Development Theory and Practice: Review

• Three Schools, Three Worlds, and Three Theories, Three economic systems
  – **Freedom**, First World: U.S., Europe: Economic Liberal Theory, **Capitalism**
  – **Equality** Second World: USSR, China: Marxist Theory and Socialist Development, **Communism**
  – **Community/Equality** Third World: Dependency Theory (Analysis of inequality) **Nationalism** and Economic Nationalism (ISI, expropriation) socialist equality,
A Deadly Political Economy Conflict

• The First World vs. The Second World

• The struggle for Third World allegiance
  – First World punishments for Third World socialists

• The Crucial role of Foreign Aid
  – As a carrot to gain allegiance
  – As a source of capital for development

• The Absence of Democracy
Korea as a case study in Rapid East Asian Development during the Cold War

• Undermines the arguments of Liberalism
• Undermines the arguments of Dependency
  – Can a case be made for self-sufficient development? Can a country cut itself off from the international capitalist economy?
• Partially supports the arguments of modified Liberalism
• Is East Asian development unique because it took place during the Cold War?
• Can it be replicated?
• Sustainable Development: What is the Theory behind it? Is it possible?
• What about post-Cold War development:
  – India? Chile? Brazil?
From First World Embedded Liberalism to Global Neo-Liberalism

The Rise of “Free Market Vanilla” and decline of other Political Economy Flavors
Rapid Economic Growth in the First World.....A Triumph for embedded liberalism and the welfare state

- The Cold War between Capitalism and Communism was raging... Fear that markets would fail again if left to themselves
  - Feeding fear that Communists in pursuit of equality would take over
  - And creating a need for the welfare state...
  - And international governing institutions: IMF, World Bank, GATT

- The reality of American Hegemony: The golden age of embedded liberalism

- The First World recovered from war and developed quickly...

- American Hegemony propped up the embedded liberal system: **HOW?**
The Dollar greased the wheels of the international liberal economy

- $\uparrow$ imports $+\downarrow$ exports $\rightarrow$ trade deficit $\rightarrow$ need to pay up $\rightarrow$ use $\$\$ as reserve and exchange currency $\rightarrow$ multilateral trade grows.

- The IMF was supposed to Do this but it was too weak.
Taking in the world’s distressed goods
What were the results of U.S. hegemony for the First World economy?

• The Welfare State was protected
• European Cooperation for the first time in history
• Decline in Trade Barriers → Economic Growth
• Comparative Advantage and Liberal model vindicated
• US Aid and capital flows to Europe
But the U.S. sacrificed to hold up the “free world”: The US Trade deficit

But no problem….no one asked for payment!
Growth of Western Europe and Japan

- If embedded liberalism and hegemonic stability were great, why did they end?

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<thead>
<tr>
<th></th>
<th>1950</th>
<th>1973</th>
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<tr>
<td>Western Europe</td>
<td>$3,700</td>
<td>$11,534</td>
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<td>U.S. and Canada</td>
<td>$5,257</td>
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<td>Japan</td>
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Deadly conflict between Capitalism and Communism, Deficit spending: Vietnam war

The United States entered the war to prevent a communist takeover of South Vietnam as part of their wider strategy of containment. Military advisors arrived beginning in 1950. Then came the massive escalation of the Vietnam war in the 1960s.

How was the war in Vietnam to be financed when there was a war on poverty at home?
Too many dollars

To finance the war, President Johnson printed more dollars, rather than take money out of the economy in taxes or cut his domestic programs. American dollars flooded world financial markets. What happens when you print dollars? A decline in the value of the dollar. Because other countries were holding dollars in reserve, the U.S. was, in effect, exporting inflation. Value drops.
Exporting Inflation

• Because other countries were holding dollars in reserve, the U.S. was, in effect, exporting inflation.

• By mid-1971, the dollar had become seriously out of line with other major currencies, and the differential rates of inflation between the U.S. and other market economies had produced a fundamental disequilibrium in exchange rates.

• (We don't really need to print money any more, to make more of it. The money supply is measured typically by four figures, known as M0, M1, M2, and M3. M0 is the total of all printed money. The others refer to certain amounts of money such as bank loans that are available to the economy but not as liquid.

• The management of these various money supplies is the foundation of Keynesian economics, which is in conflict with other approaches circulating today and arguably in decline. In the Keynes model, deficit spending is a key tool available to governments struggling out of a recession—but the flip side is that in the long run, deficit spending is inflationary.
Declining Confidence in the Dollar
Abandoning the Dollar for Gold

The American govt. was under pressure to convert the claims of billions of dollars into gold. In 1970 official claims on the dollar rose to $20 billion, while U.S. gold and other reserves amounted to only about $14 billion. There was a real threat of a run on the U.S. central bank, the federal reserve. There was not enough gold in fort Knox to pay everyone off.

The Bretton Woods Gold Exchange began to break down, as Europe got on its feet economically and began to become a strong exporter by the mid-1960's. This growing economic strength in Western Europe coincided with soaring U.S. public deficits as Johnson escalated the tragic war in Vietnam.

All during the 1960's, France's De Gaulle began to take its dollar export earnings and demand gold from the U.S. Federal Reserve, legal under Bretton Woods at that time. By November 1967 the drain of gold from U.S. and Bank of England vaults had become critical.

Central banks increased their call for U.S. gold in exchange for their dollar reserves. They calculated with the soaring war deficits from Vietnam, it was only a matter of months before the United States itself would be forced to devalue against gold, so better to get their gold out at a high price.

By May 1971 the drain of U.S. Federal Reserve gold had become alarming, and even the Bank of England joined the French in demanding U.S. gold for their dollars.
Closing the Gold Window
Dollar devaluation: The U.S. begins to borrow and plunges into debt

- Expenditures exceeded revenues
- U.S. borrowed from other countries (sold bonds to other countries)
- Why did others want to buy US debt?
  - Long term interest rates
  - US providing military security
- Capital inflow for the US but.....
- Long-term debt + overvalued $
The End of Hegemonic stability and embedded liberalism in First World’s international economy and the rise of a global “casino economy”
The First World: End of welfare state: The Triumph of economic liberalism (a la Hayek and Friedman) in the U.S. and Britain
The Second World.....
And in The Third World.....

- National independence movements led by socialists had been extinguished.
- ISI failed in Latin America
- Global recession: inability to expand exports
- Rise of Third World Debt
- Net resource transfer from South to North
- Third World Economic crisis
- Income gap between First and Third World doubled in the 1980s.
New Role for the IMF and World Bank: spread neo-liberalism to developing countries

- New role: guarantee private loans
- In return for structural adjustment (SAP)
- The Washington Consensus:
  - Stabilize, privatize, liberalize
  All contributing to........
New Role for the IMF and World Bank: spread economic liberalism to developing countries

• Moved from the mission of stabilizing the First World monetary system to guaranteeing private loans to the Third World
  – Third world debt threatened to destabilize the international financial system.
  – IMF called in to guarantee private loans

• Washington Consensus: stabilize, privatize, liberalize: put on the “golden straightjacket”

• Contributes to freedom of finance capital and multinational corporations to roam the earth
GATT becomes the WTO

- **Goodbye embedded liberalism**: increasing liberalization of trade
  - No child labor protections
  - No environmental protections
  - No health and safety protections
  - Private actors: banks, multinational corporations

- **Hello Privatization**: banks, multinational corporations (not NGOs) sit on advisory panels, permitted freer global access leading to growing sales
and the growth of unregulated global finance

- *International movements of money – both volume and speed*
- cross-border bank lending has grown about 10% annually.
- daily foreign exchange trades now exceed by a wide margin the combined reserves of all central banks.
The result: Increasing privatization

• Some say international institutions governing the global economy have been weakened
• Only those who prefer embedded liberalism say that
• The institutions have simply changed (and strengthened) to govern an international neo-liberal economy
• Privatization is the goal of neo-liberalism
So..... If the U.S. pursued economic nationalism after hegemony, how did we get a neo-liberal global economy?

• U.S. hegemony supported embedded liberalism

• Without a hegemon and with IFIs and WTO transformed to protect neo-liberalism, *Private* forces are unleashed and unregulated

• Why didn’t the world devolve into the fragmentation of the 1930s?