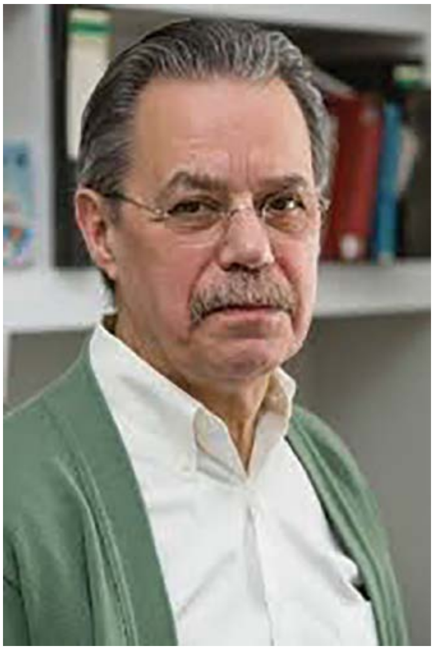
Capitalism and development in the Global South



The New Agenda team interviewed Jan Kregel, director of research at the Levy Economics Institute, director of the Levy Institute master's programme in economic theory and policy, and head of the Institute's Monetary Policy and Financial Structure programme. He also holds the position of professor of development finance at Tallinn University of Technology.

NEW AGENDA:

Capitalism has just gone through a deep financial crisis. However, it nonetheless seems to have survived. Has capitalism finally triumphed over its rival systems?

JAN KREGEL:

You can look at the work of Hyman Minsky to understand crisis under capitalism. Minsky argues that the difficulty with capitalist governments is that their objective is simply economic growth by means of increased profitability that generates investment. What Minsky argues is that by doing that you create a financial system that, in the way that it finances the investment, actually makes the system increasingly fragile as it produces successful expansion. So, Minsky argues, these crises are endogenous to the system itself. They don't arrive from the outside. The system itself produces these crises. It is the very success of the system which in fact creates the financial conditions which causes it to collapse.

So how can we get around this difficulty? Minsky says that we need to change the objective. If you have as your objective employment instead of growth in investment then, by definition, as long as your population is growing, you will have a positive growth rate. You don't even have to worry about creating subsidies for investment by creating additional profitability or by creating financial innovations to get financing for the investment. Automatically you will get a positive growth rate. You will also automatically generate the increase in demand that you need to validate what debt you do create.

One of the difficulties you have in terms of the declining labour share of national income is that it is itself a *prima facie* indication of financial fragility. This is because wage incomes generate the demand which creates the profitability which in turn allows firms to repay their debts. So implicitly what you are doing by cutting down the size of the labour force is making it that much more difficult for the system to survive.

Now Minksy had obviously read his Marx. Although he never directly cites Marx, this is a very similar proposition to what you find in Marxian theory. The difference is that Marx looked at it in terms of the direct exploitation of labour. Minsky looked at it in terms of the validation of debt. So, if you are going to validate your debt, by definition you need a strong labour force, you need a high-wage labour force and that is going to generate the demand that you need in order to provide employment and growth.

So, from that particular point of view, no, capitalism has not been successful. It cannot be successful because if you accept the idea of the endogeneity of the crises then it will always produce these crises which eliminate all the gains that are made previously. Take the recent 2008 crisis. In the US, we are only now getting back (in 2019) to labour incomes equivalent to what we had at the end of the 1990s/ early 2000s. Obviously you can say yes, capitalism is a success because it survived but it did this in a way that has not demonstrably improved the conditions of the citizens that participate in the system.

NEW AGENDA:

We can say that under global capitalism the Global South has been dealt some very heavy blows. Are there any alternatives open to these countries that could change their situation?

JAN KREGEL:

If we look at the development of the Global South, we need to start with this idea of historical development. Economies don't start developing from zero. It is not an empty page, despite Adam Smith's idea that there is some early moon state of society where people run around trapping rabbits and hunting deer. There is always a background. If we take Latin America, it had a set of initial conditions which meant that it would make it very difficult to ever have successful development.

Firstly, colonisation created what we call commodity-dependent economies. If we look at the commodities that are produced in Latin America and we ask which commodities are in fact indigenous to the area, there are cacao, avocadoes, corn, potatoes and you are more or less done. There is no coffee, no bananas, none of the commodities that we usually associate with the initial stages of Latin American development. The reason for this is that all of the investment that came in and the products to be produced came from the outside. So the Latin American economies, when they started out were, by definition, commodity dependent. In this context, a domestic accumulation process becomes very difficult. There is a great body of work by Prebisch and other development economists that explains this problem as it relates to the terms of trade. The fact is that it is extremely difficult to generate domestic surpluses on this basis.

Secondly, foreign-owned operations have dominated in the Global South. So any surplus that was generated was sent back to other countries. The process of what we call simple accumulation or basic domestic accumulation – accumulation of the capital stock which would have allowed the development of a more balanced productive structure in these economies – was, from the start, a very difficult path to follow.

NEW AGENDA:

What role did newly appointed governments play in these processes?

JAN KREGEL:

If you look at the way that democratic governments in the Global South were eventually set up, essentially all of the fiscal measures were determined in terms of trade measures because your economies were always trading. You were always moving commodities in and out. So government revenues were taxes, duties, fees on imports and exports. So, if you are trying to build up a domestic sector, the first thing you have to do is say that these revenue generating mechanisms may actually be impeding your ability to diversify the domestic economy into something that looks more balanced in terms of the primary, secondary and tertiary sectors.

Most of these governments received support from the local citizens who were usually second or third generation descendants of colonisers. When they took power the first thing they did was to eliminate all of these measures [the tariffs, fees etc.] because they wanted to say they had free trade. So Latin American governments always started out without a very strong fiscal base and were extremely weak in the sense that they had to accept decisions taken by their supporters. Argentina is a good example. Argentina is basically run by farmers who eventually compete with the industrialists. Argentina managed through a process of trade with Britain to engage in an industrial process. But it has always had an extremely weak government. If you can't raise your funds domestically then you need to borrow and you periodically go into debt. Argentina as we know has had various debt crises: in the 1920s, in the 1980s and another one now. Again, given the initial conditions, it becomes very difficult to generate any independent domestic strategy. The same thing is true of most African and Asian countries who experienced colonialism. Where don't you have these problems? In general, in Europe and you didn't have them in the US. These economies managed to develop a more balanced structure by emphasising the transfer of labour from agriculture to manufacturing and then to services.

Of course, we would like developing countries to follow this model as is laid out in the Lewis Model of Unlimited Supply of Labour or the Prebisch argument about the terms of trade. Essentially, you have to somehow reduce your dependence on primary commodities and build up a domestic manufacturing sector. If you are going to get benefits from your manufacturing sector, you get it from technical progress and from economies of scale. So that the transfer of labour from agriculture – where productivity is generally low – to manufacturing where it is higher, provides the possibility of providing the income that puts you on the development path. But in order to get the economies of scale you need demand. You have to generate a sufficient amount of *domestic* demand in order to create the markets for your manufacturing sector. This will allow it to expand sufficiently so that you can enter into a process of increasing productivity. That increase in productivity is then what is driving your development strategy. ➤➤

In many cases this is very difficult for developing countries because they are starting out at relatively low wage levels. Their manufacturing sectors are also at a disadvantage because they have to compete with the economies that are already developed and have much more efficient manufacturing sectors. This means in order to generate this sort of strategy you need some protectionist measures in order to allow your manufacturing sector to grow and to expand.

The difficulty here is that the developed countries who are going to be the ones to provide most of the initial capital for manufacturing sector investment don't want developing countries to compete with them. Again, the impediments that are in place by these historical external constraints make it extremely difficult to have a successful development strategy.

Let's look at cases of successful development. Obviously, we need to look at China and how it did this. Firstly, it introduced very strong domestic controls, keeping the economy closed and controlling the influence of external factors. It is not true to say that it didn't use FDI. They had foreign investors, but they were never allowed to take a dominant position in any activities inside the country. They couldn't have a majority stake in a productive unit in China. Their ability to enter the market was absolutely controlled by the government.

The Chinese experience shows you can achieve development in the Global South but only if you are able to control the external constraints that you face. This is not to say, however, that every country can act like China. China was able to do this because it represented the prospect of a sufficiently large market that foreign investors thought they would be able to access. Now, unfortunately or fortunately, depending on from which side you look at it, China has managed to develop its domestic productive capacity sufficiently rapidly that domestic Chinese firms can now compete with foreign firms. The foreign firms who thought that they were going to sell automobiles to 20 million Chinese people discovered that the Chinese can also build automobiles.

This is what allowed China to do what it did: They provided a prize of a massive domestic market that you, as a foreign investor, may eventually be able to access, but the Chinese ensured that you are not going to be able to do it until we are ready for you to do it. "We are only going to be ready for you to do it when we have our competitive domestic producers," was the motto.

We can take the example of Facebook. If Facebook had not been able to expand globally then it would have already collapsed because there simply aren't enough fingers in the US to keep Facebook running. The majority of Facebook users are now outside the US. That is where their growth comes from. China simply said no to Facebook because they had a domestic competitor who they allowed to expand. The president of the US then accuses China of stealing US technology. Well Facebook is not a technology. It is not a secret recipe. The trick is what we call network effects.

Network effects are, for example, when we expanded the fixed line telephone system. If one person has a telephone, then a telephone is useless. You have to have at least two people to have a telephone and for the system to work effectively everyone has to have a telephone. In the beginning, it had to be a monopoly because otherwise it wouldn't work. This means that for these types of networking systems what you are doing is to make sure that you control the person who becomes the monopolist.

So, if you are a developing country then first of all yes, you have to do manufacturing. But manufacturing is going to be very difficult for the reasons outlined above. In addition, if you believe we are in the post-industrial era then manufacturing isn't any longer the magic solution to these development problems. And if that something else is technologies which require network effects then governments are going to have to take a much stronger position in who they are going to support, how they are going to support local providers and how they will generate local employment and local income.

The question is how do you do this? Somebody has to take a decision. Somebody has to say, "if we don't control these markets then we lose them". Potential sources of employment, potential sources of income and potential sources of development are going to need to be identified. You are always going to need some sort of planning mechanism that doesn't rely on competing directly with something that already exists. Brazil decided it was going to compete with IBM, the producer of computers. This did not work because they did not have the technical capacity. Korea on the other hand said it would compete with Japan on shipbuilding but did this by learning not only how to build ships but eventually how to build ships better than the Japanese do. In Taiwan the government effectively decides what sectors are going to be supported, expanded and financed in terms of a particular strategy. Governments need to identify areas in which they can encourage the development of expertise and then this creates the new markets.

NEW AGENDA:

One of IFAA's research areas is mining in Africa but with the particular angle of developing mining resources with strong local procurement as a basis for local industrialisation. Is this the kind of thing you think can form part of such development strategies?

JAN KREGEL:

This is a very good example of what I am talking about. Let's take Norway. Norway has a sovereign development fund. We know that Norway now owns something like 5 percent of global equity markets simply because they have a lot of oil money. The question is where should they be investing? If we really want to be diversified, we don't want to be investing in petroleum. Similarly, if you want to diversify an economy that has substantial mineral resources then you don't want to invest directly in the mineral resources. So, what can you do? You can invest in the technology that is used. Norway set up units that engage in research and development for the technology which is used in order to explore and generate petroleum resources.

The same thing with Brazil. Petrobras got into a great deal of difficulty recently because of the corruption scandal. However, one of the things Petrobras started out looking to do was to extract oil from these extremely deep oil pools. When they started out, they did not know how this could be done. International investors looked at this and said that it did not make any sense and they were not willing to fund this. The Brazilian government funded it as a development strategy with the expectation that if they figure out how to pump the oil then they would have the technology. The technology itself could then be used and be sold so that they wouldn't only be dependent on the petroleum, but also the capital equipment and the technology. This is the same as what you suggest for mining.

If you are looking at the development of indigenous providers of the technology which is used in mining, then you generate what Hirschman talked about in terms of linkage effects. As long as the mine continues to function it creates the demand for the local services and then the local services create the demand for the expansion of the region. So instead of just selling the mineral rights to some foreign company to come in and extract the resources and to take the money home, in which case you end up with basically an empty hole in the ground and a lot of workers who probably died in the mine. Rather develop a balanced regional strategy by identifying those linkages to make sure that you benefit domestically from the existence of those resources.

NEW AGENDA:

The implementation of the policies we are speaking about assumes the existence of a technically capable state and one that is actually interested in realising developmental goals. What were the political economy conditions that allowed for right choices to be made in the country success stories you spoke about?

JAN KREGEL:

Yes, you would have to ask that! Well as a good Keynesian you have the presumption that you do have a state which is capable, has capacities and has politicians who are willing and able to take the national interest as their own. Now we discover that in fact this is extremely rare. The entire conservative – maybe some would say neoliberal but I prefer conservative – backlash against this decision is that this will never happen. In this view, your best solution is to have a government that is as small as you can possibly make it and intervenes as little as possible in the system.

The other part of this problem is that if we look at successful development strategies, we discover that these are largely governments that are autocratic; where decisions are taken by a central government without what we would call democratic verification. Now does that mean that these economies limit the rights of citizens? I would say no, probably not. If you look at China, it does have a very strong centralised system, but it also has an alternative form of democracy. If you look at most Chinese development initiatives, they always start at the local level. They don't come down from the top. They start locally and if it works then it's expanded and if it continues to work then it gets validated from the centre. There is a two-way movement that goes from the grassroots and from the top down. It is autocratic rather than dictatorial. It is certainly not the case that the centre dictates. The centre says that they recognise that they have objectives and we are only going to allow measures which meet those objectives to be introduced, to be validated.

The same thing is true of Korea when it went through its rapid development. The same is true of Taiwan, of Malaysia, of virtually all of the Asian Tigers. You had the Soviet system which was unfortunately a dictatorial system where commands came down from the top. This did not work. As a result of that you created this idea that strong centralised decision-making systems are not a good idea. However, look at the problems in participatory democracies. Discussions on Brexit gives a very good example of how this kind of thing can break down. You now have a parliamentary system with a democratically elected government which is absolutely incapable of deciding whether they want in or out [of the European Union].

Where is the answer to this? I don't know. I don't have a clear answer but there is some middle ground between the town meeting where you get together every night and decide what we are going to have for breakfast tomorrow (which usually means you won't get breakfast anyway), and then the system in which someone says "you guys have to have eggs and sausages or pancakes and that's it because that is all we can produce so don't try and come and vote for something else". NA