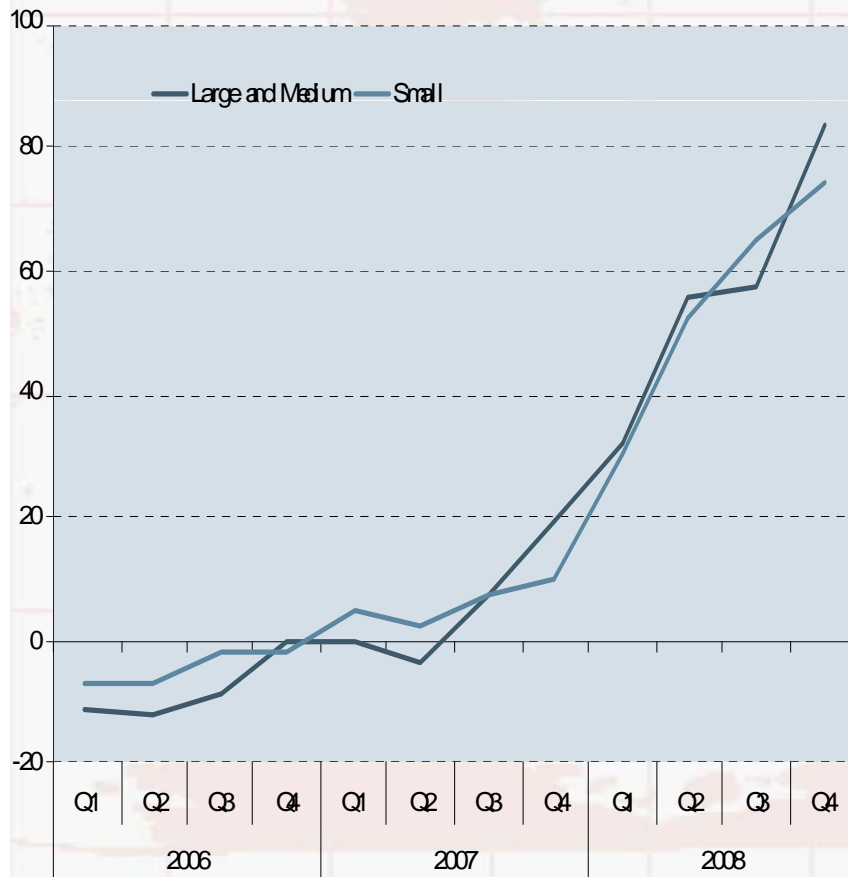
# Credit crunch: US, EU



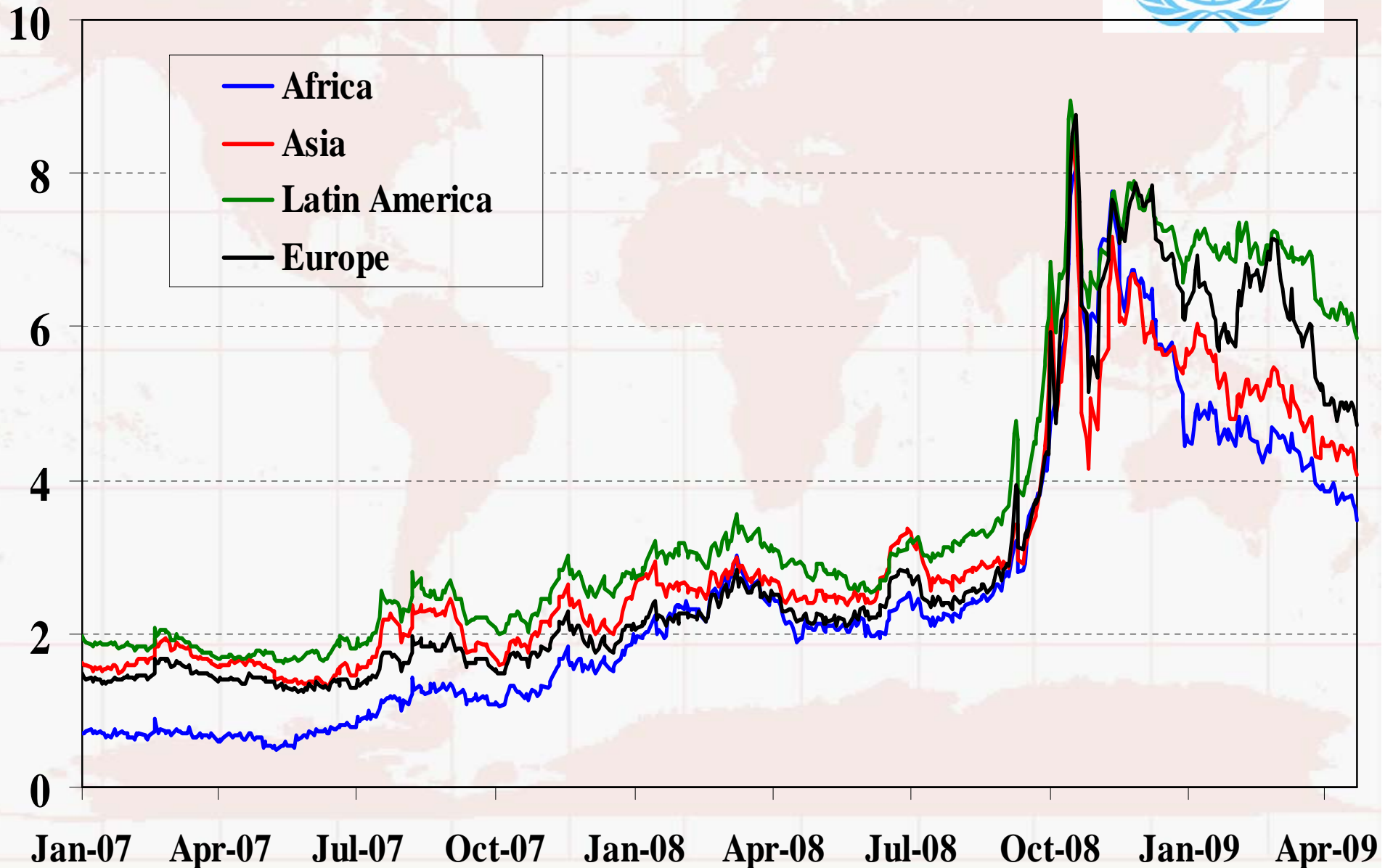
Percentage of lenders tightening standards, by size of enterprise seeking loans

Panel A: United States

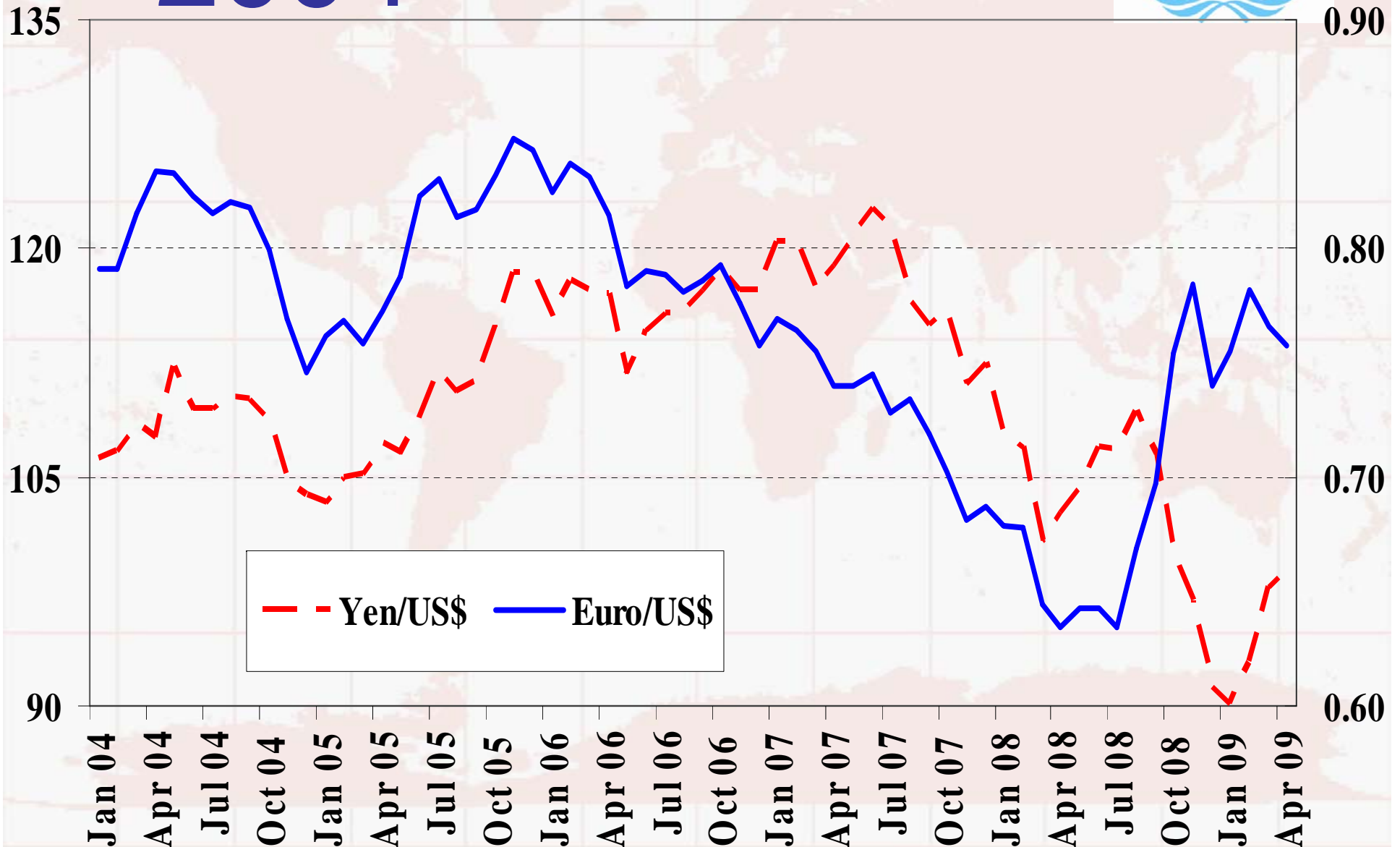
Panel B: European Union



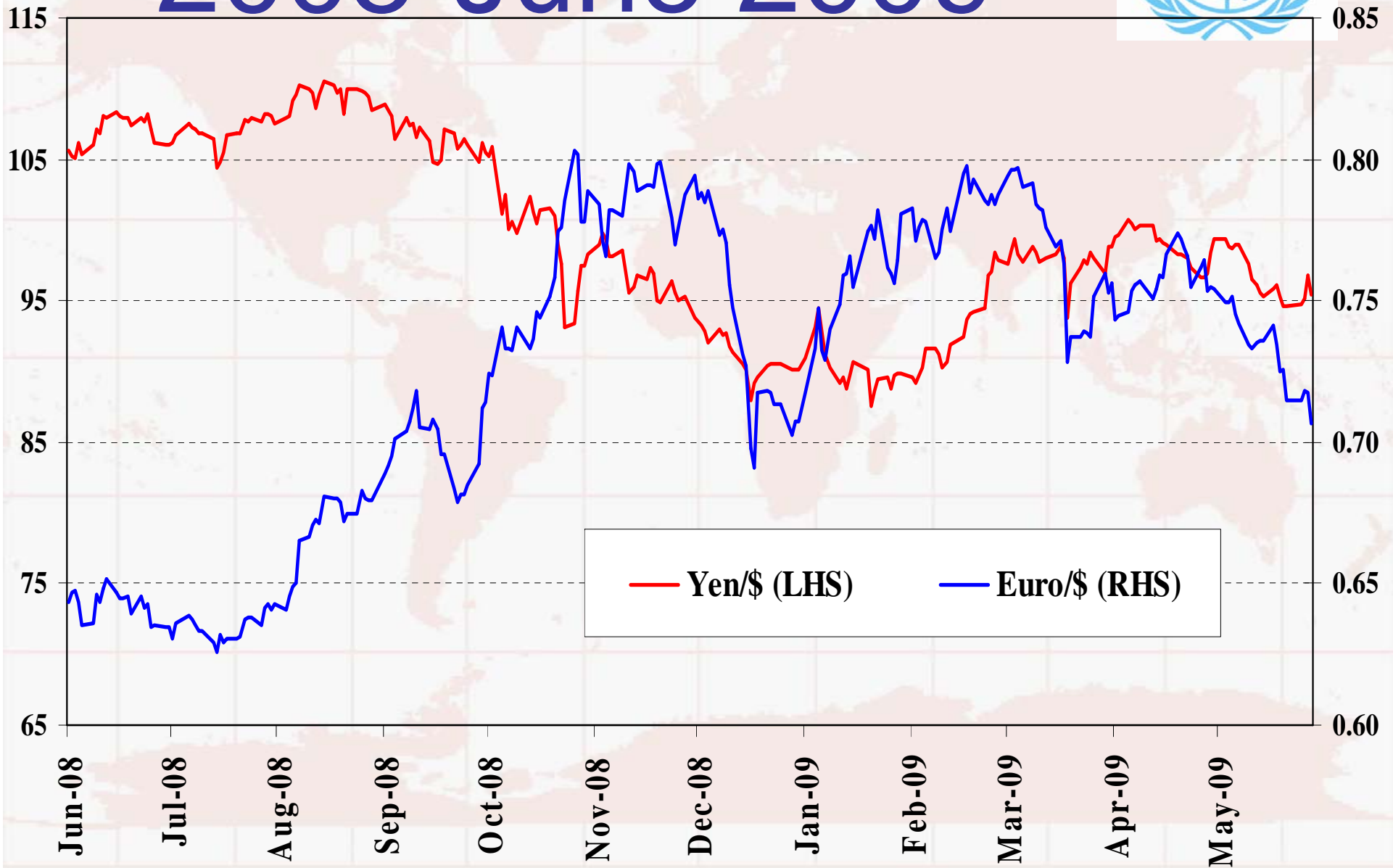
# Borrowing costs high



# 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

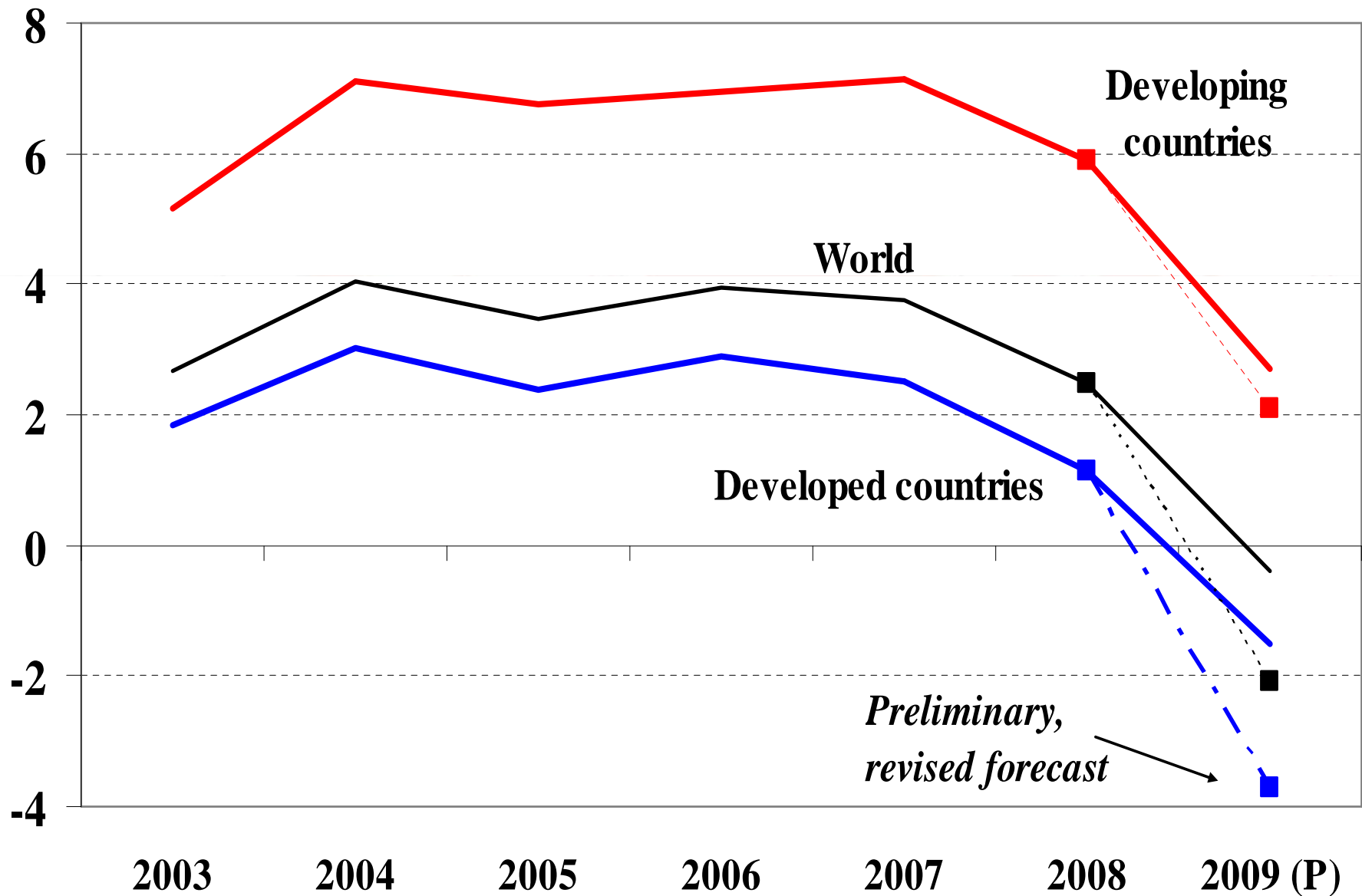
# Deflationary spiral



- 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

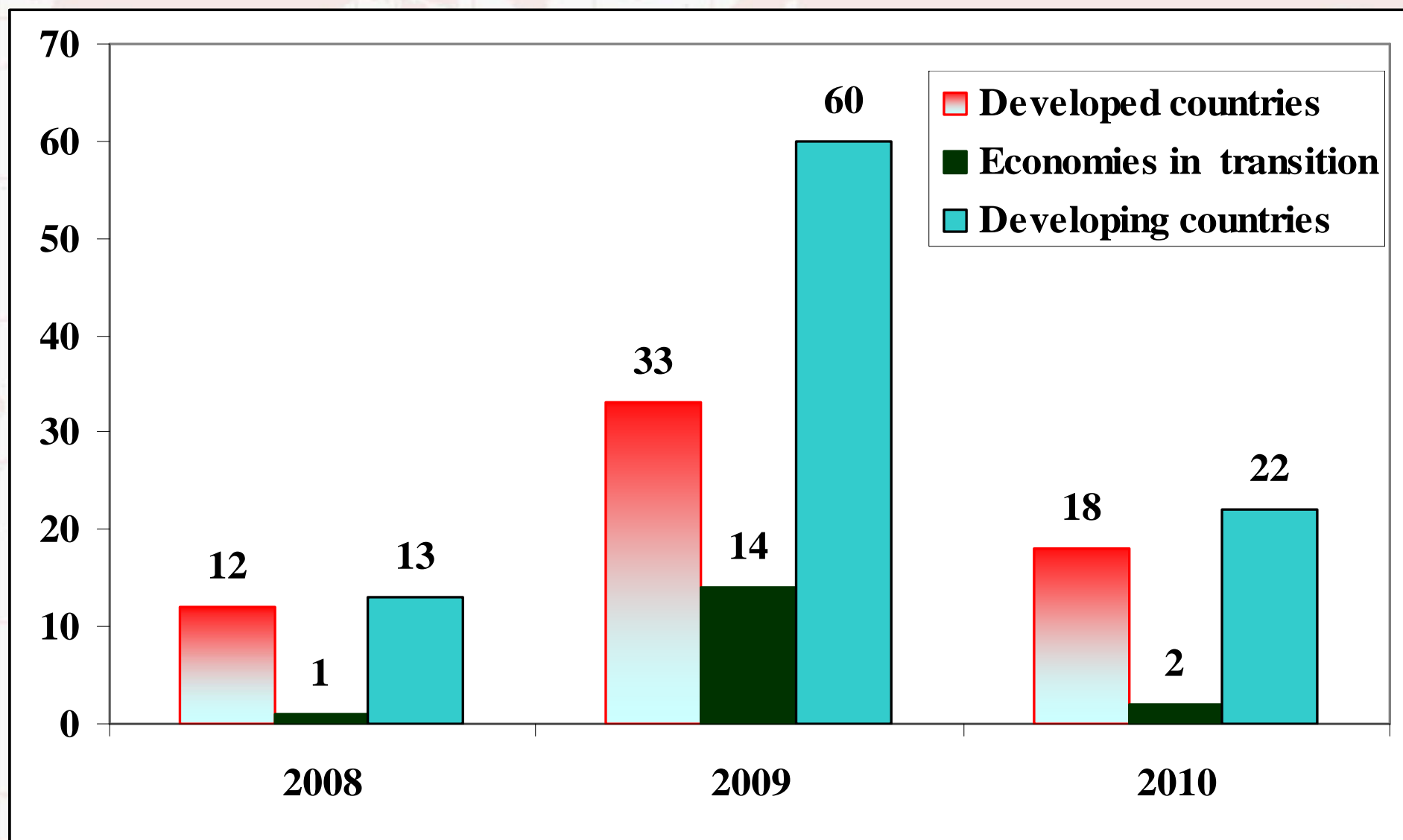


# Growth by main country groups



	Per capita GDP growth rate			Change in growth rate	
	2004-07	2008	2009	2009/2008	2009/2004-7
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

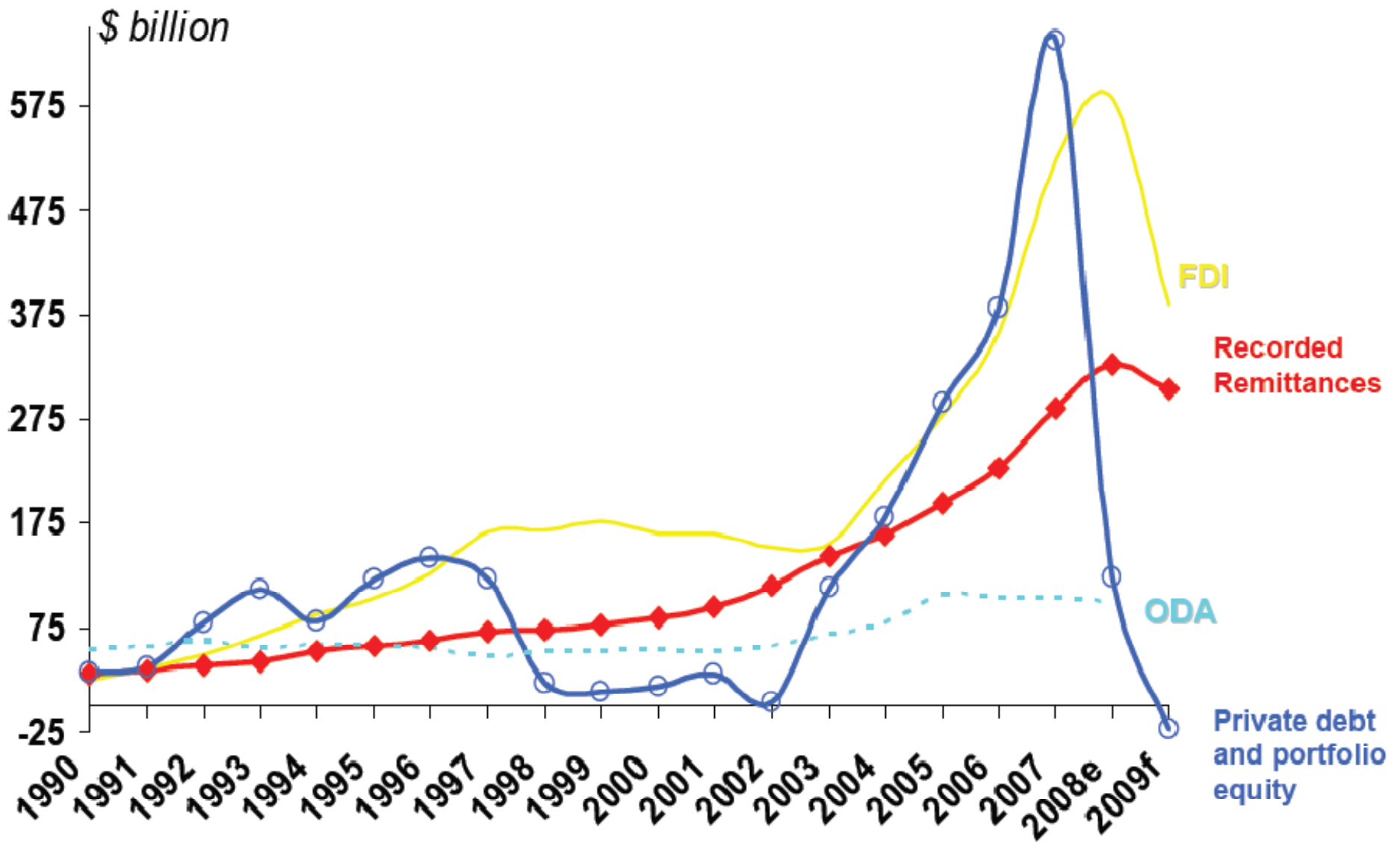


# Trade impacts: summary

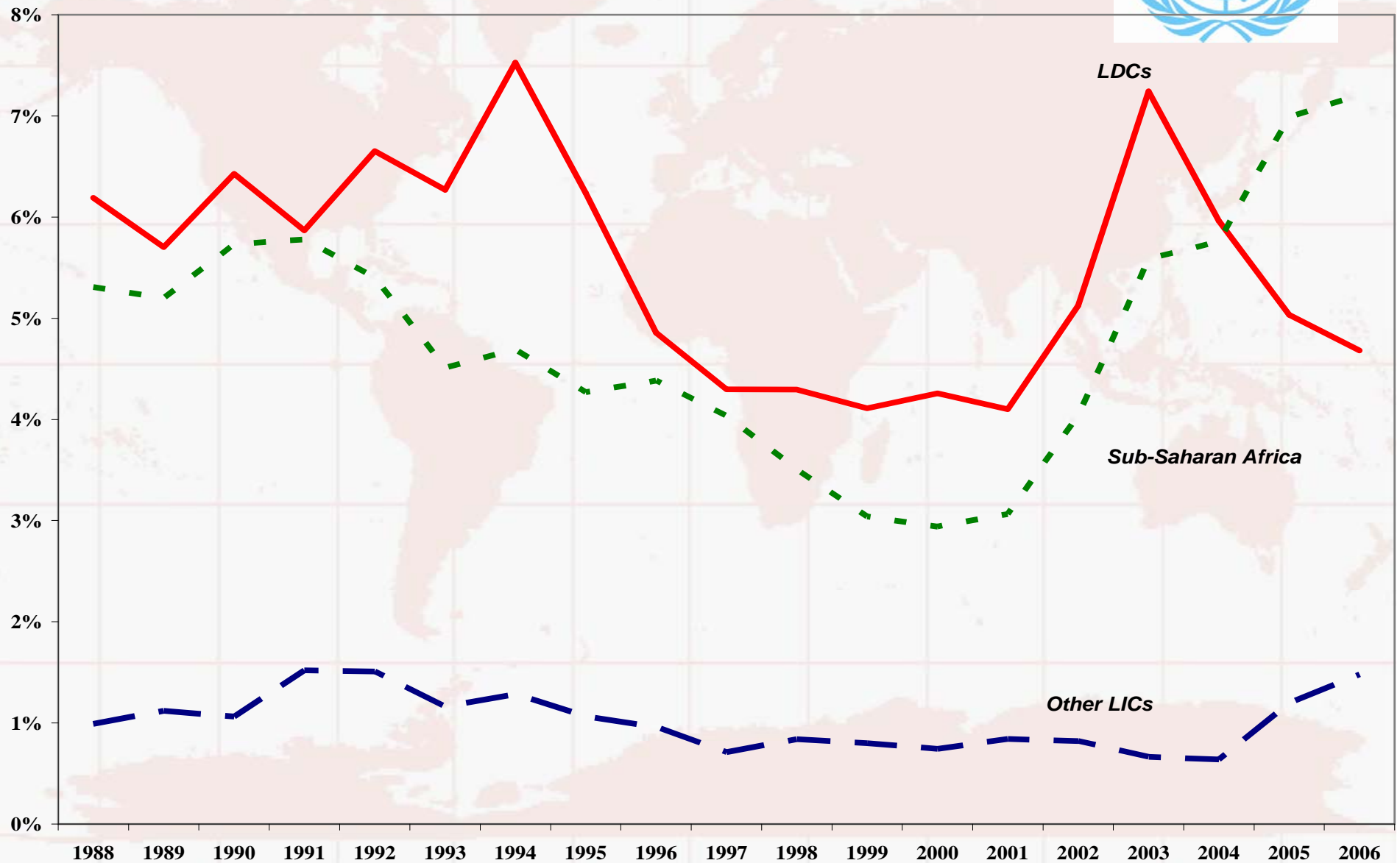


- Exports decline →  
**all developing countries**
- Terms of trade → **primary exporters**
- **Trade surpluses,**  
**reserves** run down quickly
- **But lower energy, food prices helped net food and oil importers**

# All capital inflows down

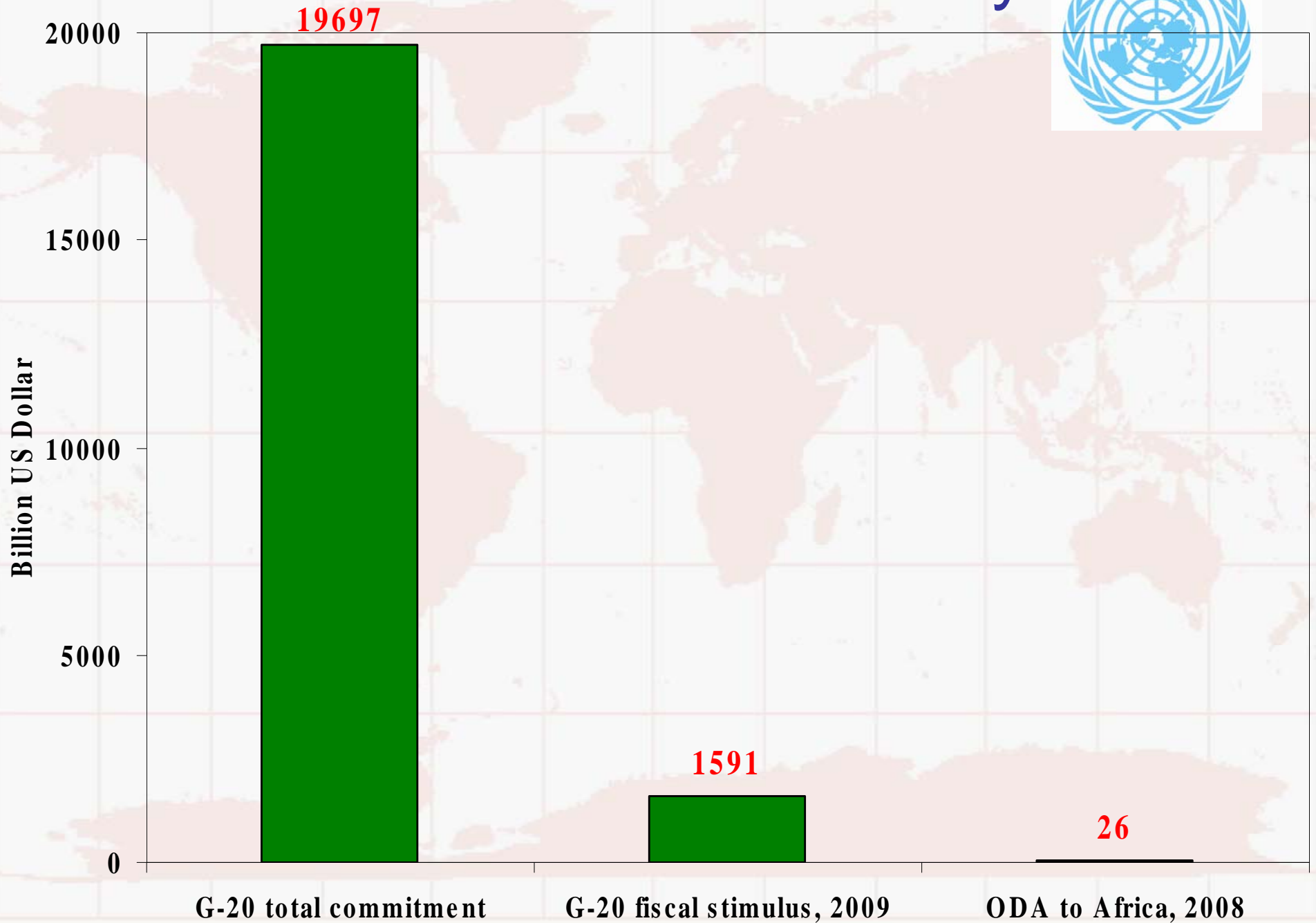


# Aid flows unreliable





# 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?

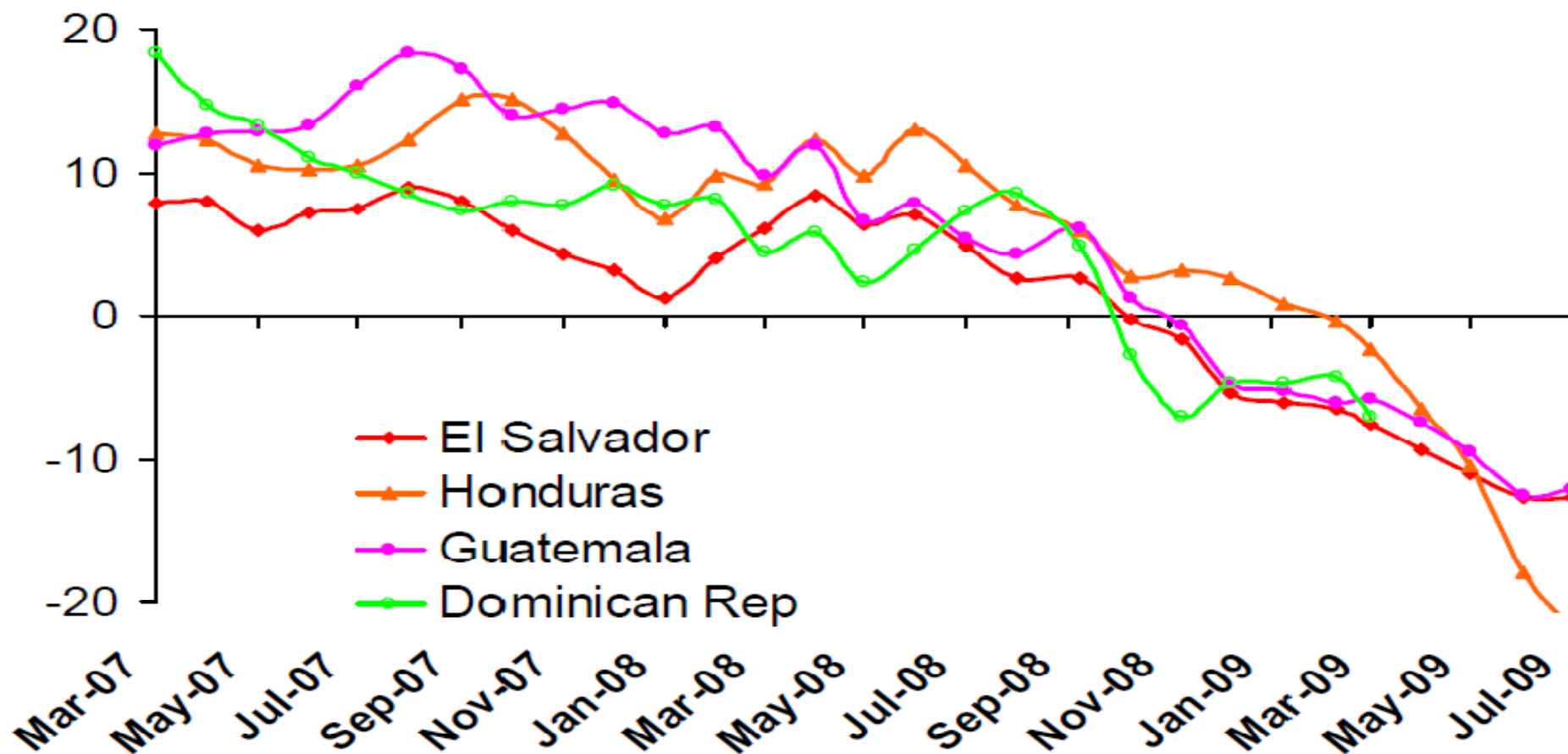


- Historically, remittances to home countries rise in crisis
- However, migrant workers in host countries now most adversely hit by job losses, lower incomes
- Evidence uneven for different migrant workers by home country, host country, crisis impact
- Debt sustainability redefined to include remittances,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

# LA remittances down



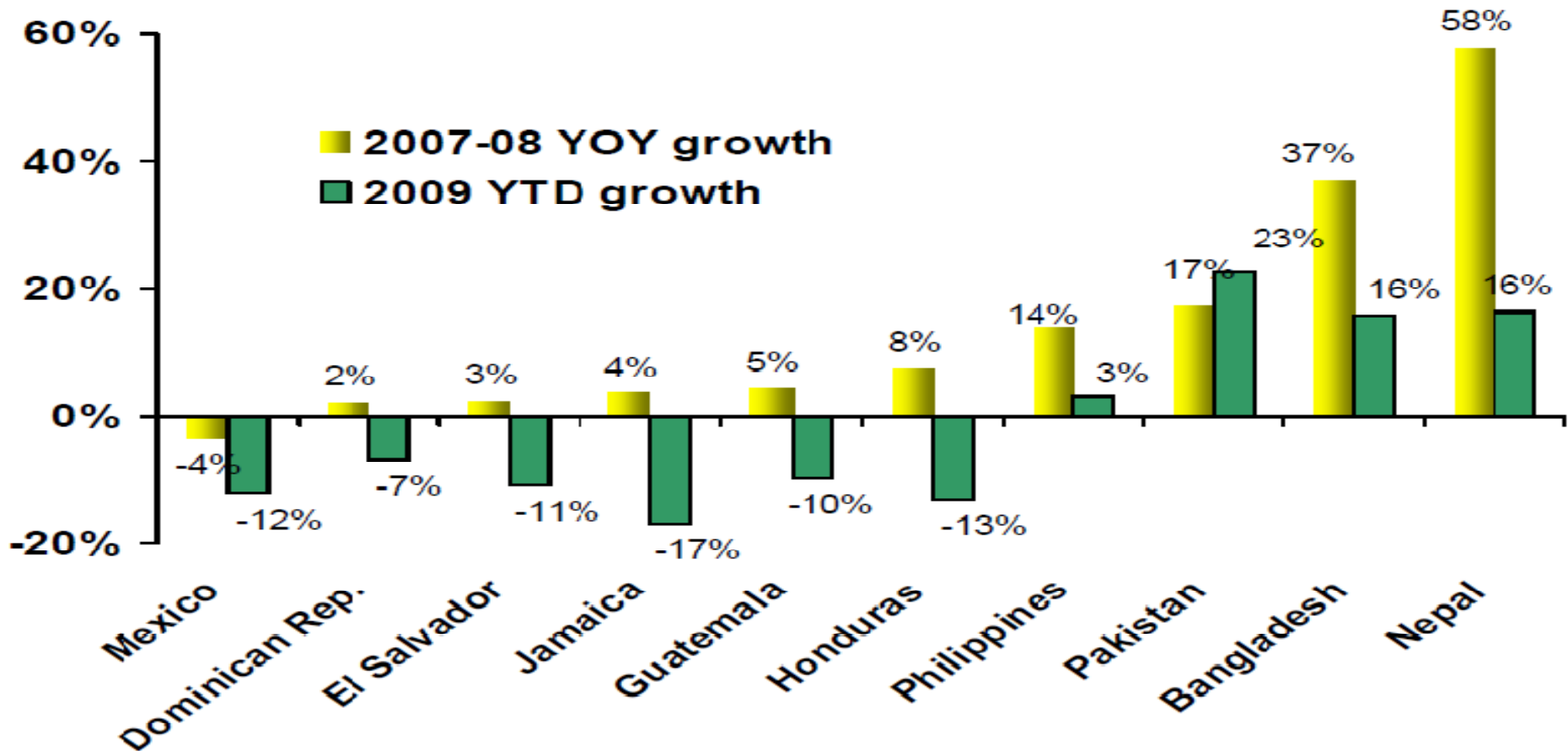
**Remittance to other Latin American countries started declining in the first half of 2009**



# But up in Asia (X rate effect)



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



# Social impacts

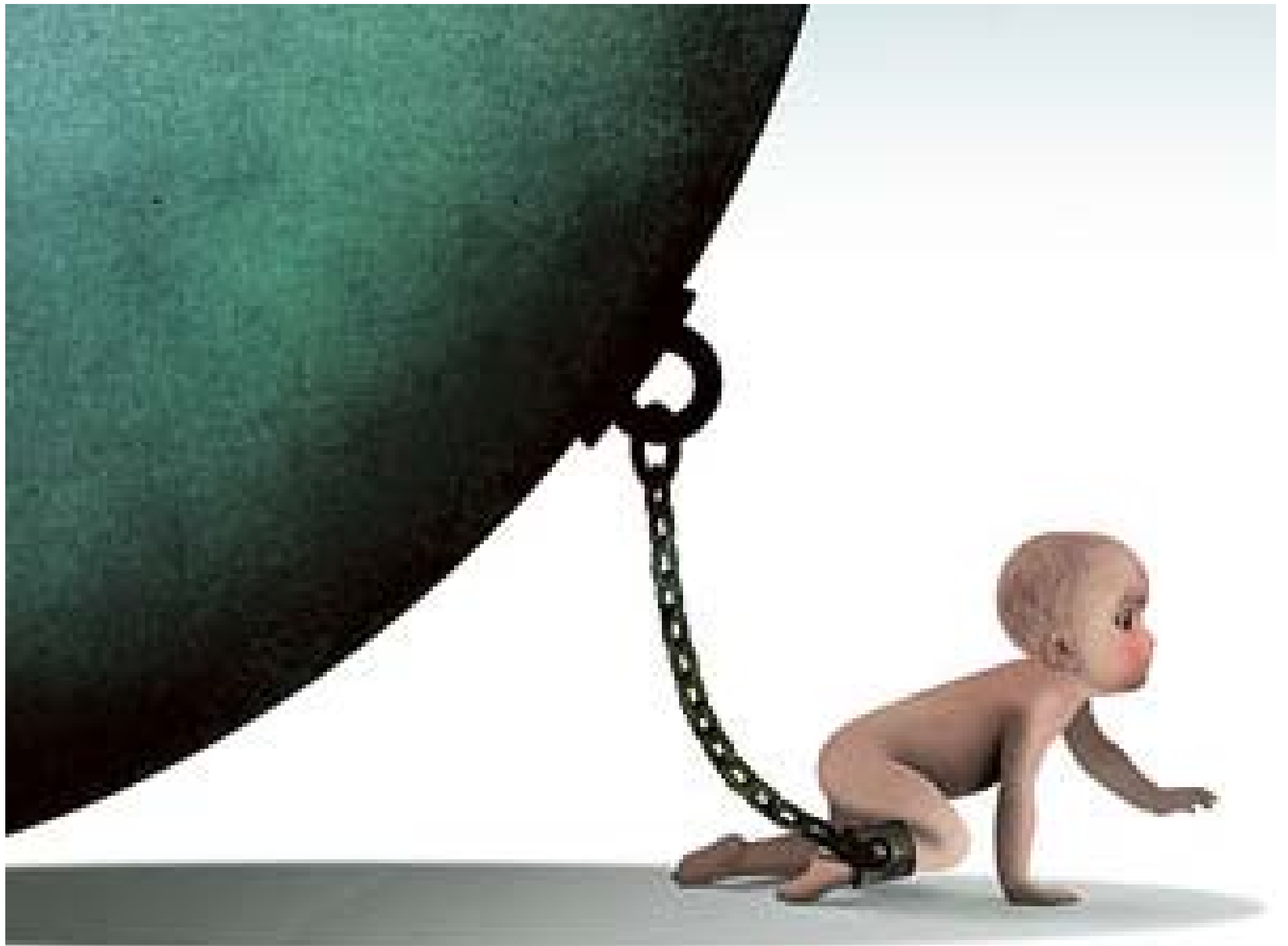


- ILO: >200 m. more working poor
- ILO: Unemployment to rise by 51m
- ILO projections based on IMF Nov 08
- MDGs, IADGs, social spending at risk
- Rising social, political unrest
- US intelligence report, February 2009:  
crisis -- greatest security risk

# Constraints on developing country responses



- IMF imposes *fiscal requirements* for stimulus
- IMF: developing country efforts *likely to fail*
- Policy -- especially *fiscal* -- *space constrained*
- *Monetary policy less effective*, worse with independent central banks, fiscal authority
- Systemic, market, institutional *pro-cyclicality*
- *Lost productive capacities* due to openness



# Growth and welfare



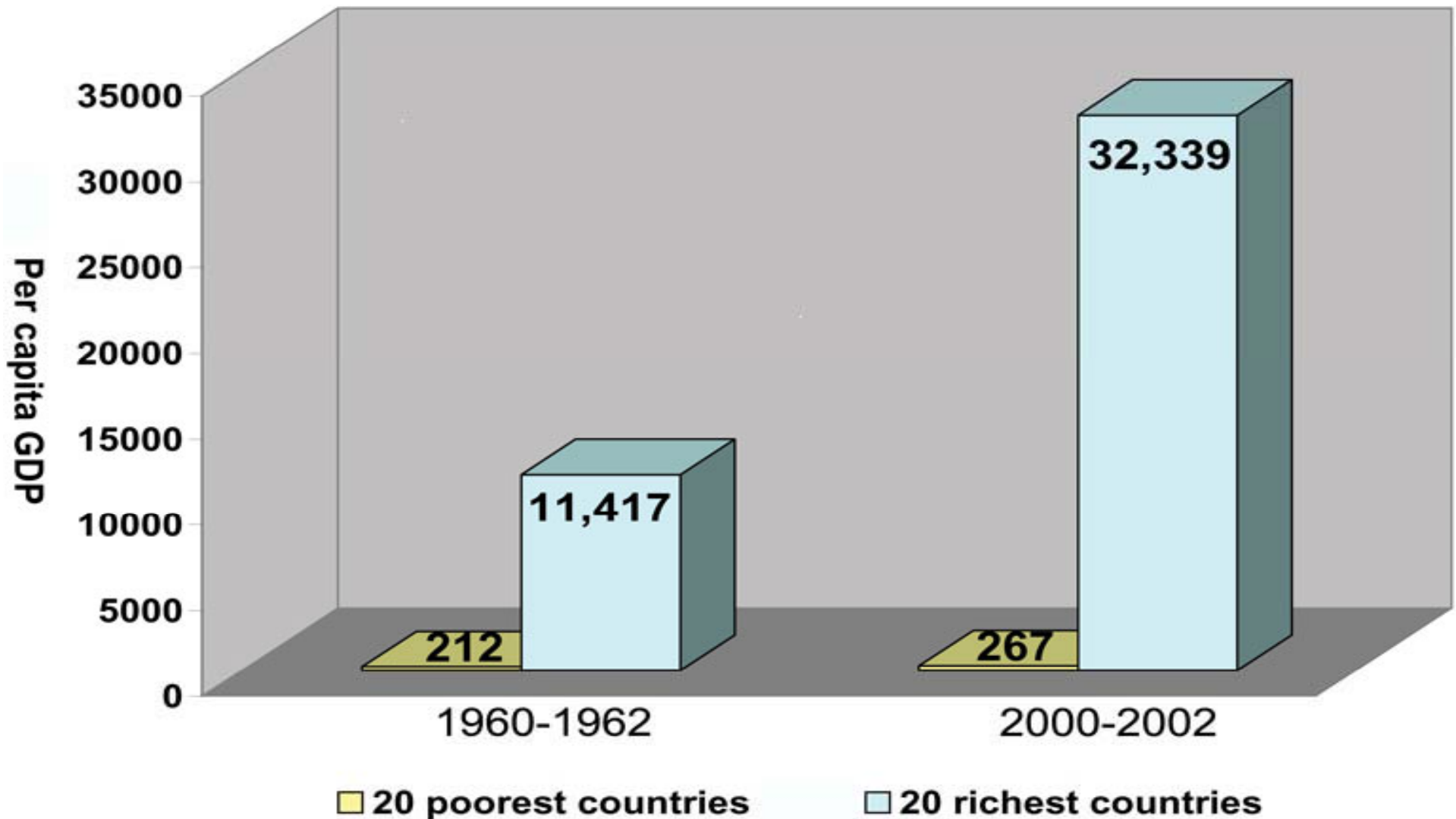
- Growth slower 1980-2002, compared to 1960-80
- Welfare improvements more modest since 1980s
- Therefore, poverty reduction slower with less growth, worse distribution

## *Recent growth after 2003*

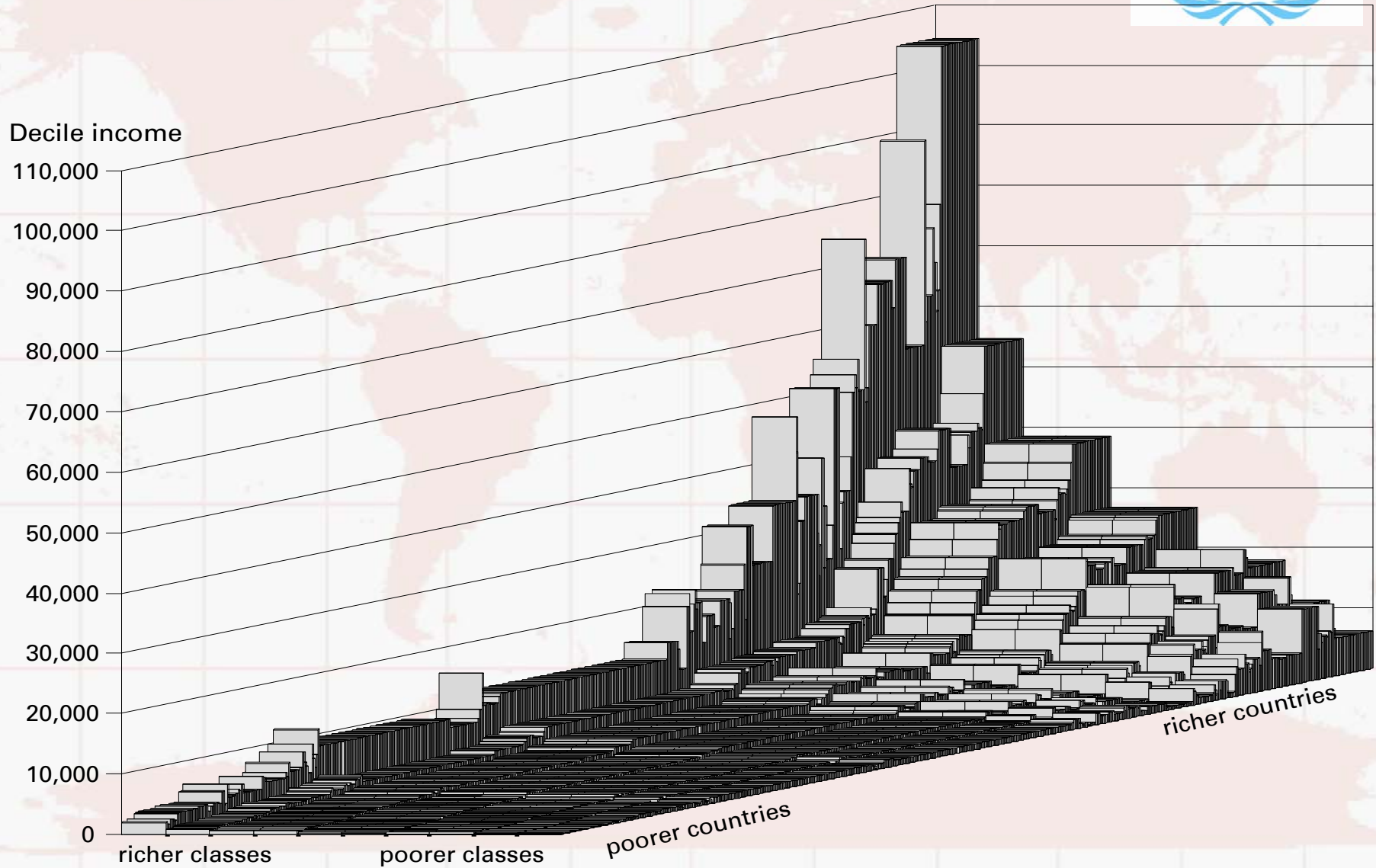
- Higher growth in South, inequality persists
- Jobless growth spreads; No poverty reduction without employment growth



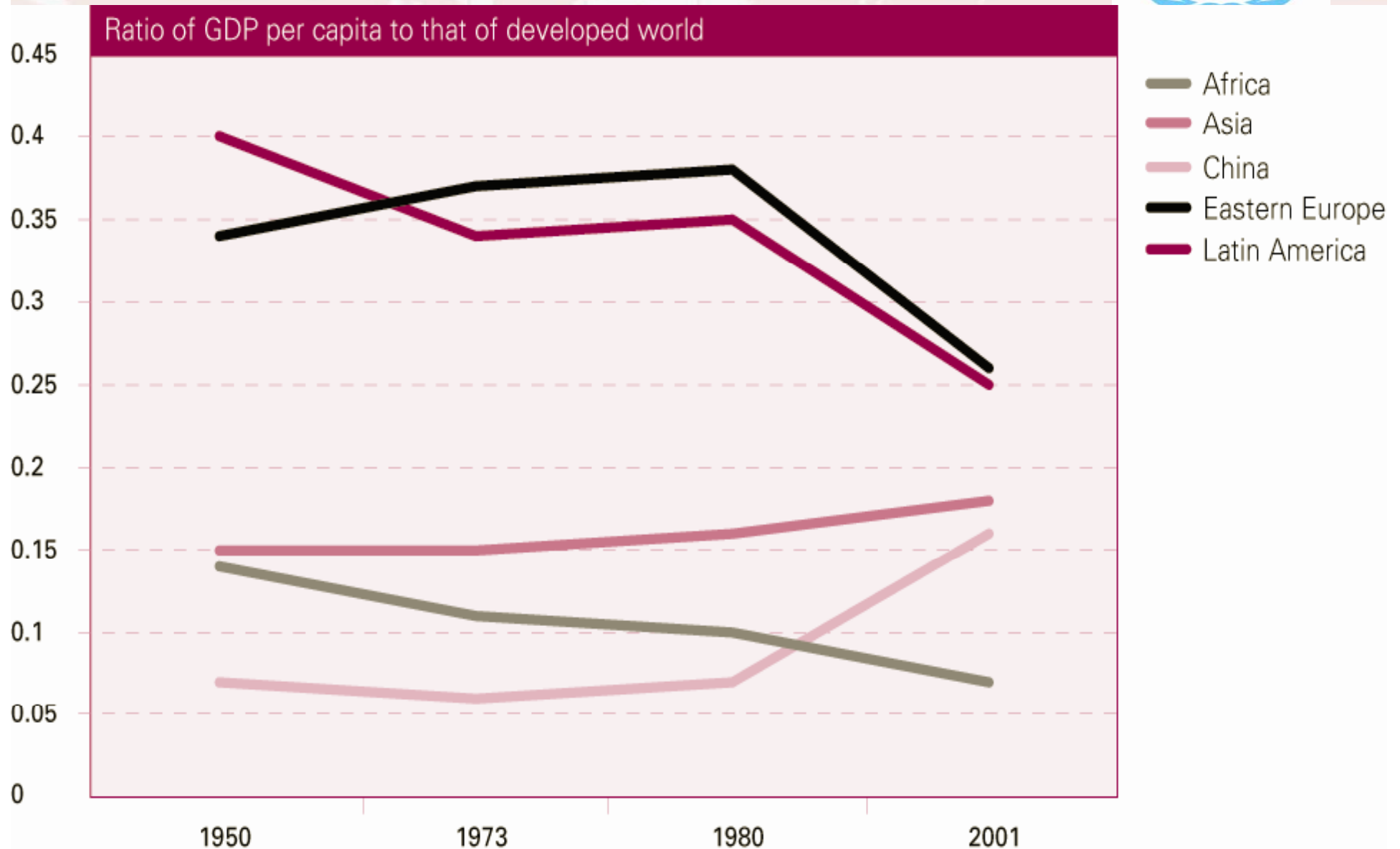
# Huge inequalities! Per capita GDP in 20 poorest + 20 richest countries



# 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

# Conditionalities, 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?

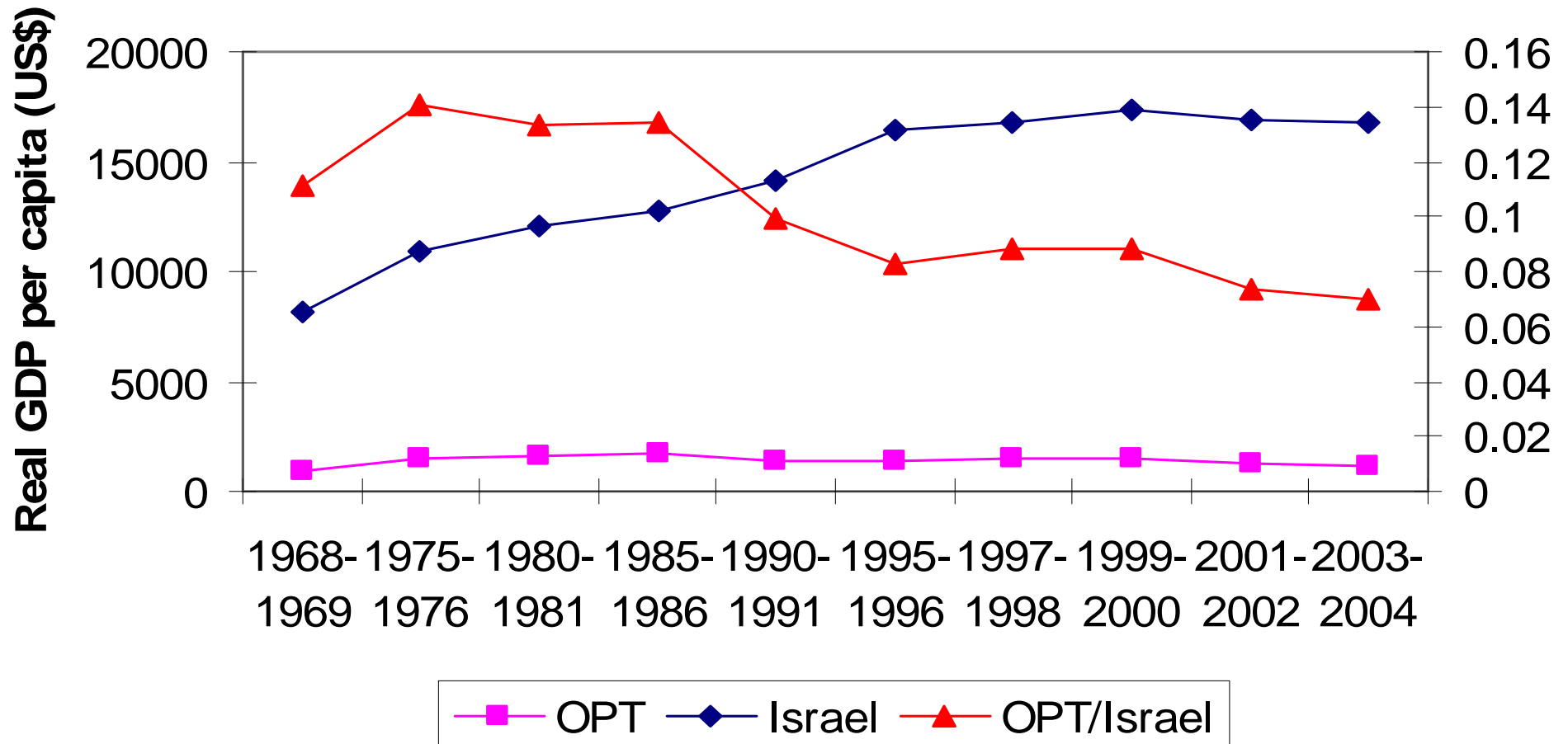


- No national currency → no seigniorage revenue
- Suffers from worst of both polar exchange rate regimes
- No control over capital flows
- Very limited fiscal capacity
- Exposed to globalization with no protection
- Israel remains Occupied Territories' main trading partner, receiving 90+% of exports
- 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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G24 [www.g24.org](http://www.g24.org) websites

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- Other documents

*Acknowledgements: Anis Chowdhury, Raja Khalidi, Mushtaq Khan, Hanna Daoudi*