Globalisation and Underdevelopment –

Why is there almost no convergence in the world economy

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The Crisis of globalisation
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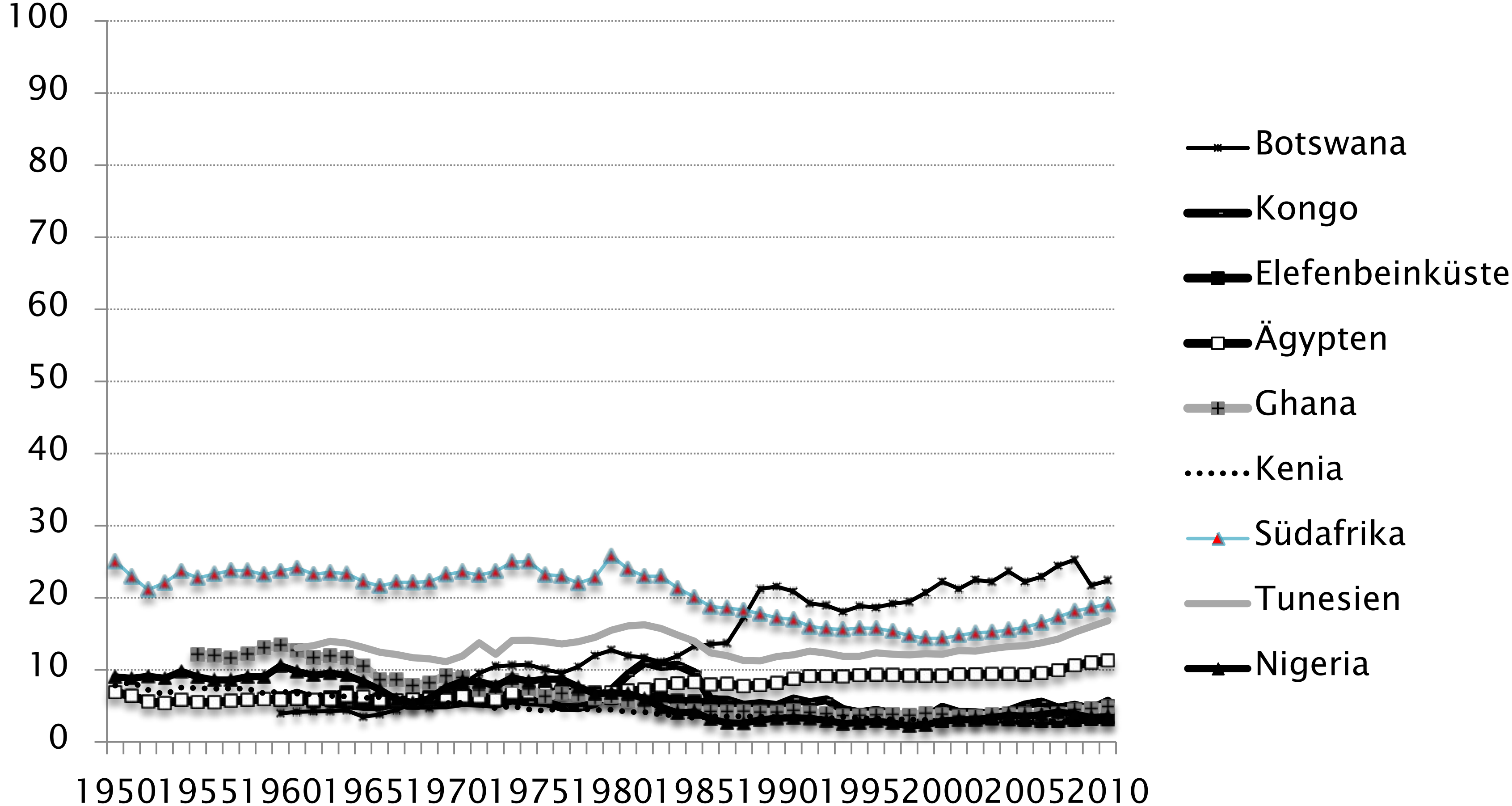
A world of no convergence and inequality

- Only a small number of countries managed to reach real GDP per capita levels comparable to developed countries

- Successful countries did not follow Washington Consensus policies

- World inequality is huge and much bigger in the typical developing country

Real GDP per capita in per cent of US real GDP per capita



Source: Penn World Tables 7.1

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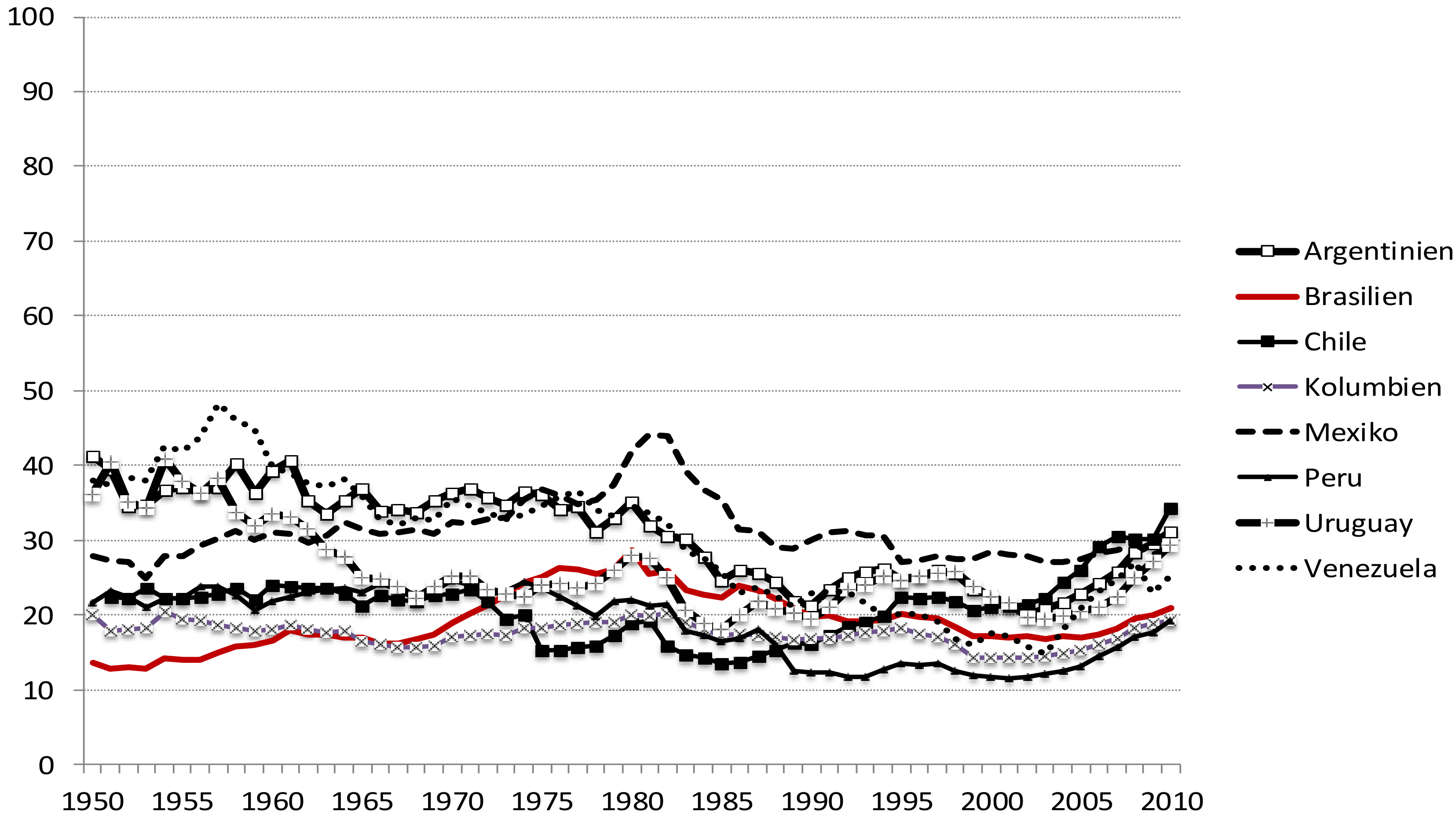

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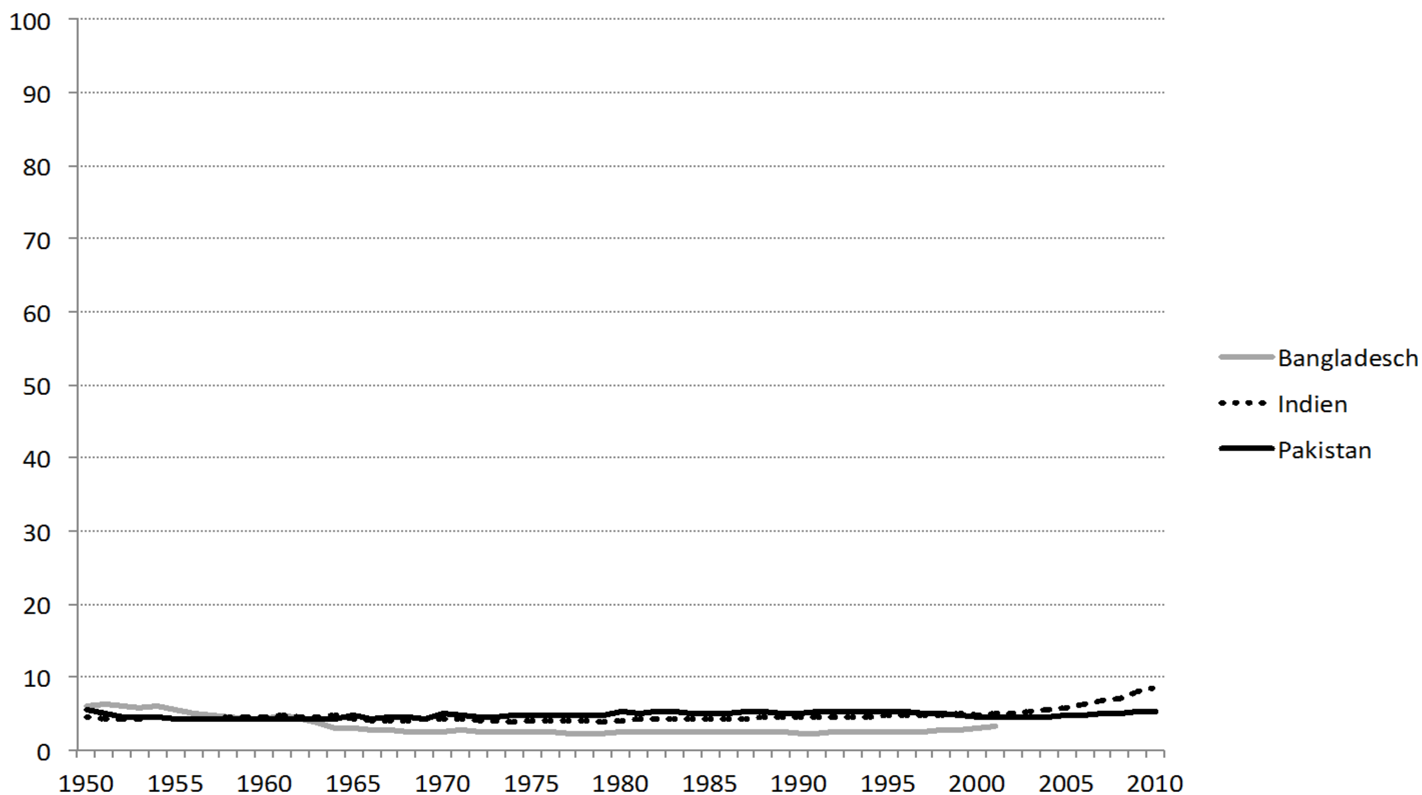


Source: Penn World Tables 7.1

Estimated Global Gini Indices, 1820–2002

Year	Gini
1820	43.0
1850	53.2
1870	56.0
1913	61.0
1929	61.6
1950	64.0
1960	63.5
1980	65.7
2002	70.7

Inequality in developing country is usually much higher than in developed countries.

Looking at most unequal countries in the world the fist developed industrial country is the USA as the 40^{th} most unequal country (World Fact Book)

Source: Milanovic (2009), World Bank

Why is there no convergence ? Heterodox economics has a wide variety of good answers

- 1. Comparative advantages lead to reproduction of underdevelopment
- Global value chains and foreign direct investment do not help much
- Premature industrialisation
- Hierarchy of currencies and financial distortions in developing countries
- Dutch disease and resource curse
- Inequality

Countries usually suffer from more than one of the problems

Comparative advantages

- Friedrich List versus Ricardo and Heckscher-Ohlin – free trade is “kicking the ladder away”
- Prebisch-Singer Hypothesis – erosion of terms of trade
- For development diversification of industries is needed not concentration on comparative advantages
- **A policy is needed “to get the prices wrong”**

Global value chains and foreign direct investment

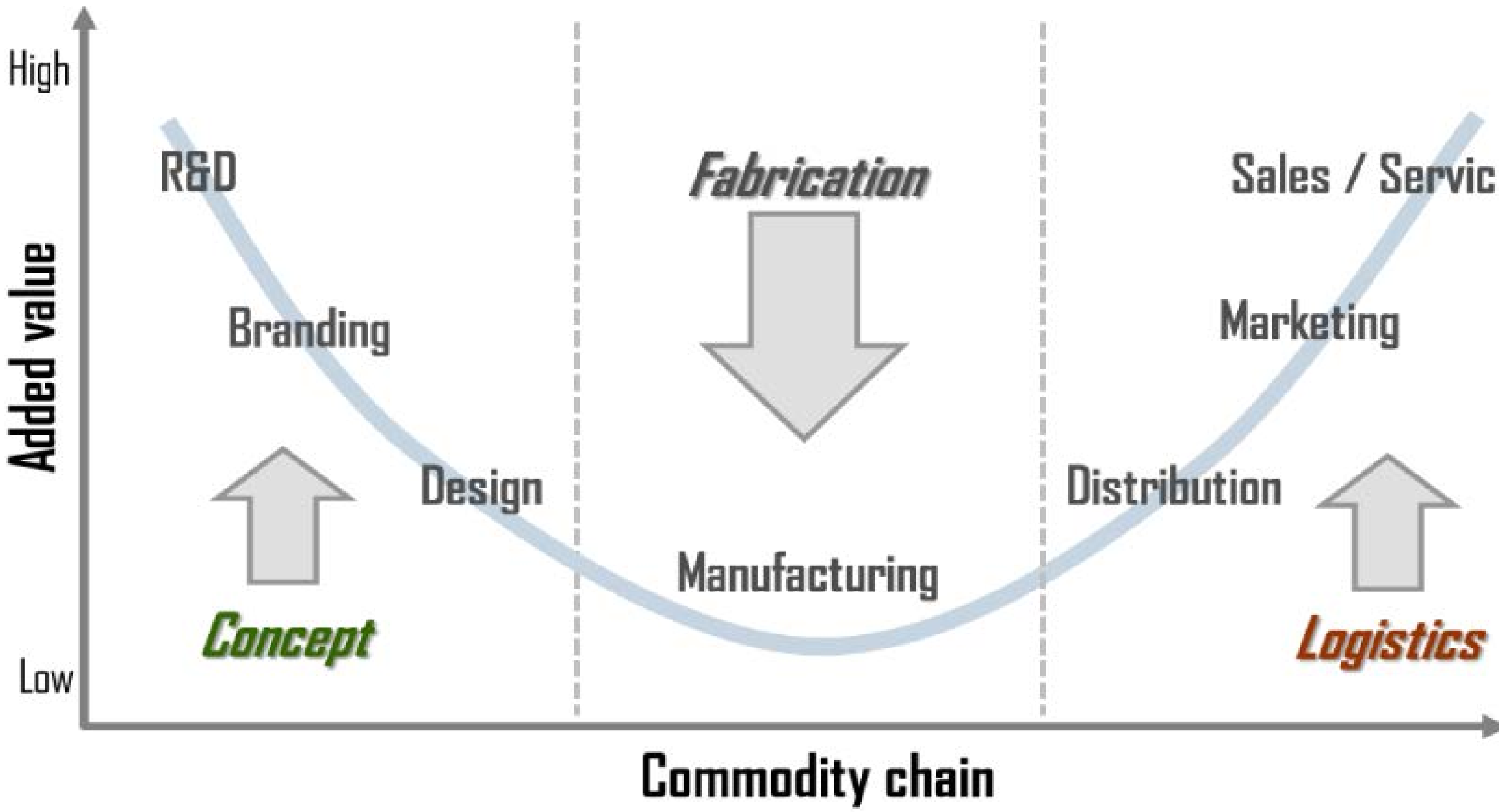
- A revolution in international trade – tasks are traded no complete goods
  - Washington consensus – open up for foreign direct investment
  - Revolution in transportation technology
  - Revolution in information technology

- Key role of multinational companies – “corporate neoliberalism” – oligopoly, monopsony and rent-seeking

- Global value chains potentially further reduces the productivity level in developing countries

- There is no incentive by lead firms to transfer substantial knowledge to developing countries

The exploitation curve



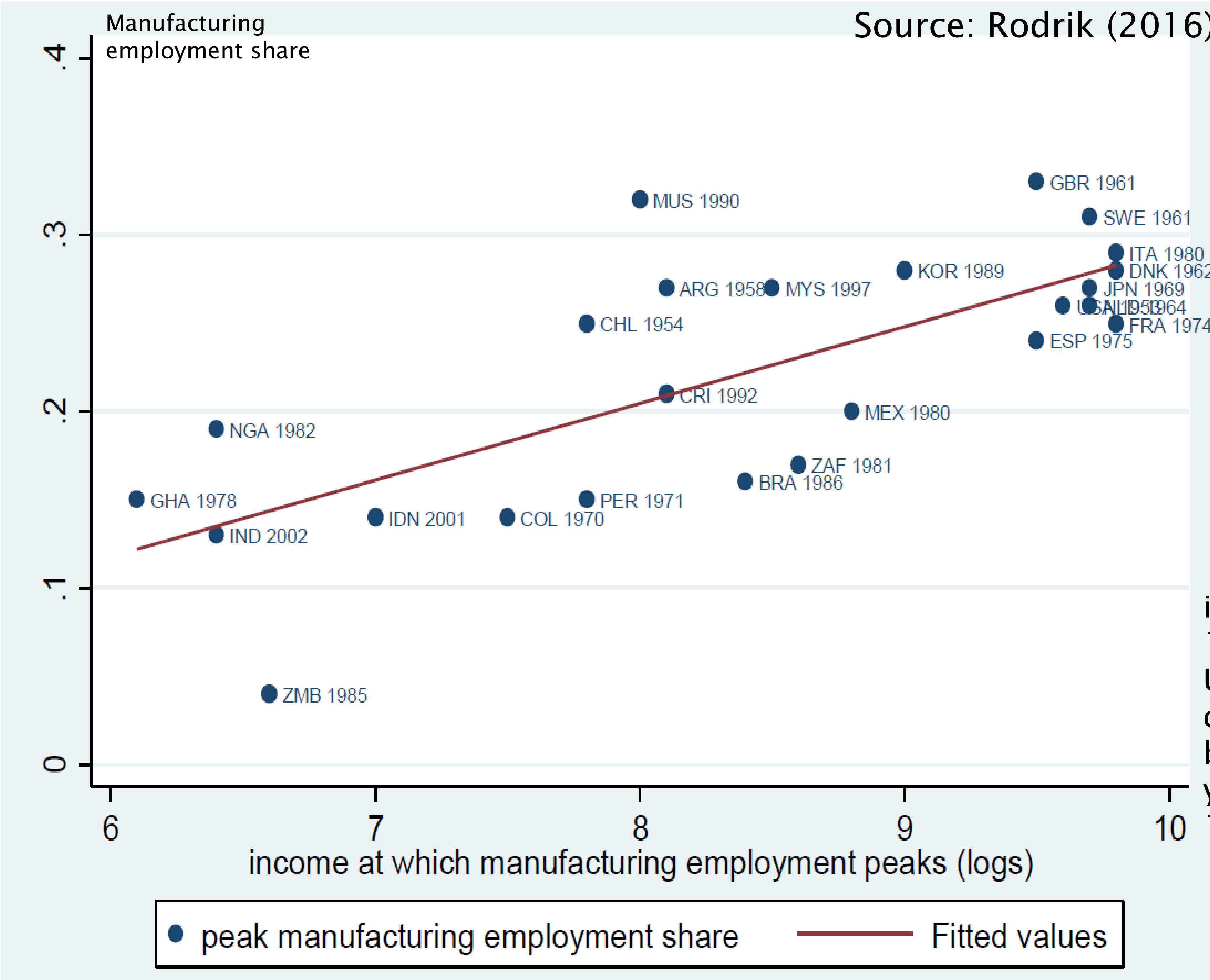
Over the last decades the exploitation curve became deeper

Premature de-industrialisation (Dani Rodrick)

- Maximum share of industry is reached in many developing countries much earlier than in now developed countries
  - There are sufficient world capacities to produced demanded manufacturing good
  - Future technological development may intensify this development

- Lack of a dynamic sector for development (Can the service sector take over this function in developing countries?)

- No traditional working class is created – no political power for more equal wages and welfare state policies



in 1000 US-dollars, base year 1990

Hierarchy of currencies and financial distortions in developing countries

- Globalisation led to deeper integration in international financial markets

- Financial globalisation led to portfolio diversification and capital flights by elites in developing countries *and* dollarisation

On the increase

Dollarization is spreading despite the risks.

(percent share of foreign currency deposits to total bank deposits)

Regions	Number of countries	1996	1997	1998	1999	2000	2001
South America	9	45.8	41.6	44.6	48.1	49.2	50.9
Transition economies	26	37.3	38.9	43.5	44.3	46.9	47.7
Middle East	7	36.5	37.2	37.7	37.5	38.2	41.9
Africa	14	27.9	27.3	27.8	28.9	32.7	33.2
Asia	13	24.9	28.0	26.8	28.8	28.7	28.2
Central America	6	23.2	23.4	24.7	24.8	25.2	27.3
Caribbean	10	6.3	7.6	6.8	6.7	6.1	6.2
Developed countries	14	7.4	7.5	7.5	6.7	7.0	6.6

Sources: *International Financial Statistics*, the IMF's Economic Data Sharing System, and statistical publications by various central banks.

Heysen, S. (2005): Dollarisation, Finance & Development, March

Financial systems in developing countries

- Schumpeterian-Keynesian credit-investment-income-creation mechanism is not working because of capital exports

- Original sin, foreign credit, dollarisation and currency mismatch – high risks and no lender of last resort

- Boom-bust cycles of international capital flows and currency crises

Dutch disease and resource curse

- Overvaluation of currencies of resource rich countries – especially overvaluation for the manufacturing sector
- Unstable development of natural resource prices
- Negative effects of rent-seeking – resource curse

Increasing and /or very high inequality

- Inequality drivers in developing countries
  - Developing countries must enforce higher real interest rates
  - Very high wage dispersion – informal sectors, weak labour market regulation, excess labour
  - Privatisation and other Washington Consensus polices
  - Global value chains stimulate the development of a dual economy

- High inequality prevents long-term growth periods (for example Ostry, J.D., Berg, A., Tsangarides, C. (2014)

  - Negative demand effects
  - Negative supply effects

Development traps

- Trap of insufficient productivity development
- Trap of non-working financial system
- Trap of high inequality
- Trap of severe ecological problems

Scenario I: Existing type of globalisation continues

- Developing countries will be integrated in the global economy at different levels of underdevelopment
- Most likely only a small group of countries will be able to catch-up – probably China and India
- Inequality between developed and developing countries stays high
- Inequality within developing counties stay high or will even increase
- Overall: Development chances are poor – not even discussing ecological problems and the preferences and ability of elites in developing countries to have national development

Scenario II: Different type of globalisation and partly de-globalisation

- Regulated and not free-trade – possibility of infant industry protection

- Massive industrial policy in developing countries

South East Asian countries (early Japan, South Korea, etc. and China) followed such policies as well as all now developed countries

- Free transfer of knowledge

  Stricter patent law is negative for development, Stiglitz among others demands free patents for developing countries

- Integrating FDI in industrial policy

  Especially important is to enforce local content and joint ventures (for example China)

- Global control of certain types of capital flows – increase national macroeconomic policy space

Most of international capital flows are harmful for development. For example, empirically open capital accounts do not support development

- Kind of a new Bretton Woods system with control of current account imbalances

Especially developing countries should strive for surpluses in the current account (see the countries successfully catching up)

- Global institutions for global governance

  for example to regulate multinational companies

- Radical ecological changes

  starting in the developed world

Pessimism of the intellect,
optimism of the will

Antonio Gramsci

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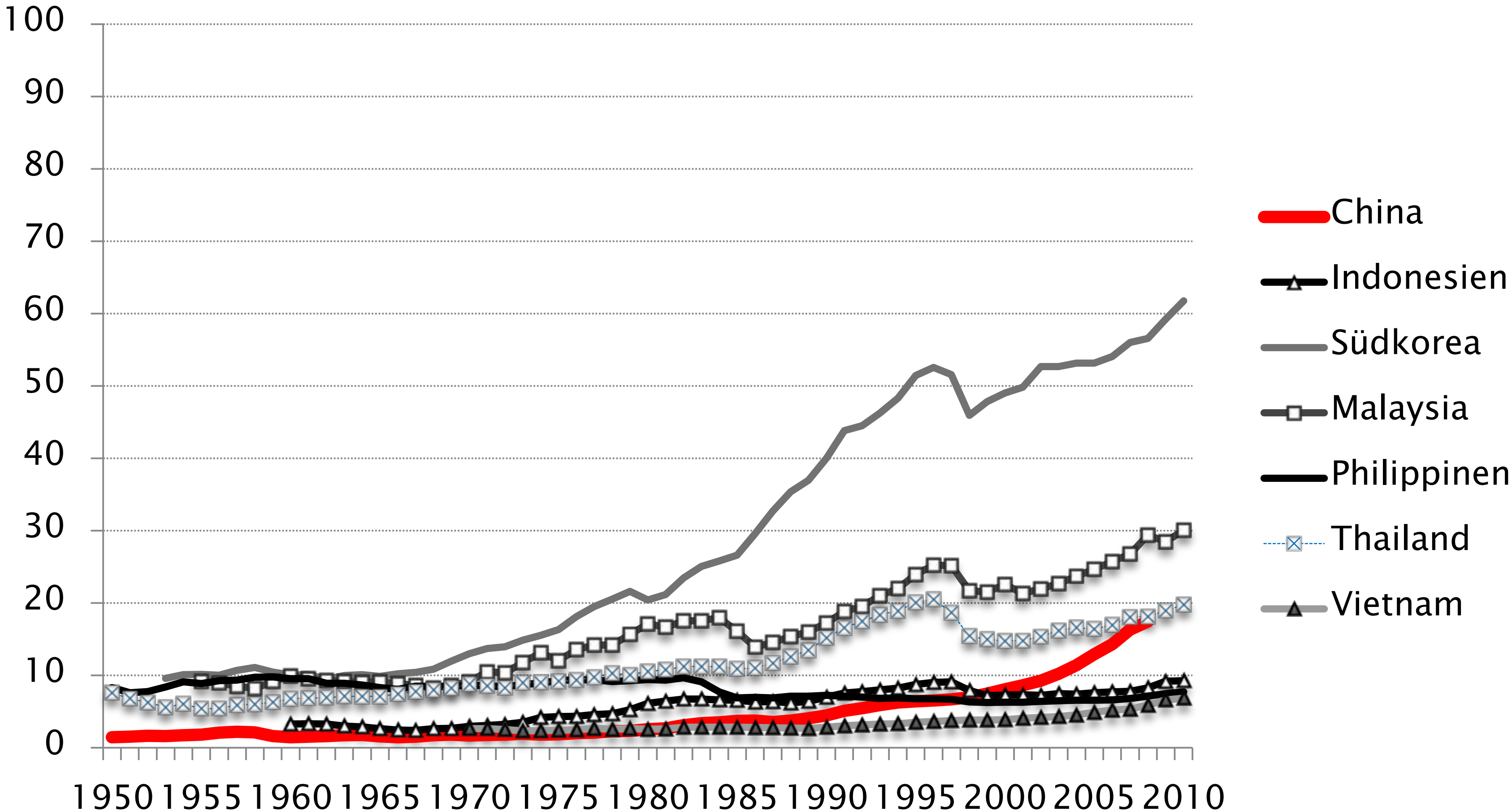


Source: Penn World Tables 7.1

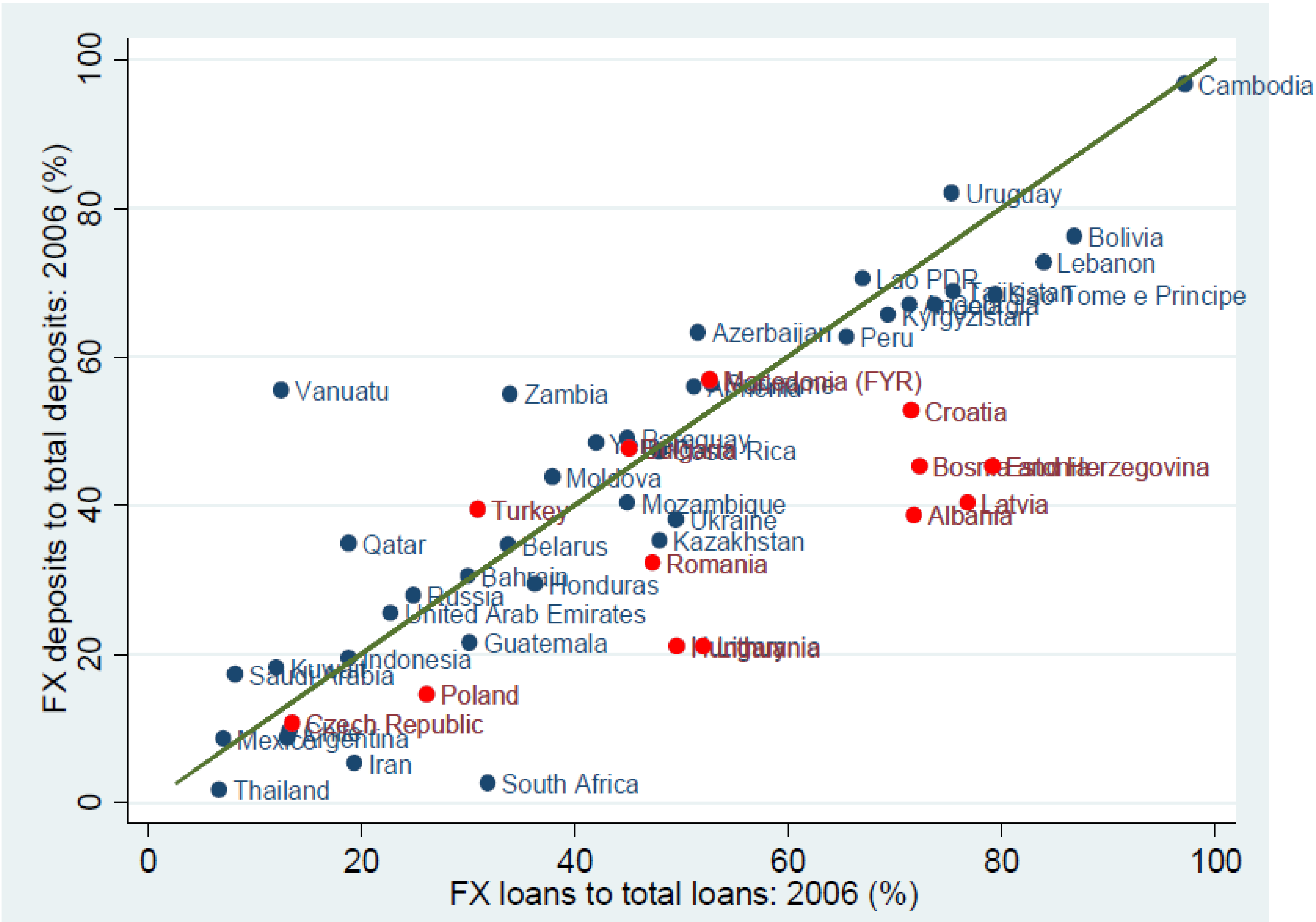
Rank	Country	DISTRIBUTION OF FAMILY INCOME – GINI INDEX	Date of Information
1	Lesotho	63.2	1995
2	South Africa	62.5	2013 est.
3	Central African Republic	61.3	1993
4	Micronesia, Federated States of	61.1	2013 est.
5	Haiti	60.8	2012
6	Botswana	60.5	2009
7	Namibia	59.7	2010
8	Zambia	57.5	2013
9	Hong Kong	53.7	2011
10	Colombia	53.5	2014
11	Guatemala	53.0	2014 est.
12	Paraguay	51.7	2014
13	Papua New Guinea	50.9	1996
14	Panama	50.7	2014 est.
15	Chile	50.5	2013
16	Swaziland	50.4	2001
17	Gambia, The	50.2	1998
18	Zimbabwe	50.1	2006
19	Brazil	49.7	2014
20	Sri Lanka	49.0	2010

World Factbook 2017

21	Nigeria	48.8	2013
22	Costa Rica	48.5	2014
23	Ecuador	48.5	December 2013
24	Mexico	48.2	2014
25	Dominican Republic	47.1	2013 est.
26	Nicaragua	47.1	2014
27	Honduras	47.1	2014
28	Bolivia	47.0	2016 est.
29	Rwanda	46.8	2000
30	China	46.5	2016 est.
31	Malaysia	46.2	2009
32	Malawi	46.1	2010
33	South Sudan	46.0	2010 est.
34	Togo	46.0	2011
35	Saudi Arabia	45.9	2013 est.
36	Singapore	45.8	2016
37	Mozambique	45.6	2008
38	Jamaica	45.5	2004
39	Peru	45.3	2012
40	**United States**	45.0	2007

World Factbook (2017)

Chart 4: Loan dollarisation vs. deposit dollarisation



Chitu, L. (2012)

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