YOUR LOGO

STATES AND MARKETS

Faculty of Economics, Thammasat University

Semester 1 2022

EE463 Globalization and International Development

Views on economic growth

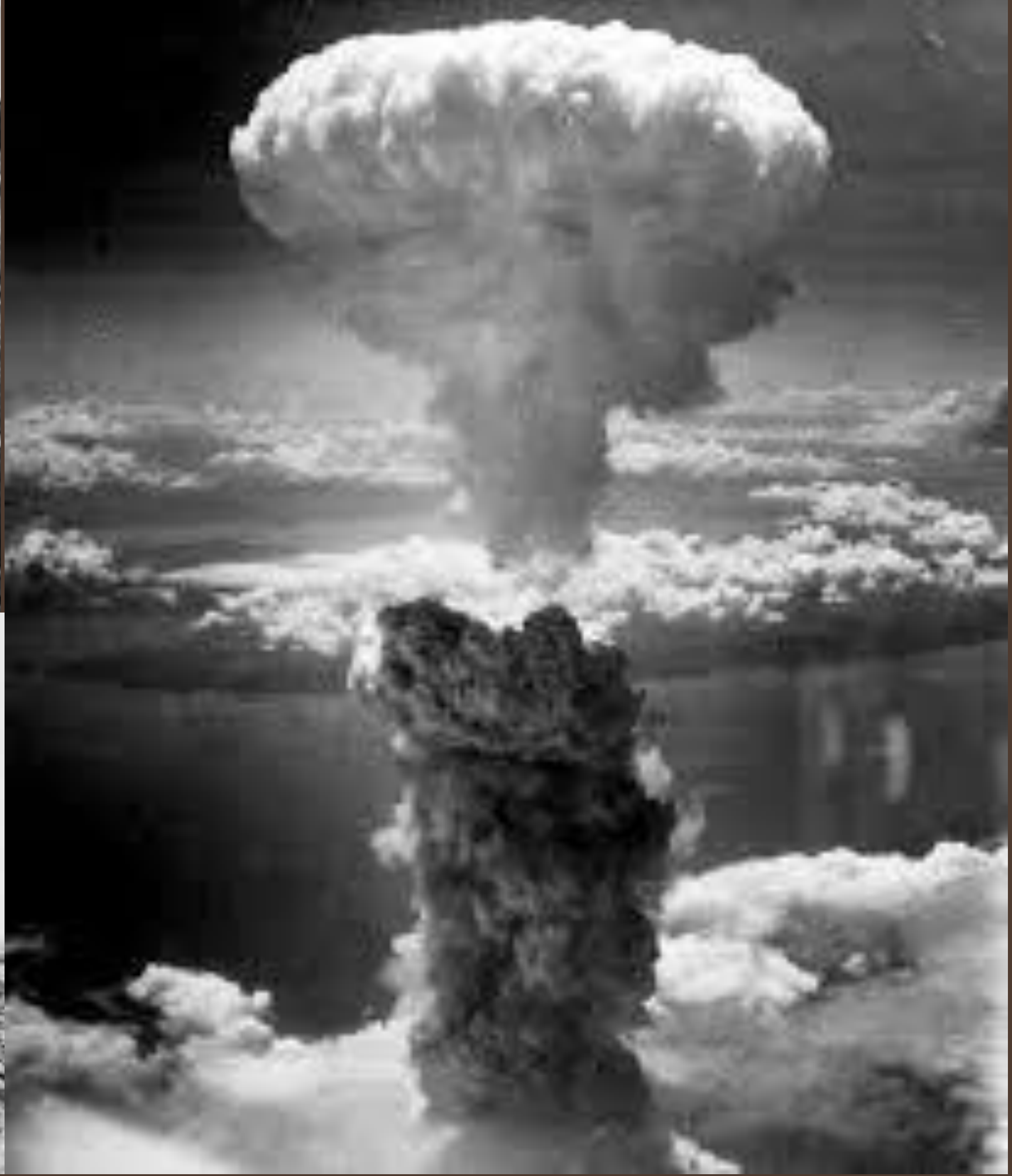
- Adam Smith: economic progress is through market specialization (invisible hand)
- David Ricardo: Growth = Savings + Investment + Accumulation of capital
- Karl Marx: capital accumulation = central driving force of growth
- Roy Harrod and Evsey Domar: Growth = Investment + Capital
- Robert Solow: Growth = Factor accumulation + Innovation
- Hollis Chenery: Poor countries need forex in the absence of investment and saving

Converging viewpoints

- Capital and investment are critical to economic growth
- Governments (state) and private firms (market) have roles to play in economic development
- What is the appropriate role of states and markets in economic development?

Experience of Post WWII Europe and Japan

- Devastation in Europe and Japan
- $25 billion aid to reconstruct Western European (Marshall Plan); $7 billion aid to reconstruct Japan (Dodge Plan)
- Results were immediate and direct; high growth rates in Western Europe and Japan
- To strengthen ties with Western Europe and Japan and to contain spread of communism



Clockwise from top left:

Destruction of St. Paul’s Cathedral, London; atomic bomb over Nagasaki; destruction of Hiroshima

Clockwise from top left: electric bulbs production line at Shibaura Electric company; women help clear rubbles, France; Germany rebuilds its infrastructure

Experience of developing countries

- Difficulties in starting modern industries in developing countries
- Initial response: provide capital (Hollis Chenery)
- Little development progress despite flow of foreign aid
- Reasons: no market, no skills, no capital

Development assistance

Rural water supply project, Cambodia

Humanitarian assistance, Ethiopia

Primary education, Indonesia

Road construction, Vietnam

Rural health, Philippines

Hydropower plant , Srilanka

Experience of the Soviet Union

- Central command Soviet Union growth model seemed to be working
- Allocation of resources done by the state
- However the system was inefficient and became irrelevant after the collapse of the Soviet Union

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WHAT MADE THE DIFFERENCE?

Western Europe and Japan

- Institutions, legal systems, and know-how were intact
- Key institutions were embodied in people
- Key business decisions by the private sector

Developing countries and the Soviet Union

- Less developed countries: inherited colonialism, where capital was in the hands of colonialists
- No functioning markets; government decides on allocating resources
- Communists: resource allocation by the state; emphasis on heavy industry and agriculture production

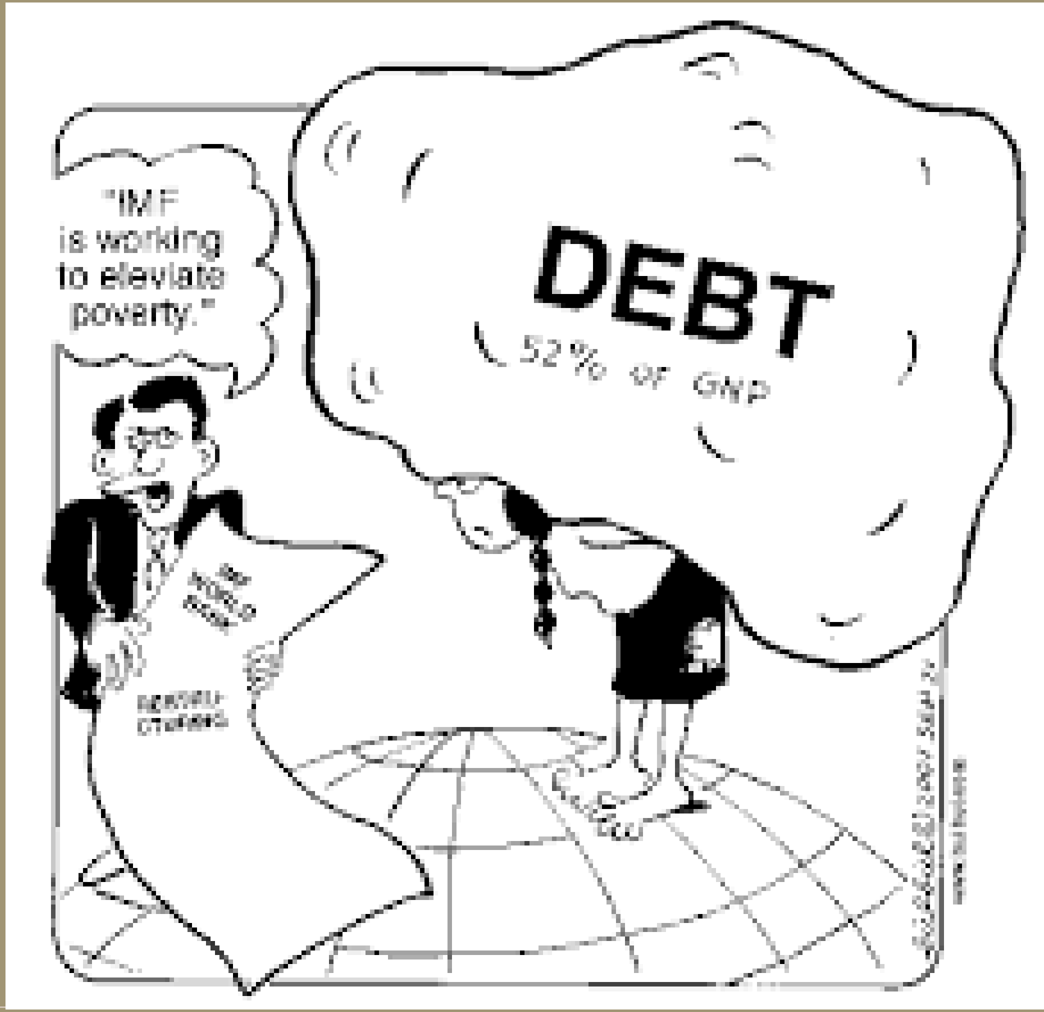
DEVELOPMENT APPROACHES

State-led growth, 1950s-70s

- Government intervention to achieve economic growth
- The Soviet “central command” approach was preferred; governments prepared national economic development plans
- Developed countries provided foreign capital and assisted in designing and managing development projects

Shift to market mechanisms, 1970s-80s

- Foreign aid to developing countries became ineffective; too much debt and few results
- Emphasis on economic growth, not on how benefits of growth are distributed
- Shift in thinking: government interference impedes growth, therefore bureaucracy should be minimized



Shift to market mechanisms, 1970s-80s

- Latin American countries began to pull out of the debt crisis
- The Soviet Union collapsed in 1989
- Eastern European countries broke away from the Soviet Union
- Baltic states became independent: Estonia, Latvia and Lithuania
- China, Viet Nam, Cambodia and Lao PDR embarked on economic reforms
- Modest reforms in India

Transition to market based economies

Countries faced heavy debt burdens, inefficiencies, and hyperinflation, particularly in centrally-planned economies

Lessons on economic transition

- Governments were able to curb hyperinflation and relax price controls
- Short-term drop in GDP and rise in unemployment
- Medium-term economic depression
- State-owned enterprises face difficulties competing a free market system because of subsidies and inefficiencies

Main lesson:

Economic transition in then short term is not easy

However in the long term if fundamental changes are made countries' outputs will generally improve

Commitment and political will are important

Structural adjustment, 1990s

- Poor economic performance and excessive government intervention: a detriment to development; therefore change is needed
- Reforms to restructure the economy to become more market-based, efficient, and open to international trade
- In 1990s, some countries were not able to repay their debts; World Bank made structural adjustment a conditionality to receive aid and loans

What are structural adjustment measures?

- Eliminate subsidies for food, fuel and education
- Eliminate tariffs
- Limit wage increases
- Abolish price controls
- Restructure state-owned enterprises

The 2000s and beyond

- Market-based reforms of the 1980s and 1990s had not addressed issues of equity
- Citizens of former Soviet Union states and Eastern Europe were not able to afford accommodation, food, and other basic necessities as subsidies disappeared
- Globalization marginalized those unable to compete
- Dissatisfaction with globalization increased and caused backlash

Conclusion

- The role of the states and markets has been a central focus of debate since the time of Adam Smith and even more so following World War II
- Following World War II, focus was on accumulating capital as key to economic growth; which was evident in the reconstruction of Western Europe and Japan
- The perceived success of the Soviet Union’s central planning model and the difficulties of newly-independent countries to develop pointed to the need for expanded government role and rejected reliance on market forces

THANK YOU!

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