Development in Post Keynesian and Marxist Theories

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Introduction

1. What is development?
2. How do we get there?
    1. From the birth of development economics to the Washington and Post-Washington Consensus
    2. Post-Keynesian Alternatives
        1. Post-Keynesian theory: classes, distribution and structural change
        2. Post-Keynesian theory: situating the role of finance in development
    3. Marxist Alternatives
        1. Understanding the Systemic: Trotsky's Combined and Uneven Development, Dependency Theory
        2. Understanding the State: Marxist theory of the state and Khan's political settlement approach

What is Development and why is it important?

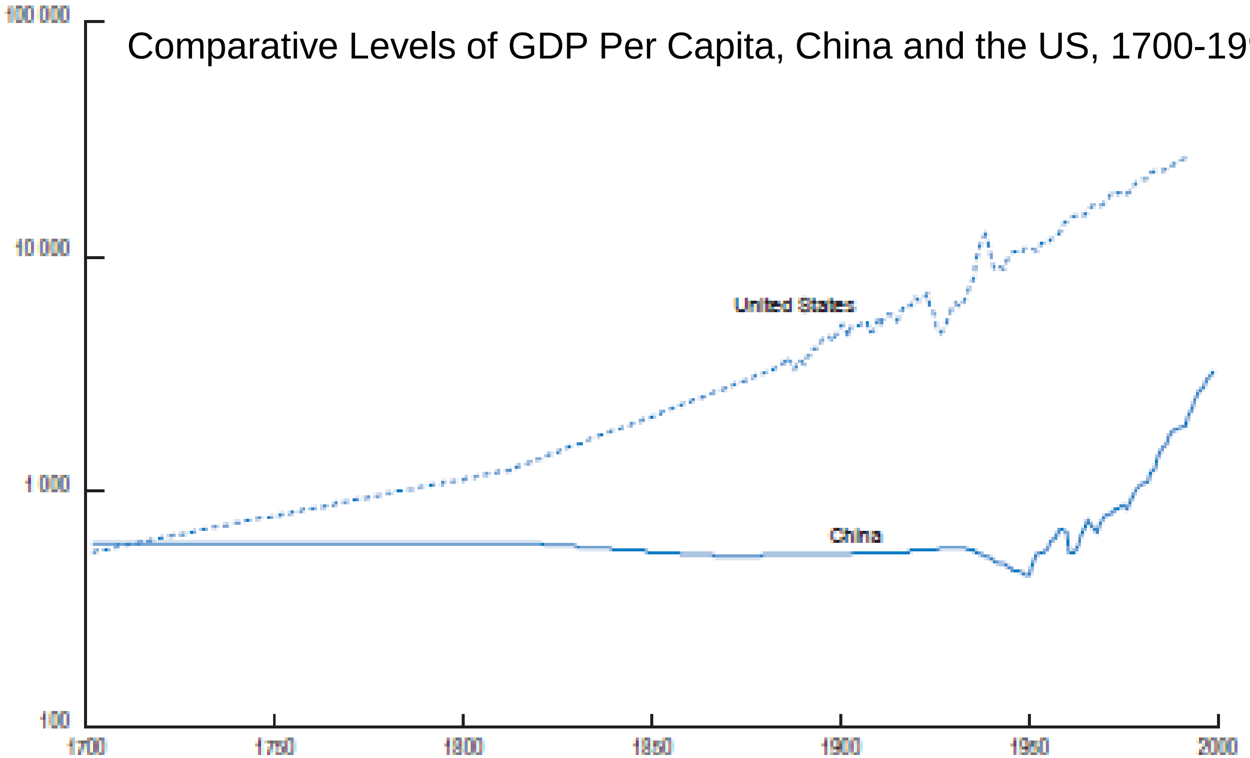
- Rapid and sustained economic growth recent phenomenon and spatially concentrated
- Divergence between rich and poor countries starts with proliferation of capitalist relations of production
  - 1000 and 1820: group A more dynamic and forges ahead to about double the income per capita of rest of world
  - 1820 and 1998: explosive growth in group A, income gap widens to 7:1

Level of Per Capita GDP, G7 vs. Rest of the World 1000-1998 (in 1990 international dollars)

	1000	**1500**	**1600**	**1700**	**1820**	**1998**
Group A (Western Europe, US, Canada, Australia, Japan)	405	704	805	907	1,130	21,470
Group B (Latin America, Eastern Europe, Africa Asia)	440	535	548	551	573	3,102

Source: Maddison 2007 – The World Economy, A Millennial Perspective

The US leapfrogs around 1820



Source: Maddisson (2007): The World Economy – A Millennial Perspective

Defining Economic Development

- No consensus on what exactly development is and, on how it should be measured or assessed
  - General agreement that development is about improvement in human welfare (meaning general human flourishing) and that it is multi-dimensional (meaning that it has a number of aspects or components).
  - This is as far as agreement among development agencies, academics and policy makers stops
- Examples:
  - World Bank uses as the standard international poverty line of $1.25 per day
  - Also funded the "Voices of the Poor" study, from 23 developing countries: found six dimensions of well-being emerged as important to poor people
  - Martha Nussbaum 2002 lists 10 central human capabilities
  - Doyal and Gough identified 11 ''intermediate needs''

Defining Economic Development

- Many different ways of thinking about development
  - Some overlap between the areas listed by different researchers
  - Many of these dimensions seem different (e.g. Doyal and Gough's intermediate needs of safe birth control; WB's voices of the poor dimension of 'security' which includes 'confidence about the future')
- This is not purely academic but exists in real debates
  - e.g. fundamental differences in opinion about whether the jobs created by Nike sweatshops are jobs that contribute to development or not…
- Implications for policy debates and political conflicts in developing countries

Defining Economic Development

- Sen distinguishes between "functionings" ("the various things a person may value doing or being'' Sen 1999: 75) and "capabilities", i.e. the range of functionings that a person can achieve in practice
  - Functionings are things a person values beings and doings (e.g. being well nourished, well-clothed or taking part in the life of the community)
  - Freedom to choose between valuable alternatives is critical in this approach/ definition of development
- Many unresolved issues:
  - How to operationalise Sen's approach
  - Is freedom of choice always a positive thing?

Development Economics: The state of affairs

From the birth of development economics to the Washington and Post-Washington Consensus

Development Theory: An Overview

Decade	Major International Events/ Turning Points	'Mainstream' Development Economics Theory	'Heterodox'/ Other Theoretical Developments
1940s – 1950s	WWII Marshall Plan Decolonisation in Asia and Africa Formation of the ECLA in 1948	Emergence of Development Economics **Classical development theory** 'Big push' industrialisation; Lewis Model	Latin American Structuralist School
1960s - 1970s	Cold War Vietnam War Oil crisis	Emergence of Growth Theories – **Solow and EGT** in application to developing countries	**Dependency** and Neo-Marxist Theories **Basic Needs approaches**
1980s – 1990s	World Bank's Berg Report (1981) End of Cold War Africa's lost decade Launch of UN HDR in 1990	**Washington Consensus** Market Fundamentalism Fall of Development Economics as a separate subject	**Sen's Capability Approach** Human Development
1990s- 2000s	Success of East Asian Tigers vs deemed failure in Africa Globalization and Criticisms of the WTO, WB and IMF (Seattle 1999)	**Post-Washington Consensus** New Institutional Economics applied to development 'problems'.	Neo-statists/ **developmental states paradigm**
Since 2008	International Financial Crisis, Recession and Austerity	What about "Development" Economics? New structuralist economics	Revival of Keynesian, Marxian and other ideas

Development theories and their influence on policy

The Birth of Development Economics

- Development Economics emerge as a discipline in the post WWII period
- At that time, two main schools of thought: Modernisation Theory and Latin American Structuralism
    - Both reject mainstream neoclassical economics
        1. Inability to answer questions of underdevelopment
        2. Looking at the long-run
    - Both pursue inductive approaches
    - Both very similar policy conclusions: developing countries should promote so-called modern sector
    - But important differences in how they conceive the major constraints to development
        - Western theory focused on the sources of increasing returns to scale and stressed the importance of surplus labour
        - Structuralism stressed external, systemic obstacles (trade structure)

Development theories and their influence on policy

Modernisation theory

- Emerges in the political context of the Cold War: scholarship is motivated by anti-communism
  - "win over" the Third World (Rostow 1960: "The Stages of Economic Growth – A non-communist manifesto")
- Different explanations for why cumulative causation does not unfold in developing countries and how governments can kick-start it
  - Rosenstein-Rodan (1943): state should coordinate simultaneous investments in consumer goods production to make mass-production viable
  - Hirschman (1958): build forward and backward linkages around existing production activities
  - Lewis (1954): transfer of 'surplus' labour from the agricultural sector, build demand and supply chains between industry and agriculture

Development theories and their influence on policy

Latin American Structuralism

- Rival to classical development theory in 1960s & 1970s
- Also see industrialisation as key to development but point to the systemic causes of underdevelopment rooted in the world economy rather than solving coordination failures
- Disparities between the centre and the periphery are perpetuated through international trade
- The hypothesis advanced by Prebisch (1950) and Singer (1950)
    - Production structures systematically favoured the “centre” and disadvantaged the “periphery”
    - Prices of primary commodities are highly volatile and overall tend to decline
    - In developing countries: prices of export have a tendency to decline, while import prices remain the same/ rise

Development theories and their influence on policy

- Developing countries faced twin imperatives of "catching up" &"breaking out"
- Change structure of production: Import-substitution industrialization (ISI)
  - Tariff and non-tariff barriers to imports, taxation of luxury goods, nationalisation of industries, subsidised access to credit etc.
  - Implemented widely in Africa, Asia and Latin America
  - The basic rationale behind these policies was to
    - Increase the share of industry in production
    - Change the structure and composition of imports – become less dependent on high value added imports

Development theories and their influence on policy

- From 1960s, newly industrializing countries (NICs) in East Asia began to grow spectacularly
- Latin American and SSA countries initially grew fast as well but fell behind after 1973 and entered debt crisis in 1979
  - 1974-79 non-oil exporting developing countries' terms of trade decline
  - Decline in export earnings compensated by external borrowing from commercial banks in the US and the UK swamped by 'Petro-dollars'
  - Helped to sustain growth but caused debt to spiral out of control after 'Volcker shock': rise in US and UK interest rates after the 1979 oil price shock
    - Dollar denominated debt held by African governments against US commercial banks increased from $2 billion in 1975 to $8 billion in 1982
    - Debt service payments in LICs rises to nearly 30% of export earnings in 1986 (over 50% in some countries)
    - Mexico first suspend repayments of loans in 1982, Brazil suspends interest payments to foreign creditors in 1987

Development theories and their influence on policy

The Washington Consensus (WC) and the Disappearance of Development Economics

- Neo-liberalism was a response to the debt crisis
- Theories questioning idea of state-intervention all together (P. T. Bauer, Deepak Lal, Bela Balassa, Ian Little)
- Profound changes inside international institutions
  - WB in the1970s under the presidency of Robert McNamara: concerned with income distribution, basic needs, infrastructure development
  - Elections of Thatcher (May 1979) and Reagan (November 1980)
  - McNamara replaced by A.W. Clausen (staunch conservative) in 1981
  - Appointment of dogmatic neoliberal Anne Krueger as Chief Economist of the World Bank in 1982
  - Systematically replaced economists in development research programme with economists holding similar views
- No need for “development” as a subject in its own right, all covered by neoclassical economics and applicable to all countries

Development theories and their influence on policy

Neo-liberalism

- Argued that SSA and Latin American countries remain poor not because they lack machines, infrastructure or money but, rather, because of misconceived state intervention leading to
  - Misguided economic incentives and hence inefficiency
  - Leads to rent-seeking (corruption) (Krueger 1974)
- Once ‘free markets’ allowed to expand: relative prices will be determined by resource availability and consumer preferences, rather than politically (World Bank Berg Report 1981)
- Debt crisis and policy reform packages (SAPs, SAFs):
  - Privatisation and extinction of state planning
  - Deregulation of trade, capital flows and the domestic economy

Development theories and their influence on policy

The Post-Washington Consensus (PWC)

- The PWC: From Letting Markets Work to Making Markets Work
- Recognition that markets do not work perfectly and fail: state intervention might be justified to correct market failures
    - Information Externalities (‘Self-discovery’, Hausman and Rodrik 2003), Information Asymmetries (e.g. credit markets, Hoff and Stiglitz 1993)
- But only to the extent that the state has the capacity to improve upon market outcomes (trade-off market vs. government failure)
- Greater emphasis on democratic “good” governance as precondition for successful policy
    - New Institutional Economics: weak enforcement of property rights as explanation for underdevelopment (North 1990)

Development theories and their influence on policy

The Post-Washington Consensus (PWC)

- Stronger role for state BUT key similarities to WC
  - At the theoretical level
    - No critique of structural issues at the global level: Bias towards domestic reforms while shying away from global reforms
    - Reflection on what makes an “efficient” state but simply move from ideal type market to ideal type state without reflection on how interests are formed at the domestic and global level (<u>no political economy!</u>)
  - At the policy level
    - Piecemeal interventions to correct specific market failures (make individual markets work)
    - Overlap between WC and PWC (especially macro): Both highly conservative in fiscal and monetary policy, support ‘free’ trade, privatisation, liberalisation and deregulation
    - Policy conditionality: from ex post to ex ante (CPIA)

Post-Keynesian Alternatives

1. Post-Keynesian theory: classes, demand and structural change
2. Post-Keynesian theory: Situating the role of finance in development

Structural Change

- Re-emerging consensus that manufacturing is engine of growth and needs to be supported by industrial policy
  - PWC explanations: market-failures in discovery of ‘comparative advantage’ (Hausman and Rodrik 2003; Greenwald and Stiglitz 2006)
  - Technology acquisition as a process of learning by doing, hence production needs to take place before competitiveness is reached (Khan 2013)
- Industrial policy itself a contentious issue
- Demand not usually considered constraint to manufacturing output growth under the assumption of potentially unlimited export markets (Amsden 1990: 11; Monga 2013: 154)

Post-Keynesian Theory and Structural Change

- Post-Keynesian theory: demand can constitute a major constraint to manufacturing output growth
  - Kaldor-Verdoorn relationship:
    - Dynamic feedback loop between output and productivity growth
    - Mass-production requires mass-consumption (Kaldor 2007: 55)
  - Export markets serve less and less as outlets for manufactured goods
    - Financialisation: rising levels of inequality, decline in wage-share and decline in domestic demand in all G20 economies (Onaran and Galanis 2014) demand regimes become debt-led or export-led (Stockhammer 2016)
    - Competition with other developing countries: export displacement (Kamau, McCormick, and Pinaud 2009) and fallacy of composition (Razmi and Blecker 2008, Palley 2004)
- Mobilising domestic sources of demand key challenge for late-industrialisers

Post-Keynesian Theory and Structural Change

Kalecki Pioneer of development thinking

- Osiatyński, 1993: Collected Works of MK, Vol. 5, for development contributions
- Little acknowledged in development circles
- Kalecki's work questioned many aspects of modernisation and neoclassical development theory:

  1. Questions that industrialisation impossible unless directed towards external markets
  2. Questions necessity of low wages: instead rising wages stimulate domestic demand
  3. Emphasises neglect of agriculture: difference between price formation in manufacturing & agriculture

Post-Keynesian Theory and Structural Change

Kalecki Pioneer of Development Economics

- Takes issue with the view that domestic markets too small
  - 3 main social classes: capitalists, workers and small proprietors
  - 2 sectors of production
    - Department I: produces investment goods
    - Department II: produces consumption goods (agricultural and non-agricultural)
  - In principle self-sustaining system: expansion of Dep I leads to increase in demand for consumer goods
- In practice no reason to assume automatic re-investment of profits:
  - Distribution between capital and labour
    - Income concentration and widespread monopolisation of economy (also Dutt 1984)
  - Class and power relationships influence formation of prices and purchasing power
    - In particular feudal and semi-feudal conditions in agriculture
    - Inelastic supply of food leading to fall in real wages
    - Benefits of price increases not accruing to small proprietors: no countervailing increase in demand for mass-consumption goods in countryside
- Result: "(…) increased profits will not be spent at all, or will be spent on luxuries." (Kalecki 1954 [1993]: 29)

Post-Keynesian Theory and Structural Change

Kalecki Pioneer of Development Economics

- Solution:
  - Support the growth of effective demand
    - Limits to income redistribution through generalized rise of wages due to high degree of informality
    - Instead redistributive public spending favouring most vulnerable classes
    - State-led investment to lead private sector investment
    - Financed through taxation on profits and the rich (reduce demand for imported luxuries, avoid speculative hoarding)
  - Necessity for institutional change in agricultural sector
    - cheap bank credit to peasants to improvements in the method of cultivation, small-scale irrigation, and cheap fertilizers

Post-Keynesian Theory and Structural Change

- Formation of dynamic domestic markets *alongside* and *as a basis for* export growth important for successful structural transformation (UNIDO 2017, Storm 2015)
- Consistent with PK theory and development experience of successful industrialisers
    - China: underpinned by an expansion of domestic-mass consumption sustained by a comparatively egalitarian income distribution (Lo and Zhang 2011)
    - South Korea: 53% of industrial output growth could be attributed to domestic demand expansion (Chenery and Syrquin 1975)
- Anticipation of growing domestic consumer markets is also important driver of investment decisions of contemporary manufacturing businesses in Africa
    - see examples from Nigeria's Dangote Business Conglomerate

Post-Keynesian Theory and Structural Change

- Production is vertically integrated, this implies an investment multiplier process less sensitive to anticipation of demand in Keynesian sense
- Multiplier effects can be stronger or weaker depending on importance and strength of linkage effects (Hirschman 1958)
- Growth of demand not necessarily smooth along the production chain: Kaldor's two stage, two sector growth model (Kaldor 1975, Thirlwall 1986)
  - If purchasing power grows more slowly in agriculture than industry, constrains growth of industry (IP needs to act along entire production chain, for food processing that involves agriculture)
  - BoP: growth manufacturing constrained by world demand for exports
    - Finding market outlets for mass-produced manufactured goods
    - Paying for productive inputs (or domestic consumption more generally)
  - Narrowing down the way in which exports constrain manufacturing output growth – in the Keynesian sense of finding market outlets or in the Kaldorian sense of limiting the ability to purchase productive inputs – is important

The Finance-Growth Nexus

- Strictly positive relationship for liberalised financial markets McKinnon (1973) and Shaw (1973)
  - Liking growth to financial development through savings and its efficient allocation to investment
  - Savings both drives investment and fully converted into investment
  - (Only) guaranteed to be good for development if unconstrained by state interference (‘financial repression’)
  - While individual country experiences varied, ‘Big Government’ and regulation were rolled back across many of these economies since the late 1980s (financial liberalisation)
- Under PWC: application of asymmetric information microeconomics
  - Sequencing of financial liberalisation (World Bank 1989, Sachs 1988)
  - Micro-credit movement particularly supported by USAID and World Bank
- After GFC: Threshold analysis
  - Identification of trigger points at which the finance-growth nexus shifts from positive to negative or vice-versa for development (Yilmazkuday 2011; Arcand, et al. 2012, Barajas et al. 2012)

Post-Keynesian Economics and the Role of Finance

- PK theory offers more differentiated account of the role of finance in development differentiating functions of credit, identifying debt structures and processes by which balance sheets are kept liquid
- Minsky's framework applied to study boom and bust cycles in open economy, liberalised developing countries (see Kregel 1998, Dymski 1999, Arestis and Glickman 2002):
  - Balance sheet mismatches and changes in cash flow to liability ratios due to foreign exchange movements
  - The build-up of fragility: short-term foreign-denominated borrowing ('super-speculative position', Arestis and Glickman 2002)
- PK scholars also highlight that financialisation has important ramifications for developing economies even if manifestations of financialisation vary across regions (Karwowski and Stockhammer 2017)

Post-Keynesian Economics and the Role of Finance

- Direct consequences of financialisation in developing countries:
  - In- and outflow of 'hot money': exposes them to banking and currency crises and prompting the costly accumulation of reserves (Kaltenbrunner and Painceira 2015)
- Replication of financialisation dynamics in developing economies
  - Non-financial corporations increasingly undertaking financial and often short-term oriented, speculative investments (Demir 2007, 2009)
  - Households becoming increasingly indebted (e.g. mediated by micro-finance institutions, Bateman 2015)
- Out-sourcing of labour processes in Global Value Chains (GVCs) instrumental in setting in motion the shift in sources and uses of profits characterising financialized capitalism (Milberg 2008)
  - Hailed as a stepping stone to economic diversification and job creation (AfDB, OECD, and UNDP 2014; Staritz, Plank, and Morris 2016)
  - Yet 'upgrading' in GVCs difficult not least given lead firms' logic of accumulation (Neilson 2014; Palpacuer 2008; Milberg and Winkler 2013)

Marxist Alternatives

1. Understanding the systemic
    1. Trotsky's Combined and Uneven Development
    2. Dependency Theory
2. Understanding the state
    1. The state in Marxist theory
    2. Khan’s Political Settlement Approach

Understanding the Systemic: Trotsky Combined and Uneven Development

- Unevenness is a systemic aspect of capitalist development of global capitalism due to process of primitive accumulation
  - Primitive accumulation: labour dispossessed from their means of self-sufficiency and subjected to capital
  - Labour processes initially remain unchanged (absolute surplus value) but eventually systemic imperatives to develop labour productivity (relative surplus value)
  - Advanced countries pull ahead (increases in productivity based on relative surplus extraction)
  - Extraction of wealth and surplus from colonies but no transition from absolute to relative surplus extraction
- Competitive success of some comes at the expense of others
- Unevenness is itself uneven: not all countries affected by the same imperialist forces
- Combination and coexistence of pre-capitalist forms of production and capitalist mode of production generate unique dynamics in specific country setting

Understanding the Systemic: Trotsky Combined and Uneven Development

Theoretical lessons

- History does not produce copy-cat transformations
  - Pre-existing class relations meet particular dynamics of contemporary capitalism
  - The two taken together generate their very specific dynamics
- Division between developed and underdeveloped countries is not fixed or immutable: shifting centres of accumulation allow for some to develop
  - Understanding who does and who does not contingent on global and national factors
  - But must involve analysis of role of the state, finance and balance of class forces and conflict

Understanding the Systemic: Dependency Theory

- Development and under-development constitute two sides of the same coin
  - Accumulation and advances in core countries based on systemic extraction of income and wealth of peripheral countries (e.g. trade, profit remittances, interest payments, transfer pricing, capital flight)
  - Dependent capitalism: dos Santos 1978; Cardoso and Faletto 1979, Frank 1967, Wallerstein 1974
- Most dependency writers consider class nature of countries
  - But classes secondary role compared to relations core vs. periphery
  - Classes not necessarily understood in classical Marxist sense (capital vs. labour): comprador ruling class, lumpenburgeoisie
    - Manages exploitation of locals on behalf of the centre and live comparatively luxurious life
    - Coincidence of interest between elites based in centre and comprador class marginalises and impoverishes masses, concentration of wealth among the few
- Development within capitalism impossible: elimination of relations of dependence requires socialism, autarky

Understanding the Systemic: Dependency Theory

- Considerable criticism of dependency theory from orthodox Marxists (Warren 1973, Kay 1975, Brenner 1977)
  - Identification of surplus transfer mechanism
  - No clear mechanism by which to pass from dependency to successful capitalist development
  - No explanation for initial division of labour
  - Overtly functionalist: subordination of agency to structure
- But points to significant concerns
  - Systemic global forces perpetuating underdevelopment
  - Extremely large flows of resources from underdeveloped to advanced economies especially since the debt crisis
    - Neoclassical analysis that views international economy as harmonious is unsatisfactory
    - Also suggests that systemic forces perpetuating underdevelopment go beyond strict class analysis of orthodox Marxism

Understanding the State

Marxist understanding of the state

- State is the outcome of power-relations in society
- State is an arena of conflict between different social groups that have common economic interests, hence activities of state apparatus determined by (dominant) class interests
  - Capitalist society the state is the ‘executive committee of capitalists and the bourgeoisie;
  - Feudal state represents interests of landed aristocracy etc.
- But state cannot be mechanically reduced to material interests because its location in the sphere of politics implies a certain degree of independence from the influence of the economy
  - Government officials have interests of their own (e.g. shaped by ideology)

Understanding the State

The political settlements approach

- Khan offers a power-based analysis of institutional creation and enforcement:
  - Criticises New Institutional Economics while offering an alternative explanation for capitalist transformation and economic development.
  - Which individuals and groups are more likely to influence choices; how is their power distributed and organised within the state and the market
- Defines political settlement as:
  - “a combination of power and institutions that is mutually compatible and also sustainable in terms of economic and political viability.”
  - Distinguishes between 4 different types of political settlements
  - Key idea: institutions have to match the political settlement

Understanding the State

The political settlements approach

From Khan (2010)		HORIZONTAL DISTRIBUTION OF POWER: EXCLUDED ELITES WEAK	STRONG
VERTICAL DISTRIBUTION OF POWER: LOWER LEVEL FACTIONS	WEAK	<u>POTENTIALLY DEVELOPMENTAL DOMINANT COALITION</u> RWANDA Longer-term horizons Implementation capabilities high	<u>VULNERABLE AUTHORITARIAN COALITION</u>
	STRONG	<u>WEAK DOMINANT PARTY</u> UGANDA, CAMBODIA Implementation capabilities weakened by multiple demands and 'blockers'	<u>COMPETITIVE CLIENTELIST</u> BANGLADESH, GHANA Shorter-term horizons: threat of powerful excluded elites Implementation capabilities weakened

Conclusions

Marxist development theory

- Arguments amongst Marxists regarding application of labour theory of value but several key insights
  - Analysis of social relations of production: understanding class interests and the state
    - What is in the interest of those who have power? How do these interests come about and change over time?
  - Systemic aspects of capitalist production: understanding forces perpetuating underdevelopment
    - Trade structures, international financial institutions, business practices like transfer pricing, capital flight, property rights protection…

Post-Keynesian development theory

- Understanding formation of markets and demand
  - Relevant for problem of structural transformation and situating past failures of ISI
- Understanding of money and finance
  - Moving beyond simple finance-growth nexus or threshold analysis
  - Manifestations and consequences of financialisation in developing countries

Appendix

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