Integrating the Concepts of Global Freedom; Economics versus Society

Dawood, Mamoon

University of Management and Technology

1 December 2016

Integrating the Concepts of Global Freedom; Economics versus Society

Dawood Mamoon

Professor,
University of Management and Technology
Lahore, Pakistan
Dawood.mamoon@umt.edu.pk

December 2016

Abstract:

The paper carries out a context specific debate on why the real sector of the economy is important to look into to establish a framework of effective development. While doing that the paper highlights that the economic policy in the real sector is to be complemented by intervening in the progress of the society by developing social, political and legal institutions. This paper presents a post Washington consensus intellectual debate that eventually made the Prelog for first Millenium Development Goals (MDGs) and now Sustainable Development Goals (SDGs).

1. Issues in Economic Development Discourse

Society is the derivative of human social evolution. Contemporary globalisation strives to integrate global society on common grounds for understanding and reemphasising all of what becomes the basis of being a human. Since ancient times, the observed practices of human civilisation explain and motivate us to derive the application of concepts like trust, welfare, empowerment and awareness towards unbiased social integration. All such concepts have been harnessed most often locally and sometimes, especially lately at a regional level. Thus, it is pertinant to ask, whether a universal application of unbiased social and economic integration is possible and if yes, then why successful application is thus far, unsuccessful.

Capitalism, a utilitarian point of origin to explain and derive economics of successful commerce and a basis for classical and neo-classical economics, defines social norms as a matter of quantified indicators to bring an overarching picture of reality, which is now known to have been constrained with relativity of approach. Markets rule in capitalism based on their efficiency as they bring equal opportunity to all to carry out commerce as well as provide social welfare at a price freely determined by various integrating market forces. Such successful analogies apply well to developed nations, which work with not only the best of business practices but developed social norms that comply with the best capabilities of all stakeholders. In developed countries, harnessing efficiency not only at the market level but also at the individual level and preserving notions like freedom of expression, human rights, tolerance and rule of law could be possible because a level playing field has been successfully established for all stakeholders through history of lessons with wars, political upheavals and economic crises.

In an effort to develop a similar level playing field in developing countries by influencing their economic policies through the experience of developed nations, Bretton Woods system formulated a plan to structurally over hall the economies in the South. The fundamental focus of these reforms were on giving markets more free hand to determine higher output per capita so that growth is achieved with higher productivity levels as production activities in developing countries would become more competitive locally and internationally.

In 1980s and early 1990s, many developing countries opened up their economies and became a more integral part of global finance and trade. At least, capital markets witnessed unprecedented growth through out the spectrum in the South. However, growing financial sectors fail to generate real output in most developing countries. Argentina's bad experience with opening up post 1980 would provide good lessons for countries that adopted structural adjustment. If anything, capital market reforms made economic development more fragile for many developing countries. Soon after the reform period, most developing countries found themselves with record foreign debt interest payments on the borrowing they had been doing on the pretext of reforms. Debt became a huge problem mostly for African region. Countries that witness rapid economic growth mostly came from East Asian region that have witnessed rapid capital inflows from developed countries. However, little did they know at the time that capital inflows have put them at higher risks of economic downturn because unlike investment in real sector, financial capital can move out as quickly as it has flown in. Soon it did happen with a small sign of panic in East Asia in 1997, where the countries formally known as 'Asian Tiger' witnessed one of the worst crises in recent financial history of the world. A capital flight of unprecedented proportions left these economies with a financial vacuum. The outcomes for the populations were devastating as the brunt of crises was born by the poor.

In 1999, Kufi Anan, the then UN (United Nations) Secretary General noted the fall out of crises with following lines in the foreword of UN survey report on Asia:

> What we once called the 'Asian financial crisis' is now a global economic, social, and political crisis that has had its most devastating impact on society's margins: the millions of poor and vulnerable men, women, and children who are in no way responsible for the fallout but who have nonetheless seen their hopes dashed, and their families thrown into terrible hardship and even destitution.

2. Post Washington Consensus Debate:

Ever since, the policy recommendations by 'the Washington Consensus' have duly been questioned by proponents and the critiques of free markets: 'Much of the glowing praise for the (East Asia) region has, since 1997, been shaken and, in consequence, altered economic thinking in the rest of the world. Debate has been raging and a massive literature has been generated about the nature of the crisis. It is now clear that for the first time in over two decades the free market orthodoxy has been put on the back foot. Where there had been a 'Washington consensus' before--that is, the unanimity of the Breton Woods institutions (the IMF and World Bank) and the US Treasury in promulgating economic reforms on the basis of free markets in trade and investment, privatization of public assets, and strict control of government expenditure, there is now the emergence of a 'post-Washington consensus' which is critical of the idea that free markets work best and questions the impact of IMFinspired 'structural adjustment programs', not just in East Asia but throughout the developing world. We can also argue that the 1997 crisis fed into the questioning of the world capitalist order' (Hasan, 2001; 2)

One of the strongest critique against free market ideology came from within : 'More broadly, the IMF was advocating a set of policies which is generally referred to alternatively as the Washington consensus, the neo-liberal doctrines, or market fundamentalism, based on an incorrect understanding of economic theory and (what I viewed) as an inadequate interpretation of the historical data. The IMF was using models that failed to incorporate the advances in economic theory of the past twenty five years, including the work on imperfect information and incomplete markets to which I had contributed. Most importantly, they had departed from the mission for which they had been founded, under the intellectual guidance of Keynes - they actually promoted contractionary fiscal policies for countries facing an economic downturn - and they advocated polices like capital market liberalization, for which there was little evidence that growth was promoted, while there was ample evidence that such policies generated instability. (Stiglitz, 2001b)

According to Stiglitz, who had also served as Chief Economist with the World Bank and many like minds, the world economy did not fall back well to the basic assumptions of free market paradigm. 'The reform agenda eventually came to be perceived, at least by its critics, as an overtly ideological effort to impose "neo-liberalism" and "market fundamentalism" on developing nations. The one thing that is generally agreed on about the consequences of these reforms is that things have not quite worked out the way they were intended. Even their most ardent supporters now concede that growth has been below expectations in Latin American (and the "transition crisis" deeper and more sustained than expected in former socialist economies).' (Rodrik, 2006; 974)

The lessons from the failure of reform process were obvious. The political economy of the world is intrinsically related to the economic outcomes. Many emphasize that it is vital to understand the history of development to understand the outcomes of development. The definition of development far exceeds than economic freedoms: Growth of GNP or of individual incomes can, of course, is very important as means to expanding the freedoms enjoyed by the members of society. But freedoms depend also on other determinants, such as social and economic arrangements (for example, facilities for education and health care) as well as political and civil rights (for example, the liberty to participate in public discussion and scrutiny). Similarly, industrialization or technological progress or social modernization can substantially contribute to expanding human freedom, but freedom depends on other influences as well. If freedom is what development advances, then there is a major argument for concentrating on that overarching objective…. Development requires the removal of major sources of un-freedom: poverty as well as tyranny, poor economic opportunities as well as systematic social deprivation, neglect of public facilities as well as intolerance or over activity of repressive states. (Sen 1999: 3)

As Sen suggests, there are macro and micro agents of economic participation to define freedom. Global freedom for comity of nations may mean free movement of labour and capital while ensuring sustainability of effort. The key word here is sustainability. It is quite evident, from discussion carried out above, that capital inflows are not sustainable in developing countries. There needs to be a way to manage these capital inflows by formulating strategies which can target the real sector of the economy in favour of these inflows. Sustainability of effort represents real change. 'Financial globalisation has not generated increased investment on higher growth in emerging markets. Countries that have grown most rapidly have been those that rely less on capital inflows.' (Rodrik and Subramanian, 2008; 18)

Hence, what becomes more important in development discourse is the real sector of the economy. To this effect, one may focus on international trade. This is not to say that well developed capital markets do not matter. Only in the framework of this discussion, they are less relevant.

Looking at the real side of economic development, a plethora of issues unravel, which needs to be considered for ensuring good economic outcomes. Good macro-economic management policies, regulations that can promote private property rights, infrastructure which can facilitate business, social empowerment which can raise the quality quotient of efforts, and trade facilitation to compete in international markets are among the few of such economic outcomes which can measure economic development far more effectively than income levels. A higher income for developing countries is an end to the comprehensive objective framework which should first represent stable institutional and market outcomes. In this respect the story to development is very simple. However, entangling these outcomes is a complex exercise. The very objective of this paper is to simplify the many relationships these economic outcomes represent to eventually determine economic welfare.

To this effect one should distinguishe between the pronounced factors which can determine economic outcomes, and processes which can facilitate these outcomes. Thus, two broad categories can be drawn. The factors, which eventually determine economic outcome for a country, are growth rates in the economic activity and distributional effects of these growth rates on different social or income groups. The factors which facilitate good economic outcomes may comprise of sound institutions and the extent to which a country is integrated with other countries in the world.

There is a rich set of literature which already investigates income driven determinants and processes of economic development. So much so that it has contributed to an element of confusion to really know what matters: 'Policy makers are condemned to a spray-gun approach: They shoot their reform gun on as many potential targets as possible, hoping that some will turn out to be the ones they are really after. A successful growth strategy, by contrast, begins by identifying the most binding constraint.' (Rodrik, 2006; p. 982)

3. Economics versus Society: How to Capture the interlinkages

In the economic analysis of economic growth, as against the *proximate* causes of growth which relate to accumulation of factor inputs, the more *fundamental* causes of growth relate to those variables which can improve the ability and capacity of a country to accumulate factors of production. The fundamental causes can be identified by rediscovering Adam Smith's insight that countries need solid institutions for markets to work. Institutions capture many legal, Political, Economic and Social outcomes which are so necessary for development of the economy and the society. Secure and stable property rights make up for the precedence of strong legal institutions. Representative political institutions with institutionalised representation of minority groups can represent institutions for conflict management. Fiscal and monetary institutions are necessary for ensuring economic stability. Many regulatory institutions which promote a successful market economy are also representation of good economic institutions. Institutions of social contract legitimise the market economy through social stability and social cohesion. All these institutional outcomes are interconnected to each other. To find their effect on growth is not an easy task and more so because the correlation may lead to selection bias, where one institution is preferred over other for reasons other than economic logic. For example, the positive effect of democracy is some time unduly emphasised without looking at what it is really capturing.

International trade, which is viewed by many as engine of growth (Dollar and Kraay, 2002; and 2003), and rightly so, is a good proxy to capture the effect of globalisation on economic growth. Both outcomes based and incidence based measures of trade barriers have been forth coming in the recent empirical literature. By utilising best possible definitions of integration, the author examines the effect of trade in relation to prevalent institutions in income generation. Dollar and Kraay (2002) suggest, trade is good for the poor because it is good for growth; but that is only a half-truth. It is also important to consider Sen's view on poverty, as not only a measurement of deprivation of incomes or incidence of poverty but also, more importantly the deprivation of capabilities, as a means to bring yet more comprehensive approach towards understanding poverty as well as economic development. Proxy for education, utilised in this manuscript takes care of Sen's concern for viewing development as process of enhanced social capabilities of economic agents.

How economic growth is achieved also matter? Economic growth which is captured by growth in per-capita income is an empirical generalisation which has to be carefully evaluated in relation to the distribution effect of income generation. Recent empirical evidence suggests that inequality increases about as often as it decreases with rising patterns in economic growth in developing countries. (Ferreira and Ravallion, 2008) It is important to separately look at the issue of inequality and its determinants. If the gains of income are only passed to the rich, such societies cannot sustain growth for long because unequal gains to growth would have significant affects on the processes through which growth has been achieved. Unequal economic outcomes can impede development and the process. It can also lead to economic isolation if domestic pressures mount against globalisation. The lessons on the failure of economic reforms in 1990s tell us that economic development is a fragile process. The fragility has already leaded to a paradigm shift in the approaches to development. In most the shift is for right reasons. In 2000, the UN has initiated work on common goals of social development in developing countries under the banner of 'Millennium Development Goals'. The World Bank has joined in to support these initiatives. Though MDGs in most developing countries were not me , they have preceded by SDGs.

'Views about development have changed in the Bank, as they have in development community more broadly. Today, there is a concern about broader objectives, entailing more instruments, than the case was earlier. Development is concerned not only with increasing GDP, but also with raising living standards more broadly. It is concerned with democratic, equitable, and sustainable development. Development is seen as a transformation of society: a dual economy is not a developed economy, and many of the earlier strategies did little to promote this broader economy, and many of the earlier strategies did little to promote this broader transformation of society.' (Stiglitz, 1999; F587)

The current economic and political landscape of the world is under-developed, where many developing countries still suffer from poor institutions which can only improve in the long run. There is no denial that more integration with rest of the world leads to economic gains. But without good institutions, the trading environment would never favour countries with poor institutions. In this respect some developing countries are not ready to integrate fully because integration is not just a matter of eliminating barriers to inter-state commerce. Convergence with global economy needs elimination of divergent social institutions and establishment of robust monetary and fiscal institution which can work through international finance more effectively and a good legal order. In the absence of these factors, global trade should allow second best options where there is room for protection on importing sectors to solve the problem of labor-surplus and capital shortage. However, promoting exports by subsidising them would be a good trade policy and it would also be pro growth. (Rodrik, 2006) The only question is: "Can developing countries export more to the developed countries?" Under current circumstances, where developed countries have heavily protected their agriculture sector, developing countries have limited options to export to. Their labour intensive agriculture goods are uncompetitive internationally due to highly subsidized agriculture sector in the larger North. But one option remains. If it is about promoting exports, developing countries can do that by trading among selves. Developing countries are not a homogenous group either. Some countries have access to higher technological production frontiers and lie higher on technical ladder than others. Such countries can be good markets for relatively less developed countries. Regional trade among developing countries is a good formula to gain from trade. Then why they do not. For many countries, the possibilities of trade reduce because of national and international conflicts which prevail in many of the developing peripheries of the world.

4. What can be Concluded:

Economic development can encompass society only when the workers are also considered as social and political participants in a society. The proximate determinants of economic development close down to income generation. However if this process of income generation is skewed to the rich because of their participatory value addition in the economic process, the link between economics and society breaks down. So social, political and legal emancipation of the population who are at the risk of being left out of economic process is necessary. MDGs and now the SDGs is the right step in the direction.

Furthermore the paper briefly hints what is not captured by development goals is the need to address civil and international conflicts effecting nations in the South and that is left to be analysed in another space.

References:

Dollar, D. and A. Kraay (2003) 'Institutions, Trade and Growth', *Journal of Monetary Economics* 50(1): 133-62.

Dollar, D. and A. Kraay (2002). ' Growth Is Good for the Poor,' *Journal of Economic Growth*, Springer, vol. 7(3), pages 195-225,

Ferreira, F. H. G. and M. Ravallion (2008) 'Global Poverty and Inequality: A Review of the Evidence,' Policy Research Working Paper No. 4623, The World bank

Hasan, R. (2001) 'East Asia since the 1997 crisis' *International Socialism Journal* (92),

Rodrik, D. (2006) 'How to Save Globalization from its Cheerleaders," CEPR Discussion Papers 6494, C.E.P.R. Discussion Papers

Rodrik, D. and A. Subramanian (2008) 'Why did Financial Globalisation Disappoint?' Working Paper http://ksghome.harvard.edu/~drodrik/papers.html

Sen, A. (1999) *Development as Freedom*, London and New York: Oxford Press.

Stiglitz, J. (2001b) 'Autobiography', Nobel Prize

Stiglitz, J. (1999) 'The World Bank at the Millennium,' *The Economic Journal*, 109, pp. F577-F597

United Nations Report on the World Social Situation (2005) *The Inequality Predicament.*