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DEVELOPING COUNTRIES AND THE CRISIS[1]

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I am going to make a few ad hoc remarks, more of an empirical nature, about the developing countries in the current crisis. I will not talk a great deal about distribution, although I do think there is a great deal to be said about that, but I will say only a word or two regarding that to speak a bit more about the way in which the changing growth pattern in the world system has been laid bare by the current crisis and what some of the implications of that may be.

As professor Shaikh mentioned, there has been an extraordinary loss of credibility of the discipline of economics, at least those dominant strands within the discipline that have emphasized market efficiency and optimality. I think it is fair to say that there has not been a moment of this kind in living memory. And yet, there is a scramble on the part of the economists who have advocated those very sanguine, panglossian perspectives to shore up their vision and to provide various sorts of rationalizations. So it is very important at this moment to have alternative ways of interpreting the economic world made available.

There is a joke which some of you may have heard which goes as follows: if one is simply confused about macroeconomics, then one has not learned very much, but if one is profoundly confused, then one has learned a great deal. I think the crisis has given the benighted masses that were only ordinarily confused the opportunity to reach the rarified state of being profoundly confused. This is one of the contributions it has made. Even many professional economists didn't have very much knowledge of the micro-structure of the financial markets before this crisis hit and they found themselves, and I include myself in that group, having to take a quick course involving intensive reading of the financial times and auxiliary materials in that micro-structure in order to understand what is taking place. With the pre-existing perspectives on offer having been too aggregative, too abstract, too simplifying and one of the things that this crisis has made clear is that the details do matter. The devil was very much in the details. And my purpose, my task today, is not to talk about that history of causation of the crisis.

Let me make one more preliminary remark; there is a tendency in the world, it is an unfortunate cognitive bias perhaps that many people have to think that all good things or all bad things must go together. And a version of that is the idea that in time everything must be getting better for everyone or everything must be getting worse for everyone. My intellectual antagonist, professor Sala-i-Martin at Columbia University, for example, has been writing a spate of articles arguing that poverty and inequality have been falling and globalization (as he understands it: free trade free capital mobility etc.) is good. So it's very important for him to say that all those things are happening together, and contrarily it seems that some of those on the other side want to argue that the exact opposite is true. I have never fully understood why it is requisite to believe in a particular set of postulates of the sort that the world is getting worse in all respects in order to advocate policies which involve greater inclusion or greater democratic participation in institutions. The world could be getting better in certain respects (at least for some) and it could be quite inadequate with respect to these two stated issues, for example.

I think that the present crisis presents us with a situation which possesses this sort of perplexity, certainly in relation to the developing countries. Some developing countries have in a sense had a good crisis. They are the ones that have, at least for the moment, shown themselves to be relatively unscathed by the crisis. Other developing countries have been quite badly hit. One illustrative comparison is between Brazil and Mexico. Mexico has been quite badly hit by the crisis because of its close connection to the U.S. economy. Brazil seems to be doing better than ever, and there are a variety of reasons why that might be true, But it seems to have been experiencing robust growth and, according to some in Brazil, there has been a marked reduction in inequality that seems to have been going on for the last five years or so. There have been various positive signs in Brazil.

Brazil is one of those countries, and this is true of a few large developing countries in particular, which appear to be experiencing a virtuous cycle of semi-autonomous growth and development. I say 'semi-autonomous' because it is at this point extremely unclear as to what extent the process is capable of being sustained purely through internal demand and internal factors. But certainly the contribution of internal demand in the large continental sized developing countries such as Brazil, China, and India seems to be very important in explaining why to some extent at least they have managed to withstand the worst of the global crisis. But of course there are variations within that group and all of them are integrated in the world economy in significant ways, which generate risks in this moment as well as opportunity in an earlier moment.

For example, Brazil continues to be quite heavily dependent on foreign investment, though diminishingly so, and commodities exports, increasingly so. And of course, China's case is well known. Chinese dependence on foreign trade makes it especially vulnerable in the intermediate and longer term to a slowdown in the global economy, but for the time being, partly through the massive stimulus package introduced by the Chinese government, China has been surprisingly able to avoid the worst of the crisis.

This is, to spell out what is obvious, a very important historical departure. For most of the last century, the dominant way of thinking about the relationship between the North and South, has been in the metaphor of train engine and caboose. The North is the train engine and it pulls the train and the South is the caboose, receiving in a rather passive way the stimuli, which is represented by the North. And this metaphor seemed to enjoy enormous empirical validity for a considerable period of time and certainly it was one that was shared across a broad range of schools of thought from dependency theorists to liberal economists. And for the first time it is that metaphor which is being questioned as a result of these empirical facts.

Those of you who have read the financial press assiduously in recent times will know that this has taken the form of a discussion on what is called 'decoupling'. The question has been asked to whether for the first time, there's a decoupling between the north and south. And as far as I can tell, there have been at least two flip flops on the prevailing wisdom whether there has been decoupling. But the very fact that the question is being asked whether there is now constitutes a very important departure and marks something that we should reflect upon here. This seems to me a crisis which is making bare some of the consequences of secular structural transformations in the world economy. So there are elements that are specific to the crisis but there is also a very important respect in which the crisis is simply making evident what was otherwise becoming true.

As many of you know, the contribution of the developing countries on the margin to global growth has been growing rapidly and is now greater than half. What this means is that those firms seeking business opportunities anywhere in the world have every reason to beat a path to the places where the incremental global growth is taking place and that is exactly what we have seen. India and China are growing in importance in the world economy, not because they constitute a large share of world output, though they do of course have that feature, but because they are contributing a large share of the incremental increase in global output, which means everything from the standpoint of business investment and opportunity.

I think that although our discipline certainly in its mainstream version gives a great deal of emphasis to the concept of the marginal, it doesn't always appreciate its significance in real economies. The other day I was reading Walter Bagehot's famous tome, "Lombard Street", and I found that in the first three pages he has a wonderful discussion of why in his time, London was the capital of world finance, and of course remains the capital of world finance). One of the arguments he gives is that London provides a large pool of liquid capital. It is not that the capital stock in England was so much greater than in Germany or France, but that the pool of capital in London can be deployed very quickly and that English financiers had developed a culture of willingness to deploy that capital in business deals.

I think this is an important factor for us to consider, that the pools of liquid capital in the world are not always where the built up capital stock is. There is enormous capital stock in this country; physical, fixed capital. For a long time it has been argued that it has the widest and deepest pools of financial capital as well, which was the reason firms wanted to list on the New York Stock Exchange. But that latter advantage is rapidly, at least in relative terms, becoming less significant than it once was.

To give you another pop cultural anecdote, the other day I was on an airplane and I saw a wonderful Japanese film called “The Vulture”. And the hero of “The Vulture” is a Japanese finance capitalist who represents the leading edge of Anglo-American finance in Japan. He is the hero rather than the villain because he helps a traditional Japanese firm, rather like Toyota Motors, beat back a hostile bid from a firm which we discover was a camouflaged front for a Chinese sovereign wealth firm. So the evil Chinese intend to take over the Japanese firm and dismantle it to teach Japan a lesson, though there may be some profit they generate from that as well.

The way in which this financier saves this Japanese firm, an icon of technological leadership and quality, is to go to Dubai where he speaks in fluent Arabic to his interlocutors, specifically a sheikh he meets, and he convinces that person to provide financing for a counter-strategy and the Japanese firm successfully beats back the Chinese. What is interesting in this story is that London and New York do not figure and the two places with the pools of liquid capital, which can provide the threat or the opportunity, are China and west Asia, Dubai. I think if we want to understand where and how power is shifting in the world economy we have to understand this element, of the role of the marginal.

The constitution of the G20 is of course one of the pieces of evidence that this is understood in the corridors of global power. It was necessary to transform the decision-making club precisely because without doing so it would no longer be possible to make the important coordinating decisions which are necessary in order to manage and perhaps rescue the world economy.

As you know, there has also been a reevaluation of the location of risk in the world system. There have been many amused articles in the financial press recognizing for example that sovereign borrowers such as Brazil are now viewed as less risky than many borrowers in the North, whether they are previously blue chip investment grade firms or sovereign borrowers in the Euro zone. This of course, ironically, is partially the consequence of the successes of structural adjustment, which managed to push the doctrine of sound finance down the throats of countries such as Nigeria so successfully that Nigeria with all of its problems is now considered to be a country in relatively sound fiscal position as are many of these countries.

Of course the IMF was experiencing this before the crisis when it was threatened with near bankruptcy and it was about to fire many of its staff (in fact it had begun shedding many of them) because countries were not borrowing enough from it. There were too many countries in a sound fiscal position and those countries wanted to go to private credit markets rather than the IMF. And perhaps now Greece will become a borrower from the IMF, but it is not going to be the traditional developing country borrowers who are going to be asking for any funds.

That is it, for the moment, but this leaves open the question of whether another shoe will drop and whether there will not be a second and deeper phase to the crisis, which these developing countries cannot withstand, which, I think, because of the international inter-linkages involved, which are various and we could discuss, is certainly one that could hit a number of these countries quite severely and change what is a story of an ambiguous and mixed empirical situation into one which involves much more of the reality of global depression.

Let me just conclude given that I am out of time by saying that if and when this second shoe does drop the increasingly multi-polar global economy will place unprecedented global difficulties or new difficulties in managing the crisis. Just one example is the difficulty that the United States will face in the intermediate and long term in preventing serious dollar decline (with all of the implications that has for U.S. living standards and domestic growth) while providing stimulus over an extended period. The United States may, to put it boldly, have to maintain a high rather than a low interest rate regime in order to defend the dollar and it may have to choose in a much more direct way than it has done so far between these goals. There will in that event be no alternative to a globally coordinated response, which will involve elements of conflict as well as cooperation between the countries involved. And it may be more difficult than ever to achieve the cooperation which is required.

END NOTES

[1] Transcription: Karthik Raghavan and Brandt Weathers.
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