The **United Nations Research Institute for Social Development** (**UNRISD**) is an autonomous agency engaging in multidisciplinary research on the social dimensions of contemporary problems affecting development. Its work is guided by the conviction that, for effective development policies to be formulated, an understanding of the social and political context is crucial. The Institute attempts to provide governments, development agencies, grassroots organizations and scholars with a better understanding of how development policies and processes of economic, social and environmental change affect different social groups. Working through an extensive network of national research centres, UNRISD aims to promote original research and strengthen research capacity in developing countries.

Current research programmes include: Civil Society and Social Movements; Democracy, Governance and Human Rights; Identities, Conflict and Cohesion; Social Policy and Development; and Technology, Business and Society.

A list of the Institute's free and priced publications can be obtained by contacting the Reference Centre.

UNRISD, Palais des Nations
1211 Geneva 10, Switzerland

Tel: (41 22) 9173020
Fax: (41 22) 9170650
E-mail: info@unrisd.org
Web: http://www.unrisd.org

Reflections on the Restoration of Development Economics

Jeff FAUX

Draft paper prepared for the discussion at the UNRISD meeting on
"The Need to Rethink Development Economics",
7-8 September 2001,
Cape Town, South Africa.

---

1. The restoration of development economics is not solely an intellectual task. If this were the case, the world's policy makers and their academic advisers would have acknowledged long ago the failure of neo-liberal policies to deliver on the acceleration of global growth promised by neo-liberal theory. And the animal spirits of careerist economists would have motivated a rush to new intellectual ground.

Instead, the economics profession's reaction to the accumulating evidence of failure has been, at best, to concede that progress along the neo-liberal path takes a little more time – and that there will, of course, be some casualties. ("Didn't we mention it? Sorry about that!") We are assured that there is no need for policies to promote social equity or democracy. Those will come as a by-product of more rapid sustained economic growth, which, if we are patient, will arrive in due course. Any renewed interest in the public sector and civil society institutions is limited to assigning them to the task of caring for the "losers" whom the deregulated market has left behind.

This reaction reminds us that the triumph of neo-liberalism in academic as well as policy circles was not entirely an intellectual exercise either. Its rise to hegemony is a part of a wider conservative political agenda.

All economic theories, like all economic systems, come with a politics. Indeed, political science itself has been defined as the practice of "who gets what." Neo-liberal economic thought is, as most of us know, connected to the multinational political and financial forces that currently dominate the post-Cold War global economy. This does not mean that all neo-liberal scholarship is politically motivated. It simply means that the rich and powerful typically support the scholarship that reinforces their view of the way the world should work. It would be odd if it were otherwise.

Over the years, these multinational interests have created a global "echo chamber" through which ideas that support their agenda resonate among the policy-making institutions, the media, universities, think tanks, and the larger literate public. They particularly targeted journalists and the media, who represent "gatekeepers" to the global policy debate.

The effect of this echo chamber on the policy debate is to drown out dissent based on empirical research with second-rate research and analysis rationalizing de-regulation, short-term investment horizons, and the increased commodification of human values.

An examination of the economic motivations and behavior of those institutions (and their clients) that determine development policy needs to be part of any serious effort to resuscitate development economics. As Amartya Sen recently observed. "The whole power structure underlying the institutional architecture itself needs to be reassessed in the light of the new political reality."

Another implication is that the arguments for a new development paradigm must be consciously organized. By itself, quality does not necessarily prevail in the marketplace for ideas.

2. Thandika Mkandawire notes in the background paper for this gathering that even those economists whose models have identified systematic market failure typically lose their intellectual nerve and allow unexamined assumptions about the incompetence or malevolence of the "state" to undercut the important policy implications of their work.

Clearly, we need a new *economic* theory of the state. This will require research that reveals the relationships between the public and private sectors. The notion that the state can be isolated from the "private" economic is patently absurd.

We also need a better empirical framework for measuring the public sector's role in development. We need to break out of the prison of the national income accounts, which classify all public expenditures as consumption. Specially calculated capital budgets and similar devises at best capture some public investment inputs, but are not connected to growth outputs. We need a systematic analysis in the treatment of public sector investment's contribution to growth. Public education, infrastructure, health care, etc., are widely regarded as essential elements for growth yet are not imbedded in our fundamental measures of economic performance.

We also need a new understanding of how the social contract gets written and applied to economic policy. This involves challenging the dominant paradigm that exiles the distributional dimensions of the economy to cultural or political realms. These areas of public life are declared beyond the concerns of economic policy, yet at the same time capable of positive transformation only by the mechanism of economic growth.

In this context, it might be useful to take a fresh look at the economic history of more advanced economies. It is striking, for example, how the global policy discussion has assumed a laissez-faire model, supposedly reflecting the economic development of the United States. This is a distortion of history that ignores the role of public investment in education, of land distribution, and of trade and industrial policy at every stage of American industrial growth – not to mention a chronically low savings rate. Today, in the name of the Washington Consensus, Argentina is being forced to endure a grotesque austerity program after three years of recession. At the same time, a conservative U.S. administration is openly using expansionary fiscal policy to in response to a modest slowdown in U.S. growth.

3. The liberation of investment and finance from national regulation, the gradual obliteration of trade barriers, and the resultant dislocation and increased migration of workers – raises the question of whether the nation-state is a sufficient unit of analysis for the study of development.

The weakening of the nation-state has gradually forced many of neo-liberal globalization's activist critics into a political cul-de-sac. Nationalism has been a last line of their resistance. In developing countries it has sustained political opposition to the rule of multinational capital, which is often seen as representing First World economic colonialism. In the developed countries, nationalism has sustained anger against multinational corporations nurtured in the First World whose relentless hunt for lower labor costs are seen as a betrayal of patriotic obligations to their countries of origin.

Opponents of neo-liberalism have thus often been forced back into a defense of national sovereignty as the only available instrument for achieving social justice and sustainable development. Moreover, from a development perspective, national cohesion – most commonly generated by nationalist sentiments – appears to be one of the central themes in the institutionalist story of successful long-term economic development. Yet sovereignty is steadily eroding under the relentless pressure of global markets. Not surprisingly, many political leaders, even those who are willing to pump up nationalist passions for some short-term gain, conclude that, ultimately, resistance is futile.

4. Neo-liberalism claims that it is the true path to democracy, which, again, is supposed to be a by-product of economic growth. But in addition to neo-liberal failure to produce that growth, there is a fundamental contradiction about democracy in the reigning model of global governance:

- A global social contract needs to be managed by global institutions,
- global institutions are dominated by multinational financial interests,
- who have no interest in a social contract.

One ultimate purpose of a new development economics must be to permit democratic and accountable government to pursue development policies that are handcrafted by them in the context of their own conditions. "One-size-fits-all" is as inappropriate for policies coming from the Left as it is for policies coming from the Right. Accountability is key. If the market is not to be the final judge, then it must be an electorate within a political system capable of correcting its mistakes.

5. Any search for a new development economics must also address the question of whether national identity is the deciding factor in whether one wins or loses in the global economy. In other words, to what extent can we postulate cross-border class interests in a marketplace that already moves money and goods – and increasingly dislocates people – across those borders?

Following Sen's suggestion that we investigate the "power structure underlying the institutional architecture" will take us beyond a look at how the international bureaucracies function. It will extend to the links between these institutions and global concentrations of capital and credit. Most of these concentrations are nested in the advanced economies. But class in the global economy cannot be defined just by the geopolitical borders between North and South. As a retired U.S. State Department official recently explained to me: "What you don't understand is that when we negotiate agreements with these poorer countries, we are negotiating with people from the same class. That is, people whose interests are like ours – on the side of capital."

There is clearly a global capitalist and managerial class which allocates investment with global models that are not merely the sum of individual national economies, but which conceive of finance, production and marketing systems across borders. The class is organized through financial markets, business alliances, and the ethnic integration of top managers within multinational corporations.

A global capitalist class implies the existing of a global working class, even if the working class is not organized beyond national boarders – or even within national borders!

6. A simple model of the global politics that accompany the global economy might postulate three global class interests: (1) the business and political interests whose search for income wealth and power is global; (2) the working classes of the individual countries of the advanced world; and (3) the working classes of the individual countries of the developing world. (I use the term "working class" in a broad sense to include those in rural and urban areas, in formal and informal sectors and in union and non-union settings.)

Despite their common adversary, those who represent the workers of developed and developing nations are divided on the issue of enforcing labor rights and environmental standards. There is general agreement on the need for such rules. But many in the Third World see the effort to enforce them with trade and financial sanctions as a vehicle for First-world protectionism.

As one Asian economist observed: "The U.S. Treasury runs the International Monetary Fund, and for years urges it to make loans to dictators who squandered the proceeds and are now dead, or retired in the South of France. Then the IMF tells us that the only way to pay their debts is to increase exports made with our cheap labor. When we do, U.S. unions complain that we are undercutting labor standards."

For their part, First-world activists see their Third-world equivalents as being too willing to align themselves with multinational capital in opposing social protections through trade and financial agreements. They are skeptical when those in the Third World who claim to be supportive of human rights resist economic sanctions—which, in practical terms, seem to be the only way to preserve those rights.

A development research agenda might investigate the question underlying a potential "grand bargain" that might be struck between the two wings of opposition to neo-liberalism. The question is: under what circumstances might the working classes of the developed world get protection for its social standards, while those in the developing world receives the policy flexibility, markets, and capital investment they need for growth?

7. Despite its weakness, the nation-state remains the critical area for the conflict of economic interests over the reigning economic policy paradigm.

Equity, human rights, and social justice will not become a part of the "constitution" of the global marketplace because some NGOs get to sit on advisory committees at the IMF or the World Bank. It will only happen when enough nation-states demand it. Therefore, if the opposition to neo-liberalism is to foster a global alliance of its developing and developed country wings, its program must parallel and reinforce national struggles for economic progress and social equity.

For example, a renewed effort to model and elaborate the Tobin Tax and similar mechanisms to stabilize financial markets and support development – both internationally and within countries – could conceivably unite political coalitions in the North and South in some common project.

8. Data on income and wealth distribution within countries are of course, scarce enough. Linking that data across nations is an even more formidable task. An empirical analysis of the class structure in a global economy of six billion people and 190 countries is, to say the least, quite a way down the road.

But it may not be beyond our capacity to study ways in which capital and labor interact in a limited set of countries in different regions. From a development perspective, regional clusters of nations can provide the economies of scale for production and marketing. From a political perspective, a path to global integration built on expanding regional markets could provide a more accommodating arena for social-democratic alternatives.

A reinvigorated study of regional integration should be a high priority.

9. Attempts at regional integration of less-developed countries have failed more often than not. One reason is that ruling economic oligarchs and their foreign investor-allies are threatened by the bidding up of wages and costs that comes from a more diverse economy. Historically, the United Fruit Company – and, therefore, the U.S. State Department – has been unenthusiastic about the regional integration of the Central American economies because it would have created competition for labor and weakened the politically conservative oligarchs that run those countries.

The European Union illustrates the greater potential for sustained economic integration when policy is focused on the development of a diverse domestic market. The extent of social protection in Europe and the elaborate debate over the restructuring of a continent-wide social contract reflect a comprehensive notion of economic integration as a tool for political and social development. Ironically, the European Union was inspired by U.S. economic history, which can be read as a process of regional integration supported by a federal constitution that nurtured (not without struggle) the growth of trade unions, civil rights, and a modest welfare state.

This more comprehensive approach stands in stark contrast to the North American Free Trade Agreement (NAFTA), which neo-liberal policy makers are now holding up as the model for development in all of the Western Hemisphere. In NAFTA, development is narrowly defined as an expansion of the volume of goods and money that flow across the border. Accordingly, the arrangement gives extraordinary protections to investors but leaves workers, the environment, and consumers to the mercies of the deregulated markets. As a result, the benefits have largely gone to capital, while labor has borne the cost of dislocation, increased insecurity, and an overwhelmed public infrastructure on both sides of the border.

The focus of North American political and scholarly debates is over whether "Canada," "Mexico," or "the United States" gained or lost from faster economic integration. Yet the seven years since NAFTA's inception have seen a weakening of bargaining power of workers and a growing inequality of income and wealth in all three countries. Indeed, the agreement was specifically aimed at encouraging cross border business partnerships, which advances in technology made much easier. But while barriers to cross-border business class collaboration were lowered, barriers to cross-border working class alliances remained, and in some ways were strengthened.

The increased migrations of people and the increasing importance of remittances further connects the labor markets of the global market in ways that need to be integrated into the study of the entire system.

10. The changing global environment may also require us to see development issues as extending through a continuum of nations from least developed to most developed. Indeed, the case for liberalized trade and finance rests on a notion of a rationalized allocation of resources that allows all of the globe's workers to move up the skills and income ladder, to eventual convergence.

But the distribution of income and wealth does not necessarily improve with per capita growth. If it did, how do we account for the countries, including the United States, which have grown richer in the aggregate and become more unequal? Those who deny the power of distributionist policies claim this is the result of a structural adjustment to a "new economy." But Schumpeter taught us that capitalism is always in a state of some sort of adjustment to the ongoing process of creative destruction.

This suggests examining the links between growth and development policies in advanced and developing countries. One obvious policy issue is the coordination of economic policies among the world's large importers. In the absence of a global central bank (which, of course, the IMF is not), the task of global economic stabilization falls to a large extent on the fiscal and monetary policies of the largest developed economies. This is an immediate issue for the entire global community. The prospect of slower economic growth in the United States, Europe, and Japan for the next few years threatens to set back development in the rest of the world even further.

In addition, increasing inequality and insecurity in the first world might well be a major constraint on the capacity of First World nations to accept the kind of resource reallocation that Third World growth requires. A comprehensive vision of the global economic future might have to include a slower-growing but more egalitarian trajectory for the world's richest nations.

11. To be effective, the process of reviving development economics must be organized. It requires its advocates to more fully enter the emerging politics of the governance of the global economy in order to influence the content of the global policy "echo chamber."

This means paying attention to the marketing of ideas. A serious effort might concentrate research for a time on challenging one or two aspects of the neo-liberal paradigm – for example, privatization or the claim that liberalized finance expands credit in less developed economies. Or the assumption about the causal relationship between market deregulation and democracy.

At the same time, some coordinated effort might be made to engage in and market studies of successful government interventions in cases of market failure and models of the impact of public investment on growth. A strategy might even target some key international publications and journalists to engage over time in a dialogue about economic strategies and alternatives to the current conventional wisdom.

Again, we must absorb our recent experience in the way ideas affect policy in the global economy. They include:

- organization networks to set common priorities
- creating "echo chambers" that resonate in policy, academic, and popular circles
- targeting and making ideas accessible to the "gatekeepers"
- seeking forums to debate the opposition
- persistence

Finally, a serious strategy for a renewed development economics – as something other than a loose term for a modest social welfare programs to placate the protestors in the streets – must be connected in some way to the networks of potential political power for whom a new approach to development is necessary for their own agendas.