Evolution of Development Strategy as Balancing Market and Government Failure

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Some Papers

Introduction (1)

• Economic Theory identifies many types of market failure, calling for state intervention.
• Political economy identifies many types of government failure, calling (perhaps) for reduced state intervention.
Introduction (2)

- Development strategies, broadly construed, can be put on a spectrum, with less market orientation, less integration into the world economy, more regulation of economic activity, greater role for public provision of social services, more redistribution, etc., at one end; and the opposite at the other end.
Introduction (3)

• 2008/9 crisis led to a bout of speculation on “the end of laissez-faire as we know it.”

• Some predicted that the crisis would mark a decisive turn in the balance between market and state which (they felt) had turned too far in one direction.
Introduction (4)

• “….he is a religious devotee of laissez-faire, and his headship….at this juncture is fatal. . . . [his approach] is fatal not only in the decisions he makes…. , but also in the appointments he recommends to important jobs…. , for which he chooses almost invariably people as laissez-faire as himself.”

Arthur Lewis on Sir Sydney Caine, 1943
Introduction (5)

• The long arc of development thinking and development strategy has seen such swings before, and back again.
Introduction (6)

• What causes the swings of the pendulum?
• A complicated question, but a combination of ideas and experience.
• This is seen in the evolution of development strategies from 1945 onwards.
• The current conjuncture seems to indicate somewhat new and unexpected insertions into the “state versus market” debate from two directions—sub-national, and supra-national.
Indian Five Year Plans and Global Thinking

• The Indian Five Year Plans from the 1950s onwards represent a concrete record of the evolution of and interplay between ideas and policy.

• Arthur Lewis, and the tendency he represented, eventually won his battle, at the bureaucratic and the intellectual level. Development strategies of the 1950s and 1960s were to one end of the spectrum.
Indian Five Year Plans and Global Thinking

• Success of Keynesian policies after prolonged high unemployment in the 1930s.

• Success of the Soviet Union in the 1930s, 40s and 50s

• Spur to setting up of the Indian Five Year Plans in the 1950s: aggregate demand management, heavy industry, tariff walls

• Agencies like the World Bank, surprising though it may seem today, were in full support of such strategies.
Indian Five Year Plans and Global Thinking

• The statist approach of the 1940s and 1950s was not without its critics—for its neglect of poverty and inequality.

• Third Five Year Plan (1961-66): explicit focus on poverty and the poor. Special attention to agriculture. Emphasis continued in the fourth and fifth five year plans.

• The statist and import-substitution approach to development continued, however. During the fourth Five Year Plan, major national banks were nationalized.
Indian Five Year Plans and Global Thinking

• 1960s and 70s: East Asia’s “Growth with equity” miracle. Income poverty had fallen significantly in the wake of historically high growth rates. Not so in India.

• Rising unskilled wages, increasing employment in light industries manufacturing for exports. But why? Trade Openness?

• Regulated and directed credit for key industries, is also an exhibit in clash of evidence on whether the “East Asia miracle” owes its emergence to policies at the “left” end of the spectrum or the “right” end of the spectrum.
Indian Five Year Plans and Global Thinking

• Sixth and seventh Five Year plans (1980-85 and 1985-89) began the process of economic liberalization. Key price controls were abolished.

• In 1991, in the wake of a financial crisis, major external liberalization measures were announced, and the gradual opening of the Indian economy was undertaken during the eighth Five Year plan period (1992-97).
Indian Five Year Plans and Global Thinking

• Of course, in many ways the 1980s saw a global turn away from the post-war statist consensus in development strategies.

• During the 1980s and 1990s the economic development discourse took a distinct turn away from the previous consensus among the economic policy making elite.

• The Washington Consensus was coined in 1989, the year of the fall of the Berlin Wall.
Indian Five Year Plans and Global Thinking

• “What we may be witnessing is not just the end of the Cold War, or the passing of a particular period of postwar history, but the end of history as such....”
  Francis Fukuyama

• “The end of history lasted such a short time.”
  Ravi Kanbur
Indian Five Year Plans and Global Thinking

• First, the East Asia crisis of 1997 was a major blow to those who were arguing for rapid capital account opening to move further to the “right” along the spectrum.

• The second set of “facts on the ground” which posed a challenge to the emerging consensus on economic policy for development in the 1990s was the disastrous experience of most transition economies of Eastern Europe.
Indian Five Year Plans and Global Thinking

• Third, more generally, many countries in Africa and Latin America which followed the prescriptions of greater trade openness and greater reliance on markets did not reap the growth benefits that were touted for them.

• Fourth, the rapid growth of India and China, and the recognition that these countries have not followed the neo-liberal prescriptions a l’outrance, has influenced the discourse.
Indian Five Year Plans and Global Thinking

• The fifth set of outcomes is the sharp increases in inequality within rapidly growing countries over the past twenty years. Whether it is China, India, Bangladesh, Vietnam, Russia, Ghana, South Africa, etc etc, and in contrast to the East Asian experience of the 1960s and 1970s, rapid growth seems to be accompanied by rising inequality. (And where inequality has declined, as in Latin America, purposive state intervention can be pointed to.)
Indian Five Year Plans and Global Thinking

• One manifestation of global rethinking: report of the Growth Commission, set up in the mid-2000s, reported in 2008.
• 2 Nobel Prize Winning Economists (Spence, Solow)
• All 19 others were Practitioners and Policy Makers, the vast majority from developing countries
• Ahluwalia, Boediono, Dervis, Foxley, Zedillo, Manuel, Okonjo-Iweala, Xiaocuan etc etc
Indian Five Year Plans and Global Thinking

• “In recent decades governments were advised to “stabilize, privatize and liberalize.” There is merit in what lies behind this injunction—governments should not try to do too much, replacing markets or closing the economy off from the rest of the world. But we believe this prescription defines the role of government too narrowly. Just because governments are sometimes clumsy and sometimes errant, does not mean they should be written out of the script. On the contrary, as the economy grows and develops, active, pragmatic governments have crucial roles to play.”
Indian Five Year Plans and Global Thinking

• “Governments should seek to contain….inequality, the Commission believes, at the bottom and top ends of the income spectrum. Otherwise, the economy’s progress may be jeopardized by divisive politics, protest, and even violent conflict. Again, if the ethical case does not persuade, the pragmatic one should.”
Indian Five Year Plans and Global Thinking

Some “bad ideas” according the Commission:

• Subsidizing energy except for very limited subsidies targeted at highly vulnerable sections of the population.

• Dealing with joblessness by relying on the civil service as an “employer of last resort.” This is distinct from public-works programs...which can provide a valuable social safety net.

• Reducing fiscal deficits...by cutting expenditure on infrastructure investment...
Bad Ideas (Contd.):
• Providing open-ended protection of specific sectors, industries, firms, and jobs from competition. Where support is necessary, it should be for a limited period...
• Ignoring environmental issues in the early stages of growth on the grounds that they are an “unaffordable luxury.”
• Underpaying civil servants (including teachers) relative to what the market would provide for comparable skills...
Indian Five Year Plans and Global Thinking

• “The Eleventh Plan [2007-2012] began in very favourable circumstances with the economy having grown at the rate of 7.7% per year in the Tenth Plan period.

• However, far too many of our people still lack the basic requirements for a decent living in terms of nutrition standards, access to education and basic health, and also to other public services such as water supply and sewerage. Disadvantaged groups, especially the Scheduled Castes and Scheduled Tribes and the minorities have benefited less than they should have. Regional imbalances have emerged across and even within states.

• The Eleventh Plan seeks to remedy these deficiencies by seeking to accelerate the pace of growth while also making it more inclusive.”
Indian Five Year Plans and Global Thinking

• So, globally, and in India, we seem to be in a “middle ground” relative to the statist 1950s and 1960s and the free market 1980s and 1990s.

• How will the pendulum move next? No doubt there will be shocks and shifts and swings as we go on.
Indian Five Year Plans and Global Thinking

• BUT all of this assumes the “Westphalian state” which Europe developed over a quarter of a millennium.

• There are two big sets of pressures on the role and integrity of the conventional nation state in the “market vs state” debate.

• These are—sub-national issues, and supra national issues.
Sub-national Pressures: The Nation State versus The States

• In big countries, and indeed globally, spatial inequality has increased substantially in the last twenty years.
• India (Gajwani, Kanbur and Zhang, 2007).
• China (Fan, Kanbur and Zhang, 2011).
• Globally (Kanbur and Venables, 2007).
• Pockets of Poverty
• India and IDA.
The Nation State versus The States

- Increasing power of local polities in many countries, not least in India.
- Country specific variations, of course. But in many Federal structures key economic powers like taxation and regulation are reserved for the state.
- In India, the central government is increasingly a coalition of regional interests.
The Nation State versus The States

• As national level issues like trade tariffs or exchange rate controls have receded, and as structural issues like regulation and taxation have come to the fore, the markets versus (nation) state question has been complicated by the question of the nation state versus the states of the nation.

• In particular, a role for the nation state to control wasteful “race to the bottom” competition between states.

• Also, redistributive role of the nation state across states of the nation.

• China—spatial inequality a big concern; back and forth on decentralization.
Supra-national Pressures: Whither the Nation State?

• Increased global economic integration is reducing room for manoeuvre of nation states on domestic economic and social policies—taxation, redistribution, labor standards, regulation more generally, etc.
Whither the Nation State?

- Dani Rodrik has famously enunciated his globalization “trilemma.”
- “I have an "impossibility theorem" for the global economy.... [D]emocracy, national sovereignty and global economic integration are mutually incompatible: we can combine any two of the three, but never have all three simultaneously and in full.... Pretending that we can have all three simultaneously leaves us in an unstable no-man's land.”
Whither the Nation State?

- “I am skeptical about the global governance option...There is simply too much diversity in the world for nations to be shoehorned into common rules...The only remaining option sacrifices hyperglobalization.”
Whither the Nation State?

• For example, consider national preferences for redistribution in the face of mobility of capital and skilled labor.

• With “hyperglobalization” nation states cannot full express their distributional preferences through policies. Indeed, the equilibrium may well be inefficient compared to cross-national coordination.

• But if such coordination is not possible because of very divergent preferences, “the only remaining option” is to address the free mobility of factors.

• Same argument applies to a range of policy issues.
Whither the Nation State?

• Note that the “market vs state” framing has not really been used here.
• The only sense in which it could claim to have been used is that “hyperglobalization” is linked to “market liberalization,”, and walking back from such globalization may be viewed as “anti-market.”
• The issue, rather, is coordination across policy making entities and how to achieve it. The balance is not one between “market and state” but “national sovereignty and global coordination.”
Whither the Nation State?

- A key issue is appropriate representation and engagement in global institutions.
- Example of India, IBRD and BRICS bank.
- Can global institutions be reformed to reflect the new realities, so they can once again play their global role?
Conclusion

• The “market vs state” debate has swung back and forth.
• We seem to be in a middle ground just now, representing a synthesis of the lessons of excessive state in the 1950s and 1960s, and excessive market in the 1980s and 1990s.
• There may be some movements in the pendulum, of course, but it would be surprising if they were big enough to take us back to the 1950s or the 1980s.
Conclusion

• The emerging issues are not so much market versus state, as the nature and integrity of the nation state itself.

• On the one hand, in many countries political and policy making power is being devolved to local entities, leaving open the question of the precise role of the nation state in economic policy making.
Conclusion

• On the other hand, globalization is undermining the ability of nation states to make policy independently and, when they do, the uncoordinated outcome is likely to be inefficient.

• The issue is not (simply) market vs state, it is a question of coordination across nation states, requiring them to give up at least some of their economic policy making sovereignty.
Conclusions

• We have been here before. At the Bretton Woods Conference global leaders struggled with similar problems and designed structures which, albeit imperfect, served the global economy well for half a century.

• Indeed, they allowed the “market vs state” debate to continue within a global frame which was appropriate for its time.

• Can a new set of structures now evolve for the next half century?
Thank You!