Liberalization and globalization: the issues at stake for the South and the UNCTAD

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25 April 1996

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South Centre Background Paper

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1. Introduction

UNCTAD IX is taking place at an important historical juncture. The conclusion of the Uruguay Round negotiations and the establishment of the World Trade Organization have contributed to the emergence of a new world order in matters extending well beyond traditional trade matters. What the implications of the new order are for developing countries and how these should be addressed are central questions for UNCTAD IX.

It is argued, particularly in the multilateral financial institutions, and within organizations of the developed countries, that the new system will be of immense benefit to the South and that developing countries should therefore hasten to integrate themselves fully into the world economy.

On that basis, it is further argued that UNCTAD -- the UN body centrally concerned with trade and development and related matters -- should make its primary task one of helping to speed up such integration. Integration, it is suggested, should not be confined to opening up the economy to international trade, but also encompass foreign direct investment and capital flows. Moreover, this view asserts that the debate on development is basically over and that there is consensus that the best way to achieve development is to enhance the role of the market, while diminishing that of the state. The role of the latter should be confined to creating a suitable environment (including macro-economic policies) for private enterprise to flourish and competitive markets to function.

This thesis, if correct, logically leads to the rather different agenda proposed for the future for UNCTAD as an international organization. Apart from "helping" developing countries to integrate more quickly and closely with the world economy, the proposed new agenda suggests that UNCTAD should concentrate largely on the least developed countries. By implication, it is proposed that the organization should no longer be a forum for North-South dialogue as it has been in the last three decades. Not should it deal with structural and systemic issues. This also is in part because it is believed that there no longer exists such an entity as the South.

In what follows, it is argued that:

- this thesis is one-sided and incorrect;
- that, in addition to long-standing unresolved issues, there are significant new issues generated by the working of the world economy which require North-South dialogue;
- that the development debate is far from over and that a diminished role for the state and an enhanced role for the market are not a universal recipe for achieving faster economic growth or for resolving social problems;
- although there are divergent interests among developing countries, the concept of the South is, if anything, more important today in the post-Cold War era than it was two decades ago.

This alternative view, based on a more careful reading of historical experience as well as economic analysis rooted in the real world of multinational corporations, economies of scale, learning by doing and oligopolistic competition, has very different implications for developing countries and for UNCTAD's future work.

Specifically, it will be argued here that it is not so much that liberalization and globalization lead to faster economic growth, but that faster economic growth is necessary for these processes to be sustainable. This, in turn, requires North-South co-operation and a system of managing the international economy that is different from that prevailing in the recent period.

2. Liberalization and globalization since 1945

In common usage, the notion of globalization encompasses a wide range of phenomena from economic activities to the internationalization of (mainly Northern) culture, education, technology and tastes. It is, however, necessary to be precise and, in the context of this paper, liberalization refers to the freeing of trade, investment and capital flows between countries. Globalization refers both to the interrelated international production facilities of the multinational corporations and to the integration of product and financial markets facilitated by liberalization.

2.1 Advanced countries

In the world economy following the Second World War, these processes have occurred at different speeds and to varying extents in different regions and countries. Both liberalization of trade and freedom of capital movements have been implemented to the greatest degree in advanced economies. Trade in manufacturing products among these countries was liberalized gradually over the whole of the post war period through successive rounds of international trade negotiations (up to and including the Uruguay Round). By the mid-1970s, at the conclusion of the Tokyo Round, the weighted average tariff on manufactured products traded among industrial countries was only 6.5 per cent, compared with 10 per cent before the Round. In 1990, this figure was down to 5 per cent.

The liberalization of capital movements among advanced economies has also occurred in stages, but in somewhat different ways than the deregulation of foreign trade. In many respects capital market liberalization between these countries has gone further than trade liberalization. Most of these economies achieved current account convertibility in the late 1950s. However, capital account convertibility in leading industrial countries took place only in the 1970s in, for example, the United States, Canada, UK and Germany and in 1980 in Japan.[1]

Capital account convertibility in the advanced countries came in the wake of the collapse of the Bretton Woods fixed exchange rate system. It was preceded by the liberalization of domestic financial markets in these countries. These were important steps in the integration of the international financial markets, which many in the financial world regard as being synonymous with globalization. The integration of stock markets occurred later still with the deregulation of domestic stock markets in leading countries (e.g. the "Big Bang" in London in the mid-1980s).[2]

Liberalization has been much less evident with respect to flows of labour between countries. Moreover, unlike trade and capital movements, over time there has

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[1]. Countries like France and Italy introduced capital account convertibility only in 1990. (*The Economist*, "A Survey of the World Economy", October 7th 1995.)
[2]

2. Integration of markets refers to the fact that the various national markets for a product or financial service become in effect one single international market. The foreign exchange market was the first to globalize in the mid-1970s; it is the biggest and perhaps the only truly global financial market. *(The Economist*, 5 October 1995.)

been retrogression in this sphere in many industrial countries. Nevertheless, it is important to appreciate that, as a part of the process of privatization, deregulation and market ascendancy in general, in the post-1980 period there has been a considerable relaxation in the domestic rules and regulations maintaining labour standards, minimum wages and labour rights. The European country which has gone furthest in this direction is the United Kingdom.

2.2 Developing countries

Compared with the advanced countries, both globalization and liberalization have occurred at a slower pace in developing countries. An outstanding feature of the post-1945 international economic arrangements was the special and differential treatment accorded to developing countries in recognition of their economic backwardness. This apparent altruism was very much the product of the Cold War and contention between the two economic and political systems -- liberal capitalism represented by the United States and the state-planning system of the former USSR. (Glynn, Hughes, Lipietz and Singh, 1990). Thus under the leadership of the United States in the GATT, "non-reciprocity" in trade relations was accepted by industrial countries whereby they agreed to provide comparatively easier access to their markets for developing country goods whilst permitting developing countries to impose tariffs on advanced country products. (Those under the Multi-Fibre Arrangement were important exceptions.)

The Uruguay Round Agreements and the establishment of the World Trade Organization (WTO) greatly reduce the scope of this concession and they reflect the changed world political situation following the end of the Cold war. The efforts by the North to engage the South in negotiations on trade and trade-related matters represented the North's efforts to respond to Southern competition by demanding greater reciprocity as well as other measures that would further their economic interests.

However, even before the Uruguay Round Agreements came into force, many developing countries had begun in the 1980s to reduce their tariff barriers. The impetus for these reforms emanated from two interrelated sources. First, they were an integral part of the new policies of the multilateral financial institutions, particularly the World Bank, whose structural adjustment lending programmes were conditional on economy-wide policy reforms in developing countries, including trade, foreign investment and financial sector reforms. Second, the economic failure and the "lost decade" of the 1980s (largely due to the debt crisis) in Latin America and sub-Saharan Africa obliged many countries to accept these conditionalities, as well as similar ones imposed by the International Monetary Fund. According to the World Bank (1990), which reviewed the structural conditionality for loans made during the period 1980-1987, nearly 80 per cent required trade policy reform and nearly 40 per cent liberalizing reforms of the financial sector. This is not to suggest that some countries did not introduce these reforms under their own initiative, ascribing their recent economic failure to their former "dirigiste" and relatively closed economic regimes.[3]

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3. One interpretation of events in Latin America is that, suffering from the debt crisis and browbeaten by

Thus, for example, Mexico reversed its successful import substitution of the previous four decades and acceded to GATT in 1986, reducing its tariffs to an average of 11 per cent by 1988. (Rodrik, 1992; Lustig, 1994.)

Similarly, in the 1980s and the 1990s many countries have greatly liberalized their foreign investment regimes, as well as reduced their controls over capital movements. Also, despite their doubtful merits for economic development, (Singh, 1993) stock markets have been established or expanded as part of financial sector reforms around the globe, even in the poorest countries . Such markets have been used in many countries to facilitate privatization, attracting in the process substantial foreign portfolio capital. This, of course, involved changes in long-standing policies against foreign ownership.

There is, however, an important difference between the trade and financial policy reforms carried out by the "unsuccessful" economies such as those in Latin America and the "successful" ones in Asia in the recent period. Countries in the two regions have carried out many similar reforms, but the process in Asia has been voluntary, gradual and guided whereas in Latin America it has usually been forced on them by the debt crisis and World Bank and IMF conditionalities, and these reforms have usually been introduced in a precipitate and wholesale fashion.

Despite the widespread implementation of trade policy reforms in developing countries since 1980, it is significant that the extent of liberalization implemented by these countries is still quite limited. To illustrate: India has been liberalizing its trade regime for the last 15 years, but the average tariff is still about 66 per cent. The car output of South Korean firms world-wide will make that country the world's third largest car producer by the end of this century, but in 1995 this country imported only 4,000 cars. Liberalization of capital flows in developing countries has proceeded further than trade policy reform largely in order to attract foreign direct investment and so-called "non debt-creating" equity flows.

2.3 Summing up

To sum up, liberalization and globalization both in industrial and in developing countries have been cumulative and uneven processes extending over many years. But, even industrial countries have a long way to go before they can be regarded as being fully liberal in the ideal neo-classical sense, that is that firms' decisions no longer need to

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the multilateral financial organizations, the Latin American ruling classes often turned to neo-liberalism -- an act which with hindsight can be considered one of self-flagellation. For example, the Mexican economy expanded at a long-term rate of growth of 6 per cent a year between 1950 and 1980 under the "dirigiste" regime. This is an outstanding record by international standards. The subsequent record of Mexico during the last ten years -- when it has been the most obedient pupil of the IMF -- is there for all to see. The economy has hardly achieved any growth at all, lurching from one crisis to the other. The reason why the Mexican government changed its economy policy was that, mistakenly, it attributed their economic failure to dirigisme and import substitution rather than to external economic chocks over which they had no control. As will be seen below, dirigisme and import substitution were also practised by highly successful East Asian economies. An important reason why South Korea managed to escape the debt crisis and Brazil and Mexico did not is that the latter two countries were subjected to much more severe external shocks. The issue is discussed more fully in section 4.4.

take into account national boundaries and that rates of return to factors of production are equal world-wide, subject only to differences in transportation costs and degrees of risk. The precise extent of liberalization and globalization will be discussed in a subsequent section in the context of a comparison in these respects between the world economy at the end of the twentieth century and that at the end of the nineteenth century.

Nevertheless, at a practical level, with respect to trade in manufactures and capital movements between leading industrial countries, there can be deemed to have been more or less free trade and capital movements in the last ten to fifteen years. This is especially so, not only in comparison with the developing countries but also, more importantly, in comparison with the situation in these economies themselves in the 1950s and 1960s. During these earlier decades most countries not only enforced international capital controls under the Bretton Woods regime, but also their domestic product, capital and labour markets were also subject to a wide range of rules and regulations in keeping with economic and social objectives.

3. The experience of industrial countries under liberalization and globalization

The leading industrial countries have now been operating under a market supremacist regime of more or less free trade and capital movements for the last ten or fifteen years. This provides an important vantage point for assessing the expectations of the current conventional wisdom that liberalization will lead to improved economic performance and prospects. As will be seen below, these expectations are not justified by the evidence: so far, the liberal economy has failed to deliver.

3.1 The record

The record is as follows with respect to output, unemployment and productivity growth.

3.1 (a) Growth of production

Leading industrial countries have experienced much slower economic growth in the post 1980 period than during the 1950s and 1960s. The trend rate of growth in the recent period was only about half of that in the former period. During the 1960s, the OECD countries expanded at a rate of nearly 5 per cent a year. Between 1981 and 1990, the corresponding growth rate was 3.2 per cent and has been lower still in the 1990s, i.e about 1.5 per cent between 1991 and 1994. Even if there was to be some improvement in economic performance in the rest of the decade, most observers and official agencies expect the average growth rate for the 1990s to be no more than about 2.0 per cent. (The World Bank, Global economic prospects and developing countries, 1994; IMF, World Economic Outlook, various issues.)

The more dynamic period in industrial countries was therefore prior to their deregulation of internal financial, product and labour markets . It also preceded the liberalization of their regulations regarding international capital movements and of international trade under the Tokyo Round, as well as their more extensive and deeper global integration.

Moreover, lower average economic growth in the recent period has not been due to the poor performance of just a few major countries but has been more or less universal among OECD members: 18 out of 20 had a lower growth rate in the period 1980-1991 than between 1960 to 1971. (Felix, 1995).

3.1(b) Unemployment

The record with respect to employment under this "liberal" regime reveals one of its most prominent failings. (See Table 1.) In the 1980s and 1990s -- fifty years after the Great Depression -- mass unemployment has returned to industrial countries. In 1994, around 35 million people were out of work in the OECD countries, that is, about 10 per cent of the labour force. If involuntary part-time workers and discouraged workers are included this would raise the unemployment level by a further 50 per cent. (OECD, 1994)

This stands in striking contrast to the unemployment record of these economies in the "regulated and illiberal" 1950s and 1960s. As Table 1 shows, between 1961 and 1970, the average unemployment rate in Western Europe was only 2.0 per cent. The corresponding rate between 1981 and 1990 was 7.4 per cent, and in 1993 it was 10 per cent. The unemployment rate has, if anything, risen since then.

It is important to stress that unemployment is not only important in itself, in the present social organisation of advanced countries, it has all prevailing economic and social linkages. Unemployment leads to poverty, social degradation and marginalization. There is evidence that it is associated with health problems an low self-esteem, is demotivating and creates insecurity and resistance to technical change. History tells us that, if it reaches a high level, it often gives rise to social and political strife with awesome consequences.

3.1(c) Productivity Growth

Not only has the record been poor with respect to output and employment, but there has also been a sharp trend decline in the rate of growth of productivity in industrial countries during the recent period compared with the 1950s and 1960s. Between 1960 and 1970, the developed countries experienced growth in real per capita output of 4 per cent a year. During the 1970s and the 1980s, the corresponding rate was only 2.2 per cent a year for each of these decades.

3.1(d) Instability

Equally importantly, the recent period has been characterized by far greater instability in terms of output and employment as well as fluctuations in interest rates. Felix (1995) provides data to show that the annual variability of real growth per capita in the Group of Seven (G-7) countries during the period 1974-1989 was more than twice as high compared with the 1960s. Similarly, real short-term interest rates were nearly three times, and long-term rates more than three times, as variable in the recent period compared with the former.

There is, however, one bright spot in the macro-economic record of the liberal economy. The rate of inflation in the G-7 countries was 3.9 per cent a year between 1960-1973 and it was 3.8 per cent a year between 1983-1993. The corresponding figures for the European Union for the two periods are 4.6 per cent a year and 5.1 per cent a year respectively. In the wake of the two oil shocks in the 1970s and the associated economic changes inflation had accelerated in industrial countries to more than twice its previous trend rate. The liberal economy can take some credit for bringing inflation down to the level of the 1950s and 1960s. However, notwithstanding this achievement, the overall record of the liberal economy cannot but be regarded as poor.

3.2 Technology

It may be argued that the failings outlined above are not due to liberalization and globalization as such but to other factors. Here the most important candidate is the nature and rate of technical change. Two contradictory arguments are made by defenders of the liberal economy with respect to technology. The first argument is that mass unemployment in industrial countries is not due to liberalization but to the much faster pace of technological change in this day and age. This proposition is not valid for, if it were, one would expect there to be an increase rather than, as noted earlier, a decline in the trend rate of productivity growth in the post-1980 period.

The other argument with respect to technology in defense of the liberal economy takes the opposite tack. It suggests that the trend decline in economic growth in the post-1980 period is due to a slow-down in the rate of technological change. Again, the evidence does not support this view. In fact the world has been experiencing a profound technological revolution -- that associated with the rise of new information and communications technology. Many scholars regard this new technological revolution as being of the same significance as the three earlier major technological revolutions of the last two centuries (Freeman, 1989). Ironically, it is this very technological revolution which is said to have facilitated and promoted globalization, particularly of finance.

The reason why, despite this technological revolution, the trend rate of productivity growth has declined rather than increased in the recent period is that the new technology is not being sufficiently widely harnessed through new investment so as to maintain, let alone improve, the trend rate of productivity growth. This is due to a trend decline in the rate of growth of real world demand which, as will be shown below, is closely connected with the process of globalization and liberalization.

3.3 The post-1980 period compared with the "Golden Age" and previous economic growth

An important but different kind of defense of the post-1980 record can legitimately be made as follows: that, although in terms of economic growth it is true that the recent period compares very unfavourably with the 1950s and 1960s, in a longer historical perspective it is not at all exceptional.

This is an important argument and deserves careful consideration. It is indeed true that the period 1950-1973 was in statistical terms a "Golden Age" in the economic history of industrial countries. During this period, these countries expanded on average at a rate of nearly 5 per cent a year, nearly twice the trend rate of growth of the previous 100 years. However, research indicates that the golden age was not a chance product. It was the outcome of a rather different model of economic development which came to be implemented in advanced industrial countries, particularly in Western Europe, in the post-1945 period. This model of capitalism, what is sometimes called the social market economy, differed in fundamental ways from that which prevailed in the inter-war period as well as that in the post-1980 period.

The social market economy model was based on a social consensus, both in the domestic economy and the international economy and was inspired by the mass unemployment and harsh experiences of the inter-war period. It involved a social "compact" between workers, employers and the government. Workers' organizations undertook to practice wage restraint in return for a commitment by employers to share fairly the fruits of technical change and productivity growth with the labour force and to contribute to the funding of universal social security through the welfare state. Governments committed themselves to maintain full employment, in part by encouraging high rates of investment through fiscal and monetary policies.

At the international level also, in response to the disorder and conflict in the inter-war economy, there was international co-operation and orderly trade and monetary arrangements under US hegemonic leadership.

This economic model functioned exceptionally well over the period 1950 to 1973 -- that is, for nearly a quarter of a century. By previous historical standards, industrial countries experienced exceptionally high rates of investment and productivity growth. Generally speaking, real wages rose in step with productivity growth, maintaining the share of profits in the national product. However, this model contained the seeds of its own destruction.

At the national level, the long period of continuous full employment and prosperity fostered the expectation among workers that there would be continued significant increases in wages and benefits. Thus when there was a productivity slow-down towards the end of the 1960s, and particularly when in the 1970s there was a rise in oil and commodity prices which squeezed profits, workers were unwilling to accept a concomitant decline in real wages. This accentuated the profits squeeze and the conflict generated rising inflation.

At the international level, the Bretton Woods system was in effect undermined by the success of the golden age itself -- the rise in the economic strength and competitive power of Germany, Japan and other countries. This resulted in US balance of payments deficits, reducing confidence in the US dollar which was the lynch-pin of the international monetary system. This matter is discussed further in Section 6.

For the golden age model to have continued, it would have required an institutional and policy renewal both at a national and international level.

For a while, in the 1970s, the governments in industrial countries followed Keynesian policies to maintain the post-war model. However, since inflation and the balance of payments problems of industrial countries could not be contained, the model was in effect abandoned in the late 1970s in the wake of the second oil price rise. In its stead, and with the United States in the lead, economic policy in the industrial countries moved towards towards restrictive monetarism -- symbolized by the so-called Volcker shock of 1978 -- which led to a quantum rise in US and world interest rates. By making the fight against inflation their first priority, industrial country governments implicitly abandoned the commitment to full employment. Although these processes have occurred at different speeds in different countries, there has been a general movement towards a market model comprising deregulation of not just the financial markets but also importantly the labour market (including in many countries measures to reduce the power of the trade unions), privatization and other aspects of market supremacy. This model stands in striking contrast to that of the golden age based on social consensus.

To sum up, it is true that current growth rates are not out of line with the long-term record of developed capitalist economies, bar the golden age. Nevertheless, in relation to the real needs of the people today, they represent an extremely important failure. Most analysts agree that, at such low growth rates, the problem of mass unemployment in European countries cannot even be dented let alone resolved. The US has a much lower unemployment rate than the Western European countries. This is in part due to the fact that there is a much lower level of publicly provided social provision for unemployment in that country than in Europe, so that workers are obliged to take up any job howsoever unremunerative it may be. Real wages of US workers have not increased on average for nearly twenty years; those of blue collar workers have actually fallen in most years since 1973. Therefore, the need in the US is for creating well-paid jobs, not just any jobs. This in turn requires faster economic growth in the US economy. In general, therefore, full employment, let alone full employment with rising real wages, will only be possible in industrial countries if they can achieve much higher rates of growth than the liberal economy has been able to deliver.

3.4 Mass unemployment and the sustainability of the new economic order

In the light of this poor record of industrial countries in the last fifteen years, one would have expected a degree of scepticism and caution among analysts and national and international policy-makers. Instead one finds a euphoria, even herd instinct, which emphasizes the positive aspects and shuts a blind eye to evidence on the negative side which may overwhelm the positive benefits. How can this be explained?

A leading US economist has aptly described in a slightly different context the formation and dynamics of a new conventional wisdom in such economic matters. He refers to a sociological self-reinforcing process.

> " ... the endless round of meetings, speeches, and exchanges of communiques that occupy much of the time of the economic opinion leaders. Such interlocking social groupings tend at any given time to converge on a conventional wisdom, about economics among many other things. People believe certain stories because everybody important tells them, and people tell these stories because everyone important believes them. Indeed, when a conventional wisdom is at its fullest strength, one's agreement with that conventional wisdom becomes almost a litmus test of one's suitability to be taken seriously." (Krugman, 1995)

Krugman was referring specifically to the euphoria about emerging markets and the "Washington consensus" until the Mexican financial and subsequent economic and social crisis. His description is as applicable to the hype concerning liberalization and globalization in general.

Contrary to the conventional wisdom, economic analysis and the lessons from economic history would suggest that it is not so much that liberalization and globalization lead to faster economic growth, but rather that higher rates of economic growth and employment are necessary for such a regime to be sustained. This was the experience of the 1930s. Faced with mass unemployment and the possibility of using import restrictions to reduce it, even the UK liberal economist John Maynard Keynes was persuaded to abandon his belief in free trade. Stanley Fischer, the present Deputy Director of the IMF, notes in this context that, in the 1930s, protection enabled the UK economy to achieve a better employment record than the more liberal US economy.

These observations with respect to the 1930s are today echoed by large parts of public opinion in industrialized countries and increasingly given political voice, especially their election campaigns.

Some economists in the North believe that a number of unfavourable features of the North's labour markets in the recent period can be largely ascribed to competition in manufactured products from the South. Specifically, this competition is blamed for a) de-industrialization; b) mass unemployment; and c) and increasing wage dispersion between skilled and unskilled workers. Although there is professional disagreement on these issues, what is clear is that, unlike in the 1950s and 1960s, in many respects the North today is as afraid of competition from parts of the South as the other way round. This general perception has important implications for the South. History suggests that, if mass unemployment is not brought to an end in the North, developed countries will resort to ad hoc protectionism, notwithstanding WTO and solemn international agreements.

4. Liberalization, globalization and the developing countries

The policies of liberalization and globalization, market ascendancy and diminished role of the state are recommended by the multilateral financial institutions for developing countries on the basis that such policies have proved highly successful in the East Asian economies (including post-1945 Japan.[4]) and in post-Mao China. The East Asian economies have indeed experienced sustained high rates of growth during the last three decades. Similarly China, a country with a billion people, has had a recent record of 10 per cent growth for well over a decade -- an unprecedented historical feat. But the claim that these achievements can be attributed to rapid and full integration of these countries into the international economy, and to the supremacy of market forces, needs to be carefully examined.

4.1 Japan and Korea

Detailed analysis of the policies pursued in these countries would indicate that the above claim of the multilateral institutions and other conservative economists is based on their ideological proclivities rather than on an objective reading of these countries' economic history. What the exemplar countries of East Asia (Japan, South Korea and Taiwan) did was to implement what may be termed "strategic" rather than close integration. This involved varying degrees of integration in different spheres and over time, according to what would best serve the aims of national economic and social development.

4.1(a) Trade

To illustrate, consider trade. During the course of their industrialization and fast economic growth, both South Korea and Japan integrated themselves with the international economy in terms of exports (their well-known "export orientation") but did not do so with respect to imports. Both countries maintained draconian import controls, whether formal or informal. As late as 1978, the ratio of manufactured imports to GDP in Japan was as little as 2 per cent, compared with 15 per cent or more

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4. Although Japanese modern economic development began with the Meiji Restoration in the 1870s, in the mid-1950s its level of industrialization was lower than that of leading countries in the recent period, despite the fact that it had built a massive armaments industry in the 1930s. In terms of several indicators of industrial development, countries like India, Mexico and Brazil produced more steel and where more industrially diversified in 1980 than Japan was in the mid-1950s. In the early 1950s, Japan produced only 5 million tons of steel a year compared with US annual production of 100 million tons. Yet it took Japan only 15 years to produce more steel than the United States and 25 years to produce more cars than the United States, starting from negligible levels of car production in 1955. (At that time, US production was 6 million cars, and that of Japan, 50,000.) This record making story of industrial catch-up is obviously of great interest to developing countries.

Indeed, World Bank (1991) starts its analysis of the lessons that it has learned from forty years of development experience by asking why countries like Japan have succeeded so spectacularly while others have failed.

Also, it is significant that the Koreans and the Taiwanese in their successful industrialization economies consciously tried to implement the Japanese model in their development strategies, adapting it to their particular circumstances.

in large European countries like France and Germany or 20 per cent in the UK. Korea protected its domestic car industry for 30 years until the point was reached where it became a major producer and exporter. (Singh, 1995)

In a recent analysis, the World Bank has now accepted that these countries implemented wide-ranging import controls. (World Bank, 1994) However, the Bank's traditional conceptual framework does not permit it to acknowledge the full significance of import controls for the industrial development of these countries. The Bank economists regard it as an embarrassment that import controls were used in East Asian economies and imply that these countries would perhaps have grown faster had they refrained from doing so.

What the Bank economists do not appreciate is that the export success of these countries was directly linked in many industries to the restriction on imports of similar products. As many students of, for example, the Japanese economy have pointed out, these restrictions gave the Japanese companies a competitive advantage in relation to firms elsewhere: it provided them with a home market cushion and high profits which allowed them to sell their products abroad at more competitive prices than would otherwise have been the case. Moreover, in return for these import restrictions, firms were expected to meet government-set export targets.

Similarly, contrary to World Bank prescriptions, Japan and South Korea did not allow unfettered foreign direct investment. Rather they discouraged foreign investment and protected national ownership of their own firms. This is not to say that they were not open to foreign technology: they indeed had a national programme to improve their technological development. This was done by two main routes: first by national efforts in universities and other technical institutions to develop technology and also by encouraging national firms to employ licensed foreign technology, subject to strict government controls.

4.1(b) Getting the prices right

Part of the Washington consensus is that aligning domestic prices with world prices is the best way for developing countries to achieve fast growth of exports and overall economic growth. Hence the emphasis put by the multilateral institutions on changes in exchange rates and removal of restrictions on imports and exports. This prescription does not, however, accord with actual practice in Japan and South Korea. As students of Asian economic history point out, the governments in these countries did not simply leave relative prices to be determined entirely by international market forces but rather pursued a vigorous and purposeful industrial policy. They deliberately changed the structure of incentives and relative prices facing producers so as to promote industrial development according to perceived national priorities. The World Bank's own data shows that the structure of relative prices of these countries compared with international prices was more distorted than that of many other developing countries such as for example Brazil, India, Pakistan, Mexico and Venezuela which are usually considered to have highly distorted prices.

4.1(c) Industrial policy

In response to criticisms made by independent scholars, the World Bank now accepts that the governments of Japan and South Korea intervened heavily in most spheres of their economies during the periods of fast industrialization in the 1970s and 1980s in the case of Korea, and the 1950s and 1960s in the case of Japan. The Bank's present thesis is that indeed these governments did follow industrial policies but that either they were irrelevant or ineffective -- that these countries would have achieved the same industrial structure had they had no industrial policy at all. This doctrine of industrial policy ineffectiveness is rejected by many independent scholars.

It is also important to appreciate that the exemplary East Asian countries did not have close integration with the world economy in the sphere of finance during their high growth phase. International financial flows were subject to government control in Japan until the mid-1970s. These controls were only relaxed when required as a condition of Japan's accession to the OECD. In Korea, in response to US pressure, these restrictions have been gradually relaxed during the last ten years, but many controls still remain.

To sum up, the experience of Japan and South Korea show that these countries have adopted policies during their periods of industrialization and fast economic growth which are quite the opposite of those recommended by the multilateral financial organizations. And yet they have achieved extensive structural change and raised the standard of living of their peoples to European levels. What, therefore, are the correct lessons to draw regarding international economic integration from the experience of Japan and South Korea? How can that experience be conceptualized?

4.2 Conceptualization of East Asian experience and analytical considerations

It has already been suggested that one useful concept in this regard is that of "strategic" integration. The important point here is that openness and integration with the world economy are multidimensional concepts, since a country can be more or less open with respect to exports and imports according to its choice. Similarly, in its other interchanges with the world economy, such as in the spheres of foreign investment, migration of labour, scientific and technical interchangea, a country can choose to exercise a smaller or greater degree of openness.

The potential benefits of trade openness go well beyond those of comparative advantage and opportunities for exchange emphasized in the traditional literature:

a) It may enable the concentration of relatively specialized resources in areas of production where world demand is highly income and price elastic;

b) It may lead to a diffusion of knowledge which may contribute to the upgrading of the quality of local factors of production;

c) It may generate competitive pressures which serve to reduce domestic inefficiencies in production;

d) It may lead to changes in income distribution which generate a greater share of accumulation in national income;

e) It may facilitate dynamic economies of scale and technical change.

Needless to say, the actual outcomes could also well turn out less beneficially. For example, changes in income distribution instead of leading to greater investment may result in increased luxury consumption, which in developing countries tends to have a high import content. In general, for these potential benefits of trade (and other forms of openness) to be realized, both history and economic analysis suggest that certain conditions need to be fulfilled.

First, market forces alone may not generate these beneficial outcomes. The government will need to play a leading role in devising appropriate policies to derive the maximum potential benefit for the country.

Second, the benefits to be derived depend crucially on the state of the world economy. When the world economy is growing fast, other things being equal, it pays to be more open than otherwise. However, if world economic conditions are adverse or if the wrong kind of openness is attempted there may be irreversible losses.

Third, there is the need to choose the optimum degree and timing of openness. There is no analytical proposition in economic theory to suggest that the best way to promote economic growth is to be open at all times and in all spheres and in all respects. Recent advances in economic theory suggest that, in the present day world of multinational enterprises, oligopolistic competition and economies of scale, even the much vaunted free trade is by no means an optimum policy.

The importance of the timing and degree of opening up cannot be exaggerated. For example, it is arguable that the opening up of the Latin American economies to trade (reduction of import restrictions) in the 1980s under IMF pressure was not optimal. These economies were in a weak state: industry had been deprived of investment and could hardly be expected to stand up to external competition. In contrast, the reduction of import restrictions in Asian countries could be expected to be more beneficial as it was done in the context of fast domestic economic growth and high rates of investment.

Of course in the Latin American case, it could be argued that exposing a weak industrial sector to international competition is beneficial in itself in so far as it leads to speedy disappearance of inefficient firms. This argument of course assumes that resources are sufficiently mobile and that there is adequate propensity to invest on the part of domestic or foreign enterprise to fully employ these resources elsewhere in the economy. The record, however, does not show that this is what has happened in countries like Mexico and Argentina.

4.3 China

The spectacular economic advance in Chinese since Mao is another example used by the World Bank to emphasize the virtues of liberalization and marketization of the economy. The Bank economists assert that the more open an economy, the greater the degree of external as well as internal competition and the higher the investment in education, the greater will be technical progress and hence the rate of growth. Thus, World Bank ,1991 (page 1):

> "Competitive markets are the best way yet found for efficiently organizing the production and distribution of goods and services. Domestic and external competition provide the incentives that unleash entrepreneurship and technological progress."

However, the interpretation of post-Mao Chinese economic policy in terms of this paradigm raises serious difficulties:

1. The extent of marketization in China, though greater than before, is still rather limited. The product markets continue to be highly segmented. Unlike an economy such as India's for example, China is far from being an integrated market for industrial products.

2. In many sectors of the economy, there is neither free entry nor exit of firms.

3. Compared with other developing countries, or for that matter even the former East European socialist economies, a free labour market exists only to a very limited degree in China.

4. The Chinese capital market can only be described as being at an embryonic stage.

5. Although China is much more open now than it was in the Maoist period, it is very far from being fully integrated into the world economy. The country continues to maintain a wide range of controls on imports, capital movements and foreign direct investment.

6. Despite the introduction of markets in the Chinese economy, there is relatively limited private ownership of land and capital. The land is still overwhelmingly publicly owned as is most of the countries' industrial capital stock.

Nevertheless, up until now, the incompleteness and fragmentation of the product, labour and capital markets, as well as widespread public ownership and very limited integration with the world economy, have not prevented the Chinese economy from growing at an extraordinary fast rate. In principle, it could be argued that growth would be even more spectacular if domestic markets were complete and there was full integration with the world economy. Yet this hardly seems likely. The alternative explanation is more convincing: that the Chinese are attempting to create an optimum combination of the "plan" and the market, whereby the "plan" continues to guide the market, rather than allowing the latter to supplant the "plan" altogether.

None of this is to deny that marketization or the open door policy has not helped the Chinese economy. Indeed, foreign direct investment, of which the Chinese have been very large recipients in recent years, has undoubtedly contributed to the modernization of Chinese industry, leading to faster overall economic growth. However, the important point is that it is a controlled and deliberate process rather than one of indiscriminate entry or acceptance of all FDI projects. In general, with respect to opening up, following the East Asian pattern, the Chinese government has been seeking strategic rather than close and unfettered integration with the world economy.

Similarly, in relation to marketization, the important policy question is what is the optimal degree of marketization? In terms of the World Bank's development paradigm the answer to this question is that there should be complete marketization of the economy and privatization of the means of production. There is clear evidence that the Chinese government does not accept this thesis. There are strong analytical grounds as well as empirical evidence for the view that, where there are effective governments, industrialization and development are best achieved by a purposeful guidance of the market by the state rather than by unfettered market forces. Not only China's own experience over the last fifteen years but also, as discussed earlier, that of the highly successful East Asian economies of Japan, South Korea and Taiwan over the last four decades point in the same direction.

4.4 Latin American economies

4.4(a) Latin American economic failure and Asian success in the 1980s
A very important question in economic development today is why did Latin American economic growth collapse in the 1980s, resulting in the "lost" decade whilst the Asian countries continued to prosper. The question derives its significance partly from the fact that, prior to 1980, the two groups of countries were growing at much the same average rate -- about 6 per cent a year. The East Asian countries during 1965 - 1980 were growing somewhat faster (7.5 per cent a year) than the Latin American economies, but the South Asian countries were growing, in that period, at a distinctly slower pace (3.5 per cent a year). But, considering Asia as a whole, there was not much difference between the average growth rates on the two continents in the pre-1980 period. (see Table 2).

It will also be recalled that, between 1965 and 1980, Brazil was acknowledged to be a "miracle" economy, recording a growth rate of 9 per cent a year -- almost equal to that of Taiwan or South Korea during this period. Similarly, the Mexican economy expanded at a rate of nearly 6 per cent a year over the three decades 1950-80, which would also put that country among the top performers in the league tables of economic growth for that long time span. Yet both Mexico and Brazil stumbled badly during the 1980s whilst Korea and other East Asian, as well as South Asian countries, were able to maintain, or even to improve upon their previous pace of economic expansion.

Indeed, what is remarkable about the 1980s is not only the inter-continental divide in economic performance which emerged, but also the intra-continental uniformity of experience. Not only did average economic growth decline sharply in the 1980s in the Latin American countries (from 6 per cent a year between 1965 and 1980 to 1.6 per cent between 1980-1990), but the collapse was almost universal. No Latin American country managed to grow even at a rate of 4 per cent a year during that decade. In Asia, on the other hand, it is significant that the economic success of the 1980s has not just been confined to the East Asian NICs but also encompassed previous laggards such as South Asian countries like India. A notable exception to the superior Asian performance in the 1980s is, however, the Philippines.

This intra-continental uniformity of economic experience is particularly surprising for the Asian countries since these countries not only have followed rather different economic policy regimes but also have very different political systems. The Asian sample contains communist countries like China as well as a wide variety of capitalist economies and democratic as well as authoritarian regimes. Among the capitalist countries, Korea's economic policy regime has been a rather different (it has been export-oriented) from India's (the country has been a prime example of inward orientation). Yet, despite the slower and much more fluctuating world economic growth, most Asian countries managed to either maintain or to improve upon their economic performance in the 1980s, whilst the Latin American countries were almost all afflicted with economic failure.

This phenomenon needs to be explained, not only for the sake of greater understanding but also because of the relevance of the explanation to the central themes of this paper -- liberalization, globalization, and the role of the state in economic development.

4.4(b) Domestic versus external factors?
The subject is controversial. The international financial institutions (the World Bank) and other conservative economists attribute Latin American failure to mistaken policy choices, namely to insufficient integration of the Latin American countries with the international economy; to too pervasive a role of the state in these economies, leading to rent- seeking, corruption and other wasteful activities; to microeconomic inefficiencies and resource misallocation;and to macroeconomic policy errors. Thus the World Bank economists ascribe Latin American poor performance in the 1980s to mainly internally determined factors rather than to external factors -- economic shocks over which they had no control. Moreover, they argued that such shocks affected both Latin America and Asia and cannot therefore account for the different outcome in Latin America.

To remedy the situation in Latin America, in line with its basic analytical conceptions concerning economic development, the World Bank's policy programme has two central elements:

a) that Latin American economies should integrate more fully into the world economy, hence the emphasis on measures such as trade liberalization, removal of price "distortions", promotion of foreign investment etc., and

b) that there should be an increase in the role of free markets and private enterprise as far as possible and a reduction in that of the state (through measures such as privatization, deregulation, financial liberalization etc.).

The World Bank theses on this subject also have been seriously questioned by independent economists. These economists argue that, although the Latin American governments made mistakes, the main reason for their economic failure was the debt crisis. This, they suggest, was caused largely by major changes in the world economy and by external forces over which these countries had no control. Contrary to the Bank, they argue that the total magnitude of the external shocks suffered by Latin American economies was much greater than that experienced by the Asian economies in the 1980s.

These opposing interpretations of the economic events of the last decade in Latin America and Asia lead to very different policy conclusions. For example, if the orthodox analysis is correct, the broad policy prescriptions of the international financial institutions for greater integration into the global economy an the reduced role of the state, naturally follow. However, if, on the other hand, the critics' view that poor economic performance in Latin American countries was largely due to external factor outside their control is more valid, the World's Bank policy recommendations will lose a great deal of their intellectual force. It is therefore important to assess the validity of these alternatives theses.

Turning to the analysis and evidence on this subject, the first point made by the critical economists concern the issue of domestic policy. They make the obvious but important point that continent-wide economic success in Asia occurred despite very considerable diversity in the (a) economic policy regimes, (b) political systems and (c) governance capacities of these countries.

Secondly, it is suggested that the world economic slowdown, due to the major changes in US and other industrial countries policies at the end of the 1970s and early 1980s (noted earlier), affected developing countries through a number of different channels. Specifically, these countries suffered four kinds of shocks; a demand shock to developing country exports; a consequent fall in commodity prices and a terms of trade shock; an interest rate shock; and a capital supply shock.

The combined magnitude of these shocks in the early 1980s was greater for the Latin American economies than for the Asian countries. These large initial shocks for the former group of countries were compounded by further external shocks during the rest of the decade, all of which contributed to the observed prolonged economic decline in these countries. The Asian economies, on the other hand, "succeeded" because they were able to adjust quickly largely due to the fact that the external shocks which they experienced at the beginning of the decade were relatively less severe. They were also not subject to further shocks of the same magnitude as the Latin American and the Sub-Saharan African countries suffered during the rest of the 1980s.

Moreover, it is important to note the sheer size of the external shocks suffered by the Latin American economies throughout the 1980s. These were so gigantic that this not only had a big impact on the real economy and its future growth prospects but, equally importantly, the ensuing re-distributive struggle over reduced economic growth also greatly disturbed the normal balance of political forces in these societies. This in turn led to extreme financial and monetary instability and episodes of hyper inflation. Critical economists suggest that if the rich countries such as the UK and the US had been afflicted with anywhere near the same kind of shocks, they would most likely have fared worse and probably suffered a much longer period of depression.

If all these external shocks are considered together -- as indeed they should be -- their combined size and adverse impact on the balance of payments of the Latin American economies was much greater than that for the Asian countries. The Latin American countries were particularly hard hit by the capital supply shock, whereby, following the inability of the Mexican government in 1982 to service its debt, banks suddenly stopped lending, not just to Mexico, but to all Latin American countries.

The World Bank economists arrive at a different conclusion about the severity and impact of the external shocks because they do not include all the external shocks to which developing countries were subject to in the 1980s. The capital supply shock is ignored or not properly examined by World Bank economists because international capital flows are regarded as equilibriating mechanisms in orthodox neo-classical analysis.

Yet, perhaps, the most important single reason why the Asian countries escaped the debt crisis of the 1980s and the Latin Americans did not was because the former were not subject to this capital supply shock, ie. they were not credit-rationed by the banks in the same way as were the Latin Americans. Banks continued to lend to East Asian economies, even though their current account deficits as a proportion of GDP were no smaller than those of Latin American countries. It is useful in this context to consider specifically, the case of Korea. That country was as heavily indebted as Mexico or Brazil, and its relevant macroeconomic indicators (current account deficit, budget deficit, inflation) were, if anything, worse than those of the two Latin American countries. Yet Korea was not subject to capital supply shock while Mexico and Brazil were. It therefore did not suffer the same balance of payments constraints and consequent import strangulation which have a detrimental impact on investment and growth.

This raises the important question why the banks stopped lending to Mexico and Brazil while they continued to lend to Korea, financing its large current account deficits. According to two World Bank economists F. Larrain and R. Vergara (1993) the Koreans were just lucky. John Williamson, from the Institute of International Economics in Washington, who coined the phrase, "the Washington consensus", ascribes this instead to a "herd" instinct on the part of the banks and to a "contagion" effect. He suggests that had Korea been a Latin American country, it would have also been subject to the contagion and would not have turned out to be so lucky.

The post-1990 revival of economic growth in Latin American countries further highlights the importance of the capital supply shock and of the credit rationing by the banks in the "lost" decade of the 1980s. The revival, such as it is (even before the 1994 Mexican economic crisis most Latin American countries were still well below their previous long-term trend rates of economic growth), was largely due to the resumption of external capital flows to these countries beginning in 1990. However, the volatility of these flows (which have largely been dominated by portfolio capital) under the liberalized financial regimes and the associated problems of economic management continue to raise serious questions about the longterm prospects of these economies.

4.4(c) Openness and Economic Structure.

We turn now to the World Bank thesis that a very important reason for the superior Asian economic performance during the last decade is that these countries had more open and export-oriented economic structures, compared to those in Latin America. This correponds to the Bank's thesis that countries which are more open are better able to cope with shocks more effectively and recover more quickly because they are more flexible.

There are, however, a number of points which must cast doubt or seriously qualify this proposition. First, the Bank's critics point out, the Latin American countries were in fact much more open to the international economy, at least on one important dimension, than the Asian economies. The former generally had larger degrees of currency convertibility and practised a far greater degree of financial openness than the latter. Most Asian countries had fairly strict exchange controls.

Secondly, a detailed analysis of economic and industrial structures of countries in the two regions provides very little evidence in support of the World Bank's hypothesis. One of the least open Asian economies at the time, India for example, was able to cope at least as effectively with the world economic crisis in the 1980s as the highly export-oriented Korean economy. The Indian economy registered an almost 50 per cent increase in its trend rate of growth in the 1980s compared with the 1970s.

As for export orientation, UNIDO data shows that during the decade of the 1970s, Brazilian manufactured exports expanded at much the same rates as did South Korean exports. Moreover, Mexico and Argentina's manufactured exports grew much faster than India's during that decade. Critical economists conclude from their analysis that the Latin American countries were derailed by exogenous shocks, in large measure because of their greater financial integration with the world economy, their greater borrowings, and their open financial markets rather than their closed trading regimes.

4.4(d) Microeconomic inefficiencies and misallocation of resources

Another allegation of the Bretton Woods institutions is that, unlike the Asian countries, the Latin American countries misallocated and wasted the loans they obtained -- using them for current consumption, and when they invested, it was in inappropriate "white elephant" projects which would not yield any returns except over a long period of time, if at all. However, econometric analysis of the consumption function of Latin American and East Asian countries indicates that the former did not use external borrowings to finance current consumption any more than the latter did. There seems to be no difference in this respect between Indonesia and Korea, on the one hand, and Brazil and Mexico on the other.

As far as the allocation of investment resources is concerned, not only Mexico and Brazil, but also South Korea used foreign loans in the 1970s to launch ambitious programmes of import substitution and development of heavy industries. The reason for this investment drive was, of course, the negative or extremely low real interest rates which prevailed at that time. Ex ante, therefore the market signals pointed towards increased investment. However, all these programmes, including those of Korea, ran into supply side bottlenecks and teething troubles of various kinds. The main reason why the Korean programme eventually succeeded while the Brazilian and Mexican ones did not was the far more severe foreign exchange constraint which the latter two countries were subject to. It is worth recalling in this context, that the Korean government's investments in heavy industries during the 1970s were much criticized in orthodox economic circles, including the World Bank. However, these investments more than redeemed themselves in the 1980s by providing the main basis of the highly successful Korean export drive during that decade.

4.4(e) Macroeconomic policy errors

With respect to the question of the macroeconomic policy errors made by the Latin American countries, economists who are critical of the standard arguments make three points in response. They note that policy mismanagement undoubtedly played a role, but policy mistakes were generally rapidly corrected and can hardly explain a decade of retrogression. Secondly, and more importantly, the issue of macroeconomic policy mistakes can only be properly addressed in the overall context of the size of the shocks which the Latin American countries were subject to and the constraints imposed by the political economy of adjustment. It is not the case that the Latin American countries were incompetent or unaware of the desirability of balanced budgets, etc., but as noted earlier, the economic shocks many of them suffered were so gigantic that their social and political institutions simply could not cope with the ensuing redistributive struggles. Many, therefore, experienced episodes of hyper-inflation and macroeconomic instability. Thirdly, the critics also note that booms in public spending and large budget deficits were present in the late 1970s, in both the subsequent good and bad performers (South Korea, Turkey and Sri Lanka as compared to Mexico and Brazil), and they were also absent or rather moderate in both types of countries.

4.4(f) The role of the state

It is clear from our earlier discussion of East Asian countries that their governments intervened heavily in all spheres of their economies. Latin American failure cannot therefore be attributed to the pervasive role of the state in the simple terms of rent-seeking, and unproductive activities etc. emphasize in the neo-classical political economy. After all, the role of the state was much bigger in Korea and Taiwan than in many Latin American countries. It should be recalled that until the early 1980s, both South Korea and Taiwan had nationalized banks (and most of their banks are still state owned), and in both countries, state-directed credit to favoured sectors and firms was an important device for planned industrial development. Moreover, it is notable that the public enterprise sector in Taiwan was one of the largest among the developing mixed economies. It was bigger in relative terms than India's or that of Argentina, Brazil or Mexico. The public enterprises have contributed 13-14 per cent of GNP and a third of gross fixed capital formation in Taiwan over the years 1950-1975, a period which witnessed the most rapid economic and industrial growth in that country.

However, the state in Latin American countries is in fact unable to act as effectively as a developmental state as the governments of the East Asian countries. In view of its historical evolution and the nature of its relationships with various social groups (eg.labour, landed interests), the Latin American state has much less "autonomy" than its counterpart in East Asia. Nevertheless, it is important to observe that the long term development records of governments in Latin American countries such as the Mexican and the Brazilian over the post-war period, until the debt crisis of the 1980s, has been a highly creditable one overall, as outlined earlier.

4.4(g) Summing up

Finally, in conclusion to this analysis of Asian economic success and Latin American failure during the 1980s, it is important to draw attention to the fact that, although the latter was due largely to international economic forces beyond the control of Latin American governments, rather than to domestic mismanagement, these countries must improve their internal organization and resource utilization if they are to recover their long-term growth rates of 1950-1980. It is also, however, necessary to reiterate that the neo-liberal policies adopted by Latin American governments under the tutelage of the Bretton Woods institutions in the last decade are not necessarily the best ones. Such policies have invariably involved further financial liberalization and often a precipitate opening up of the domestic markets to the full force of international competition even when large segments of the national industry are in a weak state due to protracted insufficient investment as a consequence of the debt crisis. The net long term economic outcome of this strategy for Latin American countries may therefore unfortunately be negative rather than positive. However, the jury on this issue will be out for a while.

4.5 African economies and marginalization

The conventional story is that African economies have suffered from being marginalized from the international economy and therefore need to rectify the situation. The implied suggestion is that this marginalization of African countries is their own fault: and the burden of correction lies with them. Is this thesis fully valid?

This notion of marginalization needs careful analysis. Could it not be that the marginalization of the African countries has as much to do with international economic forces, over which they have little or no control, as with their own shortcomings?. African countries during the last decade have not deliberately marginalized themselves by government actions to withdraw from the world economy by for example prohibiting or discouraging import or exports of foreign investment. On the contrary, under structural adjustment they have been making strenuous efforts to further liberalize their economies in all these and other spheres. Yet the results are disappointing in the sense that the level of per capita GDP of most African economies may be as low now as it was in the early 196Os. So when it is said that the African economies are being marginalized, what is suggested is that their share of the world trade and world exports is shrinking. This is clearly due to their poor economic performance, despite being more integrated into the world economy than they were previously. African countries are at a relatively low level of development and are mainly exporters of commodities. International commodity prices fell in real terms by 45 per cent during the 1980s -- a historically unprecedented fall. During this period, The Economist's index of real commodity prices fell to its lowest level in 150 years!. This gigantic external shock caused these economies to become balance-of-payments constrained and hence reduced their capacity to import which is crucial not only for production for the domestic market but also for generating exports -- a classic negative feedback mechanism. The Bretton Woods institutions cannot be spared blame in this matter as they asked every country to improve their balance of payments by increasing production and exports of primary products. This would have been perfectly sensible policy-wise if there was only one or a few countries involved. However, there is a fallacy of composition if a large number of countries are involved and all increase exports. The policy then becomes self-defeating as it results in a fall in prices. Inexplicably, the economists of these institutions seem to have overlooked this international dimension of their own actions, which was obvious to just about everybody outside these institutions with global responsibility and whose job it is to look precisely at the international implications of policies.

African countries in this situation may do better by more considered integration into the world economy. It is well-known that in the 1930s debt repudiation and protection initially imposed to protect the balance of payments at the height of the world economic crisis and government policy helped the Latin American countries to diversify their economies. This is not to suggest that these countries should repudiate their debt or implement unilateral protection -- a blasphemy in the age of Washington consensus -- but that there may be an intellectual case for a different set of policies than those currently being implemented. However, under the present circumstances of the world economy these policies would need to be multilaterally agreed. That is more likely to happen if the BW institutions themselves ask for these changes, once they recognize that fifteen years is a long enough time to conclude that previous policies (the structural adjustment policies) have not worked and a change in direction is clearly required. The new leadership of the World Bank, with the promise of change, may yet surprise us at all. Long ago the Italian thinker Gramschi talked of the optimism of the spirit and the pessimism of the intellect. One should therefore not rule out that the World Bank under its new leadership and the promise of change revise its policy perspectives in this and other equally important matters.

5. Present liberalization in historical perspective

The present era of increasing openness and growing integration in the world economy invites comparisons with a previous period in which there was also a high degree of international economic integration. That period is normally deemed to begin around 1870 and lasted until the outbreak of the First World War in 1914. It operated under the gold standard under British hegemony and was marked by high levels of international trade, international investment and finance as well as of temporary and permanent international migration of labour. As a result of the large expansion in trade, by 1913 the extent of trade openness among industrial countries, according to some important indicators, was not all that dissimilar from that today. For 16 of the more advanced countries the share of exports in GDP was 18.2 per cent in 1900 and 21.2 per cent in 1913. During the present era, the share of world exports in world GDP has increased from less than 6 per cent in 1950 to 12 per cent in 1973 and 16 per cent in 1992. The corresponding figures for industrial countries are 12 per cent in 1973 and 17 per cent in 1992.

Turning to investment flows, the stock of direct foreign investment in the world as a proportion of wold output was broadly the same in 1992 (8.4 per cent) as it was in 1913 (9.0 per cent).

Even in the earlier period there were also high levels of international capital flows comprising international bank lending and government and private bonds. Large numbers of governments raised development finance through the issue of bonds to foreigners. In the first decade of the century, foreign securities constituted more than half of all securities traded in London or Paris.

Despite many similarities, there are important differences in the nature of the economic integration of that time compared with now. First, the earlier period was marked by a very high degree of international migration. Second, capital flows in the earlier period were more dictated by "fundamentals" of trade and long-term investment in infrastructure etc. than they are now. Today, capital flows are overwhelmingly dominated by short-term movements across the exchanges. In 1992 for example, world GDP was US$ 64 billion a day, world exports were $10 billion a day and global foreign exchange transactions totalled a daily $900 billion. Third, trade in the earlier period was mainly trade in dissimilar products -- for example raw materials and manufactured goods -- whereas today it is largely intra-industry, that is similar products are traded between developed countries, whose trade among one another still accounts for the bulk of world trade. Further, unlike in the past, a large part of world trade today is intra-firm, that is between parts of the same firm.

Then as now globalization was facilitated by technological factors. In the earlier period, important technological innovations (the steamship and the telegraph) greatly increased the speed and reduced the cost of international transportation and communication. Similarly, in the present era, technological innovations in sea and air transportation and in information and communications technology have again greatly reduced the costs, complexity and time of trading goods, services and information internationally.

There is a widespread conception that it is technological improvements that have led to the establishment of international financial markets, for example the gigantic foreign exchange markets referred to above. It is further argued that these same technological developments mean that governments can no longer control these markets. Both propositions are unconvincing. The foreign exchange markets were not spawned by technology but by liberalization of regulations controlling capital flows -- i.e. these were conscious decisions of governments and not forced by some technological imperative. Similarly, if governments should decide to limit capital flows across the exchanges, technology is unlikely to stop this being carried out.

In this context, it is worth reflecting on the fact that the introduction of the telegraph at the end of the 19th century reduced the time of communication from 6 weeks between London and New York by sea to a few minutes. This greatly facilitated the operation and expansion of financial markets in that period but it did not stop countries from controlling capital movements when they needed to.

At the time of this earlier period of liberalization, the process also seemed an irreversible one but major political and economic events rapidly reversed the direction of the process.

With respect to the effects of this earlier episode of liberalization on world economic performance, it is suggested by some that it led to convergence in the living standards among different nations. Other scholars, however, point out that to the extent that any such convergence took place it was only among a small number of white settler countries and the metropolises. The colonized countries of Africa, Asia and Latin America which were inevitably drawn into the web of international markets benefited hardly at all. Countries like China, India and Indonesia suffered de-industrialization and may have retrogressed. It is also suggested that the extent that there was convergence even between the white settler countries and the metropolises, the main factor contributing to this was international migration.

6. Poor economic performance of advanced countries under liberalisation and globaalisation: reasons and future prospects

6.1 Reasons for poor performance

Section 3 emphasized that the performance of the advanced countries under the liberalized and globalized regime in the post-1980 period has deteriorated very considerably compared with that in the pre-liberalization era of the 1950s and 1960s.

In principle, liberalization and integration of international markets would benefit participating countries through greater specialization, better division of labour and more efficient allocation of investment resources. Also Section 5 outlined the dynamic benefits which trade liberalization alone can confer through learning and through innovation. Similarly, at a theoretical level, under certain conditions, trade liberalization by itself should lead to equalization of factor incomes; and if this was reinforced by free capital movements it should speed up the process of factor price equalization.

In practice, not only has the post-1980 economic performance been poor in terms of economic growth, employment and instability, there has also been little tendency towards convergence of per capita incomes or real wages in industrial countries. There is evidence of greater convergence in the pre-liberalization period than in the post-1980 period.

The current mass unemployment is a particularly serious public concern. It was also seen that the failings of the post-1980 OECD economy cannot be attributed to exogenous factors such as technology.

Why have the actual outcomes been so different from the theoretical expectations? Why has the economic performance under liberalization been so much worse than in the pre-liberal period? What, therefore, is the precise mechanism linking these detrimental outcomes to the process of liberalization and globalization?

An important part of the explanation lies in the functioning in practice of the free financial markets and their negative consequences for the real economy. The post-1980 period has been characterized by a sharp fall in the rate of investment. The rate of growth of gross fixed capital formation in OECD economies fell from about 6 per cent in 1960-1973 to a little over 3 per cent from 1979 to 1990. This fall in investment in turn has contributed to the trend reduction in productivity growth noted earlier.

The observed decline in investment is all the more surprising since in the 1980s there has been a huge increase in profitability in industrial countries. Profitability had declined very sharply in the 1970s but, as a result of the tax concessions and other pro-market policies of the post-1980 period, it recovered in leading industrial countries to the best levels attained in the mid-1960s. Moreover, the enormous rise in share prices on the world's stock markets in the post-1980 period should also have resulted in more buoyant expectations on the part of entrepreneurs and hence higher investment.

However, other aspects of the workings of the financial markets have acted in the opposite direction. International financial flows have been dominated by short-term speculative capital movements, as indicated earlier. This has contributed to huge variations in exchange rates and interest rates. Moreover, domestic financial deregulation, which encourages new forms of credit, has led to increased fluctuations in aggregate demand by making, for instance, consumption expenditures much more volatile. The latter are also affected by fluctuations in household wealth caused by volatility in asset prices. These fluctuations in the financial markets have contributed cumulatively to a sharp rise in the cost of capital.

Long-term real interest rates in the period 1981-1993 in France, Germany, United Kingdom and the United States averaged over 5 per cent a year. Historically, these are exceptionally high rates. The corresponding figure for 1956-1973 was only 1.7 per cent. Recent interest rates are higher than at any time since 1890-1899, except for the period 1930-1932 when they averaged 10.5 per cent. These high interest rates have clearly had a negative effect on corporate investment (UNCTAD, 1995).

Apart from the financial instability engendered by the workings of the financial markets and their negative effect on investment, there is also another important but related reason why in the post-1980 period, the liberal economic regime has led to a pervasive deterioration in economic performance in industrial countries. This is best brought out by comparing the present situation with the successful pre-liberalization economic regime of the 1950s and 1960s.

The earlier economic regime, as seen in Section 4, operated on the basis of social consensus at the national level. At the international level, there was also a consensus, voluntary or otherwise under US hegemony, which assured orderly international monetary and trading arrangements.

In 1941, in preparation for a more rational economic order following the Second World War, John Maynard Keynes observed:

> "The problem of maintaining equilibrium in the balance of payments between countries has never been solved ... the failure to solve the problem has been a major cause of impoverishment and social discontent and even of wars and revolutions ... to suppose that there exists some smoothly functioning automatic mechanism of adjustment which preserves equilibrium if only we trust to matters of laissez faire is a doctrinaire delusion which disregards the lessons of historical experience without having behind it the support of sound theory." (John Maynard Keynes, 1980.)

During the 1950s and the 1960s this vexed problem of international payments imbalances was not left to laissez faire.

Multilateral arrangements for managing the international financial system under the Bretton Woods institutions were established in part to deal with the matter in a coordinated fashion. In principal, payments imbalances between countries may be resolved at varying levels of world output and employment, but contrary to the expectations of the technical architects of the system, the actual agreemets which emerged has implicit in them a deflationary bias. This was manifest in the fact that, under the new system, in resolving payments imbalances between countries, the burden of adjustment would fall almost entirely on the deficit countries rather than being shared to a greater or lesser degree with the surplus countries. Keynes in particular had favoured "symmetrical" ajustment whereby not just the deficit countries would be forced to adjust, by for example, deflating their economies, but that the surplus countries may also contribute to the process by expanding their own demand.

However, in the post-war boom of the golden age, this potential deflationary bias in the IMF arrangements evidently did not manifest itself. This was due to the fact that, notwithstanding the Bretton Woods institutions and the multilateral system, the economic policy of the United States -- the then hegemonic power -- provided enough liquidity to the system, to allow adequate growth of world demand, so as to achieve fast economic growth and full employment in industrial countries. The United States did this in the early post-war period through the Marshall plan and subsequently, through its military expenditure and foreign investment abroad. The significance of this post-war co-operative international economic arrangement (including the IMF) lay in the fact that it permitted imbalances to be resolved at high rates of growth of world demand, output and employment.

However, this, together with the relative competitive decline over time of the US economy, however, also contributed to the US balance of payments deficits in the 1960s. These ultimately led to the demise of the Bretton Woods system in 1971 when president Nixon stopped gold convertibility.

In the post-1980 period, as far as industrial countries are concerned, market forces rather than governments or the multilateral institutions have come to dominate international finance. As a consequence of the sheer size of the US economy and the fact that a large part of world trade and central bank reserves are denominated in dollars, the US continues to be a major player in the present financial system (such as it is) without being the hegemon it was during the golden age. Another major player is Japan because of its enormous and persistent current account surpluses. Germany is the third big player because of the dominant role of the Bundesbank in the European Union. As far as the multilateral institutions are concerned, their role has long been reduced to that of simply monitoring and disciplining the third world, while the economic policies of developed countries essentially lie outside the purview of the IMF and the World Bank.

However, despite occasional ad hoc agreements between the Group of 7, there is now much less co-operation between leading nation states on international financial matters than in the immediate post-war decades. There is reduced willingness as well as ability to take corrective action against speculative markets which depart from fundamentals. Thus, the 1980s witnessed huge variations in the exchange rate of the US dollar with other major currencies, changes which were not based on the state of real economic variables.

Fortunately advanced industrial countries have so far displayed the minimal amount of co-operation necessary to forestall competitive devaluations of the kind which occurred in the interwar period with disastrous results. Nevertheless, in general, market forces reign supreme in the foreign exchange, the bond and other important financial markets. Although on occasion, the financial markets provide expansionary impulses (as in the case of financial flows to Mexico in the early 1990s, only to be withdrawn suddenly in December 1994), broadly speaking, they have tended to reinforce the deflationary bias of the financial system. Apart from the problem of asymmetric adjustment mentioned earlier, the financial markets have invariably obliged governments to follow restrictive policies. One analyst has explained the reasons for this as follows:

> ".....governments must today, as never before, keep a careful eye on the need to maintain market "credibility"....a credible government is a government which pursues a policy in accordance with what the markets believe to be "sound". Particularly favoured are measures designed to meet (a) "prudent" predetermined monetary target, such as maintaining a given exchange rate parity or a given growth rate of the money supply. Governments which fail to pursue "sound and prudent" policies are forced to pay premiums on the interest cost of financing their programs. Severe loss of credibility will lead to a financial crisis."

Thus the demands of credibility by the financial markets have imposed generally low growth, if not broadly deflationary macroeconomic strategies on most G-7 countries.

In conclusion, free capital movements could promote global economic efficiency by permitting capital to flow to those areas and to those projects where it would be most profitable. However, for various reasons such efficiency enhancing and socially beneficial flows, whereby capital moves, say from rich to poor countries, do not always materalize. Very often the flow is the other way around. Even if it was not (ie. did move in the right direction), to the extent that the financial markets do not allow governments to follow full employment policies, such flows may not yield overall economic benefit. Many economists would attribute a significant part of the responsibility for the poor economic performance in the post-1980 period to the lack of international co-operation between leading industrial nations. Inadequate co-operation, as we have seen, permits supremacy of the financial markets that thwart expansionary policies of governments and allow ascendency of finance over production.

6.2 Prospects for the future

The overwhelming economic need of the moment in industrial countries is to eliminate mass unemployment, maintain social welfare programs and achieve higher real wages. Most economists would agree that such an objective can only be attained if there is a large and sustained trend increase in the overall rate of economic growth. This in turn requires a concomitant in the rate of growth of real aggregate demand.

It was noted earlier, that neither international financial organisations nor independent economists expect any such improvement in the growth performance of industrial countries in the foreseeable future under the economic policies being currently pursued. These policies emphasize labour market flexibility as a route to full employment. However, with a constant level of aggregate demand, more labour market flexibility will simply lead to greater competition among job seekers and hence reduce the average real wage rather than increase it. At the international level, in an inter-dependent world economy, it is indeed true that any single country may be able to improve its competitiveness by reducing wages. But, there is a fallacy of composition in the view that all countries can do so by following such a strategy. Rather, if many countries did follow this route, it could lead to competitive devaluations of the kind which occurred in the 1930s and hence even greater instability for the international economy, to everyones' detriment. Equally importantly, such a strategy is also socially divisive and will pit industrial country workers against each other and ultimately against third world workers. The history of the post-World War II period suggests that this in turn will lead to a negative sum ad hoc protectionism in industrial countries against third world products and hence ultimately the collapse of the liberal international economy

There is however, an alternative set of policies which can in principle, not only lead to full employment with rising real wages in the industrial countries but can also provide a stimilus to production and jobs in the third world. The essential core of these policies is a large trend increase in the rate of growth of real world demand and output. However, the implementation of this demand-growth strategy requires a decisive move away from the market supermacy model and it replacement by a consensual approach to economic relations at both the national and international levels. In an integrated global economy, the first necessary step in this direction has to be greater macro-economic policy coordination at least between leading industrial countries or close trading partners. For without such coordination, if any single country on its own attempts to achieve a large trend increase in its rate of growth of demand and output, it runs the risk of provoking a balance of payments crisis or a currency crisis.

International co-operation and agreement for implementing expansionary policies is today a necessary condition for obtaining full employment with rising real wages, but it is not a sufficient condition. Sufficiency requires two other important stipulations. First, the existence of credible institutional arrangements at the national level in these countries which will restrain the growth of money wages and prices as the economy moves towards sustained full employment. Secondly, there needs to be an international agreement between industrial and developing countries on fluctuations in commodity prices. To appreciate the significance of these conditions, consider what would happen if the industrial country governments follow expansionary policies in order to achieve sustained full employment and consequently their rate of economic growth rose to anywhere near the level attained in the golden age. Most likely, it will lead to increased labour strength and militancy in industrial countries in pursuit of higher wages and better employment conditions, as well as to a sharp rise in world commodity prices, including oil. This in turn would rekindle inflation and thwart the expansionary process.

The following points are important in relation to the demand-growth approach outlined above:

First, if the institutional requirements outlined above can be met and a demand-growth strategy can be implemented, it will be a positive sum game which will benefit not only industrial countries but also developing economies. Faster economic growth in the OECD economies will help developing countries through much the same channels by which many of them were disadvantaged by the slower growth of the North in the post-golden age period. Rapid growth of production and full employment in the North should help the South by leading to increased demand for Southern products; by improvements in the South's terms of trade; by greater capital flows from the North to the South and hopefully also by the governments of the North being able to afford and willing to provide larger aid programmes. Other things being equal, this should lead to faster growth of output and employment in developing economies. Faster Southern growth will have a positive feedback effect on the North.

This positive sum characteristic of the demand-growth strategy distinguishes it fundamentally from the labour market flexibility approach currently favoured by governments in industrial countries and their international organizations.

Secondly, it is important to note that the demand-growth strategy of achieving faster overall economic growth is perfectly feasible on the supply side. This is mainly because, as noted in section 3, there exists a backlog of technology represented by the communication and technological revolution. The full potential of this technological revolution has not been harnessed so far in most parts of the world owing to an insufficient rate of growth of demand and output.

Thirdly, it will be appreciated that the demand-growth strategy is not a call for a return to the Bretton-Woods system. As the analysis in section 6.1 indicated, such a return is no longer feasible. That system was crucially dependant on a single dominant power with overwhelming economic strength. Such conditions do not exist today. It therefore makes the task of macro-economic policy coordination much more difficult but no less essential.

Nor is the proposed strategy harking back at the national level to the specific institutions which existed in the golden age in individual industrial countries. Many of these institutions, particularly in the pay-coordination sphere, proved to be inadequate towards the end of the golden age. Corresponding institutions today will need to be more robust.

There is thus a long task ahead in institutional building and renewal. The international community must find the wisdom and the capacity to carry out this task in order to solve the pressing problems created by mass unemployment and low long term economic growth in individual countries, but which also harm developing countries. It must be emphasized that mass unemployment in rich countries is not a curse from heaven, or an outcome of some inexorable technological imperatives. Rather, it is the product of human actions, a manifestation of coordination failures created by the unfettered functioning of the market economy. Appropriate alternative institutions are needed to address these coordination problems.

Fourthly, to forestall misunderstanding, this section has concentrated on the problems of low economic growth and mass unemployment in the North rather than on similar problems and that of poverty in the South. The main reason for this is not that the economic difficulties of developing countries are not regarded as being equally if not far more serious, but that in the context of this paper, the poor economic performance of the North is being discussed in relation to the liberalization and globalization experience of these countries in the last 15 years. Nevertheless, the alternative strategy proposed here will benefit both North and South. This strategy also involves limited but important international co-operation (in commodity prices) between North and South. In a more general international context, the co-operation between North and South would need to cover many different areas. Some of these ideas will be outlined in the next section.

6.3 Summing up.

The first part of this section has been concerned with the poor performance of industrial countries under a liberalized global regime of free trade and capital markets which these countries have experienced in the post-1980 period. The main conclusion of the analysis is that freely functioning capital and financial markets in these countries have harmed their growth and economic prospects through two distinct but inter-related channels. First, the volatility of the markets has raised the cost of capital and discouraged investment (both directly and indirectly through the large increase in real rates of interest). Secondly, the financial markets have in general obliged governments to follow low growth or even deflationary policies.

The second part of this section has examined the prospects for industrial countries under a liberal economic regime. The main conclusion here is that these countries are unlikely to be able to raise their trend rate of economic growth using current policies which are based on the labour market flexibility approach. It is suggested here that this approach is not only unlikely to be helpful in terms of economic growth and employment, it is also likely to be divisive for workers within industrial countries. In addition, it will further exacerbate strife between industrial country and developing country workers and, as indicated before, lead to demands for protection in industrial countries.

The paper has outlined an alternative strategy of demand growth based on co-operation between countries, and between employers, workers and governments within countries. This corporative approach involves institutional renewal and the building of fresh institutions, both at the national and at the international level. The main purpose of this analysis is to show that it is not the case that labour market flexibility is the only feasible strategy currently available to industrial countries, but that there is indeed an alternative strategy based on rather different principles which is superior both for people in industrial and in the poor countries.

7. Policy implications for developing countries, UNCTAD and the international community.

7.1 The post-cold war international economic environment and limited options for developing countries

When the Group of Seventy Seven (G77) was formed in 1964, compared with today developing countries were faced with rather favourable international economic conditions.

The advanced countries were experiencing a sustained economic boom with more or less full employment and in some cases were bringing in additional labour from abroad. There was an enormous expansion of world trade and that in manufactures was growing in volume terms at a fast rate of 10 per cent. Thus rapid growth and full employment in the North benefited the South by giving rise to an increasing demand for Southern products (mainly food and raw materials); improving the terms of trade of trade for developing countries, absorbing some migrant workers, low real interest rates and by Northern governments feeling able to afford significant aid programmes.

As noted earlier, the international trading system enshrined special and differential treatment for developing countries, especially following UNCTAD I and Part IV of the GATT. Developing countries were allowed to use import controls to protect their infant industries. Similarly the Articles of Agreement of the IMF allowed developing countries to use exchange controls to protect their balance of payments. In many cases, the Cold War and contention between the systems worked to the advantage of developing countries, permitting them to benefit from economic and technical aid from both sides. When in the early 1950s the United States refused to help India establish an integrated steel plant in the state sector, the USSR immediately stepped in with an offer to build an even bigger plant, an offer which was accepted. Later, Indian steel technicians in their thousands were trained in both the USSR and the United States.

Importantly, too, in this period developing countries were able to employ a range of export and industrial policy instruments to promote their development without much hindrance from GATT or the multilateral financial institutions.

These circumstances stand in stark contrast to the situation today. Slow growth and mass unemployment in industrial countries is leading to widespread demands for protection from Third World imports in particular. These often take the form of asking for labour or environmental standards to be applied to developing country production of goods to be exported to Northern markets.

In the view of many independent scholars, the recently negotiated Uruguay Round Agreements themselves represent a significant retrogression for developing countries in several aspects. Not only has special and differential treatment for developing countries with respect to trade been considerably eroded, but the Agreements have also established international rules and disciplines over a number of the domestic export promotion and industrial policy measures that were previously used with clear success around the world. There has therefore been a considerable loss of national autonomy with respect to policy-making in the field of trade and certain important trade-related matters.

While the multilateral rules and disciplines newly established under the WTO are said to offer guarantees of fair play, it will in fact be difficult for individual developing countries to pit themselves against more powerful trading partners to take advantage of the benefits of this new international framework. Also, it will be much less easy for developing countries to challenge developed countries on patents issues than the other way round.

Moreover, many developing countries, having deregulated their financial markets, are now open to much higher levels of risk than previously.

Another detrimental change is that, in the post-Cold War era, industrial countries no longer have to provide competitive aid to keep developing countries in the western camp.

Instead, in the current policy climate, all developing countries, irrespective of individual circumstances, are told to liberalize and to integrate as quickly and fully as possible into the world economy, in order to achieve what aid and other policies have ostensibly failed to do. Indeed developing countries are told that they are privileged to be given the opportunity to do so.

This paper, however, has argued that the liberal and globally integrated economic order in which developing countries are being obliged to participate (with far fewer special concessions than before) has so far not delivered. The case of developed countries was given particular attention because of its importance as a test case. Leading industrial countries have operated under more or less free trade and free capital movements as well as considerable domestic deregulation for the last fifteen years. The analysis of this paper shows that this period has been characterized by slow and fluctuating economic growth, mass unemployment and consequent social disintegration in these countries. There is no reason to believe that there will be any significant improvement in the economic performance of these countries, unless their policies of internal and external liberalization and market supremacy are drastically changed.

If mass unemployment continues in the North, the new international economic order is unlikely to survive. Its disintegration could take many different forms: at one extreme the world could go back to the situation following the Great Depression, with widespread protection and capital controls. Alternatively, there may be ad hoc protectionism as is already in evidence in the calls for labour and environmental standards. It is also possible that the North will, in the event, fail to implement its commitments with regard for instance to the Multi Fibre Agreement. Developed countries may well also ask for much faster financial liberalization in developing countries, much to the detriment of the latter.

The economic situation of developing countries was also reviewed and the conclusions drawn from the evidence was that those economies which had performed relatively well had not embarked on a policy of full liberalization but rather had chosen the path of strategic integration.

7.2 A platform for the South

All this has important policy implications for developing countries, requiring careful reflection on policy responses, by developing countries individually and collectively, as well as by UNCTAD, the one body in the UN which still has a policy remit to deal with interlocking global economic issues from a development perspective.

In this post-Cold War economic environment, the need for collective action by the South to meeting the evolving challenges are more important than ever. No individual developing country on its own, no matter how large and relatively developed, can expect to be able to influence the new rules of the evolving world economic order. Collectively, however, they have some chance of doing so.

Moreover, the foregoing analysis suggests that, irrespective of their level of development and degree of integration into the world economy, almost all developing countries in all regions have a number of broad common interests in relation to global economic matters and to the issues of liberalization and globalization. Together, they provide a strong negotiating platform for developing countries in the forthcoming multilateral discussions and negotiations in UNCTAD IX, for they provide the central elements of a coherent and much needed set or functions for this body.

7.2 (a) Independent assessment of world economic conditions

In the current chaos and disorder of the world economy, there is a clear need for continuing objective and independent analysis of macro-economic developments in the world economy. The UN's central economic functions have been eroded and the bulk of analysis of global economic developments is being carried out by agencies where, as shareholders, the rich countries have majority control. But the world cannot rely only on analyses of international economic events, trends and economic relations from the perspective of the rich countries and of the international financial markets.

It is therefore of the utmost importance that UNCTAD be mandated to develop its monitoring and analytical capacities sufficient to make a major contribution in this field, in particular in the fields of trade, finance and money, investment, technology, and environment, focusing in particular on the development implications, and including studying the forecasts made by other international institutions. UNCTAD should not be deflected by the hype and euphoria and about liberalization and globalization but seek to honestly and continuously analyse the implications of these developments, and the disorder and imbalances manifested by the system for developing countries.

7.2 (b) A forum for global policy dialogue

Developing countries, as much as developed countries, have a strong interest in greater international coordination of macro-economic policies to achieve short-term global macro-economic stability, sustained growth in the global economy, and long-term development in the countries of the South.

At present, developing countries are effectively precluded from participation in any international discussions that take place on these matters, since they occur if at all within institutions of the North. This situation needs to be remedied.

UNCTAD is the appropriate forum for global policy dialogue, as also for dialogue on issues on which greater North-South co-operation should be sought. These include resource flows (including ODA and debt issues), market access in the North, and preferential arrangements such as the GSP. These needs have not been supplanted or met by greater liberalization in the world economy. Indeed, the fact that they are offered as a vital package to the economies of the ex USSR emphasizes their continuing relevance.

7.2 (c) Globalization and development strategies

The development problem is far from resolved and the debate on development is far from over. It is necessary for developing countries to challenge the intellectual hegemony of advanced countries and their institutions on these crucial issues which widely affect the present and future well-being of the whole of humankind.

However, to examine and articulate new approaches is a considerable political and intellectual challenge for developing countries. The hegemony of the conventional wisdom with respect to liberalization and globalization and the various external pressures to which individual developing countries are subjected make it difficult for developing countries to undertake this task in isolation. The South therefore has a common interest in a strengthened and more dynamic role for UNCTAD in this field.

"First-best" policies and other options

It has been argued in this paper that, as far as economic development in developing countries is concerned, the "first best" policy with respect to liberalization and globalization is *not* to seek rapid and close integration but rather to define careful policies of selective integration or what has earlier been called strategic integration. This paper has emphasized the dynamic gains which can flow from integration with the world economy. However, it is argued that these can only be realized by active government policies and if integration is patterned and timed to achieve clearly defined objectives. Thus, in opposition to the analyses of the Bretton Woods institutions, a critical role is assigned here to the state in promoting economic development. Some states, however, are being undermined by the Bretton Woods overemphasis on marketization and will need help to become more effective.

If the "first best" policies are to be no longer permissible under the Uruguay Round agreements, UNCTAD has to be prepared to spell out useful alternatives --- second, third or fourth best policies.

In relation to industrial policy and the Uruguay Round Agreements it is useful to note the following points.

4

1. Most observers agree that, despite the restrictions embodied in the Agreements, it is still possible for countries to pursue an effective industrial policy, but this will have to take different forms. The restrictions in fact make industrial policy all the more necessary. This is because the time period available to developing countries to enhance the capabilities of their firms to international competitive standards has been greatly shortened by the Agreements. This therefore requires much more purposive and focused intervention in the period allowed.

2. In view of the limitations imposed on many traditional instruments of industrial policy, developing countries need to adopt a wider conception of measures which constitute such a policy. Specifically, they should pay special attention to policy measures to increase domestic savings and business investment. The latter policies are not covered by the Agreements and can be highly beneficial in promoting capital accumulation, technological change and hence international competitiveness.

3. Developing country governments can also assist their industrialization drives and the international competitiveness of their producers by concentrating greater effort on providing them, as cheaply as possible, if not freely, a wide range of industrial facilities, including training of the labour force, scientific research and development services, science and industry parks, or providing cheap land and commercial buildings. These could include in principle cheap housing for workers (as in Hong Kong), which reduces the pay bill of employers, health services etc. Hence the need for a dynamic and efficient state.

4. Developing countries should learn from the experience of countries like Japan in establishing non-governmental institutions or modes of "business practice" that can effectively promote domestic industry. Governments also need to have much closer links with the private business sector and workers organizations in order to have a clearer appreciation of their perspectives and to promote social cohesion on development policies.

All these policies require to be custom-made in the wake of the Uruguay Round Agreements to suit local circumstances. UNCTAD should assist developing countries in this task. It will involve an international data and information gathering capacity and an analytical capacity that only an international organization can provide. Moreover, some of the policy issues that may need to be tackled can only be dealt with through dialogue between developing countries and the advanced industrial countries in a multilateral framework.

This work will be particularly demanding in the case of least developed countries, most of which have only rudimentary industrial development and whose production units have a long distance to travel to reach any semblance of international competitiveness or be strong enough to survive from competition in their home markets.

7.2 (d) Uruguay Round: monitoring and "adaptation"
In helping to devise effective new development strategies for developing countries, there will be a need to monitor and assess the impact of various aspects of the Uruguay Round Agreements. In addition to carrying out this task, where necessary UNCTAD should also be prepared to do the necessary groundwork to assist developing countries to seek new ways of interpreting and implementing those parts of the Uruguay Round Agreements which prove to be particularly onerous for them. If, following careful assessment, any part of the Agreements appear to be inimical to development, UNCTAD should prepare the ground for discussions to achieve the appropriate revisions.

7.2 (e) Foreign investment
The role of foreign direct investment is now widely celebrated. Concerted efforts are being made by the advanced industrial countries to engage developing countries in talks within WTO on means to encourage greater flows of FDI to the South by establishing a new, more liberal global regime to govern FDI. This is an area in which most if not all developing countries have reason to refuse to be pressured into hasty commitments. Much more detailed and extensive analysis is required on various dimensions of the issue before embarking on multilateral discussions or negotiations.

A few facts serve to illustrate the need for careful analytical work as a basis for formulating national and international policy options. Clearly, not all FDI is equally beneficial. Historical and empirical evidence strongly suggest that it is not so much the quantity of foreign investment which counts but the nature of the investment and the sorts of linkages that are made with the local economy. For example, FDI in the form of investment in supermarkets or fast-food chains will not raise growth as much as FDI in, say, manufactured products for export, such as steel, car parts or computer components. Whereas the latter may earn foreign exchange and amortize the foreign exchange costs of the investment and foreign dividend payments, the former does not do so. These are likely to be a continuing burden on the balance of payments and thereby thwart economic growth.

FDI is often urged on the grounds that it is one of the most important mechanisms for upgrading local technological levels in developing countries. However, there is no automaticity with regard to the transfer of technology and know-how from foreign-owned enterprises to the local economy. More needs to be known about the policies and conditions which help to maximize technology transfer from foreign enterprises to the local economy. In particular, careful analysis is required of the relative cost of technology transfer through FDI compared with other means of obtaining technology such as through licences.

The experience of successful countries such as Korea and Japan is illuminating. These discouraged inward FDI during their period of most rapid economic growth -- 1970-90 for Korea and 1950-1970 for Japan. In the case of China, while it is indeed true that Chinese economic growth in the recent period has been helped by the vast amount of capital it has received mainly from overseas Chinese, it needs to be appreciated that the Chinese have been highly selective regarding the sort of inwards investments they allow and the terms on which it is permitted.

It will therefore require a renewed and strengthened UNCTAD to devote a significant part of its analytical capacity to issues relating to foreign investment and technology transfer before it can be said with any objectivity whether an international or multilateral agreement would serve the interests of developing countries.

7.2 (f) Competition policy

Another important role for UNCTAD in the evolving world economy concerns competition policy. There clearly is no level playing field when a large multinational competes with local domestic firms, large or small. There arise important questions of predation and strategic behaviour by multinationals (whereby for example instead of competing with each other the latter divide up developing country markets between themselves), mergers and takeovers by multinational firms, abuse of market power by dominant firms.

There are two areas of particular concern. First, many developing countries do not have competition policies or experience of them. This is an area, therefore, in which UNCTAD should further develop its expertise. Second, in view of the world-wide role of multinational firms, and the strategic interactions between them of the kind suggested above, there is a need for international action to enforce competition behaviour by these firms including in developing countries. UNCTAD should be prepared to make detailed proposals for negotiation in the field of competition policy, which take into account the particular needs of the developing countries and it might itself act as the international agency to administer and monitor competition policy.

The need for an adequate competition policy would , of course, be all the more necessary, in the event that an international code on foreign investment were negotiated.

7.2 (i) Regionalism, multilateralism and developing countries

The increasing number of regional groupings involving special trade and investment arrangements, among other things, between member countries raises a number of important questions. One important issue is whether the existence of such groups promotes global liberalization or limits the process. The establishment of regional groupings such as NAFTA which embrace both developed and developing countries may have additional implications for other developing countries, such as the erosion of preferences. This is an area for detailed study and monitoring by UNCTAD.

7.2 (j) Preparations for multilateral negotiations and agreements

The above has served to illustrate a number of highly critical areas where UNCTAD should be expected to play an important role in analysis and policy work, possibly in preparation for multilateral negotiations leading to international strategies, targets, broad policy agreements, codes of conduct, and other international legal instruments. Other areas to which UNCTAD should devote its attention include trade and environmental matters, commodities, debt and financial flows.

7.2 (k) Providing technical advice

There is also a strong case for UNCTAD becoming a significant provider of technical advice in the main fields of its work, where this is appropriate.

7.3 Reasserting multilateralism requires the strengthening of UNCTAD

The tasks specified above are, of course, extremely difficult, for UNCTAD which faces Northern hostility and possible extinction if it goes against received wisdom. But, as the analysis in the paper has indicated, there are considerable risks attached to being rendered dependent on the analyses and policy prescriptions of institutions such as the World Bank and the IMF, which are under the almost undiluted influence of the leading industrial powers.

Nevertheless, it is crucial to the future of developing countries that there should be a strong multilateral body which has the intellectual capacity and the intellectual autonomy (prescribed in its mandate) to carry out the above tasks in a way which takes into account the development perspectives and interests of the South and which feeds the analysis and policy conclusions into the intergovernmental process. UNCTAD must therefore be strengthened and revitalized so that it measures up to the challenge. (South Centre, 1996a)

7.4 **South-South co-operation**

Globalization can hardly merit its name if it does not involve greater economic links between developing countries, in contrast to increased interdependence between the North and the South. Indeed, increasing economic links between developing countries can be of strategic importance. In addition to improving the development capacity and rates of growth in individual countries, the higher rates of growth in the South resulting from South-South links could partially compensate for the lack of dynamism emanating from the North, and by implication bring about a more rapid change in global economic relations. This process could be speeded up considerably if more purposeful efforts were to be made through South-South co-operation.

The aim of furthering South-South co-operation to build up the South's economic strength has important implications for UNCTAD. The organization needs to ensure that, in all aspects of its work, all possible opportunities are taken for strengthening South-South contacts and South-South flows of knowledge, information etc. Furthermore an important part of UNCTAD's resources should be devoted to intensive study and promotion of the mechanisms and modalities which would best further South-South co-operation.

South-South co-operation is, of course, vital if developing countries are to achieve their aims in and through the intergovernmental process. (South Centre 1996b.) In the case of the forthcoming UNCTAD IX discussions and negotiations, no conclusion that is acceptable to the bulk of developing countries is likely to be reached without a coordinated stand by developing countries. What hangs in the balance is the possibility of keeping alive and even strengthening multilateral processes in the economics field. The other institutions whose views and actions in these matters already have excessive influence make no meaningful room for developing country representation and give little heed to their needs and interests.

7.5 North-South co-operation

At this juncture, the bulk of the world's peoples still have tremendous unmet needs in terms of jobs and adequate wages that would help them provide for their needs. The technical capacity to meet these needs continues to increase, the production potenentialities are enormous and the new world trading system offers great possibilities for improving peoples' lives. Yet the euphoria concering liberalization and globalization are not well based, in part because the very existence of unemployment, particularly in the North, is a danger to the liberal system.

Faster world economic growth is therefore essential both in the North and the South. But this can only be achieved by pragmatic policies and not market dogma or by undermining the state.

Up to now, the world economy has been run by the advanced economies to the exclusion of the South. But, the world is much more interdependent now and the collective weight of the South has increased considerably. More than ever before, therefore, North-South co-operation is required to tackle the problem of achieving faster world economic growth. Co-operation will be required in establishing and operating a new set of international monetary and other arrangements within a genuine multilateral framework in which the South has full participation.

Annexes to be inserted

Tables 1 & 2

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