This series of sessions starts by first rooting the question of financing development within the broader question of economic growth and structural change through peripheral late industrialization in developing countries. Early development economists – many of whom called themselves ‘structuralist’ – generally agreed that trade alone could not guide economic development. Rather, industrialization led by active state intervention (i.e. a developmental state practicing industrial policy) was seen as a necessary (although not necessarily sufficient) condition for development. Moreover, import substitution was seen as a necessary strategy of industrialization for developing countries given their dependence on advanced industrial countries. Indeed, ‘dependency theory’ needs to be understood as originally emerging in Latin America from the late 1950s onwards as a collection of criticisms of these early post-war attempts at ‘Import-Substitution Industrialisation’ (ISI), after which it diverged off into the grander theories of underdevelopment. However, the new liberal economic orthodoxy that became dominant from the 1980s onwards led an attack on ISI and state-led industrial policy. The advocates of this orthodoxy have not denied the centrality of industrialization (e.g. see Lin 2009), but have insisted that it must be market and trade-led, evolving out of efficiency and comparative advantage with minimal state intervention. However, this orthodox view sits uncomfortably with the fact that previous successful ‘late industrialisers,’ from the US, Germany and Japan, to Korea and Taiwan in the early post-war period, and China today, all relied on various degrees of state intervention in order to assure the success of their industrial catch-up. Even leading industrial powers today, such as the US or various countries of Europe, arguably continue to practice state-led industrial policy in a variety of subtle but powerful ways. From this perspective, the centrality of industrialization to the dynamics of wealth, power and poverty in the modern global economy will be clarified in the first part of this series of sessions, along with the classic and contemporary debates between ‘structuralists’ and ‘neoliberals’ over industrial and trade policy and how this has shaped the field of development studies since its origins in the 1940s.

The second part of this series continues from the theme of peripheral late industrialization to examine the financial vulnerabilities of developing countries, which are fundamentally rooted in the dialectical challenge of needing to finance development on one hand, while dealing with international financial subordination on the other. Although some early development economists advocated that development should and could be achieved through self-reliance on domestic resources, most acknowledged the need for at least some foreign finance, particularly given the huge foreign exchange needs of late industrialization. Given these needs, many early development economists understood that developing countries would tend to run trade deficits in their attempts to industrialize and urbanize. The original rational for aid was based on the resultant need for foreign exchange to finance developmental efforts. However, developing countries faced increasingly liberalised international financial conditions from the 1960s onwards, culminating in the 1982 debt crisis in Latin America and the subsequent financial
instabilities of the so-called ‘neoliberal era’ of globalization. Indeed, the 1982 debt crisis is crucial for understanding the rise of neoliberalism and the demise of developmentalism in the Global South everywhere outside East and South Asia (the only regions to have experienced any significant poverty reduction since this time). An important debate that emerged during the 1982 crisis and that has been repeated in crises ever since concerns whether the causes of crisis were due to internal factors in the crisis-stricken poor countries, or else due to external causes stemming from the international financial system. These issues will be clarified and discussed through a basic explanation of balance of payments.

The main learning objectives of this second part include:

- The choices and dilemmas of financing development, from mobilizing domestic savings to accessing foreign finance, whether aid, debt or finance.
- The basics of Balance of Payments and how it reflects underlying structural patterns of integration into the international economy;
- The financial vulnerabilities that result from patterns of integration into the international economy and/or the challenges of late industrialization, and the small role of aid in addressing these vulnerabilities;
- The breakdown of Bretton Woods, the 1982 Debt Crisis, neoliberal responses, and continuing financial crises up to the present.

The third part expands on the challenges of financing global redistribution in this context, or the implications of aid understood as a financial flow. More specifically, aid effectiveness needs to be understood (and was understood by early aid advocates) as a function of allowing countries to finance development by running trade deficits and, by consequence, net capital inflows (discussed in Fischer 2009, ‘Putting Aid in its Place,’ J. of International Development). For structural reasons, late industrialization and other aspects of development in the post-war era have usually resulted in trade deficits. ODA could prevent such deficits from choking off intensive developmental endeavours. Conversely, this potential of aid is lost if countries run trade surpluses (or if deficits are not the result of developmental productivity-enhancing investments). This proposition is demonstrated with reference to the balance of payments accounting identity and then with historical data from South Korea, together with some comparisons to other world regions. From this perspective, aid needs to be understood in the context of two paradigmatic phases of the post-war period. In the first phase, up to the mid-1970s, the US was mostly in current account surplus and exporting net goods, services and finance abroad, thereby supplying and financing the trade deficits of Europe and then developing countries. In this context, aid was one among other forms of net capital outflow from the US supporting industrialization abroad, as best represented by the case of South Korea. In the second phase, which started in late 1970s, the US moved into a position of persistently large and growing current account deficits, therefore absorbing finance from the rest of the world and supported by waves of financial liberalisation in the US and globally. Capital account surpluses were underlain by significant net outflows of US FDI abroad, perpetuating similar FDI outflows in the first phase despite the overall absorption of finance from abroad. The prospects for aid effectiveness in this latter phase have been far from evident given that the dominant trend in global financial flows has been essentially regressive. The session concludes with a discussion about the key to creating a truly effective aid system, which arguably must be found in genuinely redistributive financing mechanisms that enhance rather than undermine national development.
Among the major economies of the world, China’s response to the recent financial crisis has been arguably the most Keynesian, in the sense of involving huge fiscal and monetary responses, both directed towards productive activities and social welfare. The central government was able to respond in this way because of a positive fiscal situation going into the crisis as well as national and state ownership predominating in the financial system. However, China is also often criticised for not correcting fundamental imbalances within its economy between investment and consumption, which in turn is blamed for fuelling global imbalances. After reviewing some of the basic features of the government’s crisis response, a critical evaluation of the global imbalance argument is considered and an alternative post-Keynesian and structuralist perspective is suggested. Emphasis is given to China’s relatively subordinate and peripheral role as a consolidated conduit in the increasingly globalised and compounding financial disequilibria stemming from the US since the late 1990s, if not before, as well as the rapid denationalisation of China’s means of earning foreign exchange, unlike central surplus countries such as Germany. This perspective, as opposed to the prevalent neoclassical savings-glut narrative, helps to clarify some of the vital developmental lessons that can be drawn from China’s experience, as well as the constraints that the government is currently facing in addressing both internal and external imbalances. It is also clear how strong industrial policy in China together with tight state control over the domestic financial system actually serve to produce stability within this mediation of financialised global aggregate demand, rather than being the source of instability as argued by the savings-glut proponents. Debates about China’s currency (which are raging in both the US and Brazil) must be understood in this context

**Required Readings**


**Highly Recommended Readings**
Diaz-Alejandro, Carlos F. (1984), ‘Latin American debt: I don’t think we are in Kansas any more’, Brookings Papers on Economic Activity, 2, pp 335-403. Read first and third sections, pp. 335-367 and pp. 377-403 [57 pages]. Note that the last 13 pages are comments by the then-young Paul Krugman and Jeffrey Sachs.

Further Recommended Reading
Kregel, Jan (2008), ‘Financial Flows and International Imbalances: the role of catching-up by late industrializing developing countries,’ The Levy Economics...

