The Fundamental Challenge

How can countries finance development while dealing with international financial subordination?

(aid is a very small part of this bigger question)
Outline

1. Finance and Development
2. Structural financial weaknesses
3. Two post-war BoP paradigms of US hegemony
4. Balance of Payments (BoP)
5. BoP Analytical Histories
6. Financialisation and Neoliberal Globalization
7. Conclusion
1. Finance and Development

Two views: mainstream and structuralist

Mainstream: modernisation view

- Economic development is supported by (and/or reflected by) financial development
- Financial dev. includes financial deepening

(Differences based on views of regulation)

- Neoclassical: institutional form does not matter; ‘financial repression’ bad
- Keynesian: institutional form matters; finance must be regulated and subordinated to productive economy
Problem...

- Financial sectors in most developing countries already established/controlled by colonial powers at time of decolonization
  - in some cases, financial decolonization never happened (e.g. CFA in French West Africa)
- Mainstream (both n/c and Keynesian) refers to the experience of capitalist centres
- (Formal) financial systems of peripheries dominated by foreign interests, with strong external orientation
Finance: key aspect of centre-periphery system

No tendency for peripheral finance to deepen because of polarization and external-orientation

Instead, tendency to direct value away from poor people and regions, towards elites and abroad

EDEs advocated development finance in order to subvert this tendency, e.g. state-owned development banks, subsidized lending, regulation, capital controls, etc.

Ironically, this approach itself became criticized as the cause of problems (‘financial repression’).

Neoliberal solution = financial liberalisation & privatisation, but exacerbates problems
2. Recall Structural Weakness of Late Indust.

- Import dependence of late comers leads to chronic shortages of foreign exchange, even if exporting well (e.g. two gap models)

- Foreign exchange becomes a specific constraint, distinct from savings:

  - This constraint is structural: it based on the technological and input characteristics of production/consumption

    - Hence, it cannot be overcome through ‘right’ prices or demand management

    - *NOT* behavioural (as in modernisation theories)

    - Can think micro: cash flow constrains firm growth (except here there is added forex dimension)
Foreign Exchange (or ‘Savings’) Gap

- The ability to finance trade deficits becomes key constraint to industrialisation, urbanisation, etc.
- Or, an inability to finance must be compensated through some other means and puts much greater strain on processes of structural transformation
- Constrained deficits can also reflect financial constraints
- *Early rational for aid (now largely ignored)*
Essentially two strategies

1. Trade: X orientation (and ISI), or;
2. Finance: FDI, debt, portfolio, aid

- Usually a mix of both strategies

- Rep of Korea: classic case
  - chronic deficits + aid + debt; little FDI & nationally-owned (Amsden, etc.)

- Latin Am: polarisation/marginalisation
  - FDI dominates in key ISI sectors
  - Leads to variety of perverse economic, political and social dynamics (Sunkel, etc.)

- China: proves the rule up to late 1990s
These strategies presume an international context in which rich countries run trade surpluses and supply finance to poorer countries.

This structural context prevailed in the first three decades of the post-war period (Marshall Plan, etc.), but not after…
3. Two post-war BoP paradigms of US hegemony

- 1945-1970s: trade surplus and capital outflows: supports developmentalism + dependency
- 1970s-now: trade deficit and capital inflows: undermines developmentalism and restructures DC economies towards export of goods and capital
  - Fuelled by financialisation
  - ‘Neoliberalism’ used as discipline
  - Dependency continues through continued expansion of TNCs abroad despite net financial inflows to US
Imports, exports, and trade balance as percent of GDP
1982 Debt Crisis as Key Systemic Turning Point

- End of developmentalism outside Asia
- Regions most effected were most integrated into international finance (LA & Africa); those less open were able to take advantage (EA)
- The ‘oil price, inflation and debt’ myth
  - US deficits from mid-1960s as source of global inflation before OPEC cartel (Triffen)
  - Amplified through revolution in international banking (Eurodollar)
  - US$ goes off gold in 1971; new regime of floating exchange rates
Cheap Money

- Recession in North (1974-77); glut of lending to Middle Income Cs (LA)
- Money became very abundant and very cheap, almost free, even negative real interest rates
- Strong incentives to borrow + way to avoid painful adjustments and overcome structural impediments
- No ideological proclivity (even South Korea – saved by US in 1982)
- US banks became heavily exposed: little risk due to banking syndicates & floating interest rates
- Banks were bullishly pushing loans right up to crisis (like US subprime)
The ‘Volcker Shock’

- US suddenly changes the game in ‘79
- Interest rates hit 18% in 1981-82
- Simultaneous quadruple whammy
  - interest payments triple
  - new bank loans dry up
  - massive capital flight from South
  - fall in demand and prices for exports
- Starts with Mexico, then domino effect
- Crisis actually hit Africa before…
US-IMF-WB step in

- Protect international creditors
- LA governments forced to socialise costs of crisis (like today in PIGS)
- Structural adjustment programmes = generate forex to service loans
  - More exports take time (e.g. coffee)
  - Import reduction fast, but ruins economy
  - Cut government expenditure because also consumes imports and to pay for costs of socialised debt
Key Debates and Issues

- Irresponsible borrowing or irresponsible lending? Who is responsible and who should carry (and did carry) the burden?
  - Repeats in EA crisis (1997-98) & now
- Domestic Support for SAPs: local political economy in LA (see Diaz-Alejandro**)
- US hegemony reasserted: US hypocrisy and South split into two groups (Arrighi)
  - ‘Pro-cyclical’ SAPs as discipline
  - Democracy as distraction
4. Balance of Payments

- Systemic reorganisation in international finance reflected in BoP data, although need to be careful with interpretation
- BoP = Balance of inflows and outflows of money (US$ and other hard currencies) with rest of the world
- The balance must = 0 (accounting identity, not statistical or causal model)
BoP =

current account
+ financial (capital) account
+ official reserve account
+ errors and omissions
Current account

= trade account (exports – imports of goods and services)

+ income account
  • profits remittances
  • wage remittances
  • interest payments on debt
  • ‘current transfers’, including aid
Financial account =

net change in foreign/domestic ownership of domestic/foreign assets
= net change in capital gds (machines)
+ net changes of debt (part of ‘other’)
+ inflows and outflows of FDI
+ net portfolio inv. (stocks and bonds)
+ net other investment (i.e. currency transactions, bank deposits, etc.)
The rest...

- Reserves = change in savings of international currencies (usually held as US Treasury Bills + gold)
- Errors and Omissions – exploding since the deregulation of international trade and finance in 1970s (IMF)
In sum...

\[(X-M) + \text{net income} + \text{net transfers} + \text{net } \Delta \text{ debt} + \text{net FDI} + \text{net other } K + \Delta \text{ reserves} + \text{E&O} = 0\]

...or

\[(X-M) = -(\text{net income} + \text{net transfers} + \text{capital/financial account} + \Delta \text{reserves} + \text{E&O})\]

**NB: Crises can happen in any of these**
“...it is possible that a deterioration of the recorded US trade balance could be reflected in the increased profitability observed in the past ten years for US companies operating in the global market...”

“...as a result of the increased influenced of capital flows on trade and the geographical dispersion of intermediate stages of production, the current account in many countries is increasingly determined by factor incomes representing interest, profits, and dividends on foreign production, and borrowing and lending. All of these capital factor incomes are fully recorded by national origin, while goods and factor services balances are no longer representative of real underlying flows. Paradoxically, in the modern world, capital flows may no longer represent transfer of resources or the financing of productive activity, and goods flows may no longer represent production of final goods for import or export.”
5. BoP Analytical Histories
Balance/GDP (current value; GDP converted to USD at year-average market rates)

- Current Acct
- Cap+Fin Acc
- Reserves inverse (-)
- Net Es&Os
- Net Direct Investment

Diagram showing:
- Very large devaluation (>40%)
- Large devaluation (>25%)
- Revaluation ≈ 20%
- Devaluation/unification (>40% or much less)

CPI (general)
Real per cap GDP growth rate
6. Financialisation

- Increase in value of finance over trade and both over production, or;
- Higher profits for financial speculation than for productive business;
- Economic activity and social relations increasingly mediated by (private) finance;
- Policies biased towards creditors

Debates about relevance, particularly regarding developing countries (e.g. Kregel vs. Fine)
Financialisation reflects reorganization of global production by TNCs from 1970s onwards

Liberalization, deregulation, institutions and governance related to facilitating these reorganizations and globalized operations

New developments in LIC debt, e.g. bonds denominated in domestic currency in Africa