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Economic development and 'free market'

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With the failure of effectiveness of economic planning in the East Europe and Soviet Union, it is assumed that the 'free market' economies provides the only viable path for the Third World countries to follow. However, the neo-classical economic model is based on many unproved assumptions and it also fails to take adequate account of the use of natural resources.

The current ascending view to resolve Third World crisis reflects the global reassertion of 'laissez-faire' ideology i.e. a policy of non-interference. It puts forward a very simple explanation: Most of the Third World, particularly Africa, is in deep crisis because the State has intervened excessively in their economy to follow with false model of development. According to them, the African political leaders and civil servants are responsible for this mess.

Development policies whose principal goal is to increase the Gross National Product (GNP), as opposed to meet basic human needs. Such policies can encourage the Third World to liquidate stocks such as forest resources to bring the flow of assets in the economy and thus can be destructive to their environment and ecology. The economic growth does not guarantee that living conditions for the majority of the poor will be improved. Many examples of the Third World such as Kenya, Nigeria, Zaire, Brazil, Chile and Argentina prove that the 'trickle-down' idea becomes rather a dream than economic reality. Hence, to rely on neo-classical model (free market theory), which dominates the economic analysis in the West, is fundamentally flawed and therefore unsuitable for the Third World.

Economic development is often measured in Gross National Product (GNP), which says nothing about the distribution of wealth in a country. It does not measure non-market transactions and therefore under-values natural resources. The use of GNP per head as a measurement was severely criticized by Seers and others (1). This was partly on statistical grounds, planner's inability to measure the concept at all adequately and partly on the theoretical grounds, that maximum growth of per capita GNP was quite consistent with many other things which reduced welfare or utility — pollution, moral and cultural decay and psychological alienation. The hidden cost of growth was

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The theorists have suggested various ways and means for the economic development of the Third World countries ranging from emphasis on domestic import substituting planning strategy to assistance from the multinationals. These involve technology and foreign exchange constraints and might pass on the control of these countries to the advanced capitalist countries. analyses *Kalim*

Siddiqui

non-marketable.

In 1924, Ludwig Von Mises and F Hayek jointly set up an Institute for Business Cycle in Vienna, with the major funds provided by the Rockefeller Foundation. The Institute was more concentrated on mathematical and econometric models. Both of them argued for "free market mechanism" that a competitive system free of all interferences by the government — would easily find an "equilibrium". Hayek was invited to lecture at London School of Economics by British economist Lionel Robbins from Vienna in the late 1920s. The year 1929-30 was the time when the western economy was in deep crisis and in Britain, one of the leading industrial nation, the ruling elite found Hayek's ideas very interesting. (2)

In 1931, when Hayek was propagating 'free-market' mechanism, there were already more than three million unemployed people in Britain. Same year, the Labour Party of Ramsay MacDonald had joined the Conservative Government to form a national government, which was supposed to cut public expenditure and real wages. Leaders from both parties were propagating that

the massive unemployment was due to high wages.

During the same period, J M Keynes was developing non-orthodox theory to find solution for the Depression. Hayek was given a job, in one of the most prestigious British Institute, London School of Economics, as to counter Keynes. Hayek's 'trade cycle theory' rejected 'deficiency of demand'. He emphasized that pumping more money during recession only make matters worse. His business cycle was the further development of Mises' business theory, which was deeply rooted in Austrian tradition.

In mid 1920s, Austria was a unique example, where both, liberal democrats and conservatives advocated against demand expansion and they considered this to be the enemy number one.

Ludwig Von Mises and F Hayek came from the old Austrian privileged urban elites whose economic and social well-being had been shaken, whose accumulated savings became worthless due to the post-war inflation. The remnants of the old elite who were deprived of their pre-war privileges, were shaken with the rising trade union movements.

In Ludwig Von Mises words: "To appreciate duly Dr Hayek's achievements, one must take into account political, economic and ideological conditions as they prevailed in Europe and especially in Vienna at the time the World War I came to an end". (3)

Indeed, in Vienna, in early 1920s, the traditional aristocratic middle class was shrinking, which undermined their place in the society and whose political power was eroded when the country chose 'democracy' in fear of revolutionary changes.

The Neo-classical theory assumes that there exist perfect markets, where buyers and sellers have perfect information about the present and future conditions of the markets. There is free entry into the market. The theory also assumes that the economic agents are rational and their decision is linked by the criteria of maximizing their utility and the factors of production are fully mobile from one sector to another. The theory treats individuals as equals and considers 'rational economic man' as supreme. They claim that the structure of a competitive capitalist economy makes it inherently self-regulating. These ideas are alien to many Third World countries.

Moreover, they argue that economic development will be improved by freeing private business from regulation by the state. It means that the state should dismantle regulatory structures in financial, labour and goods markets. It is said that the financial markets have their efficient operations.

For many years, these ideas were rehearsed in certain universities and among the academics in the West, without much wider recognition. The leading monetarist, Milton Friedman, has been long time propagating such ideas, which had remained unnoticed. But his theory came to light only in the economic crisis of mid-1970s, when it became necessary to re-create the conditions under which profits and capital accumulation could be increased.

Monetarist-theoricians emphasised that the policy of controlling the growth of money supply, letting it grow at fixed rate, establishes the economy and puts it on the path of growth. Accepting such policy and controlling the money supply is practically difficult for the governments. They can do so through the control of the banking system. Yet banks are subjected to the fluctuating demands for their loans and

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in any case are often able to avoid national controls through their international operations.

To control the money supply, the monetarists argue for drastic cuts in the government expenditure. As they perceive, growth of money supply is the main cause of inflation and government deficits cause excessive money growth, which means the policy of austerity should be followed. Capitalists oppose the policy of full employment through state spending for several reasons: if public spending goes to certain sphere which might compete private capital for profitable ventures; and the full employment policy will make labour scarce and it will also raise the wages and the bargaining conditions of the trade unions.

The assumption that under free competition, funds and loans go to most efficient producers is simply not true. The most profitable firms are not necessarily most efficient. Indeed, under liberalized financial markets, a large proportion of lendable funds often goes to unproductive, speculative activities which do not contribute to growth, but redistribute wealth in favour of rich. The government financial institutions which allocate cheap credit to the low

income groups, have often been established precisely because private financial institutions have concentrated on lending for unproductive investments, mainly to the capitalists. Contrary to the neo-orthodox theorists, most of the advanced capitalist countries have historically had a strong tradition of intervention in the labour markets.

In the early 1980s, the policy of austerity had become the new orthodoxy throughout the West, with taking over the leaderships by Reagan in the United States and by Thatcher in Britain. (4) In the Third World, it is being imposed in several countries by the International Monetary Fund (IMF) and by other creditors as a response to indebtedness which has grown out of control. Thus, the philosophy of laissez-faire amounts in effect to a policy of letting the inequality prevail, removing protection from the working class and the poor and exposing them to the full competition with capital.

According to neo-classical doctrine, the rapid growth is best achieved when economic decisions are left to private competing individuals or firms. Their belief is centred on the fact that the government regulation interferes with freedom of individuals and firms to choose the most profitable avenues for investment and thereby causes misallocation of resources. Thus, government is seen by the neo-orthodox as 'interfering in markets', shackling the operations of business, restricting the pursuit of profits and thereby discouraging investment. The laws related to improve working conditions and minimum wage legislation designed to protect the weak, low paid and unorganised from exploitation, are considered undermining the economic development.

Indeed, neo-classical economic theory leaves the economic decisions of the entire nation to the day-to-day commercial tastes of individual consumers. Consumers are assumed 'rational' and they will budget their monetary resources as it is best for them. It argues that the people's wants are best expressed by their behaviour in the market and thus a nation's future is supposed to be based on individual decision to invest. It gives rather very simplistic solutions and essentially for short period.

According to orthodox economic theory, world trade is beneficial to both the poor, Third World (who mostly export raw materials) and the rich advanced capitalist countries (who export

the same time the effects of the devaluation on the structure of comparative prices and on the balance of payments are cancelled out. It is doubtful if a further devaluation in African countries would improve the income of the peasantry and open the way for an upsurge in agricultural export. In mid 1980s, Mali, Zaire and many other countries devalued their currencies without the slightest benefits occurring to the peasants.

Moreover, the Fund always insists that devaluation should be accompanied by austerity, which means reduction in the standards of living of the poorest strata. The withdrawal of subsidies on most essential items seems to affect severely the poor. Fund further ensures that austerity does not affect the rich, who could easily bear the burden, have enjoyed the fruits of the past borrowing, have been responsible for the debt burden and have misused the debt. But instead it forces the poor to repay the debt, who have not been responsible for the debt buildup, the one who has gained nothing from the past borrowing.

Although, the Fund officials maintain that it is strictly neutral in the matter of distribution of austerity. This is simply not true. They know very well about who should bear the burden of withdrawal of subsidies. The Fund is also aware of the losers by cutting wages and social services. While it presses for the tax concessions to domestic and foreign investors, it advises in favour of changing the laws to facilitate foreign participation in the Third World.

The World Bank, the chief supporter on the 'market mechanism' in its report of African crisis (1984), finds that the main cause of Africa's problem lies in the 'market distortions', being generated by the state policies, whose leaders serve their own short-term interests. It argues that solution lies only if African leaders learn to adopt allocation efficient market-oriented policies.

For the last several years, Fund has campaigned to open Indian market to western exporters, technology and investment, whether or not they are needed in India. The success of this campaign was achieved in 1967-68, and has been accelerated in recent years. But the success was very slow despite long dependence of India on concessional sources of aid. The early 1980s saw a series of measures of import liberalization. Indian Government blamed rise in

oil prices for such high loans. But even after restoration of peace in Assam and discovery of more oil in Bombay sea, the trend has not changed.

International financial institutions desire that the Indian government create better conditions to attract foreign investors, including the removal of anti-monopoly laws and regulations. The large amount of foreign borrowings has made the Government more vulnerable

The ideology of free trade equates the self-reliance and protectionism with inefficiency, economic distortion and injustice. Yet the literal alternative to self-reliance is reliance on others, which means dependency and vulnerability

to the lenders advice. The result is that several new foreign collaborations were approved for manufacture of light commercial vehicle, computer industry and various other important sectors of the economy in the last three or four years.

In 1981, India got loan from the World Bank on easy terms. The Bank demanded to devalue the Rupee further and also advised the government to borrow more from commercial banks. The Indian Government plans to borrow about 2 billion dollars per year, while the Bank is urging to borrow more than 4 billion dollars per year. Of course, the Bank is happy as long as India repays the loan regularly. Indeed, Bank is trying to create a situation where foreign investment and technological collabora-

tion (or exploitation) takes firm roots in India. The rich in India are being accustomed to imported consumer goods. Similarly, now several Indian industries are increasingly dependent on imported inputs and technology.

Let us study another example of Zambia, where recently a sharp rise in maize prices, the staple food of the country, led to several demonstrations in the country. To understand the present mess, I am trying to look into the economic situation of the country since the last twenty five years.

In 1965, Zambia's copper export accounted for 43 per cent of the Gross Domestic Products (GDP), 61 per cent of the government revenue and 49 per cent of the export earnings. But latter situation changed drastically and in 1975-76, copper contributed only 14 per cent of the GDP, 3 per cent of government revenue, but still 90 per cent of the export earnings. Even then when price was low in 1979, mining of copper was increased, mainly to earn more foreign exchange.

In 1971, after a fall in copper production due to Zambia's largest mine closure at Mufulira, the country was in a desperate need of foreign exchange and approached the IMF for loan. The mine was restored in 1972, but still export earnings did not increase. The terms of trade declined, while at the same time imports went up. The result was low economic activity and deterioration of budgetary and balance of payments situations. The country was forced to borrow again from the IMF.

On the Fund's advice on domestic sphere, the government was asked to constrain public expenditure. Wage freeze for government employees was imposed and a limit was put to government borrowing from the central bank. More credit was extended to the private sector in order to encourage investment. By early 1980, the country faced increased shortage of foreign exchange and during that period, copper price further dropped by 40 per cent, while the import prices rose and the country's balance of payments position was exacerbated. Fund's advice was to diversify the country's exports and first time it was aimed to reduce country's vulnerability to the fluctuations in copper prices.

The government in an effort to encourage agriculture output, increased the prices for agriculture products substantially. The main crops (maize) price was raised by 25 per cent. To con-

strain domestic aggregate demand, the government implemented a wage freeze for three years and subsidies to the consumer goods were reduced by 60 per cent. But despite all these measures, the economic situation did not improve and imports continued to rise. Industrial Development Act was passed to attract foreign investors, but it was not very successful.

The government was further forced to ask for more favours from the IMF and an agreement was reached on 250 million dollars in 1978. Zambia was forced to agree that it would adopt comprehensive measures to restore overall balance of payments equilibrium. To achieve this, the country was expected to keep domestic demand low, which means living standard for the employees and poor was supposed to fall. It also assumed that prices of copper in foreign market would improve. The Fund emphasised on the restoration of the financial viability of the mining companies. For this, mining sector was forced to suspend operation in certain high-costs mining sites and reduced some of the social services it provided to its employees. In order to rationalize the mining industry, a considerable number of the workers were sacked (9).

In agriculture, the measures were taken to develop food production and export crop cultivation. In an effort to improve domestic terms of trade for farmers, prices of the agricultural products were raised every year between 1984 and 1988, besides the new investments which were concentrated on quick yielding projects, but the economic situation deteriorated.

The 'free market' idea, articulated by the most influential multilateral agency, the World Bank, asserts that market discipline, private sector initiatives and export promotion explain the success of the Newly Industrialized Countries (NICs) such as South Korea, Taiwan, Singapore and Hong Kong (10). They idealize East Asian model of development by emphasizing a consistent policy package of 'getting the prices right for efficient resource allocation and for stabilization of the balance of payments'. Their interpretation about South East Asia distorts the record. In fact it was in these countries that the state intervention was very much an active policy in the early periods of their industrialization.

Analysis of South Korea, for example, points to strong role of the state in

directing the industrialization process. State intervention has also been strictly followed in agriculture, as the States have mobilised bureaucratic resources to direct agricultural production in support of projects, who were closely linked with the creation of strategic agro-industrial linkages. The South Korean green revolution campaign to achieve rice self-sufficiency illustrates the state's role in fostering intersectoral

ment was forced to implement land reform measures in order to strengthen the rural support.

The State had been directly engaged in reorganizing society for more effective capital accumulation through its banking, marketing and entrepreneurial activities. In South Korea the state has, in effect, created a capitalist class, which has become strong enough to bargain from the government (11).

The experience in the Third World shows that present trading patterns, far from enriching the Third World, are leading to further impoverishment of its people, and locking them into an international market over which they absolutely have no control

linkage.

In agricultural sector, the state has interfered in the markets for strategic agriculture commodities. The basic legal foundation for state control has rested in the Grain Management Law in 1950, which gave the government wide-ranging budgetary and administrative authority to purchase, store and fix prices for agricultural commodities. To a considerable extent, state intervention policy incorporated agriculture producers into national markets in a way that generated widely distributed increases in farm income and enabled the rural inhabitants to purchase industrial and consumer goods.

The early 1950 land reforms paved the way for the emergence of more dynamic agro-industrial linkages. The impetus for land reform can be traced to peasant uprisings that began in 1930s in response to harsh tenancy conditions and colonial foodgrain requisition policies which squeezed the Korean peasantry. The land reforms became more important to undermine the landlords power holds, who collaborated with the Japanese colonial authorities. The land reform in the North Korea also influenced the people, who intensified their land reform demands. Thus, the govern-

Moreover, the war in Korean peninsula provided the country with more foreign funds and western markets. The militarization of society that occurred as a consequence of the Korean War strengthened the military and state control, especially with the 1961 coup that brought General Park Chung Hee to power, over the people. Since then military generals have continued to hold the top positions within the administration. The trend continued until recently when the massive demonstration forced to hold popular election in 1987.

In 1971, the government created an Economic Planning Board to provide high level policy analysis and to coordinate responses within a differentiated bureaucracy to support the development target. In the 1970s, the gap between rural and urban households increased. By 1971, rural per capita income levels were estimated at one-third of the urban levels. This income gap threatened the Park regime's base in the rural areas. The government decided to raise the rice prices to promote production and to increase the income of the peasantry. The result was an impressive reduction in the rural-urban income gap that coincided with the increased culti-

vation of the new varieties of rice.

One of the major industrialization initiatives in Park's regime was to establish a domestic fertiliser industry. Joint venture agreements between United States and Korean government were signed to build fertiliser industry. The Korean government assumed full responsibility for marketing the products. The industry was not economically efficient in neo-classical comparative advantage terms. Budgetary subsidies were extended to support the industry. Cheap fertiliser prices encouraged the consumption of fertilisers for the new rice varieties. Many more industries were developed, as the rural households demand increased for agriculture machinery.

In Taiwan also, after the World War II, the government carried out significant land reforms. It led to selling of the public farm to tenants and a ceiling was placed on the ownership of three hectares for each farm worker. The state then purchased excess land resale to the farmers. After the war, Taiwan was subjected to mainland occupation and they used military to destroy all opposition to the new government. Thus, the government was able to carry out a massive transfer of previously accumulated surplus through the imposition of extensive land reforms.

During the land reform, the land was bought at very low price by the government and the landlords were paid in bonds and stocks in manufacturing enterprises. The government later imposed agriculture tax, which allowed the government to transfer currently produced income from agriculture sector through taxation. The government also launched the operation of rice-fertiliser barter system. This led to a dramatic reduction of political power of big land owners in the rural areas and also their power to control agriculture surplus. As a result, a substantial saving was mobilized for the industrial sector.

The upholders of the 'free market' idea look towards the market as the major guide for economic decision making. In 1930s severe economic crisis led to fall of the idea of self-adjusting markets even for the advanced capitalist countries. Kalecki pointed out exclusive reliance on protectionist industrialization is the principal solution to the problems of the economic backwardness of the poor countries. He also referred in this context the need for land reforms to overcome the institutional

barriers posed by the agrarian structure (12).

R Prebisch, a well known Latin American economist, made a break with the orthodox theory and also rejected the Ricardian notions of comparative advantage and international specialization. He believed that those ideas restricted the role of Latin American countries in the world trade to their being exporters of only primary commodities, a part from causing secular deterioration in their terms of trade.

The idea that labour-abundant countries should be able to export commodities which involve intensive use of labour by providing employment as well as increasing foreign exchange earnings derives strong support from Heckscher-Ohlin model of the international trade.

Thus arises a crucial question as to how to follow the neo-classical pattern of economic development and export intermediate consumer goods, without an industrial base? For this, some would advise to follow a domestic import-substituting planning strategy, while others might prefer to take the help of multinational corporations. The former strategy involves problems of technology and foreign exchange constraints, while the latter would appear to provide an easy solution to acquire foreign technology and capital and will help to market the products abroad. It simply means to further the control of advanced capitalist countries on the Third World (13).

The neo-orthodox theorists completely ignore the important factors which were favourable to the fast growth of the NICs economics. Important among them: high commodity prices;

increasing demand of the consumer goods in the western markets; they had easy access to foreign loans to finance their industrial investment and favourable world trade. Furthermore, NICs were specializing in different products of primary commodities and there was not much competition among themselves. However, these countries have very little relevance for formulating development strategies for big countries like India, China, Brazil and Mexico.

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