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## Development at the Crossroad (Once Again)

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# Development at the Crossroad (Once Again)

by Gay W. Seidman

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In the first throes of last year's global financial meltdown, discussions of its probable impact tended to focus on the economies of already-industrialized countries, places where finance capital is concentrated, and where real estate bubbles had popped. But over subsequent months, as it became clear that distress had spread to the auto industry and far beyond, the global impact of the collapse became clearer: the integration of international economies over the past three decades means that even the least developed countries have been directly affected by what happened on Wall Street.

The Great Recession's impact on developing economies has continued to reveal itself ever since, in drastically reduced orders for manufactured goods, steep declines in global commodity prices, shrinking migrant remittances and a drying-up of aid funds to poor regions. After decades of pressure define "development" in terms of exports – of commodities, of manufactured retail goods, and migrant labor – the dramatic fall in global markets and global prices has reverberated around the world. Overall, developing countries have seen growth come to a crashing halt: the overall GDP growth rate for developing countries was expected to be no more than 1.2% in 2009 – a startling drop from rates of 8.1% in 2007 and 5.9 in 2008 [Lin 2009].

What does this new crisis mean for development theory? What does this collapse tell us about policies which predicate economic development on exports to wealthier countries? What does the new American enthusiasm for government stimulus packages suggest for developing countries considering government interventions

in the economy? And what lessons will developing countries take away from the crisis?

### **TINA and the Washington Consensus**

These questions, of course, are not prompted solely by the financial collapse: many development economists were already challenging some basic assumptions of the “Washington Consensus” that had emerged in the early 1990s, to such an extent that it had become commonplace to talk about a “post-Washington Consensus” debate. Since the 1997 East Asian crisis, and the 2002 collapse of the Argentine peso, prominent development theorists had already questioned some of the orthodoxies of the 1980s and 1990s, suggesting a greater role for states than that envisaged in orthodox neoliberal theory.

Before turning to current debates, however, it is worth revisiting the “Washington Consensus,” which pushed countries to reduce state spending, and promoting integration in global markets by increasing exports and liberalizing tariff regimes, in context. The “triumph of liberal economics,” as Thomas Biersteker [1995] noted, was linked to shifts both in economic theory and in the real world – shifts that seemed to spell TINA, or “there is no alternative” for most developing countries. From the mid-1980s, three trends dominated theoretical discussions. First, theoretical economics increasingly asserted the long-run benefits of liberalized trade, challenging the kind of protectionist tariffs and subsidies to “infant industries” that had been mainstays of development policies during the previous two decades – a theoretical stance that seemed to be bolstered by events in the real world, as international institutions took note of the emergence of East Asian “tigers,” and their success in exporting manufactured goods to industrialized countries. Second, the international debt crisis of the early 1980s – the disastrous result of Third World borrowing, running up against Thatcher and Reagan’s monetarist policies, which raised floating interest rates to new heights – pushed policy-makers to rely more heavily on what private investments and market forces, considered more efficient and less corruptible than the oft-caricatured “bloated government bureaucracies” that were central to the import-substitution strategies of the 1960s.

Reflecting and contributing to these theoretical shifts, the International Monetary Fund adopted new policies in this period, insisting for the first time that sovereign states follow specific macro-economic policies emphasizing exports and liberalizing their economies as conditions for receiving IMF loans.

Events in international relations in the early 1990s erased even theoretical alternatives. The collapse of the Soviet Union in the early 1990s reinforced anti-statist impulses. Analyses of the Soviet Union's collapse often focused on the overwhelming role of the state in Soviet society, and the absence of what was often loosely termed 'civil society': development policy-makers began to imagine development through the prism of a new paradigm, in which the state was seen as a negative force, and "civil society" was assumed to be the main protagonist for positive change.

[Where] the older view had a new, dynamic, progressive national level energizing and overcoming an old, stagnant, reactionary local level, the new view reverses these values. Now the national level (the state) is corrupt, patrimonial, stagnant, out of date, and holding back needed change; while the local level (civil society) is understood (...) as a dynamic, emerging, bustling assemblage of progressive civic organizations that could bring about democracy and development if only the state would get out of the way [Ferguson 2006, 96].

For developing countries, this new paradigm quickly became hegemonic: the end of the Cold War meant that that capitalism was the only game in town.

And with the formation of the World Trade Organization in 1995, new rules for that capitalist game were formalized, explicitly prohibiting the protective tariffs and subsidies that had once served as developing economies' main tools. Although many developing countries were skeptical, global policy-makers insisted that developing economies would benefit from openness in the long run.

## **Modernization to Globalization**

What did these real-world shifts mean for development theory? Informed by the Cold War as well as by a new American interest in expanding its influence to Europe's former colonies in Africa, Asia and Latin America, American social scientists tended to assume that characteristics of "traditional" societies blocked "modernization." Motivated by real concern to address global poverty, as well as by fears that the world's impoverished masses might prove ripe audiences for Communist rhetoric [Cooper and Packard 1997], researchers through the 1950s and 1960s looked at local cultures, land-ownership patterns, and the like, suggesting that conservative traditions, landholding elites, or a lack of education and "human capital" restricted innovation or entrepreneurial activity – implying that western aid might help overcome these internal obstacles [see, e.g., Banfield 1967; Lerner 1967]. W.W. Rostow's [1960] famous "non-Communist manifesto" – based more on a reading of the role of railroads in Nineteenth century American western development than on any empiri-

cal research in developing societies of the Twentieth century – suggested that it would take outside investment and aid for infrastructure to enable developing countries to reach a “take-off” point allowing local economies to flourish.

By the mid-1960s, however, these assumptions had been forcefully by social scientists with stronger roots in the developing world, who argued that this perspective ignored the histories and global contexts experienced by late industrializers. Newly-independent former colonies were not simply atavistic and backward: their economies had been reshaped by experiences of colonialism, and their fledgling manufacturing industries faced a very different context than that of the early Industrial Revolution. Across Asia, Africa and Latin America, colonial authorities and settlers had reoriented economies to produce the raw materials needed by colonial powers in Europe; far from the “traditional” pre-modern societies imagined by modernization theorists, these former colonies had been disrupted and rearranged to produce the raw materials demanded by colonial powers. Furthermore, industrial producers in these developing countries faced a very different international context: any attempt to move into industrial production faced stiff competition from already-established producers from around the world.

There were, of course, significant differences in focus and emphasis within the theoretical frameworks that built on this insight. Some analysts stressed the way trade patterns inherited from colonialism continued to create trade imbalances, as former colonies continued to exporting one or two commodities, imported their manufactured goods from Europe or North America. Many others emphasized unequal power relations, as former colonial powers continued to dominate former colonies, and military and economic patterns continued to relegate developing countries to the “periphery” of the world-system. A third group focused on why these patterns persisted even in the post-colonial era, showing how local elites cooperated actively in, and benefited from, economic patterns that recreated dependence and poverty in developing regions [Amin 1976; Arrighi 1994; Cardoso and Faletto 1979; Evans 1995; Wallerstein 1979].

In all these approaches, however, the state was seen as a central player, a key agent for building infrastructure or supporting new industrial production, or in promoting economic diversification or redistribution. By contrast, recent debates in development theory have mirrored policy-makers’ turn away from the state, and much academic interest turned to economic and social actors outside the state.

Although many analysts remain skeptical of neoliberal economic strategies – essentially considering these new trade patterns as reflecting the interests of powerful industrialized countries and multinational corporations [McMichael 2007] – the study of economic change has increasingly relegated the state to a secondary role,

focusing instead on other actors and social relationships as key to understanding, and addressing, persistent poverty in developing regions. Through the 1990s and early 2000s, there was of course great variation in where analysts looked to explain global patterns. Some writers, of course, look at the very large picture, exploring globalization writ large through a focus on how decisions made by mobile capital and financial flows shape what happens around the world – in the process underscoring the powerlessness of states in poor regions [Sassen 1998; Silver 2003]. Some writers explore the internal dynamics of industrial supply chains, in which large multinational retailers sub-contract production to smaller producers around the world [Collins 2003; Gereffi 1994], or at efforts by activists to challenge the dynamics of those chains [Anner 2000; Bonacich and Wilson 2007; Seidman 2007]. A growing number of works look at how international institutions and donor agencies interact with developing countries, shaping their development policies through discursive power or through patterns of aid and assistance [Ferguson 2007; Goldman 2005]. Some analysts look at internal class relations, suggesting that globalization has moved local elites to define their interests and identities in global terms, rather than in national ones – further promoting the kind of isomorphic diffusion of neoliberal strategies and policies [Babb 2001; Robinson 2003].

### **Developmental States for a New Era?**

But once again, the real world interfered with theoretical claims: in the late 1990s and early 2000s, a series of financial crises in developing regions demonstrated the risk that lay in an unregulated global economy. By the early Twentyfirst century, development theory had turned back to reconsider the state's role, but this time with a slight twist: instead of direct economic intervention, prominent development economists spoke of regulation, and of social concerns for the poor and unemployed. In place of the pure "free market" rhetoric of the early 1990s, important development economists argued that states needed to learn to regulate capital, without stifling efficiency and innovation; and that states needed to provide social programs for their citizens, as a normal part of functioning society. As Nobel Laureate and former chief economist of the World Bank Joseph Stiglitz [2001, viii] concluded, "We have moved, by and large, to a more balanced position, one that recognizes both the power and the limitations of markets, and the necessity that government play a large role in the economy, though the bounds of that role remain in dispute. There is general consensus about the importance, for instance, of government regulation of financial markets, but not about the best way this should be done."

For academics, attempts to answer questions about “the best way [government regulation] should be done” have frequently involved attempts to analyze what has gone right, and wrong, in past examples of developmental states, and in the past decade, several important historical-comparative studies examined the institutional characteristics that seemed to have shape business-state relationships, looking at how bureaucratic agencies have fostered, regulated, and impeded economic growth [Chibber 2003; Evans 1995; Kohli 1999]. How are state regulatory bodies or development agencies “captured” by specific interests in society, and what might prevent that outcome? What characteristics of specific state bureaucracy have supported and promoted entrepreneurial activity, and what characteristics seem to permit or encourage rent-seeking behavior? While these studies have not produced blueprints for good governance, they have certainly underscored a broad range of factors, including specific institutional characteristics (including, ironically, bureaucratic cultures that may have been inherited from colonial administrations) as well as geopolitical circumstances that favored state efforts to bring foreign capital into partnerships with domestic businesses, and helped strengthen specific growth strategies.

What those growth strategies should entail is a question that lies at the murky heart of the “post-Washington consensus” debate. Most theorists recognize, for example, the legacies which left many former colonies dependent on the export of one or a handful of raw materials, leaving entire countries vulnerable to fluctuations in a single commodity market. In a competitive global economy, where WTO rules prevent states from protecting infant industries or offering direct subsidies to producers to attract them into new areas of activity, how can states promote diversification?

While everyone agrees that diversification is probably a good goal, what kinds of activity should states seek to promote? In the 1950s, government intervention was expected to move their business sectors through a well-established series of industries, starting with textiles and moving up through more technologically-sophisticated processes. In the late 1990s, government intervention tended to stress “comparative advantage,” over diversification. In the early Twentyfirst century, however, it was increasingly common for development theorists to focus on innovation: discussions of diversification frequently emphasize government support for innovators, especially in the rapidly-changing world of high technology, allowing developing countries to move directly into global industries where they do not face competition from already-established producers.

While academics searched for positive examples of successful state-sponsored innovation, the theoretical claim seemed plausible: if developing countries could find new innovative niches, especially in high technologies areas, they might “leapfrog” over competition to become leading-edge producers of new products – and thus move

immediately to an advantageous position in global markets [see, e.g., O’Riain 2004; Block 2008]. Many of these discussions pointed to India’s expanding software and pharmaceutical industries as examples. In Latin America, Brazil and Chile seemed relatively successful at finding new opportunities in a liberalized global economy, with state investment and innovation funds playing some role in promoting new industrial growth.

Along with questions about what kind and how much regulation states should engage in, or how states should promote economic diversification, debates about the “post-Washington consensus” often revolved around the state’s obligations towards citizens, in terms of providing social services and protection. Even before the crisis, global markets had become more volatile, and globalization rendered local economies increasingly vulnerable to pressures far beyond the control of local communities, or even local states. Especially after the impact of “shock therapy” in Eastern Europe, the 1998 Asian financial crisis, and the collapse of the Argentine economy in 2001, fluctuations in global prices and currency flows had clearly created new insecurities for developing economies, and inequality and poverty.

From the late 1990s, more and more prominent development theorists – including, notably, economists Joseph Stiglitz, Paul Krugman, along with UN advisor Jeffrey Sachs – began to insist that free trade did not remove the obligations of states to provide some social security and support for their citizens. It is worth quoting at some length Paul Krugman’s thoughtful self-reflection in the immediate wake of the Argentine economic crisis:

A decade ago Washington confidently assured Latin American nations that if they opened themselves to foreign goods and capital and privatized their state enterprises they would experience a great surge of economic growth. But it hasn’t happened. Argentina is a catastrophe. Both Mexico and Brazil were, a few months ago, regarded as success stories, but in both countries per capita income today is only slightly higher than it was in 1980. And because inequality has increased sharply, most people are probably worse off than they were twenty years ago. Is it any wonder that the public is weary of yet more calls for austerity and market discipline? Why hasn’t reform worked as promised? That’s a difficult and disturbing question. I, too, bought into much though not all of the Washington consensus; but now (...) my confidence that we’ve been giving good advice is way down. One has to sympathize with Latin political leaders who want to temper enthusiasm for free markets with more efforts to protect workers and the poor [Krugman 2002].

Where once proponents of the “Washington Consensus” tended to argue that “getting the price right” for exported commodities and supporting private enterprise was government’s most important task, discussions of development were increasingly likely to include some concern for social welfare. Especially after 2000, when the



United Nations adopted (and donor countries pledged to support) the Millennium Development Goals designed to eradicate extreme hunger, poverty, illiteracy and disease by 2015, it became increasingly fashionable for development theorists to view efforts to improve social welfare and address poverty as basic functions of governments, even, or especially, in developing regions.

### **Impact of the Crisis, in Practice**

In the early throes of the global crisis, most commentators focused entirely on Wall Street and the American banking industry; but within a few months, developing economies were all-too keenly aware how vulnerable their economies had become to fluctuations at the core: after twenty years in which countries around the world had been pressured to expand exports and open their economies to foreign investors, few areas of the world were protected from the impact of the sudden contraction. Several different trends – all reflecting the greater integration of the world's economies – contributed to the impact on developing countries. The recession cut the flow of finance, investment capital, aid and remittances to developing economies, and prompted consumers around the world to cut spending – further shrinking the markets on which export-dependent countries rely.

A precipitous drop in net capital flows is the first, perhaps most obvious, effect of the crisis. In 2007, private capital flows to developing countries amounted to \$1.2 trillion, a six-fold increase since 2000. In 2009, the World Bank's chief economist reported, that figure was expected to drop to a mere \$363 billion, as portfolio investment flowed out of developing regions, and direct foreign investment slowed to a trickle [Lin 2009].

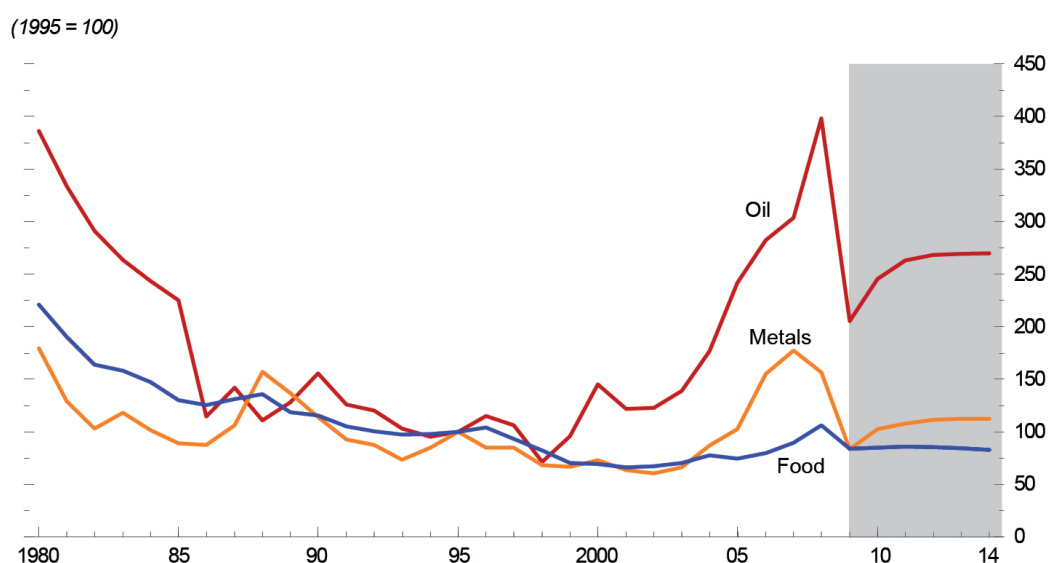
Meanwhile, at least in the short term, the contraction of consumer spending worldwide had direct impact on trade flows, especially from countries that had become dependent on sending manufactured goods like electronics and apparel to consumers in wealthier countries. In January 2009, Taiwan's exports dropped by 44% over the previous year; the Philippines by 40%; Singapore by 38%. China's exports fell by a mere 17.4%, but thousands of factories closed. Some 20 million Chinese workers were said to have lost their jobs, and China's imports dropped by about 43%, sending further ripples out through Asian economies [Khor 2009].

For countries that have benefited from migrant labor remittances, the loss of employment in industrialized countries, or in migrant-receiving regions in the Gulf states, was immediate. Remittances were expected to drop from about \$305 billion in 2008 to less than \$290 billion in 2009 – a drop that will have especially painful

consequences in the regions and households that have depended on remittances to make ends meet [World Bank 2009].

For many of the world's poorest countries, however, the most long-term impact might come from the crisis' impact on global prices for the raw materials – which still make up much of the developing world's exports. For the preceding five years, commodity-based growth seemed to hold out new promise: prices for oil, food, platinum and gold had risen rapidly, prompting talk of global shortages. Mineral-rich countries across the world had hoped to parley the boom into new wealth, especially as China began to buy more raw materials for expanding industrial production.

But since late 2008, as the following graph demonstrates (Graph 1), the sellers' market has collapsed: global prices for food and minerals have dropped to 1995 levels, and the IMF predicts that prices will stagnate for the next few years. The crisis is making itself felt across the developing world, from Angola (dependent on oil sales), to Zimbabwe (where the global collapse will exacerbate an on-going political crisis). In places where people already struggle and where safety-nets are non-existent, governments and households across the region face rising unemployment and shrinking budgets.



GRAPH 1. Real Commodity Prices

Source: International Monetary Fund, 2009

Countries that have banked on trade and economic integration have been left reeling. South Africa, for example, has been attentive to global policy suggestions since Mandela's election in 1994, trying hard to diversify its economic base and making concerted efforts to attract investments into industry and export-oriented agriculture, while cutting its protective tariffs and shrinking the state's involvement in

the economy. Like most developing countries in the post-WTO era, South Africa has emphasized growth through trade – a strategy that almost inevitably meant continued reliance on the commodities that have long dominated its economy. In 2008, nearly 60% of South Africa's exports came from minerals, and as manufacturing plants around the world cut production, South Africa's sales plummeted: exports in January 2009 were 25% below those of the previous month, and its economy shrank by an annualized rate of 2% in January. Forecasts for South Africa's immediate future are unambiguously grim. Unemployment, already estimated above 20%, is rising, as mines, farms and factories cut back production. Foreign investment and tourism, two sources of growth in the past decade, have dried up, at least for now, while a devaluing rand has further eroded local purchasing power. The impact will be felt in households far beyond South Africa's borders, as Africans from as far away as Somalia and Nigeria have moved to South Africa looking for work and opportunity. Last year, riots involving attacks on immigrants in South Africa's townships, as well as widely-publicized refugee flows from a disintegrating Zimbabwe, underscored the downside of global interdependence: the world's recession will reverberate through developing regions long after Wall Street and the City of London have begun to return to normal.

### **What Does the Crisis Mean for Development Theory?**

Of course there are notable exceptions to the grim picture unfolding across the world. While it is far too soon to be sure, some developing countries seem to be faring a little better than most. Brazil and Chile, for example, seem to have been somewhat buffered through the collapse of commodity prices. In Brazil, policy-makers point to the government's visible role in supporting national companies, through a well-funded state-run development bank and through financial controls – policies that have often been criticized by outsiders as holdovers from a previous era, but which seem to have cushioned the economy from total collapse. In Chile, royalties from copper sales during the boom years have been carefully husbanded by a government agency, to be used for supporting innovation and diversification, and to protect the economy in the event of the inevitable downturn in commodity prices. At present, we know far too little about what policies have helped countries survive this downturn, and what has not. Perhaps one way to think about future directions in development would entail examining variation among developing economies, to try to understand how and why some countries managed to avoid complete fiscal collapse.

Nevertheless, one overall lesson seems almost inescapable. Most theorists read any crisis through the lens of their own assumptions, but as global trade and growth figures sink to levels no one could have predicted three years ago, even stalwart supporters of the older ‘Washington consensus’ emphasis on market-based growth are rethinking the role of the state in development. The World Bank’s chief economist, for example, recently echoed Stiglitz and Krugman’s turn to the state, calling for public works projects on infrastructure to stimulate developing country economies, and summing up his approach in a single phrase: “We all need to adopt some kinds of Keynesian interventions” [Lin 2009]. Policy-makers at the International Monetary Fund [2009] similarly called on countries “that have policy room” to embark on public spending programs, arguing that “the timely implementation of fiscal stimulus across a broad range of advanced and emerging economies must provide a key support to world growth.”

As the global crisis pushes the “post-Washington consensus” discussion further away from a sole focus on market forces, renewed emphasis on states as core actors in promoting economic and social change harks back to an earlier era – a shift that might coincide with a theoretical redefinition of development priorities, away from a single-minded focus on exports and balance of payments, to a broader concern with quality of life issues and public services, like education, health and welfare. It is, of course, too soon to say, but wouldn’t it be an irony worth of Polanyi himself if the long-term impact of market failure and the destruction of economies were to bring the state back in?

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**Abstract:** The Great Recession has drastically reduced orders for manufactured goods, steep declines in global commodity prices, shrinking migrant remittances and a drying-up of aid funds to poor regions. The dramatic fall in global markets and global prices has reverberated around the world, hitting hardest those countries who have been most dependent on exports. What does this new crisis mean for development theory? What does this collapse reveal about export-oriented growth strategies? What lessons will developing countries take away from the crisis? This paper argues that the current economic crisis may prompt policy-makers to rethink many of the assumptions that have guided policy-makers in recent decades.

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*Keywords:* Development, global crisis, post-Washington Consensus.

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**Gay W. Seidman** is professor of Sociology and Director of Development Studies at the University of Wisconsin-Madison. Her research interests have focused on labor in developing regions, especially in Southern Africa and Latin America. In addition to *Beyond the Boycott: Labor Rights, Human Rights and Transnational Activism* (2007), her articles have appeared recently in journals such as *Third World Quarterly*, *Transformation*, *Labor History*, and *Development and Change*.