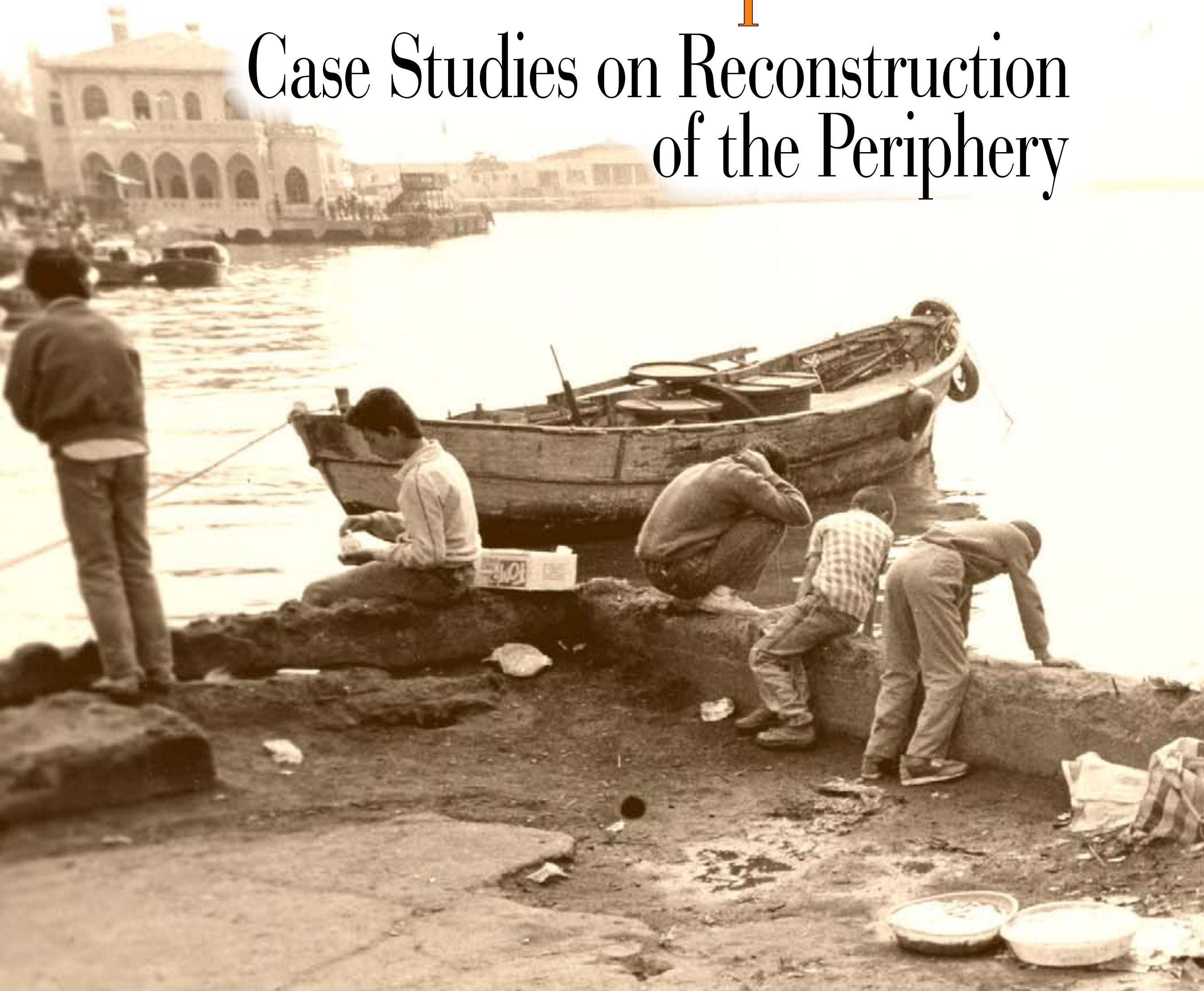
Neoliberal Globalization as New Imperialism

Case Studies on Reconstruction of the Periphery



Ahmet H. Köse ▪ Fikret Şenses
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Editors

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AHMET H. KÖSE
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INTRODUCTION

At the turn of the millennium, the neo-liberal orthodoxy juxtaposed a new set of conditionality as part of its hegemonic agenda on the developing world: privatization, flexible labor markets, financial de-regulation, central bank independence, flexible exchange rate regimes, and fiscal austerity. To this end, integration of the developing nation-economies into the evolving capitalist system has already been achieved through a series of policies aimed at liberalizing their financial sectors and privatizing major industries. Furthermore, the state apparatus had to be transformed to facilitate the hegemony of international finance capital.

The neoliberal ideology attempted to explain the motives behind financial liberalization arguing that such measures would restore growth and stability by raising savings and improving economic efficiency. A major consequence, however, has been the exposure of these economies to speculative short term capital (hot money) attacks which increased instability and resulted in a series of financial crises in the developing countries. Furthermore, contrary to expectations, the post-liberalization episodes were inflicted with the divergence of domestic savings away from fixed capital investments towards speculative financial instruments with often erratic and volatile yields. As a result, developing economies with weak financial structures and shallow markets suffered from increased volatility of output growth, shortsightedness of investment decisions and financial crises with severe economic and social consequences. Often the economic crises were realized hand in hand with the ensuing political crises. All these led to severe contraction of labor incomes and increased unemployment together with marginalization of the work force, and resulted in violation of basic labor rights in trade union activity, deprivation of rights to engage in collective bargaining and participatory democracy.

The historical importance of these crises is also revealed in their significance as a serious blunder to the neo-liberal orthodoxy, rather than just the pure economic/political mishaps. The Turkish and the Argentinean crises, for example, which erupted in the midst of an IMF-directed adjustment programs, became the clearest examples of how in an indigenous economy the unfettered workings of the myopic markets can serve as the main source of disequilibrium thorough the speculative attacks of international financial capital flows. Furthermore, with the recent attempts towards full liberalization of the capital account under pressures from the US and the IMF (the so-called Washington consensus), governments lost their independence in designing a strategic mix of these instruments for promotion of industrialization/development targets. As open capital markets replaced closed short term capital markets and regulated flows of foreign investment, governments became unable to

employ their traditional policy instruments (interest rates, government expenditures, and exchange rates) unilaterally.

This book attempts to bring together, both theoretically and empirically, a variety of contributions on the ideology of neoliberal globalization as a new phase of global capitalism-cum-imperialism. Trumpeted with the rhetoric of TINA (***T**here **I**s **N**o **A**lternative*) the neo-liberal orthodoxy has become the dominant ideology today in restructuring the periphery of global capitalism. This book addresses the diverse economic structures of the global periphery and tries to deduce lessons on the current global crisis conjuncture of global capital in governing the world.

The book is a follow-up study to the two volumes published in Turkish in honor of Korkut Boratav and Oktar Türel, leading scholars in the field of economics. It consists of thirteen studies mostly by Turkish scholars at home and abroad, on a wide range of topics, dealing with various aspects of neoliberal globalization from a critical perspective.

Ahmet Haşim Köse,
Fikret Şenses,
Erinç Yeldan

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Chapter 1

NET RESOURCE TRANSFERS AND DEPENDENCY: SOME RECENT CHANGES IN THE WORLD ECONOMY

Korkut Boratav

"If you want to hang yourself, use an English rope"
A popular Turkish saying from the 19th Century

1. INTRODUCTION

The paper aims to investigate some of the changes taking place between the periphery and the metropoles of the imperialist system in terms of relations of exploitation, net transfer of resources and mechanisms of dependency. A discussion of the conceptual framework is followed by a presentation of empirical findings. Quantitative findings are predominantly based on an analysis of balance of payments and GNP/GDP data for the post 1980-years of 26 developing (and mostly non-oil exporting) economies from Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru), semi-industrialised Africa (Egypt, Morocco, Tunisia, South Africa), sub-Saharan Africa (Cameroon, Côte d'Ivoire, Ghana, Kenya, Tanzania, Uganda, Zimbabwe) and Asia (China, India, Indonesia, South Korea, Malaysia, Pakistan, Philippines, Thailand, Turkey).

2. EXPLOITATION, RESOURCE TRANSFERS AND DEPENDENCY

The relationship between the metropoles and the periphery of the imperialist system rests on two pillars: *Exploitation* and *dependency (*or*, domination)*. Unless it is outright plunder, exploitation pre-supposes an initial transfer from the metropoles to the periphery. This initial transfer also contributes to the generation of dependency/domination relations between the periphery and the metropoles. The emergence of structural dependency affects patterns of exploitative relationships thereafter.

Relations of exploitation are generated through three channels: International trade, foreign investment leading to ownership of means of production (or, in more conventional terms, foreign direct investment) and lending/borrowing (finance capital).

Trade-related exploitation takes place through the relations of distribution between the direct producers in the periphery vs. the commercial capital in the metropoles and their *de facto* representatives in the periphery. The conceptual framework for an analysis on these lines is least complicated for trade in primary commodities exported by the periphery[1]. The relevant agents within the distributional process are (a) direct producers, merchant capital and the state of the peripheral economy; and (b) transnational, commercial capital and the state of the metropoles. The ratio of value-added accrued by (b) over (a) represents the rate of exploitation of the peripheral economy by the metropoles through trade. The chain in which the foregoing agents (starting with the direct producer and ending with the final consumer/user) are involved can be disaggregated into specific stages. Each stage within the chain usually consists of a discrete market -i.e. the market for basic inputs of direct producers, the domestic market and the international market of the primary commodity, the market at the final destination. Distributional trade-offs are reflected by the prices paid and received by the actors confronting each other –i.e. the farmers/peasants vs. the suppliers of basic inputs; the farmers/peasants vs. domestic merchant capital; exporters vs. TNCs specialised in international trade in primary commodities; final users/consumers vs. TNCs. The final price net of components of value added and costs at intermediate stages of the marketing chain (e.g. due to transportation, storage and processing) can be disaggregated into the shares of the relevant actors/agents. Relative price movements at each marketing stage, i.e. domestic and international terms of trade movements, *as far as they are not reflections of changing productivities,* represent the direction and magnitude of *distributional changes* between the relevant agents[2]. The empirical analysis of the post-1980 period in what follows excludes estimates on surplus extraction and transfers *through trade* between the two poles of the imperialist system.

Exploitation via industrial and financial capital at the metropoles is represented by surplus in the form of profits and interest revenues (and realised capital gains). When surplus extracted within the peripheral economies is transferred abroad and when the magnitude exceeds resource inflows, *net resource transfer from the periphery to the metropoles* becomes the dominant pattern[3]. Empirical specification and quantitative estimates of resource transfers in this sense will be undertaken in the following sections of the present paper.

---

[1] Some recent studies have been concluding that exports of manufactures from the periphery (and their terms of trade movements) are starting to exhibit characteristics of primary commodity exports. See e.g. Maizels (2000) and UNCTAD (2002), Chapter IV.

[2] The labour theory of value, in my view, provides the ideal analytical framework for the distributional analysis of international trade which, however, confronts empirical barriers. For a detailed conceptual specification and empirical analysis on the foregoing lines within the African context, see Boratav (2001: 395-416) and UNCTAD (1999: 44-53), this publication is a reprint of Part Two of UNCTAD (1998).

[3] Conditions in which surplus transfers through trade between the metropoles and the periphery take place also affect -albeit indirectly and in non-unique fashion- net resource transfers in this sense: When trade-related surplus transfer to the metropoles rises through declining terms of trade for a peripheral country under *unchanged trade balance in nominal terms*, net resource transfers remain unaffected. *Unchanged trade balance in real terms* under declining terms of trade results in rising trade deficit in nominal terms (i.e. net resource transfers from abroad). If foreign borrowing to cover rising nominal imports (so as *to sustain the real level of imported goods*) is not available, a trade surplus (or declining trade deficits) will be required which implies net resource transfers from the peripheral economy to the metropoles (or reduced resource inflows). In all three cases, regardless of the direction of net resource transfers, the rate of exploitation of the peripheral

3. A HISTORICAL DIGRESSION

Economic relations between the Ottoman Empire and Britain during the 19th century provide typical examples of the foregoing linkages: The free trade agreement of 1838 resulted in *improvement of terms of trade,* i.e. trade-related transfer in favour of the Ottoman economy during the first decades of the free trade regime. Roughly unchanged trade balance under improved terms of trade signified higher real levels of imported goods and of consumption (e.g. “cheaper English rope”). In the meantime, the consequence of cheap industrial imports was the widespread disappearance of traditional industries (e.g. “domestic rope production”). In other words, a *structural external (trade-linked) dependency* on the supply of basic goods accompanied favourable price movements. This was how the new international division of labour was taking root in many parts of the globe. After the essential contours of this external dependency was completed, a *reversal* of Ottoman terms of trade took place – deterioration by 35% within four decades in the second half of the 19th century (see Table 1). This implied a reversal of the preceding direction of trade-related resource transfer.

Table 1. Net Resource Transfers from and to the Ottoman Empire and Terms of Trade, 1830-1923

-	Net Resource Transfer, Million pounds sterling, annual average*	Annual Percentage Change in Terms of Trade
1830-1839	-0.17	NA
1840-1852	+0.21	Apparently rising
1853-1858	-2.40	-1.52**
1859-1963	+1.06	-3.46
1864-1875	-1.62	-0.33
1876-1908	+2.31	+0.27
1909-1913	-4.06	+0.11
1839-1913	*+0.33*	*-0.24***

Source: Calculated from Tables E-2.1 and E-6.4 in Pamuk (1994).
*: Positive values signify net transfer abroad from the Ottoman economy and *vice versa* for negative values (see text for definition).
**: Base year: 1854.

On the other hand, near the beginning of this second phase another mechanism of resource flows and dependency emerged: 1854-55 are the first years of substantial external borrowing by the Ottoman state initially to contribute to the financing of the Crimean war. An additional, but somewhat related factor was the seven-fold increase in the trade deficit in a single year, i.e. 1855. External borrowing gained an autonomous momentum used to cover rising and chronic fiscal deficits. Foreign direct investment gradually started to reach substantial levels as well. Thereafter a new cycle of *resource transfers through borrowing*

economy rises through adverse terms of trade movements (compare columns 2 and 3 of Table 1 in this context).

and direct investment from the metropoles→surplus extraction→surplus transfer→reversal of net resource transfer emerged. As Table 1 shows, the initial years (i.e. 1853-1858) were a period of net (capital-movement-related) resource flows into the Ottoman economy accompanied by the emergence of new (economic, fiscal and political) forms of dependency. As interest revenues on the debt and profits from direct investments grew (surplus extraction) and as their transfer (and, at times, the amortisation of the principal of the debt stock) to the metropoles (surplus transfer) exceeded capital inflows, direction of net resource transfers between the metropoles and the periphery was reversed (i..e.1876-1908). Finally, a resurgence of external borrowing and rising current deficits during the following five years leading to the First World War reversed the direction of net resource transfers, once again favourably to the Ottoman economy.

Table 1 depicts the periodisation based on the direction of net resource flows between the Ottoman economy and the metropoles and presents terms of trade data for each phase. It is significant to note that the overall trend for the whole period, given in the last row, turns out to be adverse, both for net resource transfers and terms of trade for the peripheral economy.

The foregoing nineteenth century example, in my view, provides the contours of metropole-periphery relations of recent decades as well. Prevalence of external exploitation under contemporary imperialism requires initial and ongoing resource transfers from the metropoles. In other words, surplus extraction by metropolitan capital cannot grow unless rising levels of financial, industrial and commercial capital are “exported” to the periphery. Such resource flows are accompanied by ongoing and, at times, new patterns and mechanisms of dependency which generate favourable conditions for metropolitan capital. Once again, *surplus extraction within the periphery* is not identical to *surplus transfers from the periphery* (exploitation can take place without a corresponding surplus transfer -e.g. profits reinvested in the periphery). The net balance between resource flows into the periphery and surplus transfers from the periphery is defined as *net resource transfers* in the present paper. The direction and magnitude of these transfers change over time. Our data and findings suggest that, depending on conjectural factors within national economies and within the world economy, there is a pendulum-like movement of net resource transfers — favourable phases for the peripheral economy followed by net resource outflows. The present phase appears to be one where *transfer of net resources out of the periphery* is starting to characterise the imperialist system.

4. EMPIRICAL SPECIFICATION OF NET RESOURCE TRANSFERS

Under simplified conditions resembling the 19th century, *capital inflows* from the metropoles result in *interest and profit remittances* from the periphery and the difference between the two provides the magnitude and direction of (capital-movement related) net resource transfers between the two poles of the imperialist system. This is, roughly, how the World Bank (WB) measures *net transfers*[4].

[4] The empirical definition in World Bank’s *Global Development Finance* is: Net transfers = Net resource flows – (interest on long term debt+profit remittances). And, net resource flows = (Net flow on long term debt+net FDI +Portfolio equity flows+grants). In terms of empirical coverage, the definition excludes interest transfers on short term debt, as well as short term non-equity inflows. Unlike other items, portfolio equity flows in WB’s definition are not “net”, i.e. outflows are excluded.

Under the contemporary and more complex pattern of international transactions between the developing and developed economies, WB's definition (see note 3 below) is unsatisfactory for the following reasons: (i) WB's estimates exclude important items of capital inflows and interest outflows. (ii) Under current conditions, certain items of capital inflows do not correspond to net resource inflows to the peripheral economy due to substantial and rising *leakages* (e.g. capital outflows by residents) therefrom (see below for further clarification). (iii) Interest transfers and profit remittances from abroad to the peripheral economy are disregarded.

Instead of an item by item specification through the capital account, the present paper opts for a more practical method directly through the current account: In empirical estimations net *resource transfer* is defined as *the current account balance minus the net income account* (the net balance of interest transfers and profit remittances) of balance of payments. Positive (negative) values signify net transfers abroad (from abroad).

5. BEFORE AND AFTER CAPITAL ACCOUNT LIBERALISATION

The *incomes balance* used in quantitative measurements of *net resource transfers*, is one of the four major components of the current account of balance of payments statistics. *Commodity trade balance, service trade balance* and *current transfers* are the remaining three components. A negative incomes balance signifies that surplus (i.e. interest and profit) transfers abroad exceed surplus revenues from abroad –a typical case for a peripheral economy[5]. Table 2 presents the net resource transfer (i.e. the current balance *minus* the incomes balance) as shares within GDP for the unweighted averages of 26 developing economies classified under four regions and by four sub-periods covering the 1980-2003 years. The full decomposition of the current balance into its four major components for the 26 countries in the four regions as well as regional averages are presented in Annex Tables A-E.

In terms of periodisation, the pre- and post-1990 years should be seen as an important dividing line. This is because capital account liberalisation in the South became widespread around 1990 for the majority of countries covered in the tables and this was a crucial factor affecting the magnitude and direction of net resource transfers between the poles of the imperialist system thereafter. This makes pre- and post-1990 comparisons significant. The exception is with the Southern cone of Latin America which passed through a phase of external financial liberalisation during the late 1970s resulting in a widespread external debt crisis affecting the region as a whole throughout the 1980s. A further division is useful between the period 1990-97 and the following years. The early phase represents a boom in international and predominantly short-term, "hot" capital flows into the periphery. Reversals leading to financial crises were the exception which took place only in Turkey (1994) and Mexico (1995) -in the latter case with a limited "Tequila spillover" into Argentina as well. The 1997-1998 East Asian crisis started a new phase in which capital outflows from developing regions leading, at times, to financial crises became much more widespread.

[5] Our annual data for the 26 countries incorporate 587 observations 557 of which give negative balance for the net income account with only 24 positive observations. Positive income balance for recent years of one country (Philippines) is, probably, due to the recording of workers' remittances at the incomes account instead of inclusion at the "current transfers" item.

International capital flows from the metropoles to the periphery declined thereafter. The periodisation in Table 2 and in Annex tables A-E is based on the foregoing observations[6].

Table 2. Net Transfers Abroad and Their Components
Unweighted Regional Averages (% of GDP)

	Current Account/ GDP	Income Balance/ GDP	Transfer abroad/ GDP
Latin America			
1980-1989	-3.53	-5.35	1.82
1990-1997	-3.00	-3.19	0.19
1998-2000	-3.35	-2.73	-0.62
2001-2003	-0.95	-3.44	2.50
Semi-industrial Africa			
1980-1989	-3.42	-3.53	0.11
1990-1997	-0.64	-2.98	2.34
1998-2000	-1.75	-2.17	0.42
2001-2003	0.29	-2.89	3.18
SSA			
1980-1989	-4.86	-3.16	-1.41
1990-1997(*)	-5.45	-4.00	-1.45
1998-2000(**)	-5.05	-2.27	-2.78
2001-2003 (**)	-2.27	-2.54	0.27
Asia			
1980-1989	-2.19	-2.12	-0.07
1990-1997	-2.82	-1.59	-1.23
1998-2000	4.54	-2.16	6.70
2001-2003 (**)	3.35	-1.84	5.19
Total Developing			
1980-1989	-3.41	-3.36	0.03
1990-1997 (*)	-3.23	-2.82	-0.41
1998-2000 (**)	-0.48	-2.33	1.85
2001-2003 (**)	0.59	-2.56	3.15

Source and Notes: IMF, *Balance of Payments Statistics* (various years) and UNCTAD data base for 1980-2000 data. 2001-2003 data are not consistent with the preceding years. For this period, GDP data is on World Bank World Development Report 2003, 2004 and 2005; balance of payments data are from IMF (2004).

(*) 1990-94 for Zimbabwe; 1990-95 for Cameroon. (**) Excludes Cameroon & Zimbabwe. 1998-99 data for Uganda; 2001-2002 data for Tanzania, India, Indonesia and Malaysia.

The relevant linkages as they have emerged during the past decades are as follows: Capital account liberalisation leads to an initial and substantial increase in foreign (non-resident) capital flows into peripheral economies. The first stage (i.e. 1990-1997) represents net positive (inwards) resource transfer reflected by growing current account deficits despite

[6] The two sub-periods, i.e. 1998-2000 and 2001-2003, used in Table 1 and Annex Tables A-E, are artificial; but that division has been necessary because of the differences in the data base and in quality of the data before and after 2000 (see note to Table 2).

the fact that *net foreign inflow→rising current deficit* transmission is affected by the presence of "leakages", i.e. outflows by residents and reserve accumulation (hoarding). FDI and portfolio-equity inflows generate profits and capital-gains; other inflows contribute to rising levels of external debt and generate interest revenues. As these surplus items are transferred abroad, their growth may exceed the growth of the current deficit, and at a particular moment (e.g. around 1998 for many countries), the situation is reversed and the national economy starts pumping net resources abroad. The situation becomes more serious if and when the peripheral economy falls into a financial crisis. When international banks start closing their credit lines, the principal of the external debt (and/or the repatriation of portfolio investments) has to be serviced as well. This means negative net non-resident flows which aggravate the situation. Further declines in current deficits or the emergence of current surpluses occur. This is the lowest point of the financial cycle which may, thereafter, move, once again, into an upward phase of renewed inflows and net transfers inwards[7].

6. REGIONAL BREAKDOWNS

The pattern, periodisation and magnitude of this cycle is specific for each peripheral economy. However, on the basis of the annual data used to construct Table 2 and Annex Tables A-E, a number of general observations are possible:

The Latin American pattern: The debt crisis of the early 1980s struck all six Latin American countries covered in our sample in varying degrees and the balance for the 1980s up till the mid-1990s shows net transfers to the metropoles (see Table 1 and Annex Table A). The situation improves gradually after 1990 and the region as a whole starts to benefit from net resource transfers from the metropoles during the late 1990s. However, this favourable phase appears to be a short one. By 2001-2003 all countries except Mexico were, once again, transferring resources abroad and the regional average (+2.50%) had exceeded the 1980s' average (1.82%). Declining current deficits and significant deterioration in the incomes balance have jointly contributed to the emergence of net resource transfers from the region.

Semi-industrial Africa is a sub-region of net resource outflows throughout all periods; but the regional averages are affected by –at times- erratic variations in individual countries. This sub-region has been spared the turbulence of Asian/Latin American-type of financial crises of the post-1997 years and the resource balance improves during the late 1990s –with the exception of Tunisia. Once again, the improvement turns out to be temporary and the regional average deteriorates significantly in 2001-2003 (see Table 2 and Annex Table B).

Sub-Saharan Africa (SSA): Official flows have traditionally dominated international capital movements into SSA. Private inflows as percentage of GDP declined during the 1990s and speculative, "hot" capital movements have been marginal throughout (see Annex Table F). Rising levels of official lending and modest, but continued bank credits had resulted in roughly stable and modest net resource inflows up till the early 1990s[8]. Higher current deficits were accompanied by a huge build-up of the external debt and rising interest/profit

[7] The financial cycle's linkages with domestic distributional indicators is another significant line of inquiry: The anti-labour impact of financial crises have acted as a "corrective" to the process of profit squeeze which appears to have occurred during the "boom" phase of the cycle in Latin America and Turkey. See UNCTAD (2000b: 61-68).

[8] See UNCTAD (2000a).

remittances. Ultimately, the full servicing of the external debt turned out to be unsustainable and, in many cases, arrears on interest payments have been added to the debt stock and, *de facto,* (and in accounting terms) restrained the further deterioration of the incomes account. Debt relief in some countries and ongoing arrears on interest obligations in others led to significant improvements in the incomes account between 1998 and 2000 and contributed rising ratios of net resource inflows. Moreover, the region has been spared from the contagion of the post-1997 financial crises. However, this apparently favourable phase ends from 2001 onwards essentially as a result of significant declines in current deficits –with Ghana and Kenya moving into current surpluses in 2003 and Côte d'Ivoire in 2002-2003. The regional average for 2001-2003 turns out to be net resource transfers to the metropoles –an unacceptable situation for the poorest region in the periphery of the international economy (Table 2 and Annex Table C).

Asia: Asia had controlled capital accounts and modest net resource inflows during the 1980s. The liberalisation of the capital account resulted in an initial rise in net inflows during the 1990-1997 phase. The impact of the financial crises of 1997-1998 and its aftermath is clearly reflected in balance of payments data of most Asian countries. Between 1998 and 2003, Asian countries reflect the Latin American situation of the preceding decade whereby most of them have been forced to move into current surpluses. Both during the 1998-2000 and 2001-2003 sub-periods, out of nine Asian countries, net resource transfers to the metropoles are observed for eight. Average regional net transfer/GDP ratios are very high (i.e. 6.7 and 5.2%) during the two periods respectively. Once again, it is the substantial shift from current deficits to surpluses which is behind this striking change -i.e. the emergence of Asia as a peripheral region transferring substantial resource to the metropoles of the imperialist system.

All developing countries: Taking the sample as a whole, the 1998-2003 years emerge as a period of deterioration in terms of net transfers abroad. This is a significant reversal of what had happened a decade earlier and the situation is worsening as we move further into the 21st century: Out of the twenty six countries in our sample, *net transfers from the metropoles* was the case for fourteen during the 1990-1997 period. This number declines to ten and five during 1998-2000 and 2001-2003 respectively. Finally, the overall balance during the same three sub periods has changed from a slightly favourable one (i.e. -0.41) in the period 1990-97 to more and more unfavourable ones (i.e. 1.85 and 3.15) during the following two phases respectively. Although changes in the current account were the instrumental factor, it is significant to note that the post-1997 years -with lower international interest rates- have also been a period of deteriorating incomes account for thirteen countries (exactly one-half) in our sample. Recipients of substantial FDI (e.g. Malaysia) have been affected by large and rising profit remittances.

Generalisations based on average ratios covering large groups of countries are always risky. Regional variations have already been noted (i.e. Latin America experiencing the adverse phase of the "pendulum" during the 1980s). Each country has a unique story which disappears when comparisons based on aggregated data are carried out. Despite these qualifications, the dominant current pattern appears to be one in which the periphery of the imperialist system is transferring net resources to the metropoles.

7. CURRENT ACCOUNT SURPLUSES: GOOD OR BAD?

The typical balance of payments of a developing country during the three decades following the Second World War exhibited current account deficits. The situation was somewhat modified, but still continued even after the tumultuous post-1980 years: 460 annual observations from our sample between 1980 and 1997 result only 76 cases with current surpluses 22 of which are from two countries with exceptional structural/political characteristics –i.e. China and South Africa- and the cumulative current account totals turn out to be positive only for the same two. However, as noted above, the most recent period in Asia and elsewhere has witnessed the emergence of current account surpluses and declining current deficits. How can we interpret such changes in the current account? Are they good or bad?

Lower deficits or emergence of current surpluses could be interpreted both as moving into positions of weakness or into to a positions of strength depending on other circumstances. A typical imperialist country with a structural current surplus exhibits a position of strength, via exporting capital abroad and, thereby, becomes capable of dominating countries with deficits. An “improved” current account of a peripheral economy which emerges due to declining (negative) growth and/or the enforced servicing of external obligations (e.g. including the amortisation of the external debt) as observed in the aftermath of financial crises corresponds to a position of weakness. For a developing economy, a position of strength emerges if the country has been moving from chronic deficits into a surplus situation prevailing under the conditions of even high growth rates. Such a development may also be interpreted as reduced levels of external dependency.

The breakdown of the countries in our sample shows that if we exclude improved trade balance due to temporary or one-off booms in exports, declining deficits (or emergence of surpluses) under the positions of weakness (i.e. while experiencing lower/negative growth and/or under external debt crises) is the dominant situation. Structural current account surpluses under high growth appear to have emerged definitely only for China during the post-1990 period. If we look into the 2001-2003 years, and take a growth rate higher than 4.5% as a threshold, countries with three surplus years and “high” growth are China, Morocco, Thailand and S. Korea. If we set 5% growth as the threshold, only China and Morocco qualify.

8. IMPACT OF RAISING US DEFICITS

Declining levels of current deficits of developing economies are, in part, a necessary outcome of the dramatic increase in the structural current deficit of USA during the past five years. Table 3 presents the recent picture. The chronic current deficit of the American economy was more than covered by the surpluses of other developed countries up till the Asian crisis. The peak of the 1990s’ boom in private capital flows to the periphery is reflected in the balance of payments data of 1997 when “the rest of the world” (covering the non-oil developing countries and the former socialist economies) registers a net current deficit of nearly 100 billion US dollars despite ongoing and sizable US deficit. However, the post-crisis years (i.e. 1998 and after) changes the picture altogether. Crisis management and debt

servicing in Asia and elsewhere combined with the dramatic rise in US current deficit reaching 414 and 531 billion US dollars in 2000 and 2003 resulted in a situation in which “the rest of the world” had to move into a consolidated current surplus ultimately approaching 300 billion dollars.

Table 3. Current Account Balance of Major Country Groups (Bn.$)

	1995	1997	2000	2003
USA	-105.8	-136.0	-413.5	-530.7
Euro Area + Japan	162.3	195.5	89.9	138.1
Other Developed	2.9	19.7	33.9	36.3
Developing Oil Exporters	2.3	18.9	100.2	71.5
Rest of the World	-61.7	-98.1	189.5	284.8

Source: IMF (2003, 2004).

The foregoing data, after incorporating the net incomes balance as well[9], show that the American economy has benefited from $437 and $563 billions of net resource transfers from the external world in 2000 and 2003 respectively. By the latter year the American economy exhibits current account and fiscal deficits reaching 5 to 6% of GDP. These are typical macro-economic indicators of a dependent peripheral economy, requiring IMF tutelage. The crucial difference is the fact that they belong to a country which can get away with it due to her super-imperialist status[10].

When the super-imperialist country absorbs huge and rising external resources, net transfers to the developing world necessarily adjust downward. This is one factor behind the change of direction in resource transfers between the imperialist metropoles and the periphery since the late 1990s. However, this situation also generates a historical opportunity for overcoming certain aspects of external dependency for some countries in the South by generating conditions for moving into *structural surpluses* consistent with satisfactory growth rates. However, as observed earlier, reduced deficits (or moves into surpluses) in the current accounts of most peripheral countries have been occurring under conditions of declining growth or financial distress. The historical opportunity created by the present conjuncture is being wasted by the predominant majority.

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[9] IMF’s *World Economic Outlook* data for September 2003 and 2004 on the net incomes balance of USA, (Statistical Appendix, Tables 29 and 27 respectively) exhibit a dramatic and substantial revision. The September 2003 and 2004 series for the US incomes balance covering 1996-2000 years all carry positive signs, with moderate discrepancies in the two publications. Starting with 2001 data, discrepancies between the September 2003 and September 2004 publications become excessive. The former publication gives -82.5 and -121.7 billion dollars for the 2001 and 2002 U.S. incomes balance respectively and an estimate of -125.3 billions for 2003 whereas the data presented in the September 2004 publication for the same years are all surpluses (i.e. 23.6, 7.2 and 33.3 billion dollars respectively). Such dramatic “corrections” on past data are left unexplained by IMF.

[10] The degree of vulnerability of the American economy *vis à vis* the astronomic accumulation of dollar assets (U.S. treasury bills and bonds) at European and Asian central banks is an issue which requires a separate and in-depth treatment.

9. NEW PATTERNS OF DEPENDENCY AND THE AUTONOMOUS GROWTH OF EXTERNAL DEBT

Liberalisation of the capital account in the peripheral economies contributes to the emergence of new macroeconomic linkages. Governments and economic management in these countries find out that expansion/contraction of national economies become more and more dependent on non-resident capital flows and the contribution of domestic fiscal and monetary policies becomes marginal. Monetary policy is subordinated to central banks which have become increasingly autonomous of third world governments, but, *de facto*, have come under IMF supervision. The predominant objective of fiscal policies has become servicing rising levels of public debt and reducing the risk of default. This is to be realised by targeting the primary surplus of the public budget. Henceforth it is, essentially, the level and fluctuations of net capital flows and their impact on domestic macro-economic variables which start expansionary or contractionary phases of the national economy. International finance capital has developed its own institutions, i.e. the so-called "rating agencies", for assessing "where to move?" IMF acts as the supervisor of the overall financial system. The "performance criteria" of these institutions are extremely strict in terms of the role of the nation-state ("less government", fiscal stringency, monetary restraint etc.)

We, thus, observe a new vicious cycle of dependency: Growth becomes dependent on external capital movements and the latter becomes dependent on the performance criteria of IMF et. al. As already emphasised, these criteria exclude national government as active agents in macroeconomic management. Ruling classes gradually fall in line with this line of thinking and national "policies" identify with IMF criteria because this is the only way "respectability" within the eyes of international finance can be acquired and economic stability and "reasonable growth" can occur.

An explanatory factor behind the increased subservience to IMF et. al. is related to rising levels of external debt of underdeveloped economies. When a particular country is downgraded by international finance, credit lines will be reduced and, possibly, closed. In addition to servicing interest payments, gradual repayment of the principal of the external debt stock may be required. This is an unmanageable situation which leads the country to cede to IMF/WB programmes. Hence, conditions which lead to the autonomous/excessive growth of the external debt must be analysed.

It is paradoxical that during the 1990s when current deficits as a ratio of GDP have been declining in most countries in the South, the total debt stock the developing world has grown by 6.5% per annum (WB data) and the debt stock to GNP has risen from 31 to 41% (or to 45% by IMF data).

This pathological phenomenon and the mechanisms behind it are observed in Table 4: During the last two decades of the past century, unweighted average current account deficit/GDP ratios for the 26 developing economies have declined from 3.6 (1980-1989) to 2.7% (1990-2000). Under "normal" circumstances, this should have resulted in lower rates of external capital inflows. On the contrary, external (non-resident) capital inflows/GDP ratios rose from 4.5 to 5.3 per cents during the same two decades. Table 5 depicts the same story by means of an index-based decomposition of non-resident flows into their four components including the current account for the two periods. Based on unweighted averages (under "Total Developing" of the table) during the 1980s, nearly 80% of non-resident inflows were

allocated to covering the current deficit of peripheral economies whereas this ratio declined to 50% in the following decade (from cumulative totals of a smaller sample the two ratios are 65 and 43 per cents respectively as presented under “Total,b” of the table). This implies that each dollar of current deficit during the 1980s was accompanied by 1.25 dollars of non-resident inflows. During the post-1990 period, on the other hand, each dollar of current deficit during the latter period was accompanied by 2 dollars of non-resident inflows (the same coefficients derived from cumulative sums, i.e. under “Total,b”**,** for the two periods are 1.5 and 2.3 respectively). It is the emergence of substantial magnitudes of “leakages” from non-resident inflows, namely resident outflows and excessive reserve accumulation -i.e. KF(r) and DR respectively in tables 4 and 5- which contribute to the decline in the share of current deficits.

The emergences of rising “leakages” are directly related to liberalised capital accounts. The bourgeoisies and rentiers of underdeveloped capitalist societies having allowed to “invest” in New York stock exchange or to buy villas in Côte d’Azur, thus, became fanatical partisans of fully liberalised financial systems. Excessive reserve accumulation, on the other hand, advocated as a defensive buffer against the anarchic conditions of the international financial system, leads to additional net burden on the incomes balance of the current account because the borrowing cost of external reserves is clearly higher than the return a developing country can obtain on international reserves (e.g. on U.S. government bonds).

Table 4. Major Items of Balance of Payments as % of GDP Regional Averages

	KF(nr)/ GDP	KF(r)/ GDP	CA/ GDP	EO/ GDP	DR/ GDP
Latin America					
1980-1989	4.38	-0.49	-3.53	-0.38	0.02
1990-2000	5.78	-1.54	-3.05	0.09	-1.27
North Africa					
1980-1989	5.56	-0.89	-4.77	0.48	-0.39
1990-2000	4.30	-1.35	-1.17	0.30	-2.09
SSA					
1980-1989	5.38	-0.27	-4.86	-0.18	-0.07
1990-2000	6.41	-0.21	-5.57	0.37	-0.99
Asia					
1980-1989	3.41	-0.44	-2.15	-0.20	-0.62
1990-2000	4.59	-1.44	-0.96	-0.42	-1.77
Total Developing					
1980-1989	4.45	-0.46	-3.55	-0.16	-0.28
1990-2000	5.30	-1.15	-2.66	0.00	-1.49

Source and coverage: Coverage and data source (unweighted averages) are the same as Table 1 with the exclusion of South Africa (hence the difference between CA/GDP ratios for that region between this table and Table 1).

Abbreviations: KF(nr): Net non-resident capital flows. KF(r): Net resident capital flows. CA: Current account balance. EO: Net errors and omissions. DR: Change in reserves where the minus sign signifies increase and *vice versa*. Balance of payments identity: KF(nr) + KF(r) + CA + EO + DR = 0

Table 5. Major Items of Balance of Payments, Index Numbers, Regional Averages

	KF(nr)/ GDP	KF(r)/ GDP	CA/ GDP	EO/ GDP	DR/ GDP
Latin America					
1980-1989	100	-11.2	-80.6	-8.7	+0.5
1990-2000	100	-26.7	-52.8	+1.5	-22.0
North Africa					
1980-1989	100	-16.0	-85.7	+8.7	-7.0
1990-2000	100	-31.3	-27.1	+7.0	-48.6
SSA					
1980-1989	100	-5.0	-90.3	-3.4	-1.3
1990-2000	100	-3.3	-86.9	+5.7	-15.5
Asia					
1980-1989	100	-12.9	-63.1	-5.9	-18.1
1990-2000	100	-31.4	-20.9	-9.2	-38.5
Total Developing					
1980-1989	100	-10.3	-79.8	-3.6	-6.3
1990-2000	100	-21.7	-50.2	0.0	-28.1
Total, (b)					
1980-1989	100	-17.4	-64.5	-11.1	-7.0
1990-2000	100	-29.7	-42.7	-5.4	-22.2

Source: Table 4 and Table 2 for the first 15 rows (based on unweighted averages. Total, (b), is derived from the cumulative sums of a narrower sample of countries. The latter coverage is: Argentina, Brasil, Chili, Colombia, Egypt, India, Indonesia, Malaysia, Mexico, Pakistan, Peru, Philippines, South Africa, South Korea, Thailand, and Turkey. Balance of payments identity: KF(nr) + KF(r) + CA + EO + DR = 0 (see Table 4 for abbreviations.)

Capital inflows have, thus, become increasingly detached from the financing of current deficits. An autonomous growth of the external debt, equally detached from current deficits took place. It is the uncontrolled expansion in the stock of the external debt, rather than the growth of interest/profit remittances, which is crisis-prone and is at the root of rising degrees of dependency. As for assets abroad acquired by residents of a peripheral economy, they are no cure during a debt crisis, because all indicators and negotiations are made in terms of the *gross* (as opposed to *net*) external debt of the relevant country.

As the new century unfolds, it is becoming more and more evident that none of the expectations from opening up to finance capital in peripheral economies and from rising levels of international capital movements have been realised. The current conjuncture is one in which net resource transfers (related to capital movements) from the periphery to the metropoles of the imperialist system are becoming prevalent. Such conjunctures offer opportunities for peripheral countries to reduce mechanisms of dependency and move into more self-reliant patterns of development. But, historical experience suggests that such opportunities have usually been wasted. As discussed earlier, higher and sustainable growth under conditions of reduced dependency has been very exceptional during the current conjuncture as well. On the contrary, the reversal of net resource transfers between the two poles of the imperialist system is being accompanied by increased degrees of dependency,

particularly, due to high levels of external indebtedness in the South. This is a situation reflecting the worst of both worlds.

Annex Table A. Decomposition of the Current Account, Latin America, % of GDP, Period Averages

	CA/ GDP	TBgoods/ GDP	TBservices/ GDP	Inc. Bal./ GDP	Cur. Tr./ GDP	Transfer abroad/GDP
Argentina						
1980-89	-3.09	3.05	-1.04	-5.11	0.01	2.02
1990-97	-2.02	0.76	-1.19	-1.89	0.30	-0.13
1998-2000	-4.10	-0.14	-1.50	-2.58	0.12	-1.52
2001-2003	3.35			-4.33		7.68
Brazil						
1980-89	-2.02	3.09	-0.98	-4.17	0.05	2.15
1990-97	-1.15	1.51	-1.02	-2.01	0.37	0.87
1998-2000	-4.43	-0.40	-1.25	-3.04	0.25	-1.39
2001-2003	-1.69			-3.80		2.11
Chile						
1980-89	-7.00	2.85	-2.17	-8.27	0.58	1.27
1990-97	-3.15	0.99	-0.34	-4.51	0.72	1.37
1998-2000	-2.40	0.35	-0.47	-2.97	0.69	0.57
2001-2003	-1.28			-4.31		3.03
Colombia						
1980-89	-2.95	0.22	-0.82	-3.73	1.38	0.79
1990-97	-1.82	0.18	-0.73	-3.20	1.94	1.39
1998-2000	-1.51	0.91	-1.50	-2.28	1.37	0.77
2001-2003	-1.66			-3.35		1.69
Mexico						
1980-89	-0.82	3.42	-0.46	-4.66	0.88	3.84
1990-97	-3.78	-1.27	-0.47	-3.19	1.15	-0.60
1998-2000	-3.31	-1.49	-0.48	-2.66	1.33	-0.64
2001-2003	-2.37			-2.05		-0.32
Peru						
1980-89	-5.29	1.56	-1.46	-6.17	0.78	0.88
1990-97	-6.10	-1.84	-1.43	-4.34	1.51	-1.76
1998-2000	-4.39	-2.05	-1.33	-2.86	1.85	-1.53
2001-2003	-2.04			-2.82		0.78
L. America						
1980-89	-3.53	2.37	-1.16	-5.35	0.61	1.82
1990-97	-3.00	0.06	-0.86	-3.19	1.00	0.19
1998-2000	-3.35	-0.47	-1.09	-2.73	0.93	-0.62
2001-2003	-0.95			-3.44		2.50

Source and notes: See Table 2.

Annex Table B. Decomposition of the Current Account, Semi-Industrial Africa, % of GDP, Period Averages

	CA/ GDP	TBgoods/ GDP	TBservices/ GDP	Inc. Bal./ GDP	Cur. Tr./ GDP	Transfer abroad/GDP
Egypt						
1980-89	-4.11	-15.39	1.04	-1.81	12.05	-2.29
1990-97	3.26	-13.01	5.87	-1.57	11.97	4.84
1998-2000	-1.97	-10.64	2.57	0.96	5.13	-2.94
2001-2003	1.41			-1.09		2.50
Morocco						
1980-89	-5.41	-8.13	-0.38	-4.46	7.56	-0.95
1990-97	-1.48	-7.11	1.65	-3.87	7.86	2.39
1998-2000	-0.77	-7.70	3.00	-2.77	6.70	2.00
2001-2003	4.08			-2.86		6.94
Tunisia						
1980-89	-4.79	-11.51	5.48	-3.82	5.06	-0.97
1990-97	-4.61	-11.32	6.00	-4.13	4.83	-0.48
1998-2000	-3.24	-10.87	7.85	-4.46	4.24	1.22
2001-2003	-3.76			-4.88		1.12
S. Africa						
1980-89	0.64	5.85	-1.04	-4.02	-0.14	4.67
1990-97	0.28	3.74	-0.69	-2.34	-0.42	2.63
1998-99	-1.03	2.35	-0.33	-2.41	-0.63	1.38
2001-2003	-0.58			-2.72		2.14
Semi- industrial Africa						
1980-89	-3.42	-7.30	1.27	-3.53	6.14	0.11
1990-97	-0.64	-6.92	3.21	-2.98	6.06	2.34
1998-2000	-1.75	-6.72	3.27	-2.17	3.86	0.42
2001-2003	0.29			-2.89		3.18

Source and notes: See Table 2.

Annex Table C. Decomposition of the Current Account Sub-Saharan Africa, % of GDP, Period Averages

	CA/ GDP	TBgoods/ GDP	TBservices/ GDP	Inc. Bal./ GDP	Cur. Tr./ GDP	Transfer abroad/GDP
Cameroon						
1980-89	-5.03	3.53	-4.52	-3.69	-0.35	-1.34
1990-95	-2.46	6.35	-3.92	-5.00	0.11	2.54
Côte d'Ivoire						
1980-89	-9.66	10.40	-8.10	-7.65	-4.31	-2.01
1990-97	-5.91	12.40	-7.78	-8.52	-2.00	2.62
1998-2000	-1.27	17.08	-8.04	-6.70	-3.62	5.42
2001-2003	3.36			-6.02		9.38
Ghana						

Annex Table C. (Continued)

	CA/ GDP	TBgoods/ GDP	TBservices/ GDP	Inc. Bal./ GDP	Cur. Tr./ GDP	Transfer abroad/GDP
1980-89	-2.65	-1.04	-3.32	-2.23	3.94	-0.42
1990-97	-5.31	-6.68	-4.39	-1.90	7.66	-3.41
1998-2000	-8.62	-14.25	-2.49	-1.86	9.98	-6.76
2001-2003	-0.88			-2.45		1.57
Kenya						
1980-89	-4.92	-7.25	2.67	-3.35	3.00	-1.58
1990-97	-2.23	-6.73	4.41	-4.47	4.57	2.25
1998-2000	-2.46	-10.15	2.33	-1.44	6.80	-1.02
2001-2003	-1.33			-1.04		-0.29
Tanzania						
1980-89	-7.81	-11.20	-2.22	-2.06	7.68	-5.75
1990-97	-12.80	-14.86	-4.41	-2.98	9.44	-9.82
1998-2000	-6.71	-8.75	-2.43	-1.12	5.59	-5.59
2001-2002	-3.92			-0.55		-3.37
Uganda						
1980-89	-1.90	-0.69	-4.69	-0.86	4.34	-1.04
1990-97	-4.72	-7.13	-7.36	-1.53	11.31	-3.19
1998-1999	-6.19	-9.50	-8.46	-0.24	12.01	-5.95
2001-2003	-8.60			-2.65		-5.95
Zimbabwe						
1980-89	-2.05	2.78	-3.20	-2.26	0.63	2.26
1990-94	-4.75	0.74	-3.94	-3.62	2.07	-1.13
SSA						
1980-89	-4.86	-0.50	-3.34	-3.16	2.13	-1.41
1990-97	-5.45	-2.27	-3.91	-4.00	4.74	-1.45
1998-2000*	-5.05	-5.11	-3.82	-2.27	6.15	-2.78
2001-2003**	-2.27			-2.54		0.27

Source and notes: See Table 2. (*) Excluding Cameroon & Zimbabwe. (**) Excluding Cameroon & Zimbabwe and 2001-2002 for Tanzania.

Annex Table D. Current Account Decompositions, Asia % of GDP, Period Averages

	CA/ GDP	TBgoods/ GDP	TBservices/ GDP	Inc. Bal./ GDP	Cur. Tr./ GDP	Transfer abroad/GDP
China						
1982-89	-0.38	-1.05	0.31	0.21	0.15	-0.59
1990-97	1.53	1.89	-0.06	-0.54	0.24	2.07
1998-2000	2.45	3.92	-0.45	-1.53	0.51	3.98
2001-2003	2.57			-1.16		3.73
India						
1980-89	-1.60	-2.35	-0.30	-0.26	1.31	-1.34

1990-97	-1.33	-1.61	-0.69	-1.16	2.14	-0.17
1998-2000	-1.10	-2.40	-0.55	-0.85	2.71	-0.25
2001-2002	0.65			-0.67		1.32
Indonesia						
1981-89	-3.10	5.04	-4.27	-4.10	0.23	1.00
1990-97	-2.46	4.21	-3.64	-3.41	0.38	0.95
1998-2000	4.53	16.75	-6.39	-7.14	1.31	11.68
2001-2002	5.00			-4.75		9.75
Korea						
1980-89	-0.04	-0.24	0.43	-1.19	0.96	1.14
1990-97	-1.70	-1.04	-0.68	-0.22	0.24	-1.48
1998-2000	7.02	7.93	-0.16	-1.32	0.56	8.34
2001-2003	1.69			-0.08		1.77
Malaysia						
1980-89	-2.82	8.34	-5.93	-5.35	0.12	2.53
1990-97	-5.60	3.21	-3.65	-4.86	-0.30	-0.73
1998-2000	12.84	25.39	-3.03	-6.91	-2.60	19.76
2001-2002	8.39			-7.74		16.13
Pakistan						
1980-89	-2.73	-9.50	-1.03	-1.72	9.53	-1.00
1990-97	-4.38	-5.14	-1.86	-3.04	5.66	-1.34
1998-2000	-1.78	-2.74	-1.37	-3.41	5.74	1.63
2001-2003	4.96			-3.52		8.48
Philippine						
1980-89	-3.54	-4.32	2.37	-3.10	1.52	-0.43
1990-97	-4.14	-11.00	3.37	2.12	1.37	-6.26
1998-2000	8.30	5.24	-3.39	5.82	0.63	2.49
2001-2003	3.62			5.34		-1.72
Thailand						
1980-89	-3.90	-3.61	0.51	-1.28	0.49	-2.62
1990-97	-6.33	-4.08	-1.27	-1.42	0.44	-4.91
1998-2000	10.18	11.86	0.20	-2.26	0.38	12.43
2001-2003	5.58			-1.19		6.77
Turkey						
1980-89	-1.64	-4.40	2.01	-2.29	3.05	0.65
1990-97	-0.98	-6.14	4.30	-1.77	2.63	0.79
1998-2000	-1.55	-7.96	5.46	-1.80	2.75	0.24
2001-2003	-2.34			-2.78		0.44
Asia						
1980-89	-2.19	-1.35	-0.66	-2.12	1.93	-0.07
1990-97	-2.82	-2.19	-0.46	-1.59	1.42	-1.23
1998-2000	4.54	6.44	-1.08	-2.16	1.33	6.70
2001-2003*	3.35			-1.84		5.19

Source and notes: See Table 2. (*) 2001-2002 for India, Indonesia and Malaysia.

Annex Table E. Decomposition of the Current Account, Regional and Period Averages, % of GDP

	CA/ GDP	TBgoods/ GDP	TBservices/ GDP	Inc. Bal./ GDP	Cur. Tr./ GDP	Transfer abroad/GDP
L America						
1980-89	-3.53	2.37	-1.16	-5.35	0.61	1.82
1990-97	-3.00	0.06	-0.86	-3.19	1.00	0.19
1998-2000	-3.35	-0.47	-1.09	-2.73	0.93	-0.62
2001-2003	-0.95			-3.44		2.50
Semi-industrial Africa						
1980-89	-3.42	-7.30	1.27	-3.53	6.14	0.11
1990-97	-0.64	-6.92	3.21	-2.98	6.06	2.34
1998-2000	-1.75	-6.72	3.27	-2.17	3.86	0.42
2001-2003	0.29			-2.89		3.18
SSA						
1980-89	-4.86	-0.50	-3.34	-3.16	2.13	-1.41
1990-97	-5.45	-2.27	-3.91	-4.00	4.74	-1.45
1998-2000	-5.05	-5.11	-3.82	-2.27	6.15	-2.78
2001-2003	-2.27			-2.54		0.27
Asia						
1980-89	-2.19	-1.35	-0.66	-2.12	1.93	-0.07
1990-97	-2.82	-2.19	-0.46	-1.59	1.42	-1.23
1998-2000	4.54	6.44	-1.08	-2.16	1.33	6.70
2001-2003	3.35			-1.84		5.19
All Developing						
1980-89	-3.41	-1.18	-1.20	-3.36	2.33	0.03
1990-97	-3.23	-2.42	-0.92	-2.82	2.93	-0.41
1998-2000	-0.48	0.11	-0.93	-2.33	2.66	1.85
2001-2003	0.59			-2.56		3.15

Source and notes: See Table 2.

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Chapter 2

THE LEVEL OF ACTIVITY IN AN ECONOMY WITH FREE CAPITAL MOBILITY

Prabhat Patnaik and Vikas Rawal

1. INTRODUCTION

The purpose of this paper is to argue that the "opening up" of an underdeveloped economy to free capital flows, instead of boosting its rate of growth as "neo-liberals" claim, would have the precisely opposite effect of unleashing *ceteris paribus* a tendency towards stagnation and greater unemployment. The reason for this is simple. The "neo-liberal" claim is based on the assumption that such "opening up" would cause a substantial increase in the rate of productive investment in the economy. This claim, even if much direct foreign investment were to flow into the economy, is not necessarily valid, since such DFI inflow may well be of the sort that replaces domestic investment, and hence (its import content as well as the import-content of the output flow it generates being higher than that of domestic investment) causes unemployment and a reduction in the level of activity ("de-industrialization"). In addition, however, such "opening up", while bringing in very little direct foreign investment in practice (no matter whether of the domestic-investment-replacing sort or not) typically exposes the economy to the vortex of globalized speculative financial flows, *and such exposure necessarily has an adverse effect on the level of activity*, which in turn by damaging the inducement to invest, unleashes or accentuates the tendency towards stagnation mentioned earlier.

Sections 2, 3 and 4 of this paper present the argument theoretically, in the context of a country pursuing a flexible exchange rate regime. Sections 2 and 3 argue that the average level of activity, through the fluctuations arising from random movements in financial inflows, is lower in an economy with a flexible exchange rate and open to financial flows than would have prevail with capital controls, *even when the expected real effective exchange rate in the former case is the same as the rate that would prevail with capital controls*. Section 4 advances the proposition that even if there are no fluctuations of this sort, the level of activity in the free-financial-flows case would still be lower *if the expected real effective exchange rate in this case is different from what would prevail with capital controls*. The

relation between these two arguments, whether they are additive or not and the conditions under which they are, would become clear in the course of the discussion. Section 5 gives the results of some simulation exercises carried out on the models of the first two sections to illustrate the nature of the arguments, section 6 carries the argument forward to a regime where the exchange rate is kept at a fixed level through Central Bank intervention; section 7 provides some "stylized facts" (*á la* Kaldor[1]) to underscore the relevance of the theoretical argument; and section 8 contains some concluding observations. Even though the concern of this paper is with growth, the theoretical arguments of the first three sections are presented, for the sake of simplicity, in the context of a stationary economy. The implications, of the conclusions derived from this model, for a growing economy however are quite clear. And finally, since our objective is to focus attention on the role of speculative finance, the discussion is conducted on the assumption of a given magnitude of non-speculative "long-term" capital inflow. Whether this latter magnitude itself would be reduced if there are controls on speculative inflows is an issue that is discussed briefly in the last section.

2. Financial Flows and the Level of Activity: The case of Inflationary Barrier

In an economy with flexible exchange rate, which is open to free capital flows, there is an appreciation of the exchange rate when *ceteris paribus* capital, in the form of finance, moves in. This appreciation has the effect of lowering the level of domestic activity, and of increasing the level of unemployment, by shifting demand away from domestic to foreign-produced goods. When capital flows out, however, we do not have an exact reversal of the story. We do not have, *beyond a point*, any increase in the level of activity, since a depreciation of the exchange rate brings in its train inflationary pressures, which create economic and social instability. To prevent such a *denouement*, the government takes anti-inflationary steps by way of cutting back on public expenditure and, in general, deflating the economy, which again adversely affect the level of activity and unemployment.

There is in short a basic asymmetry between the effects of a currency appreciation and those of a currency depreciation on the level of activity of an underdeveloped economy: since the imported-input-cheapening effect of an exchange rate appreciation is not quickly "passed on" to final goods prices (there being little urgency about *bringing down inflated profit-margins* in an oligopolistic set-up), it is only quantity adjustment that prevails, i.e. the level of activity is reduced. But the effect of an exchange rate depreciation in increasing imported-input prices is quickly "passed on" in the form of higher final goods prices (since any reduction in profit-margin beyond a point is promptly resisted), which forces the government to resort to deflation. As a result, *both exchange rate appreciation and exchange rate depreciation, compared to some particular "benchmark" level, have the effect of reducing the level of activity*. And since an economy open to financial flows can not, by definition, remain pegged to this "benchmark" level of the exchange rate, the *average* level of activity in such an economy is lower than what would have prevailed if it had been pegged to this level (which could have been the case with capital controls).

[1] Kaldor's famous reference to "stylized facts" appears in Kaldor (1961).

The question immediately arises: what determines this "benchmark" level of exchange rate? The obvious answer, in view of what has just been said, is: that level of the exchange rate below which there would be an inflationary tendency that is "unsustainable". This "unsustainability" however can be understood in two alternative ways. One is in the sense in which Joan Robinson had talked about an "inflationary barrier" or more recent literature talks of "accelerating inflation", namely a level of exchange rate below which the imported input cost would be so high that when capitalists enforce their minimum acceptable mark-up, the left-over product wage would be unacceptable to the workers, pushing up money wages (and hence making the "wage-unit" unstable). If workers in this case begin to anticipate inflation, then the inflation rate would accelerate. On this interpretation, it follows, one can think in terms of an exchange rate which constitutes, for a certain given level of the product wage "acceptable" to the workers, the lowest of the "non-accelerating inflation rates of exchange", NAIRE[2].

The second interpretation of "unsustainability" of inflation has validity even when workers are not organized enough to push up money wages despite product wages falling below a certain threshold. Even in such a case however there is a "political inflationary barrier" in the sense that governments lose elections (or more generally their legitimacy) when product wages fall below this threshold[3]. They are therefore sensitive to inflationary pressures and cut back on public expenditure when this happens[4]. We shall be discussing each of these two cases, the first case in section 2 and the second case in section 3. For simplicity however we shall not be talking of accelerating inflation at any stage; we simply assume that the government acts against inflation *per se* whenever it rears its head.

Let us now express some of these ideas in terms of the following model, which assumes for simplicity that production requires only one current material input which has to be imported (the argument can be easily extended to the case where there are several domestically-produced inputs being used):

$$p(t) = \text{Max}\left[\{p(t-1)\}\,;\,\{(a.p'.e(t) + w(t).l\}(1+\pi)\right]$$

where p denotes the price of the final good in domestic currency, p' the price of the imported input in foreign currency (which is assumed to be given and, in the context of our discussion, unchanging), e the price of the foreign currency in terms of the domestic currency, a the amount of imported input per unit of final good, w the money wage rate, l the labour input per unit of final output, and π the *minimum profit mark-up*. The equation captures the fact that profit margins above π are sluggish to move down.

The money wage rate the workers get is what enables them to obtain the acceptable level of the product wage w'(assumed for simplicity to be constant though it could be made a

[2] The assumption of a unique NAIRE, like that of a unique NAIRU, lacks validity even in a world of homogeneous, and equally well-organized, workers facing homogeneous capital, let alone when workers are split into "organized" and "unorganized" sections. This is because every level of the exchange rate above this critical level should also yield non-accelerating inflation, like every level of unemployment higher than the critical level in the standard models, if prices are taken to be downward-inflexible in oligopolistic markets.

[3] Strictly speaking this proposition applies to the real wage (i.e. command over the consumption basket) rather than the product wage (i.e. command over the production basket). But throughout this paper it is assumed that the workers' consumption and production baskets are identical.

[4] The idea of a "political inflationary barrier" which figured in Patnaik (1972) was discussed at length in Patnaik (1990).

function of the level of activity without damaging the argument) *at the expected price of the final good*. But since in the present section we are discussing the case where the government does not allow inflation to occur (i.e. the economy is never allowed to cross the inflationary barrier for the sake of maintaining stability), the expected and the actual price coincide. Hence the price equation can be re-written as:

$$p(t) = \text{Max}\ [\{p(t-1)\};\ \{(a.p'.e(t) + w'.p(t).l)(1+\pi)\}] \qquad (1)$$

Real output in the economy is given by

$$Y(t) = c\,Y(t) + I' + G(t) + N(t)/p'' \ldots \qquad (2)$$

where the proportional consumption function is for simplicity, I' refers to (some) depreciation level of investment, G to government expenditure and N to net exports *in foreign currency*; p'' is a weighted average of foreign currency prices of the traded goods. It should be noted that domestic and world prices of traded goods are not assumed to be equal at the going exchange rate. It is a world of oligopoly and prices of similar products by different producers need not be equal. The value of p'' will change depending on the composition of exports and imports and their relative proportion to one another. All that we assume for the argument is that N and N/p'' move in the same direction.

Government expenditure is given by the following

$$\text{If } [p(t) - p(t-1)]\,\big|_{G(t)=G^*} = 0, \text{ then } G(t)=G^*$$

$$\text{If } [p(t) - p(t-1)]\,\big|_{G(t)=G^*} > 0, \text{ then } G(t) \text{ is such that } p(t) = p(t-1) \ldots \qquad (3)$$

which expresses the sensitivity of government expenditure to inflation. What determines G*, the "benchmark" level of government expenditure, will be specified shortly.

$$N(t) = N(e(t)/p(t), Y(t)) \ldots N_1'>0,\ N'_2 < 0 \ldots \qquad (4)$$

which makes the foreign currency value of net exports (at any given level of Y) an increasing function of the "real" price of foreign exchange (which means that the Marshall-Lerner condition is satisfied).

As regards the net inflow of finance, we deliberately make a simple and conservative assumption (so as not to be accused of exaggeration), namely,

$$F(t) = F[e(t-1)/p(t-1) - (e(t)/p(t))^*] + \varepsilon(t) \ldots F(0) = 0 \text{ and } F'>0 \qquad (5)$$

where F is net financial inflow (net of net current account payments of interest on financial flows as well[5]), (e/p)* the "benchmark" level of the "real" price of foreign exchange and ε is a random term with mean 0. According to this specification foreign capital inflow has a

[5] This definition of net financial flows may appear somewhat odd at first sight, but since we assume net financial inflows to be zero at the "benchmark" level of activity (but for a random term with zero mean) the net interest payment owing to such inflows would be too small to matter.

stabilizing rather than *destabilizing* effect on the foreign exchange market since there are inelastic expectations about the real price of foreign exchange. The equation can be interpreted as follows: there is a consensus among speculators that no matter what the current e/p, it would get back to (e/p)* which makes their behaviour stabilizing (The time-lag could have been introduced, more realistically perhaps, into (4), but introducing it here makes for simplicity). What is specific about (5) however is not just the deliberately conservative assumption that speculation always acts in a stabilizing manner, but also the implicit assumption that the *expected real exchange rate by speculators and the "benchmark" real exchange rate (which is the smallest among the non-inflation-inducing ones) coincide.* There is no reason whatsoever for such coincidence and in section 4 we shall explore the implications of the more likely case of divergence between the two. But for the sake of highlighting only one thing at a time let us assume this coincidence.

Finally we have the equilibrium condition for the foreign exchange market

$$A+F(t) = -N(t)\ldots \quad (6)$$

Where A is the autonomous amount of non-speculative long-term capital inflow (again net of net interest payment on such long-term flows). These six equations determine the six unknowns p(t), Y(t), N(t), G(t), e(t), and F(t), given p(t-1), I', w', p', p'', G*(t) and [e(t)/p(t)]*. The determination of [e(t)/p(t)]* is given by

$$[e(t)/p(t)]^* = [1/(1+\pi) - w'.l] / a.p' \ldots \quad (7)$$

which from (1) corresponds to the minimum possible real effective exchange rate. Now when this prevails and $\varepsilon = 0$, F = 0, so that –N(t) = A from (vi). Let the level of Y at which, with e/p = (e/p)*, N= -A in (4) be denoted by Y*. Then G* can be defined from (2) as Y*(1-c)-I'+A/p''.

This completes the description of our model.

It is clear that the economy can settle at an equilibrium such that there is neither inflation nor any change in the exchange rate, where G(t)=G*, e(t)/p(t) = (e/p)*, and Y=Y*. But even if it did, random disturbances would push it away from equilibrium. For instance a sudden inflow of finance would push it towards an appreciation of the nominal and also real effective exchange rate, which would have the effect of reducing the level of activity in the economy. True, such reduction would be transitory, because of stabilizing financial outflows and also because of possible random movements in the opposite direction. But when financial outflows threaten to depreciate the real effective exchange rate below the "benchmark" level, the government steps in to prevent such a *denouement* by curtailing its expenditure and thwarting incipient inflation. In the process, however the level of activity again slips below the "benchmark" level, i.e. Y again falls below Y*. Taking both types of movement together the *average* level of activity would always be lower than Y*, which could obtain if such speculative financial movements could be cut out and non-speculative long-term inflow A alone came into the economy. It follows then that between a situation where capital movements are controlled and one where such movements are unrestricted, the latter experiences on average a lower level of activity (provided that A remains the same between the two situations, on which more later).

3. Financial Flows and the Level of Activity: The Case of Political Inflationary Barrier

Let us now move to the case of the “political inflationary barrier”. In the above model the workers always got the product wage they desired, but here we assume that they do not, because *money wages are fixed* and the price-level can rise owing to the exchange rate depreciating below the “benchmark” level. Any such depreciation however precisely because the money wages are fixed would entail a real effective exchange rate depreciation as well which, unlike in the model above, would enlarge net exports both in foreign currency as well as in volume terms, and hence have an expansionary effect on output and employment. We have in other words some element of symmetry now between situations of currency appreciation and of currency depreciation. If the former reduce the level of activity, the latter result in an increase in this level, precisely for the same reason, namely changes in the relative attractiveness of domestic *vis á vis* foreign goods.

Even so, however, the *average* level of activity, through the phases of expansion and contraction, would be still lower than the “benchmark” level which could be made to prevail through the imposition of controls on speculative capital flows. This is because we still do not have complete symmetry between the two cases, of exchange rate appreciation and depreciation. The reason is that in the case of an appreciation, since oligopoly pricing behavior precludes any reduction in final goods price, despite imported input prices going down, there is no signal for an increase in government spending, and hence no actual increase; on the other hand when prices go up relative to the “benchmark” level through an exchange rate depreciation, the government cuts back its expenditure. In the depreciation case therefore the effect of net exports on the level of activity is partly offset by the reduction in government spending, while in the appreciation case there is no such counterbalancing of the effect of net exports. In other words, the positive effect of depreciation on the level of activity is more muted than the negative effect of an exchange rate appreciation. On *average* therefore the level of activity is lower than in the case of capital controls. This conclusion follows from assumptions which are deliberately conservative, such as an unambiguously positive relationship between exchange rate depreciation and the level of activity (which many would question) and the stabilizing effect of financial flows on the foreign exchange market (which is certainly rather sanguine).

Instead of presenting the argument of this section in formal terms we shall simply illustrate it through the simulation exercise of section (4). But the overall conclusion of the discussion so far may be stated as follows. In any economy characterized by a government spending policy that reacts essentially to inflation, and a pervasive presence of oligopolists who do not cut prices but only increase it if an increase in prime costs threatens their minimum profit mark-up, exposure to free movement of international finance has the effect of reducing on average the level of activity compared to what could prevail in the absence of such exposure.

4. Noncoincidence of the Expected Real Exchange Rate and NAIRE

There is an additional reason why this would happen which we now take up. We have so far assumed that the real effective exchange rate expected to prevail by most speculators coincides precisely with the minimum real effective exchange rate compatible with price stability. There is however no reason why this should be so. The minimum non-inflationary real effective exchange rate is not a visible entity; nor is it necessarily the one that prevails on average through time in an economy with free capital flows. It does not therefore have any material existence as far as the speculators are concerned; there is no reason then why they should expect this rate to prevail. On the other hand if their expected real effective exchange rate is different from this rate then there is an additional reason for a lower level of activity than what would prevail if the economy was pegged at this rate. If the expected real price of foreign exchange is denoted by (e/p)', then what we are saying is that (e/p)'≠ (e/p)* except by accident.

Equation (5) in such a case would read

$$F(t) = F\,[\{e(t-1)/p(t-1)\} - (e/p)'] + \varepsilon(t)\ldots \qquad (5)'$$

Now if (e/p)' < (e/p)*, which means that the real effective exchange rate (which is the reciprocal of e/p) is *higher* than the minimum non-inflationary rate, then in the absence of random shocks it is only (e/p)' that would prevail, which means that the level of activity would be lower than would have been the case if (e/p)* had prevailed, i.e. lower than if there had been capital controls. On the other hand if (e/p)' > (e/p)*, i.e. the expected real effective exchange rate is *lower* than the minimum non-inflationary level, then, since the government would stabilize the economy at (e/p)* in order to avoid inflation, the expected real exchange rate would be lower than what prevails. There would then be perpetual capital flight which can be sustained only by the perpetual maintenance of a lower level of activity than would be the case with (e/p)*, i.e. than would be the case with capital controls. Thus, as long as there is a divergence between (e/p)' and (e/p)**, no matter which is higher,* there would be a lower level of activity in the free-financial-flows case than with the capital-controls case.

It may appear at first sight that while the case of (e/p)'< (e/p)* is a plausible one, in the sense that (e/p)' is what actually prevails in such a case and therefore expectations, being formed on the basis of actual experience, remain tethered to it, the opposite case is an implausible one, since what actually prevails there is (e/p)*. How can speculators continue to *expect* (e/p)' when what prevails in the market is (e/p)*? The reason they do so, which is why the case is *not* implausible, is that at (e/p)*, which actually prevails, there is a continuous capital flight. *This fact must also shape their expectations.*

It follows then that there are two distinct reasons why the level of activity with free capital flows would be lower than in the absence of such free flows: first, even if the expected level of the real effective exchange rate is equal to the minimum non-inflationary rate, fluctuations around it would, because of their asymmetric effect, keep the level of activity lower on average than if there were capital controls eliminating or minimizing such fluctuations.. Secondly, the expected level of real effective exchange rate would be quite different from the minimum non-inflationary rate, in which case even in the absence of

fluctuations and no matter which rate is greater, the level of activity would be lower than if the two rates coincided.

These two arguments, it should be noted, are not always additive. If the economy actually experiences (e/p)’, then fluctuations around this would not cause any further lowering of the level of activity on average. Fluctuations matter only when the economy experiences (e/p)*. But if (e/p)*<(e/p)’, so that (e/p)* is what is actually obtaining then the two arguments do become additive, i.e. fluctuations cause a further lowering of the level of activity when superimposed upon this situations. Likewise when (e/p)’<(e/p)*, but fluctuations are large enough to threaten to take (e/p) above (e/p)*, then there would have to be additional deflation to prevent this, and hence on average the level of activity would be even lower than (e/p)’ alone prevailed without any fluctuations. Thus the two arguments are additive under certain circumstances but not others.

5. THE SIMULATIONS

To illustrate the nature of the argument we carried out some simulation exercises for the models of sections 2 and 3, the results of which are presented in this section. We took p’’ to be constant (which of course is unrealistic but simplifies matters a great deal and is not too violent an assumption since N and N/p’’ are supposed to move together), and took all our variables as deviations from their respective “benchmark” levels (using lower case letters for them), in which case we have $y(t) = \alpha. n(t)$ where α is a constant multiplier, and $n(t) = -f(t)$ as the equilibrium condition in the foreign exchange market. We used certain explicit functional forms: for (5) we took

$$f(t+1) = -k.m(t) - j.m(t)^2 + \varepsilon(t+1)$$

where k and j are constants and m is the real effective exchange rate (the reciprocal of the real price of foreign exchange). For (4) we took

$$-n(t) = h.y(t) + d.m(t)$$

where h and d are constants.

From these one can obtain the following:

$$m(t+1) = -a.m(t)-b.m(t)^2 + e(t+1) \ldots \qquad (8)$$

where a and b are positive constants and e is a random disturbance term with zero mean, for all $m \geq 0$. (It must be remembered that m can never become negative because of the government’s anti-inflationary policy). From the multiplier we can obtain

$$y(t)= -\theta.\ m(t) \text{ for all } m \geq 0$$

and $y(t) = \delta.\ e(t)$ for $m(t)=0$ and $e(t)<0$,

where both θ and δ are positive constants.

The movements of both m and y, taking both positive and negative disturbances, are given in figure 1[6] for alternative values of the parameters. It is clear that the average level of y(t) is negative (or the ratio of Y(t) to Y* is less than 1) denoting a lower level of activity than the "benchmark" level (which would obtain with capital controls).

We have also done simulations taking the value of a in (8) to be negative. This is the case where a higher-than-benchmark real exchange rate stimulates financial inflows for some time, but this stimulus ceases as the rate reaches a certain level. The picture is much the same as before and is given in figure 2.

In the section 3 model, the picture remains the same for m>0. But now m can become negative. When it does become negative, the government reduces its expenditure to supplement the effect of a real effective exchange rate depreciation. We therefore have as before

$$m(t+1) = -a.m(t)-b.m(t)^2+ e(t+1) \text{ for } m(t+1)>0$$

but, $q.\ m(t+1) = -a.m(t)-b.m(t)^2+ e(t+1)$ where $q>1$, whenever $m(t+1) <0$.

Again,

$$y(t) = -\theta.m(t) \text{ for } m(t)>0$$
and $y(t) = -\theta'.m(t)$ for $m(t)<0$, where $\theta' < \theta$[7].

As figure 3 makes clear, even though in this case we have m becoming negative and y becoming positive, the *average* y through the fluctuations is negative as argued in the text.

6. DRAWBACKS WITH THE CENTRAL BANK INTERVENTION IN THE FREE FINANCIAL FLOWS FRAMEWORK

It may be thought that Central Bank intervention for stabilizing the currency can obviate the need for any capital controls. The government in other words can with impunity peg the economy at the level of activity corresponding to Y* without any control over capital flows if only the Central Bank intervenes in the foreign exchange market to eliminate exchange rate fluctuations. Such however is not the case. If the Central Bank does intervene to keep the exchange rate at some fixed level, then a whole range of other problems arise as long as the economy is open to free financial flows. Let us turn to these.

Let us introduce Central Bank intervention in a world which, until then, had corresponded to the model of section 2, and assume that the Central Bank intervenes to stabilize the exchange rate exactly at the moment when Y = Y*, e(t)/p(t)= (e/p)*, and e(t)/e(t-

[6] See Appendix.

[7] This can be precisely worked out. We make the assumption, without any loss of generality, that p''=1, and that government expenditure cuts follow a particular rule, such that for m(t)<0, g(t)=ξ.m(t), where ξ is a positive constant less than d. In such a case y/m = (ξ-d)/ (1-c+h) which is a negative term but less negative when ξ exceeds 0 than when it equals zero.

1) = p(t)/p(t-1) =1. (We adopt this procedure rather than looking at the equilibrium properties of a fixed exchange regime because our argument precisely is that there is no equilibrium in such a regime, which rules out any comparative statics). Now suppose there is a sudden inflow of finance. The Central Bank would hold additional reserves to keep the exchange rate stable. These extra reserves would certainly increase the level of "confidence" of the financiers in this economy, because of which there would be more inflows. In equation (5) in other words an additional argument would have to appear in the F(.) function, namely the magnitude of foreign exchange reserves held by the Central Bank. If Y is kept pegged at Y*, then clearly the magnitude of reserves would keep increasing, *and there would be no equilibrium.*

Why, it may be argued, should this be any cause for concern? The obvious answer is the following: since all reserves amount to foreign lending, i.e. holding claims upon foreigners, and since typically the rates of return earned on reserves are no more than a tiny fraction of the rates earned by those whose financial inflows contribute to the accretion of reserves, it follows that holding reserves entails borrowing dear from abroad to lend cheap abroad. Quite apart from the fact that holding reserves (in excess of what may be required for transactions or buffer purposes) represents a waste of resources *relative to what use could have been made of them*, it also has *in itself* adverse implications for a country's economy which is borrowing dear to lend cheap. It gratuitously increases the debt-overhang of the economy which can come crashing down with severe consequences. (Such crashing being completely unpredictable cannot, however, be seen as some peculiar form of an equilibrating movement). Stabilizing the currency in this manner therefore, even in the best of circumstances, not only makes the economy an increasingly favourite "parking place" for foreign exchange, but does so with severely adverse potential consequences for it.

Of course excessive foreign exchange reserve accumulation can be liquidated through an increase in the level of investment in the economy. But this has three problems: first, it amounts to using short-term, highly-liquid funds for holding long-term assets (the same would be true if the reserve accumulation is used for liquidating the country's long-term external debt); secondly, it amounts to using foreign exchange resources for investment that does not necessarily fetch any foreign exchange earning. Both these considerations make such a course of action pregnant with the possibility of an illiquidity crisis for the country. Thirdly, even if the possibility of such a crisis could be minimized through an appropriate choice of investment projects, the only agency that can actually undertake such investment projects, without any regard for profitability calculations, is the State; but since any investment activism on the part of the State can have serious consequences for the "confidence" of the financiers, such activism perforce has to be eschewed. Private investment may not get stimulated at all by the sheer fact of foreign exchange reserve accumulation (via its impact on credit availability); and if it does, it is likely to take forms which threaten the country with an illiquidity crisis (as happened in East and South East Asia in the late nineties[8]).

Typically of course excess reserve accumulation tends to generate pressures for increased imports of consumption goods, which means in effect pressures for larger luxury consumption. But this course, in addition to the problem of illiquidity mentioned above, does not even add to any assets, and represents indeed a running down of assets without any corresponding running down of liabilities, the worst of all possible worlds.

[8] For a discussion of the East and South East Asian crisis see the various papers in Jomo (1998).

It follows that Central Bank intervention to fix the exchange rate, even under the best of circumstances, i.e. even if the economy is stabilized at Y* with zero inflation, and a stable level of real effective exchange rate which also happens to be the lowest sustainable level (and hence the best from the trade point of view for the country), creates serious problems because the rate earned by the country is a fraction of the rate paid, and because of the tendency of the reserves to keep accumulating (until doomsday strikes). Fixing the exchange rate must be accompanied by controls over capital flows (and the ability to use the tariff instrument) if the country is to get out of deflation without inviting a reserve pile-up.

7. THE INDIAN EXPERIENCE

The Indian experience bears out many of the claims made in this paper even though India does not have a convertible currency and is still far from being completely open to financial flows. At the beginning of July 2003 India's foreign exchange reserves, already rapidly increasing under a regime of Reserve Bank stabilization of the rupee value, amounted to $79 billion. At the beginning of March 2004, they amount to $109 billion. There has in other words been an accretion of reserves of $30 billion over a mere eight-month period, which is larger than the entire amount of DFI inflows that occurred over the entire decade of the nineties. The fact that opening up the economy to global capital flows, which is usually justified in the name of drawing larger DFI inflows, actually has the far more significant effect of exposing it to the vortex of globalized finance, is clearly borne out by the Indian experience.

The economy is currently faced with an acute dilemma. While allowing the rupee to float without Central Bank intervention would give rise to an appreciation of the currency that would be highly damaging for domestic production and employment, pegging the rupee to a fixed exchange rate (within a narrow band) as is the case now simply makes India a haven for foreign exchange inflows and hence contributes to swelling reserves. Since these reserves earn no more than around 1.5 percent returns per annum, while the finance whose inflow has contributed to these reserves, earns (including capital gains) at least ten times that rate, the piling up of reserves is detrimental to the country's interest. (This is in addition to the fact that such piling up is making the country a magnet for drawing in further reserves at present).

Various proposals have been mooted from time to time for making use of the reserves, but all of them flounder on considerations of the sort mentioned in the last section. While the agency of the State cannot be used for converting reserves into investment (since a basic characteristic of a "neo-liberal" economy which also happens to inspire maximum "confidence" in global financial circles is the eschewing of investment activism by the State), private investment has not shown any great dynamism despite the state of easy credit induced by the burgeoning reserves, and despite also the fact that according to official estimates India's growth rate on the whole appears to have been quite impressive, with certain sectors in particular (such as IT-related services) growing rapidly (for reasons unconnected with the arguments of this paper). Gross fixed capital formation, taking the public and private sectors together, as a proportion of the GDP has remained consistently below the level reached in the mid-nineties throughout the period of growing exchange reserves. (The mid-nineties peak itself was roughly of the same order as the peak reached in 1990-91, i.e. before the "neo-

liberal' policies were introduced). On the whole therefore short of imposing controls on capital flows there does not seem to be any way out of the dilemma faced by India, a conclusion that conforms to the theoretical arguments of the present paper.

8. CONCLUSION

Economic theory has not yet come to terms with the macroeconomic implications of autonomous global financial flows. Mundell and Fleming who were among the early writers to recognize the significance of international financial flows not only confined themselves to looking solely at the impact of such flows on the scope for policy autonomy of national governments, but also based their arguments on assumptions which in today's context are not tenable. The equilibria across which they made comparisons were each characterized by the property that the actual amount of capital inflow into the country was exactly equal to what was needed to cover its current account deficit on the balance of payments. Why this should happen is not clear; what is more, we do know that it does not happen. It is of course true that in a world with global mobility of finance the rates of interest (a proxy for the spectrum of returns) must be the same in all countries (net of risk-premia); but when the rates of interest are equal in all countries, it is not the case that capital would flow into each country exactly to match its current account deficit. It would have an autonomy in its global pattern of flows (which can of course be sought to be explained in terms of "expected returns" but such an explanation would border on a tautology), the macroeconomic consequences of which were not investigated by Mundell and Fleming whose theory in effect *precludes autonomous financial flows*.

With autonomous flows it is the capital account that drives the current account as was the case with our section 2 model, unless the Central Bank comes in to ensure that capital account inflows do not have the adverse current account implications that a floating exchange rate implies. With a floating rate for instance, if there is an autonomous capital inflow, then the currency appreciates until a widening current deficit and/or an expectation of depreciation in domestic currency value have created a sufficiently large demand for foreign currency to establish a new equilibrium exchange rate. In the absence of inelastic expectations about the exchange rate, which is a typical phenomenon in third world countries,[9] and the reasons for which need not detain us here, the entire burden of adjustment of capital inflows falls on the current account. Central Bank intervention for stabilizing the value of the domestic currency is in fact analogous to its acting as a "bear" when the exchange rate is appreciating, i.e. having inelastic (in fact zero-elastic) expectations about the exchange rate. But no matter whether there is Central Bank intervention or not, the macroeconomics of an economy exposed to financial flows, which have autonomy, must be examined *sui generis.* When we do so, the "neo-liberal" argument that the exposure of an economy to global capital flows increases its growth rate becomes untenable.

Finally, it may be asked: if capital controls are imposed against financial flows, would they not affect adversely the inflows of direct foreign investment? The answer must clearly be in the negative: direct foreign investment appears to go precisely to those countries which

[9] In this paper of course we have assumed inelastic expectations; but this assumption was made with the objective of deliberately understating our argument.

already have a high ratio of domestic investment to GDP. This is because such countries already have a high growth rate and DFI attempts to take advantage of the growing market. It is not surprising that the East and South Asian economies drew huge amounts of DFI even when they had strict capital controls. The same is true of China today which gets phenomenal amounts of DFI despite having capital controls. Indeed one can argue that the removal of capital controls, by actually precipitating financial crises in such economies, or threatening to do so, result in deflation and a curtailment of growth which discourages DFI. Even this last-resort argument for capital account liberalization therefore is also untenable.

APPENDIX: FIGURES FOR THE SIMULATIONS

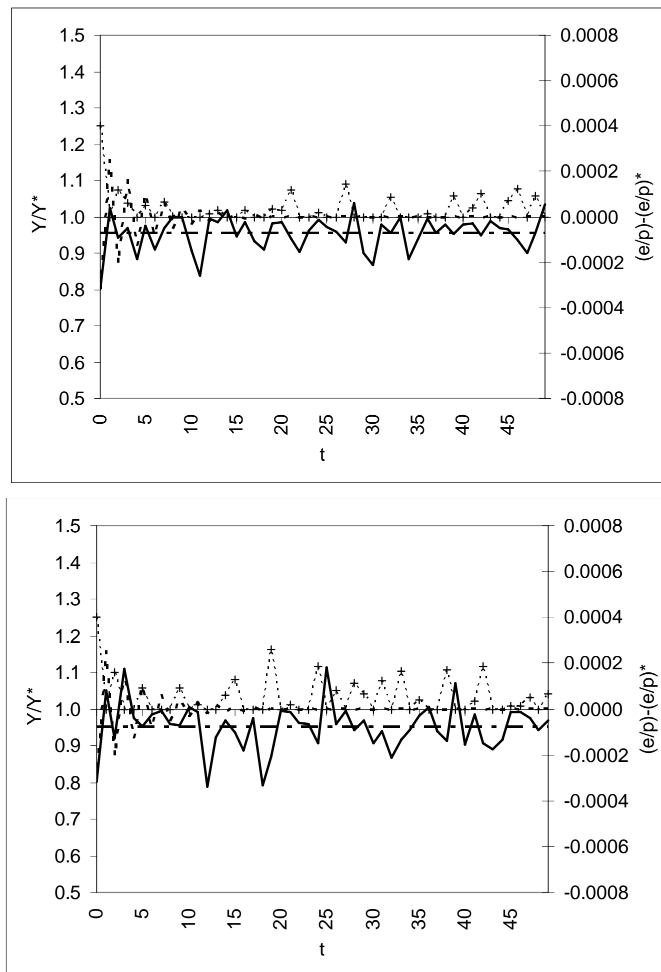
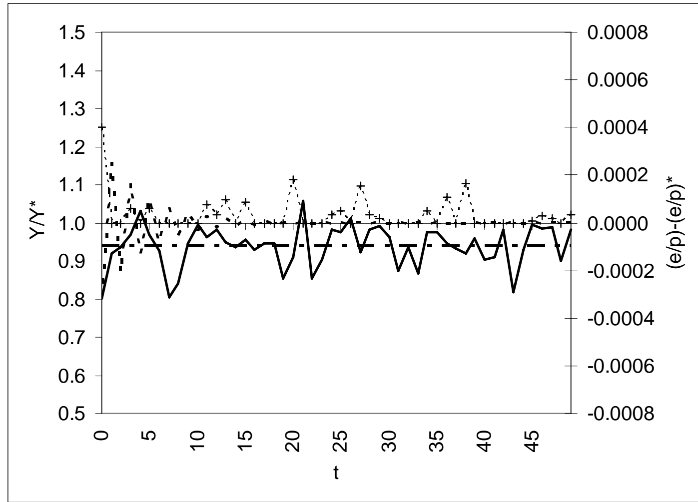
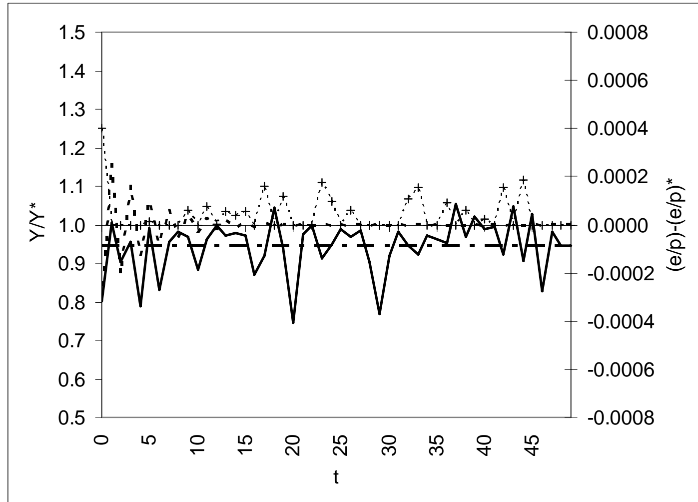


Figure 1. (Continued)



Y/Y*
(e/p)-(e/p)*
t



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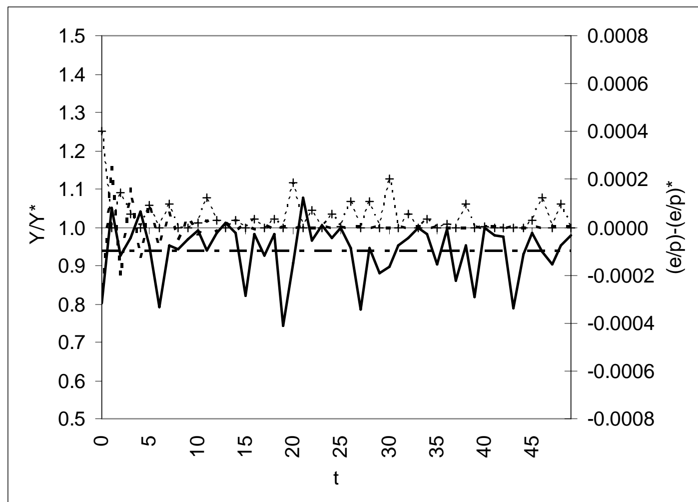

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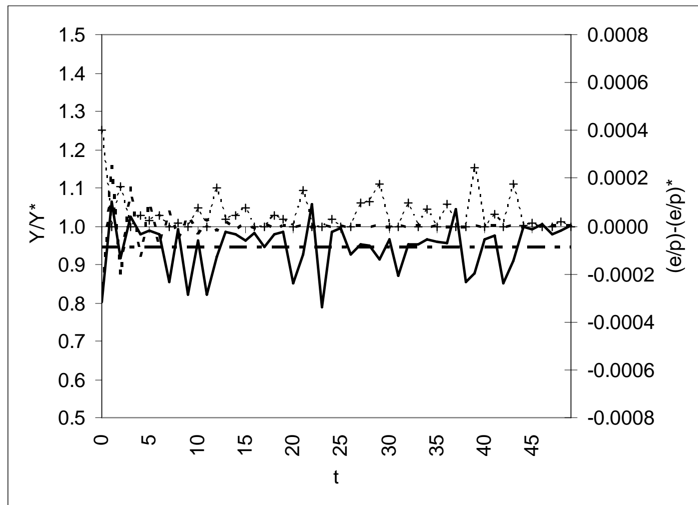


[Y/Y*] [Y/Y*]^ Average (Y/Y*) [(e/p)-(e/p)*]

Notes: These simulations are based on following parameter values.
a= 0.8
b= 0.0001
θ=5
δ=10
$\varepsilon(t)\sim N(0,10^{-4})$
$\varepsilon'(t)\sim N(0,10^{-8})$

Figure 1. Simulations for the model described in section 2.

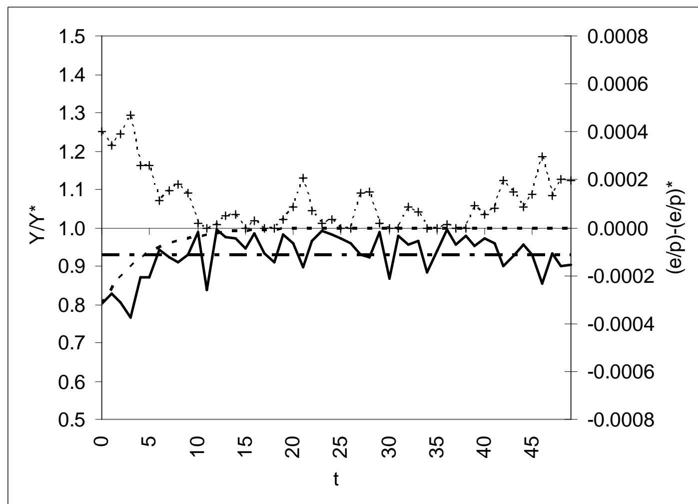
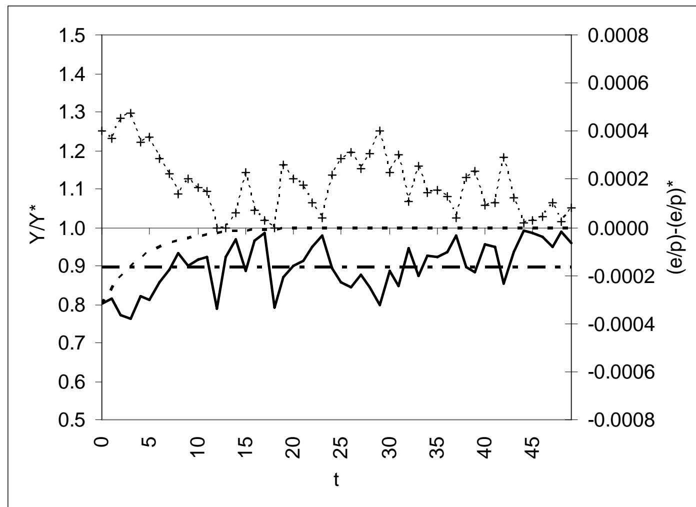
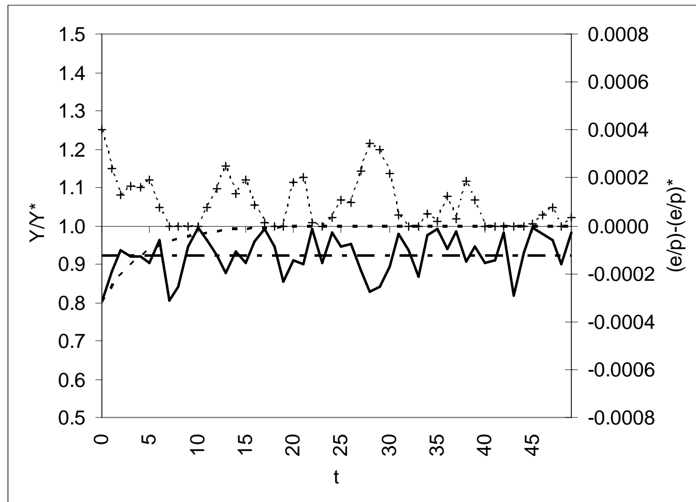


Figure 2. (Continued on next page)


Y/Y*
(e/p)-(e/p)*
t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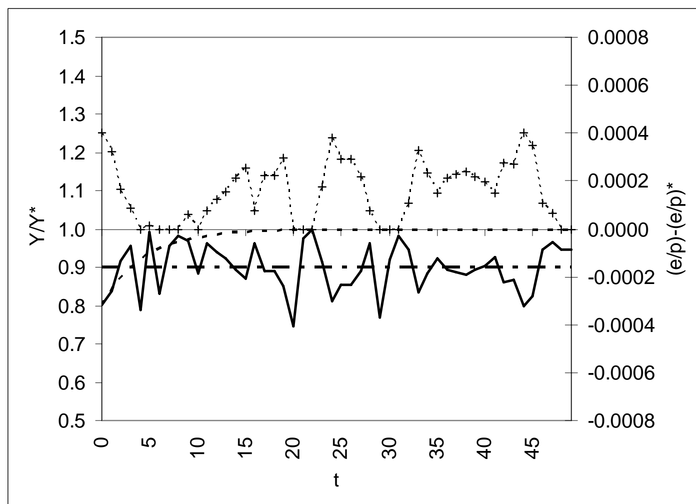
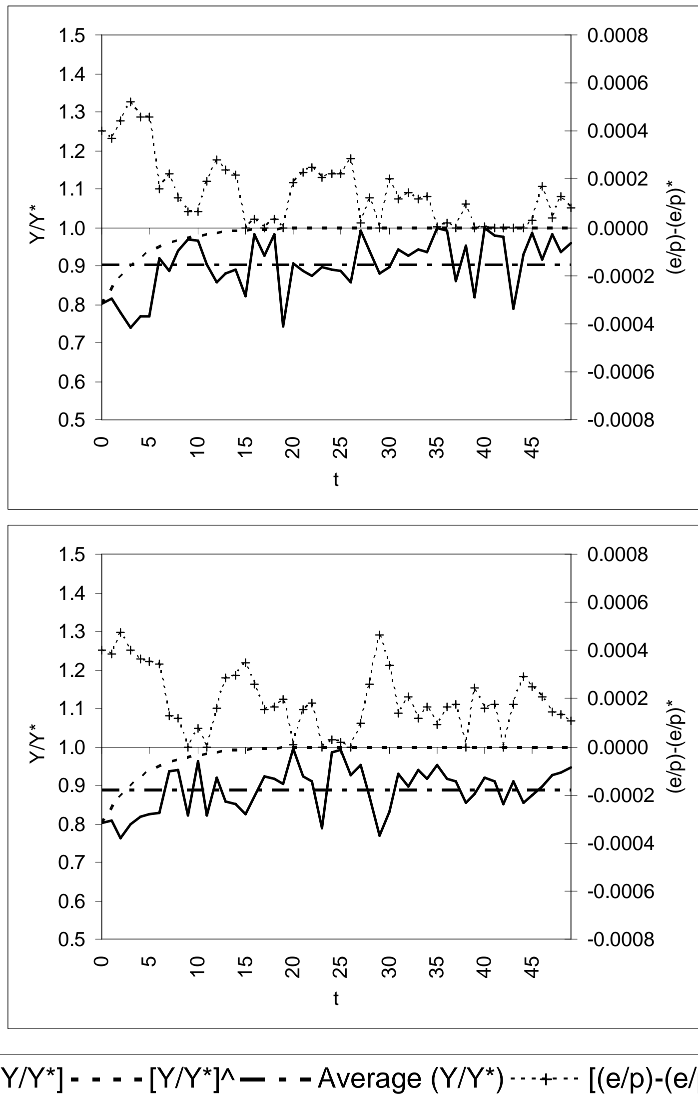
(e/p)-(e/p)*
t


Y/Y*
(e/p)-(e/p)*
t



Notes: These simulations are based on following parameter values.

a= -0.8

b= 0.0001

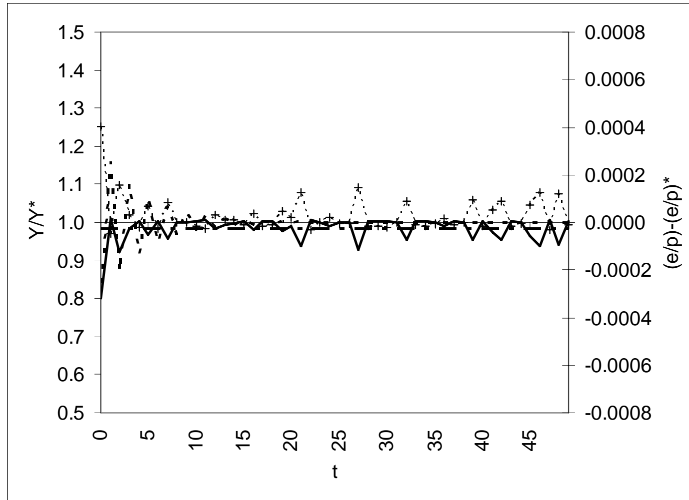
θ=5

δ=10

ε (t)~ N(0,10^{-4})

ε' (t)~ N(0,10^{-8})

Figure 2. Simulations for the Model Described in Section 2 (assuming negative value for a).


Y/Y*
(e/p)-(e/p)*
t
1.5
1.4
1.3
1.2
1.1
1.0
0.9
0.8
0.7
0.6
0.5
0.0008
0.0006
0.0004
0.0002
0.0000
-0.0002
-0.0004
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-0.0008
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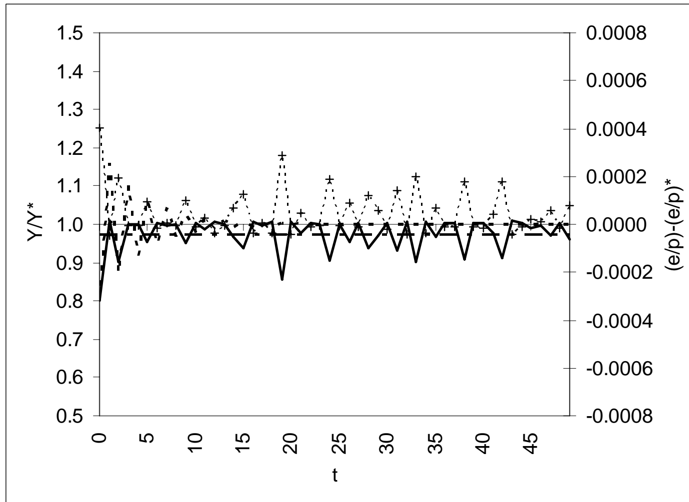
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(e/p)-(e/p)*
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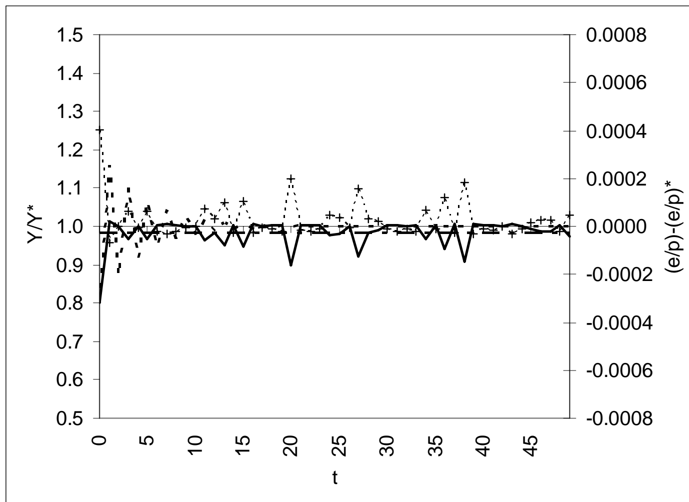
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(e/p)-(e/p)*
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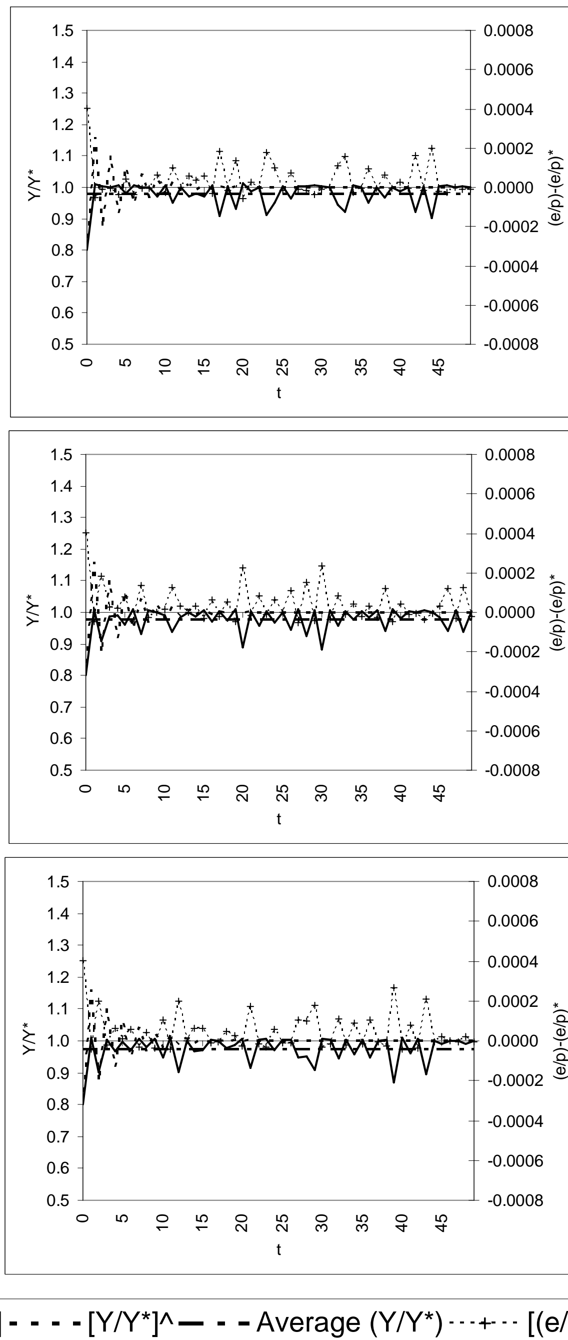
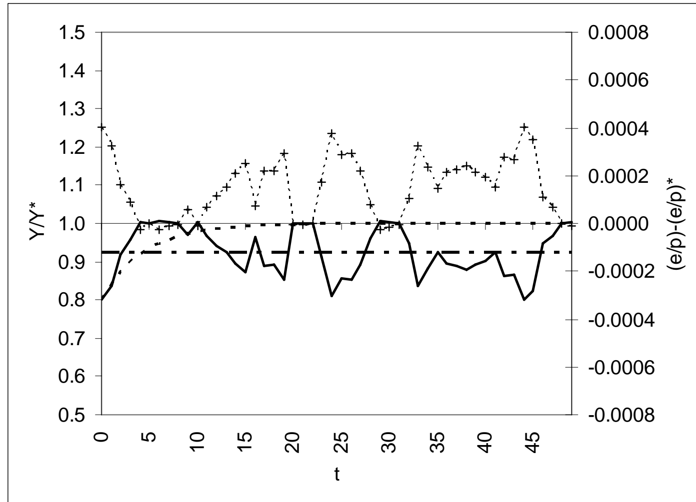
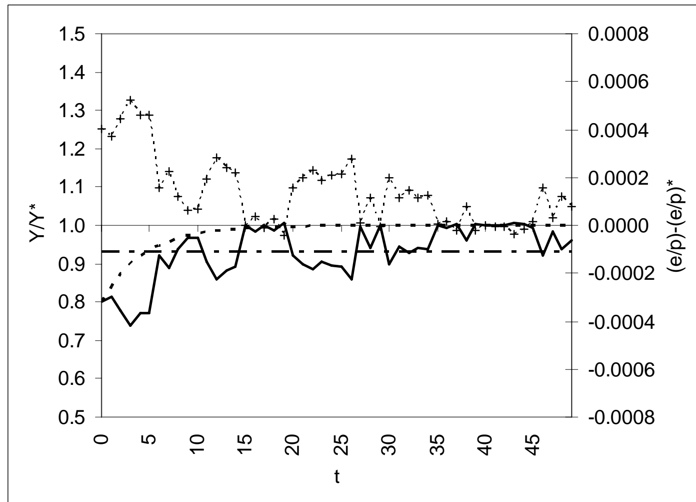
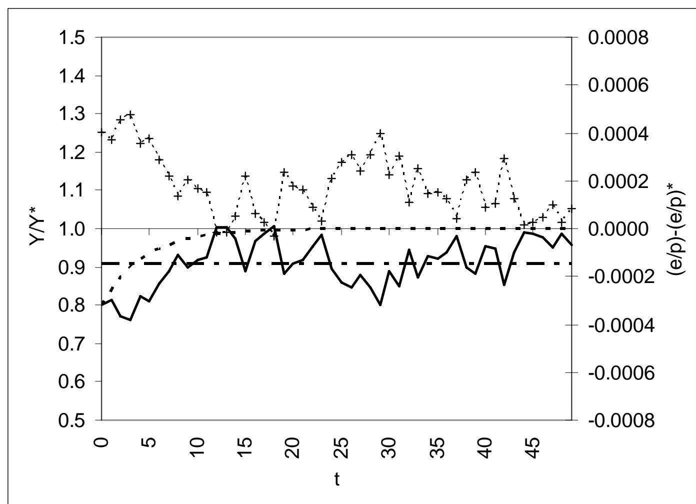


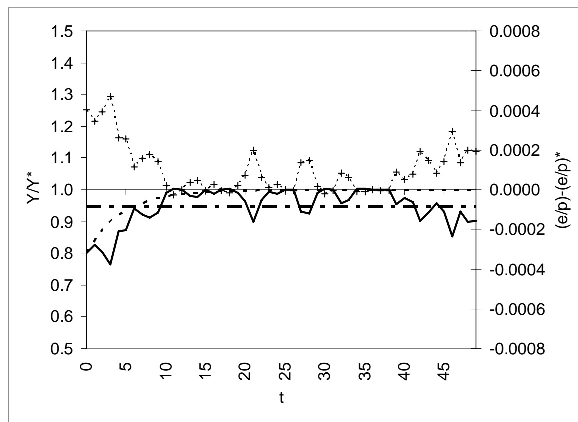
Notes: These simulations are based on following parameter values.
a= 0.8
b= 0.0001
θ=5
θ'=2
$\varepsilon'(t) \sim N(0,10^{-8})$

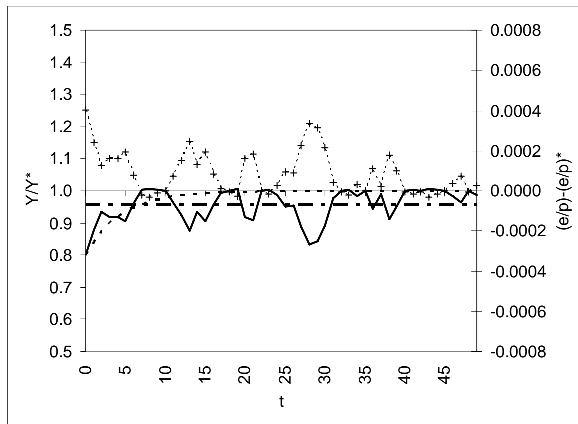
Figure 3. Simulations for the Model Described in Section 3.

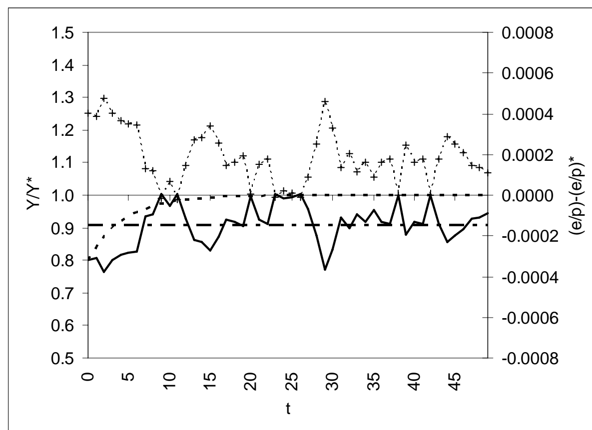

Y/Y*
(e/p)-(e/p)*
t


Y/Y*
(e/p)-(e/p)*
t


Y/Y*
(e/p)-(e/p)*
t







[Y/Y*] [Y/Y*]^ Average (Y/Y*) [(e/p)-(e/p)*]

Notes: These simulations are based on following parameter values.

a= -0.8

b= 0.0001

θ=5

θ'=2

$\varepsilon'(t) \sim N(0,10^{-8})$

Figure 4. Simulations for the Model Described in Section 3 (assuming negative value for a).

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Chapter 3

GLOBALIZATION AS THE HEGEMONIC CONCEPT OF NEOLIBERAL IDEOLOGY

Erinç Yeldan

1. INTRODUCTION

The term “globalization” stands out as the hegemonic concept of the neoliberal ideology, reflecting one of the main items in the current political economy agenda. This buzz-word seems to have a spiritual power in its own right as it provides a center-force directing our daily discourse on economic, social, political, and cultural relations.

The concept is mostly revealed as part of a modern project on “citizenship” along with references to such slogans as: “*being a citizen of the globalized village”* and *“adjusting to the needs of the global markets”*. In this sense, the term itself carries a dual conceptual meaning: a *definition*, and a *policy recipe*. As a *definition*, the term refers to the increased integration of the world’s commodity and finance markets and its cultural and social values. Within the context of this definition, liberalization of the commodity trade and financial flows yield the narrowest economic implications of the globalization process. At a more general level, this process entails“… a programme for destroying collective structures which may impede the pure market logic” (Bourdieu, 1998). In order to sanctify the power of the markets in the name of economic efficiency, this “infernal machine” requires the elimination of administrative or political barriers which limit the owners of capital in their quest for maximization of individual profit, which, in turn has been upheld as the supreme indicator of rationality (*ibid*).

Thus, the concept also covers a list of economic-political- and social actions that is regarded necessary for a country to “embrace” globalization. Brought under the term “Washington Consensus”, these conditionalities are often imposed as part of the austerity programmes designed by the International Monetary Fund (IMF) and the World Bank.

Accordingly, in a market economy under capitalist competition, the profit rate (or, more generally, the rate of return to capital) is heralded as the supreme objective and the state apparatus is to be re-organized to ensure highest profitability of capital. This re-organization

aims at reducing the role of the public sector in regulation of the economy, and is dressed with the rhetoric of terms such as “governance” and “market-friendly, credible governments”.

The main dictum of the globalization rhetoric rests its arguments on the allegation that “globalization is the natural product of human history and as such it is unavoidable”. Thus, all countries should follow the necessary policies (often termed as structural reforms) to take advantage of this magical process. Only then the bounties of globalization would follow to those countries that succeeded implementation of such reforms. Given this logic, the main responsibility of the developing countries is to open their economies to international capital and to implement the necessary reforms warranted by the transnational companies (TNCs) and international financial institutions (the so-called IFIs).

In this sense, the development strategy no longer encompasses indigenous targets on industrialization, fixed capital investments, or strategic trade policies; but is reduced to only one concept: adjust to the needs of international capital, or in the words of Dani Rodrik (1992), “be a host to the most beautiful welcome party for foreign capital”. It is through this logic that the economics profession has witnessed a deep transition in its terminology. Concepts such as “under-development” or “developing countries” are replaced by “emerging markets” and “market actors”.

Perceived from this angle, it is clear that the term globalization is an *ideological* concept, advocating the interest of capital, rather than a neutral concept of historical progress. As the main concept of the neoliberal ideology, the terms reflect the strategic interest of international capital. The main actors of this ideology are the TNCs, the IFIs, and the multi-national organizations such as the IMF, the World Bank and the World Trade Organization (WTO).

Under the new era of globalization of capitalism, it is observed that the 500 largest TNCs account for 30% of global production and 70% of global commodity trade (UNCTAD, 1994; Petras and Weltmeyer, 2001). On the other hand, the volume of daily trade in the foreign exchange markets accelerated from US$ 190 billion in the 1970s, to US$1.2 trillion in early 1990s, and to US$1.2 trillion currently. This number has outpaced the annual volume of global commodity trade by 70-folds. According to Petras and Weltmeyer (2001: 17) for every 1$ of transaction carried out in the real sector, the finance sector utilizes a transaction volume reaching to 25-30 dollars. As the main actor of international finance, the banking sector has diversified its international operations rapidly and increased its international credits to the developing world from US$32 billion in 1972 to $90 billion in 1981 (Strange, 1994. 112).

Thus, the term globalization reflects the main ideological concept of the TNCs and the IFIs to re-organize the global commodity and the financial markets to better serve their strategic interests, rather than a neutral term depicting miracles of technological advances as often alleged. In this sense, globalization is a cover-phrase disguising the ideological interest of globalizing capital and entails a set of strategic policies to re-arrange the role of the developing nations in the international division of labor and to consolidate the capital’s supremacy over labor.

This study extends the arguments set forth in the above introductory paragraphs and aims to discuss the underlying ideological purpose of the term “globalization”. The rest of the paper is organized under sections. In section II, I discuss the two recent waves of globalization of the last two centuries. Section III takes the globalization of finance a closer look. In section IV I discuss the concept of development strategy and argue that under the conditionalities of the globalization ideology, implementation of a viable developmental strategy is virtually not possible. Section five summarizes and concludes.

2. THE TWO-WAVES OF GLOBALIZATION OF WORLD CAPITALISM

As stated in the Introduction above, the term globalization is portrayed as a natural process of technological advances and integration of the world societies as a common, global village. Yet, the history of capitalism reveals that even if the term is analyzed in this simplistic (disguised) fashion, it does not apply only to the current era of human history and that over the course of its history, capitalism has lived through cycles of such internationalization, expansion and contraction. Indeed, the history of capitalism of the last two centuries reveal two independent long cycles of internationalization of capital. The first of these cycles roughly correspond to the post-industrial revolution era of 1870-1913. This era is observed to come to an end with the outbreak of the two major wars of the 20th century and of the rise of the Soviet-system and the so-called “welfare state” policies of the Western world. This interlude of seemingly “tamed” capitalism and regulatory framework on global finance is finally broken down by the last quarter of the 20th century, and capitalism has entered a new cycle of (current) globalization. As such, even though one observes many important characteristic differences among the two, I will refer to the first one as the 19th century cycle, and the latter as the 20th century cycle of globalization.

Leaving out the differences for the moment, the most important common feature of the two cycles of internationalization of capitalism is the rapid rate of economic growth witnessed over the last 250 years. The acceleration of growth was incepted in the weaning and cotton ginning industries in the 1730s. This was followed by the rapid advances achieved in rail road transportation (1820s) and trans-oceanic shipping based on steam power (1840s). Given these developments, the structural composition of labor force has changed rapidly and, in England for instance, the share of industrial labor in the total has increased from 30% in early 1800s, to 47% in 1840, and to 49% in 1870 (Baldwin and Martin, 1999).

The rapid rise of growth rates was indeed phenomenal. The world economies were almost at the subsistence level of economic activity by the turn of the 1800s. Average rates of economic growth accelerated rapidly to 2 percent during the 19th century and rose above 3 percent over the 20th century course of development. During this process the rate of growth experienced by the leader of world capitalism is observed to have accelerated at each new round. While the rate of growth experienced by Netherlands, the then leader of world capitalism between 1580 and 1840, was only 0.2 percent; the upcoming leader, England, enjoyed a rate of growth of 1.2 percent during its reign 1820 through 1890. The rate of growth of the current leader, USA, averaged 2.2 percent over 1890 to 1990.[1]

We know that the other side of this underlying process of economic growth was a concomitant phase of *de*-industrialization of the regions which we refer today as the “third world”. For example, India, which was the leader of the world textile manufacturing until the 18th century, has been converted into a peripheral economy which imports 70 percent of its textile consumption in exchange for raw cotton by the 19th century.[2] Thus, the first wave of 19th century globalization was invigorated over a relatively equal distribution of income in a world producing at roughly subsistence level of consumption. Yet, the initial conditions of world income distribution inherited by the second wave of globalization in the late 20th century rested upon a deeply unequal structure.

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[1] For further discussion and specifics see, Parente and Prescott, 1993.
[2] See, e.g., Collins and Williamson, 1999; Landes, 1969.

Consequently one of the major distinguishing characteristics of the 20th century globalization regards the uneven distribution of world income upon which the consequent process of liberalization and deregulation are initiated. This second globalization wave is observed to deepen the existing/created unevenness of world income strata even further. As documented by the *1998 Trade and Development Report* of UNCTAD, the world *gini* coefficient of income distribution was 0.66 in 1965; increased to 0.68 in 1980; and to 0.74 in 1990. The average of the lowest percentile of world income was 74$ in 1965, in comparison to the average of the highest percentile which was 2,281$. This gave a ratio of 1-to-31. By 1990, the figures for the comparable percentiles were calculated to be 283$ for the lowest, and 17,056$ for the highest group. This meant a ratio of 1-to-60.

Concomitant to the intensified deterioration of the distribution of income strata, the 20th century globalization also witnessed a drastic change in the structure of the liquidity generation mechanism across the globe. While the liquidity mechanism of the 19th century was based mostly on the gold standard, the 20th century monetary systems mostly utilized *fiat* currencies. The fact that most of the major currencies of the world markets were based on nominal fiat values, which were effectively off-the gold standard after 1973 meant a system where "countries give up the exchange rate as an instrument of monetary policy up-front and must accept whatever exchange rate the global system generates" (Adelman and Yeldan, 2000b: 102). Set across a system of freely mobile international capital flows, flexible exchange rates amplify the swings in the financial markets by allowing speculation on foreign exchange markets that are excessively large; excessively liquid; excessively volatile; imperfectly informed; and subject to herd psychology.

Thus, it is this feature of the 20th century financial capital centers invited Adelman and Yeldan (2000b) to assert that "the process of economic development is at risk because the nature of global institutions for short term capital flows is robbing developing countries of their autonomy" (p. 96). To be able to better evaluate this assertion, we need to capture the essence of the concepts of financial liberalization and development strategy more closely.

3. THE RISE OF FINANCE CAPITAL

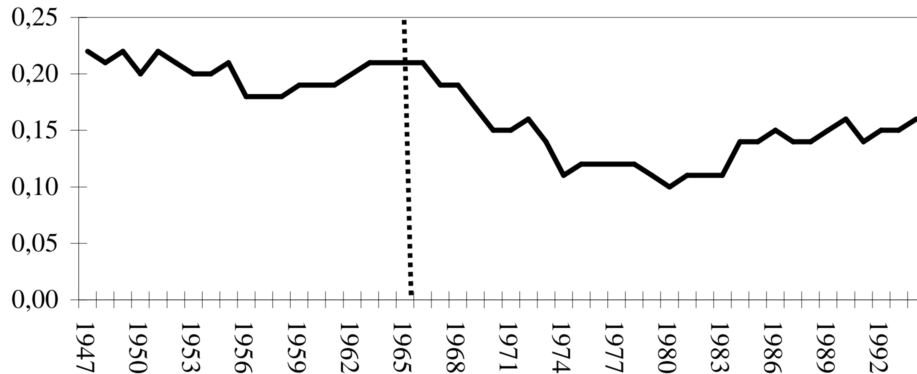
One of the most distinguishing features of the 20th century wave of globalization is the ascendancy of finance over industry under a regime of fiat currencies. This gave rise to an immense speculation activity driven by massive capital flows led by myopic expectations.

This process has been the result of the demise of the *Fordist* production technologies in sustaining profitability of capital. The Fordist model was based on mass-production for a mass-consumption market. The need for mass-consumption has, in turn, necessitated a generally tolerant stance towards wage-labor by way of recognition of many labor rights. As a result, the strategy relied on the generation of a domestic mass consumption market based on strong wage incomes. The nature of technologies available back then enabled high productivity increases that led to sustained profitability for industrial capital.

With the advent of wide spread production facilities across the globe, however, the Fordist mass-production-mass consumption strategy reached its limits. Led by intensified competition through technological reverse-engineering, imitation and cheap labor costs,

developing countries mainly of East Asia started to capture market shares which traditionally belonged to the *North.*

In Figure 1 below I depict the long run tendency of manufacturing profits in the US. The late 1960s clearly reveal the fall in rates of return to US manufacturing industry capital.



Source: Moseley, 2001.

Figure 1. Profit Rates in US Manufacturing, 1947-1994.

As a response, pressures to sustain profitability amounted. As rates of return in industry fell, the returns to finance capital were intensified. Calls for "financial liberalization" and "structural adjustment reforms" to guarantee "flexibility of labor markets" have echoed the ideological will of this transition.

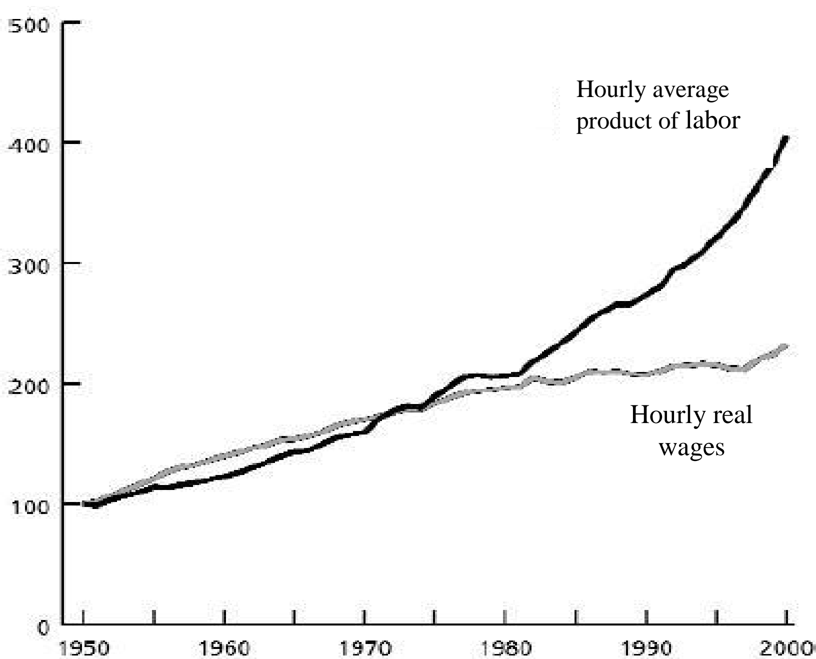
In the meantime, there were further developments at work in the international financial markets. Massive surplus dollars were accumulated as a result of three phenomena:

(1) The US financed the war costs at Vietnam with rapid increases in liquidity;
(2) Oil shocks of 1973 and 1978 have led to a massive accumulation of petro-dollars in the Western banks. This in turn necessitated a vent for "re-cycling" The excessively big liabilities of the banking system. Thus, the foundations of the *debt-trap* were laid out.
(3) Finally, the rapid population growth based on the so-called "baby-boomers" reached their retirement age. The retirement funds of the now-old baby-boomers necessitated even higher rates in the global financial markets. This led to the emergence of various financial instruments to accommodate the increased pressures in finance, such as derivatives, repos, hedge funds, etc.

These developments in the real and financial spheres have generated their own ideology, and the trinity of de-regulation, privatization and technological revolutions in banking and finance led to the supremacy of finance over industry in particular, and of capital over labor, in general. In the meantime, the economics profession witnessed the demise of the Keynesian demand management and the rise to hegemony of the neoliberal ideology. The demise of "development economics" was recognized as a welcome event, and economics as a science has been transformed to an engineering technical subject of technocrats and mathematical wizards. This opened up a whole new episode in human history, as "developing countries"

came to be referred to with the seemingly neutral concept "new emerging markets", and "development policy" was replaced by "financial conditionality".

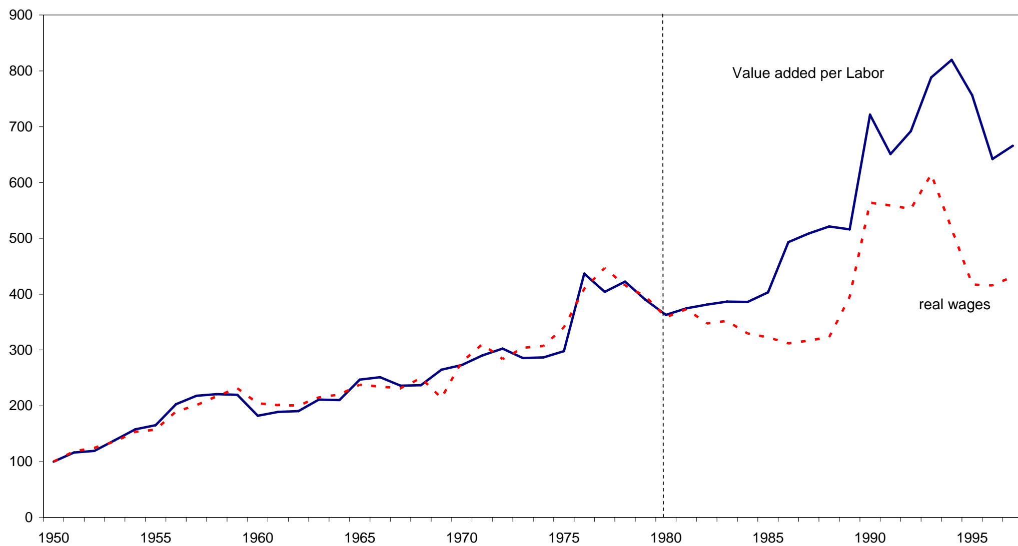
Capital's assault on labor continued with new forms of industrial organization. With intensified policy changes towards flexibility and privatization, position of wage-labor eroded everywhere. This process was most visible in the US, the hegemonic center of global capitalism. In order to depict this phenomenon Figure 2 portrays the paths of real wages and real labor productivity in US manufacturing in the second half of the 20th century. As clearly visible, the Fordist period under the Keynesian policies is associated with real wages following to a large extend the movements in labor productivity up until 1970s. The late 1970s, however, reveal the extend of capital's gains against labor. As the real wage rate stagnates, its path remains significantly below the real average product of labor. This difference yields the increased exploitation of wage labor in the last quarter of the century.



Source: "The New Face of Capitalism: Slow Growth, Excess Capital and A Mountain of Debt" *Monthly Review*, editors, 2002. (*www.monthlyreview.org/0402.editr.htm*)

Figure 2. Labor Productivity and Hourly Real wages in US Manufacturing (1950 = 100).

A different facet of this observation was at play across the Atlantic as well. Figure 3 below contrasts the US wage labor's position with that of a developing market economy, Turkey. The figure portrays comparable data and the verdict is exactly the same. Wage rates of the Turkish manufacturing labor follow the average real product until 1980, and under conditions of military dictatorship during the 1980s, a significant gap is created among the real wage earnings and real labor productivity by way of intensified exploitation of labor.



Source: TURKSTAT, Annual Manufacturing Surveys.

Figure 3. Labor Productivity and Real Wages in Turkish Manufacturing (1950-1997).

Clearly very similar processes had been operational both at the North and South under neoliberal globalization. The end of the Fordist technological organizations led to the demise of the welfare state which enabled a comparatively tolerant attitude towards wage labor. As this delicate balance on mass production for domestic consumption eroded, capital has found a new opportunity in financial returns. Overall this process has led to the demise of the welfare state and an outright hostile attitude against the rights of labor.

As a result, share of labor in national incomes fell everywhere. According to Petras and Weltmeyer (2001) and Diwan's (1998) data, share of wage labor fell from 48% (1970) to 28% (1985) in Chile; from 41% (1970) to 25% (1989) in Argentina; from 37% (1970) to 27% (1989) in Mexico; from 40% (1970) to 17% (1986) in Peru. Similarly, according to calculations of Yeldan (2000, Chapter III) the share of wage labor in manufacturing value added was reduced from 28% in 1976 to 15% by 1987.

This abrupt shift in the distribution of income against labor coincided with the assault against indigenous strategies for economic development. I now turn to this issue.

4. Economic Development Defined Proper

First, let's highlight the distinguishing characteristics of the process of *economic development* proper from *growth*. Succinctly put, the term "economic growth describes the process by which an economy dominated by agricultural activities carried on with low levels of capital per laborer is transformed into one in which industry and other non-farm activities produce the bulk of society's output using high levels of capital per worker" (Putterman, 2001: 142). As an extended outcome of this process, the proportion of output produced for consumption directly by the producer declines while the share of consumption produced by

others increase. This phenomenon reflects the nature of commercialization embedded within the modern economic growth itself.

Economic development, on the other hand, refers to that process of growth "that translates into wide spread improvements in well-being" (*ibid*: 143). Following this vision, Adelman and Yeldan (2000b) note the following five determinants of economic development, as distinct from mere economic growth:

(1) self-sustaining growth;
(2) structural change in patterns of production and consumption;
(3) technological upgrading;
(4) social, political, and institutional modernization;
(5) widespread improvement in the human conditions.

Accordingly, prior to World War II, today's developing countries experienced only cycles in economic growth, but not economic development. These cycles were in turn very much under the discretion of the cycles in the industrial countries through their input demands of primary food and raw materials from the developing world.

After the end of World War II, several new elements coincided to enliven economic development as a real possibility: (1) through a succession of movements for independence, most developing countries attained political autonomy; (2) this, in turn, coincided with a favorable international environment which granted a fairly strong economic autonomy in managing their industrialization targets.

Yet, it is precisely this economic and, by extension, political autonomy that is under severe attack by the current stage of neoliberal global agenda, putting the underlying policies of economic development at risk. The new wave of globalization, with the unfettered workings of highly liquid and volatile flows of financial capital, restricts the autonomy of the developing countries to pursue strategic policies to attain indigenous industrialization targets. To understand why this is the case, we must look at the underpinnings of the current exchange rate and open capital account regimes, and explain how the free international movement of short term financial capital undermines the ability of countries to induce economic development targets, depriving them of even the basic instruments of stabilization and austerity.

To be able to take better account of the disruptive mechanisms of this structural fragility, we have to note the famous *tri-lemma* underlying an open economy that the international economists are fond of. In an open economy, the monetary authority can independently choose only one of the three following instruments: the nominal exchange rate, the interest rate, and the stock of money, leaving the determination of the other two to the interplay of the market forces. In fact, the interest rate and the exchange rate lose their independent autonomy all together, and turn into a single variable whose value is characterized by their relative magnitudes vis-à-vis each other. In this setting, raising the net differential of the interest rate and the rate of depreciation of the exchange rate above the world market levels triggers a large foreign capital inflow, setting the structural foundations of a culminating financial crisis: the increased flow of foreign capital leads to an appreciation of the exchange rate, causing a deterioration of international competitiveness. Exports stagnate while import demand escalates. As this process continues, current deficit widens and foreign speculators lose confidence in the domestic currency. This might itself signal the confinement of the

domestic asset markets to a vicious trap: in order to overcome the rising country risk and gain International creditworthiness, the central bank is compelled to raise the interest rates even further and start hoarding international reserves. In fact to market the economy as an attractive site for the international speculators, governments will necessarily be compelled to maintain interest rates at levels higher than they otherwise would prefer. This will set of a vicious circle of uncontrolled inflows of foreign capital, appreciation of the exchange rate, deterioration of the current account balance, erosion of the confidence… all of which necessitate even higher rates of interest calling for the re-commencement of the cycle. Elements of this vicious cycle are further studied in Kaminsky and Reinhart (1999), Diao, Li, and Yeldan (2000), Dornbusch, Goldfajn and Valdés (1995), Velasco (1987), Diaz-Alejandro (1985), and more recently referred to as the *Neftci-Frenkel cycle* in Taylor (1998) (following Neftci (1998) and Frenkel (1998)).

The initial bonanza of debt-financed public (*e.g.* Turkey) or private (*e.g.* Mexico, Korea) spending escalate rapidly, and severe the fragility of the shallow financial markets in the home country. Eventually the bubble bursts and a series of severe and onerous macro adjustments are enacted through very high real interest rates, sizeable devaluations, and a severe entrenchment of aggregate demand, while the short term "hot money" flows have already rushed out of the country leaving it broke and deprived of the traditional tools of adjustment and austerity. Conversely, setting the net differential of the interest and the exchange rates bellow the world market levels set the stage for capital outflow, directly triggering the crisis.

Yet, what is clearly at stake is not only the choice of economic development path. Countries that are dependent upon capital inflows need to adopt or maintain contractionary monetary policies in order to secure investor confidence and international creditworthiness. Thus, the governments of the emerging markets who seek to attract and maintain inflows of foreign capital are severely constrained in the *ex ante* sense to adopt a set of restrictive monetary and fiscal policies (Grabel, 1996).

In this environment portfolio investors become the ultimate arbiters of national macroeconomic policy (Cizre-Sakallioglu and Yeldan, 2000; Frieden, 1991). Public policy became synonymous to populism and waste. Democratic institutions are put under siege through endless lists of conditionalities set forth by the IMF and the World Bank. The IFIs report rating scores in aligning the indigenous economies under the strategic realm of finance capital. Even direct political decisions are under scrutiny. Consider for example the rejected war motion by the Turkish parliament, disapproving the US troops to utilize the Turkish soil in the early days of the Iraq's invasion. In exchange for a total aid of 25 billion dollars, USA had asked permission from Turkey to use its borders with Iraq. The motion was rejected and a chaos ensued driven by the IFIs and their rating agencies. The following excerpt from *Morgan Stanley Economic Forum on Turkey*, is a critical example (March 4, 2003):

> "the latest parliamentary decision to reject the much-debated 'war motion' is such a risk that will no doubt disturb the fragile equilibrium...(Turkey) is unlikely to get the promised $24 billion that would ease pressure on the domestic debt market..."

The report concludes with the stunning question:

> "what happens if the parliament does not altogether vote for the economic reforms, arguing that 80 % of the Turkish population is against the IMF program?"

The report is not only concerned with the loss of 25 billion dollars liquidity for the Turkish financial centers, but also is concerned hat the people may further exercise their rights over the future of the IMF-led austerity program in Turkey. In the classic words of Diaz-Alejandro, a twist can also be mentioned: *"Good-bye Budget deficits, hello democracy deficit..."*.

5. CONCLUSION

In this paper I have argued that the new wave of globalization led by open capital markets and unfettered financial flows constrain the developmental states in pursuing strategic industrialization and development targets. Yet, history provides overwhelming evidence that successful long term economic development entails a state-led process of systematically transforming dynamic interactions between institutional change, technological progress, and structural change in the profile of production, distribution, and consumption. Nevertheless, the pace of industrialization and modernization that the developing countries can achieve are severely constrained under the post-Bretton Woods era of financial liberalization orthodoxy. Such efforts are restricted to a balanced budget, entrenched fiscal expenditures, and a relatively contractionary monetary policy with an ex ante commitment to high real interest rates. All of this signify reduced political autonomy in the developing world in exchange for market access to industrialized North, and itself is a bad bargain as far as development is concerned (Rodrik, 2001).

The detrimental consequences of the free movement of short term capital flows are not limited to the erosion of the developmental objective. They are further held responsible for depriving the governments from the classic tools of austerity and setting the stage for full-fledged financial crises. As open capital markets replaced closed short term capital markets and regulated flows of foreign investment, governments became unable to employ their traditional policy instruments (interest rates, rate of monetary expansion, and exchange rates) unilaterally: Flexible exchange rates amplify the effects of these international capital flows, by allowing speculation on foreign exchange markets that are excessively large; excessively liquid; excessively volatile; imperfectly informed; and subject to herd psychology.

In the words of the UNCTAD's 1998 *Trade and Development Report*, "the ascendancy of finance over industry together with the globalization of finance have become underlying sources of instability and unpredictability in the world economy. (…) In particular, financial deregulation and capital account liberalization appear to be the best predictor of crises in developing countries" (pp. v and 55). Almost all recent episodes of financial-cum-currency instability disclose that the observed sharp swings in capital flows are mostly a reflection of large divergences in domestic financial conditions relative to those of the rest of the world. Reversals of capital flows are often associated with deterioration of the macroeconomic fundamentals in the recipient country. However, "such deterioration often results from the effects of capital inflows themselves as well as from external developments, rather than from shifts in domestic macroeconomic policies". (*ibid*, p. 56).

From a policy point of view, the very starkness of the picture of the diminished possibilities for attaining developmental targets painted throughout this paper implies that many of the remedies suggested for achieving sustained growth and avoiding future financial crises will do no such thing. These include: financial sector reform; better information; the creation of a new international institution to supervise international financial transactions and operate as a lender of last resort; cleaning up corruption in lending; getting government out of the targeting business; and improving the governance of the corporate sector. Notwithstanding the importance of these structural reforms, the single most important source in our analysis for a crisis to develop was short term financial markets open to international financial flows which are navigated by the herd behavior induced by the speculative and short sighted portfolio investors. In this vein, our readings of the recent history of failed developmental objectives and financial crises suggest that the primary basic remedy for attaining sustained development lies in regulating short-term international flows, and highlight once again the now classic dictum due to Keynes, "*above all, let finance be primarily national"*.

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Chapter 4

IMBALANCES IN THE WORLD ECONOMY AND CONGESTION IN THE PERIPHERY

Ahmet Haşim Köse and Ahmet Öncü

1. INTRODUCTION

Reviewing the recent history of world capitalism after 1980, it would not be a mistake to say that the countries of the centre have established a political yoke over the bloc of peripheral countries through the mediation of the economy. One of the consequences of the global neo-liberal restructuring, which we can conceive as the extensive capitalization of the world, has involved the restriction of the capacity of the nation-state to intervene in the economy and the reordering of the right to private appropriation at the expense of public property and its consequent extension. The global bearer of this transformation has been the composite "subcontracting" agent consisting of the IMF and the World Bank. The priorities of the first and second generations of structural reforms embodied in the Washington Consensus and its successor, the Post-Washington Consensus, have involved a series of "reforms" extending from the reconstruction of the peripheral countries under conditions of the open economy to the restructuring of the state within these societies. Having been rendered *passive* vis-à-vis "market rules" through the first-generation reforms labelled deregulation, the state has once again become *active* as an agent of re-regulation, extending the market to embrace all spheres of the social, through the second-generation reforms. So-called structural adjustment programmes, served under the rubric of good governance, have forced peripheral states to redefine and reorient their institutional and legal set-up, earlier shaped by their specific historical and social relations, so as to cater to the interests of global capital flows.

It may be said that, having been pushed into a permanent debt spiral starting with the 1990s, the group of peripheral countries find themselves within a process of uncertainty resulting from the extension of economic crises into social crises, the future consequences of which are difficult to discern. The fact that this dramatic process has so far been met, save for a few countries or regions, with inaction derives from the congestion resulting from the substitution of the traditional informal and modern formal institutional relations of solidarity

by market relations under the pressure of the imposition by the centre of *economic liberalism* on the periphery. In the midst of wide segments of people being increasingly proletarianised and thus made dependent on the market and its disciplinary power structure, social inequality is deepening and conflicts are intensifying, while at the same time all instruments of redistribution through which the state might have ameliorated the worsening distribution of income are destroyed one by one. The commodification of social relations leads in immediate fashion to the replacement of values of solidarity by utilitarianism and creates an environment of *bellum omnium contra omnius*. On the one hand, this results in a crisis of legitimacy for the state and, on the other, the growing proletariat displays a consciousness, or lack thereof, torn between self-estrangement and an orientation of becoming a class-for-itself. The present situation is, then, a state of "permanent crisis", whose outcome is hardly predictable.

The overlapping of this state of permanent crisis in the periphery with a period of growing imbalances and discord within the centre indicates in direct fashion that the present mode of regulation and expansion of the fragile world economy is approaching its limits. There is no doubt that the sustainability of the present mode of regulation of the world economy is intimately tied up with the endurance and fragility of the subaltern classes or, in Braudel's (1977) terms, material life. Hence, to identify correctly the class nature of the deepening contradiction between the ongoing project of the restructuring of the state in peripheral societies and material life is relevant to an understanding of the ways in which the political and social, as well as economic, preferences of the world system are evolving. At present, the state of permanent crisis in the periphery, coupled with the attempt to overcome this crisis on the basis of policies favouring imperialist interests, leads to a confrontation over antagonistic contradictions between the "*comprador*" bourgeoisie acting as the local link of the global bourgeoisie, on the one hand, and the dispossessed strata of the bourgeoisie and the proletariat stricken with ever-increasing unemployment and exclusion, on the other.

Taking the concept of capitalism as its point of departure, this article will dwell on the modes of regulation of the world economy in times of prosperity and crisis for US hegemony and analyse the current contradictions, deriving from accumulation and distribution, of capitalism as a system of states. The central objective of the article is to draw attention to disparities created by the global accumulation of capital in the neo-liberal period between spaces divided politically in state-form. With this purpose, we examine trade and capital flows for the centre and periphery and try to depict imbalances and disparities within capitalism on the world scale by disaggregating the consequences of the crisis of over-accumulation on the basis of states and blocs of states. To borrow the terms used by Claudio Katz (2004), present-day capitalism displays "grey" areas within the blocs of the centre and the periphery. Neither the centre nor the periphery is internally homogeneous and the cost imposed by imperialism on these countries ranges from stagnation to breakdown. This draws attention to the disproportional impact of the global crisis on the system of states and reminds us that the limits of the seemingly established contradictory harmony between the state and capital blocs of the centre are directly linked to the capacity of endurance of the peripheral countries shouldered through trade and capital flows. Today's world economy presents itself as a contradictory whole consisting of the articulation of regions of overproduction and under-consumption. The unquestionable consequence of this contradictory whole for peripheral countries is their conversion into "transfer" societies of a kind that consume less than what they create through global trade and capital relations.

2. REMEMBERING AND UNDERSTANDING CAPITALISM

At the theoretical level, the conceptualisation of capitalism requires, alongside the universal relationship that capital establishes with labour, a perception of the power of capital over society at large (Thompson, 1978; Wood, 1995, 1999). For the Marxist method, this necessity derives from the fact that capital is, as well as an economic relation, also a political relation that arises in a certain social formation. To put it differently, in addition to being a value relationship, capital is equally a social relationship involving a class contradiction between capital and labour, one veiled by the commodity fetishism (Marx, 1986). Hence, a study of how and through what processes capital as a social formation is able to reproduce its power and how it is able to overcome the conflicts and contradictions between the classes necessitates an analysis of the political relation between capital and the state (Clarke, 1991).

The wielding of the means of production by the capitalist class results in the appearance of capital vis-à-vis labour both as a property (*capital as property*) and an entity that possesses the function of organising production (*capital as function*). This dual property accords capital the superior position of appropriating the surplus-value that is the difference between wages, the value of the reproduction of human labour, and the value produced by labour. In this manner, the property wielded by capital over the means of production grows incessantly. This particular transformation of private property into capital is at the same time the growing expansion the power of capitalist class over society. It is in this sense that capital accumulation *qua* a power relation may be defined as the ability of capital to obtain the consent of labour to sustain its existence within the wage relationship. When taken at an abstract level, the most important barrier in the way of the expansion of capitalist social relations, in other words the most critical crisis from the standpoint of capital, is the unavailability of wage labour on the basis of the principle of profitability (Clarke, 1994; Wood, 1995). The occurrence in practice of such a situation implies that capital cannot establish its social power over labour. It may thus be said that the upper limit of the expansion of capital accumulation within the social space will be determined by the supply of labour consenting to the wage relationship.

Property relations within a social space organized in the form of a state are mainly political relations whose legitimacy is established juridically. In capitalist society, social space is divided into two, as the private and public spheres. The conversion of the private sphere into capital as property assumes the existence of a dispossessed group of people. Historically approached, as Marx (1986) has shown through his concept of primitive accumulation, this arose simultaneously with the emergence of the proletariat. Henceforth, as long as proletarians remain dependent on capital, all the values that they will produce will end up doing nothing but expand capital as property, a force that is alien to and acts against them, thus resulting in their impoverishment the more they produce capital (or property) (Marx, 1979). However, within a capitalist society, capital as property does not exclusively confront the proletariat, but equally involves a contradiction between the capitalists themselves, as a consequence of competition and devalorisation (Clarke, 1994). Though it may be the proletariat that is at the centre of the impoverishment process, nonetheless one should not overlook the fact that those former members of the propertied classes who have lost their capital are always part of this process (Clarke, 1988). Because, as Marx (1986) showed, capital as property will sustain its existence and expand with the continuous dispossession of

many from among the ranks of the propertied classes. The history of bourgeois society is the history of the growth of the expropriation of many capitalists by other capitalists. Hence, the general history of capitalism is as much a history of competition and contradiction among capitals as a history of the subordination of labour by capital.

In capitalism the link between capital *as such* and capital as property can be seen by unveiling the meaning of money, the most general form of property. If we assess the meaning of money in capitalist society for this aim, we see that in bourgeois society the ambition to possess beyond simple need is an indispensable part of the motive to accumulate money (Clarke, 1988). This is because possession of money implies possession of commodities, which stand for everything in this society (Holloway, 2002). At this point, we should remember that to the extent that money is capital, it is a political relationship. For the mystical support for the building of confidence in this fetish, of which ever more is coveted for possession, as the universal equivalent of value is the state. In bourgeois society where capital as property arose, since one of the fundamental tasks of the state is the protection of private property, here the state bears the responsibility of protecting the value of the object or instrument used as money. To the extent that it can deliver this responsibility, it can gain the confidence of capital as property and thus persuade capital to stay within its frontiers and grow. This, in turn, consolidates the power of the state.

Viewed from this angle, the socio-political function of the bourgeois state is the normalisation of property around rights defined on the basis of citizenship and thereby the provision of a basis for the formation of a social hegemony that regulates the class contradictions of commodity society (Overbeek, 2004). This shows that the state independently from the "logic of capital" can wield a degree of autonomy from the ruling capitalist class, and hence, can have an interest of its own. The latter called "the logic of the state" is a direct outcome of the capitalist state's being dependent on political contradictions emanating not only from class dividedness but also from the structures and practices of bourgeoisie citizenship (Berger, 2001; Jessop, 1982 and 2002). In this context, the state's capacity of intervention in class relations through the mediation of a nationally administrated monetary system, itself representing the relative autonomy of the state from classes, is a means to supersede and harmonize conflict of interests among different fractions of the capitalist class as well as between the capitalist class as a whole and the working class (Bonefeld and Holloway, 1996; Clarke, 1988).

The logic of the power of capital accords priority to the provision of guarantees for the wage- labour relation and the maintenance of the right to private property under conditions of "limitless" accumulation and profit on the world scale (Harvey, 2003a, b). Throughout the history of capitalism spanning five centuries, a vast system of thought that makes it possible to regulate the economic, political and cultural spheres on the basis of this fundamental premise has been developed, as well as institutional mechanisms that correspond to this system of thought, and parallel to the expansion of capitalist social relations these ideas and institutions have been transformed into traditions. State power, on the other hand, creates its own original logic in opposition to the power of capital within certain limits and tries to harmonise social conflicts and contradictions on the ground of legitimacy. It is to this purpose that it tries to maintain a monopoly of the power to use coercion within its own borders, as was pointed out by Max Weber. Since the legitimacy of its power is based on the provision of justice, the state is able to wield the monopoly of the exercise of coercion through the regulation of the justice system, or, in other words, of law. Given that society does not consist

exclusively of owners of capital, were the system of law erected by the state to be reduced to the logic of the power of capital, it would become much more difficult for the state to don the mantle of legitimacy.

Once the logic of capital becomes relatively autonomised from the capitalist class, capital, reified by capitalist social relations, is transformed within the system of nation-states into a social entity, national capital, and hence alongside the fetishism of commodities arises a fetishism of citizenship deriving from the sentiment of belonging to a nation (Hobsbawm, 1990). While the political geography of world capitalism is thus subjected to a division between "us" and "them" on the basis of this overlapping between property and citizenship, capital as property is perceived as if it were under the common property of a nation. To the extent that nation-states can consolidate this identity of "us" during the period when capitalism functions smoothly, the commodity fetishism can mystify its secret even further and creation of an autonomous political sphere is made possible, a sphere that can veil the fundamental contradiction of the capitalist system. Moments of general crisis, on the other hand, by preparing the ground for the recognition of property to non-citizens, either rigidify further the fetishism of citizenship, leading to the emergence of a nationalist reflex through which a certain fraction of the capitalist class carries the proletariat in its wake, or, alternatively, by exploding the illusion of the fetishism of bourgeoisie citizenship, neutralise the illusion of the fetishism of commodities, thus making it possible for the proletariat to gain total independence from the bourgeoisie and to develop a revolutionary reflex (Hobsbawm, 1994).

The construction of hegemony within the system of capitalist states is a struggle for power between nation-states and focuses, in the last analysis, on the question of whose currency is to serve as world money, i.e. as the global means of circulation in financial and commercial transactions on the world market (Marx, 1986; Arrighi, 1999). As Arrighi (1999) pointed out, in this struggle for power between states, the last word will be said by the state that succeeds in maintaining within its own borders the greater part of surplus-value production on the world scale. This generalisation based on historical observation points to the importance, from the viewpoint of world hegemony, of capital as function, that is to say productive capital, in addition to capital as property.

The holding of capital as property in money-form presupposes an ongoing production of commodities, that is to say the accumulation of productive capital. To put it differently, if money has no material counterpart, it ends up being no more than fictitious property. That is why money has to partake of the circuit M-C-M', that is to say, it has to be converted into "circulating money". This formula, which Marx (1986) calls the general formula of capital, shows us that the individual capitalist can increase her/his money through financial, commercial or productive transactions. On the other hand, the constant increase in the material counterpart of money is only made possible by the production of new value. This is simply repeating the verity that capital as property necessitates wage labour. The production of surplus-value, in turn, is carried on according to the law of value, working its way out through the price mechanism. Capital that assumes the function of producing surplus-value aims, as a general tendency, for a higher than average rate of profit. This can come about in one of two ways: the "capitalist" is able either to sell his or her goods for a price that is higher than its value or, given the price, to produce at a lower value. These two conditions make it possible to explain how competition shapes the dynamics of commodity production as the latter expands tendentially on the world scale. If capitalists have the expectation that market

prices will be above prices of production (values), they will increase investments and employment, and thus production.

Nevertheless all accumulation cycles are also cycles of devalorisation (Clarke, 1994). Within this dual process embedded in one cycle, the value of commodities will begin to fall, commercial competition between national capitals will be stepped up on the world market, many of the productive capitalist firms will be crowded out of the market and this will result in the centralisation of capital on the world scale concomitant to its concentration. In this sense, the extended reproduction of capital on the world scale provides, on the one hand, for the development of productive forces and, on the other, creates the preconditions of over-accumulation: the average rate of profit begins to decline and the relation of correspondence between the money- and commodity- forms of capital will deteriorate, resulting in a breakdown between the two. Within this process money-capital appears more and more as a thing-in-itself and, moving away from the sphere of production, will head for a mode of appropriation based on movable and immovable assets.

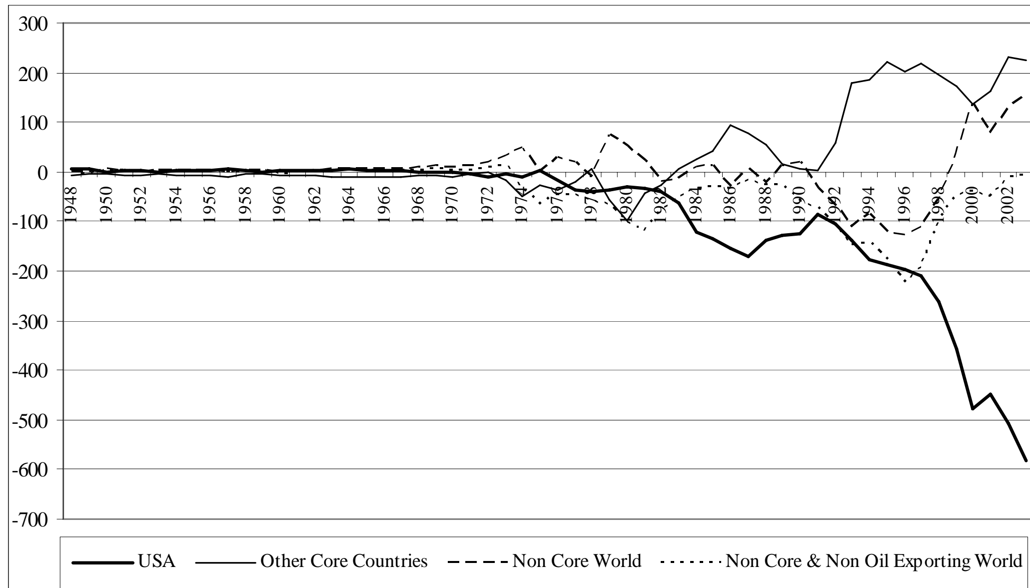
It should be recalled that this process, through which money-capital takes a path of growth relatively autonomous from productive capital, is a political process and initiated by the state which has the largest stock of material wealth within its borders and the biggest highly concentrated and centralised productive capitalist groups that control the highest magnitude of capital as property (Arrighi, 1994). Needless to say, the currency of this state has the characteristic of being world money, which assumes the function of the universal equivalent of value on the world scale. Hence, the power behind the money capital that, having abandoned the sphere of production, is transformed into fictitious capital is the political power of the blocs of capital that are able to orient the hegemonic state.

3. Brief Background regarding the Onset of the Current Crisis

If we now proceed, taking Marx's concepts of money-capital and productive capital as our point of departure, to determine the specific features that world capitalism has assumed during various epochs, it is possible to argue that in the hegemonic set-ups established so far, leaving aside roughly the period between 1930-1970, money-capital has been kept outside the control of the state, thus being granted the freedom of movement under a "cosmopolitan" identity (Overbeek, 2004). The "cosmopolitan" identity of money capital by allowing the spatial separation of production and consumption processes has prepared the ground for the concentration of capital accumulation in one region, the region of "core states". This structural feature of the world capitalism has not only spatially segmented the regions along overproduction and under-consumption axes but also by bringing forth the devolarisation of capital been the harbinger of general crises of the world system (Schwartz, 2002-3; Hopkins and Wallerstein, 1979). At the end of the nineteenth century accepted as the end of classical liberalism this structural tendency concurred to lead to the fusion of the monopolies with the state in the core region, resulting in the rise of state capitalism, and increasing competition between the nationally based blocs of capital ended up leading to in an inter-imperialist war (Baran and Sweezy, 1966; Schwartz, 2002-3).

The general crisis coupled with the danger of a socialist revolution led to major transformations in the state form of the core region (Hobsbawm, 1994). In the core a search for a relative autonomisation of states from cosmopolitan capitalist classes dominated the political arena in order to create a power structure that could cater to the interests of the entire society, while money-capital was still able to roam the world unobstructed (Arrighi, 1994). In the first phases of this transition, in the USA the model of state capitalism prioritising the accumulation of productive capital gained the upper-hand (Hardt and Negri, 1994). The sudden fall of prices on the world market, faster than in ordinary times, as a result of the Great Crash of 1929 prepared the ground for the imposition by the state of restrictions to the flow of money-capital and, in the process, the state wrested the management of money from the grip of private blocs of capital, i.e. of "high finance", transforming it into an instrument that could be controlled politically in a direct manner. The international financial system established by the US, the power that came out strengthened as a result of the second inter-imperialist war, at Bretton Woods in 1944 sealed the break away from the direct subordination of states to high finance, or, in other words, the power of the capitalist class.

From then on, while the US turned over the management of money to the Federal Reserve System domestically, on the world scale the IMF and the World Bank were granted the function of mediating between the central banks of imperialist states and the Federal Reserve. On the basis of these arrangements the dollar assumed the quality of world money and its power and credibility were directly linked to the political and military might of the US (Halliday, 2001; Magdoff, 2003, Beaud, 2003). In a period in which monetary control was captured by the state, while American blocs of productive capital started to extend production outside the borders of the US, a process of capital accumulation based on production and consumption on the national scale was started both in the imperialist countries and in a majority of peripheral states remaining outside the orbit of the Soviet bloc. Viewed from this angle, although the model of capital accumulation oriented to exports observed in the Far East and Southeast Asia seems to stand apart from the system thus built, this arrangement appears as a direct outcome of the US policy towards this region and, as a variant of the model of capital accumulation based on productive capital, does not really deviate from the characteristic features of the period (Schwartz, 2002-3). In sum, after 1945 the US was able to contain inter-imperialist contradictions through the construction of a system of regulation that prioritised the relatively autonomous power of the state vis-à-vis the power of the capitalist class. In this sense, while we witness, in the post-war period, the provision of the conditions of capital accumulation through the establishment of stability in the world economy by a "super-imperialist" power, nation-states have gained a capacity to manage and regulate that is relatively autonomous from blocs of capital. This state of affairs appeared to function in uninterrupted fashion until the late 1960s.



Source: International Financial Statistics Data Base, Country Statistics.

Figure 1. Trade Balances in the World Economy, 1948-2003, Billion Dollars.

This post-war arrangement of the international economy under the leadership of the US, based on a priority accorded to productive capital, also sought to meet the condition of balanced trade between blocs of states. In effect, Figure 1 shows that world trade balance was achieved within and between blocs in the period 1948-1970 and, concomitantly; individual states were not allowed to deviate from trade balance. This is a result of the fact that, both in the bloc of central states and in the bloc of peripheral states, monetary and fiscal policies focused on the long-term growth, without allowing for an excess supply at the domestic level, all this in line with the dominant mode of capital accumulation (Adelstein, 1991; Aglietta, 2000). In this period, the share of foreign trade in national income was low and, thanks to government control over capital flows, the impact of developments in the world economy did not reach significant proportions. In effect, fixed but adjustable foreign exchange rates made it possible to re-establish trade balance through adjustment in the exchange rate of the national currency. It is thanks to this that there arose no need for a direct pressure on real wages and that intensification of the capital/labour contradiction was avoided. On the other hand, due to the diversity of the national policies pursued by different states, there came about a differentiation between national wage levels, leading to a geographic diversification of rates of surplus-value and profit. In this context, the share of wages within national income continued to rise in Europe as a result of the remarkable power of organised labour. In the US and in many rapidly industrialising countries as well, the adoption of a model of accumulation based on the expansion of the domestic market led to a similar course of development (Levine, 2001).

During the period 1950-1970, when nearly all flows of financial capital were limited to official resources, the US tried to overcome the question of the over-accumulation of capital through the directing of the flow of productive capital to the central bloc, particularly to Europe (Burnham, 1996, Tabb 2001). On the other hand, by opening up its domestic market

to Europe and Japan, the US also made possible the resolution of the problem of overproduction in these regions (Brenner, 2002). Thus, capital accumulation proceeded rapidly on the basis of "extended reproduction" (Harvey, 2003a). Profits were ploughed back into new technologies, fixed capital and intense investment in infrastructure, as well as growth. This is the basic development that led to an excess supply on the world scale, bringing along an intensification of competition between the blocs of centralised productive capital in the advanced industrial countries. On the other hand, the struggle for survival between national capitals is not confined to market competition on the basis of prices: the boosting of productivity through the adoption of new technologies and investment in fixed capital has an even greater role to play in this competition (Brenner, 2002). On this basis, German and Japanese corporations, which were able to make extensive investment in fixed capital throughout the 1960s, overtook US corporations with each passing year. This tendency led, in the bloc of central countries, to a further concentration and centralisation of capital, on the one hand, and to the emergence of a vast surplus capital that was not amenable to profitable investment in the productive sphere on the other. In short, at the threshold of the 1970s, the limits of "capitalism in one country", or rather of the reproduction of capitalism on the national scale on the basis of state regulation relatively autonomous from the power of the capitalist class, had been reached (Holloway, 1996; Clarke, 1988). It was in this context that blocs of financial capital in the US started to pressure the US government with the purpose of gaining the freedom to circulate the surplus capital over national borders, thus demanding to reduce state power directly to the logic of capital (Dumenil and Levy, 2001).

From a multitude of angles, the year 1971 appears as the beginning of the end for the model of "regulated capital accumulation" constructed in the post-war period (Aglietta, 2000). As is obvious from the foregoing, although the preconditions that prepared the transformation may be dated a decade back, it was in 1971 that the US registered a deficit in the trade account for the first time since 1893. This acted as a turning point in that this was later to become one of the invariable structural features of the new period (see Figure 1). It was also during the same year that the US unilaterally revoked the international financial system established at Bretton Woods and laid the basis for blocs of financial capital to execute transnational transactions free from state control. This political manoeuvre supported by the British government not only resulted in a revival of New York and London as international financial markets, but also led blocs of capital in the other central countries, under threat of loss of "competitiveness", to demand deregulation of their respective national financial system, thus accelerating the creation of an ideological climate that forced "financial liberalisation" the world over (Hobsbawm, 1994). As a result of this development, having been subordinated to the state after 1945, "markets" would henceforth come to dominate states once again. This, in turn, would imply the wholesale capitulation of the world economy to undisguised economic liberalism and, concomitantly, to the fetishism of commodities and of capital. In other words, after 1971, the liquidation of the Keynesian welfare state and, in the periphery, the developmentalist state, which had made great strides in some of these countries, was firmly placed on the agenda.

When assessed in the light of world politics, it is easy to see that the real content of this transformation may be summarised as the imposition of "pure economism" to the rest of the world by the US, which, on the other hand, keeps for itself the prerogative of maintaining the active role of the state in directing the economy. In effect, by freeing the dollar from the fixed gold exchange parity of Bretton Woods in 1971, the US has acquired a limitless right of

seignorage and has been able to maintain Keynesian macro policies in a manner appropriate to the conditions of financial liberalisation. Relying on its political power, the interest rate policy of the Fed, and the policies imposed by the IMF and the World Bank on other countries, the US has also been able to sustain its devalorised productive capital through adjustments to the parity of the dollar. Since the 1970s, the US has periodically devalued the dollar to protect its multinational corporations against foreign competition and thus been able to sustain its weight in world manufacturing. The depreciation of the dollar has created competitive edge for US multinationals producing abroad by reducing the costs of the latter, since they mostly use inputs produced within the US, and it has also arrested the decline in domestic manufacturing within the US. The fundamental problem with this policy, on the other hand, is the structural crisis of the system, which follows from the over-accumulation of capital (Bonefeld, 1996). This is precisely why every period of expansion has resulted in a threat of inflation as well as an increase in the US foreign deficit, demonstrating that the policy of an undervalued dollar is no solution at all (Brenner, 2002). In the face of the persistent, even deepening crisis of over-accumulation, the US has not been able to find any other way out except for reducing the tax burden on corporations and slashing public expenditure in order to compensate for its policy of high real interest rates. On the one hand, this policy has attracted funds from abroad to cover the foreign and fiscal deficits, and, on the other, it has made possible to export US stagnation to the rest of the world. This forms the backbone of the contradiction within deregulated world capitalism between states, a contradiction that has been intensifying since the end of the last century (Panitch and Gindin, 2003, 2005). By pushing the rest of the world to excessive savings, to under-consumption and to contraction, the US has transformed its own decline to the decline of the whole world. The geographic distribution of this decline has, as in all epochs of historical capitalism, been uneven. The breakdown has hit hardest the bloc of peripheral countries, forced to expanding exports and pushed to dispossession under the burden of ever-growing debt (Amin, 1997). Also, the forcing of state power to capitulate to a direct and immediate subordination to the logic of capital and the consequent deepening of the crisis of legitimisation of the state takes incomparably greater proportions in these countries. This sheds ample light on the characteristics of twenty-first century imperialism and prospects for the future (Magdoff, 2003). Hence, the study of the transmission of the crisis tendency all over the world and the way this crisis has been experienced by the other countries takes on a certain importance.

4. The Economic Geography of Present-day Capitalism and its Crisis

It is possible to differentiate between the different regions of present-day world capitalism as regions of “growth”, “stagnation” and “depression”, all of these being situated within a common and general crisis tendency, and to observe the impact of the crisis on the basis of this diversity. With this purpose, and *as a first approximation*, the economic geography of the present global crisis can be established through a threefold classification as regions of (i) overproduction/overconsumption, (ii) overproduction/underconsumption and (iii) underproduction/underconsumption. In what follows, we attempt to link this abstract model to the actual regions of the world economy, which are separated from one another as

constellations of states. To recapitulate, we aim to present observations on the unequal spatial distribution of global crisis by taking into account the general tendencies in the world economy since the 1980s. In Figure 2 and 3, prepared for this aim, we present observations on the national economies of the core- and non-core states.[1] In Figure 2 the regional distribution of the total world investment and consumption expenditures and the ratio of exports to national incomes are portrayed in order to highlight the imbalances in the processes of production and consumption. In Figure 3, the balance of payments links in the world economy is considered and the consequences of the differential impacts of global crisis are depicted in terms of current flows. It must be stressed that all numbers in the figure are net balances in the logic of balance of payments. The net balances chosen here help us to see how and where “spatial fixes” were being made in particular periods, as reflected from the current trade and capital flows. The following observations, which when taken as a whole provide us with the neoliberal account of the global economy, are presented in terms of two sub-periods: the 1980-1990 and the post-1990 sub-periods. While in the first sub-period trade was liberalized, in the second one in addition to the further liberalization of trade, capital flows were “forcefully” deregulated. In all of the figures the period of 2000-2003 is additional included in order to emphasize the intensification of the impacts of global crisis at the present time. While interpreting the figures, observations on Turkey, where this article was written, are particularly underlined in order to give an idea about its position and congestion in the world economy.

It should be pointed out from the outset that the data presented in Figure 2 include investment in sectors such as housing, infrastructure and services as well as additions to productive capital such as machinery and equipment. While the latter type of investment is directly linked to the production of value, the connection of the former type of investment with value production is indirect or limited. Viewed from this angle, it is possible to talk about the function of the latter type of investment as increasing productive capital, while the former type has the function of creating demand. This functional differentiation within overall investment, which we can call capacity and demand creation, respectively, is crucial particularly for the US economy.[2] Nonetheless, it is clear that the data in question does

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[1]All data are from IFS. In the figures observations are calculated as period averages. The total number of states included in the calculations is 158. Data on some of the states are not available for the whole period of analysis. In such cases they are incorporated into the calculations only for those years when data on their national economies became available. The years in parentheses below indicate when IFS started to regularly publish data on such countries.

Core States: EU-10: France, Austria, Belgium, Luxemburg, Denmark, Finland, Sweden, Italy, Ireland, Netherlands; EU-3 (European Periphery I): Portugal, Greece, Spain; OCC (Other Core Countries): Australia, Canada, Norway, New Zealand, Switzerland, Iceland.

Non Core States: China (1982); Russia (1994); SEA (South East Asia): Korea, Singapore and Hong Kong (1998); Asia (4): Indonesia, Malaysia, Philippines, Thailand; EU-10 or EU-P (European Periphery II): Romania, Bulgaria, Hungary (1982), Poland, Slovenia (1993), Lithuania (1992), Estonia (1992), Latvia (1992), Czechoslovakia (Czech Rep., Slovak Rep.); TE (Transition Economies): Azerbaijan (1993), Kazakhstan (1995), Kyrgyz Rep., (1993), Turkmenistan (1996), Armenia (1993), Georgia (1997), Albania (1988), Macedonia (1996), Belarus (1993), Tajikistan (2002), Moldova (1994), Ukraine (1994); LA-3 Argentina, Brazil, Mexico; ROW (Rest of the World, Countries could not be included in the other blocks of the sample).

[2] “The objective conditions of our day assign the US capitalism the function of acting as the driving engine of the world economy. Lately, this function is performed through domestic consumption in this country which is fed by borrowing. During the first two years of the 2001-2004 period, while contribution of investment spending to GDP is negative, the US economy could grow only on the basis of growth in consumption expenditure. Even in the second two years period where investment spending is positive, it should not be forgotten that

provide us with an insight into the geography of world production. On this basis, one can see that during the 1980's the US made approximately one fourth of world investment expenditure. Moreover, after the aggravation of the world crisis in 2000, this share rose further to reach 28 %. As can be seen from the data, the share of almost all other central and peripheral economies within world investment has declined. This is even more marked for Japan and Germany, whose shares had risen all throughout the 1990s. In the bloc of peripheral countries the only exception is China. As the new region of production, China has increased her share of investment since 2000. Naturally, when we look closer into these investments, we can observe the impact of the flow of multinational corporations into China in order to obtain profits from the low cost of labour power in that country. Starting with the 1990s, a dramatic fall in the investment share of the peripheral countries can be observed. The overall share of the peripheral countries taken aggregately (shown in the column ROW in the Figure) has been halved since the early nineties. The share of Turkey within overall investment expenditure is around 1 % and has shown a tendency to drop after the crisis of 2000, parallel to the general tendency in the bloc of peripheral countries.

Here, too, a similar trend may be discerned. The US had a share of around 30 % within world consumption expenditure in the 1980s, but raised this share to around 35 % after the crisis of 2000. A fall in the share of almost all the other central countries within world consumption expenditure is a clear tendency. Again the most dramatic fall is observed for the group of peripheral countries. As for Turkey, her share within world consumption expenditure is below 1 % and has declined to around 0.6 % after the crisis of 2000.

The observations already presented with respect to the distribution of world investment and consumption expenditure gain on even more significance when brought together with the share of exports in national income for the different groups of countries. As may be seen from the data, the US, which had a share of approximately 25 % in world investment expenditure and 30 % of world consumption expenditure in the 1980s, reached an exports-to-national income ratio of barely 10 % in the same period. Moreover, in the aftermath of the 2000 crisis, this ratio displayed a decline, albeit small, relative to the average for the 1990s. The interesting observation is the rise in the ratio of exports to national income experienced by all central and peripheral countries, save Japan (Akyüz, 2003, UNCTAD 2002, 2003a). The rises witnessed in the peripheral countries could appropriately be called spectacular. For instance, in the group of Asian countries the ratio of exports to national income surpassed the 50 % level in the 1990s, to reach 65 % in the aftermath of the 2000 crisis. Turkey as well displayed a tendency similar to the one observed elsewhere: her exports increased in the 1990s to reach the level of around 30 % after the crisis of 2000.

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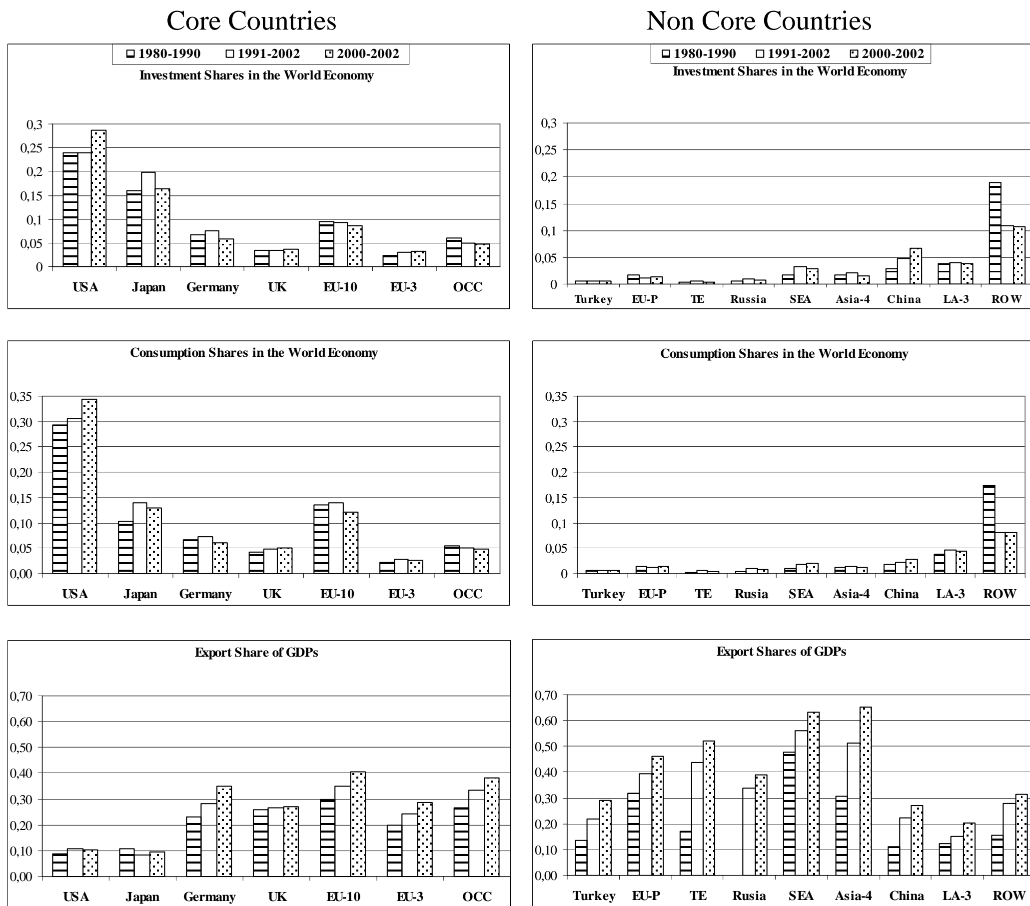
investment in housing has a significant share in total investment spending. Taking 2003, for example, we see that the contribution of housing investment to GDP (0.43 %) is higher than that of fixed capital investments (0.33 %). For the same period, it must be added that although to a lesser degree public spending, including military spending in the first place has also supported growth. For example, the contribution of state expenditure for the year 2004 (0.24) can be explained largely by the contribution of military spending (0.44) (net contribution turns out to be 0.24, since the contribution of non-military spending as well as state/local governments were negative)." (ISSAT, 2005: 48).



Source: International Financial Statistics Data Base, Country Statistics. For abbreviation and explanations see endnote 1.

Figure 2. Distribution of World Investment and Consumption and the Ratio of Export to National Incomes, *Period Averages*.

This growth in export performance could be perceived as a resounding success and even given a standing applause, if one were to be loyal to the daydreams of orthodox economists. However, this observation also calls to mind the following questions: (i) In a world in which almost all countries are forced to increase exports and generate a trade surplus, which country or countries enjoy/s the luxury of sustaining a deficit? (ii) Why is it that countries are trying to increase their exports at whatever cost and that this aim forms the backbone of economic policy? (iii) What kind of conflicts do export wars create between the different national bourgeoisies? Do these conflicts and the competition linked to them present any differences from the imperialist wars of the last century? (iv)What different consequences follow for central and peripheral blocs from contradictions arising from competition? (v) What are the consequences of the intensifying competitive wars likely to be in the future?

The Turkish economy provides an interesting case in answering these questions. To recall briefly, although Turkey has been subjected to structural adjustment programmes directly or indirectly since the 1980s, she has not been able to get rid of her foreign deficit and her

domestic and foreign debt stock has constantly increased.[3] The year 2000 represents in the history of neo-liberalism in Turkey a turning point that may be characterised as "being absolutely forced to pay back the debt". On the basis of orthodox stabilisation policies executed under the watchful gaze of the IMF and the World Bank, Turkey was *politically forced* to generate both a budget surplus and a foreign trade surplus. Turkey and similar peripheral countries have been entrapped in a "trade prison", where they cannot, try as hard as they may, produce a trade surplus, and therefore have to meet the liabilities following from the repayment of debt not through trade surpluses but through a process of "dispossession".

When we proceed to lay bare the secret of the economic geography of global capitalism with these observations as momentarily our point of departure, it is possible, as has already been said, to divide the integrated world capitalist system into three major regions: (i) The overproduction/overconsumption region: this consists of the super-imperialist USA. (ii) The overproduction/underconsumption region: in the bloc of central economies, this corresponds to the economies of the European Union, led by Germany (Boltho, 2003), and Japan, where the tendency to stagnation is intensifying. In the bloc of peripheral economy, China and the Asian economies are part of this group since they consume less than they produce. (iii) The underproduction/underconsumption regions: these are regions of intense crisis, which not only produce well below their production potential, but also transfer an important part of what they produce to the rest of the world. The peripheral economies that are part of these regions have become "forced" export regions especially under the impact of the crisis of 2000, but cannot overcome their trade deficit and have become directly dependent on global capitalism on the basis of their *indebtedness*. That is why the social formations in this region share the characteristic feature of an ever-growing permanent crisis. Turkey is one of the original cases within this group of countries. This kind of country where the current account deficit persistently rises despite increases in exports suffers, on the one hand, a deterioration in the distribution of income and is forced, on the other, to meet its debt liabilities by alienating, i.e. selling, the "assets" that they hold. Privatization, the sale of real estate that belongs to the public, the transfer of private capital to global capital are all so many forms of this loss of assets. The loss of assets and increasing impoverishment are clear testimony that these countries are face to face not only with economic, but also political crises of an ever-growing intensity.

Figure 3 presents a general overview of the world balance of payments. The organization of the figure represents the logic of the organization of the balance of payments. Thus, the

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[3] It is possible to characterize the last quarter century of Turkey as a period of transition from one stabilization program to another. The neoliberal transformation of Turkey begins with the 1980 military coup and the concomitant 5-yeared structural adjustment and stabilization program framed by the IMF and the World Bank. It is interesting to note that this program is the forerunner of orthodox stabilization programs that would be put in use in many peripheral states later in the 1980s and 1990s. The program introduced in Turkey was legitimized by reference to the so-called high level of foreign debt and the macroeconomic imbalances ensued there from. In 1980 the ratios of foreign and domestic debt to the national income were 22 % and 14 %, respectively. In spite of a quarter century spent with the IMF and the World Bank for the stated aim of establishing stabilization in the economy Turkey is currently under another stabilization program. The program put into effect in 2000 ended with a severe crisis in 2001 and the ratios of foreign and domestic debt to the national income hit alarming levels and reached 69 % and 79 %, respectively. In other words, in the great search for stabilization Turkey failed to pay back her debt but succeeded increasing it even if she continued increasing her payments every passing decade. The shocking outcome of this outlandish process is that Turkey used nine years of national income to service her debt and experienced ever growing debt! (For the outcomes of neoliberal structuring of the Turkish economy and the last crisis see Boratav, Yeldan, Köse, 2001; Akyüz and Boratav, 2002; Arın, 2003; ISSAT 2005).

ordering of the observations is from trade flows to reserve accumulations. The first segment of the figure where trade balances are shown allows us to reconsider the previous analysis in terms of state constellations. In the second segment financial flows in form of net investments are documented. These flows include both new investments called green field investments and mergers and acquisitions that represent the concentration of capital.[4] As expected, the core states are net capital exporters. In terms of foreign direct investments China is the leading receiving state.[5] China and other states that attract FDIs, as we emphasized previously, are at same time net merchandise exporters and hence low consumption regions.[6]

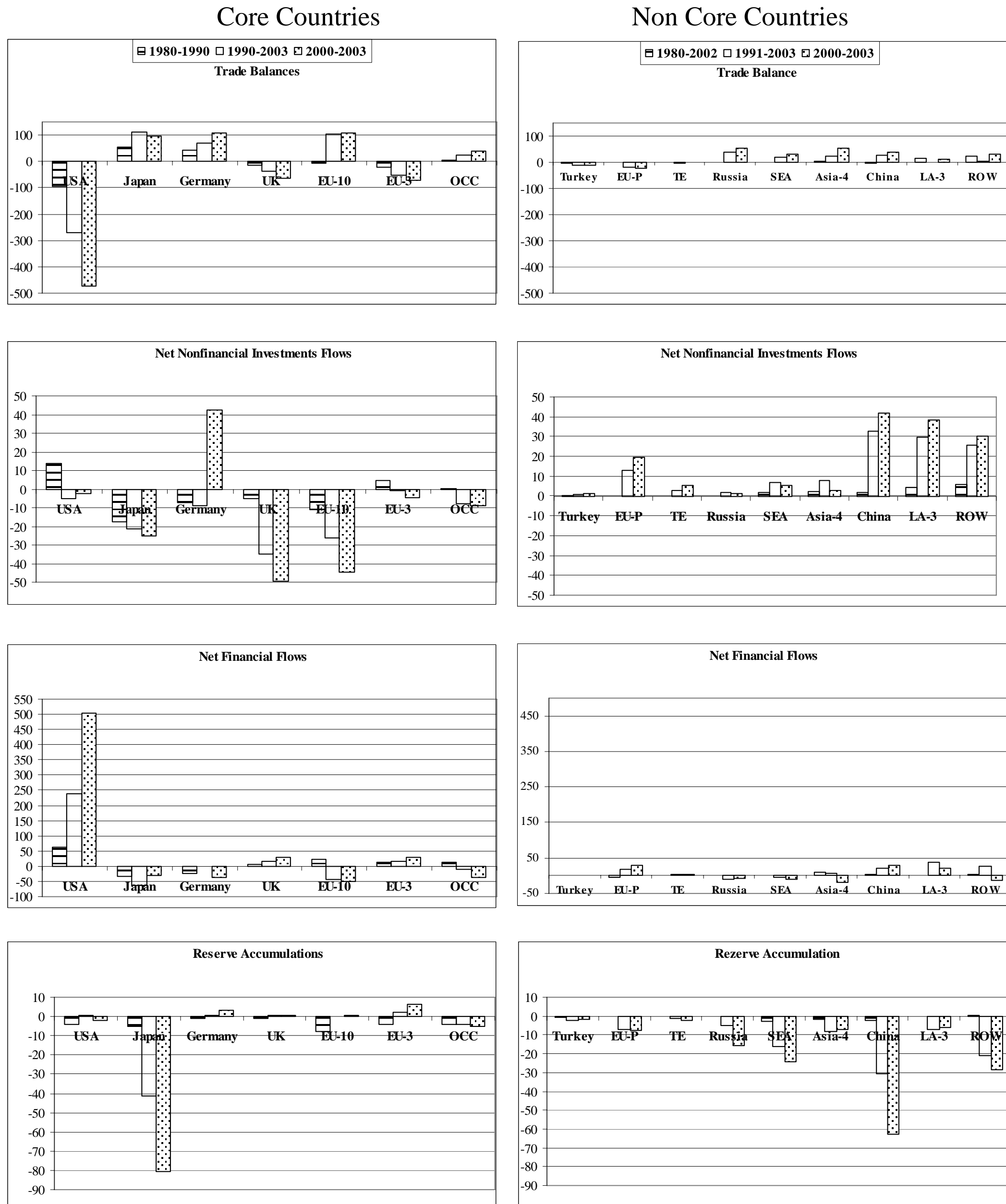
To enquire at this point into financial flows will help us to see how equilibrium is established between "surplus" and "deficit" countries in the world economy. To this end considering first the foreign currency reserve accumulations documented in the last segment of the figure may help us decode the real meaning of trade surpluses and foreign debt accumulation. By definition, foreign currency reserves are the assets held or accumulated by a country in foreign currency. These assets are to be expected to accumulate as a result of trade and capital flow surplus revenues, but it should not be forgotten that in countries such as Turkey that suffer periodic crises, these also represent liabilities resulting from foreign debt. We should remember that approximately 70 % of world reserves are held in US dollars. In other words, under normal conditions, surplus countries that have built up large reserves in US dollars are creditors of the US.

Negative values in the figure represent (by dent of the technical logic of balance of payments accounts) the reserves held by the country or group of countries in question. The observations to be made on the basis of this figure can be classified under four headings: (i) The US, the country that we have characterised as the region of "overproduction/ overconsumption", holds reserves close to nil despite the fact that it persistently runs a foreign deficit and is the highest debtor country in the world; (ii) The country that systematically builds up reserves in the bloc of central economy is Japan. To interpret this conclusion in a different manner, Japan, which at present displays a *tendency to stagnation*, holds its foreign trade surpluses of the 1980s as reserves predominantly in dollars and is therefore a creditor to the US, whose economy runs the biggest foreign deficit in the world year after year; (iii) The EU, which is trying to create a currency ("the" Euro) that would act as an alternative to the world currency represented by the US dollar, is the group of countries within the bloc of central economies that holds (accumulates) the smallest amount of reserves (dollars), partly under the impact of the fact that foreign trade in this case is predominantly made up of intra-EU trade flows; (iv) As can be seen from the column to the left of the Figure, the entire group of peripheral economies was forced to accumulate reserves throughout the 1990s. This tendency is most intense in the case of China and Asia, which consume less than they produce, i.e. persistently generate trade surpluses. It should not be

[4] The positive value in 2000-2003 for Germany included in the core states constellation is the result of the acquisition of the German Mannesmann Corporation by the English Vodafone Corporation in 2000. This is the first and the biggest case of the acquisition of a German corporation by a foreign corporation. This event is also exemplary in regard to the annihilation of the European autonomous national economic model by the international financial networks (Tabb, 2001). For detailed information about Vodafone-Mannesman "deal" see (UNCTAD, 2003b).

[5] Throughout the 1990s China received the 24 % of all FDI flowing into the non-core states. Brazil, Mexico, Hong Kong with 8 % and Singapore and Argentine with 6 % followed China (UNCTAD 2002, 2003 b).

overlooked that countries like Turkey, which accumulate some additional reserves, albeit incrementally, in effect do not generate surpluses, but accumulate debt mostly in dollars.



Source: International Financial Statistics Data Base, Country Statistics. For abbreviation and explanations see endnote 1.

Figure 3. A Summary of the World Balance of Payments Accounts, 1980-2003, Billion Dollars. *Period Averages*.

[6] The new peripheral zone of the EU (EU-P), just like the previous peripheral zone (EU-3), has been experiencing trade deficits. The recent capital flows into this zone is an indication of the expansion of the EU's frontiers toward this region.

Where is the counterpart of the reserves in question held or used? Before turning to this question, we should remember the fact that central banks do not keep their reserves in the safe, but, on the contrary, try to reduce the cost of holding reserves or even to make a financial gain in return for these reserves by organising transactions on the basis of these assets on international financial markets. In other words, reserves form the most important resource of international financial markets. Hence, in order to answer the question asked above, we have to identify the countries to which international financial flows are directed and in which they are concentrated. The answer to this question can be seen in Figure 2.

As can be seen from the Figure, the financial flows that are said to be circulating globally in fictitious manner are in fact concentrated and "fixed" in one single country: the country that runs the greatest foreign deficit in the world, the country that is the greatest debtor in the world, the region of "overporduction/overconsumption", i.e. the USA. In the light of this observation, let us reformulate our question in the following manner: if dollars, the national currency of the US, are held as foreign currency reserves by economies that are forced to generate surpluses, whether they be *debtor or creditor*, and if these reserves are recycled through the mediation of international financial markets into the US and if the US persistently carries on this attitude, what is the meaning of this vicious circle? As long as the structural relationship in question persists, this means that the US is converting its liabilities to the world economy into receivables. The persistence and stability of this configuration reflects the power of the US on the world currency that is the dollar and forms the material basis of the yoke established by US imperialism on the world scale. Conceiving money as an economic object, orthodox economics can hardly grasp the fact that the US has established a system of relations of control and subordination on the world scale through the mediation of the dollar.

We can finally suggest that the fixing of financial flows in the US is the fundamental mechanism of surplus transfer in the current global capitalism. The political power of the US over the control of world currency allows her to fix capital within her own territoriality and subjugate the global capital relation to her own state logic. Thus, the US is still a "super imperialist" state. This abstract (or rather ghost like) power of control over the abstract form of capital in the Marxian sense is also the main instrument of the US in establishing domination over historical-concrete spaces in the world. There is no doubt that the capacity to intervene in the global capital relation via the world currency is also an intervention in the power structures of capital in different states. One possible outcome of this particular form of intervention seems to be the breakdown of the power blocs formed by fractions of bourgeoisie and the concomitant crises of the state. Countries like Turkey within which the crises tendencies have been long intensifying are candidates for such state crises and possible socio-political spaces for the haunting of people by the ghost of chauvinist nationalism and racism.

5. CONCLUSION

A salient feature of the literature on the historical and structural characteristics of the world economy is that in its approach to centre-periphery relations, it accords priority to the study of the centre. This "view from the top" cannot be entirely dismissed, of course, but it tends to conceive the position of peripheral societies within the world system as a residual

category subordinated to the dynamics of the centre. Those peripheral societies that can, through the mediation of their inherent individual and shared characteristics, influence the world economy in an independent manner is overlooked. If the developments pointed out and the implications drawn in this paper are valid, it becomes necessary to conceive peripheral countries not only as passive objects, but also as having an active role as an agent. Naturally, the impact the periphery has does not reach the level of taking part in the setting of the rules of the game or in the regulation of the system. But, on the other hand, during the crisis periods of the world economy, the periphery exerts direct (breakdown, rupture from the system) or indirect (periodic crises, impact on the regulation of trade and capital flows, competition and the like) effects on the centre. In a sense, such episodes imply the emergence of moments of structural failure, when the requirements of the rules and regulations determined by the central bloc to be imposed on the periphery can no longer be met adequately by the latter. This kind of development indicates a blockage in the "structural adjustment" role of peripheral countries and, in general, triggers the process of "double movement" set free by resistance from below to the pressure from above, a process depicted by Polanyi in his analysis of "market economies". These moments, which we shall call "punctures" or "cracks", are moments when the scale and limits of regulation from above are determined. That is why a study from below of the world economy as a structure is as indispensable as one from above in order to grasp the movement and characteristics of the structure in a holistic way.

Again as this paper has clearly shown, the world economy is a formation that takes on its characteristics through the mediation of global relations and relations at the state level and also the contradictions inherent to these relations. This formation has sustained its historical existence through the resolution of the capital/labour contradiction deriving from capital accumulation on the world scale and the intra- and inter-state class contradictions that are present within the system of states. Of these, the former is the fundamental contradiction of this whole, while the latter is the secondary contradiction. However, the secondary contradiction is at least as decisive as the fundamental contradiction from the point of view of the shaping of the whole at a given moment. The resolution of both contradictions simultaneously, with primacy accorded to the fundamental contradiction, establishes the conditions for the balanced growth and the expansion of the limits of the whole. The progressive aggravation of the fundamental contradiction within the bloc of countries where capital has already been concentrated and centralised to the point where it becomes impossible to resolve will make its pressure felt on the mode of resolution of the secondary contradiction and force a new mode of resolution at this level. This state of affairs will either remove the obstacles in the way of the organising of capital and concomitantly of the growth and expansion of the system or, in exactly opposite fashion, may lead to the preponderance of the secondary contradiction over the fundamental contradiction, thus resulting in the fragmentation of the world economy into distinct states or blocs of states and the ensuing contraction of the world economy. Such a chaotic moment defines, within the concrete unfolding of class struggle, the objective conditions for a revolutionary rupture that can open up the horizon for the emancipation of labour from the yoke of capital.

The simultaneous resolution of the fundamental and secondary contradictions within the world economy has been possible as a result of the establishment, organisation and maintenance by one of the central states of a system of international political economy that defines the economic and political rules of the game on the world scale. Frequently defined in

terms of concepts such as hegemony, the regime of accumulation, the formation of an international power structure, the balance of power, this political project involves the construction of systems of money, capital and trade and their mutual harmonisation. At a certain stage of the development of historical capitalism, the processes of regulation and control of the systems of money, capital and trade have been turned over to blocs of capital that manage and direct collaboration in the "networks" of finance, production and trade on the world scale, these blocs being called at present multinational companies (MNCs). As was mentioned before, within this system that tended to predominate after 1945, official international financial institutions operate with one face turned to states, but the other turned to MNCs. The major reason that brings this "unstable" relationship is the central role within the world economy of the MNCs, which represent supranational class alliances of nation-state based, highly concentrated blocs of monopoly capital. When "over-accumulation", the fundamental fetter for surplus-value production, sets in, that is to say, when the profit extracted by capital from productive investments fall, the capital concentrated in the bloc of central states is accumulated relatively more in money-form and the spatial expansion of productive capital is transformed, from being a tendency, into a *de facto* necessity. The MNCs, with their dominant position in the production of surplus-value (valorisation), its distribution and realisation on the global scale, expect in such periods from international official institutions the breaking of the resistance of states that may raise sovereignty rights in opposition to the limitless freedom for the movement of capital.

The global expansion of surplus-value production heightens, on the one hand, the contradiction between capital and labour, thereby universalising it, and, on the other, by spatially separating the processes of the production and realisation of surplus-value, deepens as well intra- and inter-state contradictions manifested in the division of surplus-value. Because it is the MNCs with their respective bases in the bloc of central states that organise the networks of production and trade, the realisation of profit still takes predominantly place in the centre. On the other hand, production increasingly moves to the margins of the periphery, increasing the transfer of surplus to the centre and accelerating primitive accumulation in these regions. This is precisely the situation depicted by Baran, in which at the same time as the share appropriated by peripheral societies within the surplus they produce declines, the proletariat, which has no other means of sustaining its material existence apart from the mediation of the market, is growing at an unprecedented rate. This goes hand in hand with the transformation of a great number of states, first and foremost peripheral states, into debtor countries within a world economy characterised by ever-growing financialisation. This is in fact an expression of what may be considered as one of the fundamental tendencies of the capitalist world economy, i.e. the "law of uneven development". For this reason, all these chaotic tendencies lead not only to a heightening of contradictions between capitals, but at the same time to the aggravation of the fundamental contradiction that is the class antagonism, particularly in the peripheral regions to which production is more and more delocated.

The debtor/creditor relationship inherent within international financial flows is intensified through channels of productive capital and results in the emergence of forms of direct appropriation of the surplus, in addition to the transfer of surplus-value. In this context, the direct appropriation of surplus brings in its wake, depending on the "intensity" of indebtedness, not only the pocketing of the currently produced surplus, but also the transfer of social wealth in the form of *property* to "foreign" capital. If we remember that in the very

essence of capitalism organised as a state there exists a social contract based on property rights linked to citizenship, the debtor/creditor relationship between citizens of different states, by practically annulling state guarantee for the nation-based right to property, requires the rules for appropriation to be defined anew. This requirement makes the reconstruction of the existing configuration of debtor states in line with a mode of appropriation that may be defined as the right to property independent of citizenship. The arrangements imposed by blocs of international capital and official organisations under the title of "global governance" may be interpreted as a project for transforming the capitalist state form in the direction indicated above.

In this context, the most critical short-term question for present-day capitalism is whether there will emerge from within the system of nation-states a common resistance against the monetary yoke of the US. This question is crucial for understanding the fundamental inter-state contradiction and the related conflicts between national groups of capital in the present situation. Face to the policy of the US based on the persistent generation of a deficit and an excess of consumption over production, can Japan and the European Union, for instance, or a group within the bloc of peripheral states establish an alliance and adopt a common policy? Can they, to this end, re-regulate the parity of the dollar around common goals as was done in the past or at least work towards this? In order to determine whether this kind of development is possible, one should remember that states that have accumulated reserves are sensitive to rates of interest as much as they are to exchange rates. For instance, for European Union economies, which have had to generate trade surpluses in order to grow, the parity of the dollar vis-à-vis the Euro is of crucial importance. The appreciation of the dollar against the Euro, while acting positively for EU trade, has, at the same time, a negative impact on US exports. Since in such a situation the trade deficit of the US will grow even further, her need for foreign financing will increase even more. This increasing need for foreign financing will result in a rise in US interest rates. Such a development will be in the short-term interest of Japan, the reserve economy that is the creditor of the US. If we extend this analysis by bringing into the picture other economies such as China, it will become clear that the crisis will snowball on the world scale, but that, at the same time, the economic interest of the capitalist classes that control these states lies in the perpetuation of these imbalances. In short, world capitalism confronts us as a system that is not able to resolve its crisis by taking a leap forward.

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Chapter 5

SURPLUS ALLOCATION AND DEVELOPMENT UNDER GLOBAL CAPITALISM*

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1. INTRODUCTION

Mainstream thinking in economics currently tends to describe the problem of economic development as one of differential economic growth across space; a differential which is ascribed to seizing or missing opportunities to solicit foreign investment, to attract subcontracting orders, to upgrade activities in value chains and to grow by exporting. This approach to development overlooks the mounting case-by-case evidence on the lope-sided distribution along value chains (Gereffi 1989: 525; Gereffi 1994: 102-3; Feenstra 1998: 36; Kaplan and Kaplinsky 1999: 1794; Chossudovsky 1998: 87-90; Figueroa 1996: 37, 39; Talbot 1997: 18[1]; Dikmen 2000: 215, 243). The evidence raises questions concerning the international distribution of the 'gains from trade' and suggests that, if international growth differentials are driven by international distribution mechanisms rather than the other way round, then the development issue demands greater attention to global distribution mechanisms.

Economic development involves fixed capital accumulation. The capacity to undertake fixed investment in underdeveloped countries that import capital goods depends on these countries' terms of trade, as much as on their efforts to save and export. Institutionalist economists, aware of the importance of the terms of trade for accumulation, have been careful to qualify their own recommendations for strategic trade and industrial policies in that such policies might be self-defeating at the global level, since implementation of export-based upgrading policies among many underdeveloped countries may cause a general deterioration of the terms of trade (UNCTAD 1996, Part Two Chapter III; UNCTAD 2002, Part Two Chapter IV; Mayer 2003).

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[1] Page number on internet version.

Hence a framework apposite for studying the global distribution of investible resources is necessary to understand the sustenance of differences in per capita incomes between countries. Such a framework should preferably take the global social product as given, and focus on attempts of firms and governments to extract the maximum surplus out of the social product, on the struggle between social groups and nations to appropriate the generated surplus, and on how the surplus is used.

This essay is an endeavour to understand and assess the developmental consequences of global economic integration by focussing on the generation, transfer and utilization of the global surplus. It tries to address the following questions: (1) How does globalization affect surplus generation? (2) Where does the global surplus accumulate? (3) How is the global surplus absorbed? (4) What prospects does this pattern of absorption hold for the capital accumulation needs of poor countries? The essay continues as follows: the second section presents a brief description of the surplus concept, and questions whether the tendency for the share of the surplus in GDP to rise has abated under globalizing capitalism. The third section discusses at an abstract level how the surplus is generated and allocated in internationally organized production. In the fourth section empirical clues on the last question are investigated, which seem to indicate an increasing flow of surplus from periphery to core. The fifth section takes up the problem of surplus absorption and juxtaposes the rising consumption of the surplus in the core with the fixed capital formation in the periphery. Section six concludes.

2. THE SURPLUS

It seems useful to begin by reviewing the theoretical framework we will employ. The social surplus is a basic concept of classical political economy which has been revived in the post-war period by Paul Baran and Paul Sweezy.[2] They defined it as

> " ... the difference between what a society produces and the costs of producing it. The size of a surplus is an index of productivity and wealth, and of how much freedom a society has to accomplish whatever goals it may set for itself. The composition of the surplus shows how it uses that freedom: how much it invests in expanding its productive capacity, how much it consumes in various forms, how much it wastes and in what ways". (Baran and Sweezy, 1966: 23).

The surplus can be calculated in alternative ways. One is to estimate the necessary costs of producing the national product, and to deduct the costs from the national product. This raises the conceptual problem of calculating the necessary costs of production. Some of the outlays recorded as costs by firms (such as outlays for superficial product differentiation and advertising) may be unnecessary from the social viewpoint. Hence the determination of the necessary costs is crucial for this first method. A second method is to estimate the various expenditures absorbing the surplus (non-essential consumption, investment etc.) and to add them up.

[2] Baran and Sweezy made the surplus a measurable concept. Lippit (1985), Danielson (1990) , Yeldan (1995) provide similar definitions and descriptions of the concept. A more general theoretical presentation of the classical surplus approach can be found in Garegnani (1988).

The difficulties of estimating the surplus at the global level either way are obvious.[3] This paper does not attempt to estimate the global surplus produced, but uses available statistics to make conjectures about *trends* in the generation and the disposal of the surplus.

The re-elaboration of the surplus concept in the post-war period is connected to the evolution of certain features of capitalism. In *Monopoly Capital* (1966) Baran and Sweezy argued that capitalism had made a transition from a competitive phase to a monopolistic phase in the twentieth century. In their view, the concentration of capital in giant corporations enables them to fix prices, in contrast to nineteenth century capitalists who worked under more intense competition. These giant corporations set their sales prices by adding mark-ups to production costs. Such price setting gives the corporations control over the partition of the value added with their workers.

Corporations also strive to increase their profits by reducing their production costs. On the macroeconomic plane, the general endeavour to reduce production costs (inclusive of labor costs) tends to raise the share of the surplus in GDP. This rising surplus can be sustained only if it is absorbed. The consumption of capitalists, the consumption of employees in non-productive activities (e.g. superficial product differentiation, advertising, litigation etc.), investment and some part of government expenditure (e.g. public investment, military outlays) are the main outlets for absorbing the surplus.

As forty years have elapsed since the above framework was formulated, it is legitimate to ask: has the increasing ratio of trade to global output in the last decades of the twentieth century impaired the diagnosis of Baran and Sweezy with regard to the monopolization of capital, and with respect to the inclination for the surplus in GDP to increase? Has increasing trade and integration of markets raised competitive pressures so as to restrict the pricing latitude of industrial conglomerates?

The immediate effect of global trade expansion obviously must be to increase overall competition, as greater numbers of firms would come to compete in formerly segregated markets. But a countervailing effect would emerge when large firms with greater financial resources and organizational advantages eliminate smaller firms (as happens when large transnationals take on firms of peripheral countries in opened markets).

Another countervailing trend to the competition-enhancing effect of trade expansion is mergers and acquisitions, on which there is evidence in the core countries. Statistics show that in the US the number of merger and acquisition ‘deals’ have risen in a wave in 1965-73, in another wave in 1981-89 and between 1992 and 2000 (USBancorp 2001-3 : 4). The advent of the euro triggered a boom in cross-border megamergers in Europe, an increase of 87% from 1998 to 1999 (Graff 2000). Overall, “[a] powerful trend increase in the extent of firm level concentration of global markets share could be observed in industries as diverse as aerospace and defence, pharmaceuticals, automobiles, trucks, power equipment, farm equipment, oil and petrochemicals, mining, pulp and paper, brewing, banking, insurance, advertising, and mass media” (Nolan 2003: 302-3).[4] Indications are that the competition-enhancing effect of trade is

[3] There are surplus estimations for the US (Baran and Sweezy 1966, Stanfield 1973, Dawson and Foster 1992 and Lippit 1992) and one for Turkey (Somel 2003). Baran reports estimations of potential surplus -hypothetical surplus that could be produced in full employment- for a number of underdeveloped countries (1967: 227). Other work on the surplus in underdeveloped countries include Kanth (1987), Lippit (1987 and 1988), Danielson (1990) and Yeldan (1995).

[4] Frequent reports in The Economist (February 19, 2004; April 7 2005; July 14, 2005; September 1, 2005; September 8, 2005) testify to an ongoing boom in M&A activities in the US and Europe.

balanced (perhaps even overwhelmed) by the monopolizing effect of the centralization of capital, which may sustain the ability of large corporations to control the market prices of their products.

On the other hand, if mergers and acquisitions imply an increase in the average size of the workforce of corporations, this could stimulate a counterbalance to corporate power by higher unionization and worker militancy. However, the increasing mobility of capital, goods and services on the one hand, and unemployment on the other is weakening unionization in the core countries, and making workers accept temporary employment, part-time employment, flexibility in hiring and dismissing, flexible working days and weeks, and flexibility in assigning tasks in the workplace (Walby 2000).[5] Increasing flexibility in labor relations shifts various risks related to the product markets and the associated costs from firms onto workers. Enhanced flexibility cannot but boost gross profits. Hence the trend towards increased flexibility in labor practices clearly implies increased surplus generation for given output in individual countries.

The neoliberal global reform agenda also includes measures to increase surplus generation through fiscal and institutional reforms, both in developed and underdeveloped countries. Lowering taxes on corporate profits, capital gains and high incomes; increasing taxes on consumption; raising fees on public services and privatization of these services, of utilities and of social security – all these policies aim at disburdening the high income earners and property owners of contributing to financing essential services for the maintenance of the labor force (Jones 2001: 13).[6] These reforms also contribute to increasing the share of surplus in total output.

In brief, in the era of neoliberal policies evidence does not seem to suggest that the tendency for the share of surplus in GDP to rise in individual countries may have waned. If so, what is happening to the surplus generated in international production?

3. Outsourcing to the Periphery

Baran and Sweezy argued (1966; Baran 1952, 1967) that the surplus of underdeveloped countries had been and was being drained away to the centers of the world-system. Their description of core firms' overseas activities in *Monopoly Capital* can be read as a description of offshore outsourcing activities today if one replaces 'subsidiary' with 'suppliers' (1966: 200):

> What they [giant multinational corporations] want is monopolistic control over foreign sources of supply and foreign markets, enabling them to buy and sell on specially privileged

[5] See JIL (2004: 58) for the unionization rate decline in Japan over 1945-2003; JIL (2000) for the unionization rate decline in Japan, US, Germany (1985-1997) and the UK (1990-1997); Friedman (2005: Table 4) for the decline in the unionization rate in the US 1953-2000 and the decline in combined unionization rate in Canada, France, Germany, Italy, Japan and the UK 1980-1990. The weakness of labor and trade unionism in most peripheral countries needs no substantation.

[6] Privatization of socially owned assets and services is a tendency of capitalism that stretches back to the sixteenth century English enclosures, a tendency that was driven off course by Keynesian policies in the twentieth century (Nasser 2003). Shaikh (2003) shows that the 'net social wage' has been a small fraction of GDP in the major industrialized countries in the 1980s and 90s. Privatization is penetrating the most vital services, provoking sharp social responses, as in the water crisis in Bolivia in 2000 (Gosh 2003; Moberg 2004).

> terms, to shift orders from one subsidiary to another, to favour this country or that depending on which has the most advantageous tax, labour and other policies...

The authors' view was that imperialism had a two-fold function with respect to the surplus: finding cheap foreign sources of supply (which increases the surplus in the home country), and using other countries' markets as outlets (which helps absorb the surplus of the home country).

A major motive of transnational companies in their current practice of outsourcing parts of production to underdeveloped countries is to cut production costs, hence to increase gross profits. When the corporation of a core country decides to outsource its production to a peripheral country, or when it shifts its sources of supply of intermediate inputs to a peripheral country, this increases global surplus creation. Global output remains the same, the costs of producing it decline.[7] For the firm, the effect of offshore outsourcing is the same as if it were to reduce its own (in-house) costs of production, or were to outsource to a cheap supplier in the home economy. If the workers in the core country dismissed due to the offshore outsourcing find newly created jobs and continue to produce surplus, then global output increases and surplus creation increases *a fortiori*. If the workers dismissed due to the outsourcing remain unemployed, then their consumption (provided by family, unemployment benefits etc.) absorbs part of the surplus produced by other workers in employment. Should the supplier in the peripheral country expand her production to meet the order under subcontract, there will also be some increase in surplus creation in the peripheral country. In this case the total increase in surplus may accrue to both countries' economies - in indeterminate proportions.

Rough estimates suggest that by outsourcing globally a multinational firm may be able to lower its costs by as much as 50-70% (*The Economist,* 2004: 4). The McKinsey institution estimates that for every dollar American firms spend on services from India, the US economy receives between $1.12 and $1.14 in benefits (Drezner 2004). Of that dollar spent in India only part contributes to surplus generation in India; the rest is the necessary cost of production. But the $1.12 accruing to the US is pure surplus.

It is worth noting that the effect of offshore outsourcing on productivity in the core economies is ambiguous. The formula

$$\text{productivity} = \frac{\text{sales revenue} - \text{material input cost}}{\text{number of workers}}$$

shows that an increase in material input cost (due to the increase in outsourced inputs) and a reduction of the in-house workforce (due to outsourcing) may ultimately affect the outsourcing firm's productivity either way. The gains that motivate firms to outsourcing are not gains in labor productivity (which arguably could legitimize outsourcing from a social viewpoint), but gains in gross profits – i.e. in surplus appropriation.

[7] Here the implication is that integration of national economies through trade is reducing the 'necessary costs of production' which is taking the attribute of a global concept.

4. GLOBAL SURPLUS TRANSFERS

To substantiate their argument on the transfers of surplus from the periphery, Baran and Sweezy (1966: 191-201; also Baran 1967: 228-230) showed that the repatriated profits from investment exceeded investment in peripheral countries by core countries' firms, and that investment returns of firms in core countries exceeded their returns in the periphery.

Today we have access to more factual information and analytical tools for gauging international transfers of surplus. The first indicator of surplus flows is trade balances: a country that runs a trade surplus must be transfering net resources (part of its saved surplus) elsewhere. World Bank Indicators show that the high-income countries (and also the high-income OECD countries) have recorded deficits in their trade in goods and services with the low and middle income countries through 1999-2002 (summary figures in Table 1); hence the periphery has been realizing a net transfer of resources to the core, assuming that prices reflect values of resources.

This recent surplus of the periphery in recorded trade might not accurately reflect the magnitude of the real transfer if the prices of peripheral exports were increasing at a higher rate than the prices of core exports. However, evidence suggests the converse. In a recent study investigating the terms of trade of twenty-six developing countries Ram (2004: 251) found that "[w]hile there are some cases of positive trends, the overall scenario is of sizable negative trends for most developing countries over the thirty-year period 1970 to 1999." Another study reports the deterioration of the terms of trade in manufactured commodities for underdeveloped countries in their trade with the EU by an average annual 2.2 percent over 1979-1995 (UNCTAD 1996: 148). Yet another calculation shows an average annual terms of trade deterioration for non-oil exporting developing countries of 1.3 percent for 1982-1988, and an average annual deterioration of 1.5 per cent for 1989-1996 (UNCTAD 1999: 85). Morisset (1998) highlights the increasing difference between commodity prices in international trade and their prices in developed country markets, suggesting that the increasing spread may be due *inter alia* to the ability of large international trading companies to influence such spreads. He reports that "the spread between world and domestic prices almost doubled in all major commodity markets during 1975-94" (1998: 503). To sum up, in view of the terms of trade deterioration of the periphery, trade balances -whether in surplus or in deficit- tend to underestimate the periphery's actual resource exchange with the core countries.[8]

Changes in the periphery's terms of trade with the core can be tracked to various variables that affect the costs of production in different countries: real wage differences, differences in profit margins, tax policies etc.[9] Another important variable that bears on terms

[8] Computations of the ecological and natural resource content of trade are not central to this paper but significant from the viewpoint of surplus transfer. A study of the environmental and natural resource content of trade between the developed and underdeveloped countries finds that industrialized countries are in general physical net-importers of natural resources from other world regions. In some material categories (like fossil fuels and basic metal products) "a clear tendency toward an increasing physical trade surplus can be observed" (Giljum and Eisenmenger 2003: 16). The authors highlight the role of declining primary commodity prices in sustaining the imbalance in trade in physical resources. Lipke (2002) and Jorgenson and Rice (2005), using ecological footprint per capita, likewise find a net transfer of ecological capacity through trade from the periphery to the core.

[9] Emmanuel (1972) argued that real wage differences are the main determinants of relative prices of the exports of core and periphery; and that differences in profit rates do not play the defining role in these prices.

of trade and on resource transfers in core–periphery trade is the undervaluation of underdeveloped countries' currencies with respect to their purchasing power parity. Köhler (1998) has suggested that, as the purchasing power parity exchange rates compiled by international agencies are based on a comparison of prices of a certain basket of goods and services in the US and in other countries, the purchasing power parity figures can be interpreted as, roughly, the price of goods and services in local currency units in other countries that are priced at one dollar in the US. Hence the difference between a currency's purchasing power parity and its market exchange rate to the dollar can be used as a rough measure of the overvaluation or undervaluation of a countries' exports with respect to their values in the US.

Table 1. External Balance in Goods and Services of Country Groups (Annual Average Balance, billions current US dollars)

	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2002	2003	2004
High income	-1	-21	-39	86	165	-71	...	...
High income: OECD	-35	-67	-68	49	112	-159	...	...
Low income	-14	-27	-24	-19	-27	-18	-25	...
Middle income	-12	1	17	-1	-13	93	140	127

Source: World Bank, World Development Indicators.

Table 2. The Ratio of GDP at Current US Dollars to GDP in Current International Dollars (for selected underdeveloped countries)

	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004
Bangladesh	0,39	0,31	0,28	0,27	0,25	0,22
Bolivia	0,41	0,35	0,43	0,42	0,44	0,38
Brazil	0,60	0,48	0,44	0,52	0,66	0,40
Chile	0,73	0,78	0,44	0,52	0,59	0,48
China	0,64	0,39	0,28	0,22	0,24	0,22
Colombia	0,37	0,41	0,28	0,28	0,39	0,29
Egypt	0,47	0,40	0,37	0,32	0,40	0,36
India	0,37	0,35	0,30	0,21	0,20	0,19
Indonesia	0,62	0,59	0,36	0,34	0,30	0,29
Kenya	0,70	0,59	0,46	0,32	0,36	0,39
Malaysia	0,75	0,72	0,56	0,55	0,53	0,44
Mexico	0,55	0,58	0,41	0,60	0,52	0,68
Nigeria	1,33	1,25	0,48	0,34	0,35	0,41
Pakistan	0,47	0,46	0,33	0,29	0,28	0,27
South Africa	0,36	0,43	0,39	0,42	0,39	0,32
Thailand	0,50	0,46	0,39	0,44	0,40	0,30
Turkey	0,79	0,53	0,43	0,54	0,49	0,44
Venezuela	0,99	1,19	0,70	0,51	0,65	0,74
Vietnam	...	...	...	0,14	0,20	0,19
Zimbabwe	0,66	0,61	0,40	0,31	0,22	...

Source: Calculated from World Bank http://devdata.worldbank.org/dataonline/ by dividing "GDP (current $)" data by "GDP, PPP (current international $)" data and taking arithmetic averages over periods.

Table 2 shows the deviation of exchange rates from purchasing parities for 20 peripheral countries. Dividing the GDPs in current dollars by GDP in current international dollars highlights the under- or overvaluation of currencies in market exchange rates compared to their purchasing powers. The undervaluation in some of the countries (the South Asian countries, China, Indonesia, Malaysia, Zimbabwe) appears to have been increasing. To note some extreme cases: the average undervaluation of the national currency against the US dollar compared to its purchasing power in 2000-2004 was 78 per cent in Bangladesh and China, and 81 per cent in Vietnam and India.

Table 3 shows the same exchange rate deviation for the currencies of ten major core countries. The dollar exchange rates of the core currencies appear to gyrate around unity; and the figures indicating an undervaluation generally do not approach the extreme degrees seen in underdeveloped countries. It follows that the currencies of underdeveloped countries generally tend to remain undervalued not only with respect to the US dollar, but also with respect to the currencies of the other major core countries. The undervaluation of peripheral countries' exports with respect to their values in the core countries implies that outsourcing production to the periphery generates *an unrecorded flow of surplus* to the economies of the outsourcing firms in the core.

Köhler (1998) estimated the unrequited transfer due to distorted exchange rates from 97 underdeveloped countries to 22 OECD countries for 1995 and found a transfer amounting to 8 percent of the GDP of the OECD countries and 24 percent of the GDP of the underdeveloped countries.[10]

Table 3. The Ratio of GDP at Current US Dollars to GDP in Current International Dollars (for selected core countries)

	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004
Belgium	1,12	0,82	0,83	1,06	1,06	0,90
Canada	1,09	1,00	0,96	1,03	0,88	0,87
France	1,10	0,93	0,95	1,14	1,12	0,95
Germany	1,11	0,90	0,97	1,22	1,20	0,98
Italy	0,70	0,68	0,80	1,01	0,91	0,84
Japan	0,97	0,90	1,22	1,50	1,49	1,24
Netherlands	1,09	0,89	0,88	1,03	1,03	0,91
Sweden	1,47	1,16	1,17	1,43	1,28	1,09
Switzerland	1,12	1,00	1,15	1,40	1,43	1,24
United Kingdom	0,71	0,81	0,76	0,94	0,95	0,99

Source: Calculated from World Bank http://devdata.worldbank.org/dataonline/ by dividing "GDP (current $)" data by "GDP, PPP (current international $)" data and taking arithmetic averages over periods.

[10] Lipke (2002), using and refining Köhler's method, finds a positive correlation between the unequal exchange in goods and the unequal exchange in ecological content of exports and imports (ecological footprint).

Table 4. Low and Middle Income Countries' Official Reserves Relative to Imports (world reserves and GDP)

	1981-1985	1986-1990	1991-1995	1996-2000	2001-2003
Ratio to imports	0,21	0,22	0,30	0,41	0,52
Ratio to GDP	0,04	0,04	0,07	0,11	0,15
Ratio to world reserves	...	0,18	0,27	0,35	0,39

Source: World Bank, World Development Indicators.

Note: Total reserves comprise special drawing rights, reserves of IMF members held by the IMF, and holdings of foreign exchange under the control of monetary authorities. Gold holdings are excluded. Imports refers to imports of goods and services and does not include factor incomes.

What drives the currency undervaluation in peripheral countries? Capital account convertibility in peripheral countries instigates a private demand for dollars and for other reserve currencies as a store of savings and for capital flight.[11] In addition, volatile international capital flows unleashed by this convertibility compel central banks to accumulate large reserves in order to prevent currency crises, generating a rising official demand for reserve currencies. The accumulation of foreign exchange reserves in poor countries is seen in Table 4. The rising trend of the ratio of reserves to imports and to GDP reftects an increasingly costly hoard, and a source of downward pressure on the exchange rates of peripheral national currencies against the reserve currencies.[12]

Table 1 showed that the high income countries as a group have been running trade deficits in goods and services, largely due to OECD countries' deficits in the 1980s and in recent years. Table 5 reveals that when the undervaluation of the currencies of the low income countries is used to find a rough estimate of the value of their exports in the markets of the core countries, this undervaluation overshadows these countries' recorded deficits in trade of goods and services. Similarly, Table 6, comparing the value in the core countries of middle income countries' exports with their recorded external balance in goods and services, suggests that the undervaluation these countries' exports to the core countries may far exceed their recorded trade surpluses. However, peripheral countries do not trade only with the core countries, but also trade with each other. The different rates of undervaluation of currencies of peripheral countries (highlighted in Table 2) suggest that trade among these countries also incurs unrequited surplus transfers.

[11] "In the emerging markets, for each dollar of net inflow there was a net outflow of 14 cents in the 1980s, but of almost 24 cents in the 1990s. For developing countries as a whole, this share more than doubled during the 1990s alone" (UNCTAD 1999: 106).

[12] In an alternative explanation for the undervaluation of currencies in the periphery, Reich (2004) argues that a country with a lower productivity in the production of tradables compared to its trading partners must have lower wages than its trading partners to be able to price its tradable goods competitively ("the law of one price"), given the exchange rate of its currency. Then wages in the non-tradables sectors in this country would also have to be lower. If productivity of labor in the non-tradables sectors of this country is comparable to that of its trading partners, then the prices of non-tradables are underpriced comparatively to the corresponding non-tradable goods in developed countries. Reich attributes exchange rate distorsion to this underpricing of non-tradables in excess of productivity differentials. But this cannot explain why transnational companies outsource production of tradable goods to suppliers in peripheral countries.

Table 5. Low Income Countries' Annual Exports in Current International Dollars and Their External Balances (billion US dollars)

	1980-1984	1985-1989	1990-1994	1995-1999	2000-2003
GDP in PPP $/GDP current $ (=current e-rate/PPP)	2,36	2,93	4,03	4,31	4,69
Exports in current dollars	66	65	91	133	192
Exports in PPP $	154	191	366	575	953
Exports in PPP $ - exports in current $	88	126	275	442	750
External balance on goods and services (current $)	-24	-21	-16	-24	-14

Source: World Bank World Development Indicators.

Notes: PPP $ rate/current $ rate is calculated by dividing GDP in current international US dollars by GDP in current US dollars. Exports in current international dollars are calculated by multiplying exports of goods and services by the PPP $ rate/current $ rate. Exports in current dollars are actual earnings from exports. All figures are simple arithmetic averages for periods indicated.

Table 6. Middle Income Countries' Annual Exports in Current International Dollars and Their External Balances (billion US dollars)

	1982-1984	1985-1989	1990-1994	1995-1999	2000-2003
GDP in PPP $/GDP current $ (=current e-rate/PPP)	2,20	2,59	2,56	2,53	2,98
Exports in current $	471	475	773	1292	1803
Exports in PPP $	1004	1231	1975	3278	5132
Exports in PPP $ - exports in current $	534	757	1202	1986	3416
External balance on goods and services (current $)	11	4	2	1	130

Source: World Bank World Development Indicators. Note: Calculations are same as in Table 5. Averages begin in 1982 for lack of 1980 data.

Tables A1-A3 in the appendix and Table 7 below present a tentative calculation of unrequited transfers through exchange rate distorsions between regional groups of core and peripheral countries. The reader should be reminded of the exclusion of East European and Central Asian transition economies from the estimations, and of our crude assumptions underlying the calculation of the distorsion factors for whole regions -necessitated by the incongruence of aggregate data from ECLAC and from the World Bank- so that the tables should be taken rather as a methodological exercise than an estimation with any claim for precision.

Still, with due caution, the figures in Table 7 merit some scrutiny. The total value of unrequited transfers appears to increase with trade from 1985 to 2000. Latin America's surplus transfers seem to concentrate in the US and Canada, while that of developing Asia appears more balanced between Western Europe, North America and 'other industrialized countries'. The net unrequited transfers from the Asian periphery overshadow that from the other two peripheral regions. The change in the relative position of Africa with respect to 'developing' Asia and Latin America from 1985 to 2000 is to be noted. The table shows an upward stream in 2000 of undervalued exports from Africa to 'developing Asia', from Asia to Latin America, and from the latter region to the core countries; and the confluence of surplus from each of the 'developing' regions directly to the core blocks.

Table 7 depicts a hierarchy of transfers – the "structured inequality" of the world-system demarcated by territorially based states (Tabb 2005: 50). Asian peripheral countries' undervalued exports to other peripheral countries may serve to underpin local support in peripheral countries for free trade policies. Workers in Turkey, for example, may be unaware of the market price in the EU of their products exported there, or may not notice how export competition against other Asian producers pushes down their wages and deprives them of their jobs; but they may see more easily the advantages of purchasing cheap consumer articles imported from China or India which enable them to survive on their wages.

Table 7. Net Unrequited Transfers between Different Regions, 1985 and 2000 (billion current international dollars)

1985 Destination/ Origin	Western Europe	US and Canada	Other industrialized	Latin America and Caribbean	Asian developing	Africa
Western Europe	-	65	10	-	-	-
US and Canada	-	-	-	-	-	-
Other Industrialized	-	21	-	-	-	-
Latin America and Caribbean	37	90	12	-	-	1
Asian developing	67	117	102	2	-	2
Africa	48	18	3	-	-	-
2000 Destination/ Origin	Western Europe	US and Canada	Other industrialized	Latin America and Caribbean	Asian developing	Africa
Western Europe	-	70	53	-	-	-
US and Canada	-	-	46	-	-	-
Other Industrialized	-	-	-	-	-	-
Latin America and Caribbean	34	225	17	-	-	-
Asian Developing	976	1282	875	90	-	-
Africa	132	52	14	13	8	-

Source: Table 3A. Inter-regional flows are ignored.

5. Surplus Absorption

From the viewpoint of economic development, the critical matter in the use of the surplus is fixed investment in the underdeveloped countries. To investigate whether the level of fixed capital formation in the periphery offers any prospects for per capita income

convergence, it seems logical to focus on fixed capital formation *per capita*, as labor productivity is largely determined by the quantity of the means of production per worker, and its quality. Table 8 shows per capita gross fixed capital formation figures for underdeveloped regions as ratios to the corresponding figures in the high-income OECD countries, and for the low income countries and the middle income countries as blocks, estimated both on market exchange rate and purchasing power parity bases. The relevant ratio for a country should lie between the two estimates, depending on how imported investment goods and domestically produced investment goods are combined in fixed capital formation.

Table 8. Per Capita Gross Fixed Capital of Peripheral Country Groupings Relative to per Capita Gross Fixed Capital Formation in High-income OECD Countries

	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2002
East Asia and Pacific (a)	0,04	0,04	0,03	0,03	0,05	0,06
East Asia and Pacific (b)	0,06	0,08	0,09	0,14	0,19	0,22
Europe and Central Asia (a)	...	...	...	0,10	0,08	0,08
Europe and Central Asia (b)	...	...	...	0,30	0,23	0,23
Latin America and Caribbean (a)	0,22	0,20	0,12	0,11	0,13	0,12
Latin America and Caribbean (b)	0,37	0,33	0,28	0,24	0,25	0,24
Middle East and North Africa (a)	...	...	...	...	0,06	0,07
Middle East and North Africa (b)	...	...	...	...	0,18	0,18
South Asia (a)	0,02	0,02	0,02	0,01	0,02	0,02
South Asia (b)	0,05	0,06	0,06	0,07	0,08	0,09
Sub-Saharan Africa (a)	0,07	0,05	0,03	0,02	0,02	0,02
Sub-Saharan Africa (b)	0,11	0,09	0,06	0,05	0,05	0,05
Low income (a)	0,03	0,02	0,02	0,01	0,01	0,01
Low income (b)	0,05	0,05	0,05	0,06	0,06	0,07
Middle income (a)	0,12	0,11	0,08	0,06	0,07	0,08
Middle income (b)	0,21	0,21	0,20	0,18	0,20	0,22

Source: World Bank World Development Indicators.

Note: (a) The ratio of per capita gross fixed capital formation of indicated countries to that of high-income OECD countries in current US dollars.

(b) The ratio of per capita gross fixed capital formation of indicated countries to that of high-income OECD countries in current international dollars.

The table reveals that the ratios in general appear to be stagnating in purchasing power parities, and appear to be decreasing in current US dollars. The ratios for East Asian and the East European and Central Asian grouping show upward trends. If these upward trends were to continue, they would imply a convergence not of per capita stocks, but of *rates of increase* of per capita stocks. As long as the absolute difference between per capita fixed investment in two regions continues, the gap in per capita stock of fixed capital deepens. Convergence of per capita capital stocks of peripheral countries with the core countries would necessitate that the figures in the table be over unity – moreover, *substantially* over unity. Given the figures, the prospects for the low and middle income countries' raising their capital accumulation and labor productivity to levels commensurate with that of the core countries seems to be nil.

The alternative mode of surplus absorption is that part of private and government consumption that cannot be categorized as necessary for the maintenance of the workforce. There is no doubt that such non-essential consumption is widespread in the periphery of the world-system (formerly among the comprador and 'traditional' ruling classes, now among the emerging transnational élite groups[13]) and that this consumption diverts resources away from investment. It lies beyond the scope of this paper to estimate non-essential consumption for groups of countries. However Table 9 reveals that as the peripheral countries are being officially exhorted to raise their saving rates, the propensity to consume in the core countries is increasing. An increase in the share of consumption in national income in core countries may be interpreted as impinging on the global surplus, unless there are reasons to suppose that the necessary costs of maintaining the labor force in the core rises faster than GDP. The declining overall saving rate and trade deficits of the core countries as a block flies in the face of the need to make provisions for aging core populations.

The United Sates and the European Monetary Union countries as a group have been contributing less to global saving (relative to GDP) than the middle income countries since the 1970s, and Japan appears to have joined the former group in this respect since 2000. The high income OECD countries' final consumption share in GDP has risen by four percentage points from 1975-1979 to 2000-2003, and the final consumption share of the low income countries has declined by four percentage points. The average saving rate in the core has dropped to the level of the low income countries in 2000-2003. The increase in the consumption rate from 0.78 in 1999 to 0.79, 0.80 and 0.81 in 2000, 2001 and 2002 in the high income OECD countries has deprived the world of roughly 1.49 trillion dollars (1.55 trillion in current international dollars) of saving in the three years, a sum equal to 1.5 percent of world output in those years (1.1 percent by current international dollars). The increasing flow of global surplus to the core countries makes it both possible and necessary to increase consumption rates in the core.

The rise in the consumption rate in the major core countries appears to be maintained *inter alia* by a rising household consumption rate in the US and Japan. Private consumption expenditure is sustained by advertising, superficial product differentiation and planned obsolescence. Asset prices inflated by speculation (such as the current housing bubble in the US) play a part in encouraging consumption. As income levels in the core countries become increasingly polarized, corporate sales strategies develop mass markets in segments, e.g. in markets for 'life-style model' consumer goods and markets for discount-store consumer goods (Jones 2001: 14).

Capitalists, for their part, present advertising as necessary to serve consumers, who are portrayed as having mysteriously become more whimsical in their demands and preferences.[14] World advertising expenditure (Table 10) amounted to around one percent of world GDP in 2003 and 20 percent of the fixed capital formation expenditure of the low and middle income countries combined. Much of expenditure on advertisement can be seen as a waste of resources that is used to abet further waste. Another factor that instigates private consumption in the core countries is consumer credit, which has enabled US consumers to accumlate a debt of ten billion dollars at the end of 2004 (Wolff 2005).

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[13] Sklair (1994).

[14] An ICC Policy Statement argues "In an increasingly competitive environment and the tendency toward shorter product life spans, new products and services must be introduced without delay to the local market so that business can meet consumer expecations and or preference …" (ICC 2002).

The share in GDP of the other component of final consumption expenditure, government expenditure, in the core countries appears to stable, balanced by Japan's rising share and a declining trend in the US. In the context of government expenditure, US military expenditure played an important role in absorbing surplus during the Cold War (Baran and Sweezy, 1966: Chapter 7). In the 1990s the proportion of disclosed military expenditure in GDP and in central government expenditures has been slightly declining according to World Development Indicators; in 2002 its share in GDP was 3 percent in the US, and 2 percent in the European Monetary Union. But a comparison of the level of military spending with investment figures in the periphery yields a more telling picture.

Table 9. Final Consumption as Percentage of GDP (%)

	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2003
Low income	84	85	83	82	82	80
Middle income	74	74	73	74	74	73
High income: OECD	76	78	78	79	78	80
European Monetary Union	77	79	78	78	77	78
Japan	67	69	67	67	71	74
United States	80	81	83	84	82	85
Per capita GDP as percentage of High Income OECD						
	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004
Low income	7	6	6	6	6	7
Middle income	17	18	18	17	18	19

Source: World Bank, World Development Indicators. Per capita GDP ratios (not in percentages) calculated by dividing 'GDP per capita, PPP (current international $)' figures of low and middle income country groupings by that of the high-income OECD countries.

Table 10. Advertising Expenditure through Major Media* (billion US dollars)

	1996	1997	1998	1999	2000	2001[a]	2002[b]	2003[c]	2004[c]
North America	105.6	112.6	118.9	124.9	131.2	146.7	150.3	158.4	167.9
Europe	72.9	78.6	83.4	87.7	92.2	76.9	86.9	89.5	95.0
Asia and Pacific	61.7	67.2	67.2	70.4	74.0	61.3	66.2	69.7	75.0
Latin America	21.1	24.2	26.7	29.6	33.1	18.3	14.1	13.7	16.1
Rest of World	5.3	6.1	6.8	7.6	8.4	9.4	11.4	14.2	17.4
Total	266.5	288.8	303.1	320.1	338.9	312.6	328.9	345.5	371.4

Source: For 1996-2000 figures: http://www.asianmediaaccess.com.au/ftimes/adspend/summary.htm (14 July 2005), original source: Zenithmedia.

[a] ZenithOptimedia Press Release June 30, 2003.

[b] ZenithOptimedia Press Release July 19, 2004.

[c] ZenithOptimedia Press Release April 18, 2005.

*Major media comprises newspapers, magazines, televison, radio, cinema and outdoor advertising. The internet is also indicated in the source tables for figures beginning 2001.

Table 11. Military Expenditure (billion US $, 2003 prices and exchange rates)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Western Europe	209	210	209	211	214	216	215	220	223	220
North America	347	328	326	319	320	332	335	375	424	466
World	789	772	774	765	773	806	819	864	927	975

Source SIPRI. http://www.sipri.org/contents/milap/milex/mex_wnr_table.html

Western Europe comprises Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, Malta, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, UK. North America comprises US and Canada.

Table 11 shows the share of the core in global military expenditure.[15] In 2003 world military expenditure figures of the Stockholm International Peace Research Institute amounted to 53 percent of gross fixed capital formation in the low and middle income countries combined (1758 billion current US$ - World Development Indicators); and the military expenditure of the core corresponded to 37 percent of this investment. The opportunity cost of military expenditure is only one side of the coin. Maintaining military might, flexing it and intermittently using it is necessary for the core countries to maintain the momentum toward deregulating trade and capital movements, and controlling global natural resources.

6. Conclusion

In conclusion, it emerges from the observations above that the basic tendencies in the production and growth of the social surplus described by Baran and Sweezy have not changed under ‘globalizing capitalism’. New economic policies, corporate strategies and international rules of conduct appear to promote increasing surplus transfers from the periphery to the core of the world-system.

In order to lift itself out of destitution the periphery is exhorted to remove restrictions on trade and capital flows, and to compete for advantageous positions in global value chains controlled by transnationals by improving quality, reducing costs, innovating etc. The export-led growth economic strategy compels peripheral producers to individually compete for exportation by repressing wages, and conceding much of the surplus produced to their trade partners in the core countries. Part of the surplus accruing to the periphery is consumed by transnational élites imitating the consumption of the well-to-do in the core societies. On the other hand dollarization, capital flight and official reserve accumulation exert downward pressure (a pressure unrelated to trade balances) on the exchange rate of peripheral currencies. The undervaluation of peripheral currencies, reflected in deteriorating terms of trade, translates into a loss of surplus to the core countries, and reduces the capacity of poor countries to import capital goods from the core. The resulting meager per capita fixed capital formation in the underdeveloped countries bodes grim prospects for the welfare of future generations of working people in the periphery.

[15] It should be recalled that in many countries part of military expenditure is concealed in other government accounts and SIPRI cannot give data on a number of countries.

These trends are maintained by the insertion of millions of workers in Asian hinterlands into global production networks, and by the willingness of peripheral states governed by transnational élites to continue free trade and capital transactions policies, and to accumulate foreign exchange reserves. Africa's poor populations await their turn to be drawn into the world labor market, to eke out a subsistence and produce a surplus, of which a large part will likely flow to the core.

In order to prevent the drift of the victims of globalizing capitalism to irrational reaction (religious or nationalist fanaticism, 'clash of civilizations' etc.) and to focus their attention on the real issues, social scientists and activists should open to debate the social and economic consequences of the export-led growth idea, all the theories and policies that give precedence to global efficiency over national saving and investment, and the social psychology of consumerism. There is pressing need to promote socio-economic programs based on the principle of self-sufficient and self-reliant national development, wherein the people can decide through democratic procedures how they will dispose the social surplus they produce (how they will distribute it, how much they will save, invest, export) under less pressure from world markets dominated by transnational companies, and with less interefence from international institutions and core states. Within the framework of the capitalist world-system, there is little hope for solving the deep social contradictions the system reproduces. The solution, reason shows, lies outside the logic of the system.

APPENDIX

Table A1. World Exports by Origin and Destination , 1985 and 2000 (billions US dollars)

1985 Destination/ Origin	Western Europe	US and Canada	Other industrialized	Total industrialized	Latin America and Caribbean	Asian developing	Africa	Total developing	Total by origin
Western Europe	663	115	35	813	18	55	27	102	915
US and Canada	84	157	53	294	24	40	7	71	362
Other industrialized	51	106	22	179	7	57	4	66	245
Total industrialized	798	378	110	1284	49	152	38	239	1522
Latin America and Caribbean	33	64	9	106	15	4	2	20	128
Asian developing	77	93	91	259	7	84	4	95	356
Africa	64	18	4	86	2	4	2	9	95
Total developing	175	175	104	453	24	95	9	126	579
Rest of world	73	4	7	84	2	18	7	24	108
Total by destination	1045	557	221	1821	75	265	51	389	2209

Table A1. (Continued)

2000 Destination/ Origin	Western Europe	US and Canada	Other industrialized	Total industrialized	Latin America and Caribbean	Asian developing	Africa	Total developing	Total by origin
Western Europe	1952	352	115	2427	77	222	46	345	2764
US and Canada	283	505	145	934	245	184	8	436	1371
Other industrialized	153	237	46	436	23	260	8	283	720
Total industrialized	2389	1095	306	3790	337	666	61	1064	4862
Latin America and Caribbean	61	283	15	360	77	23	0	100	459
Asian developing	360	452	291	1103	38	628	15	681	1784
Africa	84	31	8	130	8	31	8	38	168
Total developing	505	766	314	1585	123	674	23	819	2404
Rest of world	283	38	15	337	8	38	8	54	390
Total by destination	3185	1899	636	5720	467	1378	92	1937	7657

Source: Figures calculated from Table 2.2 (“Structure of World Imports, By Origin and Destination, 1985 and 2000” showing exports in percentages of world exports) from ECLAC (2002: 33); and from world “exports of goods and services” figures in World Development Indicators of the World Bank (http://devdata.worldbank.org/dataonline).

Note to ECLAC table: The data on world imports refer to the total imports of 82 reporting countries, corresponding to approximately 90% of world trade. 1985 refers to the annual average for the period 1984-1986. 2000 refers to the annual average for 1999-2000. The countries not included as reporting countries are primarily those with economies in transition. Western Europe: European Union plus Switzerland, Norway and Iceland. Other industrailized: Japan, Australia, New Zealand and Israel. “Rest of World” is not included as a destination for lack of information. Asian origin, [sic] “Rest of World” refers to economies in transition, Oceania except Australia and New Zealand, free zones, etc.

Table A2. World Exports by Origin and Destination, 1985 and 2000 in Current International Dollars (billion current international dollars)

1985 Destination/Origin	Western Europe	US and Canada	Other industrialized	Total industrialized	Latin America and Caribbean	Asian developing	Africa	Total developing	Total by origin
Western Europe	1052	182	56	1291	28	88	42	161	1452
US and Canada	86	161	55	302	25	41	7	73	373
Other industrialized	62	129	27	218	8	70	5	81	299
Total industrailized	1200	473	138	1811	61	199	54	315	2123
Latin America & Caribbean	80	155	21	257	37	11	5	48	311
Asian developing	176	211	206	588	15	191	10	216	809
Africa	128	35	9	173	4	9	4	18	190
Total developing	385	402	236	1018	57	211	20	282	1310
2000 Destination/ Origin	Western Europe	US and Canada	Other industrialized	Total industrialized	Latin America and Caribbean	Asian developing	Africa	Total developing	Total by origin
Western Europe	446	80	26	554	17	51	10	79	3395
US and Canada	293	523	151	968	254	190	8	452	1420
Other industrialized	126	196	38	360	19	215	6	234	594
Total industrialized	2818	1152	330	4309	367	678	71	1109	5409
Latin America and Caribbean	112	517	28	657	140	42	0	182	839
Asian developing	1387	1741	1121	4249	148	2420	59	2626	6875
Africa	227	82	21	350	21	82	21	103	453
Total developing	1725	2341	1170	5257	308	2544	80	2911	8167

Source : Calculated from Table A1 and exchange rate distorsion factors. Exchange rate distorsion factors found by dividing GDP, PPP (current international $) figures by GDP (current US$) figures from World Development Indicators of the World Bank (http://devdata.worldbank.org/dataonline) for 1985 and 2000. As the regional data of the World Bank do not correspond to those of Table A1 drawn from ECLAC, approximations for exchange rate distorsion explained in Table A4 were used.

Table A3. Unrequited Transfers through Exports due to Exchange Rate Distorsion, 1985 and 2000 (billion current international dollars)

1985 Destination/Origin	Western Europe	US and Canada	Other industrialized	Total industrialized	Latin America and Caribbean	Asian developing	Africa	Total developing	Total by origin
Western Europe	389	67	21	478	10	32	16	60	597
US and Canada	2	5	2	9	1	1	0	2	11
Other industrialized	11	23	5	39	1	13	1	14	53
Total industrialized	403	95	27	525	13	46	17	76	601
Latin America and Caribbean	47	91	13	151	22	6	3	28	182
Asian developing	99	118	115	329	8	107	6	121	453
Africa	64	18	4	86	2	4	2	9	95
Total developing	210	227	132	567	33	118	11	158	731
2000 Destination/Origin	**Western Europe**	**US and Canada**	**Other industrialized**	**Total industrailized**	**Latin America & Caribbean**	**Asian developing**	**Africa**	**Total developing**	**Total by origin**
Western Europe	446	80	26	554	17	51	10	79	631
US and Canada	10	18	5	33	9	7	0	16	49
Other industrialized	-27	-41	-8	-76	-4	-45	-1	-49	-125
Total industrialized	429	57	23	512	22	12	9	45	555
Latin America and Caribbean	51	234	13	297	63	19	0	82	380
Asian developing	1027	1289	830	3146	109	1792	44	1945	5091
Africa	142	52	13	220	13	52	13	65	285
Total developing	1220	1575	856	3664	185	1863	57	2092	5756

Source: Calculated by taking differences of corresponding regional export figures in Tables A1 and A2.

Table A4. Exchange Rate Distorsion Factors for Regions in Table A2

Region in Tables A1-A3	Country/Region in World Development Indicators	Year	Exchange rate distorsion factor	Weights (from annual exports in billion current dollars)	Regional exchange rate distorsion factor
Western Europe	European Monetary Union	1985	1.587	-	1.587
		2000	1.228	-	1.228
US and Canada	US	1985	1.000	0.752	1.029
	Canada		1.116	0.248	
	US	2000	0.986	0.769	1.036
	Canada		1.202	0.231	
Other Industrialized	Japan	1985	1.169	0.812	1.218
	Australia		1.222	0.114	
	New Zealand		1.720	0.029	
	Israel		1.756	0.045	
	Japan	2000	0.694	0.769	0.826
	Australia		1.290	0.134	
	New Zealand		1.480	0.028	
	Israel		1.123	0.069	
Latin America and Caribbean	Latin America and Caribbean	1985	2.423	-	2.423
		2000	1.826		1.826
Asian developing	East Asia and Pacific	1985	0.466	2.742	2.274
	South Asia		0.1000	3.238	
	Middle East and North Africa		0.433	1.548	
	East Asia and Pacific	2000	0.675	4.199	3.853
	South Asia		0.099	5.041	
	Middle East and North Africa		0.226	2.306	
Africa	Sub-Saharan Africa	1985	0.379	2.794	2.004
	Middle East and North Africa		0.621	1.549	
	Sub-Saharan Africa	2000	0.352	3.400	2.691
	Middle East and North Africa		0.648	2.306	

Note: The distorsion factor for Western Europe is based on the World Bank's GDP figures for European Monetary Union; the distorsion factor for US and Canada is average of World Bank's GDP figures for the US and Canada, weighted by exports of goods and services; the distorsion factor for other industrialized countries is average of distorsion calculated from World Bank's GDP figures for Japan, Australia, New Zealand and Israel, weighted by these countries' exports of goods and services; the distorsion factor for Latin America and Caribbean is calculated from World Bank's GDP figures for this region; the distorsion factor for Asian developing countries is average of distorsion factors calculated from World Bank's GDP figures for East Asia and Pacific, South Asia and the Middle East and North Africa, weighted by these regions' exports of goods and services; the distorsion factor for Africa is average of distorsion figures calculated from World Bank's GDP figures for Sub-Saharan Africa and the Middle East and North Africa, weighted by exports of goods and services.

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Chapter 6

Does Economic Growth Mean the Rise of the Wealth of Nations?*

E. Ahmet Tonak

"... It is important to remember that ... the fundamental variables determining ... the medium- and long-term *growth rate* ... and the *structural transformation* of the economy depend upon the *capital profile*."
Korkut Boratav[1]

1. Introduction

The response to the question "Is economic growth tantamount to the rise of national wealth?" has been pretty much the same ever since Adam Smith. Yes, economic growth does mean the rise of national wealth. But with an affirmative response, one gets, whether one wishes it or not, the impression that all economic theorists for the last 250 years agree about such issues as growth and national wealth. Any such impression distorts the facts. Radically breaking with the Classicals in terms of the conceptualisation of such essential domains of economic activity as *production*, *distribution*, and *consumption*, the post-Classical economists also rendered the concepts of growth and national wealth measurable within the context of systems of national income accounts. Accordingly, whether an economy is growing or not is determined by monitoring real changes in gross domestic product (GDP), the most fundamental category of the macro-economic systems of national accounts. Economic growth exists when real GDP increases over a specified period of time. Moreover, since this very category of GDP also includes "product," it follows that rising economic wealth implies "more products". For instance, the real GDP of Turkey went up to TL 118,718 billion in 2000, from TL 50,296 trillion in 1980, resulting in an overall growth rate of 136 %, implying that national wealth has actually multiplied. This interpretation, shared by most economists, often goes unquestioned. In fact, this view of economic growth has risen to the sacrosanct and

* The author thanks Hakan Arslan for his contribution.
[1] Boratav (2000: 151; emphasis added).

is treated as a "pure economic fact". And why not? The rise in Turkish per capita GDP amounts to 55 % for the period in question, surpassing even the USA (51 %) and Canada (38 %).[2]

This article will bring to the fore a conceptual framework necessary to question this rather uncritically adopted 'economic truth,' and will draw certain conclusions which only an alternative analysis reveals. We will begin by defining the principal spheres of economic activity from the perspective of Classical tradition, and then explore the definitional assumptions of the currently used systems of macro-economic accounts. The empirical concretization of our conceptual framework in the case of the Turkish economy reveals a tendency which has become increasingly manifest in the post-1980 period. In the final section, we will offer empirical evidence from the US economy to demonstrate the need for an alternate macro-economic system of national accounts, and attempt to uncover the relationship between economic growth and non-production activities.

2. What is Production?

The conceptualization and classification of main economic activities within the Classical tradition revolves around the concept of *use-value*, and the question of *what is done* with the use-value, and in *what sort of activity*. *Use-value* is defined as the goods and services to which consumers attribute the capacity to meet given needs. The condition of commodification is not required for a given good or service to qualify as use-value. It suffices that for whatever reason some attribute a potential satisfaction to a good or a service.[3]

In that sense, use-value is a subjective category that applies to any society. On the other hand, the almost complete commodification of use-values under capitalism is a historical phenomenon peculiar to the socio-economic formation in question which is by definition the generalised commodity production.

Having defined the concept of use-**v**alue, we may also define *production activity* as an economic activity in which existing use-values are used up —productively consumed— in the *creation* of new use-values. In short, production is the activity of creating a use-value. Classical economists' ascribing principal importance to production activity should not be construed as a failure on their part to appreciate the significance or the necessity of other economic activities. On the contrary, Marx expounds how *distribution* and *consumption* activities make up the integral aspects of reproduction and conceptualizes both with utmost care. In view of its quantitative as well as qualitative importance in modern capitalist societies a fourth activity must also be defined, s*ocial maintenance and reproduction*. The activities other than production are also defined in reference to the concept of use-value. For instance, *distribution* activity should, in the final analysis, be seen as one in which use-values are utilized in the process of transferring use-values from their immediate possessors to their final users. Personal *consumption* is, in that respect, an activity in which use-values are consumed by last users. *Social maintenance and reproduction* —which comprises a whole range of

[2] Per capita GDP rose, in real terms, from TL 1,131,000 in 1980, to TL 1,751,000 in 2000.

[3] "The nature of such wants, whether, for instance, they spring from the stomach or from fancy, makes no difference." Marx (1979: 35)

activities, such as administrative, legal, military, etc.— is an activity in which use-values are used up to ensure the continuity of the social system.

Based on the above definitions and on the criterion of the creation/consumption of use-values, we can now classify the main economic activities in two major groups. Figure 1 depicts that classification.

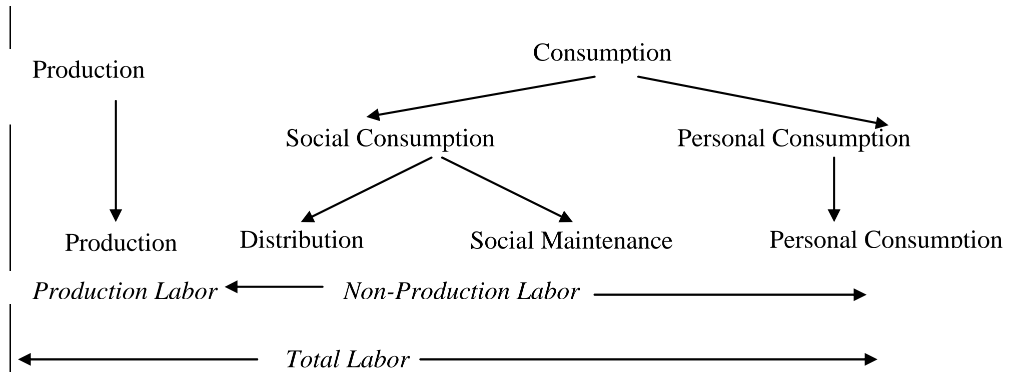

Figure 1. Classification of Economic Activities.

One should note that though as parts of non-production activities, distribution and social maintenance are seen as a form of consumption, since they also consume use-values. But, at the same time these very activities themselves also employ labourers. Even though in terms of the total labour expenditure of the nation, labour expended in distribution and production does matter; it must, however, be seen as non-production labour since the activities in which such labour is expended are not production activities *per se*. This classification is essential if we are to clarify the distinction between *productive* and *unproductive* activities —a notorious debate within Marxian economics. One could even go so far as to argue that some of ambiguities in the debate originate in the failure to define the aforementioned spheres of economic activities in a clear cut manner.[4] The classification we suggest, as Marx himself did, assumes that the category of productive labour, as a subset of production labour, is specific to capitalist production alone.[5]

The distinctive nature of our classification should become obvious by comparing it to the concept of production (and hence, that of product) of the conventional systems of national accounts. The agency that collects and disseminates the national income accounts data in the USA is the Bureau of Economic Analysis (BEA) within the Department of Commerce. The criterion set forth by the BEA as to whether an activity counts as production is very explicit:

> "The basic criterion used for distinguishing an activity as economic production is whether it is reflected in the *sales and purchase* transactions of a *market* economy" (cited in Eisner, 1988: 612; emphasis added)[6]

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[4] It is not possible to go, within the rather limited scope of this article, into the details of the debate in question. Readers should be able to find a detailed discussion of the issue in Shaikh and Tonak (1994), and Savran and Tonak (1999).

[5] In the last section, a succinct account of the empirical implications of our classification is provided. For a more detailed exposition, see Shaikh and Tonak (1994).

[6] Note that the definitional criterion in question is not specific to the USA. As a matter of fact, the framework imposed by the UN on all member states departs from the very same conceptual approach.

One does not need to go on at great lengths to point out how radically the BEA definition differs from ours. Yet, it is useful to further reflect the content and basic concepts of the BEA definition. The logic of the BEA criterion implies that, as long as the *outcome* of a given activity is marketable, the outcome then becomes a product while the activity itself is considered as production activity! Putting it differently, the criterion as to whether a given activity counts as production or not, refers not to the activity itself, but to the *market*. But then, this implies that the criterion is made *external* to the activity itself.

In classifying the sectors of the economy and measuring the GDP, the BEA-type of criterion is also adopted and applied to Turkish macroeconomic data by the State Institute of Statistics (SIS). In that framework, SIS considers trade, state services and financial institutions as production sectors on an equal footing with genuine production sectors such as agriculture, manufacturing and construction. While this difference in the classification of sectors/activities might appear as a matter of semantics to some, its importance becomes clear once the specific purpose and uses of the systems of macro-economic accounts are considered. We know that national income accounts claim to be the unique data base through which the structure, patterns, and the performance of an economy can empirically be observed in. Moreover, such a data base also claims to render the assessment of the level and development of national wealth possible and to offer objective grounds for the identification of economic problems. The major statistical reference for national macroeconomic policies as well as decisions made by international institutions is the national income accounts, through which macroeconomic data are supplied in a systematic way. Therefore, the issue we tackle here clearly transcends semantics. One must also keep in mind that, while economic policies setting the course of the economy are determined on the basis of existing empirical data, the latter, in turn, very much depends upon our classification of economic activities.

3. TRENDS IN THE TURKISH ECONOMY

Conventional national income accounting does not question whether the origin of economic growth lies with consumption or production. The monetary ‘products’ of financial institutions, banks, and intermediary institutions of the stock market exchange are considered to be part of the GDP, and growth in such sectors is conceived as the growth of the overall economy and rising national wealth. Yet, from the point of view of Classical economics, the growth of such sectors simply means the rise of their appropriated share of the social surplus generated by production sectors. Hence, in a society where such a tendency is dominant, the amount of available economic surplus to be channelled to production investment is lower, and prospects for long-term accumulation and growth are dim. In other words, the relative growth of non-production sectors must be seen not as enrichment, but rather as a tendency which limits the growth potential of national economy.

The tendency in question, illustrated below for the Turkish economy, is revealed by considering some sectors as productive and some others as unproductive, utilizing the definition of production previously presented.[7]

[7] Productive sectors are agriculture, industry, construction, transportation, communication, professions and services. Sectoral GDP contributions are given in Appendix 1- A and B

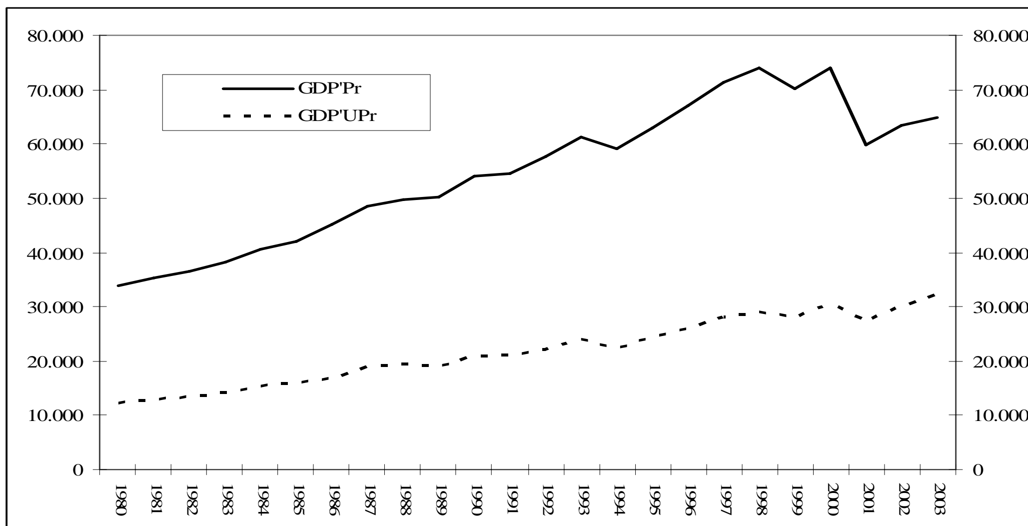

Figure 2. GDP'Pr & GDP'UPr (Billions; in 1987 TL).

As seen in Figure 2, during 1980-2003 the total real GDP of the productive sectors (GDP'Pr) increased by 91.3% while the real GDP of the non-productive sectors (GDP'Upr or, according to our classification, the GDP of the social consumption activities; financial institutions, trade, and government services) increased by 162.5%.

In Figure 3, the evolution of the GDP shares of production and social consumption are seen. As opposed to an increase of 110.2 % in GDP', the ratio of production sectors' GDP'Pr to non-production sectors' GDP'UPr declines by 27.1 %. It is possible to view this tendency as the expression of a long-term structural limit encountered by capital accumulation. On the other hand, during times of short-term crises, such as 1994 we can observe a change in the direction of the tendency in question.

Against the background of a real GDP decline of as much as 4.5 %, the short term reaction of productive sectors to the crisis through 1994 seems to have been different from and slower than that of social consumption sectors. While contraction in production sectors was confined to only 3.4 %, the decline in non-production sectors reached a high of 7.2 % (the decline was around 10 % and 1.4 % in the trade and finance sectors, respectively). A deeper crisis of 2000-1 also exhibited the same but less dramatic pattern of contraction differences: the amounts of decline were 5.6 % and 10.2 % in productive and non-production sectors, respectively. Adaptive differences could, in part, be explained by the structural properties of financial and trade sectors and relatively higher employment elasticities. However, a detailed analysis of the causes of the sort of short term fluctuations as observed in the above-mentioned periods and economic policies which possibly gave rise to those crises are beyond the scope of this article.[8]

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[8] Boratav and Yeldan (2001) could be cited as an essential source where the relationship between economic policies and short term fluctuations in question, and, *inter alia*, the 1994 crisis is discussed, in conjunction with other causes.

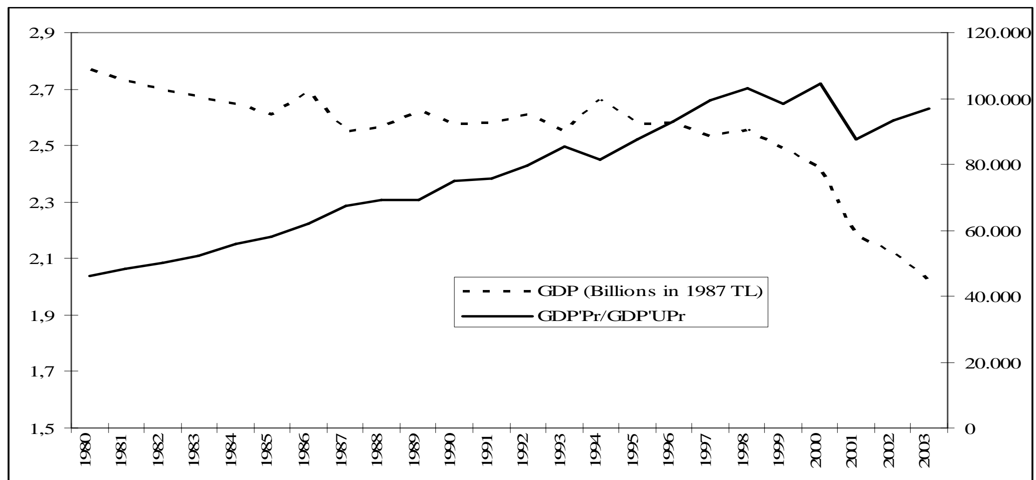

Figure 3. Changes in GDP' & GDP'Pr/GDP'UPr.

4. Marxian Empirical Application

The central concern of Classical economists is the identification of those factors that lead to succesful economic performance and those that lead to bottlenecks. As previously summarized, the Classical approach finds its expression in the dual classification of production *versus* social consumption (trade, administrative, financial) activities/sectors. This classification enables one to separate labour expenditure and employment into production and non-production. Such a classification does not mean that production labour is more necessary than, or superior to, or even more characteristic of the proletariat than the latter. On the other hand, as exemplified by Smith's own formulation, considering the service sector labour expenditure as non-production, simply because the *outcome* of the activity is a service rather than a good is not in concordance with the criterion we have developed. Smith tends to build the criterion for labour classification upon the qualities (physical qualities) of the *outcome* (service/good) in which labour is embodied (crystallized), rather than the quality of the activity in which labour is realized.

A more sophisticated and detailed version of this approach comes from Marx. The vitality of capitalist economy depends upon its capacity to generate profits, while the quantitative magnitude of profit depends first on surplus value production as the determining source, and, second, *profit-on-alienation.*[9] This is the perspective from which Marx further elaborated and concretized the distinction between productive and unproductive activities, offering specific examples from a variety of professions. Since from a Marxian point of view, surplus value is seen as the determining source, the life-blood, so to speak, of profit, it is important to identify which part of labour expenditure is *productive of capital*, i.e. has the capacity to create surplus value. In this regard, it is quite understandable why the debate on

[9] The idea conveyed by the term *profit-on-alienation* is that, as opposed to profit on surplus value, profit can also arise from the circuit of capital and other spheres of social life, depending on some sort of unequal exchange (Marx, 1984).

productive/unproductive labour should be conceived of as a leading concern for Marxist economist.

Classical economists were able to see that only that part of net product —i.e. product net of capital consumption— which is re-invested in production would determine the rate of growth. Hence, what percentage of net product would go into production, and what percentage would go into consumption, was the crucial question. On the other hand, while important in terms of raising overall employment and effective demand, the labour employment of non-production sectors is otherwise seen as social consumption expenditure. To be more exact, the labour employment of any sector would require an increase in the amount of inputs used up in production, and in the amount of consumption goods demanded by labour. Yet, *increased employment in production sector alone entails an increase in surplus value*. Employment in non-production sectors, on the other hand, are not productive of surplus value, and do not have a pro-growth effect.

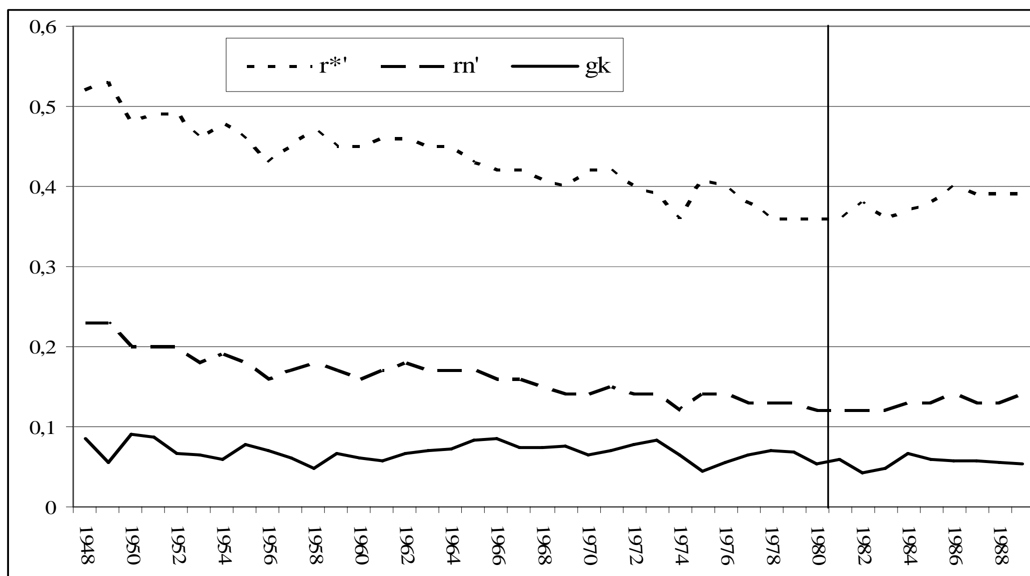

Figure 4. Rates of Profit and Growth – US.

The following charts offer a concrete view of issues such as labour employment, what percentage of the surplus returns to production, etc. for the US economy.[10] The rate of profit ($r^{*'}$), measured in terms of Marxian categories and adjusted for variations in capacity utilization is the common and essential determinant of the rate of profit (r_n') computed directly from the national income accounts, as well as, the actual rate of capital accumulation (g_k).[11] Looking at Figure 4, one can see that US data for 1948-89 fall into two distinct sub-periods. Not only that but the course followed by the rate of surplus value (S^*/V^*) and by the value composition of capital (C_f^*/V^*) reveal structural trends which remain unobserved in conventional statistics. Table I below indicates that, from 1948 to 1980, the rate of surplus

[10] Even a succinct account of the elaboration and generation of the data used in the pictures would considerably extend the size of this paper. Hence, readers are advised to refer to Shaikh and Tonak (1994) for details.

[11] The proof for this relationship is given in Appendix 2. For a more detailed exposition and discussion, see Shaikh and Tonak (1994).

value increases by a modest 21.8 %, while the value composition of capital increases by 77.4 %, together producing a decrease in the rate of profit ($r^{*'}$) by 30.8 %. This empirical finding offers concrete and incontestable support for Marx's theory of the falling rate of profit.

As in Turkey, the share of non-production activities increased in the USA as well, through the years 1948-89. The 16 % increase in the social burden rate (b) illustrated in Figure 5 is an empirical manifestation of the structural change in question. Figure 5 reveals that the social savings rate does not depend on just the savings decisions of firms and individuals, as orthodox theory would have it, but also on the decisions of firms and governments to engage in non-production activities.[12]

The second sub-period, from 1980 to 1989, spans the reign of the Reagan-Bush administrations, when various attacks on workers' gains and living conditions generated a dramatic increase in the rate of surplus value. The annual trend rate of the rate of profit reached twice the rate of the previous sub-period. Low profitability and slow accumulation inhibited capital-intensive investment, and, as a net effect, the rate of profit ($r^{*'}$) increased by 8.3 %.

Table 1. Change in the Rate of Profit and its Determinants-the USA

	Total Change (%)		Annual Trend Change (%)	
	1948-80	**1980-89**	**1948-80**	**1980-89**
S^*/V^*	21.8	17.9	0.6	1.8
C_f^*/V^*	77.4	6.9	1.6	0.7
$r^{*'}$	-30.8	8.3	1.0	1.1

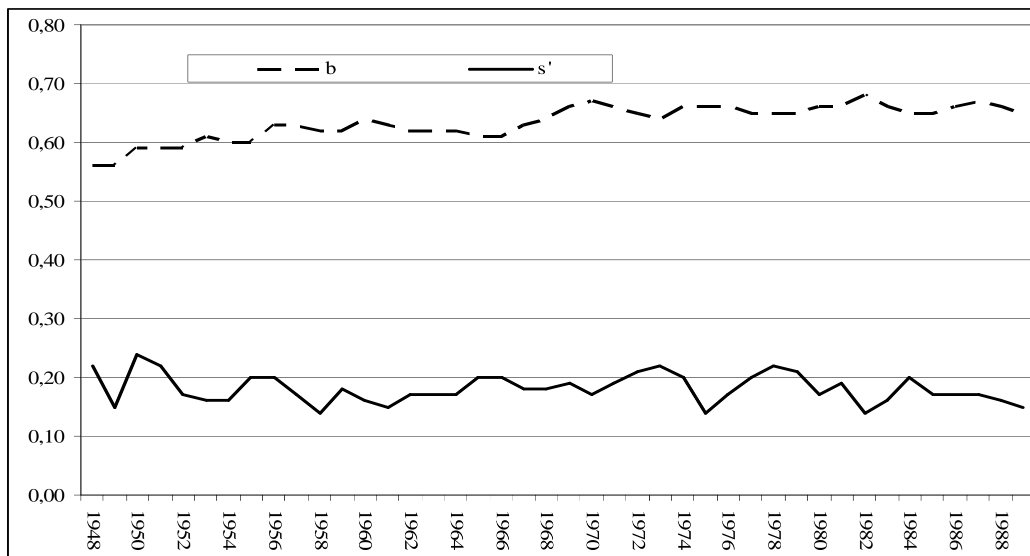

Figure 5. Social Burden & Savings Rates – US.

[12] For the definitions of and interrelations among the variables used above, see Appendix 2 and Shaikh and Tonak (1994: 210-6).

5. Conclusion

The point of the present article is that, without establishing this alternate data base, the real nature of the structural changes in a capitalist economy, and the limits imposed by such changes on growth can not be ascertained. And this general argument**,** of course, applies to the Turkish economy as well. However strongly motivated ~~as~~ one may be, by political analysis**,** any critical empirical effort, in quantitative terms, is bound to end up with limited outcomes, as long as one's data base is a product of the conceptual frame of reference of orthodox economics. So much so that, in some cases, the uncritically adopted concrete trend happens to turn upside down, and the ability to discover new trends stimulates a change in theoretical explanations.

Though being an example drawn from the US case, it is nevertheless worth mentioning to prove our point a variant of radical crisis theories that attributes a central role to decreasing labour productivity (Naples, 1987). The approach in question uncritically adopts and employs the conventional labour productivity data. But, when computed on the basis of the distinction between productive and unproductive labour, productivity as the central category of this approach, turns out to be 3-4 times the productivity obtained on the basis of conventional data, with a rate of growth exhibiting a rather different pattern.[13] Once again, at the core of the wage profit-squeeze theories widely adopted by the radical wing, there lays a profit-wage rate computed on conventional grounds. When used uncritically, the conventional rate leads to the following consequence and crisis explanation: The rate of profit and the rate of accumulation falls due to the higher share workers get in value-added.[14] Yet, when computed utilizing the data base developed in Shaikh and Tonak (1994), it turns out that the profit-wage ratio falls by 30 %, whereas the rate of surplus value rises by 40 %![15,16]

There are serious obstacles to performing similar computations for Turkey. Some of the crucial data series are simply absent, and the existing series suffer from serious problems of content and continuity, and bureaucratic red tape presents great obstacles.[17] Nonetheless, we expect in the near future to publish the results of initial efforts to construct an alternate data base of macro-economic accounts.

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[13] Shaikh and Tonak (1994: 131-6)

[14] At one point, such explanations of the British and the US crises were quite *à la mode*. See, e.g.: Glynn and Sutcliffe (1972), Boddy and Crotty (1975), Sherman (1986), Weisskopf (1979), Bowles, Gordon and Weisskopf (1984).

[15] Shaikh and Tonak (1994: 113-22).

[16] Another example is our critique and alternate calculations of the definitional assumptions of the so-called Regulation school (Shaikh and Tonak, 1994). Tonak (1991) provides a critique of an attempt by Arın (1986) to analyse the Turkish economy from the perspective of Regulation school.

[17] National income accounts have not been re-arranged to incorporate the information on intermediate inputs. While the UN urges member countries to make the necessary changes, most countries, including Turkey, have so far not complied with that demand. New Zealand is among the few countries that has re-arranged her data base, and, Cronin (2001) is a work which has reached interesting results by using the alternate system of accounts we have developed in Shaikh and Tonak (1994). As we have shown in Shaikh and Tonak (1994: 93-108), when intermediate inputs are not incorporated into the national income accounts, it is possible to approximate sectoral values by means of using the input-output tables.

APPENDIX 1-A
GDP CONTRIBUTIONS BY PRODUCTIVE SECTORS AND THROUGH SOCIAL CONSUMPTION (BILLIONS; IN 1987 TL)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Productive Sectors											
TOTAL	33.913	35.402	36.585	38.146	40.664	41.996	45.113	48.438	49.670	50.099	53.940
Agriculture	*12.636*	*12.398*	*12.786*	*12.667*	*12.727*	*12.669*	*13.255*	*13.314*	*14.356*	*13.272*	*14.177*
Agriculture and Livestock	11.480	11.190	11.686	11.515	11.597	11.531	12.171	12.236	13.209	12.166	13.137
Forestry	943	965	830	850	867	845	821	802	798	791	774
Fishing	212	243	270	302	264	294	262	277	349	315	266
Industry	*11.197*	*12.224*	*12.821*	*13.628*	*14.975*	*15.909*	*17.667*	*19.276*	*19.618*	*20.529*	*22.302*
Mining and Quarrying	1.031	1.108	1.112	1.089	1.127	1.258	1.439	1.475	1.407	1.590	1.550
Manufacturing	9.284	10.161	10.813	11.620	12.695	13.418	14.827	16.319	16.575	17.076	18.729
Electricity, Gas and Water	882	955	896	920	1.154	1.232	1.401	1.482	1.636	1.863	2.023
Construction	3.097	3.161	2.866	3.365	3.761	4.273	4.745	5.452	5.159	5.472	5.411
Transportation and Communication	5.792	6.370	6.817	7.133	7.758	7.652	7.856	8.660	8.761	9.045	10.123
Business Services	1.191	1.248	1.295	1.354	1.441	1.493	1.590	1.736	1.776	1.781	1.926
Social Consumption											
TOTAL	12.237	12.957	13.562	14.281	15.350	16.081	16.767	18.975	19.387	19.091	20.936
Financial Institutions	1.910	1.935	2.008	2.047	2.070	2.120	2.207	2.288	2.389	2.447	2.496
Trade	7062	7685	8218	8851	9680	10262	10765	12898	13139	12739	14421
Government Services	3.265	3.337	3.336	3.384	3.600	3.700	3.795	3.789	3.859	3.906	4.019

APPENDIX 1 – B

GDP Contributions by Productive Sectors and through Social Consumption (billions; in 1987 TL)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Productive Sectors													
TOTAL	54.460	57.684	61.264	59.180	63.027	67.088	71.319	74.080	70.081	74.034	59.939	63.450	64.882
Agriculture	*14.049*	*14.651*	*14.462*	*14.358*	*14640*	*15284*	*14925*	*16176*	*15426*	15962	14923	15948	15549
Agriculture and Livestock	13.052	13.489	13.391	13.266	13490	14176	13883	15080	14350	14888	13898	14837	14501
Forestry	730	900	732	752	832	792	729	726	695	714	656	756	689
Fishing	267	262	338	341	318	316	313	373	381	360	369	354	359
Industry	*22.909*	*24.268*	*26.259*	*24.775*	*27766*	*29745*	*32834*	*33494*	*31814*	33738	31207	34142	36794
Mining and Quarrying	1.620	1.624	1.520	1.642	1529	1566	1638	1791	1662	1643	1498	1432	1390
Manufacturing	19.175	20.281	22.166	20.473	23321	24980	27838	28165	26569	28278	25974	28678	31140
Electricity, Gas and Water	2.114	2.363	2.573	2.660	2916	3199	3358	3535	3583	3817	3735	4033	4264
Construction	5.473	5.814	6.271	6.114	5857	6201	6510	6559	5730	5991	5662	5346	4866
Transportation and Communication	10.085	10.899	12.080	11.835	12511	13459	14485	15198	14586	15655	5662	5346	4866
Business Services	1.944	2.051	2.192	2.098	2253	2399	2565	2653	2525	2688	2484	2669	2808
Social Consumption													
TOTAL	21.117	22.091	23.998	22.262	24.463	26.018	28.155	29.014	28.179	30.609	27.499	29.950	32.130
Financial Institutions	2.515	2.463	2.453	2.417	2424	2477	2573	2753	2898	2958	2666	2477	2319
Trade	14484	15370	17209	15474	17558	19073	21109	21523	20413	22686	19788	22392	24686
Government Services	4.117	4.259	4.336	4.371	4481	4468	4473	4738	4868	4965	5045	5082	5125

APPENDIX 2

Consider an economy consisting of production, trade and public sectors.

The following are the definitions of surplus value (S^*) and surplus product (SP^*) which are equal to each other in value terms:

$$S^* = P_n + T + E_u \quad (1)$$

$$SP^* = I_n + CONC + G + E_u \quad (2)$$

where,

P_n	:profit type income (net of profit and indirect taxes)
T	:T_p + IBT (profit taxes + indirect business taxes)
E_u	:$M_t + W_t$ = expenses of unproductive sector (trade) = $U_t + CONW_t$
M_t	:material costs of the trade sector
W_t	:wages of the trade sector
U_t	:input-product
$CONW_t$	:consumption of the trade sector workers
I_n	:net investment
CONC	:capitalist consumption
G	:government non-production use of products and (via government employment) of wage goods

From (1) $P_n = S^* - T - E_u$ (3)

From (2) $I_n = SP^* - CONC - G$ (4)

Equation (3) indicates that the total profit of production sectors can be obtained by deducting total taxes and unproductive expenses from surplus value, while (4) indicates that total investment can be obtained by deducting capitalist consumption and government expenditure from surplus product.

Dividing the terms of (3) by the utilised stock of capital (K^*. u), we get the national income accounts based the capacity utilisation- adjusted net rate of profit (r_n').

$$r_n' = (1 - t - e_u) . r^{*'} = (1 - b) . r^* \quad (5)$$

$r_n' = P_n / (K . u)$
$r^{*'} = S^* / (K^* . u)$

$t = T / S^*$	: tax share in surplus value
$e_u = E_u / S^*$	: trade sector expenditure in surplus value
$b = t / e_u$	: social burden rate

Equation (5) indicates that the rate of profit ($r_n^{'}$) equals the Marxian rate of profit multiplied by the proportion of surplus value not going to business taxes (t) and to unproductive expenses (e_u).

Since, under conditions of normal accumulation (i.e., when capacity utilisation fluctuated around a normal level), the rate of profit is determined by the rate of surplus value and the value composition of capital. The actual rate of profit ($r_n^{'}$) is determined by $r^{*'}$. On the other hand, $r_n^{'}$ will fall relative to the Marxian rate of profit $(r^{*})^{'}$, when a greater proportion of surplus value is absorbed in business taxes or unproductive expenses. That is why (b) is defined as the rate of social burden.

Dividing the terms of equation (2) by $K^{*'}$, we get

$$(SP^{*} / K^{*'}) = (I_n / K^{*'}) + (CONC / K^{*'}) + (G / K^{*'}) + (E_u / K^{*'}) \quad (6)$$

And, from (6), using ($SP^{*} = S^{*}$), we obtain the actual rate of accumulation as

$$g_k = (I_n / K^{*'}), \text{ and,}$$
$$g_k = (1 - c_c - gov - e_u) / (S^{*} / K^{*}) = (1 - c^{'}) \,.\, u \,.\, r^{*'} = s^{'} \,.\, u \,.\, r^{*'} \quad (7)$$

where,

c_c : CONC / S^{*} (the share of capitalist consumption in surplus product)
gov : G / S^{*} (the share of government expenditure in surplus product)
$c^{'}$: (c_c + gov + e_u) (the share of non-production expenses in surplus product)
$s^{'}$: ($1 - c^{'}$) (social savings rate)

Equation (7) shows that, as already argued in the main text, the Marxian rate of profit ($r^{*'}$) is the principal determinant of the actual rate of accumulation (g_k).

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Chapter 7

ECONOMIC POLICY REGIMES AND THE PROFITABILITY: THE TURKISH ECONOMY, 1968-2000*

Benan Eres

1. INTRODUCTION

In a capitalist economy, the investment decisions that determine the magnitude and pace of the accumulation, and hence economic development are fundamentally taken by the private individuals who act solely on the motive of profits. The law of motion of the capitalist form of economic organization necessitates production on an extended scale in pursuit of profits, independent of the extending (or maybe even shrinking) objective needs and requirements of society. The obvious criterion of profitability for the private individuals in making investment decisions is the amount of return relative to the amount of investment in monetary terms.

These private individuals are bounded by many constraints differing in degree and effectiveness. The degree and effectiveness of these constraints can be simply defined as the extent to which these decision-making individuals have power to manipulate and alter these constraints. Obviously, with this criterion, the international order of world capitalism is the least flexible of all constraints. This becomes more apparent if one considers a less developed, or more accurately an underdeveloped economy, like the Turkish economy. State, the most developed form of organization in a national economy, on the other hand constitutes a rather accessible area that individual decision-makers can penetrate. National economic policies imposed systematically are open to the influence of collective interests that could be either directly allied to the government or organized vis-à-vis the state in many different forms.

* This study and its conclusions depend substantially to the findings of my dissertation study at the University of Utah. The whole study wouldn't be possible without the invaluable contributions from Al Campbell, the chair of the dissertation committee, and the committee members, Hans Ehrbar, Matias Vernengo and Nazım Ekinci. I hope this article is as contributive as my committee would like it to be. Any shortcoming, obviously, belongs to the author.

In an economy like Turkish economy, where the state has always explicitly put its reliance on the private initiative for economic development[1], the economic policy aiming at development via industrialization can be explored in means of the effects of policies on the individual investment decisions. One important aspect of this exploration is the relationship between the different policy regimes implemented extensively by the state and the overall profitability in the economy.

In line with this argument, this paper aims at drawing a rough picture of the overall profitability in means of the profit rate in the total capitalist industries with reference to the different policy regimes implemented in the Turkish economy.

For the inquirer the most binding constraint is the availability of the data that is appropriate for the standard procedure developed and applied to the developed economies. The procedure we applied for the Turkish economy is derived from the 'broad' definition of the profit rate and the attached nature of the data utilized for the U.S. economy by Duménil and Lévy (1999 and 2001). The data allowed us to cover the period from 1968 to 2000. Fortunately, the period contains two broad policy regimes: Import Substitution Industrialization (ISI) and Managed Export Promotion (MEP).[2]

Next section briefly explains the procedure and the associated data problems for the Turkish economy. Third section gives the overall picture of the profit rate in the Turkish economy and summarizes the general findings. The comparison of the picture presented in the third section with the generally accepted periodization of the Turkish economy vis-à-vis the successive policy regimes, and exploration of the distributive component of the profit rate, are the subjects of the last section.

2. Definition of the Profit Rate and the Data Problems

One of the most widely used measures of the profit rate is the ratio of the net profit of the total capitalist sectors to the net capital stock. Net profit is, in turn obtained by subtracting compensation to the employees plus imputed self-employed compensation, depreciation and net indirect business taxes from the value added. The general formula and the data sources for each component are given in the appendix.

Furthermore, even though the profit rate is calculated for the whole economy, certain sectors should be excluded from the calculation, since not all the sectors operate for the pursuit of profit, hence are not capitalist. Two universally accepted sectors that should be excluded are the housing sector and the government services.

Consequently, it is the minimum requirement to have the data for the whole economy as well as these sectors. Such data is not readily available for the Turkish economy. The bulk of the available data necessary for the calculation of net profit is provided by OECD's Annual

[1] Boratav (1990 and 1993) gives an overall picture of the classes in Turkey and develops substantial criticism of the view that the state bureaucracy is a class antagonistic to the private capitalist interests. He identifies the Turkish state as a fundamentally capital-oriented organization and defines the periods of contradiction between the state and capital as extraordinary episodes that do not constitute the characteristic of the Turkish capitalism.

[2] For the first part of the discussion we began our categorization with the standard two regimes, import substitution and export promotion. The discussion here will make clear that the latter period needs to be divided into two very different periods, so later we will refer to three regimes.

National Accounts Tables CD (1960-1997), State Planning Organization's (DPT) and State Institute of Statistics's (SIS) online databases. The missing data, especially for the sectoral distinction stated above, is estimated accordingly with the procedures suggested by Özmucur (1995) for the estimation of the sectoral decomposition of the standard cost components of gross domestic product, i.e. compensation to employees, consumption of fixed capital, and the net indirect business taxes.

Unfortunately, Turkey is not in the list of countries for which OECD provides net and gross capital stocks in its publication, 'Stock and Flows of Fixed Capital'. There are two major series for the single digit sectoral capital stock for Turkey. Maraşlıoğlu and Tıktık (1991) provide a series for the years from 1968 to1988. A more recent series is constructed by Saygılı, Cihan and Yurtoğlu (2002) accordingly with the procedure OECD more or less standardized. This series covers the years from 1972 to 2000. We combined these two series, taking the latter as the benchmark, by making use of the similarities between the trends of the two series for the overlapping years. Both series are for the gross capital stock. Testing the U.S. profit rates by making use of gross capital stock in stead of net capital stock shows that this deviation in the data does not constitute any significant deviation in the results in means of the trend. It is, hence, reasonable to ignore this shortcoming.

3. The Profit Rate in the Total Capitalist Industries

Figure 1 summarizes the profit rates in the Total Capitalist Industries from 1968 to 2000. Two general observations are that there are primarily three cycles of upswing and downswing[3] and that between 1968 and 2000, the overall tendency of the average profit rate is downwards.

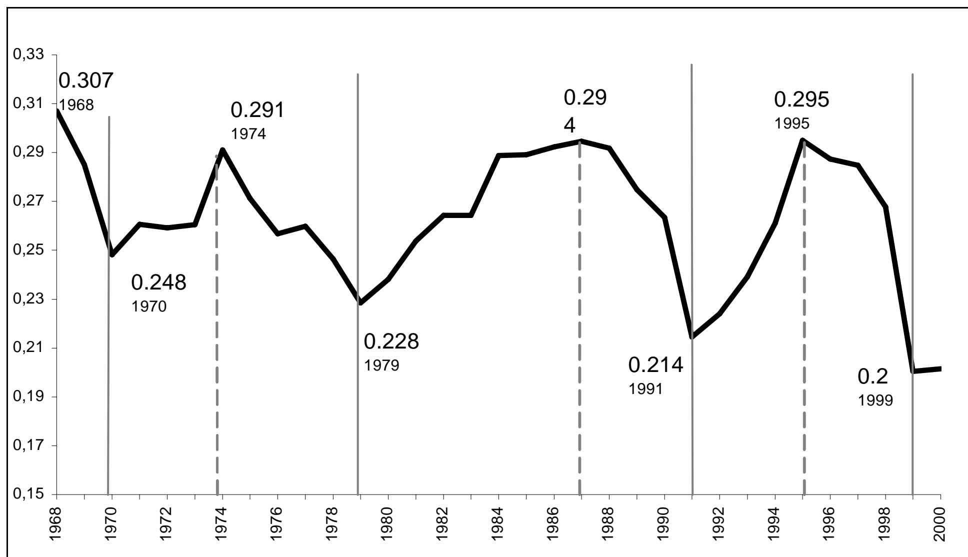

Figure 1.The Profit Rate: Total Capitalist Industries, 1968-2000.

[3] Unfortunately the unavailability of data prevent us from going back before the year 1968. Although the highest profit rate in these data is realized in 1968, there is no reason to believe that it is a peak year, and so it is not possible to consider the full downswing that ends in 1970.

The first of these cycles starts in 1970, reaches its peak in 1974, and concludes its downswing in 1979. The corresponding years for the second and third cycles are 1979, 1987, 1991 and 1991, 1995, and 1999, respectively. It is apparent that each trough is below the level of the preceding one. The profit rate falls to 24.8 percent in the 1970 trough, 22.8 percent in 1979, 21.4 percent in 1991 and finally to 20 percent in 1999.

Peak levels are also consistently increasing. In 1974, the profit rate is 29.1 percent. It obtains the slightly higher levels of 29.4 and 29.5 percent at the 1987 and 1995 peaks, respectively. However, the decrease in the consecutive trough levels is much larger than the increase in the peak levels. Overall, the rate of profit dropped 34.4 percent from 1968 to 2000, giving an average rate of growth of approximately –1 percent per year.

Besides the general declining trend, the profit rate in the Total Capitalist Industries is very volatile as compared to advanced industrial economies, as for example the United States for which we calculated the profit rate for testing comparability. Moreover, volatility in the movement of the profit rate in each cycle, described above, shows a generally increasing pattern.

It is not possible to consider cycles for the US profit rate . Instead, 1982 stands as the year when a general trend of decline comes to a halt and a rising trend begins. The average annual growth rates of the US profit rate are –3.4 percent and less than 2 percent for the 1968-1982 and 1983-1998 periods respectively. Table 1 summarizes the growth rate of the profit rate during each upswing and downswing for the Turkish economy. The comparison clearly reveals the more volatile nature of the profit rate in the Turkish economy.

At each consecutive upswing the total amount of growth increases. This is also true for the downswings. The rate of increase in upswings first falls and then substantially rises. This can be observed from the annual average growth rates. The annual average rate of decline, on the other hand seems to increase consistently at each consecutive downswing from 4.3 percent to 6.8 and then to 8 percent. There seems to be a general, though not strictly uniform, trend toward increasing volatility in the profit rate.

Table 1. Growth Rates of the Profit Rate in Total Industries (percentage)

Upswings			Downswings		
	Total	Annual average		Total	Annual average
1970-1974	17.2	4.3	1974-1979	-21.5	-4.3
1979-1987	28.9	3.6	1987-1991	-27.1	-6.8
1991-1995	37.5	9.3	1995-1999	-32	-8

4. Cycles of Profit Rate and the Periodization of the Economy

The direction of causality between the implementation of economic policies and the profitability is theoretically ambiguous. It is clear that both directions of causality are observable. One can argue that economic policies are designed and implemented, fundamentally accordingly with the general performance of the economy, and specifically

quantitative and qualitative profile of investment. Hence, profit rate is at least an indirect, but a significant criterion for policy design. On the other hand, structural characteristics of domestic economies as well as the world economy, crystallized in the overall division of labor among economies, are argued to create an environment where national policy-makers are rather bounded, to the extent that the profitability is a minor element in policy design. The analysis in this study does not take a clear stand in favor of any of these arguments. In summary, our analysis is simply tracing what happened to the profitability with regards to different policy regimes implemented, together with an analysis that traces how the conditions of profitability might have shaped the policy regime. The distinction is made wherever necessary. Within this framework we now turn to a brief discussion of the policy regimes designed and implemented during the whole period in question.

In the previous section, the periodization of the trend of profit rate has been made by simple observation on its cyclical movement. This periodization, however, almost perfectly fits to the general conditions of the Turkish Economy. The period of analysis covers considerable parts of two different regimes of economic policy. The year 1963 is known as the beginning of the planning period in the Turkish economy. The underlying industrialization policy was the Import Substitution Industrialization (ISI). The building of a significantly protected domestic market is the key feature for ISI. A relatively closed economy with high tariff barriers, overvalued currency in the service of national industries' imported input demands, and a regulated financial system with negative real interest rates are some of the pillars of this economic regime (Boratav, 2003; Barkey, 1990). In addition, the importance of the domestic demand requires a considerable compromise on the part of the capitalist class in their struggle against the working class. It is almost universally accepted that ISI was exhausted by the mid-1970s (Boratav, 2003; Barkey, 1990; and Boratav, Yeldan, Köse, 2001). The following crisis period gave birth to a major policy shift. The structural adjustment was initiated under the brief military regime and consistently continued to be implemented after the parliamentary regime was resumed. Export-promotion formed the basis of this new economic regime. Market supremacy was the ideological and theoretical backbone that was present at all levels of policy prescription and implementation.

The culmination of similar policy practices in most of the developing world points to a major shift in worldwide economic policy regimes, that altogether is often referred to as 'neo-liberalism'. After more than two decades of policy experiences, theoretical debates, worldwide crisis, and consecutive failures of such economic policy packages, the distinction between the export promotion as a practical aim and economic liberalism as the ideological and theoretical theme of these policies becomes more and more apparent. Specifically, the role of the government in these policy packages is a hotly debated area. It has been shown however that the most admired examples of rapid economic development in East and South East Asia were not the products of pure market-dependent liberal economic policy regimes. To the contrary, the role of the government has been a significant determinant of the degree and success of economic development (Amsden, 1989; Chang, 1994). In line with this argument, it is often mentioned that it was the export-promotion industrialization in its unorthodox form that consolidated and even augmented the considerable role of the government in economic growth that was inherited from preceding ISI regimes, that was successful. It can be further argued that one determinant of the failures of export-promotion policies is specific policy steps that embrace the liberal market ideology.

Neo-liberal policy packages with direct emphasis on export-promotion in the wake of the exhaustion of ISI strategies practically aim at relative promotion of the status of the economies in the world division of labor. In the forms they are imposed by the strong lending hands of the IMF (late 1970s) and World Bank (structural adjustment program of 1980s), the leading target shifts more to creating the ability to service the debt accumulated by developing countries during the ISI period. One of the most characterized differences between these two policies is that the export promotion sometimes relies heavily on the liberal hypothesis about the market supremacy. It is evident from the experiences of many East and Southeast Asian developing economies that export-promotion can be a successful way out of a trade deficit and foreign exchange constraint. However, its successful implementation also calls for intensive state intervention via selective credit policies, careful industrial strategy and so on.

On the other hand, it is widely accepted that whether relying on liberal ideology and its theoretical paradigm or constructed practically with an interventionist perspective, an export promotion strategy rests on distributional arrangements in favor of the capitalist classes. One of the significant determinants of the extent of the loss on the side of labor, however, is the choice of policy in creating the exportable surplus. Two basic choices are the contractionary fiscal and monetary policies, and income distribution policies directly targeting the capital-labor relations.

An export promotion strategy is fully initiated in Turkey by the January 24 1980 Reform Package. Two basic structural adjustments are the distributional arrangements reregulating the relations between capital and labor, and the industrial policy via credit and tax-subsidy arrangements. Both require a degree of intervention and centralized state initiative.

Industrial policy clearly targeted the manufacturing export industries. The prominent interventionist measures were the investment incentive certificates, establishment of specialized Foreign Trade Companies, and the production tax rebates for the manufacturing exports (Öniş, 1991). One interesting development on the income side of this overall fiscal arrangement was extra budgetary funds. A considerable amount of nontax income was generated by these funds for the government by this fiscal innovation (Öniş, 1991; Celasun, 1990). By 1989, the culmination of the growing pressures from the working class and the fiscal mismanagement that could not institute mechanisms of transfer from foreign exchange earned by private export industries to the public sector which was in debt in foreign exchange forced the government to switch from unorthodox to orthodox policies (Rodrik, 1990; Boratav, Yeldan, Köse, 2001; Ekinci, 1998). The loose stand of the IMF in stand-by agreements and the World Bank in structural adjustment loans that had helped the government especially during the early phase of the MEP came to a total end by 1988. The World Bank had been arguing strongly against the tax-schemes and the fiscal innovation of extra-budgetary funds, and also pressuring Turkey toward market-oriented liberal policies. The unorthodox fiscal tools were terminated in accordance with the World Bank's demands in 1988. The direction taken was substantially manipulated by the World Bank and the IMF (Öniş, 1991).

When it came to the capital-labor relations, what happened cannot be described as simply leaving the decisions to the market forces. It is argued that, given the bargaining power of the working class obtained during the ISI period, implementation of the January 24 1980 reform package desperately necessitated the military take-over of September 1980 (Boratav, 2003). The military banned the leading union confederations immediately after the takeover. Besides

this massive 'intervention', the state assumed an even greater role of arbitration in the capital-labor relations with new institutional and legal arrangements. The 1982 Constitution and later the 1983 Labor Code sealed the state's stand in favor of the capitalist class (Yeldan, 1995; Boratav, 2003). The Supreme Board of Arbitration was established by the same code. The determination of the real wage was far from by the free play of the market forces. It was closely monitored and substantially repressed by continual state intervention until the rising opposition reached a level that was unbearable for the government.

The efforts aiming at market-orientation, on the other hand were as follows: basic prices, the exchange rate, the interest rate and the product prices of the state economic enterprises were left to market determination. External trade was liberalized alongside with the incentives and promotions to the export sectors in December 1983-January 1984. Naturally, the overvalued currency was constantly devalued in a newly introduced crawling peg regime. Another attempt at trade liberalization was the establishment of the free trade zones (Öniş, 1991; Ekinci, 1998).

Financial liberalization, however, was relatively gradual. The 1982 'Banker Crisis' emerged due to the sporadic Ponzi-finance practices after the interest rate ceilings were removed. This development, as well as the sustained reluctance of the Turkish private banking sector to increase interest rates in accord with a pattern of price competition until 1984, retarded the liberalization of the financial system to a certain degree. It was concluded with the capital account liberalization only as late as 1989 (Atiyas and Ersel, 1994). Legal and institutional barriers to foreign direct investment were also removed. A program of privatization of the state economic enterprises was developed by 1984, but it had to wait until 1987 to be initiated and it really got going only during the 1990s (Öniş, 1991; Boratav, 2003). Furthermore, throughout the 1980s, the public sector continued to play the role of the leading investor of fixed capital, though it targeted infrastructure investments rather than manufacturing (Öniş, 1991).

In line with these developments, we will now, as mentioned above, divide the export promotion period into two distinct periods (the former of which has two sub-periods). The whole post-1980 period is subdivided into a stabilization and structural adjustment period of January 1980-November 1983; a trade-oriented liberalization period of November 1983-November 1987 and lastly the full liberalization of the post-1987 period (due Öniş, 1991). For our purposes, the first two phases of the post-1980 period we call the Managed Export Promotion period (MEP). The second half of the MEP from 1984 to 1988 can be referred to as a transitionary period before Full Liberalization (FL) is undertaken. 1989 is the starting point of full liberalization both in external trade and finance, hence our three periods: ISI (1963-1979), MEP (1980-1988) and FL (1989-present).

As presented above, the cyclical trend of the profit rate almost perfectly reflects these turning points pointed out by exploration of the economic policy regimes and standard macroeconomic variables. The downward trend since 1974 that ends in 1979 trough seems to be one of the reasons that triggered the wholesale shift in the policy regime, whereas the transition from MEP to FL in 1989 is rather imposed relatively independently from the overall profitability of the economy. It is obvious that there is a slowdown in the rising trend of the profit rates after 1984. However, when compared to the crisis period of late 1970s, this policy shift has a lot less to do with the profitability.

The nondistributional arrangements of the unorthodox portion of the export promotion program were substantially under attack from the international financial institutions. The

overall deterioration of the fiscal indicators with increasing demands from foreign lending institutions forced the government to adopt 'liberal market-orientation' policies (Öniş, 1991). The measures taken after the early phase of the export promotion strategy was exhausted in 1988 in the face of crisis were basically the completion of the full liberalization of the economy.

The full liberalization period, without the distributional arrangements that are no longer feasible presents a sharp decline in the profit rate until 1991. It is also apparent from figure 1 that after 1988, the volatility in the profit rate exhibits a rising trend. It can be argued that the relative stability in the general profitability in the Turkish economy has been strongly disturbed by the opening up of the economy in line with attempts at full liberalization. In such an environment, given the concentration levels at certain manufacturing industries, the expected pattern on behalf of the private sector is to rely on strategies related to capacity utilization rates, rather than investment, together with practices of mark-up pricing. Less concentrated sectors, however, are left to high uncertainties in decision making. It is clear that the full liberalization does not provide a positive environment for private sector investments.

What was the basic component of economic policy regimes that contributes most to the cyclical behavior of the profit rate? Fortunately, besides its cyclical trend, the profit rate as a pure indicator allows us to investigate two broad affects of these policies: The technological and distributional effects. In order to be able to conduct such an analysis, the profit rate can be rewritten as the product of two economically meaningful components:

$$r = \frac{\Pi}{K} = \frac{\Pi}{O} \times \frac{O}{K}$$

r: profit rate, Π : net profits, K : capital stock, O: value added.

The first term of the multiplication is the profit share out of total value added. The second term is the output-capital ratio, or capital productivity. The former represents the broad indication of distribution, whereas the latter signifies technological aspect of profitability. The profit share is a strong indicator of distribution. However, capital productivity is rather ambiguous. For instance, a rise in the capital productivity can be due to a rise in the labor productivity or de-mechanization or technological advance, or all of these. The relative impact of the distributional component on the trend of profit rate is enough to reveal the weight and share of distributional policies on the profitability.

Figure 2 and 3 show graphically the trend of these components. Overall, the profit share is increasing since 1970, notwithstanding that, between 1974 and 1976, it shows a declining trend, and also in 1979 it is slightly below its 1978 level. This picture is in line with the view that the distributional balance between capital and labor is on average in favor of the capital during 1970s (Boratav, 2003). It is especially interesting to note that the gains in the profit share after 1970 corresponds also to the 1971 military ultimatum and two years of restriction on the right to strike (Barkey, 1990). The August 1970 program that resembled the January 1980 program in many respects was also introduced when the average profit rate and the profit share both reached low levels at the beginning of the first cycle defined above.

After a sharp increase in 1980 from 51.7 to 57.2 percent, the rise in the profit share continued at a slower rate until 1985 when the share reached 63 percent. The decline after this 63 percent definitely accelerated between 1989 and 1991, when it hit a low of 44.8 percent.

Then it started a more decisive and rapid rise until 1995 followed by a gradual fall. The 1995 figure is still less than the historical peak of 63 percent.

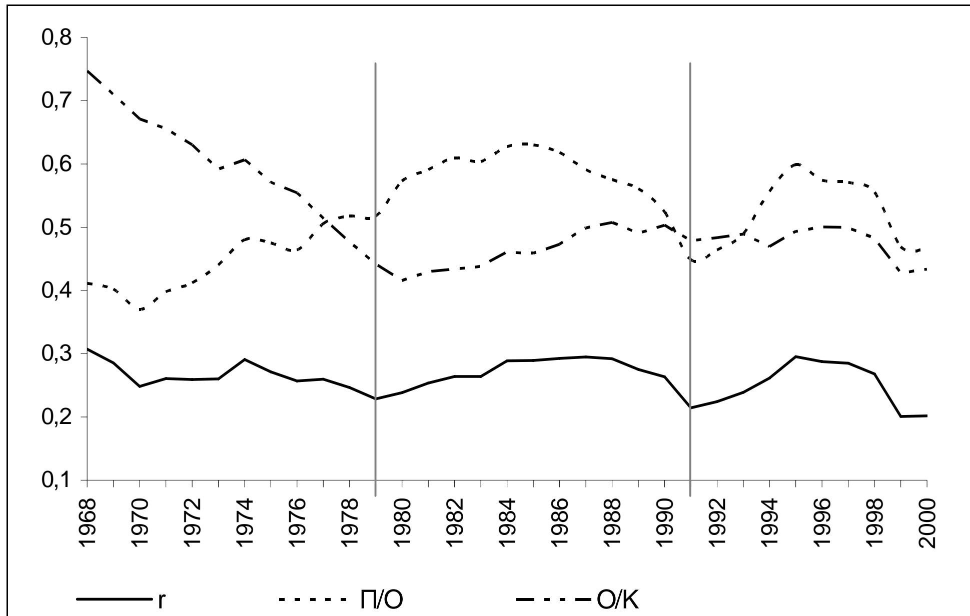

Figure 2. The Profit Rate, Profit Share and Productivity of Capital (Total Capitalist Industries), 1968-2000.

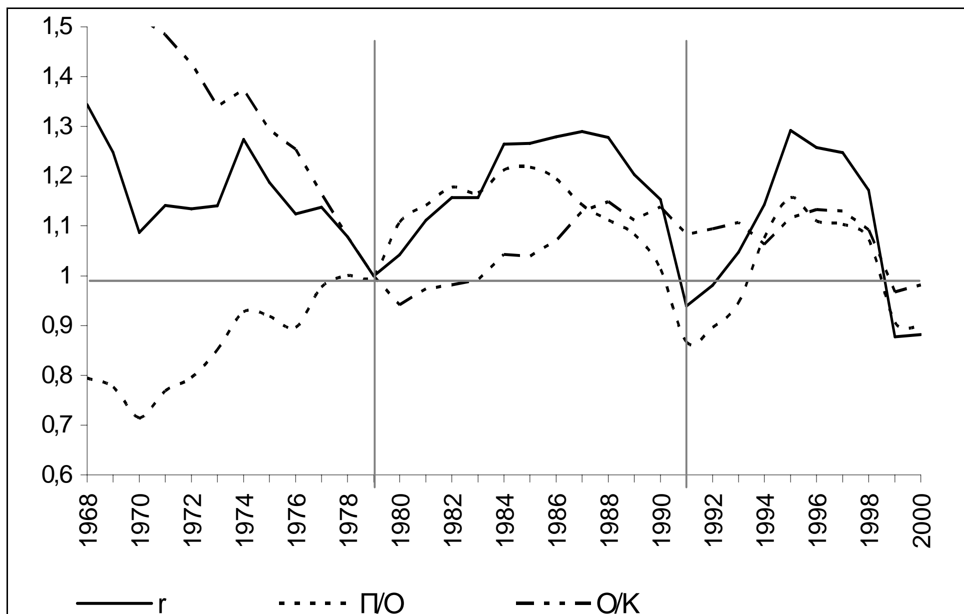

Figure 3. The Profit Rate, Profit Share and Productivity of Capital (Total Capitalist Industries – Normalized to 1 for 1979), 1968-2000.

Capital productivity followed a different path. Its continuous decline from 0.74 in 1968 onwards stopped only in 1980 at 0.41. A very gradual rise was realized until 1988, when the capital productivity reached only 0.5. After 1988, capital productivity remained more or less stable for a decade. This stability was eventually disturbed by a sharp fall in 1999.

Capital productivity seems to play a considerable role in the fall of the profit rate between 1968 and 1979. Its tendency to lower the profit rate was largely counterbalanced by the rise in the profit share, though we saw before the profit share could not fully offset the fall in the capital efficiency and so there was a slight overall downturn trend in the profit rate before 1980. The capital efficiency increased some in the 1980s, reinforcing the stronger rise in the profit share, which resulted from the overwhelming weight of the distributional regulations of the structural adjustment program.

Normalizing on 1979 makes clearer that both capital productivity and profit share contributed to the rapid rise and than fall of the profit rate after 1980, but the influence of the profit share is obviously greater than that of capital productivity. Even though capital productivity continues to fall until 1980, the sharp increase in the profit share in the same year is translated into a dramatic increase in the profit rate that begins the profit rate recovery under the MEP.

The fall in the profit share after 1985, however, does not immediately translate into a fall in the profit rate. The rising trend in the capital productivity lasts until 1988, after which eventually both components on average exhibit a decline, which can also be seen in the decisive decline in the profit rate. It is, however, obvious again that the role of distribution is more decisive compared to the technological factor in this decline which ends up in 1991 with the lowest level of profit rate since the beginning of our data in 1968.

In spite of the more or less stable level of the capital productivity between 1988 and 1999, another cycle of rise and fall by the profit share is clearly in line with the parallel rise after 1991 and fall after 1995 in the profit rate.

5. CONCLUSION

The exploration of the link between the economic policy and the profitability in the Turkish economy reveals that the rate of profit exhibits a cyclical trend that coincides with the turning points in the economic policy regimes. Although, it is not clear whether the shifts in the policy regimes are triggered or manipulated by the general level of profitability, one can argue that one of the indicators that necessitated the transition from ISI to MEP might have been the overall profitability. However, this relation is either very weak or even nonexistent for the transition from MEP to FL. The full liberalization is believed to be rather imposed by international financial organizations on domestic policy-makers.

On the other hand, the fundamental element in the achieved rise in the profit rate after 1980 can be primarily attributed to the distributional arrangements of the new policy regime in favor of capital and in expense of the wage earners. Furthermore, the observed trend of the profit share during the latter phase of the broad export promotion policy regime supports the view that the switch from MEP to FL is also a result of the exhausted possibilities of wage repression policies.

The measures taken after 1988 do not necessarily reflect a search for policies to counterbalance the bottlenecks of the distribution policy, that might include better management of interventionist policy tools like export tax rebates or implicit trade protection of the extra budgetary funds, or further introduction of selective credit policy instruments.

The financial liberalization, on the other hand created further problems. The fragile relation between profit rates and accumulation is jeopardized by distorted interest rates at substantial high levels. This transformed the already hesitant patterns of wealth holding towards rentier practices. That means a significant undoing of any effort by the state to make private industrial accumulation attractive, which was the path taken by the MEP.

APPENDIX

The general formula of the profit rate and the sources of data are given in the following table:

$r = \frac{\Pi}{K}$, $\Pi = O - Cmp - d - T$		
Component	*Definition*	*Source of data*
r	Net profit rate.	
Π	Net profits.	
K	Net capital stock.	Gross Capital Stock estimated by Maraşlıoğlu and Tıktık (1991) and Saygılı, Cihan and Yurtoğlu (2002) is substituted.
O	Value Added of the Capitalist sectors.	OECD CD and DPT Online Database.
Cmp	Compensation to the employees plus self employed compensation.	OECD CD (Cost Components of GDP Tables). Sectoral estimation procedures are due Özmucur (1995). Self employed compensation is estimated by making use of the DIE Statistical Yearbooks of Turkey (several years) (Population by Economic Activity and Employment Status Tables) and DIE Household Labor Force Statistics Online Database.
d	Depreciation (Consumption of Fixed Capital).	OECD CD (Cost Components of GDP Tables) and DPT Online Database. Sectoral estimation procedures are due Özmucur (1995). Input-Output Tables provided by DIE are also used to calculate rate of depreciation in line with Özmucur's procedure.
T	Net Indirect Business Taxes.	OECD CD (Cost Components of GDP Tables) and DPT Online Database. Sectoral estimation procedures are due Özmucur (1995).

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Chapter 8

A "HOT" DEBATE: FINANCIAL CRISES IN TURKEY, MEXICO AND SOUTH KOREA

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> Dr. Frankenstein (the policy maker), after creating the monster (external financial liberalization), observes its destructive activities (uncontrolled debt growth); but instead of putting the monster back to sleep (bringing back traditional controls), uses all the means under its control (interest and exchange rate policies) to tame the untameable creature. This is, in short, the dismal story of external financial liberalization in developing countries during the past decade (Boratav, 1993:17).

1. INTRODUCTION

Following the trend started in the 1980s and became quite distinctive during the 1990s, the financial systems of the center and the periphery converged towards the Anglo-Saxon market-based model. Let it be so: *prima facie* reason for all evils in the age of the so-called globalization is the unstable character of capital accumulation in the central economies, especially in a world with no limitations to finance capital. For the sake of its own profitability, global finance capital has always been seeking to overcome the devaluation of capital by penetrating into developing and underdeveloped countries. Along with the hegemony of neo-liberal policies and *laissez-faire* ideology, these countries, which are now called "emerging markets" in neoliberal parlance, liberalized capital movements across borders and reduced or totally eliminated foreign exchange controls. This paved the way for deregulation of the domestic financial markets. Thus, offered high arbitrage incomes brought about the large scale short-term capital inflows to such countries, especially in form of "*hot money*". Consequently, the hot money inflows themselves became the cause of instability with high and growing volatility which finally resulted in serious financial crises. Meanwhile, the advocates of neo-liberal policies anticipated that liberalization policies would inevitably

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remove inequalities between countries and result in convergence. As a matter of fact, convergence has taken place, but not in the way as anticipated by the neo-classical approaches. The "trinity" of financial liberalization, deregulation and integration with international markets has made many countries converged in financial crises; in line with that, instead of reducing intra-national and international income disparities, it has sharpened them.[1]

Triggered by such instability, repeatedly were observed the financial crises, some major of which outburst in Turkey in 1994 and 2000-2001, in Mexico during the years 1994-95, again in 1995 and later in 2001 in Argentina, in 1997 in Southeast Asia, in Russia in 1998, in Brazil in 1999 and 2002. Financial instability as a global fact, on the one hand, is experienced as a very geographical peculiarity; it is, on the other, with abraded border of the "nation", experienced with common features. Thus, from a point of view centered on above mentioned phenomena, not only the detection of similarities but also of differences enables us to elaborate on the present condition of the world and her future, at least it gives us the clues to understand. Turkey, of course, from the geographical standpoint should have been focused on; since the introspection is possible with the case. So, this study aims to make a comparative analysis of the financial crises of Turkey in 1994 and 2001, Mexico in 1994-1995, and South Korea in 1997.

Mexican and South Korean financial crises were selected for a comparison due to two reasons: Firstly, before the 1997 Asian crisis, two regions were distinguished on how they were affected by financial circumstances in developed countries, and on the impact of their own financial policies. These were Latin Americas where financial liberalization policies were implemented rapidly (*big bang* with the sole objective of international market integration) and East Asia where financial policies were designed in order to serve the objectives of economic development. In this context, Mexico can be considered as a typical country in the first category, while South Korea emerges as an important country in the second one. Therefore, the South Korean and the Mexican experiences have been selected for a comparison with Turkey with which they have some similarities. Secondly, fundamental macroeconomic indicators of these two countries can allow the exposition of the hot money flows resulted in instability and financial crushes. When the pre-crisis macroeconomic indicators are taken into consideration, as will be made explicit later, although Mexico and South Korea, unlike Turkey, had quite fiscal balances, they could not avoid the financial crises. Over and above, even the South Korea's incompatible industrial strategy and her proper economic indicators could not preclude the crisis. That is, why the selection of Mexico and South Korea as somewhat reagents provides us with the chance of searching out the reasons Turkish crises. In spite of exhaustive analysis of both Mexican and Korean cases (and recent ones on Turkish case), there will be some methodological and empirical novelties in this study: (i) a detailed analysis of the balance of payments data utilizing a useful and functional conceptual framework will enable us to distinguish arbitrage-seeking ("hot") capital movements from other inflows/outflows[2]; (ii) a decomposition of inflows/outflows into the resident and non-resident components will generate a framework by means of which parallel (pro-cyclical) and diverging (counter-cyclical) behavior of residents/non-residents

[1] For theoretical debates (from the Orthodox line to the structuralist, post-Keynesian and Minskyian approaches), see Krugman (1998), Stiglitz (1989), Akyüz (1993), Boratav (1993, 1999, 2003), Boratav and Yeldan (2001), Burkett (1987), Diaz-Alejandro (1985), Ffrench-Davis (1993), Grabel (1995), Kregel (1996), Taylor (1998).

[2] Boratav (1999) developed a method of calculation of these magnitudes based on IMF's new (1993) BOP (Balance of Payments) statistics.

can be distinguished; (iii) although it is usually possible to find out the destination of resident outflows, non-resident “hot” inflows can, in some countries, be decomposed into the types of asset[3] in which they are invested. Such decompositions can provide the basis for further causal or policy-based analysis.

There is another vital conceptual point to be mentioned: It is the term *new cycle*. A number of economists critical of the neo-liberal policy recipes have emphasized the role and importance of capital movements (and particularly their “hot” components) and their reversal in generating a new type of cycle which, in some cases, incorporates a financial crisis. The large increase in capital inflows leading to a boom and the reversal of it, accompanied, in some cases, by banking and/or currency crises is the typical pattern that explains our *cycle*. Residents may aggravate or dampen the cycle. Although the composition of inflows to developing countries and their maturity has varied over time and by countries, and such variation has affected the overall volatility of the flows, the common feature during the 1990s has been a rapid expansion of private short-term capital flows into and out of developing countries. Accordingly *the new cycle* guides us to the very simple understanding (by empirical means) of our three cases.

The following section compares the financial systems and the process of financial liberalization and deregulation in each country prior to the crises and overviews the path financial crises have followed in each economy. Section three undertakes to set forth the method of calculation of the magnitudes of capital flows and examines the empirical data. A general assessment in the light of the findings of previous sections, in section four, urges us to conclude.

2. An Overview of Structural Shifts in the Financial Policies Framework

A glance at the three countries examined in this study reveals that, as already described above, in each, their financial systems were liberalized *(Dr. Frankenstein -the policy maker- created the monster -external financial liberalization-)* during the pre-crisis periods. In this context, it should be pointed out that with respect to structural transformations experienced during the last twenty years, the economies of Turkey and Mexico resemble each other in large, while South Korea displays quite a different path.[4] In this framework, the section serves to fulfill our expectation of having a very simple historiography of the policy shifts in the countries in question for the last quarter, which make financial environment homogenous, and consequently ground for the financial crises.

Like of many others of the post-war period Turkey’s import substitution industrialization strategy continued from the 1960s through the 1970s, and came to an end with the crisis of

[3] “The individual constituents of short-term inflows undertaken by non-residents (generating liabilities to the recipient country) are: portfolio investment in equity (essentially in stock markets) and short-term debt (money market) instruments (e.g. Treasury bills); short-term loans to banks and ‘other sectors’; change in currency and deposits in the national currency held by external agents and other short-term external liabilities of banks. The same cross-border transactions undertaken by residents are considered outflows” (Gabriele, Boratav and Parikh 2000: 1044).

[4] For details on the fundamental transformations in the financial policies of Mexico, South Korea and Turkey see: Lustig and Ros (1999); Chang, Park and Yoo (1998); Türel (1993) and Williamson and Mahar (1998).

1977-79. Following the major balance of payments crisis, facilitated by the military coup of September, the 1980 program were to be implemented. One of the central elements of the 1980 stabilization/liberalization program adopted in Turkey was the internal liberalization.[5] In July 1980, deposit and credit interest rates were deregulated. This led to "Ponzi" type financing that caused an intense pressure over interest rates, which resulted in "bankers crisis". In 1986, the Istanbul Stock Exchange was established along with an interbank money market and foreign exchange market, and the Central Bank diversified its monetary instruments by starting open market operations. Financial instruments were diversified and the use of credit cards became widespread followed by the increasing availability of consumer credits. In 1985, the Treasury began to auction bills and bonds, thus giving rise to substantial increases of interest burden on public finance. These all led to difficulties in financial supervision.

The 1989 regulation on "convertibility" was a critical step towards external liberalization. Foreign exchange controls on capital outflows were removed, and both the current[6] and capital accounts were completely liberalized. Thereafter the combination of the overvaluation of the Turkish Lira and high interest rates became instrumental in attracting short term capital. The expansion that accompanied this state of world led, in 1993, to an unprecedented high level of trade, thus the current account deficit. In addition, the burden of high interest payments also worsened the fiscal balance[7]. Ultimately, the Turkish economy with such a fragile character made the way for the major financial crisis of 1994.

This situation continued with the exchange rate dis-inflation and stabilization program sponsored by the IMF till the year 2000. Thereafter, under no-sterilization policy rule capital inflows led to decline in interest rates and increase in domestic credits. The appreciation of the Turkish Lira was accompanied by an "explosion" of net capital inflows by non-residents during the first ten months of 2000. The appreciation of the TL caused the rapid deterioration in the current account deficit by the end of 2000. The economy became vulnerable to speculative attacks and, finally the program collapsed with two attacks on the domestic currency (TL) in 2000 and 2001. Analytically, "during the 1980s, the linkages between these variables appear to be in the direction of growth-current account deficits-capital inflows (…) The 1990s appears to have transformed the direction of foregoing linkage into capital inflows-growth-current deficits" (Boratav and Yeldan, 2001). And when capital inflows are not sustained, or turn into capital outflows, the process is reversed, as was witnessed during the financial crises of 1994 and 2000-2001.

From a more micro perspective, such steps towards financial liberalization changed the behavior of economic agents, contributing to the conditions that laid the groundwork for a financial crisis. For example, after the liberalization, credit interest rates rose to excessively high levels. The high credit interest rates in turn seriously increased the costs of firms relying

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[5] Our discussion of financial liberalization in Turkey draws heavily on Akyüz (1990), Boratav (1995), Boratav and Yeldan (2001) and Türel (1993).

[6] By the mid 1980s, import quotas were mostly removed, customs tariffs reduced, and generous incentives were offered to exports. During the 1980s, "fictitious exports" scandals emerged, with the increase of export incentives.

[7] "The new issues of securities by the state increased from 6.9% of GNP in 1988 to 38.7% in 1999" (Boratav and Yeldan, 2001:6). This development contributed to a rise in interest rates. Paradoxically, it was the orthodox recipes on financial liberalization which, through rising interest payments, caused unsustainable fiscal imbalances blamed, later on, as the main cause of crisis by orthodox analysis.

heavily on credits.[8] Meanwhile, it became increasingly difficult for banks to find reliable customers with such high interest rates on loans. Non-performing loans rose substantially. Another development from the banks' point of view was a serious increase in speculative activities and banks inevitably started to act as institutional rentiers. Given the situation, the capital inflows gave rise to appropriate financial instruments such as “repos”. [9]

Repos were legalized, but without any requirement obligations for banks; besides the tax-exemption to government bonds and treasury bills rendered these operations highly profitable. In the meanwhile, external financial liberalization made it possible for banks to start borrowing foreign currency abroad and to invest these funds domestically in kind of financial instruments mentioned above. Furthermore, repos were not confined with transactions between the Central Bank and other banks, the tax-exemptions encouraged any agent enjoying the funds to invest them in a similar fashion. As a result, some banks were unable to meet their liabilities on time, thus increased the “open positions” and eventually raised the liquidity risks. After the 1994 crisis, when banks began to go bankrupt, savings deposits started to be insured 100 % to cease the deposit flights. Throughout 2000, the number of banks that were transferred to the Saving Deposits Insurance Fund (SDIS) kept on increasing. It soon became apparent that in addition to open market operations, interbank money market operations also became a source of large profits and losses.[10]

To sum up, after 1980, when both internal and external financial liberalizations were implemented, and when financial deepening took place in large, private sector debts increased and the public sector could borrow only at very high interest rates. Thus, while only three banks and several intermediary institutions went bankrupt in 1994, the bankruptcies were much more widespread and the crisis was much more severe in 2000-February 2001.[11]

Having the same transformations with the Turkish economy, Mexico too abandoned import substitution industrialization in the early 1980s after fundamentally redefining the role of the state in economic sphere. After the debt crisis of 1983 that profoundly concussed the Mexican economy (as other Latin American economies), Mexico began to implement an orthodox stabilization program (Aspe, 1993). After a short while, in the mid-1985, at the time the country faced a balance of payments crisis, she was forced to devaluate the peso. On top of it, the drop in oil prices in 1986 aggravated Mexico`s foreign debt problem. Consequently, Mexico became the first country to sign a memorandum of understanding on borrowing with commercial banks in 1990, under the sponsorship of the Brady Plan (Lustig and Ros, 1999).

Fortunately, the recipe was at hand: financial liberalization. Steps such as the removal of reserve requirements and interest ceilings in 1988 taken towards the deregulation of financial

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[8] During the period of 1986-88, interests as a percentages of the gross value added of large private firms was substantially over the share of wages. Furthermore, it was observed that large companies still operated with high debt/net asset and debt/equity ratios, and a large portion of their debts were short term (Türel, 1993:148; 155).

[9] In situations where the market has a temporary liquidity problem, banking system reserves are temporarily increased, and on the date of transaction, the State Domestic Debt Bonds are bought by the Central Bank, with a promise to sell at a certain price in the future. Thus, the Central Bank provides money for the market with a repurchasing agreement, and withdraws money from the market with an inverse repurchasing agreement.

[10] In 1994, the share of overnight transactions in proportion to total transactions had reached 98,56% (Annual Report of CBRT, 1994). The importance of this figure emerges when we take into consideration the fact that in the month of March, the share of overnight operations reached 350%. On the other hand, in the months of May and June after the crisis, the Treasury was forced to make sales with an interest rate that reached 200%.

markets were followed by the opening of the stock market to foreign investors in 1989. In December 1989, state banks were opened up to foreign partners and codes restricting foreign ownership of financial institutions were abolished (Ros, 1994). In the early 1990s, the "Pacto" succeeded in bringing inflation down and public sector reforms swiftly proceeded. However, Mexico's recovery still depended on foreign savings to finance trade deficits, and there was a need for policies that would "shake up" the foreign capital owners' expectations (Lustig and Ros, 1999). The first step in adopting such policies was the decision taken to liberalize the financial sector even further.[12] The liberalization of trade, the reduction of obstacles to foreign ownership and the harmonization of Mexican laws with "international standards", along with the decision to participate in GATT in 1986, were the essential components of the new financial policies. The second step that would change the expectations was the beginning of the NAFTA with the USA, at mid-1990s.

The "measures" combined with the drop in interest rates in the USA led to an increase in the flow of portfolio investments towards Mexico. Between the years 1983 and 1993, the gross capital inflows rose from 3.5 billion dollars to 33 billion dollars. Although, to some extent those inflows were the repatriation of capital which had fled in the previous years, a large proportion was due to the new portfolio investments, of which worrisomely in large portion were made up of short-term inflows (Lustig ve Ros, 1999). Influenced by factors such as the political shock caused by the assassination of presidential candidate Colosio, a highly fragile banking system and reversed expectations, the course was to banks' ruins. In March 1994, just after the assassination of Colosio, the foreign exchange reserves dropped from US$ 26 billion to US$ 18 billion almost overnight. The monetary authorities decided to "sterilize" the fall in international reserves by increasing net domestic credits, keeping the monetary base approximately constant, and more importantly indexing domestic debt to the dollar. The peso-denominated *cetes* (short-term treasury bills) were replaced by the exchange rate-indexed tesobonos (short-term treasury bills denominated in dollars). The endeavors for sterilization and debt management triumphed in intended objectives of stopping capital flight and of relieving the pressure on domestic interest rates – at least for a while. The inevitable outburst of the crisis was the outcome of many other significant factors (Griffith-Jones, 1998: 100): the drop in domestic interest rates while interest rates in the USA were rising, the current accounts deficit growth to 8 % of the GDP in 1993 and 1994, the relatively high value of foreign exchange rate due to the fixed exchange rate commitment, the evaluation of the transfer of a significant portion of public debt into dollar-denominated papers as a reflection of inadequate reserves, and unanticipated political developments.

[11] Respectively, *Marmarabank, TYT Bank, Impexbank; Türk Invest, Çarmen, Pasifik; Türk Ticaret Bankası, Interbank, Bank Ekspres*, *Yaşarbank, Esbank, Egebank, Yurtbank, Sümerbank*; *Etibank, Bank Kapital, Demirbank.*

[12] Two of these measures were particularly important (Motamen-Samadian, 2000): i) The privatization of banks which started in May 1990 and ended in June 1992. ii) The relaxation of capital controls in November 1991, which was accompanied by a quasi fixed exchange rate regime. Although the privatization of the banking sector in Mexico with these reform programs helped the government reduce the public debt, it did not lead to greater competition and efficiency in this sector. Rather, it contributed to a greater concentration of capital in the financial system and the main outcome of the privatization was the change in the structure of banking industry from a state monopoly to a private oligopoly. Banks that were privatized in this process began to take advantage of falling international interest rates, and began to borrow from outside the country with low interest rates, and lend domestically with high interest rates. In addition to this, a significant increase in short-term capital inflows was permitted. Between 1992-94, external debts of commercial banks and of the non-banking private sector increased by 34.2% and 62.5%, respectively (Motamen-Samadian, 2000).

The short-term character of the capital inflows is determinant over the occurrence of financial crises, regardless of their autarchic exertions. In Mexico, large capital inflows were used for unproductive purposes such as supporting the peso, fuelling speculative investments in real estate and financial assets, encouraging private and public consumption, financing domestic capital flight, and consequently there remained no room for investments in tradable-goods sectors. Besides, it has been suggested that in the early 1990s, Mexico, with its semi-stagnant economy and large current account deficits, displayed symptoms of the so-called Dutch disease which is caused by resource-based export booms. But the Mexican case was different: instead of catching the disease through the trade account, it caught it through the capital account of the balance of payments. Although the same symptoms of fragility were present in other reforming Latin American economies, Mexico was a leader in attracting capital flows. Hence Lustig and Ros (1999) suggested that this phenomenon be called the "Mexican disease."

The Korean tale was somewhat different: a plan dominant one. Along the process that started with the first plan after the World War II, especially between 1962 and 1966, there was the objective of changing the price matrix faced by the private sector in a direction preferred by the planners.[13] The state was generally transferring investible funds at low prices from depositors to investors (mostly to *chaebol*s).[14] Until the financial crisis that emerged in East Asian countries in 1997 and spreaded rapidly over the region, South Korea had significantly progressed in her productive structure with the determined industrialization efforts since the 1960s, and had "miraculously" improved her world trade share. Unanimously, South Korea accomplished this developmental leap by intervening in financial markets. In the early 1960s, the state borrowed abroad in order to finance the import of capital goods, and this took place with the intermediary role of publicly owned banks under government approval and guarantee, implementing a strict program of restrictive regulations of direct foreign investment and foreign exchange rate controls (Haggard and Maxfield, 1999). The balance of payments problems, encountered in 1971, called for some domestic financial reforms, before long the balance of payments was quickly recovered without any fundamental change in external financial policies. The oil crisis of 1973-74 led to more interventionist state in South Korea. Thus situated, during this time foreigners were being allowed only indirect investment through mutual funds like the "Korea Fund" and the "Korea Europe Fund". Although deregulation of interest rates started in 1981, during most of 1980s the state retained the right to set financial prices while successfully controlling inflation. Even so, the interest rate deregulations were speeded up towards the end of 1988.

In the early phases of the deregulation, the liberalization of capital inflows was emphasized more than that of capital outflows, and a full liberalization of capital accounts could not be even imagined until the early 1990s. Until the second half of 1980s, domestic firms were not allowed to transfer their funds abroad. In accordance with the State's

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[13] It is clear that the success observed in the Korean economy was a consequence of state management using development-oriented planning as a tool. In Amsden`s (1989) characterization the developments referred to as "late industrialization" are quite interventionist experiences in which selective import controls are widely used to protect certain export-oriented activities, and serious obstacles were placed on the entrance of foreign investors.

[14] "This arrangement was terribly irrational from the perspective of allocative efficiency, but efficiency itself was never a virtue in Korea. The Koreans wanted industrialization, and they got it by giving cheap money to the *chaebol (-is a group of firms owned and managed by a family that has oligopolistic or monopolistic control in an industry-)*, forcing them to build industries and to export more" (Woo-Cumings, 1997: 79-80).

preferential regulations related to *chaebol*s, 14 large corporations were allowed to issue bonds with the approval of the Ministry of Finance. In a closed and highly regulated financial system, there was an extremely protectionist attitude vis-a-vis foreign financial intermediaries. From 1985 to 1988, South Korea had amounts of large current account surpluses. The surpluses constituted 8 % of the GDP in 1987 led the government to loosen controls on capital imports, and in 1988, she encouraged firms to pre-pay their debts and invest abroad. In 1989, when the current account surplus turned to a deficit, controls both on capital exports and inflows were re-installed (Woo-Cumings, 1997). Throughout the 1980s, capital account operations were tightly regulated. The government placed many restrictions on capital inflows and outflows to minimize the destabilizing effects of short term capital flows and to ease the country's industrialization policies.

However, all this began to change in the early 1990s. Despite the absence of foreign exchange shortage, the liberalization of South Korean economy was quite gradual. It is clear that the financial liberalization process in South Korea was more influenced by global processes and the developments taking place in New York and Washington than a process that would go along with economic modernization and the correction of "errors" committed during the heavy industrialization period in the 1970s, as suggested by traditional analysts (Woo- Cumings, 1997). The pressure on South Korea was not originating from the balance of payments, but from developed countries, especially the USA.[15] In 1988, the US Treasury, given the authority to identify countries who were manipulating foreign exchange rates identified South Korea as such. In February 1990, financial policy discussions started between the USA and South Korea and progressed very slowly (Haggard and Maxfield, 1999). The deregulation and opening up of the financial markets started seriously in 1993, and this gained speed with Korea's entry into OECD, as the 29th member (Park, 1999).

Eventually, South Korea, like Turkey and Mexico, making ground for the maturity mismatch problem, arrived at the gates of the financial crisis. The combination of deregulation and opening up of the financial markets in South Korea and the Latin American tempest of 1994-1997 led to a rise in foreign capital inflows that were mostly short term and speculative (Park, 1999). Early in 1994, if the ceilings on banks' medium and long term borrowing from international markets had not been reduced, the ceilings on short term borrowing of foreign currency would have been removed. This forced commercial banks to finance long term domestic loans with short term foreign loans. While in 1993, 65 % of total liabilities of commercial banks were short-termed, this ratio rose to 79 % in 1994 (Park, 1999:151). Since commercial banks lent the funds (that they borrowed on short term money markets) to their clients as long term loans, a serious maturity mismatch arose, just as it had arisen in Turkey and in Mexico. As disclosed by the financial crises, the short term debts could not be rolled over indefinitely and the short term credit facilities should not be used as tools of finance of long term investments.

[15] A larger number of American and European banks demanded liberalization in order to enter the Korean market and expand their operations. The Reagan government put great pressure on the Korean government on behalf of American banks. By the end of 1993, the number of foreign banks in Korea had almost doubled: from 40 in 1981, to 73. (Woo-Cumings, 1997:81).

3. ANALYSIS BASED ON BALANCE OF PAYMENTS DATA[16]

3.1. The Method of Calculation for Capital Flows and Related Definitions

Because of the role and importance of capital flows (especially their “hot” components) and their reversal in generating a new type of cycle which, in some cases, incorporates financial crises, the calculation of the magnitudes of capital flows gives us important and interesting findings, revealing some similarities and dissimilarities between these experiences. The initial impact of international short term capital movements on a national economy takes place through the gross volume of cyclical inflows and outflows (Boratav, 1999; Boratav and Yeldan, 2001; Balkan and Yeldan, 1996). Thus, in what follows, empirical analysis starts with the gross amounts of capital inflows and outflows. The new classification of the balance of payments data given in the 1993 systematic of the IMF Balance of Payments Statistics (BOPs) provides us with a fairly detailed framework for the decomposition of capital flows. On the basis of this classification, Boratav (1999) developed a method of identifying short term arbitrage-seeking capital which was also used in UNCTAD’s *Trade and Development Report* dated 1999. The estimates of capital movements in this paper are based on this method.

In line with this, resident/non-resident decomposition of capital flows will ensure the ‘net’ and ‘gross’ distinction. The agents who carry on arbitrage-sensitive activities as a result of the liberalization of external finance are resident and non-resident rentiers, domestic firms, resident and foreign banks. A further classification may be made according to the tools and sectors towards which the funds are directed such as the funds directed towards public financing, stock markets and the banking sector by means of treasury bonds and bills, equities and deposits. This classification can be extended to other sub-groups as far as the data permit. Thanks to the new systematic of the IMF, “it has become possible i) to distinguish between resident vs. non-resident capital flows, ii) to separate components that originate from official and private sources, and to identify the kinds of assets and liabilities that constitute capital flows” (Boratav, 2003:18). Within this framework, *capital inflow* refers to the acquisition of assets by non-residents and a positive sign, while the sale of domestic assets by non-residents is considered as a negative capital inflow. Thus, net capital inflow is obtained by balancing the purchases and sales of assets by non-residents within a country.[17] Capital flows according to the IMF balance of payments statistics include items under the categories of *capital and financial accounts* of the balance of payments. *Capital outflow* refers to the acquisition of foreign assets by residents and a negative sign. The sale of foreign assets is depicted as negative capital outflow, and refers to a positive sign. The term “net capital flow” indicates the difference between these two:[18] the difference between the gross values of capital inflows

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[16] This section is based mostly on Boratav (1999; 2003) and UNCTAD (1999).

[17] Inflows that do not create debits are made up of foreign direct investments and portfolio investments in equities. What remains behind from private inflows are bonds and bank credits.

[18] In IMF Balance of Payment statistics, capital outflows are made up of debt items under the headings of: “direct investments outside the country,” “capital transfers,” and asset items under headings such as “portfolio investments” and “other investments.”

and outflows. When the total net capital inflows are larger than total the net capital outflows, this term appears to be positive (UNCTAD, 1999: 100).[19]

In the balance of payments identity of a typical under-developed country, we observe that net capital flows originating from non-residents should be equal to the "current account deficits" and "leakages" (Boratav, 1999; Boratav, Yeldan, 2001:13). "In other words, the difference between the net inflows and the financing of the current account deficit is made up of three items of leakage: the recorded and unrecorded (net errors and omissions) resident outflows and accumulated reserves. Negative values for both reserves and the net errors and omissions items, in this regard, should be considered as anomalies. In case of large-scale capital inflows exceeding current account deficits, some items of capital inflows that result in reserve accumulation may not be recorded. Such a contradiction may be "corrected" by means of a positive sign for the net errors and omissions item. Those inflows represent unrecorded capital and are not reflected in the reserves. The negative values of both items point to capital outflows (unrecorded outflows) that take place along with the massive inflows" (Boratav, 1999). The method developed by Boratav to estimate capital inflows/outflows and the "hot" components of them is summarized below with the items that correspond to the IMF new balance of payments statistics. As observed (see appendix), the items have been decomposed to the extent permitted by the IMF standard balance of payments classification.

3.2. Empirical Findings on Capital Flows[20]

There remains the analysis of capital flows on the basis of annual data for Turkey, Mexico and South Korea. First of all, we have a double distinction: i) the pro-cyclical/counter-cyclical capital movements by resident/non-resident agents' and ii) their "hot" components.[21] All these become 'clear and distinct' in the boom/bust analysis. To this end, the boom/bust cycles associated with capital movements are to be distinguished by the years capital flows were controlled or liberalized. As seen on Table 1, while in Turkey during

[19] Normally, the positive (+) sign of liabilities indicates the capital inflows of non-residents, and the negative sign (-) of "assets" indicates the capital outflows of residents. Typically, in a developing economy, (Boratav, 2003:19):

Accounts of Bops: Signs: Meanings:

Net capital flows by non-residents (NKI) (+) the capital inflows of non-residents
in exceptional circumstances and
under heavy crisis conditions (-) the capital outflows of non-residents
+ capital flows by residents (NKO) (-) the net recorded capital outflows of residents
+ the balance of current accounts (CA) (-) chronic deficits
+ reserve movements (DR) (-) the increase
+ *net errors omissions (EO)* (-) unrecorded capital flows of residents
= 0

"When the capital outflows of residents are valid over a long period from the point of view of accumulated values, it means that this economy is continually exporting capital to the outside world, and therefore as far as the systematic of the balance of payments is concerned, it has acquired characteristics of developed capitalist countries" (Boratav, 2003:21). As will be discerned later, the above situation appears applicable in an analysis of the situation in South Korea.

[20] For abbreviations see the appendix.

[21] The most descriptive of which are net errors and omissions and reserve movements that would "normally" be pro-cyclical, that is, capital flight with financial instability and capital inflows otherwise; however, the data show that there may be exceptions unique to each country.

the pre-liberalization period, i.e.1980-89, 67 % of the capital inflows financed the current account deficit, this ratio (CA/NKI) fell to 24 % during the 1990-1999 period as a whole, and to 22 % after the crisis of 1994 (1994-1996). In the post-crisis period of 2001-03, this ratio remained around 29 %. As for Mexico, it appears that during the 1990s, the total capital inflows by non-residents have financed a larger proportion of the current account deficit compared with the 1980s. This can be reasoned on the ground of the 1980s' debt crisis. Despite serious hot money outflows, compared to 1994, the non-resident inflows increased in 1995; nonetheless, it financed only 6 % of the current account deficits (CA/NKI). Since South Korea, unlike Turkey and Mexico, had a current account surplus, it would be meaningless to attempt to interpret this ratio for her.

A general comparison of developing countries between the 1980s and the 1990s reveals that in the latter period, a lower proportion of the net capital inflows were used for the current account deficits finance and the remaining constituted the leakages.[22] (UNCTAD, 1999:111). Unlike Mexico and South Korea, Turkey followed this common trend. As mentioned earlier, in Turkey, capital inflows, far from financing current account deficits, tend to set off a cycle that increases current account deficits. To have a more concrete view of the crises in this respect, following subsections, for sake of subtlety, quarry the hot money along with the leakages for our three cases.

i) Leakages from Inflows by Non-residents

In Turkey, the net capital inflows by non-residents had positive values before financial crises, at times of crises however, capital outflows became the norm. The difference in values between the years 1993 and 1994, and 2000 and 2001 has reached approximately the level of -19 billion dollars (Table 1).

In Mexico, whereas net capital inflows by non-residents increased in the crisis year, and as opposed to Turkey, this is a counter-cyclical movement; and in spite of hot money outflowing, the NKIs take a positive sign. This is largely due to the fact that the credits provided by the IMF are found under "other investments" liabilities item, (with code no.4766), on the IMF balance of payments statistics. On the other hand, foreign direct investments (FDIs) to Mexico were in large amounts; even though in 1995 the amount of FDI dropped a little, NKIs continued to have the positive values.

In South Korea as well, despite the massive drop of the post-crisis period, the amount of capital inflows by non-residents (NKI) maintained its positive sign. What's more, this was accomplished while non-residents' hot money components were outflowing (just as happened in Mexico). Even in cases of no increase (as seen in Mexico), it's possible to talk about two elements of continued capital inflows by non-residents. Those are the IMF credits and FDIs. An elaboration on FDIs to South Korea reveals an unexpected shift. While in 1997, there were FDI worth $ 2,844, in 1998, the figure went up to $ 5,405 millions. Since under normal conditions foreigners will not invest in a country experiencing crisis, the situation can be explained by the acquisition of domestic assets by foreigners through the "fire sale" of the assets in the post-crisis phase.[23] The capital inflows by non-residents handled in the lines above are to be detailed for its portion that is comprised of recorded/non-recorded capital flows by residents and reserves, leaking out of the current account financing.

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[22] This observation is valid for developing countries that chronically have current deficits.
[23] See UNCTAD, 1999, 2001 and 2003.

a) Recorded Capital Flows by Residents

In Turkey, net capital outflows by residents proportional to net capital inflows by non-residents (NKO/NKI) has increased during the period of 1990-2003, compared to the period 1980-89 of capital controls. While the net capital outflows by residents (NKO) increased during the crisis (the pro-cyclical magnitude and sign) in Mexico and South Korea, the case was reversed in Turkey during the first financial crisis. Capital exporting residents during the pre-crisis period executed capital inflows during the 1994 crisis. As for the years 2001-2002, the outflows kept on in reduced amounts.

Compared to the 1980s, the cumulative quanta of the net capital inflows by non-residents in Mexico decreased in the 1990s. This higher NKO/NKI ratio of the 1980s may be explained by the debt crisis of early the 1980s and the large scale of capital flight that accompanied the crisis. However, a glimpse at different sub-periods reveals some striking figures. In Mexico, the net capital outflows by residents during 1989-93 amounted to 9 % of the net capital inflows by non-residents, and during 1994-1996, 36 % of non-resident inflows were assigned to finance outflows by residents. By contrast, the NKO/NKI ratio for South Korea attained high levels in the 1980s. This resulted from the high level of South Korean investments to other countries (notably to those of Southeast Asia).

Hereby it may be observed that the net capital outflows by residents —the leakage from net capital inflows by non-residents— have increased after the liberalization of capital movements in Turkey. Despite the Mexican and South Korean exceptions, a trend similar to the one in Turkey has been observed in many countries.[24]

b) Non-recorded Capital Flows by Residents (EO)

In Turkey, the non-recorded capital flows by resident/ net capital inflows by non-residents (EO/NKI) ratio was positive during the 1980-89 period; and in the period 1990-93, the non-recorded outflows reached 12 % of capital inflows by non-residents. Non-recorded capital outflows were observed in both Mexico and Turkey in the pre-crisis years. The process accelerated in Mexico in 1995, whilst it was reversed throughout the 1994 crisis in Turkey, but an outflow of $1.6 billion was experienced during the 2001 crisis. As for South Korea, a positive value was observed during the pre-crisis period and a pro-cyclical change was observed in the crisis year.

[24] See Boratav (2003).

Table 1. Financial Boom/Bust Indicators

		Years	NKI	NKO	NKOE	CA	EO	DR*	DR/NKI	NKO/NKI	EO/NKI	CA/NKI
Turkey	Cumulative	1980-89	15529	-3471	-561	-10408	2910	-4561	-0.294	-0.224	0.187	-0.67
	Cumulative	1990-99	58292	-20184	-23468	-13981	-3284	-20843	-0.358	-0.346	-0.056	-0.24
	Cumulative	1990-03	91444	-31673	-34068	-28646	-2395	-28732	-0.314	-0.346	-0.026	-0.313
	Cumulative	1989-93	24788	-10021	-11984	-8844	-1963	-3960	-0.16	-0.404	-0.079	-0.357
Boom	Cumulative	1990-93	24536	-10333	-13265	-9782	-2932	-1489	-0.061	-0.421	-0.12	-0.399
Bust & after	Cumulative	1994-96	9615	288	2627	-2144	2339	-10098	-1.05	0.03	0.243	-0.223
		1993	12831	-3868	-6090	-6433	-2222	-308	-0.024	-0.301	-0.173	-0.501
		1994	-6259	2409	4175	2631	1766	-547	0.087	-0.385	-0.282	-0.42
	Minus	1994-1993	-19090	6277	10265	9064	3988	-239	0.013	-0.329	-0.209	-0.475
Boom	Cumulative	1995-97	27173	-4832	-6853	-7454	-2021	-12866	-0.473	-0.178	-0.074	-0.274
		1997	11300	-2711	-5305	-2679	-2594	-3316	-0.293	-0.24	-0.23	-0.237
		1998	3677	-3453	-5444	1984	-1991	-217	-0.059	-0.939	-0.542	0.54
	Minus	1998-1997	-7623	-742	-139	4663	603	3099				
Boom	Cumulative	1999-2000	25527	-7576	-8295	-11125	-719	-6107	-0.239	-0.297	-0.028	-0.436
		2000	16362	-3601	-6215	-9765	-2614	-383	-0.023	-0.22	-0.16	-0.597
		2001	-2588	-1887	-3521	3390	-1634	2718	-1.05	0.729	0.631	-1.31
	Minus	2001-2000	-18950	1714	2694	13155	980	3101				
Bust & after	Cumulative	2001-03	16790	-7888	-4385	-4900	3503	-7506	-0.447	-0.47	0.209	-0.292
	Cumulative	2002-03	19378	-6001	-864	-8290	5137	-10224	-0.528	-0.31	0.265	-0.428
Mexico												
	Cumulative	1980-89	72376	-20852	-42282	-27031	-21430	-3063	-0.042	-0.288	-0.296	-0.373

Table 1. (Continued)

		Years	NKI	NKO	NKOE	CA	EO	DR*	DR/NKI	NKO/NKI	EO/NKI	CA/NKI
	Cumulative	1990-2000	199409	-22604	-33388	-141091	-10784	-24929	-0.125	-0.113	-0.054	-0.708
Boom	Cumulative	1989-93	104636	-8917	-9443	-76006	-526	-19186	-0.183	-0.085	-0.005	-0.726
Bust & after	Cumulative	1994-96	53503	-19368	-26881	-33566	-7513	6944	0.13	-0.362	-0.14	-0.627
		1994	20258	-5670,1	-8994	-29662	-3324	18398	0.908	-0.28	-0.164	-1.464
		1995	22829	-7356,6	-11604	-1576	-4248	-9648	-0.423	-0.322	-0.186	-0.069
	Minus	1995-1994	2571	-1686,5	-2611	28086	-924	-28046				
South Korea												
	Cumulative	1980-89	12758	-12464	-16109							
	Cumulative	1980-93	52564	-33603	-37900	4916	-4297	-19580	-0.372	-0.639	-0.082	0.094
		1994-2002	134792	-82804	-99529	19888	-16725	-55151	-0.729	-0.614	-0.124	0.148
Boom	Cumulative	1994-96	109454	-58894	-60855	-35530	-1961	-13068	-0.119	-0.538	-0.018	-0.325
Bust & after	Cumulative	1997-1998	16770	-17904	-29132	31455	-11228	-19093	-1.139	-1.068	-0.67	1.876
		1996	48431	-25187	-24092	-22923	1095	-1416	-0.029	-0.52	0.023	-0.473
		1997	18956	-17566	-22575	-8256	-5010	11875	0.626	-0.927	-0.264	-0.436
	Minus	1997-1996	-29475	7621	1517	14667	-6104	13291				

Source: IMF, Balance of Payments Statistics (various years).

* Minus sign indicates increase.

The exceptions are still to be stated. It is possible to explain the Turkish situation by factors specific to the country. According to Boratav (1999), the reason for the incident of 1994 may be the non-recorded money movements from the dollar towards Treasury bills offering high interest rates. A high negative value of EO/NKI in Mexico between1980-89 may be reflecting a preference for foreign assets during and immediately after the debt crisis that affected Latin Americas entirely. As was expected with liberalization, non-recorded outflows decreased in the 1990s. In Korean case, however, the ratio of EO/NKI increased somewhat all along the 1990s compared to the period 1980-93. The ratio increased seriously during the crisis years and reached a level indicating 67 % of the capital inflows by non residents. Therefore, it appears that non-recorded capital flows by the residents are affected by reasons each country's differentia specifica.

c) Changes in the Reserves

While during the 1980-89 period reserve accumulation in Turkey amounted to 29.4 % of the net capital inflows by non-residents (DR/NKI), in the 1990s, it increased to 35.8 %. As for Mexico, these ratios were 0.04 % and 12.5 %, respectively. So, as revealed by the ratios, both countries were forced to accumulate much more reserves after the liberalization of capital accounts. Traditionally, when capital movements were controlled, reserve levels were required to offset temporary disequilibria in the current balance, to offset the gaps between the payments of import and export bills, usually equivalent to imports' bill of three or four months. However, with the liberalization of capital accounts, the precautionary reserve levels requirement increased radically, thus most developing countries were to be forced to accelerate the accumulation of reserves. And this meant an additional and "expensive" drain on non-resident inflows (Boratav and Yeldan, 2001:14). In contradistinction to the situation in Turkey and Mexico, in South Korea during the 1980s, the reserve accumulation exceeded the net capital inflows by non-residents. This difference displayed by South Korea in the 1980s may be understood by noting the fact that the current account indicated a surplus of $ 18.5 billion in the same period.

Even in countries with large reserve accumulations, financial crises result in serious erosions in reserves during the crisis periods. The 1994 crisis in Mexico has resulted in a decline that was almost equal to the amount of reserves accumulated in the 1989-93 period, and that was 90 % of the non-resident capital inflows; whereas for the South Korean financial crisis, the DR/NKI ratio betokened an erosion of 62 %. The ratio is irrelevant for Turkey, since the net capital inflows by non-residents displayed a negative value in 1994. An assessment of reserve movements in Mexico and Turkey reveals that they were clearly counter-cyclical in 1994. In Turkey, reserve accumulation seriously dropped off in 1993, in comparison with 1992, and a limited increase was recorded for the following year. In Mexico, similarly, following the serious erosion of 1994 came the reversal in 1995. Taking into consideration the increase in counter-cyclical net capital inflows by non-residents, this reversal may be explained by the large amount of the IMF funds received ($ 11.9 billion). As to South Korea, in 1997, the serious erosion in the reserves ($ 11.1 billion despite the IMF credits) proved a pro-cyclical change. In 1998, South Korea received an additional $ 5 billion IMF credit and piled reserves up to the level of $ 30.9 billion. Compared to the credits received by Mexico and South Korea, the credits received by Turkey from the IMF were limited: $ 344 millions in 1993, $ 347 millions in 1994; and despite the fact that the IMF

provided Turkey with a fairly large credit ($ 10 billion) after the 2001 crisis, the erosion of reserves reached $ 2.7 billion (IMF, 2004).

Table 2. "Hot Money" Inflows and Outflows

Turkey	Years	STI	STO	EO	STOE	NSF	NSFE
Cumulative	1980-89	2454	-2697	2910	213	-243	2667
Cumulative	1990-99	14630	-11375	-3284	-14659	3255	-29
Cumulative	1990-03	12698	-13045	-2395	-15440	-347	-2742
Cumulative	1989-93	9897	-9746	-1963	-11709	151	-1812
Cumulative	1990-93	9664	-9346	-2932	-12278	318	-2614
Cumulative	1994-96	-1374	2772	2339	5111	1398	3737
	1993	4478	-3242	-2222	-5464	1236	-986
	1994	-5913	2446	1766	4212	-3467	-1701
Minus	1994-1993	-10391	5688	3988	9676	-4703	-715
Cumulative	1995-97	5705	-1212	-2021	-3233	4493	2472
	1997	1166	-1538	-2594	-4132	-372	-2966
	1998	2267	-1083	-1991	-3074	1184	-807
Minus	1998-1997	1101	455	603	1058	1556	2159
Cumulative	1999-2000	7770	-4138	-719	-4857	3632	2913
	2000	4863	-1958	-2614	-4572	2905	292
	2001	-8516	-91	-1634	-1725	-8607	-10241
Minus	2001-2000	-13379	1867	980	2847	-11512	-10533
	2001-02	-10976	-9	-1718	-1727	-10985	-12703
Cumulative	2002-03	1721	379	5137	5516	2100	7237
Mexico		STI	STO	EO	STOE	NSF	NSFE
Cumulative	1980-89	6	-17631	-21430	-39061	-17625	-39055
Cumulative	1989-93	39805	-1251	-526	-1777	38554	38028
Cumulative	1990-2000	45039	-9094	-10784	-19878	35944	25161
Cumulative	1990-94	43356	-3560	-8353	-11913	39796	31442
Cumulative	1994-96	-6207	-12077	-7513	-19590	-18285	-25797
	1994	4001	-3198	-3324	-6522	803	-2521
	1995	-13622	-2825	-4248	-7073	-16447	-20695
Minus	1995-1994	-17622	373	-924	-551	-17249	-18174
South Korea		STI	STO	EO	STOE	NSF	NSFE
Cumulative	1980-89	2796	-1998	-3645	-5642	798	-2846
Cumulative	1980-93	21192	-11017	-4297	-15314	10176	5879
Cumulative	1994-02	30541	-21985.4	-16725.2	-38710.6	8555.6	-8169.56
Cumulative	1994-96	49420	-20831	-1961	-22792	28589	26627
Cumulative	1997-1998	-32389	-2585	-11228	-13813	-34973	-46201
	1996	20542	-9283	1095	-8188	11259	12354
	1997	-16081	-10434	-5010	-15443	-26514	-31524
Minus	1997-1996	-36623	-1151	-6104	-7255	-37774	-43878

Source: IMF, Balance of Payments Statistics (various years).

ii) Arbitrage-seeking Short Term Capital Movements (Hot Money Flows):

The total assets item showing the "hot money" flows of residents reveals that in all three countries, the residents took hot money out of the country in the pre-crisis year. Then, the pro-cyclical outflows continued during the crisis year (in reduced amounts -in 2001- in Turkey and in Mexico, and increased amounts in South Korea) and some counter-cyclical inflows took place in Turkey in 1994. This might have stemmed from the fact that domestic banks struggling to pay their debts were forced to liquidate their external assets, because especially in the Turkish experience, the currency and banking crises went hand-in-hand (Boratav, 1999). An examination of total liabilities, in other words, non-resident hot money movements designates capital inflows in all three countries during the pre-crisis years, while this magnitude changes to negative during crisis years, in short, it moves in a pro-cyclical direction.

When we review the values associated with hot money movements by non-residents and residents within the framework of crisis and recovery, some interesting findings are to be arrived at. Both gross and net (NSF = STI+STO) hot money movements by residents and non-resident are shown in Table 2. The hot money inflows by non-residents (STI) show an important increase during the 1990s, in comparison with the 1980s (an increase from $ 2.5 billion to $ 14.5 billion). In the period between 1990-99, the share of hot money inflows within the inflows by non-residents (STI/NKI) increased by 10 %, over the 1980-93 period, and in the 1990-93 period, which was referred to above as the boom period, it reached 40 %.

In Mexico, while hot money flows by non-residents were negligible in the period of 1980-89, they reached $ 45 billion in the period 1990-2000. A similar development was observed in South Korea as well. Thus, after the liberalization of capital accounts, large scale increases in hot money inflows by non-residents are observed in the capital movements of all three countries.

The "hot money" components (STOE: short-term outflows, including unrecorded outflows) within the capital flows by residents are rather striking. While for Turkey, in the period 1980-89, we can speak of only a limited inflow of hot money, a value amounts to $ 14.6 billion, indicating 62 % of the outflows by residents (STOE/NKOE[1]), was recorded[2] in the period of 1990-99. Unlike Turkey, in Mexico, the residents took large amounts of hot money out during the 1980s (important non-recorded outflows), and the ratio of STOE/NKOE preserved the high level of 60 % in the 1990.

While, in South Korea, the ratio in question did not change between two periods, it climbed up to 68 % in 1997. The significance of hot money flows by residents and non-residents during the crises augmented in Mexico and Turkey. In Turkey in 1994, there was the hot money component that exceeded capital inflows by residents (counter-cyclical) and hot money outflows that almost amounted to the total of the non-resident capital outflows (pro-cyclical). In Mexico, counter-cyclical[3] net capital inflows by non-residents and pro-cyclical hot money outflows took place simultaneously. Especially between 1994 and 1996, the "hot" money outflows by residents constituted a considerable portion of net capital outflows. The figures in South Korea, however, reveal that during the crisis, the size of hot

[1] Net capital outflows by residents, including unrecorded outflows (see Table1).

[2] In Turkey, the hot money inflows-outflows of non-residents amount approximately to plus-minus 4-5 % of the GNP, while the hot money outflows of residents, amount to approximately plus-minus 3-4 % of the GNP.

[3] As mentioned earlier, IMF loans are among the most important factors behind this counter-cyclical value that emerged in both Mexico and South Korea during the financial crisis.

money outflows by residents were almost equivalent to counter-cyclical inflows by non-resident. In the same period, the hot money component of outflows by residents is 47 %. It seems that although they have some different patterns of behavior, residents of all three countries have perceived the negative turn of events earlier than non-residents and brought about large amounts of hot money outflows during the pre-crisis year.

The net hot money flows by residents and non-residents hide some inclinations that are open with gross values mentioned above; however, it has been observed in many countries that the net value is not positive as expected by the liberalization of capital accounts. "It's noteworthy that the country whose hot money balance sheet produced the highest positive values after 1990 was India which continues to implement effective controls on capital accounts" (Boratav, 2003:29). In Turkey, after the 1989, at the time capital accounts were liberalized (1990-2003), net hot money flows by resident and non-residents (NSFE) produced an outflow of $ 2.7 billion. While similar net hot money outflows may be observed in South Korea after the liberalization of capital accounts, Mexico differed from this pattern due to the debt crisis and produced large amounts of hot money outflows during the 1980s. However, while the balance of hot money flows in Mexico was positive after 1990, residents engaged in considerable amounts of hot money outflows. It may be thought that in Mexico this becomes almost a permanent resident behavior.[4] In South Korea, despite the net hot money inflows in the period 1994-96, residents took out $ 22.7 billion of hot money. During the crisis and in its aftermath, pro-cyclical net hot money outflows may be observed. Thus, it is obvious that net flows will be misleading for an analysis of hot money inflows/outflows and their impact on the economy.

4. CONCLUSION

A comparison of the experiences of Turkey, South Korea, and Mexico discloses that the deregulation of financial markets and the removal of controls on capital movements result in financial instability and crises regardless of the fiscal balance. When Turkey experienced a financial crisis in 2000, she reduced inflation rate, increased growth rate and improved her financial position significantly as a result of a structural adjustment and stabilization program. Similarly, the Mexican crisis emerged at a time when Mexico, as a country that established financial discipline and reduced inflation substantially, was considered as "successful". And as for South Korea –a country that sustained stable growth for many years, with no public deficit and stable prices and a current account surplus– it could not avoid a boom-bust cycle, and was drawn into a crisis. In all three experiences, the rapid increase in capital –especially "hot money"- inflows caused by non-residents was an important factor of instability. Accordingly, when such inflows suddenly turn into outflows, they trigger off financial crises.

Thus, the findings of this study on the financial crises of Turkey (1994 and 2000-2001), Mexico (1994-95) and South Korea (1997) underline some similarities in the three experiences, despite the presence of their diffrentia specifica. A look at the capital movements that make the ground for this study reveals that the behaviors of actors who bring about these flows change from country to country, and from actor to actor within the country. For instance, a review of total assets shows that in all three countries, there were hot money

outflows by residents during the pre-crisis years and pro-cyclical outflows continued during the crisis periods (they were reduced in Mexico and increased in South Korea) —but in Turkey there were some counter-cyclical inflows in 1994. Thus, even though these three countries display some different behavioral patterns, the residents perceived negative turns sooner than non-residents. When we look at total liabilities, in other words hot money movements by non-residents, we see that in all three countries, the substantial capital inflows of the pre-crisis years turned into negative values during the crisis years; in short, they moved in a pro-cyclical manner.

In our triad, hot money flows increased considerably both in absolute and relative terms during the 1990s. In the crisis years, the gross hot money inflows/outflows reached large magnitudes and became an important component of instability. Thus, we arrive at the conclusion that short term arbitrage-seeking speculative capital movements played a decisive role in all three financial crises. There is a broad agreement that the boom-bust cycle in capital flows needs to be moderated. Because of this, the reintroduction of capital controls and the reactivation of crucial policy tools in developing countries are essential. It is clear that capital controls (putting the monster back to sleep —bringing back traditional controls) are “necessary but insufficient” for preventing the crises. Otherwise, future crises are inevitable. As one observer has argued: “If Asia’s people allow themselves to be persuaded that their politicians were the central problem and that they should cede control of their financial systems to international rules and institutions, they will be making a dramatic mistake, ensuring the ‘Latin Americanization’ of Asia” (Bienefeld, 2002:122). The domestic and foreign debt impasse of Turkey (monster’s destructive activities —uncontrolled debt growth) is rapidly pulling the country towards a Latin-Americanization process. It may even be “convergence” that will take place by the Latin-Americanization of the developing countries.

APPENDIX

	I. The Items of Capital Movements in the Standard Framework of Balance of Payments Statistics		
	IMF codes		
Capital account	Credit: 2994	Debit: 3994	
Direct investment	4555		
Direct investment abroad	4505		
	IMF codes of residents	IMF codes of non-residents	Explanations
Portfolio Investment	4602	4652	
Portfolio investment in equity securities	4610	4660	Portfolio investment in equity securities

[4] In the period 1980-97, with the exceptions of 1986, 1989, 1992 and 1997, there is a constant outflow by resident.

APPENDIX (CONTINUED)

	I. The Items of Capital Movements in the Standard Framework of Balance of Payments Statistics		
Portfolio investment in money market instruments	4630	4680	Portfolio investment in treasury bonds
Other Investment	4703	4753	
Short-term loans: Banks	4724	4774	Short-term loans to domestic (foreign) banks
Short-term loans: Other sectors	4727	4777	Short-term loans to domestic (foreign) firms and household
Currency and deposits: Banks	4733	4783	Changes in currency and deposits in national (foreign) currency held by non-residents (residents)
Currency and deposits: Other sectors	4734	4784	
Other short-term assets and liabilities: Banks	4745	4795	Other sectors: Firms and households
Other short-term assets and liabilities: Other sectors	4748	4798	
Net errors and omissions (EO)	4998		Non-recorded capital flows of residents

II. The Method of Calculation of Capital Flows:	
A. The Decomposition of Capital Flows	B. The Decomposition of "Hot" Short-term Capital Flows
Net capital inflows by non-residents (NKI) = 2994 + 4555 + 4652 + 4753	Short-term inflows by non-residents (STI) = Total liabilities = 4660 + 4680 + 4774 + 4777 + 4783 + 4784 + 4795 + 4798
Net capital outflows by residents (NKO) = 3994 + 4505 + 4602 + 4703	Short-term outflows by residents (STO) = Total assets = 4610 + 4630 + 4724 + 4727 + 4733 + 4734 + 4745 + 4748
Net capital outflows by residents, including unrecorded outflows (NKOE) = NKO + EO	Short- term outflows, including unrecorded outflows STOE = STO + EO
Current account (CA) = 4993	Net short-term flows (NSF) = STI + STO
Reserve changes: Negative (-) means the increase (DR) = 4800 Net errors and omissions EO = 4998	Net short-term flows, including unrecorded flows (NSFE) = Total assets + Total liabilities + EO = 4660 + 4774 + 4783 + 4784 + 4795 + 4798 + 4610 + 4724 + 4733 + 4734 + 4745 + 4748 + 4998

Sources: Boratav (1999, 2003), UNCTAD (1999) and IMF Balance of Payments Statistics Yearbook (2003).

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Chapter 9

GLOBALIZATION, INEQUALITY AND THE LABOUR MARKET

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1. INTRODUCTION

The idea that globalization can create "losers" as well as "winners" has, after an initial resistance, begun to attract the attention of economic researchers and of policy makers, at both the national and multilateral levels. Much of the discussion to date has concerned countries and regions that have remained stuck at very low levels of income. A good deal of effort has been given to measuring the extent of global poverty and examining the processes of marginalization (World Bank, 2001; UNCTAD 2002). While there can be little doubt that poverty alleviation is an important policy challenge, at a more fundamental level, auditing globalization must mean re-examining the links between income distribution and growth at different levels of economic development.

Conventional economists have approached this issue by reviving the idea of economic convergence. In particular, trade and capital flows have been introduced into endogenous growth models thereby expanding the range of development paths facing poorer countries and giving greater emphasis to the conditional influence of policy measures. On this basis, a good deal of empirical testing has reported an improved global income distribution over the past two decades largely due to cross-country convergence brought forth by the strong growth performance of open developing economies.[1] However, this conclusion has been widely criticized on both empirical and analytical grounds.[2] While it is not the intention to review

[1] The convergence literature is vast, see for example Sachs and Warner (1995); Ben-David (1995); Sala-i-Martin (1996).

[2] For an assessment see Kozul-Wright and Rowthorn (2002). The extent of the partiality among conventional economists in examining the links between globalization and income distribution can be seen in the recent study by the CEPR (2002). Despite documenting a dramatic rise between 1970 and 1992 in the share of the top 10 per cent of the world's population from 50.8 to 53.4 per cent, the study concludes "the evidence suggests that globalization had positive effects on the world distribution through pushing up Asian growth" p. 67. As is

that debate here, it is apparent that much of the discussion of distribution and growth under contemporary globalization dynamics has paid insufficient attention to trends in functional incomes. In fact, growing wage inequality between skilled and unskilled workers appears to have been a universal trend over the past two decades; profit shares have risen in many countries and rentier incomes have also risen sharply (UNCTAD 1997). Although a full assessment of these trends has yet to be undertaken, there appears to be a close connection to the contemporary globalization process, and in particular from the divergence in bargaining power which has accompanied the greater mobility of capital.

In the two decades following the end of the Second World War full employment, steadily rising real wages and the strengthening of the welfare State were the common features of labour markets in all the leading industrial economies. This was supported by a multilateral regime of trade and capital flows established at the end of the Second World War to regulate international economic flows to ensure their consistency with domestic growth and employment goals. As a result, the deep insecurity that had marked the conditions of workers in these countries during the inter-war period had, by the end of the 1960s, become a distant memory. All that ended abruptly with the oil price shocks and the collapse of the Bretton Woods system in the early 1970s. In continental Europe, the return of labour market insecurity took the form of sharp and persistent rises in unemployment, while in the United States and the United Kingdom increasing wage inequality between skilled and unskilled workers became the dominant trend.

The coincidence of high unemployment levels and growing wage inequality in the North with sharp increases in manufacturing imports from the South has led to concerns over a destructive link running from more open trade relations to the labour market. While recognizing that rapid trade liberalization and surges in imports can cause dislocations in the labour market, this paper argues that in today's globalizing world, the link between trade and employment cannot be properly examined independently of either overall demand conditions or the workings of global financial markets. This is also true for the impact of technological change, also part of the contemporary globalization process associated with the information-communication revolution, which is often suggested as an alternative explanation of recent labour market problems.

The conventional analysis, in particular, ignores the dominant role played by finance capital in the current integration process. International capital flows have been growing a good deal faster than trade since the collapse of the Bretton Woods system, with a marked surge to developing countries in the 1990s. At the same time, financial shocks and crises have become a much more frequent occurrence in the international economic system. As a consequence, and particularly in the case of developing countries, financial liberalization and capital movements have been a growing influence on labour market performance.

This paper adopts an integrated approach to labour market problems in the context of the globalization process. It begins with the links between trade and technology and labour market problems in the North. It rejects any strong direct link in either direction and concludes that a faster pace of accumulation holds the key to reducing unemployment in the industrial countries. The next section asks how liberalization has affected labour markets in developing countries. Although it finds significant differences between countries in the

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clear from this remark, the interpretation of global trends in distribution hinge to a very large extent on assessments of China's recent economic record, see Berry and Serieux (2003).

effects of trade liberalization on wages and employment, the impact of financial liberalization appears to have been generally negative for workers throughout the developing world. The final section draws some policy conclusions.

2. EMPLOYMENT AND WAGE INEQUALITY IN THE INDUSTRIAL COUNTRIES

2.1. North-South Trade and Labour Markets

An important factor behind rising rates of unemployment and increasing wage inequality in most industrialized countries over the past two decades has been the loss of jobs in manufacturing. This has largely been due to a displacement of unskilled labour on a significant scale in a number of industries in which developing countries have increased their market share. A number of arguments have been put forward to suggest a causal link between these two developments. First, given that the wage of unskilled workers in the South is a fraction of that paid in the North, increased trade between the two regions results in a dramatic fall in the relative price of labour-intensive goods in the North and in the wage of unskilled workers relative to that of skilled workers. Second, wage inflexibility and other market rigidities in the North determine whether workers whose jobs are destroyed by trade are absorbed into other sectors producing non-tradable and skill-intensive goods or join the ranks of the unemployed. Third, trade with the South tends to lead to significant productivity improvements because of defensive innovation and corporate restructuring in response to competition from southern exports, thereby compounding the disadvantages of unskilled workers there.[3] However, despite the analytical elegance of these arguments, a closer look at the evidence shows that the growth of North-South trade does not provide a convincing explanation of the labour market problems in the industrial countries.

2.1.1. Manufacturing Trade and Unemployment

The first question to address is whether the general trend of declining manufacturing jobs in industrial countries could be explained by manufactured exports from the South. While such exports have risen by more than 10 per cent per annum in volume since 1970, they are still small in relation to the developed countries' combined gross domestic product (GDP). At the beginning of the 1990s, imports of manufactures from developing countries by member countries of the Organisation for Economic Co-operation and Development (OECD) accounted for 1.8 per cent of GDP, whereas the figure in 1999 was 3.2 per cent. There are, however, notable differences among the major industrialized countries in the extent of penetration. In the United States, the penetration ratio rose from around 0.5 per cent at the beginning of the 1970s to over 1 per cent a decade later; and by 1999 it exceeded 4 per cent. In Western Europe where labour market problems appear to be more acute, the trend of increasing penetration has been less dramatic, rising from 0.5 per cent in the early 1970s to 2.7 per cent in 1999.

[3] See e.g. Wood (1994), Chapter 7.

In any event, for southern imports to have had a noticeable impact on employment, they must have significantly lowered the demand for labour through the trade balance. Assuming that the labour contents of exports and imports do not undergo significant changes, a deterioration of the trade balance (at any given level of domestic aggregate demand) will almost certainly lead to declining employment. In fact, over the past three decades the North consistently ran a surplus on manufacturing trade with the South, at least up to the end of the 1990s, when the Asian crisis turned this around (figure 1).

However, behind this evolution of the manufacturing trade balance for OECD countries as a whole lies a sharply diverging trade performance among the major countries. While the trade balance of the European Union (EU) with the developing countries moved substantially in line with the OECD average, the United States and Japan diverged widely from the average, but in opposite directions. Exports from Japan in the 1980s fell modestly but skyrocketed in the 1990s with imports rising only slightly. As a consequence, Japan recorded a very high surplus even after the Asian crisis. The United States, on the other hand, suffered greater export losses in the 1980s, while it already had a much sharper rise in imports than Japan, from 1981 onwards. The United States has had a deficit since 1984. In the 1990s this pattern continued: the United States recorded a large and rising deficit which reached unprecedented levels after the Asian crisis.

Manufacturing employment in the North over this same period fell in three phases (figure 2). Of the total fall in employment, around one-quarter occurred in the first half of the 1970s, was more than one-half from 1980 to 1985, and under a quarter during the 1990s. Manufacturing employment fell most dramatically during 1980–1985, when the manufacturing trade surplus shrank because of sharp import compression by developing countries in the aftermath of the debt crisis rather than because of an increase in their exports.[4] It is also telling that Germany and Japan, the best performers in terms of exports and trade balances with the South, were clearly the worst performers in overall growth and employment, including manufacturing employment.

Thus neither the evolution of manufacturing trade balances nor that of import penetration ratios suggests that there is any significantly close relation between North-South trade in manufacturing and unemployment. It is true that observing the evolution of import volumes and of import penetration by developing countries in the industrialized countries does not capture all the potential North-South trade dynamics. Even if these indicators were unchanged, rapidly industrializing developing countries could still be substituting for OECD countries in the markets for manufactures of third countries. This effect would be reflected in smaller exports from OECD countries or a reduction in their import penetration of developing-country markets. Data on the latter are not available, but trade figures do not indicate that this effect has been very strong in recent years. On the whole, OECD manufactured exports to developing countries other than the newly industrializing economies (NIEs) rose substantially in the 1990s and especially to those countries showing the biggest jumps in manufactured exports.[5]

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[4] It has been estimated that the reduction of the OECD trade surplus in manufactures with developing countries during the 1980s due to lower exports was more than double the reduction due to the rise of imports. See UNCTAD (1995), tables 28–29. Over the entire period 1970–1993 the swing in net manufactured exports, as a share of GDP, for the G-7 countries taken together has been in the same direction as the change in employment, but this does not hold for either individual countries or for shorter periods.

[5] See UNCTAD (1999), Part Two, Chapter IV.

2.1.2. The Skill Content of Trade, Relative Wages and Employment

According to traditional trade theory, for low-skill manufactured imports from developing countries to have been an important influence on labour markets in the North, this rise would have had to be associated with a decline in the relative price of low-skill products. Indeed, a good deal of effort has been spent on determining whether relative prices have changed in the predicted direction. The finding of a number of research studies that the international price of skill-intensive goods has fallen over the past two decades or so relative to the price of low-skill labour-intensive goods has been taken as evidence against a trade-based explanation of growing inequality. However, there have been strong methodological and empirical counter-arguments. In particular, price movements do not appear to offer consistent evidence about the effect of trade because of uncertainty as to how these prices would have moved in the absence of trade and the sensitivity of the findings to the products chosen and the measurement of their skill content.[6]

There can be little doubt that differences in the skill content of imports and exports of manufactures could be a source of labour market imbalances since jobs can be lost in the industrialized countries even when net exports to developing countries are rising.[7] The observation that unemployment in the North is higher amongst workers with the lowest educational and professional attainment has given rise to the hypothesis that it is the lower skill, but higher labour, content of imports relative to exports that has contributed to rising unemployment and/or falling real wages in these occupational groups.[8] According to this view, growing exports of skill-intensive goods to the South increase wages for skilled workers in the North but the industrialized countries cannot provide compensating job opportunities for those workers displaced by imports from low-skill manufacturing industries. Thus, to better identify the unemployment problem, the various subsectors of the manufacturing industry must be classified according to factor technology or skill content.

Despite methodological problems regarding the measurement of skill content,[9] the changing employment profile of the leading industrial countries over the past three decades is reasonably clear. In the “high-skill” industries employment in the G-7 countries as a whole rose, but by only 1.5 per cent, from 1970 to 1993, while in the “medium-skill” industries it fell by 9.4 per cent. The most dramatic change has occurred in the “low-skill” industries, where close to 27 per cent of jobs (some 5.8 million) were lost; that is, more than two-thirds of all jobs lost in manufacturing during this period. An analysis of North-South trade according to categories of skill embodied in the products reveals, not surprisingly, a deficit for the industrialized countries in low-skill goods since the mid-1980s, which is the outcome

[6] See UNCTAD (1995), p. 133, and the references therein.

[7] See Rowthorn and Ramaswamy (1999).

[8] A recent variant of this approach suggests that the growth of outsourcing by northern multinational corporations has become an increasingly important channel for exporting unskilled jobs; see Feenstra and Hanson (2001). The migration of unskilled workers from developing countries has also been cited as a possible source of labour market problems in the North. However, without denying a negative impact on some groups, most studies have found that the overall impact has been marginal, for a review see Stalker (2000), particularly Chapter 6.

[9] The skill content of a sector is usually measured as the share of “production” workers in total employment. However, classifying sectors is not without problems since it depends on the definition of sector size and the level of disaggregation. Discrepancies resulting from sector definition are of particular importance for some of the most dynamic subsections of manufacturing, such as communication equipment and semiconductors, and office and computing equipment, which, if treated separately, would fall within the high-skill industries,

of both lower exports than at the beginning of that decade and increasing imports, especially from 1983 onwards. However, imports of such products have been levelling off since 1990, while exports have again risen in recent years, thus leading to a narrowing of the deficit.

The evolution of employment in the different skill categories thus appears not unrelated to that of trade – both have moved roughly in the same direction over the period as a whole and for the major OECD countries taken together – but the evidence does not suggest a very close relationship.[10] This conclusion is confirmed by the evolution of employment and trade in the various subsectors within each category as well as by cross-country comparisons of sectoral employment changes.

Between the early 1970s and the early 1990s, the greatest losses in employment occurred in the textile and clothing industries (ranging from 59 per cent in the United Kingdom to 29 per cent in Japan) and the ferrous metal industry (ranging from 70 per cent in the United Kingdom to around 30 per cent in Canada). These two subsectors alone accounted for the loss of more than 5.2 million jobs in the G-7 countries over the entire period 1970–1993, i.e. almost two-thirds of the total reduction in manufacturing employment. Other sectors typically losing employment were non-ferrous metals (particularly in Europe) and non-metallic mineral products (particularly in France and Italy). All these sectors are classified as low-skill. But employment fell considerably also in several medium-skill or even high-skill industries in some countries: scientific instruments in Italy, France and Canada (by 56 per cent, 28 per cent and 27 per cent respectively); the chemical industry in Italy (over 50 per cent); and fabricated metal products in the United Kingdom (about one-half). While employment losses are clearly concentrated in low-skill sectors, employment gains have not been the preserve of high-skill sectors. In fact, the best employment performance in the major industrialized countries was in the low-skill rubber and plastics industry. In five of the G-7 countries employment also rose in printing and publishing, which counts among the high-skill sectors, but also from a low base.[11]

2.2. Technology, Wages and Unemployment

An alternative explanation for rising unemployment and wage inequality lies in the development and diffusion of new technologies. This explanation appeals on a number of levels, not least in shifting any suspicion away from trade. More specifically, the idea that new technologies have accelerated the pace of sectoral change in employment from manufacturing to services, as well as a shift from unskilled to skilled labour within sectors, appears to offer a very direct link with the structural problems of contemporary labour markets. In particular, the bias in contemporary technologies towards a more intensive use of knowledge inputs is seen to favour skilled workers, simultaneously raising their productivity relative to that of the unskilled. On this account, these effects have led to unemployment of

whereas if included in the more traditional and broadly defined "non-electrical and electrical machinery" sector would be classified as part of the medium- or low-skill industries.

[10] For example Rowthorn and Ramaswamy, op cit., estimate that less than one-fifth of jobs lost in Northern manufacturing since 1970 can be attributed to North-South trade. A similar figure has been cited in other studies.

[11] UNCTAD (1995), pp. 139–143.

the low-skilled in countries where wages are sticky and to widening wage differentials in countries where wages are flexible.

Skill-biased technological change has, in recent years, been associated with the increasing economic importance of collecting, storing, processing and distributing information. Not only has the industrial landscape already been transformed by the rise of the semiconductor and computer industries as well as of related services such as software design, but also the tremendous productivity improvements in these industries have brought about rapid falls in the price of information-based technologies. Coupled with improvements in the speed, capacity and accuracy of generating and managing information, this has led to the widespread use of computers, integrated circuits and robotics in both industry and households. Similar trends in satellite technology and fibre optics have advanced carrying capacity, increased the locational coverage of these technologies and enlarged the application of related services. Information-technology goods have also become one of the most rapidly growing components of world trade.

These trends have coincided with a relatively fast rate of high-tech investment in such industries as electronics, machinery and chemicals, where, correspondingly, the demand for highly educated workers with problem-solving skills appears to be greatest. There is also evidence that the use of computers and the research and development intensity of jobs are both positively linked to higher wages, and it seems likely that the relative wage of skilled labour was further increased by the slower expansion of the number of college graduates in the 1980s.[12]

These various pieces of evidence have been taken as confirmation of the skill-biased technology explanation of growing wage inequality in the North in the 1980s and 1990s. However, firm- and industry-level studies, while pointing to a labour-saving bias in new production techniques, do not find a great impact of new technologies on either job creation or job destruction, which suggests that productivity improvements, along with price reductions and product improvements, have generated compensating income growth and employment.[13] Moreover, shifting from partial evidence to a more general explanation of labour market problems is not so simple. In the United States productivity growth in skill-intensive industries did not accelerate relative to other industries until the latter half of the 1980s, well after inequality (and unemployment) had begun to increase. There is also some evidence to suggest that the rising relative wages of skilled workers was strongly biased towards professional business services and legal services and that the wages of more obviously technology-using professions, such as computer specialists and engineers, actually fell relative to those of high-school graduates during the first phase of the information technology revolution.[14]

Furthermore, although the higher premiums for educational attainment are consistent with a shift in demand towards more skilled labour, this cannot explain the declining ratio of unemployed unskilled to skilled labour in many industrial countries, including the United States, during the second half of the 1980s and the first half of the 1990s. Indeed, if skill-biased technological change had been the operative force in labour markets, then in countries where labour markets were less flexible, such as in Western Europe, there should have been a

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[12] See Berman, Bound and Grilliches (1992); Krueger (1993); Bartel and Lichtenberg (1987).
[13] See Freeman and Soete (1995).
[14] See Pierce and Welch (1994); and Krugman (1994).

clear and steady rise in the ratio of unskilled to skilled unemployment. This, however, does not appear to have been the case.[15]

Finally, it is far from obvious that the pace of technological change has accelerated dramatically in the last 20 years compared with the 1950s or 1960s, when the labour force profile was also steadily shifting towards higher skills while unemployment fell to historically low levels and the relative wage of skilled and unskilled workers showed no clear trend. These decades were marked by a backlog of new technologies from the inter-war period, the introduction of which had a profound impact in such basic activities as transportation, as well as giving rise to new industries in such areas as consumer durables. It seems unlikely that the process of skill upgrading has accelerated over the past two decades at the kind of pace that would be required in order to explain the dramatic shifts in labour market performance.

2.3. Investment and Employment

The evidence showing a direct link from either trade or technology to rising unemployment or increasing wage gaps in the North is not convincing. Rather, macroeconomic conditions, and particularly those relating to investment remain the decisive influence on labour market performance. Trade with poorer countries and technological change have, in fact, been ubiquitous features of the post-war economic landscape in advanced industrial economies. There is little evidence to suggest they have become more pervasive influences on the performance of these economies over the past 25 years, at least on a scale which could explain the dramatic changes in employment levels and wage inequality during this period, particularly in the manufacturing sector.

The fundamental flaw in both trade- and technology-based explanations of rising unemployment and inequality in the North is their assumption that there is always an adequate level of aggregate demand. In fact, because all technological change is embodied in human and physical capital, and because leading industrial economies must, faced with catching-up pressures from NIEs, invest in new capacity of one kind or another, any discussion of the impact of technological change or trade independently of the macroeconomic determinants of capital accumulation is unhelpful.

Since 1973 the industrialized economies have suffered from a fundamental imbalance between investment in fixed capital, productivity growth and growth of the labour supply.[16] Much of the rise in structural unemployment is related to the slowdown in investment, which in turn is closely linked to restrictive macroeconomic policies and deregulation of financial markets. Empirical evidence leaves no doubt that there is a positive correlation between investment and employment (UNCTAD, TDR, various years).This tends to confirm one of the main lessons from the 1930s, one which seems to have been forgotten in all the talk about “fundamental reforms” and “structural deficiencies” that a faster pace of capital investment is unlikely to occur without a substantial improvement in business expectations concerning future sales and the key determinants of the costs of and return on investment. Macroeconomic policies are vital for improving both sets of expectations. For one thing, the

[15] See Nickell and Bell (1995).

[16] The details of this imbalance are spelt out in greater detail in UNCTAD (1995), Part Three, Chapter III; see also Rowthorn and Ramaswamy (1999).

level of effective demand determines total sales and profits. For another, monetary policy can directly affect the degree of macroeconomic and financial volatility and instability and thus influence the risks and uncertainties associated with investment decisions. Without policies designed to bring about a faster expansion of demand and greater financial stability, there is little hope of finding a solution to the unemployment problem. During the 1990s, only the United States Federal Reserve, among the central banks of the leading industrial economies, was willing to systematically test the limits of expansionary policies compatible with stable inflation. The resulting strong performance of investment in the United States in recent years, particularly in the high-technology sectors, has generated a rapid increase in productivity, particularly in manufacturing, thereby preventing the re-emergence of inflationary pressures despite the high rates of growth and low unemployment.

The concern in other major industrial countries that faster demand expansion would only lead to faster inflation is difficult to justify in the current economic conditions. Not only is there a considerable slack in the labour market, but also the institutional changes that have been introduced since the beginning of the past decade and greater global integration of markets have made it much more difficult for a wage-price spiral to emerge. Given the reduced bargaining power of the unions and increased competition in the labour market, workers are wary of pricing themselves out of the market. There is also a greater realization that in today's environment of increased global competition, workers' jobs depend on the profitability of their companies. This has been a major factor in establishing a closer link between productivity and compensation. Indeed, one of the most significant features of the economic performance of all major industrial countries in the 1990s was a clear tendency for unit labour cost growth to fall and profit margins to rise. Inflation rates continued to fall in the United States and Western Europe throughout the 1990s, while in Japan the price level was actually falling.

The fact that unit labour costs are the most important determinant of the inflation rate is of the utmost importance for any determined effort to tackle unemployment. If nominal wages rise at the same rate as productivity plus the target rate of inflation, increases in productivity can be translated into real income and demand with the minimum friction possible. The task of creating additional jobs would then become the responsibility of other policy measures, in particular monetary and fiscal policy. That is precisely the economic policy assignment which was so successfully pursued in the United States in the 1990s. It was not so much the flexibility of labour markets that was responsible for the large increase in jobs and decline in unemployment there, but rather the flexibility of monetary policy in interpreting its responsibilities.

3. Trade, Financial Flows and Labour Markets in Developing Countries

In recent years developing countries have striven hard, and often at considerable cost, to integrate more closely into the world economy. Because many of these countries had long histories of more inward-oriented development strategies, the expectation was a considerable acceleration in their economic growth, diminished vulnerability to external shocks and a more equitable distribution of income. Trade liberalization would ensure the best allocation of

resources according to comparative advantage, securing the export revenues needed to import key ingredients of faster growth. Financial liberalization would attract foreign capital seeking high returns, allowing the developing countries to invest more than they could save without running into payments constraints, as well as bringing technology and organizational skills through increased flows of foreign direct investment.

The growths of world trade, particularly following the completion of the Uruguay Round of trade negotiations, and, perhaps even more decisively, the recovery of financial flows to developing countries in the 1990s were taken as confirmation that a new era of prosperity was beginning to unfold. However, in the face of deep-seated imbalances and biases in the international trading and financial systems, the gains from integration in terms of faster growth, greater employment opportunities and reduced levels of poverty have so far proved disappointing. The humbling of the Asian tigers since 1997 has revealed the heightened vulnerability of even the strongest developing countries to external shocks. The extent to which liberalization policies have themselves contributed to this disappointing outcome will be considered below.

3.1. Trade Liberalization and Labour Market Performance

According to conventional analysis the immediate impact of trade liberalization should be to change relative prices in line with a country's resource endowments. Thus, a general move towards greater openness in the world economy should be reflected in narrowing wage gaps among countries. While it is recognized that there may be temporary adjustment costs, eventually demand for labour should shift towards less-skilled workers in the South narrowing the wage gap with skilled workers and triggering a process of wage convergence between developed and developing countries.

Although a number of studies have reached the conclusion that trade liberalization in developing countries does not adversely affect employment conditions, these findings have been roundly criticized on both methodological and empirical grounds.[17] The vague definition of openness and the failure to distinguish episodes of export promotion from those of import liberalization have resulted in misrepresentation of trade regimes, and made it difficult to make cross-country comparisons and interpret the findings. Moreover, the failure to present an explicit counterfactual and biases in country selection has raised serious doubts about the validity of these studies. Indeed, the more recent evidence from liberalization episodes in Latin America and sub-Saharan Africa suggests that an increase in unemployment has often accompanied liberalization programmes.[18]

In one study of changes in earnings of three different skill groups of labour in 10 Latin American countries in recent years, all except one of the countries experienced widening gaps between skilled workers and unskilled workers. With few exceptions, real earnings of unskilled workers fell during the periods covered, with declines exceeding 20 per cent in many cases.[19] The gap in earnings between public employees and workers in larger firms on

[17] The most prominent of these studies is Papageorgiou, Michaely and Choski, eds. (1990); see also Matusz and Tarr (1999). For critical reviews see Greenaway (1993); Buffie (2001), Chapter 6; and Helleiner (1995).

[18] For discussions of these findings, see Gosh (2003); Amadeo (1996); Ravenna (1994); Rama (1994); Buffie, op. cit.

[19] UNCTAD (1997b: 135).

the one hand and skilled workers on the other hand also widened in most countries, though by a lower margin.[20]

Increased wage dispersion in manufacturing during the recent period of globalization has also been reported by the ILO, for a sample of 30 countries in Africa, Asia and Latin America which compares average real wages in 1975–1979 with those in 1987–1991.[21] It was found that in about two-thirds of all the countries real average wages had fallen, and that the fall was correlated with a rise in wage dispersion. The economies in which wage dispersion diminished include the first-tier East Asian NIEs, where it was accompanied by significant increases in labour productivity. The only exception to diminishing wage dispersion in East Asia is Hong Kong (China).

A number of explanations have been offered to reconcile the increased wage inequality with the mainstream trade theory based on comparative advantage. Perhaps not surprisingly technological factors have received particular attention. If trade liberalization and increased capital mobility accelerate the introduction of best-practice technology in developing countries, and if the use of such technology requires specially trained labour, the increase in demand for skilled labour may lead to a widening of the wage gap. However, a fairly sizeable shift in technology would be required, which should be reflected in a sharp increase in imports of capital goods as well as in an expansion of exports of skill-intensive products. But the greater openness observed in Latin America has not generally been associated with a significant increase in investment and technology transfer. Manufacturing investment in the region has also been sluggish since rapid trade liberalization began, even in the presence of massive inflows of capital. For the seven major Latin American countries taken together, investment in machinery and equipment was lower than in the early 1980s and there was little evidence by the end of the decade to suggest that "investment rates had recovered to the point where high and sustained growth can be guaranteed".[22]

More important, the observed shift in wage differentials towards skilled labour has not been associated with any significant increase in the exports of more skill-intensive products.[23] In some instances demand for skilled labour has increased relative to that for unskilled labour without a significant increase in investment to upgrade the industry and move exports towards technology-intensive products. Industries producing low-technology products have replaced less-educated with more-educated labour. This skill-upgrading may have been triggered by trade liberalization when the industries concerned were no longer able to compete with imports. Also, competitiveness could not be restored simply by lowering the wages of unskilled labour: it necessitated in addition the hiring of more skilled labour.[24]

The emergence of low-cost producers of labour-intensive manufactures from Asia during this period has no doubt changed the parameters in international trade for other exporters of such products. However, its effect has not been uniform. The first-tier East Asian NIEs, where about half of the exports consisted of such goods in the mid-1980s, have responded to

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[20] ECLAC (1997: 60). Additional evidence is presented in Robbins (1996); Pissarides (1997); and Wood (1997). Despite the mounting evidence about the impact of trade liberalization on increased earnings inequality in Latin America, a recent study by the Inter-American Development Bank (IADB) reports a positive effect of trade liberalization on personal income distribution. However, no attempt is made to reconcile these findings with all this other evidence to the contrary; see Londoño and Székely (1997).

[21] ILO (1996), table 5.9 and related text.

[22] ECLAC (2000), p. 233.

[23] UNCTAD (1997b), p. 136.

[24] Cragg and Epelbaum (1996).

this new competition by restructuring and upgrading their labour-intensive exports, and by shifting towards skill-intensive products.[25] This upgrading began before imports were liberalized in the second half of the 1980s. The share of labour-intensive products in the combined exports of the Republic of Korea and Taiwan, China fell from over 40 per cent in 1985 to 25 per cent in 1994, while the share of skill- and technology-intensive exports doubled, reaching over 56 per cent in 1994.

It thus appears that the effect of trade liberalization on wages and income distribution differs among countries, depending on the domestic and international conditions under which it is implemented. While resource endowments are certainly important in determining comparative advantage, there are also other factors that influence the degree of competitiveness of various industries. In this respect, it is important to recall the textbook argument invoked to counter the idea that low-wage countries have an unfair competitive advantage in international trade relative to high-wage countries. It is not just relative wage costs, but unit labour costs, that determine international competitiveness. Two countries with similar relative endowments of skilled and unskilled labour can have different productivity levels in any given industry, depending on their success in learning and upgrading.[26]

Herein lays the main difference between trade liberalization in the first-tier East Asian NIEs and most other middle-income developing countries. In the former, liberalization followed the successful implementation of industrial and trade policies; protection and support were removed in large part because they were no longer needed. In the latter, on the contrary, liberalization has largely been triggered by the failure to establish efficient, competitive industries in labour- and/or skill-intensive sectors. Accordingly, the impact of increased competition brought about by trade liberalization on income distribution has been crucially different.

3.2. Financial Liberalization and Labour Market Performance

The 1990s have also witnessed a concerted push to open up the capital account in developing countries, accompanied by a rapid expansion of private capital flows into these countries. Differences among countries in their policy approach to capital flows and their macroeconomic effects have been examined in various studies.[27] However, against a general backdrop of rapid liberalization and deregulation of financial markets, a large proportion of these flows consisted of liquid capital attracted by short-term arbitrage margins and prospects of speculative capital gain. These have proved extremely volatile and subject to bandwagon effects, capable of generating gyrations in security prices, exchange rates and trade balances, and ultimately culminating in severe financial crises. Such volatility was a particular danger

[25] Differences in the ability of different countries to respond to increased competition in labour-intensive products are also reflected by movements in the manufacturing terms of trade. During 1979-1994 the world price of manufactured exports of developing countries fell relative to that of the skill-intensive exports from industrial countries by about 2 per cent per annum. The decline was largest in LDCs, followed by ACP, Latin American and Mediterranean countries, while it was significantly smaller in East Asia; for the Republic of Korea, the manufacturing terms of trade indeed moved favourably during that period. See UNCTAD (1996), Part Two, Chapter III.

[26] World Bank (1995), p. 58.

[27] The G24 Discussion Paper Series offers a rich source of such studies; see also UNCTAD (1999); UNCTAD (1997a); and Helleiner, ed. (1998).

in countries where the liberalization of capital flows was prompted by the need to finance growing external deficits, as was the case in much of Latin America. But the danger was also present in countries with good records of economic management and a track record of well-managed integration into the global trading system, as was the case in East Asia.

The evidence from recent experience suggests that large swings in economic activity associated with financial boom-bust-recovery cycles have far-reaching consequences for growth and labour market conditions in developing countries.[28] Surges in capital inflows often lead to a deviation of key macroeconomic aggregates such as savings, investment, fiscal and foreign balances, exchange rates, employment and wages from their longer-term, sustainable levels. The rapid exit of capital and financial crises, on the other hand, tend to lead to overshooting in the opposite direction. The recovery process, which restores aggregate income to pre-crisis levels, generally results in a different configuration of key macroeconomic variables from those prevailing before the outbreak of the crisis. In particular, they tend to result in large shifts in income distribution and poverty, which can be corrected only after many years of growth.

The policy of reliance on capital inflows to support a consumption-led growth based, at least partly, on rising wages had a populist twist as it helped to correct some earlier distortions in income distribution at the expense of labour which followed the debt crisis of the early 1980s. Indeed, most Latin American episodes and the Turkish boom during 1989-93 and then again in 2000 had been preceded by a period of significant erosion of real wages and by large declines in the share of wages in industrial value added. This populist policy mix thus served to avoid hard policy choices and allowed price stability to be achieved without running into distributional conflicts. However, since this situation depended on maintaining capital inflows, the rapid exit of capital and the decline in economic activity laid bare the latent conflicts, often leading to a redistribution from wages to profits.

Labour market conditions deteriorated in all countries with the outbreak of the financial crisis. Indeed, it appears that reduced incomes and employment in organized and informal labour markets have been the main social conduit of the adverse impact of financial crises on poverty and equality.[29] Rising informalization and disguised unemployment appear to have been the trend almost everywhere in Asia, but despite such flexibility and generally declining participation rates, unemployment rose in all crisis-hit countries.[30]

The sharp deterioration in the conditions of labour, particularly among the unskilled, is a major reason why the reduction in poverty levels has so far lagged behind economic recovery

[28] These experiences include the recent financial crises in East Asia, Latin America and Turkey and some earlier episodes of financial crisis in other parts of the developing world, including the Southern Cone crisis in Argentina and Chile in the early 1980s. Most of these episodes were examined in past issues of the *TDR*. For the Asian crisis see UNCTAD (1998), Chapters II and III, and UNCTAD (2000); the crisis in the Southern Cone UNCTAD (1998), Part One, Annex to Chapter III; and in Mexico and Argentina in 1994–1995, UNCTAD (1995), Part Two, Chapter II; see also the discussion of the Brazilian crisis in UNCTAD (1999), Chapter III.

[29] This view is shared in almost all recent World Bank publications on the East Asian crisis. See also Diwan (2001). According to another study by Dollar and Kraay (2000) the incomes of the poor do not fall more than proportionately during economic crises. Studies on income distribution by the UNCTAD secretariat show that the economic crisis beginning in the early 1980s was associated with a rise in the share of the top 20 per cent at the expense of the middle classes rather than the poorest 20 per cent. It was also noted that crises could generate a process of "equalizing downwards" in rural economies in Africa, but it is not clear whether such results could be generalized to emerging markets facing sharp declines in output due to financial crises; see UNCTAD (1997a), Part Two, Chapter III.

[30] See Asian Development Bank (2000), p. 51; World Bank (2000a), pp. 117–119; Clerissi (1998).

in the crisis-hit countries of Latin America and East Asia. Indeed, empirical studies show that there is a significant asymmetry in the impact of growth and crises on poverty in developing countries: the poverty-alleviating impact of a given rate of growth is significantly weaker than the poverty-augmenting impact of a comparable decline in GDP.[31]

The persistence of widespread poverty and declines in wage incomes despite the recovery of output provide *prima facie* evidence that financial cycles result in regressive income distribution. However, it appears that for various reasons related to data problems as well as conceptual difficulties, the standard measures of income distribution cannot always capture such changes. In the Republic of Korea, for instance, data show that while in the first quarter of 1995 the incomes of the richest 10 per cent were about 7 times those of the poorest 10 per cent, they were more than 10 times higher in the first quarter of 1999.[32] By contrast, Gini coefficients appear to have remained unchanged in Indonesia and Thailand, despite substantial increases in the poverty-stricken population in both countries.[33]

It is also extremely difficult to assess the equally important impact of financial crisis on wealth destruction, which appears to have hit primarily small- and medium-sized enterprises that provide extended family employment opportunities. The loss of income and employment in these sectors probably increases the share of population dependent on wage labour and leads to an increase in formal unemployment. It may also contribute to the rise in saving ratios and explain the lag in consumption observed after the crisis as attempts are made to keep family-owned businesses alive.

4. Conclusion

During the 1980s mass unemployment and growing wage inequality became a veritable scourge across much of the industrial world. These problems persisted in many countries during the 1990s. How they are dealt with in the new century will influence the future course of all economies, whether developed or developing, given their interdependence.

Despite growing support for globalization, liberalization and outward-oriented development in the industrialized countries, labour market problems have been blamed on imports of manufactured products from the South. The solutions proposed range from erecting import barriers (“protectionism”), to imposing higher labour standards on southern producers (“social clause”), to lowering labour standards in the North (“flexible labour markets”). Each of these responses – including the third, favoured by advocates of free markets and minimum government – would slow the industrialization of developing countries without resolving the labour market problems in the North.

While trade provides only a superficial explanation of unemployment and wage inequality, the same can also be said for the most popular alternative – technological change. Both factors have tended to reduce the demand for unskilled labour in industrial countries but

[31] World Bank (2000b), p. 54.

[32] Chang and Yoo (1994), pp. 32–33.

[33] One explanation is the fact that household surveys on income disregard relative price changes in countries (such as Indonesia) where the poor faced significantly higher inflation than the rich. Another is that household surveys undertaken in 1998 included questions about household incomes during the preceding year (i.e. 1997) and therefore failed to capture the full impact of the crisis. On these empirical issues, see World Bank (2000a), pp. 114–116.

not on the scale or timing, consistent with the problem. Moreover, dislocations of labour as a result of new competition or new technology are nothing new in economic history, and, besides, demand for skilled labour has also been weak in many countries. What, then, has made it so difficult for the labour displaced by structural change to find remunerative work elsewhere in the economy?

The root of the problem lies in the slow pace at which demand, output and investment in most industrialized countries have been expanding over the past two decades. Even if labour is made less costly and more skilled to employers, business will invest on the scale required to provide more and better jobs only if it is confident of buoyant sales. The strong labour market performance of some industrial countries during the 1990s provides ample evidence that unemployment and growing wage inequality in the North do not have an international origin. Notably in the United States, but also in some smaller European economies, trade with the South has been consistent with achieving the goal of full employment.[34]. With the resumption of rapid and sustained growth, full employment and opening of markets in industrial countries in areas of export interest to developing countries, the South would have a chance to tackle simultaneously its development challenges and its labour market problems. Such a strategy would mean "all-boats-afloat"; it would create jobs in the North while benefiting – not hurting – the South. At the same time it would remove the main threat to the liberalization of trade.

With the obvious success of some countries in the North in reducing unemployment by demand management and high growth rates, the conventional policy approach needs to be reconsidered across the developed world if labour market security is again to become the norm for working people. The findings of this paper point to three broad policy conclusions. First and foremost, any effective answer lies in appropriate macroeconomic policies to increase productive investment and expand employment. Under these conditions both trade and technology can reinforce a virtuous circle of economic growth, job creation and productivity gains. This will certainly require better policy coordination among the leading industrial economies along with more effective governance of international capital flows than has been the case since the collapse of the Bretton Woods system, and a better managed exchange rate system among the G3 currencies.[35]

Second, improvement in labour market conditions will also require a reorientation of development policies at the national and global levels, particularly with respect to the speed and pattern of integration of developing countries into the global economy. Rapid and premature liberalization after the debt crisis of the 1980s, not underpinned by appropriate institutions and productive capacity, has been a source of steady deterioration in labour market conditions in many Latin American and African economies, frequently compounded by ineffective or misguided adjustment programmes. In Asia even countries with a history of strong output and employment growth fell victim to volatile capital flows and economic policy errors, with the burden of adjustment falling heavily on wages, employment and social conditions. Rapid financial liberalization, in many cases representing a reversal of years of more measured integration into the global economy, was a major factor.

Finally, regaining control over financial markets and reduced reliance on external private capital flows will be a central policy challenge for all developing countries in the coming

[34] For the success of smaller European countries see Rotschild (2000).
[35] See UNCTAD (2001), Part Two, for further details.

years. Policies to invigorate productive investment, stimulate technological upgrading and enter new markets will also be needed. For many developing countries, building and strengthening capacity in the manufacturing sector remains the surest way to increase productivity, allowing for both higher wages and export competitiveness. Experience shows that market forces cannot be relied upon to realize this goal and that a mixture of macroeconomic and industrial policies will be required in order to strengthen capital accumulation and private entrepreneurship.[36] Furthermore, the international community will have to face up to the pronounced external constraints on development and to the need for exports and development assistance, rather than unstable private capital flows, to underpin a return to rapid and sustained growth in developing countries. All of these are essential ingredients of a successful strategy for improving labour standards in developing countries.

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[36] See further UNCTAD (2003), Part Two.

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Chapter 10

LIFE AFTER CRISIS FOR LABOR AND CAPITAL IN THE ERA OF NEOLIBERAL GLOBALIZATION

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1. INTRODUCTION

Since 1980s, the world economy has been guided by neoliberal economic policies such as openness to trade, foreign direct investment and financial capital flows, and the dismantling of government regulations in financial markets, goods and labor markets. These policies reduce the role for macroeconomic policy interventions with the claim that free market capitalism would increase efficiency, growth and provide a fair distribution where all factors of production receive a return consistent with its marginal productivity. However, after two decades of domination of neoliberal policies, growth on average is lower, the unemployment problem has been persisting, and the distribution of income is changing at the expense of labor (Crotty and Dymski, 2000; Pollin, 2002; Easterly, 2001; Went, 2000). Obviously the problems of the current economic model are not neutral with respect to classes. Neoliberal policies on a national as well as international level were the answer of the capital to the crisis of the "Golden Age" of capitalism. The balance of power relations in favor of capital, which had made this shift possible, have not changed much ever since. This unfavorable situation of the labor movement makes it unavoidable for workers to carry the burden of adjustment during the shift as well as during episodes of crises.

The pro-capital redistribution of income in the era of neoliberal globalization has been experienced in the advanced capitalist countries as well as the developing countries. The increase in the mobility of capital and the stagnation in aggregate demand have been the central powers behind this synchronized development. The stagnation in demand led to higher

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unemployment and eroded the bargaining power of labor vis a vi capital. In the mean time, the increase in the mobility of capital has not only contributed to this erosion in the bargaining power of labor, but also increased the fragility built in the capitalist system via increased financialization and speculation. This, coupled with the tight fiscal and monetary policies, and a decrease in the purchasing power of the masses due to lower wages, set the conditions for the vicious cycle of deficient aggregate demand, low growth, low employment, and a crisis- prone global economy. Figure 1 summarizes these effects of neoliberal globalization on labor.

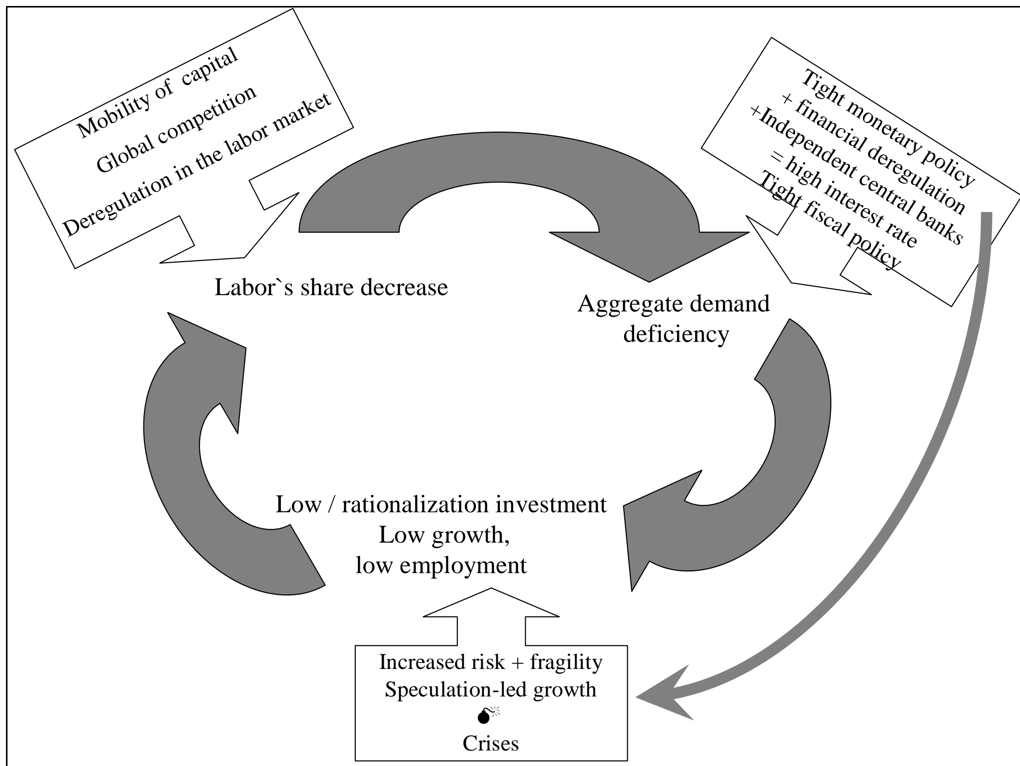


Figure 1. Neoliberal Globalization and Labor.

The aim of this chapter is to discuss the outcomes of neoliberal globalization from the perspective of labor in the developing countries, with a particular emphasis on the crises that followed the substantial liberalization in capital accounts in the 1990s. Although a lot has been said about the effects of capital account liberalization on the macroeconomic performance of the economies, less attention is paid to the different effects on labor vs. capital, according to the best of our knowledge at the time when this work was prepared, with the exception of the seminal works by Lee and Jayadev (2005), Harrison (2002), Diwan (2001), Rodrik (1998), Crotty and Dymski, (2000), Crotty and Lee (2002, 2004). This chapter analyses the outcomes of neoliberal globalization from the perspective of the class struggle between labor and capital over distribution in ten developing countries, and focuses on the episodes of crisis as part of this general struggle where the question on who will carry the burden of adjustment is part of the struggle. The concern of this study is the developing countries, which have liberalized their economies extensively, and have experienced financial

crises in the 1990s, or are strongly effected by the financial crises in other developing countries and due to data limitations, the analysis is restricted to ten countries, i.e. Argentina, Brazil, Chile[1], Mexico, Indonesia, Korea, Malaysia, Philippines, Thailand, and Turkey. This selection is also interesting because, it represents the major big developing economies of Latin America and Asia, which have an important share in the world trade. One distinguishing feature of this work from previous empirical work on the effect of globalization and crisis on distribution is that a detailed focus on countries will enable us to analyze the differences and similarities in the changes in distribution and unemployment across countries with respect to their different growth regimes. Also, although the works referred above cover a wide range of countries, their time span does not include the Asian crises in 1997, and the following crises in Latin America and Turkey. Finally, this work discusses the effect of labor's share on employment, whereas previous research concentrates on explaining the effect of globalization on labor's share.

In the following, there will be three main issues of analysis: Firstly, what is happening to employment as the labor costs are decreasing? This question is empirically discussed by testing whether the lower wage share has had any effect on unemployment, as the neoclassical theory claims, or whether unemployment is primarily driven by the goods market conditions *à la* Keynes. Second, the effect of the growth regime on distribution will be analyzed. An empirical analysis of the cyclical behavior of labor's share is carried out to understand whether the crises episodes change the effect of demand on distribution. Last the specific consequences of economic policy choices and liberalization on distribution are analyzed, in terms of foreign trade, foreign direct investment, exchange rate, interest rate, and fiscal policies.

The rest of the chapter is organized as follows: Section 2 reviews the literature on the effect of neoliberal globalization on distribution. Section 3 presents the empirical analysis on the effect of neoliberal globalization on distribution and employment. Section 4 discusses the corner stones of an alternative policy framework, and concludes.

2. LITERATURE: DECIDING ON A RESEARCH QUESTION IS NOT A POLITICALLY NEUTRAL CHOICE

In the mainstream camp, there is a growing amount of research restricted to the effects of liberalization on growth, poverty and inequality (e.g. Dollar and Kraay, 2004; Milanovic, 2002a&b). As the liberalization programs failed to deliver the promised results, there has been a boom in the research on poverty by the IMF and World Bank experts in the 1990s. Similarly, the World Bank, who is scared of the anger of the "hungry masses", has increased its concern for special projects targeting the poorest. But in the last instance all this research still tries to convince the audience about the merits of liberalization, privatization and tight monetary and fiscal policies[2]. The ideological background of this research choice is clear: It

[1] Chile, although is not part of the countries that have had a financial crisis, the deterioration of the economic performance of the country since 1998, makes it a case to be analyzed, not the least because it still is being cited as a success story in Latin America.

[2] See Dağdeviren, Hoeven and Weeks (2001), for a critical discussion of this literature. Angeles-Castro (2004) shows that FDI worsens inequality, and exports based on primary sector does not form an appropriate basis for

on the one hand hides the fact that not only poverty is increasing but also labor as a class has been losing against capital. On the other hand, it points at organized labor to be blamed for inequality within the labor. Indeed translating it to a more direct result, the policy conclusion boils down to the ridiculous claim that some workers are poor or unemployed because some other workers are not poor enough.

However, looking at the conclusions of neoliberal globalization from a class perspective shows a rather different picture. There is a limited but valuable accumulation of research on the impact of globalization on labor, although with clearly varying degrees of critique of neoliberal globalization[3]. UNCTAD (1997) reports that the rise in inequality within and across countries accompanied a general decline in the share of wages in the national income. The work by Rodrik (1998), Diwan (2001), Harrison (2002), Lee and Jayadev (2005), based on an international panel of advanced capitalist as well as developing countries report empirical tests of the effects of globalization on labor. Rama (2001) also finds out that exposure to world markets is associated with lower wages, but he places the focus mostly on unskilled workers, as trade and foreign direct investment increases the returns to education. Fallon and Licas (2002) show that during the financial crisis of 1990s, economies that suffered the sharpest currency depreciations suffered the deepest cuts in real wages, and these cuts were even associated with some rises in unemployment. They also show that although employment fell much less than the decline in production and even increased in some cases, these aggregates mask considerable churning in employment across sectors, employment status, and location, and points at the long-term effects of the short-lived crises on particularly poorer households. Boratav et al. (1996) in a study for 14 developing countries, discuss that the structural adjustment programs have led to wage-cycles, where downward movements are of greater magnitude than even the most prominent upward movements, showing the prevalence of a downward trend in most of the countries. Crotty and Dymski, (2000) and Crotty and Lee (2002, 2004) discuss the political economy of the Asian crisis from the perspective of the class struggle between the international and domestic capital and labor. Pollin (2002) and Haque (2004) discusses the effects of globalization, and market fundamentalism on the workers of the South and the North, and discusses policy alternatives for an egalitarian development. The work by Akyuz, Flassbeck, and Kozul-Wright (2005) in this volume is an important recent contribution.

The empirical studies by Rodrik (1998), Diwan (2001), Harrison (2002), Lee and Jayadev (2005) are particularly of concern to this study. The results point at some regularities about the falling trend in labor share across countries, although the effects are at times controversial: Rodrik (1998) and Harrison (2002) find a negative connection between the share of trade in GDP and labor share; however according to Diwan (2001) the negative impact is dominated by normal years, whereas during a crisis there is a positive effect. Capital controls have a positive effect on labor share (Rodrik, 1998; Diwan, 2001; Harrison, 2002;

reducing inequality, whereas a strategy based on industrialization can have better consequences for income distribution. Galbraith et. al. (2000) also present a critique of these studies from the point of view of data they use, which is based on a mixed source of distribution data, and suggest the use of industrial wage data, which is consistent and has a wider coverage across countries for the analysis of income inequality.

[3] Some of this work is still unpublished and in progress, as the authors themselves report. Since the whole research area is in a progress of improvement, there may be some more unpublished research papers that will only reach our attention in the coming years.

Lee and Jayadev, 2005)[4]. The absence of capital account restrictions is associated with wages that are lower by 22% (Rodrik, 1998). Losses to labor within a crisis tend to be large in the presence of liquid financial capital (Diwan, 2001). Labor share is higher in larger countries, with the effect being more important during crises, thus size offers some protection (Diwan, 2001). Diwan (2001) also finds a large negative trend in the labor share that cannot be explained by these variables. Diwan (2001) reports that the secular fall of the labor share is especially marked for countries, which have experienced financial crises. Thus, financial crises are episodes of distributional fights, which leave "distributional scars". Foreign direct investment has a negative effect on labor's share, indicating that favorable conditions for capital mobility coincide with low wages (Harrison, 2002). This may also be capturing inverse causality. Government spending has a positive effect (Lee and Jayadev, 2005; Harrison. 2002; Diwan, 2001), but during the crisis years labor ends up paying back the debt (Diwan, 2001). Harrison (2002) finds that labor share or wages are strongly and positively connected with capital/labor ratio, as a measure of development, however concludes that the positive effects of increased capital accumulation is wiped out by the negative impact of reduced capital controls and depreciating exchange rates in poorer countries. Harrison (2002) and Lee and Jayadev (2005) argue that large swings in the exchange rate lead to a fall in labor share.

3. NEOLIBERAL GLOBALIZATION AND CRISIS AS PART OF THE CLASS STRUGGLE

This section discusses some empirical regularities about the consequences of neoliberal globalization and the crises on distribution of income and labor market outcomes based on data from the World Bank World Development Indicators Database (WDI), 1993 and 2003, United Nations (UN) National Accounts Database, OECD Industrial Structural Analysis (STAN), the Economist Intelligence Unit (EIU), and the IMF International Financial Statistics (IFS).

The data on distribution and labor market outcomes is the hardest of all to access for not only developing countries but also OECD countries. In spite of the reporting problems and high costs associated with data collection on income, the lack of data on factoral income distribution is worth noting, particularly compared to the improved data quality regarding most other variables regarding the financial sector and international flows. Labor share data exists in the World Bank WDI database for the share of wages in manufacturing value added until 1993, but then the release of this data is terminated in the following versions of the same database. It is possible to calculate the labor's share in manufacturing based on wage and productivity data in the EIU database, but the wage data starts from 1980s onwards for some countries, and from 1990s for most others. UN National Accounts Database provides

[4] Diwan (2001) argues that the effect is larger during a crisis, and adds that there also is a lot of variability in these effects between poor and rich countries, as well as from medium to longer run. A larger trade and a more open capital account are associated in poorer countries with increases in the labor share in the long run and the reverse in richer countries, since capital accumulation is beneficial to labor. However, according to Lee and Jayadev (2005), although crises exert an additional downward pressure, they do not change the coefficient of capital account openness considerably. The same is through for developing countries, and for the long run as well.

distribution data, however unfortunately the data about the compensation to employees, nation wide as well as in manufacturing, is provided only for a subset of the countries, which are analyzed in this study. Furthermore this database also provides information only from 1990s onwards for most countries. Another problem is related to the quality of the nationwide data. For example, OECD National Accounts Database reports estimations for labor's share for developing member countries, but in Turkey there is no nation wide labor compensation data collected. Similarly the OECD nationwide labor's compensation data for Korea has been revised recently, such that the extent of revisions covers data way back to 1970s. Based on these observations, we conclude that the labor's share data for manufacturing industry is more reliable and offers longer time series for a larger range of countries; thus in spite of problems, and discontinuities in the available data series, this study is based on manufacturing data rather than nationwide income distribution. Another advantage of working with manufacturing data is to abstract from the structural change and industrialization in the economy, which can lead to a reduction in the share of self-employment income, thus an increase in labor's share if everything else were constant[5].

In line with the choice of the manufacturing wage share as the indicator of distribution, for consistency in the empirical estimations, sector specific variables, i.e. growth, and export and import ratios will also be defined as the growth of value added in manufacturing value added, and the share of exports and imports in manufacturing value added. This also has the advantage of focusing on the manufacturing sector, which is the locomotive of growth in developing countries, and which was also accepted as the engine of export boom in the context of structural adjustment programs.

The manufacturing labor share data for Turkey, Mexico and Korea are from OECD STAN Database and national sources. For Brazil, Chile, Philippines, and Thailand, the UN manufacturing data is combined with the WDI database, and for Argentina, Indonesia, and Malaysia WDI data is combined with the EIU database based on percentage changes. Unemployment data is from EIU. The source for the other variables is World Bank, EIU and IFS.

3.1. General Patterns: Growth, Wage Share and Unemployment

Before looking at the labor market outcomes, it is useful to have a comparative overview of the growth performance of the economies in the 1970s and post-1980s. The annual average growth rate of GDP is lower and its volatility is higher in the post-1980s compared to 1970s in all countries but Chile. The change is particularly dramatic with a decline in period averages, which is even greater than 2 percentage points in Argentina, Brazil, Mexico, Indonesia, Korea, Philippines, and Thailand who have been the fast growers of 1970s. In Brazil, Mexico, Indonesia, Korea, Philippines, Thailand and Turkey the deterioration in growth is continual with 1990s being worse than 1980s, whereas in Argentina and Mexico there is an improvement in 1990s compared to 1980s, however the period averages are still lower than those in 1970s. Since the empirical analysis is based on labor's share in

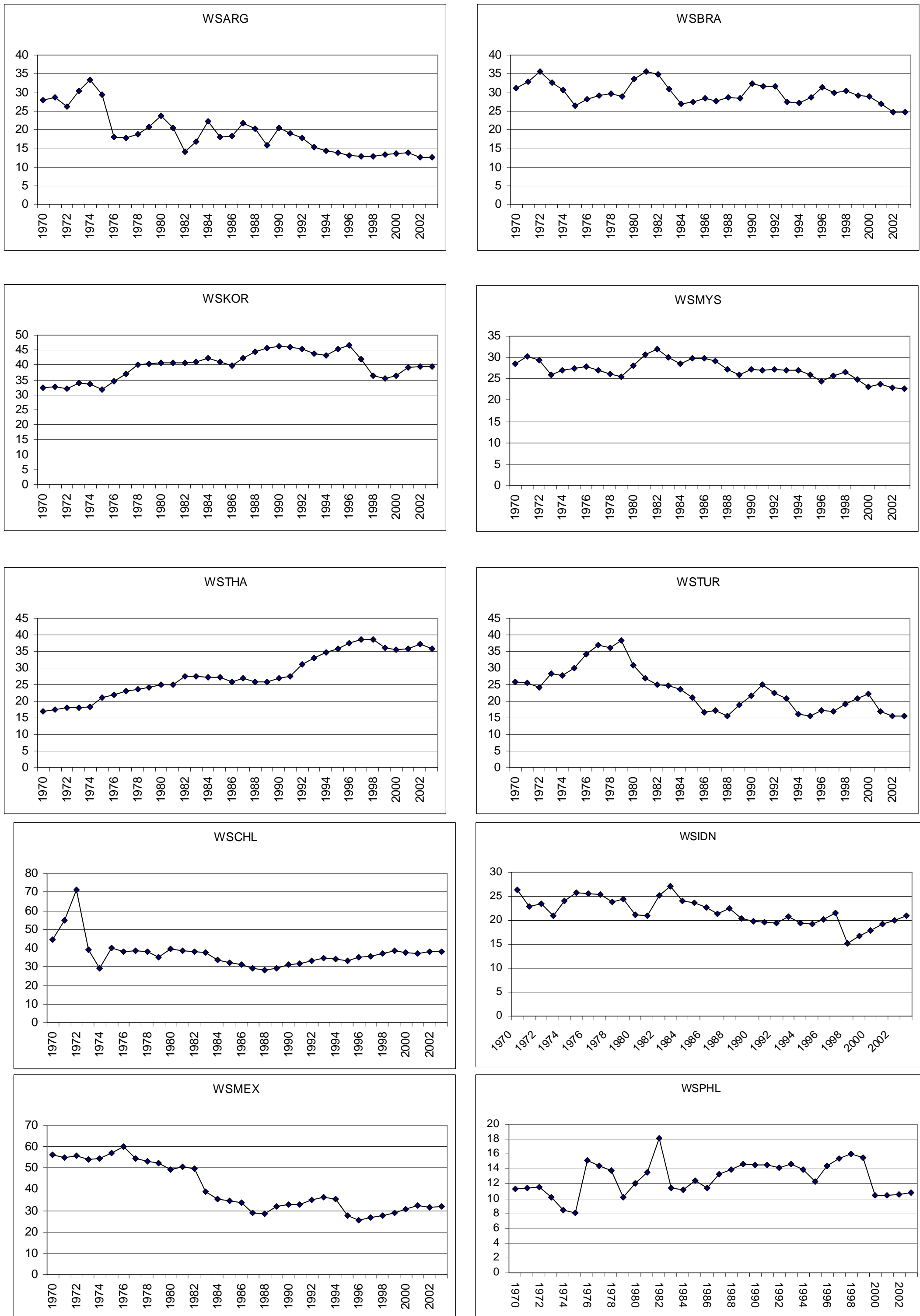
[5] Galbraith et. al. (2000) discuss data related issues in the analysis of inequality, and they suggest the use of industry wage data. Although their analysis is focusing on wage inequality rather than factoral income distribution, we share the common point of finding industrial wage data as a more reliable source of income data.

manufacturing, we will also briefly discuss the developments in terms of the value added in manufacturing. The first block of Table 1 reports period averages for manufacturing growth. The pattern is the same as GDP.

The second block of Table 1 shows the wage share in manufacturing value added. Figure 2 also shows the time series for each country. The wage share is lower in the post-1980s compared to 1970s in all countries with usually significant margins other than in Korea, Philippines, and Thailand. In six out of ten countries (Brazil, Indonesia, Malaysia, Mexico, Thailand, and Turkey) the volatility of the wage share has increased over time. The decline is particularly dramatic in Argentina, Chile, Mexico, Indonesia, and Turkey with the decrease between the two periods ranging between 14.4% and 38.3%. In Argentina, Brazil, Indonesia, Malaysia, Mexico, and Turkey also the wage share in the 1990s is lower than that in the 1980s.

The crises of the post-1990s have a clear and long lasting effect in all countries. In almost all countries GDP, as well as manufacturing value added starts to recover a year after the crisis and restores its pre-crisis level mostly in one year, however the fall in wage share is much more persistent. Furthermore the percentage fall in the wage share by far exceeds the rate of decline in economic activity even during the crisis. During the crises in 1994 & 2001 in Turkey, 1995 in Mexico, 1998 in East Asia, and in 2001 in Argentina, and their reflections in Brazil, the fall in the wage share continues for mostly 2 or even 3 years, reaching up to a cumulative level of 30.2% in the case of Turkey in three years during 2001-2003. In Indonesia the decline was short lived, but extensive with a rate of 29.5%. In Mexico ever since 1994, in all East Asian countries since 1997, in Brazil since 1998, in Argentina since 2001, in Turkey since 2001 the wage share is lower than the pre-crisis level as of 2003. In Mexico, which has had the early crisis of 1994, labor’s share has not recovered even nine years after the crisis.

The broad numbers about real wages deflated based on a general consumer price index hide an important information about how different income groups are affected as inflation accelerates after the crisis. Given that food consumption forms a significant proportion of the consumption budget of working class households, higher food price inflation will affect them more adversely than others and decrease real wages even more than what we observe based on average consumer price inflation rates. Food price inflation has exceeded average consumer price inflation rates in Turkey in 1994 and 1995 by 3.7 and 9 points respectively, in Mexico in 1995 and 1996 by 4.2 and 7.2 points respectively, in Indonesia from 1997 to 1999 by values ranging between 2.1 and 34.7 percentage points, in Korea in 1998 and 1999 by 1.2 and 2.0 points respectively, in Malaysia from 1997 to 1999 by values ranging between 1.5 and 3.6 points, in Argentina in 2002 by 8.8 percentage points. In Mexico ever since 1994, in Korea, Indonesia and Malaysia since 1997 this distortion has not been corrected. In Argentina the result is yet to be seen.



Note: See text for detailed notes on data. The country codes are indicated next to the abbreviation WS.

Figure 2. Wages / value added in manufacturing industry (WS).

Data on unemployment rates exist only since 1980s onwards for almost all countries. Figure 3 shows the time series for each country. Therefore it is not proper for long term analysis, as well as time series estimations. However, still a couple of notes are in place here. There is an increasing trend in unemployment in Argentina, Brazil, Indonesia, and Philippines, which had further adverse shocks after the crisis of 1997 with lasting effects. In Turkey, the unemployment rate has been stable at a high rate without any improvement in the era of liberalization, and a serious hike up since the recent crisis of 2001. In Mexico, unemployment rate which increased seriously after the 1994 crisis, returned back to pre-crisis level only after five years, and there is an increasing trend in the 2000s. In Korea and Malaysia unemployment rates had declined to quite low rates during the post-1980s due to the powerful employment creation capacity of the economy, which however was dramatically disturbed by the crisis of 1997. The most dramatic shock after the crisis among the East Asian countries has been in Korea, where unemployment rate has increased from 2.6% in 1997 to 7.0% in 1998. The same trend has also been valid for Chile, who has been experiencing an increase since 1994 and particularly since 1998 after a continuous falling trend during the 1980s and 1990s. In most countries after the crisis, unemployment goes on increasing for two years. In Turkey for three years, and in Philippines, Malaysia and Indonesia for six years after the crisis, the increase is still going on. Since the crisis of 1997 and 2000s, in no country the unemployment rates have returned to the pre-shock levels as of now.

3.2. Distribution, Unemployment and Growth Pattern

In this Section the effect of the growth regime of neoliberal globalization on distribution is discussed. The estimations results are presented for a model, where the percentage change in the wage share in manufacturing is estimated as a function of growth (current and lagged), nominal depreciation rate of the currency (current and lagged), and its own lag[6]. The theoretical background of the basic model estimated here is discussed in Onaran (2005). This equation to be estimated here is a reduced form derived from a model, where distribution is jointly determined via wage bargaining by workers, price setting by firms, and improvements in productivity. The price setting behavior also includes the imported inputs, where the pass through effect of the depreciation of the local currency also becomes important.

[6] Due to the existence of unit root in the wage share, and the explanatory variables, we use them in first difference form. In this and the following regressions that will be reported below, the estimation period is determined by data limitations, unless otherwise stated. Different from previous empirical work cited above, which relies on pooled panel data estimations for sub-groups of countries, based on income groups or regional entities, this study performs separate estimations for each country. The estimation technique used is a Seemingly Unrelated Regression (SUR) model, and the coefficients of the explanatory variables as well as constant terms are heterogeneous across countries. The advantage of this methodology is that it allows for cross-country heterogeneity, and is able to analyze empirical regularities within the context of heterogeneity. SUR estimation allows for common international shocks, not captured by the country specific explanatory variables, eg. an international crisis like the Asian crisis, to have effects on the dependent variable via the correlation of the country specific residuals. However, the disadvantage is the shortness of the time series limiting the degrees of freedom. The SUR model is estimated using estimated contemporaneous correlations between country specific error terms, $\hat{\sigma}_{ij}$ from a first-stage pooled OLS regression. In the case of unbalanced data, the covariance terms are down-weighted by dividing with the maximum of the number of observations. Provided that the number of missing values is asymptotically negligible, this approach yields a consistent estimator of the matrix of contemporaneous correlations that is generally invertible.

Table 2 shows the results of this regression. The wage share does not have any cyclical behavior (at conventional levels of significance) with respect to the current value of growth in more than half of the countries, whereas in Argentina it has a pro-cyclical pattern, and in three (Chile, Malaysia, and Thailand) a counter-cyclical pattern. The lag of growth is positively and statistically significantly related with wage share in five countries (Argentina, Chile, Malaysia, Mexico, and Thailand), and negatively related in Indonesia. The lagged value of the wage share is significant and negative in Chile, positive in Mexico and Turkey, with the degree of persistence ranging between 0.10 and 0.39. Although lagged dependent variable is mostly insignificant, however, it is important in preventing the problem of autocorrelation. We do not try further lags due to problems of degrees of freedom.

Nominal depreciation has the expected negative significant effect on wage share in six out of ten countries (Argentina, Chile, Indonesia, Korea, Mexico, Turkey), and in three of these countries (Argentina, Chile, Turkey) the lag of nominal depreciation is positively significant, indicating that a change in the rate of depreciation is the variable that reflects the pass through and unexpected inflation effect of a nominal depreciation. The economic significance of the negative effect of depreciation is ranging from a low level of -0.003 in Argentina, which has experienced many years of hyperinflation, and three digit rates of nominal depreciation, to a high level of -0.22 in the case of Turkey. In Indonesia the lag of nominal depreciation also has a significant negative effect, whereas in Philippines the lag has a positive significant effect. Be it due to the official devaluations of the early stages of liberalization or the market made depreciations after financial crises, there is a clear trade-off between rate of depreciation and the wage share. Given that developing countries are import dependent, a depreciation, which creates an increase in the price of the imported goods generates an important increase in overall input costs. Depending on the balance of power relations, the increase in input costs is mostly offset by a decline in labor costs. Similarly, the reverse is also true, during episodes of capital inflow, and appreciation of the currency. However, these episodes are sooner or later disturbed by the increased current account deficits and fragility in the economy leading to crisis, as the regular practice after capital account liberalization.

If we interpret these results for a crisis year, the cause of the decline in the wage share during a crisis is explained by mostly the dramatic rates of nominal depreciation (Argentina, Chile, Indonesia, Korea, Mexico, Turkey). The persistence of the decline in the wage share is mostly related to the lagged effect from either growth or past year's decline in the wage share, or to the lag of nominal depreciation as in the single case of Indonesia.

The result that the decline in economic activity during the year of the crisis not having a direct significant effect, other than in two countries, raises two questions: Is the result robust when nominal depreciation is not included? In the simplest specification with only growth (current and lagged), and lagged wage share, current growth has a positive significant effect in Indonesia, Mexico, and Turkey as well. Thus after controlling for nominal depreciation, the effect of growth is not significant any more in these countries. To put it differently, during a crisis, most of the shock is captured by nominal depreciation.

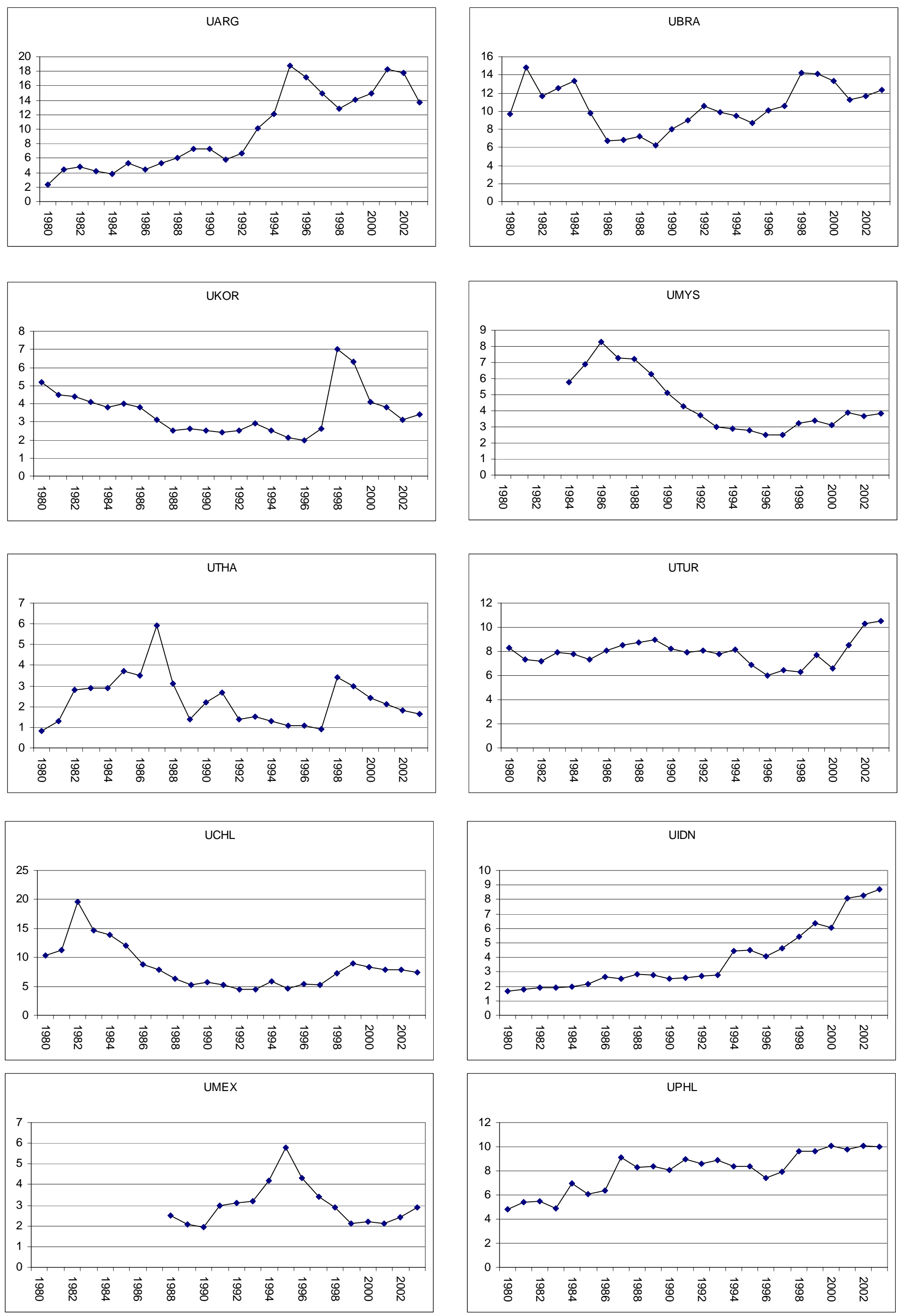
Table 1. Stylized Facts

		Argentina	Brazil	Chile	Indonesia	Korea	Malaysia	Mexico	Philippines	Thailand	Turkey
		Growth in Manufacturing Value Added %									
1970-79	Mean	1.91	9.55	1.37	12.82	17.92	11.43	6.44	6.55	11.46	6.11
	Volatility	3.32	0.47	8.22	0.34	0.32	0.49	0.45	0.50	0.35	0.93
1980-2003	Mean	0.23	0.96	3.58	9.50	8.82	9.13	2.81	2.15	8.23	5.34
	Volatility	35.06	6.20	1.77	0.77	0.75	0.87	1.82	2.04	0.81	1.15
		Wage Share in Manufacturing Value Added									
1970-79	Mean	25.07	30.49	42.85	24.28	34.91	27.51	55.22	11.44	20.27	30.71
	Volatility	0.23	0.09	0.28	0.07	0.09	0.06	0.04	0.21	0.14	0.17
1980-2003	Mean	16.54	29.47	34.59	20.79	41.83	26.94	34.06	13.32	31.16	20.29
	Volatility	0.21	0.10	0.10	0.12	0.08	0.09	0.20	0.15	0.16	0.21

Table 2. Estimation Results [1]

	Argentina		**Brazil**		**Chile**		**Indonesia**		**Korea**	
	Coefficient	*Prob.*	*Coefficient*	*Prob.*	*Coefficient*	*Prob.*	*Coefficient*	*Prob.*	*Coefficient*	*Prob.*
Constant	-3.460	0.168	-0.577	0.720	-0.105	0.971	11.029	0.000	-0.483	0.708
growth t	0.465	0.039	-0.185	0.267	-0.482	0.077	-0.172	0.363	0.157	0.095
growth t-1	0.723	0.002	0.219	0.156	0.513	0.053	-0.581	0.002	0.047	0.595
dws t-1	-0.045	0.701	0.069	0.619	-0.394	0.020	-0.144	0.291	0.126	0.310
nominal depreciation t	-0.003	0.101	0.000	0.886	-0.069	0.001	-0.132	0.000	-0.172	0.002
nominal depreciation t-1	0.008	0.000	-0.001	0.653	0.068	0.000	-0.065	0.048	-0.082	0.186
R2	0.239		0.057		0.351		0.503		0.501	
	Malaysia		**Mexico**		**Philippines**		**Thailand**		**Turkey**	
	Coefficient	*Prob.*	*Coefficient*	*Prob.*	*Coefficient*	*Prob.*	*Coefficient*	*Prob.*	*Coefficient*	*Prob.*
Constant	0.281	0.859	-1.551	0.416	-5.544	0.370	3.187	0.189	5.780	0.274
growth t	-0.284	0.002	0.209	0.411	0.682	0.411	-0.333	0.081	-0.539	0.146
growth t-1	0.177	0.081	0.376	0.113	0.303	0.644	0.317	0.069	0.303	0.383
dws t-1	0.065	0.628	0.280	0.075	-0.121	0.273	-0.036	0.807	0.393	0.013
nominal depreciation t	0.045	0.576	-0.102	0.002	0.128	0.578	-0.200	0.141	-0.216	0.000
nominal depreciation t-1	-0.042	0.622	0.044	0.206	0.433	0.099	-0.032	0.803	0.112	0.096
R2	0.365		0.467		-0.015		0.086		0.257	

[1] Estimation Method: Seemingly Unrelated Regression; Sample: 1972 – 2003; Included Observations: 32; Total System (Balanced) Observations: 320; Dependent Variable: Percentage Change in the Wage Share in Manufacturing (dws).



Note: See text for detailed notes on data. The country codes are indicated next to the abbreviation WS.

Figure 3. Unemployment rate (U).

The second question is related to the stability of the coefficient of growth: Is there a change in the cyclical pattern of distribution in time? There seems to be no statistically significant break in this relation in the post-1980s, as the slope dummy for 1980s for growth is insignificant for all countries[1]. However, there can be a break in the cyclical behavior of labor's share during the crisis periods, which is not reflected in the normal years. To address this question, the normal years vs. recession years are separated in the basic model, which is reported in Table 3[2]. The coefficient of growth during a recession year is positive in Indonesia, Malaysia, Mexico, and Turkey, indicating that wage share is pro-cyclical during a crisis, with the decline in the change in the wage share ranging between 1.4% (Malaysia) to 7.8% (Turkey) for a 1% decline in growth. The recession intercept dummy, on the other hand, is insignificant in all countries other than in Philippines where it has a negative sign. When the recession dummy is not included, also in Argentina, the wage share is pro-cyclical during a recession, although there is no response during normal years. When the nominal depreciation is not controlled for, wage share is pro-cyclical during a crisis in Korea as well, whereas in Philippines the wage share has a counter-cyclical character during a recession. The results are also robust when the high vs. low growth years are differentiated. These findings are different from Diwan (2001), who performs separate estimations for crisis and non-crisis years for a panel of countries, and argue that labor's share is pro-cyclical during non-crisis years, and counter-cyclical during crisis years. This result might be due to problems associated with pooling a heterogeneous group of countries (even in the sub-sample of poor vs. rich countries), defining the crisis based on nominal depreciation rate greater than 25% rather than recession years, and dividing the time series, rather than comparing the coefficient shifts within the data.

Clearly aggregate demand deficiency and adverse price shocks associated with currency crises in the 1980s explains part of the decline in the wage share. Next, the effects that are related to neoliberal globalization are interpreted.

3.3. Economic Policy and their Effects on Distribution

The policy choices about budget expenditures reflect clearly how the state is involved in the class struggle during the era of neoliberal globalization. Figure 4 shows the share of wages and interest payments in government expenses. The share of wages in government expenditures has a general declining trend: in Chile and Korea since 1980s, in Brazil, Mexico and Turkey during early 1980s and once again in 1990s with a period of relative increase in between, and in Argentina, Indonesia, Malaysia, and Thailand since late 1980s or early 1990s. The crisis episodes in Mexico, Turkey, Indonesia, and Thailand mark additional sharp decreases. As the share of wages in government expenses contract, the share of interest payments increases in most cases. Real interest rates hike up in all cases of crisis and in some

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[1] We also failed to find a significant negative trend in the wage share estimations, which is consistent with the results of Lee and Jayadev (2005) for upper middle income developing countries, but different from Diwan (2001).

[2] The variable "contraction of GDP during a recession" is growth of GDP multiplied by a dummy variable for recession years, which is defined as a decline in manufacturing value added, which in all cases also correspond to a decline in GDP or per capita GDP. Wald tests are carried out for the joint significance of the sum of the coefficient of growth and the slope dummy for the rate of contraction in recession years. An intercept dummy for the recession year is also included.

situations like in Turkey or even in the strong economy of Korea they stay at a higher plateau for a long time. Even when the crisis does not directly affect the country, as in the case of Chile, Mexico and Turkey during the Asian crisis, interest payments still increase for a while. While the demands of international and domestic borrowers are met, wages and social expenditures and investment have to take their shares of budget cuts.

In a study for OECD countries, Epstein and Power (2003) report that in Turkey, Mexico and Korea, the share of the rentier in national income has increased following periods of financial liberalization; but this increase has not come at the expense of profit shares accruing to non-financial corporations, suggesting that there is a material basis for unity, rather than rivalry, between industrial and financial capital. This result obviously is related to the decline in labor shares, which compensate for the increase in financial costs for industrial firms. Evidence also suggests that industrial firms also find the chance to increase their returns from financial activities. When the change in wage share in the economy is regressed on the change in the share of interest payments in total budget expenditures or the real interest rate (current and lagged) for the post-1980 period[3], the results indicate that financial liberalization, either through the increase in interest expenditures of the government or a general increase in the real interest rate, has a negative effect on the wage share in seven out of ten countries (Argentina, Indonesia, Korea, Malaysia, Mexico, Thailand, and Turkey).

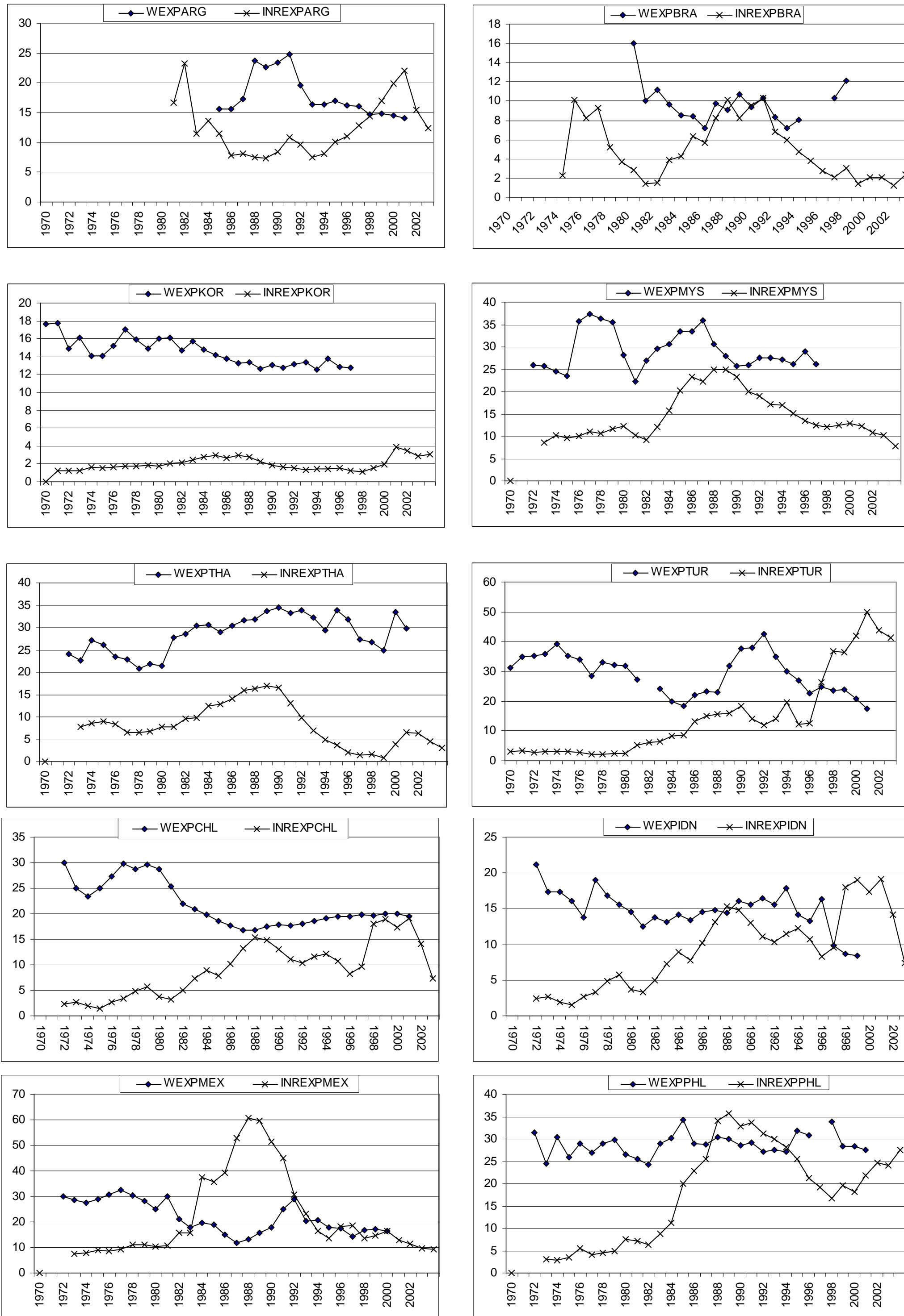
On the other side of the medallion, fiscal contraction creates further negative effects on wages, apart from its direct effects through reduced demand, further supporting the argument that the composition of demand is important. The change in the ratio of the government final consumption expenditure to GDP has a positive effect on the change in wage share in seven (Brazil, Chile, Malaysia, Mexico, Philippines, Thailand, Turkey) out of ten countries.[4].

The expected positive effects of openness and liberalization on labor's share also have not been realized. Export boom in manufacturing has basically had either no, or negative effect on labor's share[5]. Exports fail to deliver the expected positive effects even in East Asian countries with a strong industrial policy as well. The import intensity on the other hand has a negative effect only in Argentina and Chile. However in the case of exports and imports, the coefficient homogeneity test cannot be rejected for both lags of exports, as well as the second lag of imports. When the estimation is repeated for the restricted specification with homogenous coefficients, the first lags of both variables are insignificant, but the second lag of the change in export intensity is negative, whereas the second lag of the change in import intensity is positive. The joint significance test for the two lags indicates a negative effect of exports, and no significant effect of imports. The results are robust, even when the nominal depreciation or even growth and lagged wage share is not controlled for. Thus, as the results without the growth variable shows, the negative effects of exports dominate the positive growth effects.

[3] The estimation results are available upon request.

[4] The estimation results are available upon request.

[5] To avoid endogeneity problems, the foreign trade variables are introduced in lagged form (two lags are used). When we look at the joint significance of the first and the second lag of the export intensity, in four countries (Brazil, Mexico, Philippines, and Turkey) the increase in the export intensity of the manufacturing industry has a negative effect on the change in the wage share. The estimation results are available upon request.



Note: See text for detailed notes on data. The country codes are indicated next to the abbreviation WEX for the share of wages and INREXP for the share of interest payments in government expenses.

Figure 4. The share of wages (WEX*)) and interest payments (INREXP*) in government expenses (%).

Table 3. Estimation Results[1]

	Argentina		Brazil		Chile		Indonesia		Korea	
	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.
constant	0.833	0.885	-1.162	0.637	2.049	0.638	9.121	0.000	-1.294	0.348
growth t	-0.043	0.951	-0.250	0.366	-1.132	0.088	-0.334	0.093	0.176	0.111
growth*recession dummy	0.789	0.438	-0.023	0.976	1.324	0.101	5.041	0.003	0.762	0.274
recession dummy	-2.115	0.788	0.438	0.927	4.407	0.507	8.390	0.119	3.908	0.253
growth t-1	0.587	0.039	0.339	0.079	0.689	0.009	-0.427	0.011	0.081	0.421
dws t-1	-0.017	0.891	-0.012	0.936	-0.420	0.022	-0.124	0.301	0.157	0.295
nominal depreciation	-0.003	0.092	0.000	0.920	-0.080	0.001	0.046	0.554	-0.155	0.021
nominal depreciation t-1	0.007	0.001	0.000	0.927	0.082	0.000	-0.028	0.344	-0.068	0.303
R2	0.257		0.059		0.367		0.649		0.538	
	Malaysia		**Mexico**		**Philippines**		**Thailand**		**Turkey**	
	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.
constant	3.971	0.015	-4.274	0.206	-0.080	0.991	3.895	0.134	13.691	0.046
growth t	-0.632	0.000	0.354	0.448	-0.456	0.652	-0.373	0.059	-1.419	0.016
growth*recession dummy	2.047	0.000	1.626	0.084	-1.590	0.403	0.132	0.852	9.260	0.033
recession dummy	2.379	0.574	7.306	0.106	-17.408	0.065	-3.034	0.506	41.284	0.154
growth t-1	0.240	0.005	0.574	0.028	0.497	0.469	0.277	0.153	0.340	0.324
dws t-1	0.003	0.983	0.249	0.133	-0.021	0.865	-0.019	0.901	0.381	0.012
nominal depreciation	0.338	0.001	-0.079	0.016	0.142	0.617	-0.127	0.426	-0.223	0.000
nominal depreciation t-1	-0.006	0.935	0.053	0.170	0.363	0.251	-0.025	0.880	0.113	0.080
R2	0.581		0.545		0.004		0.126	0.377	0.377	

[1] Estimation Method: Seemingly Unrelated Regression; Sample: 1972 – 2003; Included Observations: 32; Total System (Balanced) Observations: 320; Dependent Variable: Percentage Change in the Wage Share in Manufacturing (dws).

Table 4. Estimation Results[2]

	Argentina		**Brazil**		**Chile**		**Indonesia**		**Korea**	
	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.
Change in unemployment	0.594	0.107	0.269	0.363	0.990	0.002	0.622	0.000	1.269	0.000
growth t	-0.153	0.000	-0.235	0.000	-0.325	0.000	-0.037	0.008	-0.147	0.000
dws t-1	-0.025	0.251	-0.022	0.537	0.084	0.109	0.007	0.456	-0.093	0.000
R2	0.344		0.477		0.641		0.115		0.702	
	Malaysia		**Mexico**		**Philippines**		**Thailand**		**Turkey**	
	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob.
Change in unemployment	0.363	0.026	0.419	0.021	0.278	0.137	0.730	0.013	0.136	0.448
growth t	-0.047	0.000	-0.095	0.002	-0.016	0.603	-0.084	0.001	-0.028	0.172
dws t-1	0.020	0.457	0.018	0.332	-0.014	0.118	0.014	0.693	-0.015	0.125
R2	0.440		0.471		0.094		0.212		0.091	

[2] Estimation Method: Seemingly Unrelated Regression; Sample: 1980 – 2003; Included Observations: 24; Total System (Balanced) Observations: 219; Dependent Variable: Percentage Change in Unemployment.

In terms of the other promising tool of international liberalization, foreign direct investment (FDI, in first difference form), there is sign of a positive effect only in Brazil and Malaysia. However, the joint significance tests for the two lags of the change in FDI indicates a negative effect for four countries (Chile, Indonesia, Mexico, Philippines), and a positive effect for Malaysia[1].

These stylized facts demonstrate the pro-capital role played by nation states in the meantime. Crotty and Lee (2004) emphasize the importance of the crisis episodes for facilitating the radical neoliberal restructuring which could not be achieved through democratic process under normal economic times. Right after the crisis, the conditions of the IMF are usually accepted, and the initial bail out credit to save international firms arrives. Public debt increases as guarantees to the financial systems and large firms are satisfied and running primary surpluses becomes the major duty of nation states. Privatization, mostly in the form of a cheap sell out to foreign capital supplies the additional resources for the country to pay back its ever growing debt. The ideological discourse about the so-called inefficiency of the state is supporting this process and further arresting the social expenditures and state investments. Since governments choose or are obliged to choose not to raise taxes or default on their creditors sufficiently, public deficits end up being paid by labor. In the meantime, public wages are adjusted. Declines in private sector wages follow as the fear of job loss grows due to possible downsizing or bankruptcies. Organized employers push labor unions to accept dramatic wage cuts or compulsory unpaid leaves to avoid job losses. Eventually profits are restored and when the crisis is long past, it is the working masses, who have carried the burden of adjustment. The crisis also creates a hysteresis effect destroying the bargaining power of labor for a long period. Eventually, the growth potential of the economies is deteriorated due to increased fragility, volatility and lower investment, with further adverse effects on labor.

3.4. The Effects of Neoliberal Economic Policy and Globalization on Employment

The fact that the rate of unemployment has been increasing in countries, where wage share has been decreasing, is pointing at the weakness of the demand side of the labor market to generate new jobs simply based on cost cutting. The export-led industrialization strategy has so far failed to deliver its promises in terms of creating jobs. Although the share of manufacturing exports from developing countries has risen dramatically, the rate of increase in industrial employment has decreased in some leading exporter countries like Brazil, Mexico, Turkey, Korea, Malaysia, Philippines and decreased in absolute terms in the case of Argentina. When all developing countries try to implement the same export-led strategy, some countries just fail, since not every one can be the winner. As competition becomes fiercer, either the capital intensity of production increases via new investments in the case of many East Asian countries, or labor shedding becomes a general tendency in some other countries like in Latin America. Under deepening competition lower real wages do not suffice

[1] The joint negative effect of a 1 percentage point increase in FDI/GDP for the past two years is ranging from -2.4% (Chile) to 8.9% (Mexico). For the other countries it is not possible to verify either the wage dumping effect or the promised positive effect. The Wald test also indicates that the coefficients of both lags of FDI are heterogeneous across countries. The results are robust when inflow of FDI is used instead of net FDI. When nominal depreciation is not controlled for, the second lag of the change in FDI also has a negative effect in Thailand. Moreover, these results are robust to the exclusion of growth. The estimation results are available upon request.

to generate more jobs in export industries. An analysis for the apparel industry, which is the ultimate export industry for developing countries, shows that there is no statistically significant relationship at all between real wage and employment growth in 45 OECD and non-OECD countries (Pollin et al, 2004).

As high unemployment rates suppress real wages, the decline in the share of wage income contributes to the aggregate demand deficiency, making it worse for job creation capacity of the economy. When the change in unemployment rate is regressed on GDP growth and the first lag of percentage change in the wage share for the period of 1980-2003[2], in 8 out of ten countries growth has a significant effect in the expected direction on unemployment (except for Philippines and Turkey), whereas the change in the wage share has no significant positive effect (i.e. an increase in the wage share resulting in an increase in unemployment rate) in any of the countries. The estimation results are in Table 4. Moreover, in Korea, wage share has a significant negative effect on unemployment. So as opposed to what neoclassical theory claims, the lower wage share has a statistically much less reliable effect on unemployment, and unemployment is primarily driven by the goods market conditions, as suggested by Keynesian economics[3]. A change in the wage share has no positive effect on unemployment.

4. Conclusion: Is there a Way out for Labor?

Neoliberal policies have failed and will fail to deliver their promises in terms of creating jobs and a fair return to labor. In the majority of the countries, aggregate demand deficiency explains the decline in the wage share, and the rise in unemployment. The expected positive effects of openness and liberalization on labor's share through exports have not been realized, and quite contrary have either resulted in negative bargaining pressures over labor or have been outweighed by the effects of nominal depreciations. In the case of FDI, there is either negative or no significant effect. The fiscal contraction and financialization have also intensified the downward pressure over the wage share in the majority of the countries.

The durability of the neoliberal paradigm is obviously in doubt. The slogan of "TINA" (There is no alternative) is worn out, but there still is some time until the majority of the population in those countries can unite and say: "Another world is possible." The policy tools for preparing the ground for building an alternative economy for people and not for profits would range from financial market regulations at domestic and international level, to labor market regulations, industrial policy, international trade regime, fiscal policy and debt "management".

A lot is said about financial market regulations, when alternative policies targeting stability are discussed. At the national level interest ceilings, capital adequacy requirements, margin requirements on stock trading, requirements limiting the composition of loans, and at the international level capital controls are the most widely discussed tools (Pollin, 2002;

[2] Due to the existence of unit root in unemployment rates and wage share, we use them in first difference form. Moreover, to avoid the problem of endogeneity, the first lag of the change in wage share is used, since changes in unemployment rate may also affect the wage share. In this and the following regressions that will be reported below, the estimation period is determined by data limitations, unless otherwise stated.

[3] Onaran and Stockhammer (2004) based on a structural VAR model for Korea and Turkey, show that employment react strongly to investment and changes in capacity utilization, whereas cost of labor has no effect.

Akyuz, 2000; Crotty and Epstein, 1999). Even IMF officials, or some mainstream economists like Krugman, or the Economist (see Cook, 2003) argue that some sort of capital controls may be the least damaging way out of the crisis. The Tobin tax on foreign exchange transactions are usually seen as an efficient way of raising the costs of short-term speculative trading, while not affecting much the long term capital flows. Radical economists suggest a more extensive regulation, and the extension of Tobin tax to include all financial transactions via a so-called Keynes tax (Crotty and Epstein, 1999; Pollin, 2000). An alternative financial policy also requires international coordination beyond capital controls. They emphasize the need to construct global institutions that would support progressive national programs. Eatwell and Taylor (2000) suggest a new Global Financial Authority. Arestis and Glickman (2002) suggest that a revamped IMF/World Bank could be the counterpart of a "big government" or "the big bank" in an open economy. Crotty and Dymski (2000) rightly emphasize that capital controls are not enough for creating a global economic environment for long term, sustainable, egalitarian, high-employment growth in both the North and the South.

Obviously these regulations would supply a wide area of maneuver for governments to direct macroeconomic policy towards employment creation, welfare state or redistribution programs. However, the role of the market rules, and the scope of national financial institutions are left as open questions. Little is said particularly about the nationalization of the financial system, which is vital for directing resources to the priorities of an industrial strategy. Taking a clear position against the so-called central bank independence is also vital in order to have full control over the policy tools.

On the real side of the economy an alternative macroeconomic policy framework has to target employment, redistribution of income in favor of labor and a decent supply of social services. A public investment-led expansion is the core tool of such a strategy. This would not only generate demand, but would also promote longer-term productivity growth in critical industries. This strategy is in striking contrast to the existing mania of inflation targeting.

The international dimension of such a policy requires a selective trade policy, which would serve the interests of a strategic industrial policy based on priorities. There needs to be a new line for promoting exports via productive investments. Such a policy of export promotion could also make international competitiveness compatible with an expanding domestic market thanks to high wages and employment. The other important international component is to found new global institutions with an aim to coordinate and synchronize expansion as an alternative to beggar may neighbor policies. Pollin (2002) discusses that such an international coordination would also help to manage the inflationary effects and import leakages associated with expansionary employment targeting macroeconomic policy, and would create a foreign demand multiplier effect for all countries involved. The international coordination is also important in building a new tax policy, to prevent the race to the bottom to attract or keep investment. The synchronization of capital and corporate taxation is a complementary suggestion to the international taxation of financial flows, regarding the real side of the international capital movements.

There is also need for a totally new line of labor market policies, in order to enable working people to benefit from growth, a revitalization of labor market regulations, the establishment of a decent minimum standard for a living wage, improving the workplace conditions and the right to organize are obviously necessary. Also in the short run, in order to create new jobs the shortening of the working hours without deterioration in wages is

required. Unfortunately less focus is made on this issue[4]. This is vital, because not only the demand side macroeconomic policies require a certain time lag to be effective, but also it improves the working conditions, and last but not the least creates the time needed for workers to participate in the decision making process and political life.

Obviously, this alternative line of macroeconomic policy requires a full mobilization of the resources of the society to generate more jobs under better conditions. However, building an alternative is impossible without radically solving the problem of domestic and international debt burden, which is channeling the productive resources and wealth created by working masses to the domestic and international financial headquarters[5]. The recent debt default of Argentina demonstrates that the IMF, as well as the lenders can be pushed to the defensive side with decisive steps. The popular pressure, as well as the national conglomerates troubled with high debt service in Argentina has pushed the government to resist the IMF, whereas the lack of such a pressure in Turkey has made it the favorite example of Anne Krueger for the case of a country which pays its debt regularly while it still continues to grow, even if at the cost of working people's life standards. Debt stand stills and orderly debt work-outs were discussed as part of post-crises management within the context of debates to build a new international financial system after the Asian crisis; however there has been wide spread resistance against such measures from the headquarters of finance (Akyuz, 2000). The bankruptcy scheme for the heavily indebted countries, which was backed by the IMF's deputy manager, Krueger, was also rejected by the US Treasury under the pressure of the Wall Street. Obviously, a unilateral default organized by a cartel of indebted countries, rather than a case by case bargaining to each country, could break this resistance. The solution of international debt must also be accompanied by a solution to domestic debt. A progressive wealth tax over the ownership of government debt instruments would provide the opportunity to default on a significant part of the debt held by institutional investors, while only taxing the individual savings[6].

Obviously any policy suggestion requires a clarification of the alliances, which are required for the persuasion of this agenda. The possible alliances in theory include everyone who is hurt by neoliberal policies, ranging from workers to domestic oriented capital. But the big question is whether there exists such a group of capitalists, whose interests would require an alliance with workers? Or would they prefer to support the big international capitalists and their domestic partners with anti-labor policies, while provoking a nationalist and regressive

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[4] See Bosch and Lehndorff (2001) for a review of the collective working time reductions in Europe over the past 20 years. They report that most empirical studies show positive employment effects, but the institutional conditions under which the working time reductions occur are of particular significance.

[5] The governments, which avoid taxing capital found themselves indebted, and as the international debt mountains, they resort to domestic debt to finance their Ponzi scheme. In the meantime, in some other countries, the private sector's international debt fuels growth, and when credibility of the firms collapses, the governments are obliged to nationalize the debt. As far as the international debt is concerned, indeed developing countries had already paid a significant amount of the international debt before the hike of the interest rates in 1980. However, today developing countries are still three times more indebted than in 1982, because of the high interest rates since the 1980s (Toussaint, 1999). In the meantime the debt has changed composition with a shortening of maturity and with a shift of the source towards international banks from states, which changed the bargaining power at the expense of the indebted countries. This shift becomes clearer when the consequences of the debt crises in the 1980s are compared to the debt crises of 1930s in Latin America, when the numerical importance of individual bond holders with little bargaining power made extensive defaults possible, which were followed by active industrial policies (Thorp, 1998).

[6] This proposal had taken place in the macroeconomic policy suggestions of UNCTAD for EU member states in 1995.

rebellion via misdirecting and exploiting the discontent of the poor? Apparently the pro-labor line of the agenda outlined above will quite from the beginning conflict with those of the inner-oriented circles of small scale capitalists. A good example is the right wing conservative government of Turkey, who owes its power to dissatisfied workers, as well as the unemployed immigrants in the cities, but has been combining an anti-labor stance with an outward oriented policy in terms of foreign policy to meet the needs of the large scale capitalists, and in the meantime has been trying to support the redistributive struggle of a new emerging group of capitalists, who are trying to increase their domestic and global market share.

Given the power of the global capitalists today, the national consensus, which was specific to the unique historical conditions of the "Golden Age" cannot be repeated once again, not even under new national or international institutions. The realization of the pro-labor demands would soon start threatening the limits of the capitalist system of production based on private property rights. Thus the cross roads will be reached sooner or later and the social change will be determined by not only the domestic balance of power structures but also international conditions. The only possible alliance for the macroeconomic policy agenda outlined above is among different segments of the working class, including the unemployed. Most recently, in the middle of a violent crisis Argentina was the stage for cases of within class solidarity and self-organization, ranging from the self-management of workers in bankrupt factories to solidarity networks between the unemployed and the neighborhood and factory committees, which have flourished (Cockcroft, 2003). Obviously changing the balance of power relations for creating an alternative is not impossible, but hard. For example, the Argentinean experience has failed to transform itself in the short run to a struggle for power (Lucita, 2003); neighborhood committees lost importance in the meantime; the number of self-managed firms remained limited and open to reclaims of the ex-owners; the movement of the unemployed has been co-opted into government work projects at poverty wages (Hearse, 2004). Similarly, Zapatistas in Mexico have been facing the limits of social transformation even after creating their own self-organized space. In the neighboring country, Brazil, the left wing Workers` Party, in spite of a strong past in grass-roots struggle, is isolated and surrounded by the threat of international finance, and is compromising to pass laws awaited by the liberals, such as the independence of the Central Bank, in spite of the critiques from within the government party (Machado, 2003). Nevertheless, the Venezuelan and Bolivian experience is teaching us that another direction is possible, if the self-organized, radicalized people are strong enough to push for a change.

This shows that, although nation state is an effective means of pushing for reforms, international coordination and synchronization is absolutely vital for a permanent change. The effort of Brazil to find ways of revitalizing MERCOSUR, or Vernezuella, Bolivia. and Cuba building ALBA (Bolivarian Alternative for the Americas) as opposed to ALCA (Free Trade Area of the Americas) hints at various possibilities. International coordination among the political organizations and trade unions in the developing countries as well as in the advanced capitalist countries can at least create a larger area of maneuver for a decisive alternative movement of the working people. The initial examples of such a front exist in the numerous international organizations and actions like the "50 years enough" campaigns against the Bretton Woods organizations, the Committee for the Cancellation of Third World Debt, ATTAC, the World Social Forum and world wide protests, which have gained regularity.

Hope is out there, even if there is a long way to go to generate strong institutions for simultaneous and decisive action.

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Chapter 11

SOCIOECONOMIC EFFECTS OF ECONOMIC CRISES: A COMPARATIVE ANALYSIS OF THE EXPERIENCES OF INDONESIA, ARGENTINA AND TURKEY[1]

Fikret Şenses and Murat Koyuncu

1. INTRODUCTION

Since the early 1990s, many developing countries have experienced economic crises following the liberalization of their capital accounts. These crises, often caused by the volatility of short term capital movements have had far-reaching effects, spreading from the financial sector to the real sector and then to socioeconomic indicators. The crises in individual countries have also had adverse effects in other countries, threatening the stability of the whole international financial system. 1994 Mexican, 1997 East Asian, 1998 Russian, 1994 and 2000-2001 Turkish and 2002 Argentinean crises have attracted the most attention in this respect.

The vast literature on economic crises has mainly concentrated on their causes and impact on the financial and the real sectors. The effects of crisis on income distribution, poverty, and the labor market, public expenditure on social sectors such as health and education, and indeed the whole social fabric of society which can be referred collectively as the socioeconomic effects have remained largely unexplored. The main objective of this study is to redress this imbalance in the context of three countries, Indonesia, Argentina, and Turkey, worst hit by economic crises in recent years.

Socioeconomic effects arise from a combination of many factors beyond those directly traceable to economic crises. Among these other factors the most noteworthy are the reaction of the public to the crisis and the attitude of domestic governments and key Bretton Woods institutions (BWI) like the World Bank and the IMF. These institutions which have played a major role in the neoliberal transition of a large number of developing countries during the past quarter century have often been in the forefront in the design of post-crisis economic

[1] This is a revised version of Koyuncu and Şenses (2004), published in Turkish.

programs. The fact that both Turkey and Argentina were caught in crisis in the midst of an IMF program makes it all the more important to examine the reaction of BWI.

Against this background, the study attempts to answer the following questions. What are the major socioeconomic effects of economic crises? What determines the magnitude of these effects and their pattern in different countries? Why is a comprehensive and active social policy package often missing from the post-crisis structural adjustment and stabilization programs? Which factors are likely to bring about a change in the attitude of domestic governments and the BWI toward more active social policies in the post-crisis setting?

Several factors have bedeviled our efforts to present a full account of the socioeconomic effects. Effects such as the deterioration of social relations, the rise in corruption and violence, despair and helplessness of individuals and society at large in the face of increasing dependency on external resources and institutions are not easy to quantify and document. The effects that are quantifiable, on the other hand, pertain to indicators for which available data is the most deficient. Finally, there is an acute lack of information about the relations between the countries in crisis and the BWI.

The study consists of five sections. In the following three sections, socioeconomic effects of the crises in Indonesia, Argentina and Turkey are analyzed in that order. The last section concludes.

2. Indonesia: From the Social Miracle to Social Explosion

Indonesia was regarded as one of the success stories of East Asia at the onset of the 1997 crisis. It had an uninterrupted growth record of 30 years, during which its GDP quadrupled. This was accompanied by a substantial improvement in socioeconomic indicators. Poverty rate fell from 70 percent in 1965 to 19 percent in 1996, and the illiteracy rate declined from 61 percent to 15 percent (Hill, 2000: 5, Table 1.2). The crisis in 1997 had a devastating effect on the economy and was responsible for the ensuing social explosion. Real GDP fell by 13 percent in 1998, manufacturing production declined by 34 percent and inflation rate jumped from six percent to almost 60 percent. Socioeconomic effects of the crisis were even more worrisome. As real wages plummeted, poverty rate doubled. There were riots, arson and looting all over the country, leading to the loss of more than one thousand lives.

This section first analyzes the socioeconomic effects of the 1997 crisis and then discusses the measures taken in response to it.

2.1. Socioeconomic Effects of the Crisis

2.1.1. Labor Market

The labor market has proven to be quite flexible in the face of the crisis with both wage employment and real wages declining drastically (Table 1). The flexibility of the labor market was attributed to the availability of considerable surplus labor and the absence of trade unions and protective labor legislation (Manning, 2000: 106). It seems that the labor market adjustment has taken the form of a rise in agricultural employment and non-wage employment rather than unemployment which increased only slightly from 4.7 percent in

1997 to 5.4 percent in 1998. In 1999, as the country started a fragile recovery, there was some improvement in employment and wage indicators.

Table 1. Labor Market Indicators, Indonesia, 1997-1999

	1997	1998	1999
Unemployment Rate (%)	4.7	5.4	6.3
*Real Wage Index**	100	68.0	75.2
Employment			
Agriculture	100	113.1	110.9
Industry	100	87.6	97.3
Wage Employment	100	94.5	96.4
Non-Wage Employment	100	106.8	107.8

*: For Manufacturing

Source: IMF (2002: 81, Table 2).

2.1.2 Income Distribution and Poverty

The crisis produced mixed results in this respect: While there was a sharp increase in poverty indicators, income distribution registered some improvement (Table 2). Tjiptoherijanto and Remi (2001: 11-12) suggest two factors to explain the improvement in income distribution. The first is that the crisis may have affected the modern-formal sectors in which the middle and high income groups are concentrated more than the traditional-informal sectors. The second factor is attributed to consumption smoothing by these very groups- an option not available to the poor already living at subsistence levels.

Table 2. Income Distribution and Poverty Indicators, Indonesia, 1996-1999

	Feb 96	Sep 98	Dec 98	Feb 99	Aug 99
Gini Coefficient	0.36	0.32			0.33
*Poverty (%)**	19.2	37.2	24.2	22.9	18.2
Poverty Severity Index (P2)					
Urban	0.85		1.27	0.93	0.74
Rural	1.06		1.48	1.18	1.17

*: Headcount ratio, using national poverty line

Source: Dhanani and Islam (2000: 12-13 and 19, Figure 3-4 and Table 6).

After rising sharply during the first year of the crisis, both the headcount poverty rate and the poverty severity index have returned to their pre-crisis levels by August 1999. Dhanani and Islam (2000: 15-16) underline the transient nature of poverty in this period and argue that the initial worsening was due to the 'inflation shock' in 1998. The reduction in inflation and the social protection measures introduced by the government have contributed to the rapid improvement in poverty indicators. The crisis seems to have had a more lasting effect on rural

households with the depth of poverty as measured by Rural Poverty Severity Index (P2)[2] remaining above its pre-crisis level.

2.1.2. Education and Health Expenditures

The impact of the economic crisis on public health and education expenditure was mild with only slight changes in the share of education and health expenditures in GDP and in consolidated government budget (Table 3). The share of education expenditure in government expenditure declined from 15.7 percent in 1997 to 14.1 percent in 1998. As a share of GDP, educational expenditure actually increased from 2.8 percent in 1997 to 2.9 percent in the following year. There were, however, slight declines in national enrolment rates of primary and junior secondary schools (Lanjouw, *et al.*, 2001: 14, Table 4). During the same period, the share of health expenditure GDP went up from a mere 0.5 percent to 0.6 percent, while its budget share remained constant at 3.5 percent.

The effect of the crisis has not been uniform for different sections of the population. The percentage increase in dropout rates of the poorest quartile of children in primary school and upper levels were three to five times worse than the richest quartile's (Frankenberg, *et al.*, 1999: 21-22, Table 1 and Table 2). For health, there was no major deterioration in the overall service quality and health status of children, except a decline in the use of health services by children under 15.

Table 3. Education and Health Expenditures of Indonesian Government, 1996-1998

	1996	1997	1998
Education Expenditure/GDP (%)	2.8	2.8	2.9
Education Expenditure/Government Expenditure (%)	15.4	15.7	14.1
Health Expenditure/GDP (%)	0.6	0.5	0.6
Health Expenditure/Government Expenditure (%)	3.1	3.5	3.5

Source: Lanjouw, *et al.* (2001: 57-58, Table A1 and A2).

2.2. Social Safety Net Programs

A distinctive feature of the Indonesian experience was the introduction of the Social Safety Net (SSN) programs as part of the government's social policy response to the crisis. These programs which were aimed to mitigate the negative socioeconomic effects of the crisis can be summarized under four main headings: food security, employment creation, education and health (Table 4).

[2] Developed by Foster, Greer and Thorbecke (1984), also known as FGT (α=2) index. This index measures the depth of poverty by taking the square of the distance between the income levels of the poor households and the poverty line.

Table 4. Social Safety Net Programs in Indonesia

Safety Net Area	Programs
Food Security	Sale of subsidized rice to targeted households
Employment	Job opportunities through labor-intensive work programs
Education	Targeted scholarships, and block grants to the schools in poor regions
Health	Subsidy program for health services and nutritional support for pregnant women and their children

Source: Sumarto, Suryahadi and Widyanti (2002: 6, 26, Table I and VI).

The government attached a great deal of importance to the SSN programs which in 1998 accounted for 5.6 percent of total government expenditures. The major component of the SSN programs was the rice subsidy program covering a massive 40 percent of the total population. It reached more than one half of the households in the first quintile, thus enabling the poor to buy the main staple of Indonesian people for a quarter of the market price (Sumarto, Suryahadi and Widyanti, 2002: 16). Tabor and Sawit (2001: 279) have estimated that the average monthly per capita transfer through the rice subsidy program has been around 10 percent of the average income of the poor households in 1998. Dhanani and Islam (2000: 17) have argued that the transfers through this program may have prevented 7 to 12 percent of households from falling into poverty. Although the other components of the programs had a relatively limited coverage with smaller benefits for the poor, SSN programs are regarded as having contributed significantly to the alleviation of the burden of the economic crisis on the poor (Dhanani and Islam, 2000: 17-18).

Another aspect of the SSN package that deserves further attention is its timing and the motivation behind it. Safety net measures under the package were put in action in mid-1998, exactly one year after the eruption of the economic crisis (Dhanani and Islam, 2000: 16). The social upheaval during that one-year period as prompted by the economic crisis reached massive proportions, claiming more than 1000 lives and leading to the resignation of President Suharto, who had been in power for the past three decades. One of the first actions of the new government which took office in May 1998 was the introduction of the SSN package. Pritchett, Sumarto and Suryahadi (2002: 19-20) have summarized the situation clearly: “The SSN programs were being designed literally in the shadow of burned out buildings and with ongoing protests and hence there was a desire to design programs that could generate political support”. Evidently, safety net programs were the direct result of the public reaction to the crisis and its effects.

Another point of concern in this respect is the attitude of the BWI which had a close relationship with the Indonesian government over the course of the crisis, especially in the design of post-crisis stabilization and structural adjustment programs. Official statements of the IMF[3] on Indonesia during the period from the beginning of the crisis to January 1998 do not include any comments on either the socioeconomic effects of the crisis or the policy measures designed to mitigate them. On January 15, at a time when public protests were gaining momentum, the IMF stated that if the government reallocated some of its budgetary expenditures of lesser importance to alleviation of the plight of the most vulnerable people in

[3] Official IMF statements (‘News Brief’s) on Indonesia are available at http://www.imf.org/external/country/idn/index.htm?type=9998#6.

the country, this would be approved by the Fund. Requiring the government to meet this spending on social safety nets without increasing its total expenditures already cut to the limit during a severe crisis, the IMF has made it clear that it was more committed to a balanced budget than to poverty alleviation. It was only when the new government introduced the safety net measures explicitly into the new Letter of Intent[4], IMF changed its attitude and approved the poverty alleviation package and the budget deficits that it would entail. The chronology of these events clearly shows that the change in IMF's attitude was prompted by the social explosion in the country and the new government's belated yet decisive approach to deal with it.

The World Bank's involvement in the SSN programs began only in mid-1999, a year after they were first introduced (World Bank, 1999: ii), and two years after the eruption of the crisis. Moreover, the amount of the loan, 600 million dollars, fell drastically short of coping with the gravity of the problem. For the 37.5 million Indonesians who were under the poverty line in 1999, this represented a meager 16 dollars per poor person. Its late response to the crisis and weak commitment to the poverty alleviation efforts of the government has shed considerable doubt over the World Bank's concern about the socioeconomic effects of the crisis in Indonesia.

3. ARGENTINA: MARCHING INTO SOCIAL CHAOS UNDER THE SUPERVISION OF THE IMF

In December 2001, Argentina drew the attention of the world with its deep economic and political crisis amidst widespread demonstrations and riots. Some have blamed the IMF-supported stabilization and structural adjustment program for pushing the country into a vicious debt-crisis-debt cycle (Dinerstein, 2001). Others have put the blame squarely on the government for not fully complying with IMF's directions (Mussa, 2002). Leaving aside the debate on who is responsible for it, the crisis marked the economic and social collapse of a country that had implemented BWI-supported stabilization and structural adjustment programs during the last quarter of a century, at different periods and with different intensities.

The main thrust of Argentina's story is the neoliberal Convertibility Plan which was implemented for 10 years, between April 1991 and December 2001, with the continuous support of the BWI. It is for this reason that the socioeconomic effects of the Argentinean crisis should be examined in longer term perspective against the background of the Convertibility Plan.

3.1. Socioeconomic Effects

3.1.1. Labor Market

The most pronounced effect of neoliberal reforms on the labor market was a rise in the unemployment rate which increased steadily from 6.5 percent in 1991 to 17.5 percent in 1995

[4] Letter of Intent dated June 24, 1998 is available at http://www.imf.org/external/np/loi/062498.htm.

and remained around 14-15 percent in the second half of 1990's (Table 5). Moreover, underemployment rate has followed a similar path and reached 14.6 percent in 2000. As the Argentinean economy had recorded positive growth rates during the 1990s, except 1995 and 1999, worsening of unemployment can be linked with certain aspects of the neoliberal transformation of the economy. Two main channels in this transformation were of particular importance. First, 150,000 workers, corresponding to 10 percent of the number of unemployed were laid off during the privatization of state enterprises (Altimir, Beccaria and Rozada, 2002: 77). Second, the production of large firms as the real force behind Argentina's export success was biased towards capital-intensive methods as the fixed exchange regime was instrumental in artificially cheapening imported capital goods (Pastor and Wise, 1999: 486).

Between 1991 and 2001, real wages increased in the formal sector and exhibited a declining trend with some minor fluctuations in the informal sector (Table 5). The increase in real wages in the formal sector can in part be explained by the historical bonds of labor unions with Menem's Peronist Party, which remained in office between 1989 and 1999, and in part by economic factors such as the rise in productivity (Pastor and Wise, 1999: 489). However, as productivity increased faster than wages, workers' share in national income declined during this period.

The crisis in 2001 had an adverse effect on both wages and unemployment. While unemployment rate increased by 2.3 percentage points and reached 19.7 percent, underemployment rate rose by 3.7 percentage points and reached 19.3 percent, in 2002 (Table 5). Meanwhile, real wages declined by 21 percent in the formal sector and by 34 percent in the informal sector. This sharp worsening of labor market indicators points to the devastating impact of the crisis on the working population.

Table 5. Labor Market Indicators, Argentina, 1991-2002

	1991	1993	1995	1997	1999	2000	2001	2002
Employment Rate (%)	6.5	9.6	17.5	14.9	14.2	15.1	17.4	19.7
Underemployment Rate (%)	8.3	9.1	11.9	13.2	14.0	14.6	15.6	19.3
*Average Real Wage-Formal Sector **	840**	957	939	944	976	979	970	769
*Average Real Wage-Informal Sector **	634**	643	576	603	561	529	549	363

*: For Greater Buenos Aires region, in 2002 Pesos.

**: Data for 1992.

Source: Unemployment data from the Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html; Real wage data from World Bank (2003: 12, Table 1.7).

3.1.2. Income Distribution and Poverty

The Convertibility Plan had a negative impact also on income distribution with the Gini coefficient increasing from 0.45 in 1990 to 0.53 in 2001 (Table 6). Top 10/Bottom 10 ratio, comparing the income of the richest 10 percent and poorest 10 percent of the population increased sharply from 21.6 in 1990 to 58.1 in 2001 and further to 85.5 in May 2002 in the immediate aftermath of the crisis. This was accompanied by a further increase in the Gini

coefficient from 0.51 in 2001 to 0.53 in May of the following year. As the economy began to recover after that point, there was a slight improvement in both measures.

Table 6. Income Distribution and Poverty Indicators, Argentina, 1990-2002

	1990	1992	1994	1996	1998	1999	2000	2001	2002-May	2002-Oct
Gini Coefficient	0.45	0.46	0.47	0.49	0.50	0.49	0.51	0.53	0.55	0.53
Top 10/Bottom 10 Ratio	21.6	22.0	24.6	35.3	35.2	33.8	39.6	58.1	85.5	43.8
Poverty Rate (%)	40.4	23.0	21.3	30.8	29.5	31.0	33.1	37.1	55.3*	
Extreme Poverty Rate (%)	11.3	4.7	4.5	8.7	7.8	8.6	9.3	12.6	26.2*	

*: Average annual data for 2002.

Sources: World Bank (2000: 3, Table 1) and (2003: 57, Table A.4), and ECLAC Online Database at http://www.eclac.cl/badestat/.

Note: Poverty rates are based on the Argentinean government's official poverty lines, which are as follows. Poverty Rate (Row 4) is based on the poverty line of $160 per male adult per month in 1998. Extreme Poverty Rate or Indigence Rate (Row 5) is based on the food consumption portion of the poverty line and was equal to $69 per month in 1998 (World Bank, 2000: 4).

Poverty figures in Table 6 show that poverty incidence in Argentina has improved sharply during the 1990-1992 period. However, this improvement was more a result of the taming of hyperinflation of the 1980s than deliberate poverty alleviation efforts of the government. Moreover, after 1994, poverty rate rose continuously and reached 37.1 percent in 2001 while extreme poverty rate tripled during the same period.

The effect of the 2001 crisis, however, was much more dramatic. In 2002, both the poverty and the extreme poverty rates hit historical highs, even surpassing the very high levels of 1990, the last year of the hyperinflation period. While the poverty rate rose by 18.2 percentage points to 55.3 percent, extreme poverty rate more than doubled, from 12.6 percent in 2001 to 26.2 percent in 2002 (Table 6). The crisis brought the majority of the population, nearly 21 million people, face to face with poverty with nearly 10 million people classified as extremely poor.

3.1.3. Social Sector Spending-Education and Health

Social sector spending of the Argentine government as a percentage of GDP was quite high and increasing during the Convertibility Plan period (Table 7). But this result needs to be qualified on both counts. With regards to its level one should take note of the fact that public spending on social sectors in Argentina includes social insurance spending. As the latter is financed mainly by its beneficiaries and not by the government, this spending category, representing around 39 percent[5] of total public social spending (PSS), exaggerates the actual level of PSS by a big margin. Likewise, given the high elasticity of PSS with respect to changes in GDP[6], the increasing trend of real PSS should be attributed mostly to the expansion of the Argentine economy during this period, rather than the government's

[5] The figure, calculated from Ministry of Economy and Production of Argentina data, represents the average for the 1991-2000 period.

[6] According to World Bank (2000:97), the elasticity coefficient for PSS for the 1980-97 period (1.3) was much higher than the coefficient for government expenditure (0.95).

commitment to socioeconomic problems. In fact, the procyclical characteristic of PSS was confirmed during the crisis when at a time it was most needed PSS decreased from 22 percent of GDP in 2001 to 17.1 percent in 2002 (Table 7).

Table 7. Social Sector, Education and Health Spending of Argentine Government, 1991-2002

	1991	1993	1995	1997	1999	2000	2001	2002
Public Social Spending/GDP (%)	17.1	20.2	21.2	19.8	21.6	21.2	22.0	17.1
Education Expenditure/GDP (%)	3.6	4.1	4.3	4.3	4.9	5.0	5.2	4.3
Health Expenditure/GDP (%)	4.3	4.6	5.0	4.5	5.1	4.9	5.1	4.4

Source: Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html

Both education and health spending as a percentage of GDP expanded throughout the course of Convertibility Plan (Table 7). Education spending/GDP ratio rose from 3.6 percent in 1991 to 5.2 percent in 2001. However, the situation worsened after the 2001 crisis; the ratio decreased to 4.3 percent in 2002. Considering the GDP itself has declined by 11 percent in 2002, educational expenditures plunged by 28 percent in absolute terms with obvious ramifications for the quality of education. Another factor of concern was that 72 percent of all households and 90 percent of poor households have reduced their spending on school materials after the crisis (World Bank, 2003: 20).

Public expenditure on health as a share of GDP increased during the 1990s, except for the 1996-1998 period, from 4.2 percent in 1990 to 5.1 percent in 2001, and then declined to 4.4 percent in the following year of crisis, representing a fall of 22 percent in real terms.

3.2. Social Assistance Programs

Argentina has been implementing social assistance programs targeted to poor families for over two decades. In 1998, there were 58 targeted programs in Argentina covering a wide range of areas including health, employment, training, education, shelter, clothing, and cash grants,[7]. Despite this thematic richness, the low level of funding combined with the politically manipulated, scattered and inefficient structure of programs prevented them from providing a reliable safety net for the poor. Table 8 shows that during the 1997-2001 period TSS contracted by a massive 13.2 percent in real terms. Seen in conjunction with the rise in the absolute number of people in extreme poverty, this has meant a fall in TSS per poor person by more than 50 percent after 1997 (Table 8).

Although TSS as a percentage of GDP rose after the 2001 crisis, its real level remained almost constant (Table 8). Since there was a sharp increase in the number of poor people during the crisis period, per poor person spending in the first year of the crisis declined further to one half of its level in 2001.

[7] See World Bank (2000: 152-162, Annex 1) for short contents of all of these 58 programs.

Table 8. Public Expenditure on Targeted Social Programs, Argentina, 1997-2002

	1997	1998	1999	2000	2001	2002
Targeted Social Spending/GDP (%)	1.6	1.6	1.4	1.5	1.5	2.4
Real Targeted Social Spending Index (1997=100)	100.0	100.5	89.3	92.3	86.8	87.0
Real Targeted Social Spending Per Poor Person (1997=100)	100.0	96.0	76.5	72.2	49.5	23.6

Source: SIEMPRO (2002: 20, Cuadro 3 and Cuadro 4).

Argentine government's main social policy program after the crisis was an expanded version of a previously implemented social workfare program named *TRABAJAR.* The new program, *Jefes y Jefas de Hogar,* provided employment opportunities for unskilled labor, the majority of whom being poor, through infrastructure projects with a wage rate lower than the ongoing market rate. Galasso and Ravallion (2003: 15) have estimated that the new program has reached two million people and caused the extreme poverty rate to decline by two percentage points.

The Argentine government seems to have given a faster social policy response than the Indonesian government had done to the 1997 crisis. Although the budget resources allocated fell short of coping with the gravity of the problem, a social assistance program was put into implementation in April 2002, only a few months after the eruption of crisis. However, the interim period was full of events that were reminiscent of the Indonesian case. There were widespread public protests, looting and street violence, contributing to political instability and the eventual resignation of the government. As in the case of Indonesian Social Safety Net program, the new government's main concern in introducing the social assistance program was to contain the social explosion and restore law and order.

The response of the IMF and the World Bank to the Argentinean crisis bore a close resemblance to that in Indonesia. The IMF did not seem to be interested in social policy matters with the social assistance program receiving IMF approval only after its announcement by the new government. Likewise, the World Bank supported the program with a $600 million loan, but only six months after the program was put in action.

4. TURKEY : SOCIAL POLICY AS A MISSING COMPONENT IN POST-CRISIS PROGRAMS

The Turkish economy has been characterized by boom and bust cycles, during which periods of rapid growth were followed by sharp contractions or economic crises. This pattern of growth did not change after 1980 when the transformation of the economy from an inward-looking and state-dominated one to an outward-oriented and market-based one began under the auspices of Bretton Woods Institutions. If anything, this pattern was reinforced by the move towards capital account liberalization as an integral part of this transformation in 1989 after which economic performance became increasingly dependent on the volatility of short-term international capital flows.

Against this background, Turkey experienced three major economic crises during the 1994-2002 period; first being in 1994, second in November 2000 and the third in February 2001. 2000 and 2001 crises are generally viewed together as the 2000-2001 crisis since they were separated only by a few months and were closely related with each other. These crises were initiated by sharp capital outflows from Turkey, causing the financial markets to collapse in a short period of time. The effects of the crises spread quickly from the financial sector, to real sectors such as manufacturing and then to socioeconomic indicators affecting the welfare of the entire population. Among the most common effects of these crises were a deep contraction of the economy, a sharp rise in inflation and unemployment and a fall in real wages. The crises were typically followed by the introduction of stabilization and structural adjustment programs under BWI supervision. Some of the typical measures taken as part of these programs such as suppression of real wages and reduction of public employment and spending in social sectors exacerbated the negative effects of the crises.

The main objective of this section is to analyze the socioeconomic effects of the 1994 and 2000-2001 crises in conjunction with the impact of the ensuing stabilization and structural adjustment programs, and the respective response of governments, BWI as well as the Turkish people to the crises.

4.1. Socioeconomic Effects of the 1994 and the 2000-2001 Crises

4.1.1. Labor Market

4.1.1.1. 1994 Crisis

Turkey's labor market could hardly be considered as a rigid one prior to the 1994 crisis (Şenses, 1996: 83). In 1993, the share of wage employment in total employment was slightly more than one-third, and the ones with access to a social security scheme accounted for a mere 42 percent of the total number of employed persons, representing formal employment. Yeldan (2001: 96) has estimated that even in the manufacturing sector, which generally contains the highest share of formal employment among all sectors, the share of formal employment in total employment was only 57 percent in 1993.

The impact of the 1994 crisis on the labor market was felt more on real wages than employment (Table 9). The stabilization program introduced in April 1994 shortly after the outbreak of the crisis also contributed to the sharp fall in real wages, partly through the introduction of a wage freeze in the public sector. Unemployment increased from 7.8 percent in 1993 to 8.2 percent in 1994 while underemployment rate rose from 6.9 percent to 8.2 percent. During the same period, manufacturing employment fell both in public and private enterprises, by 7.4 percent and 2.2 percent, respectively. Meanwhile, all real wage indicators fell by more than 20 percent, except public sector gross wage which declined by around five percent.

Table 9. Labor Market Indicators, Turkey, 1993-1995

	1993	1994	1995
Unemployment Rate (%)	7.8	8.2	6.9
Underemployment Rate (%)	6.9	8.2	6.7
Manufacturing Employment Indices (1992=100)			
Of Private*	100.6	98.4	108.0
Of Public	93.8	86.9	74.9
Real Wage Rate Indices (1993=100)			
Minimum Wage	100.0	78.6	74.4
Private Gross Wage	100.0	79.9	68.4
Public Gross Wage	100.0	94.7	74.5
Civil Servants' Net Salary	100.0	78.0	74.3

*: For establishments with more than 9 workers

Sources: Unemployment and employment figures are compiled from the Household Labor Force Survey results and Manufacturing Industry Statistics of the State Institute of Statistics available at State Statistics Institute website (www.die.gov.tr). For real wage indices; IMF (1998: 148, Table 36).

Although the economy was quick to recover with an eight-percent growth rate in 1995 real wages continued to fall with different intensities reflecting to some extent the effect of the stabilization program which, while losing some of its early momentum was still in force. Real civil servants' salaries and the minimum wage declined by around five percent, private sector gross wages fell by 14 percent, and public sector gross wages fell by 21 percent in 1995 (Table 9). On the other hand, as the economy entered a recovery phase, employment started to pick up and unemployment and underemployment went down to 6.9 percent and 6.7 percent respectively, in 1995. Employment in the private manufacturing sector which rose by more than 10 percent surpassed its pre-crisis level, while manufacturing employment in the public sector continued to fall[8].

4.1.1.2. 2000-2001 Crisis

Turkey experienced a short-lived boom during the first ten months of 2000 under the exchange-rate-based stabilization program, which was launched on December 9, 1999. Although the November 2000 crisis brought the economic expansion to a halt for the rest of the year, average growth rates of real GNP and manufacturing output were over six percent for the year as a whole. This had a positive but limited impact on employment indicators. In the manufacturing industry, for example, while employment in the private sector declined by 1.4 percentage points, public sector employment continued its downward trend with a 5.4 percentage points fall in 2000. Unemployment for the country as a whole decreased to 6.9 percent in 2000 from 8.3 percent in the previous year and underemployment fell from 9.8 percent to 7.4 percent in the same period (Table 10).

Real wages presented a mixed picture in 2000. While the minimum wage and civil servant salaries decreased by 14 percent and 11 percent in real terms respectively, private sector wages increased by one percent and wages of public sector workers rose by seven

[8] Neoliberal economic policies which required the state economic enterprises to be shut down, privatized or under-invested were largely responsible for this loss of employment in the public sector (Şenses, 1996: 85-86).

percent (Table 10). Although the stabilization program aimed to restrain wages through a forward indexation mechanism, this could not be implemented in the public sector and in some of the private sector firms as agreements were mostly bound in the previous year (Uygur, 2001: 12).

Table 10. Labor Market Indicators, Turkey, 1999-2002

	1999	2000	2001	2002
Unemployment Rate (%)	8.3	6.9	9.1	11.5
Underemployment Rate (%)	9.8	7.4	6.5	6.1
Manufacturing Employment Indices (1992=100)				
Of Private*	91.7	90.3	82.5	84.4
Of Public	89.0	83.6	78.2	70.9
Real Wage Rate Indices (1993=100)				
Minimum Wage	123.9	105.8	91.1	98.4
Private Gross Wage	92.8	93.8	74.8	…
Public Gross Wage	105.0	112.3	99.3	90.2
Civil Servants' Net Wage	95.1	84.1	81.0	85.6

*: For establishments with more than 9 workers

Sources: Unemployment and employment figures are compiled from the Household Labor Force Survey results and Manufacturing Industry Statistics of the State Institute of Statistics available at the website of State Institute of Statistics (www.die.gov.tr). Real wage indices are from Undersecretariat of Treasury (2003: 34, Table 1.1B).

In February 2001, the country was hit by perhaps the most severe of its crises to which the Turkish government responded with a comprehensive structural adjustment and stabilization program (The Strengthened Program[9] of April-May 2001), signaling a deep recession. TSP aimed to reduce the public sector expenditures by cutting public employment and suppressing real wages. These measures, combined with the adverse effects of the crises themselves, produced negative results for the working population, as reflected in employment and wage indicators of 2001 (Table 10). Although the underemployment rate declined slightly, the overall unemployment rate reached 9.1 percent. Private and public manufacturing employment indices fell by 8.6 percent and 7.7 percent, respectively. On the wages front, private sector workers were the hardest hit, experiencing a real wage loss of around 20 percent in 2001. Minimum net wage and public sector wages have declined by 14 percent and 11 percent, respectively. The least affected section of the labor force was the civil servants, who saw their real salaries decrease by less than four percent. Real wage losses of such proportions have meant that all wage categories were below their 1993 levels.

Interestingly, the recovery of 2002, with real GNP growth of 7.8 percent and manufacturing output growth of more than 10 percent, failed to prevent unemployment from rising further to 11.5 percent in 2002 (Table 10). Although there was a slight improvement in private manufacturing employment, public employment in this sector continued to decrease as

[9] The program is known as 'Program for Moving to a Stronger Economy (PMSE)' in Turkey. We use the name 'The Strengthened Program', since TSP, which is structured in the May 2001 Letter of Intent, is in some respects different from the PMSE, which was announced in mid-April. There will be further information on this issue in the following sections.

the retrenchments in state enterprises were sustained as a part of the stabilization program[10]. Since 2002 was an election year, the government somewhat relaxed its tight incomes policy and increased civil servants' salaries and the minimum net wage by 5.7 percent and eight percent, respectively.

4.1.2. Income Distribution and Poverty

In the absence of periodic household income and consumption surveys to provide systematic data for examining in detail the trends in income distribution and poverty and the impact of crises on them we draw on the three surveys available for 1987, 1994 and 2002. Apart from the comparability of surveys, the fact that the effects of the crises cannot be isolated from those of other events that took place in the long intervals between the surveys poses formidable difficulties for our examination.

4.1.2.1. Income Distribution

Between 1989 and 1994, the government pursued an expansionary economic strategy, which was based on significant wage increases for labor, and high interest income gains, artificially low input prices and low taxes for the capitalist class. This strategy came to a halt with the financial crisis of early 1994. The expansionary strategy and the subsequent crisis resulted in a sharp deterioration in income distribution during the 1987-94 period.[11] While the share of the richest quintile rose by nearly ten percent, income shares of the first four quintiles declined. The Gini coefficient increased from 0.44 to 0.49 and the ratio of income share of the richest quintile to the poorest increased from 9.6 to 11.2 (Table 11).

Table 11. Income Distribution and Inequality Measures, Turkey, Urban and Rural, 1987, 1994 and 2002[12]

	Turkey			Urban			Rural		
Quintiles	1987	1994	2002	1987	1994	2002	1987	1994	2002
1st (Poorest)	5.2	4.9	5.3	5.4	4.8	5.5	5.2	5.6	5.2
2nd	9.6	8.6	9.8	9.3	8.2	9.7	10.0	10.1	10.3
3rd	14.1	12.6	14.0	13.6	11.9	13.9	15.0	14.8	14.7
4th	21.2	19.0	20.8	20.7	17.9	20.5	22.0	21.8	21.7
5th (Richest)	50.0	54.9	50.1	50.9	57.2	50.4	47.8	47.7	48.0
Gini Coefficient	0.44	0.49	0.44	0.44	0.52	0.44	0.42	0.41	0.42
Top20/Bottom20	9.6	11.2	9.5	9.4	11.9	9.2	9.2	8.5	9.2

Sources: SIS 1987 and 1994 Household Income and Consumption Expenditure Survey Results and 2002 Household Budget Survey Results, which are available at: http://www.die.gov.tr/TURKISH/SONIST/HHGELTUK/hhgeltuk.html, SPO (2001: 19, Tables 11,12) and Yükseler (2003: 3, Table 1).

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[10] As a result of continuous lay-offs and privatizations, the number of workers in the state-owned manufacturing enterprises in 2002 was less than half of that in 1992.

[11] Information is based on the total household nominal income data, as collected by the SIS Household Income and Consumption Expenditure Surveys (HICES) of 1987 and 1994.

[12] In 2002, SIS reduced the size of the survey sample and made some changes in the survey, with the aim of converting the large scaled HICES to an annual income and consumption survey called Household Budget Survey (HBS). Hence, the results of these two surveys may not be directly comparable. See Yükseler (2003: 2) for a discussion of the differences between 1994 HICES and 2002 H BS.

The overall deterioration in income distribution stemmed from the urban areas. While the richest urban quintile increased its income share from 50.9 percent in 1987 to 57.2 percent in 1994, all other urban quintiles saw their shares falling. Consequently, the urban Gini rose sharply from 0.44 to 0.52 and Top 20/Bottom 20 ratio increased from 9.4 to 11.9. On the other hand, rural income distribution improved slightly between 1987 and 1994. Rural Gini fell from 0.42 in 1987 to 0.41 in 1994, and the Top 20/Bottom 20 ratio declined from 9.2 to 8.5. These improvements were due to the increasing shares of the poorest two quintiles in rural areas.

The period between 1994 and 2002 was marked with economic instability. Volatile growth rates, high interest rates and chronic high-inflation, which the governments of the period continuously tried to bring down with unsuccessful stabilization programs, were the major characteristics of the economy during this period. The 2000-2001 crisis further exacerbated the situation; the economy contracted drastically in 2001 by nearly ten percent and inflation reached 68.5 percent.

Although the end year of the period under consideration, 2002, was one of recovery, one would expect the overall result of a period with such characteristics to be in the direction of higher inequality. However, the results of the 2002 Household Budget Survey (HBS), as presented in Table 11, are in open contradiction with these expectations. According to the HBS results, in 2002, overall income distribution was more equitable than in 1994. The Gini coefficient and the Top 20/Bottom 20 ratio declined to 0.44 and 9.5, respectively, from 0.49 and 11.2 in 1994. This improvement was due to the rising income shares of the first four quintiles in urban areas, as the richest quintile's share declined.

However, there are serious doubts over the validity of the argument that income inequality, particularly inequality in urban areas, was reduced between 1994 and 2002. The most important issue here pertains to the shrinkage of the share of financial asset income by 36 percent from 1994 to 2002, according to the results of 1994 HICES and 2002 HBS. (Yükseler, 2003: 9, Table 6). This result is not plausible as the main characteristics of financial markets have not changed. Public debt increased continuously, offering high real interest rates on public debt instruments. Furthermore, this period was characterized by a sharp increase in transaction volume of financial markets and the share of financial assets in GNP. Underreporting of financial income by the richest quintile may be a more plausible explanation for the anomalous results derived from the 2002 survey[13]. Yet another reason to doubt these results comes from poverty indicators discussed in the following section, which show that poverty, particularly urban poverty, has risen sharply from 1994 to 2001. Had the incomes of the poorest segments of the population grown as the HBS results suggest, such an increase in poverty incidence could not have taken place[14].

4.1.2.2. Poverty

There are only a handful of studies on Turkish poverty[15]. Nearly all of these studies use HICES data, but different methodologies, and more importantly, none of them makes intertemporal comparisons *i.e.* between 1987 and 1994 or between 1994 and 2002, except Dağdemir (2002). For the post-2001 crisis period, the only study measuring the level of

[13] See Yükseler (2003) for a detailed discussion.

[14] Another reason for doubting the survey results is the rise in luxury consumption expenditure that could be observed in daily life as reflected in mass media.

[15] See Erdoğan (2002) for brief summaries of all of the ten studies on Turkish poverty during 1990s.

poverty is a World Bank report (World Bank, 2003a), which is based on Household Consumption and Income Survey (HCIS) conducted by the Bank itself. This study's methodology is the same as that of another report published by the Bank (World Bank, 2000a), making them comparable. Hence, the poverty analysis here is based on Dağdemir's study for the 1987-1994 period, and two World Bank reports for the 1994-2002 period[16].

Dağdemir (2002: 469) uses two poverty lines. The first one is based on the minimum calorie requirement of an individual, and called the minimum food cost (MFC). The second one adds some other necessary non-food expenditures to MFC, and reaches to basic needs cost (BNC), which is roughly 50 percent higher than MFC. His findings according to the MFC line suggest that there was a rise in urban poverty from 6.9 percent in 1987 to 8.7 percent in 1994 (Table 12). However, a fall in rural poverty from 21.2 percent to 20.2 percent has countervailed this rise, and the general poverty level of the country has remained constant at 11.5 percent from 1987 to 1994. According to the BNC line, both the urban and the rural poverty rates have increased from 14.3 percent to 20 percent and from 41.5 percent to 42.5 percent, respectively. These rises have generated an increase in the overall poverty incidence in Turkey, from 27 percent in 1987 to 29.5 in 1994. These results show that although poverty was mostly a rural phenomenon, urban poverty worsened significantly during the 1987-1994 period, most probably as a result of the 1994 financial crisis, which had a much bigger impact on urban sectors.

Table 12. Poverty in Turkey, Urban and Rural, 1987 and 1994 (percent)

	Turkey		Urban		Rural	
Poverty Line	1987	1994	1987	1994	1987	1994
Minimum Food Cost	11.5	11.5	6.9	8.7	21.2	20.2
Basic Needs Cost	27.0	29.5	14.3	20.0	41.5	42.5

Source: Dağdemir (2002: 472, Table 1).

Both World Bank reports use four poverty lines: i) an internationally standard poverty line of "One-Dollar-A-Day" per capita; ii) a minimum food basket cost line; iii) a basic needs basket cost line; and iv) a relative poverty line set at one-half of national median income[17]. All poverty indicators worsened between 1994 and 2001 (Table 13) with the sole exception of extreme poverty based on the "One-Dollar-A-Day" line, falling from 2.5 percent in 1994 to 1.8 percent in 2001. As the World Bank (2003a: 11) itself has noted, however, with such small numbers the difference is within the standard error of the samples. The 1994-2001 period was also characterized by a sharp deterioration in urban poverty which nearly tripled from 6.2 percent in 1994 to 17.2 percent in 2001 (Table 13). This reflected the severe impact of the 2000-2001 financial crisis on the urban poor through highly restricted job opportunities and the upsurge in food prices by 80.2 percent that was bigger than the increase of 68.5

[16] In April 2004, State Institute of Statistics published a poverty report based on the 2002 HBS available at http://www.die.gov.tr/TURKISH/SONIST/YOKSL/yoksul.htm. However, this report's findings are not comparable to the World Bank (2000a) report –or any other study currently available– because of methodological differences.

[17] The World Bank reports provide only aggregate data, without the urban and rural distribution. The only exception to this is the urban food poverty rate given in the 2003 report which, however, fails to provide data on the overall food poverty rate.

percent for the general price index (Şenses, 2003: 104-105). Similarly, there was a sharp rise in the economic vulnerability rate as measured by the basic needs cost line, increasing from 36.3 percent in 1994 to a massive 56.1 percent in 2001[18].

Table 13. Poverty in Turkey, 1994-2001 (percent)

	Turkey		Urban	
Poverty Line	1994	2001	1994	2001
$1/day per capita (at 1985 PPP prices)	2.5	1.8		
Local cost of minimum food basket	7.3	…	6.2	17.2
Local cost of basic needs basket	36.3	56.1		
One-half of national median income	15.7	21.5		

Sources: World Bank (2000a: 36, Table 1; 2003a: 11-23)

4.1.3 Social Spending-Education, Health and Social Assistance

In Turkey, public expenditure on social sectors[19] consists mainly of three categories: education, health, and social assistance[20].

Table 14. Education, Health and Social Assistance Expenditures of Turkish Government, 1993-1996

	1993	1994	1995	1996
Public Social Spending/GNP (%)	7.2	6.0	5.4	5.0
Public Social Spending/Government Expenditure (%)	29.8	25.9	24.6	19.1
Education Spending/GNP (%)	4.1	3.1	2.7	2.5
Education Spending/Government Expenditure (%)	16.7	13.5	12.3	9.4
Health Spending/GNP (%)	2.9	2.7	2.5	2.4
Health Spending/Government Expenditure (%)	12.0	11.5	11.3	8.9
Social Assistance Spending/GNP (%)	0.3	0.2	0.2	0.2
Social Assistance Spending/Government Expenditure (%)	1.1	0.9	1.0	0.8

Sources: State Planning Organization, Main Economic Indicators, 1950-2003, online edition, which is available at http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm; Ministry of Health (2003: 68); SHP (2002: 27, Table 14); World Bank (2000a: 60, Table 2); BYDK (2003: 14); http://www.emekli.gov.tr/ISTATISTIK/65yas.html; http://www.muhasebat.gov.tr/mbulten/T4-2-6.htm.

[18] This shows the majority of the Turkish population was facing the risk of falling into poverty. This threat was much bigger in the Southeast region with a vulnerability rate of 93 percent (World Bank, 2003a: 23).

[19] Social assistance spending covers direct or in-kind transfers made to the poor and vulnerable segments of the population by the government. Social Assistance and Solidarity Fund (SASF), Social Services and Child Protection Agency, Old Age and Disability Assistance Scheme and the Green Card Scheme are the four major social assistance mechanisms/institutions covered here.

Table 15. Education, Health and Social Assistance Expenditures of Turkish Government, 1999-2002 (percent)

	1999	2000	2001	2002
Public Social Spending/GNP	8.1	7.8	7.8	8.1
Public Social Spending/Government Expenditure	22.5	20.9	16.9	19.0
Education Spending/GNP	4.2	3.8	4.0	4.1
Education Spending/Government Expenditure	11.8	10.0	8.6	9.5
Health Spending/GNP	3.3	3.5	3.2	3.5
Health Spending/Government Expenditure	9.1	9.3	6.9	8.1
Social Assistance Spending/GNP	0.6	0.6	0.6	0.6
Social Assistance Spending/Government Expenditure	1.5	1.5	1.4	1.4

Sources: Same as Table 14.

4.1.3.1. 1994 Crisis

The 1994 crisis and the subsequent April 5 Stabilization Program resulted in reductions in all categories of social expenditure (Table 14). Between 1993 and 1996, public social spending as a proportion of GNP declined from 7.2 percent to five percent while its share in total government expenditure fell from 29.8 percent to 19.1 percent.[21] Educational spending was the worst affected category, decreasing from 4.1 percent to 2.5 percent as a share of GNP and from 16.7 percent to 9.4 percent as a share of government expenditures during the same period. This, together with the decline in health and social assistance spending during the same period reflects as much the adverse effect of the crisis as the inaction of successive governments in the face of severe economic crisis.

4.1.3.2. 2000-2001 Crisis

There was a fall in the share of public social spending in total government expenditure from 20.9 percent in 2000 to 16.0 percent in 2001. Although public social spending as a proportion of GNP in 2001 maintained its level in the previous year (Table 15), this actually represented a fall in absolute terms as GNP declined by 10 percent in that year. A similar pattern was observed in education spending. Education spending to GNP ratio had even a slight increase in 2001, but decreased in absolute terms and as a share of government expenditure. While health spending decreased in both measures, social assistance spending remained almost constant as a share of GNP and government expenditure. These highly aggregate figures reveal that social expenditures were somewhat better protected during the 2000-2001 crisis as compared with the 1994 crisis although social policy was not among the priorities of the government, as discussed in the next section.

[20] Transfers to the social security institutions are here excluded from social spending as they emanate from the operational deficiencies of the social security institutions and are not the outcome of government's deliberate social policies.

[21] The fact that there was a 23.5 percent fall in per capita social spending in 1994 alone indicates the severe impact o f the crisis.

4.2. Responses to the 1994 and 2000-2001 Crises

Despite the adverse socioeconomic effects of the 1994 and 2000-2001 crises, governments have, as many governments before them, failed to take any major social policy measures to deal with the situation. Instead, they were primarily concerned with macroeconomic stabilization, hoping that the economic recovery would trickle down to the socioeconomic indicators. This approach has not changed even in the setting of the 2000-2001 crisis during which the possibility of social explosion was openly discussed at the highest level of state authority.

In tackling the question why active social policies were not integrated into the post-crisis stabilization and structural adjustment programs, we now consider the post-crisis responses of the governments, civil society and the BWI to the crises.

4.2.1. 1994 Crisis

The April 5 stabilization program introduced shortly after the outbreak of the 1994 crisis did not include any measures to cushion the negative effects of the crisis. If anything, its fiscal austerity component, emphasizing wage suppression and cuts in public spending, may have exacerbated the initial impact of the crisis on the poor and the vulnerable groups. The government's decision to transfer 74 percent of the income of the Social Assistance and Solidarity Fund (SASF) to the general budget in 1994 (Şenses, 1999: 439, Tables 1-2) was also indicative of the government's insensitivity in this respect.

The attitude of BWI was characterized by a similar lack of concern and insensitivity. Although the IMF did not actively participate in the design of the April 5 program, it supported it with a stand-by credit. While the absence of any IMF documents on the program or its implementation precludes us from passing firm judgment, it is likely that the Fund approved the program without any reservations as social issues were not yet on the policy agenda of the IMF. The World Bank, on the other hand, was preoccupied with the privatization and social security reform components of the program through sectoral reform loans. The only World Bank document available on the 1994 crisis and the ensuing stabilization efforts does not contain any statement on their socioeconomic effects (World Bank, 1996). Instead, it commends the labor compensation and relocation plans of the government in the context of the privatization program as a tool for gaining political support for that program (World Bank, 1996: 48-49). World Bank's limited interest in socioeconomic issues seems to have been prompted primarily by the smooth functioning of the privatization program rather than protecting the low income groups.

The immediate reaction of civil society to the crisis was confined to the demonstrations of labor unions in 1994 (Şenses, 2003: 111). Despite the initial ineffectiveness of these demonstrations, public anger against the crisis and the stabilization program produced an important result: "a major dislocation in Turkish politics" in the December 1995 elections (Cizre-Sakallıoğlu and Yeldan, 2000: 501). According to the authors of the latter study, the winner of the 1995 elections, Welfare Party (WP) with an openly Islamist stance, owed its success to the reactive voting of the urban poor. In the absence of notable leftist alternatives, WP gained the support of the low-income sections of the population with its main slogan of 'Just Order' and a solid stance against the inequalities within the economic system. This enabled the WP to more than triple its votes from around six percent in the previous elections to 21 percent in the 1995 elections. However, the coalition government led by the WP did not

change the course of economic policies in the direction of equality as the WP had promised. The only notable success of the WP in this regard was its resistance to its coalition partner's requests to use SASF's resources for other purposes[22].

4.2.2. 2000-2001 Crisis

When the country was hit by the first of the twin crises in November 2000, the government was already implementing an exchange rate based stabilization program with the full support of the IMF and the World Bank. The program did not include any measures on the social policy front. Neither did the revised version of the program, which was announced in December 2000, contain any statements about the possible negative socioeconomic effects of the November crisis let alone any measures to deal with them.

After the eruption of the February 2001 crisis, this revised program was also abandoned and a new stabilization program was prepared under the leadership of the new Minister of Economic Affairs, Kemal Derviş. The new program was announced internationally on May 3, 2001 through the Letter of Intent of the Turkish government to the IMF. The Letter of Intent contained the details of the economic policies to be implemented under the new program – The Strengthened Program (TSP), as it was called in the letter of intent. However, the social policy intentions of the government were mentioned in the last paragraph and were confined to only three sentences. Here the government stated its intentions to improve the social protection programs with World Bank assistance to reduce the negative impact of the crisis on the vulnerable segments of the population. Interestingly, this phrase was not included in the previous version of the program[23], which was announced to the Turkish public in mid-April as the Program for Moving to a Stronger Economy (PMSE). Instead, in that version reducing the public debt burden was declared as a tool for reducing income inequalities and poverty in the long-term. The difference between the two versions may be due to the discussions the government may have had with the World Bank in the interim period.

The intentions of the government seemed to be materializing when the World Bank approved a $500 million Social Risk Mitigation Project (SRMP) loan in August 2001. SRMP was aimed to improve the social safety net mechanisms both institutionally and financially in order to mitigate the negative effects of the crisis. The Bank agreed to make an immediate disbursement of $100 million to support the ongoing social assistance programs of the SASF on conditions that the government shows a satisfactory macroeconomic performance and fulfils the initial conditions of the SRMP (World Bank, 2001a: 23). The rest of the loan was going to be used for the institutional development of the safety net mechanism and two new safety net programs: Conditional Cash Transfers and Local Initiatives.

Although the magnitude of the first part of the loan fell drastically short of providing a cure for the negative effects of the crisis[24], the second component of the SRMP had the potential of contributing to the development of the social assistance system. However, the

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[22] At the same time, the WP was accused of using the resources of SASF for political purposes. See Şenses (1999: 445-446) for details.

[23] The version of TSP dated May 3 2001 is available at the IMF website: http://www.imf.org/external/np/loi/2001/tur/02/index.htm The first version, PMSE, is available at Central Bank's website: http://www.tcmb.gov.tr/yeni/duyuru/eko_program/program.pdf.

[24] In 2001, $100 million was approximately equal to 0.1 percent of GNP or a quarter of the total spending by the SASF in that year.

available evidence[25] shows that the project could not be implemented as planned. An audit report on SASF has stated that the SRMP funding was not available to the SASF for 2001, and the amount of credit obtained from this source in 2002 was less than $3 million (Prime Ministry High Auditing Council–BYDK, 2003: II). Since the initial disbursement of $100 million was planned to be transferred directly to the SASF until the end of 2001, this means that the implementation of SRMP was delayed for a long period.

The report by the BYDK (Turkish acronym for Prime Ministry High Auditing Council) does not provide information about the reasons for the lack of funding, but it is most likely that the Turkish government failed to fulfill its initial commitments for the loan, leading to the suspension of the disbursement by the Bank. Considering that the first of the two conditions, macroeconomic performance, was found satisfactory for other loans of the World Bank (World Bank, 2003b: 2-3), the problem seems to be related to the fulfillment of the initial conditions of the SRMP associated with the SASF. Most important of these conditions was an increased funding for ongoing SASF operations by the government. On this issue, the BYDK (2003: II) has reported that 40 percent of the 2001 income of the SASF was diverted to the general budget of the government. This is a replica of government strategy followed after the 1994 crisis. Considering that the 2000-2001 crisis has created a much heavier impact on the poor, and that the program was designed by a team led by the ex-Vice President of the World Bank who was responsible for the Bank's Poverty Reduction and Economic Management Unit, the reallocation of poverty alleviation funds to other areas indicates that Turkish governments have maintained their insensitive attitude to social policy even when the poor households' need for assistance was bigger than ever.

A major point of criticism for the World Bank in this context stems from the motives of the SRMP. The Bank has openly declared that the social pressures emanating from the negative effects of the crisis would constitute a major risk for the economic reform program of the government, but strengthening the safety net through the Bank's SRMP would help the government to gain political support (World Bank, 2001a: 11). So, it seems that the name of the loan, Social Risk Mitigation, originates from the risks for the economic reform program caused by the society, rather than the risks for the society caused by the program.

IMF has preserved its silence on the social front also in the aftermath of the 2000-2001 crisis. IMF statements on the strengthened program and its implementation have seldom included references to socio-economic issues, and when they did, those sections of the statements would be quite short, generally reiterating World Bank's views[26].

Public reaction to the 2000-2001 crisis was more intense than that of the 1994 crisis. The demonstrations were held in many provinces and some of them involved violence and damage to property (Şenses, 2003: 111). Interestingly, organized segments of the self-employed were leading these demonstrations, instead of trade unions, and one of the most

[25] World Bank did not publish any reports on the implementation of the SRMP after the cited Project Appraisal Report of August 2001 until August 2004, even though there were at least three reviews of the project planned for the interim period. While this prevents a comparison of the BYDK (2003) data with the Bank's, it may at the same time point to implementation problems.

[26] For example, when the journalists asked Michael Deppler, Director of the European I. Department of the IMF, about the possible political implications of a reduction of public employment due to its huge social costs, he responded that there were certain aspects of the program for reducing and equally distributing its negative impact. This statement resembles the views of the Bank on the relation between the SRMP and the need for political support. Transcript of the press meeting is available at http://www.imf.org/external/np/tr/2002/tr020204.htm.

affected groups, the poor, were not involved. Another interesting feature of the demonstrations was that protests were not directed only against the government, but also the IMF and the World Bank. In any case, the demonstrations faded away after the announcement of The Strengthened Program. But before they faded away, the possibility of social explosion was seriously discussed at different layers of the society[27]. Such a possibility may explain the initial rhetorically active position of the government for pursuing stronger social policies.

As in the case of the 1994 crisis, public reaction to the economic situation was sharply reflected in the following general elections, which took place in November 2002. None of the three parties constituting the coalition government that was in office during the crisis period could take enough votes to jump over the 10 percent threshold for entering the National Assembly. Moreover, only two parties, both of which unrepresented in the National Assembly during the crises, were granted this right. Justice and Development Party (JDP), which was one of the successors of the Welfare Party, won a clear majority of seats in parliament by collecting 34 percent of the votes, while the Republican People's Party (RPP) came in second with 19 percent. During the election campaign, JDP was distinctive with its focus on income inequality and poverty issues. This enabled it to collect the reactive votes of the poor and vulnerable segments of society, who bore the brunt of the crisis. As in the case of its ancestor, Welfare Party, the main factor behind JDP's success was the public reaction against the crisis and the stabilization programs. However, once in power, the JDP government seems to have lost its earlier fervor for poverty alleviation Şenses (2003a: 333).

5. CONCLUSION

Although the economic crises became common since the early 1990s, their socioeconomic effects have been largely neglected as a research subject. This neglect partially reflects the priorities of the hegemonic neoliberal approach in the economic field, which is promoted by Bretton Woods institutions. On the other hand, it can be partially attributed to the difficulties in the analytical assessment of the effects as they are not easily quantifiable, weak in terms of data and blended with the effects of other events. Due to these constraints, this study is confined to the socioeconomic indicators with sufficient data, such as those of labor market, social expenditures, poverty, and income distribution. Moreover, our analysis covers the pre- and post-crisis economic programs, responses of the public, governments and the BWIs to the crises, since all of these have influenced the magnitude and the direction of socioeconomic effects.

Our assessments of the socioeconomic indicators of three countries that have been deeply affected by the crises show that the effects are devastating in general. However, our findings also indicate that there is a variety of experience among these countries with the magnitude and duration of the effects of crises varying across different sectors and income groups in

[27] At the National Security Committee meeting on 29 June 2001, for example, the military wing of the committee presented a report to the government members. It warned them about the negative effects of the economic program on the public, stating that "there may emerge a social explosion in the near future". The results of a public opinion survey, on the other hand, showed that 59.7 percent of the respondents believed that "there would be a social explosion in the coming days". See http://arsiv.hurriyetim.com.tr/hur/turk/01/06/30/turkiye/01tur.htm and http://www.radikal.com.tr/haber.php?haberno=16817&tarih=07/10/2001 respectively for these newspaper articles.

individual countries. Some socioeconomic indicators have moved in different magnitudes and sometimes even in different directions. For example, Indonesian income distribution improved after the 1997 crisis. A comparison of Turkish labor market indicators between the 1994 and the 2000-2001 crises demonstrates that there can be diversity between different crisis episodes in the same country. While the 1994 crisis affected real wages mostly, both the real wages and the unemployment worsened after the 2000-2001 crisis. This variety of experiences indicates that one should avoid easy generalizations, and work through the individual country indicators –for each crisis episode– in detail. Likewise, one should take note of the different reactions of domestic governments, the general public and international organizations to crises in different countries.

Nevertheless, our results show that there are some common socioeconomic effects of crises as well. An increase in unemployment due to the plunge in labor demand, sharp falls in real wages and social expenditures, and worsening of poverty are the major common effects.

Post-crisis responses of governments, Bretton Wood Institutions and the public constitute a set of major determinants of socioeconomic effects. These responses also vary between different countries and between different crises. Sensitivity of governments to the issue depends on many factors. Relative importance of socioeconomic issues on the social agenda stands out as a major factor. For example in Indonesia, poverty alleviation and equitable growth were important issues for the society unlike in Argentina and Turkey, and the country recorded a significant success in those areas between 1967 and 1997. This should have been conducive to Indonesian government's positive attitude in the post-crisis period. On the other hand in Turkey, economic growth and informal solidarity networks within the society were traditionally assumed to be sufficient to alleviate the poverty, inducing a passive stance for the government in this respect.

It is observed that the BWIs are not very sensitive to the matter. Socioeconomic issues are known to be outside the interest areas of IMF historically. The Fund's increasing interest in poverty and inequality that has recently developed within the context of the so-called Post-Washington Consensus remained rhetorical and did not transform to effective action. Although the World Bank, which focuses more on social issues, seemed more sensitive to the negative socioeconomic effects of crises, the size of resources allocated by this institution for this purpose has been very small compared to the devastating impact of the crises. This problem has raised doubts over the sincerity of the Bank's behavior. It seems that the World Bank's interest in this area is for reducing the political frictions in the public against the neoliberal reforms rather than improving the living standards of the low-income population groups. On the other hand, insensitivity of BWIs to social issues is in part caused by the passive stance of governments. Indonesian experience has demonstrated that if the government of the crisis-hit country makes the socioeconomic effects a priority, the attitude of BWIs changes remarkably. It is in this context important that negotiations of domestic governments with these institutions should be more transparent. This would at least enable us to apportion the blame for inaction on the poverty front with a smaller margin of error.

Within this framework, public reaction to the economic crises and their socioeconomic effects is a major factor affecting the responses of the governments and the BWIs, hence the nature of economic policies implemented in the post-crisis period. The forceful reaction of the Indonesian people, which even resulted in a regime change, led to the government's sensitive approach to the social issues and the lessening of BWIs' reluctance to allow social safety net measures. The reaction chain of this process is illustrated in Figure 1. The significant decline

in government's sensitivity as the reactions subsided over time indicates that it requires a constantly reactive public to build up a pro-poor political command. On the other hand, public reactions in Argentina and Turkey did not result in significant action by governments. Responses of the governments to those reactions came out to be ineffective in Argentine case and rather rhetorical in the Turkish case. In Turkey, which arguably has at least by developing country standards better democratic credentials the more substantial public reaction is expressed through the ballot box, with political parties with poor records on the socioeconomic front swiftly removed from power. This does not guarantee however that the new party that takes over will stick to its election promises once in power. It would however be simplistic to argue that it is only in closed political regimes that street protests constitute the main public reaction as mass demonstrations which can aptly be described as social explosion have taken place in both Indonesia and Argentina with different degrees of political openness. Hence, the initial pattern and the end result of public reactions are not the same everywhere.

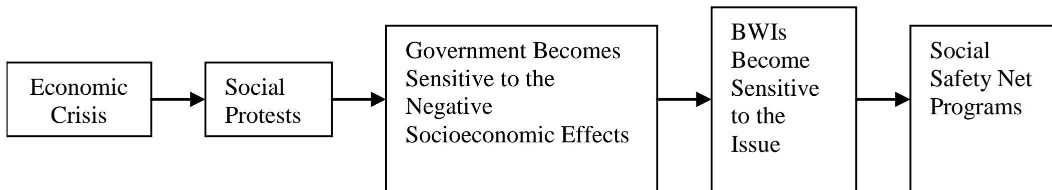

Figure 1. Reaction Chain – From Social Protests to Safety Net Programs.

The discussion so far should not in the least be interpreted to support the argument that economic growth and macroeconomic stability are not required for alleviating the adverse socioeconomic impact of crises. On the contrary, success in those spheres would obviously contribute to mitigating the adverse effects of the crisis on the low income groups, especially if the growth has pro-poor, equitable features. But it should also be recognized that success in these spheres is not sufficient and needs to be supported by active government policies on a broad front, aimed primarily at employment creation, protection of social expenditures that are of particular relevance for low income households and more generally at poverty alleviation. The Indonesian experience has demonstrated that an active social policy stance by the government can be very effective in coping with the adverse impact of the crisis. It has also shown that even within the straightjacket of IMF programs there is room for poverty alleviation as long as the political will is present. Without denying the significance of such relief effort by the government, one should also concede that this is the maximum that can be tolerated under the neoliberal framework which shies away from tackling the more fundamental ownership and distribution problems and thus fails dismally to remove large sections of the population from abject poverty.

Considering the scale of negative socioeconomic effects of economic crises which may extend well beyond the short term, international institutions and domestic governments should seek ways to avert crises, but also be ready for them. Since the crises often erupt rather unexpectedly and cause panic at both the national and the international levels, governments should get prepared in advance by drawing emergency plans. These plans would comprise

arrangements ranging from building up an up-to-date socioeconomic database to the setting up of flexible safety net mechanisms that would expand during crises.

On a grander scale, preventing the negative effects of economic crises is identical with the objective of implementing equitable economic and social policies. This objective is, however, confronted by formidable obstacles headed by the skewed power relations in both the national and international spheres (Öniş and Şenses, 2005). In this regard, democratization of relations in both spheres is essential to prevent the negative effects of crises or more generally to reach a fair allocation of resources. At the national level, this task requires the poor to get organized politically as an effective pressure group and press for their rights. This calls for the need for a new type of democracy opening up the channels that have hitherto blocked such organization. At the international level, it requires the developing countries to have a strong voice in the global economic environment and change the decision making processes in Bretton Woods Institutions in a genuinely pro-poor direction[28].

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Chapter 12

RETHINKING THE NATURE OF THE BEAST: THE TURKISH STATE AND THE PROCESS OF EUROPEANIZATION

Galip L. Yalman

1. INTRODUCTION

The protracted saga of Turkey's quest for the European Union (EU) membership provides an interesting case for analysing the changing modalities of state-market and/or state-civil society relations. At the same time, it provides a highly illuminative case to articulate the ways in which the EU emerges as a key player which changes the rules and the structures of policy making for the member states as well as for others aspiring to be full members. More generally, there is a need to come to terms with the complex and multidimensional processes of transformation which may be labelled as the process of *Europeanization*, to borrow a trendy terminology from the institutionalist literature on European integration, as many new and prospective members of the EU are faced with the dual tasks of political and economic development and adjustment to a rapidly changing international environment. As succinctly put,

> Turkey's development path is being pivotally affected and supported by the EU accession course, giving this general process of modernisation and democratization an important Europeanisation twist. (Tocci 2005: 82)

On the other hand, as it has been observed, while there has recently been an academic growth industry on Europeanization, the analysis of the Turkish case has continued to be an exception.[1] For the studies on the latter case reflected a preoccupation with the legacy of a state tradition that has become another growth industry in its own right for the specialists on the subject.

[1] See Diez et al. 2005 for an elaboration in this regard.

Yet, it is necessary to contemplate this process of Europeanization as a particular manifestation of, what can be referred to as, the transnationalisation of the processes of state as well as class formation rather than a norm-driven process of institutional change and/or empowerment of civil society actors as contended by the institutionalist-cum-constructivist accounts. Hence, there is also a need to study the impact of Europeanization on both the state structures and the societal actors in different national contexts by taking into account the changing modes of incorporation into the world economy for the peripheral economies in question. Thereby, it may be possible to assess the extent to which the EU functions, along with the Bretton Woods institutions, as a structural feature of the domestic transformation in Turkey. That is, put differently, as a nodal point in the organisation of the institutional framework and rules for varying modes of governance involving a wide range of interests, economic as well as civil and political. This could be problematised as the internationalisation of specific policy regimes as the key players in policy regimes increasingly tended to include those outside the country as sources of policy ideas, policy design and implementation (Jessop 2002a, 2002b). Otherwise put, the whole process could be viewed as a current manifestation of the ways in which capitalism develops in a combined and uneven manner in the era of neoliberal hegemony.

An analysis of the changing dynamics of state-market relations in the context of the process of Europeanisation understood as such also provides an opportunity to challenge the continuing predominance of liberal-individualist and statist-institutionalist approaches in comparative politics and/or comparative political economy. A cursory review of the debates - which have dominated the academic as well as the political agenda since the 1980s - about the role of the state in a capitalist economy, would highlight two particular deficiencies. Firstly, the dominance of a dualistic conception of state/market and/or state/society relationships in so far as these spheres are perceived as being externally related, if not as ontologically distinctive domains, with their own logics and principles; secondly, the tendency to approach the relations between states and markets in terms of alternative 'paradigms', thus reproducing varieties of relativism, if only to reiterate the validity of a theoretical edifice with universalistic aspirations. A critique of these approaches thus becomes a political imperative for they do play a significant role in the maintenance of the hegemony of neoliberalism in discourse as well as in policymaking. Such a critical perspective is also deemed necessary to challenge the so-called cultural turn in the social sciences which purports to develop an understanding of systems of signification and subjectivity as constitutive of social reality, and insists for the cultural and social construction of boundaries between the economic and political as imaginatively narrated systems.

2. Capitalism and the State: Relative Autonomy vs. Good Governance

As the dissatisfaction with the hard core of the neoclassical welfare economics mounted, the need for a 'theory of government' which would assign to the state a central role as a vital, integral element in the construction of an 'efficient' market economy has increasingly been underlined (Bates 1989: 5; Chang 1994; Stiglitz 1989: 39). Similarly, as the rent-seeking literature has been criticised for failing to account for the 'success stories', particularly of

state-led industrialisation, there has been an increasing interest in exploring the possible ways in which the so-called predatory state could be transformed into a developmental one (Bardhan 1990; Evans 1989; Öniş 1991). These attempts have generally taken the form of attempting to construct a functionalist 'theory of the state' which would explore the ways in which the structure of property rights can be (re)adjusted so as to achieve economic stability and prosperity, thus ensuring that the state plays a 'positive' role as the protector and enforcer of property rights instead of being degraded as the main source of insecurity and uncertainty (Eggertsson 1990; Dornbusch 1993: 4; Chang 1994: 132).

More recently, it has become fashionable to argue for yet another version of such a functionalist theory in quest of attempts to facilitate the adjustment of the capitalist states in general, those of the periphery in particular, to the political economy of globalization, mainly understood in terms of the processes of financial liberalization. Thereby, as there would be an increased focus upon the ways in which the "capacities of the state" could be enhanced so as to deliver "collective goods efficiently", the World Bank and the IMF – not to omit the EU - would be seen in pursuit of "changing institutional structures established for different purposes to fit the rules of the game" (World Bank 1997: 3). This would not only entail an acknowledgment of the need for state intervention as a positive attribute of a functioning market economy, but it would also highlight the identification of the state as a key agent of change. More precisely, there will be a shift of emphasis in the characterisation of the state as the basic determinant of the structure of property rights (Campbell & Lindberg 1990; Radice 1999: 14). For, it will not simply be degraded anymore as the cause of insecurity and uncertainty which debilitates the functioning of a market economy. Hence, the proliferation of notions such as the "regulatory state" and/or "competition state" with the celebrated function of fostering the newly discovered "collective goods" of the era of globalization such as commodification of public services and competitiveness of the firms as well as the economies (Cerny 2000; Chin 2000; Jayasuriya & Rosser 2001; Phillips 2002). While others would argue that the globalization of finance functions as an objective constraint on the state's capacity to intervene (Patnaik 1999), i.e., curtailing its capacity to act in a way that will prioritize competitiveness especially in the periphery of the capitalist world.

Either way, the state turns out to be the key actor for the realisation of the 'market reforms', since social classes and/or interest-based organisations are portrayed, at best, as ineffectual advocates, or more likely, as obstacles both for the necessary policy changes and for the coherence of the policies once they are set on the agenda (Bates & Krueger 1993; Biersteker 1992; Richards & Waterbury 1990: 225). In other words, the (relative) autonomy of the state functions as a principle of explanation, as 'interest-based' explanations are found wanting to account for the initiation, or lack of initiation, of these reforms. If taken for granted, this also implies either a lack of ability on the part of the individuals, groups, firms, etc. which comprise these interests, to translate their calculations of economic benefits into public policy (Gourevitch 1977), or conversely, the existence of groups of interest which are unable to go beyond, in Gramsci's terms, their 'economic-corporate moment' (Gramsci 1971: 181). Either way, from the point of view of neoliberal political economy, this serves to underline the 'public good' nature of the policy reforms (Bates & Krueger 1993; Schamis 1999). But this presents a series of inconsistencies for the perspective(s) in question. For, in as much as the creation of competitive markets and integration into the world economy are envisaged as the goals of these policy reforms (Williamson 1993), the states and/or governments are expected to contribute to the provision of these internationally acclaimed

public goods by overcoming the resistance of different sections of the society which are said to have a vested interest in opposing the policy changes (Roemer & Radelet 1991; World Bank 1985). In a sense, the market reforms are expected to be carried out for the good of the market agents but in spite of the very same agents.

Thereby, the initiation of 'policy reforms' could only be accounted for by means of exogenous factors such as the emergence of 'enlightened technocrats' and/or the international financial institutions and/or supranational bodies such as the EU acting as the 'third party' (Bates & Krueger 1993: 464; Waterbury 1992). Ironically, the protagonists of the rent-seeking analysis who, initially, set out to challenge the *autonomy* of politics by constructing a social theory on the basic individualistic postulate of microeconomics (Barry 1987: 25), end up in search of a theory which would justify the *necessity* of an autonomous state to check the 'disruptive influence of distributional coalitions'. For others combining the jargon of the World Bank with that of the statist-institutionalists, "embedded autonomy" turns out to be a key to understand what the conditions of good governance are (Jomo 2001; Teichman 2002).

While the ultimate objective, for one perspective, is an economy based on a more market-oriented allocation of resources, and structurally adjusted to the emerging forces of globalisation; by contrast, for the other, it might as well entail a desire to preserve a 'developmental state', setting the national priorities on 'behalf of' the capitalist class, and 'guiding' the markets for the realisation of these objectives. Yet, there is clearly a common theme in so far as the state autonomy is perceived as a necessary, if not sufficient, condition for the formulation and implementation of 'coherent' and 'rational' policies (Deyo 1987:230; Jenkins 1991; Krueger 1993: 118; Wade 1990: 375; World Bank 1993: 167). In particular, 'its capacity to act as an agency of reform' is seen by both perspectives as a function of the degree of the insulation of the policymakers from their surrounding social relationships (Evans 1989; Miliband 1977: 87; Wade 1990: 375; World Bank 1993: 167). Implicit in both is a predilection to approach the state as an 'ideal collective capitalist', functioning to improve the conditions of capital accumulation, albeit subject to a variety of constraints (Jessop 1990: 35; Offe 1984: 120).

In fact, it has been a long established practice of a particular style of theorising about the state to postulate the state autonomy from the dominant classes as being indispensable for the pursuit of policies deemed essential for the systemic interests of capitalism and/or long term interests of the bourgeoisie and/or the interests of the society in general. This has, of course, been expressed in a variety of different contexts. But formulated in terms of the restructuring requirements of the economy and/or capital, the autonomy of the state is said to have been necessitated so as to overcome the possible sources of resistance by those fractions of capital and/or sections of the business elite whose interests could be prejudiced (Barkey 1989; Fitzgerald 1979: 5). Developed mainly within the problematic of 'late-industrialisation', this emphasis on the autonomy of the state emerges as a positive attribute to the extent that the state is expected to remove the bottlenecks in order to hasten the pace of economic development. Viewed as such, autonomy becomes an attribute of a 'rational state' (Mommsen 1989: 39; Silberman 1993: 3).

It was typical of the so-called neo-Marxist theories of development to envisage a state independent of those interests opposed to industrialisation, both domestic and foreign, in order to accomplish the objective of 'independent industrialisation' (Colman & Nixson 1986: 313). In a similar fashion, to the extent that the structural adjustment policies are presented as necessary and beneficial in the long-term, then, they would appear as a strategy for 'capital in

general' which could only be carried out by a state, autonomous from the particularistic demands of 'many capitals'. Reproduced in the wake of the Asian financial crisis of the late 1990s in the form of what one could refer as 'crony'-bashing, it simply reveals an inability to contemplate the possibility that processes of financial liberalization, too, generate incentives for rent-seeking behaviour irrespective of the institutional peculiarities of the states in question (Schamis 1999).

Even in those accounts which would not identify 'cronyism' among the factors contributing to the Asian crisis, the loss of embedded autonomy would be regretted. More worryingly, the transition to democratic regimes in countries such as Thailand or South Korea would be seen as falsifying 'the proposition that more competitive politics yield better policies' (Wade 1998; see also Chang et al.1998; Haggard 2000). Thereby, the Olsonian denunciation of interest-group based politics is to be reiterated, as the relationship between the political parties and businessmen has been characterized by the pursuit of distributive objectives, seeking unproductive rents rather than the common or public interest. More curiously, embedded autonomy emerges as a characteristic of authoritarian regimes rather than a specific feature of East Asian style 'private interest governments'. However, this was in line with the emphasis put on the centralisation and concentration of executive authority 'outside of normal institutional channels' by the statist-institutionalist approach for breaking 'anti-reform networks', and *ipso facto*, to realise the insulation of central decision makers from distributive claims (Haggard & Kaufman 1992: 23). The upshot of all is that the advocates of such theories do not seem to heed the warning made long ago by one of the most important state theorists of the last century, namely, that the relative autonomy of the capitalist state cannot be taken in the sense of the state being the locus of a coherent and rational policy 'external' to capital (Poulantzas 1975: 158).

3. THE TURKISH STATE TRADITION AS THE LYNCHPIN OF NEOLIBERAL HEGEMONY

In regard to the particularistic theories with their emphasis on 'path dependence' as an explanan of historical development processes, it is noteworthy that there is a very strong tendency among the contemporary studies to account for the distinctive features of the Turkish social formation, and its state in particular, both in its pre-Republican and contemporary phases in terms of, what can be best described as, a distinctive ontology which would, in turn, require a particular epistemological position. Of course not all those who could be considered as taking part in this enterprise would agree that it does invoke an 'Orientalist' understanding of a particular 'region' or 'culture'. Indeed, some advocates of this particular reading, dubbed as the Turkish state tradition, apparently shared Edward Said's critique of Orientalism (Keyman 1995: 98-99). Nonetheless, and notwithstanding significant methodological differences among its proponents, the Ottoman-Turkish social formation appears as a *prima facie* case to develop particularistic theories which purport to enhance our understanding of the historically contingent and specific social forms. Thus, the Turkish state whether in its pre-Republican or in its contemporary form is considered as a 'deviant case' which defies explanation by Euro-centric, foundationalist social analyses, euphemistically referred to as liberal and Marxist theories. It becomes the *specifica differentia* of the

Ottoman-Turkish social formation whether expressed in terms of the Weberian or Marxian problematics. From a methodological point of view, it fulfills a function analogous to that of Islam within the Orientalist problematic, since its treatment as an independent variable seems to be justified because of its perception as a phenomenon pervading almost all aspects of life. Yet, most of these studies would presumably refuse to be identified with, what may be dubbed as the cultural relativism of the particularistic studies, since they remain within the confines of the modernist assumption that the different must be resolved into the universal.

The remarkable thing about most of these studies is that they are primarily anti-state in inclination, their methodological penchant to treat the state as an independent variable notwithstanding. Although the underlying theme of these reconstructions is the implicit depiction of the Ottoman and/or the Turkish state as a *sui generis* entity, there is no inclination whatsoever either to exalt it as an ideal to be aimed at or to celebrate it as a goal already reached as representing the organic unity of society. On the contrary, the presumption seems to be to recognize the importance of the state as a key explanatory variable of the development process, though more often than not as an impediment to capital accumulation and/or civil society and/or democratization. Hence their anti-statism, since the state in question is perceived as an obstacle, blocking the development of the society, polity and/or the economy in accordance with an idealised Western model, and in the present context, with the Copenhagen political and economic criteria of the EU's enlargement.

Interestingly, this inclination for the particularistic theories so as to enhance our understanding of the historically contingent and specific forms of life would coincide with - what can be called - a post-neoliberal tendency that disputed the universalistic claims of liberal individualist project (Gray 1989: 263; 1993). If the latter was to revoke the (anti-Enlightenment) belief that each 'culture' has its own 'form' to realise, thus requiring its own method of discovery of the thread which guides it, then, a similar paradigmatic approach would be justified for the Turkish state, conceived as detached from its social base and its economy being subordinated to the whims of the holders of state power. For not only the state is portrayed as an impediment, but also the relevance of social class is questioned for the social formation concerned, if not dismissed altogether as a rather ineffective agent of change (Arıcanlı & Thomas 1994; Bates & Krueger 1993). Thereby an apparent paradox emerges as the ideal case of 'high stateness' turns out to be an instrument of particularistic interests. This is generally explained away in terms of the problematic of the Weberian approach as the perpetuation of the patrimonial rule (Mardin 1969).[2] That is, also, how the history of capitalist development, or lack of it, apparently, becomes explicable in terms of a more or less pre-ordained unfolding logic of a peculiarly Turkish Leviathan.

Notwithstanding the warnings that 'crude dichotomies and hermetically sealed concepts' would not do justice to the complexity of the Ottoman social formation (Kasaba 1998: 154), most of the theorising on the Ottoman-Turkish state are made in terms of contrasts with ideal-typical forms which are not concepts that designate an object to be explained and/or provide a mechanism of explanation for that object. Put differently, while the concept of the state seemed to have an objective meaning in the Turkish context, in the sense that it represented a real phenomenon that was external to the consciousness and/or to the conceptual apparatus of the observer, it turns out to be a perfect example of the misconception of social reality being

[2] This has been a favourite theme for many to characterise state-society relations in the developing world in the post-1980 era; see Mouzelis 1994; Oszlak 1986.

concept determined in the sense of being exhausted by subjective meanings. Just to cite a very recent example, it has been contended that

> The state is a concept with an unequivocal referent in the Turkish context. In its eyes, the nation is an organic totality whose true interests can be known and fostered only by the Kemalist governing elite. (Keyder 2004)

Whether this was the (mis)representation of the reality by the scholars themselves or its (mis)conception by the political elite and/or bureaucrats in question, it would nonetheless reiterate the identification of the Ottoman/Turkish state as the constitutive agent of the social formation, on the assumption that it had differed in its origins from those of the West, conceptualized in contractarian terms. Hence, it would not be possible to conceptualise the state in question either as a mode of association or as an institutional arrangement, specifically constituted to provide 'protection' for its 'associates'. Such attempts to distinguish the state of the East from that of the West seem oblivious to the fact, however, that the liberal contractarian account of the state (as a 'purely coercive institution') is conspicuously silent about the processes of state formation in general. In particular, the fact that this contractarian approach was not at all concerned with the historical 'origins' of the state, but rather engaged in a logical exercise, seems to have been glossed over.[3] But this presents a particularly difficult dilemma for those who were generally pre-occupied with showing the uniqueness of their case, for they had to establish its 'historical' rather than 'logical' origins, unless they subscribe to a methodologically nominalist position.

To the extent that the institutions of that state are portrayed as the source of power and embody the idea of the state, they appear as if they were the expressions of a primary essence. Thus, unwittingly, the implication of such a theoretical stance would be an attribution of an 'expressive unity' to the social formation in question as well as a rejection of the claim - associated with the Enlightenment thinking - of the universal applicability of all 'laws' to all historical entities. This would, in turn, pave the ground for a relativist outlook with important policy implications. Such a relativist outlook would be duly reproduced by the proponents of anti-foundational analysis while seemingly denying any allegiance to Orientalism. Yet, in its post-modern version, the Turkish state would nonetheless be still identified as the constitutive agent who 'gains its identity as an active subject of nation-building' (Keyman 1995: 101).

However, it is difficult to resist the temptation to take issue with this particularistic tendency which would, in its institutionalist moment, concur that institutional structures of the states are to be given explanatory primacy. For it was not at all clear what was so unique about this 'tradition' since we were actually presented with a vivid illustration of that hybrid conception of the state both as a strategic 'actor' and an 'arena', as well as a set of institutions. As a causally efficacious agency, its power would be a function of its capacity to create institutions as well as its ability to extract and mobilise resources. And to the extent that its power would be directly related with its capacity to define and enforce property rights, to use the terminology of the new institutionalist literature, it would not necessarily be any different from any other capitalist state. Indeed, it is noteworthy that the Turkish state emerges as the spearhead of this drive for liberalization-cum-democratization process, whilst

[3] Barry 1989, p.63; Spruyt 1994, p.84.

its institutional edifice has been itself subjected to a radical overhaul in due course, as it will be discussed in the following section.

As it has been the case with the New Right which proved to be the hegemonic mode of thinking for the 1980s and beyond , the 'success' of this particularist account has had less to do with its banality as a paradigm of intellectual endeavour than its function as an ideological construct to re-establish the hegemony of a particular class. Thus, it becomes essential to come to terms with the state and civil society, or the market for that matter, not simply as objects of inquiry, but as 'hegemonic apparatuses' in their portrayal by the dominant paradigms as being externally related, if not as ontologically distinctive domains, with their own logics and principles. It is, therefore, important to understand the links between the philosophies, however precarious their foundations could be, through which people understand the world and the practices through which they operate in it. That is, it becomes imperative to explore, in this particular instance, how the portrayal of the Turkish state as something external to consciousness, facilitates relations of class power and to show how it rationalises certain strategies, thereby contributing to the establishment of particular mechanisms of (capitalist) social control (McLennan 1996).

4. RESTRUCTURING THE TURKISH STATE IN THE CONTEXT OF EUROPEANISATION

The revival of this relativist account in the context of Turkey's pre-accession process to the EU is noteworthy since it had a direct bearing upon the ways in which the political project of economic and political liberalisation was attempted to be justified in accordance with the IMF stand-by agreements and EU's Copenhagen criteria. For it would be employed as part of an ideological crusade to restructure the state as such during the last two decades and a half so as to initiate a process of structural reforms. However, it also highlights the entrenched tendency among the scholars concerned for the misconception of social reality as *concept determined* in the sense of being exhausted by subjective meanings, as it becomes impossible to disentangle the Turkish state from its particular reading, namely, the 'state tradition', as *both* are characterised as having experienced a 'legitimacy crisis' (Keyman & İçduygu 2003). This could thus be seen as a perfect example of what the realist philosophers of science have identified as 'the linguistic fallacy' - 'the guise which the epistemic fallacy now customarily wears in … post-modernist thought'. That is to say, the conflation of the analysis of social reality to 'our discourse about being' (Bhaskar 1993: 206).

The Turkish state would emerge as a Janus-faced entity in many such accounts since it would personify the prerogatives of an undemocratic legacy. While the continuity with the Ottoman past rather than a break with it has been asserted, the Kemalist regime was held responsible for the absence of a civil society (Sunar 1996). Hence the need to activate the forces of civil society will be underlined in order to defeat that dragon, and pave the ground for overcoming the shortcomings of this legacy (Heper & Keyman 1999; Keyder 2004). Yet, the onus is also on the state to act as a rational agent so as to initiate not only a process of institutional reforms, but, *ipso facto*, a transformative change in the nature of social reality, albeit discursively:

> [For] the state does not possess a coherent ontological identity … its very identity is discursively constructed. The state … has no ontological status apart from the various acts which constitute its reality … (Keyman 1995: 101)

Ironically, there are interesting parallels between the ways in which the advocates of this ideological crusade portray the Kemalist project of the nation building – which functions as one of their scapegoats as reflected in the calls for a 'Second Republic' (Toprak 1996: 117) - and their own justification for the need to comply with the Copenhagen political criteria.[4] In this view, 'the Kemalist will to civilization attempted to transform the passive Oriental subject into an active one, a process in which the nation-state was to play the organizing role'. Similarly, and presumably still 'employing the epistemological and ontological distinction between the Occident and the Orient' (Keyman 1995: 103), 'a gradual shift from the traditional interpretation of the monolithic Turkish nation to a redefined notion of political community that requires a more inclusive and truly civic concept of citizenship' would be deemed necessary so as to make 'its modernity[5] liberal, plural and multicultural' (Aydın & Keyman 2004).[6]

By the same token, the way the 'reforms' will be realized, would hardly be any different from the ways in which the nationalist elites had been depicted as establishing the founding principles of the Turkish republic, that is to say, 'imposed from above' (Keyman 1995: 104). The difference being, of course, that the culprit in the current circumstances would be of a different kind. Rather than being demonized as acts of an authoritarian regime, as it had been the case for the early Republican era, the conditionalities of the EU as well as those of the IMF and the World Bank that have been imposed upon the Turkish polity and the economy will be celebrated as equally necessary, that is to say, 'to enlighten the people and help them make progress' (Heper 1985: 51).

No doubt, this underlines the impact of European governance on the processes of socio-economic and political transformation in Turkey as the EU emerges as a major determinant of political change in the country in terms of its pre-accession political criteria. At the same time, it was no doubt reflecting a continuing disenchantment with the IMF-World Bank-led structural adjustment episode to the extent that the state is portrayed as an impediment to the emergence of a market economy in accordance with an idealised Western model, thus perpetuating an adherence to an alleged 'tradition' of the state as a constant of the Turkish political economy. As reflected in the studies by the Western observers of the Turkish structural adjustment in the 1980s, the market-oriented reforms of the decade had been found

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[4] "The nationalist discourse … is in fact a product of Orientalism, a reversed Orientalism. … It is through nationalist thought that the post-colonial state gains its identity as an active subject of nation-building. The result is the construction of a community within which different subject positions are dissolved into the national identity." (Keyman 1995, pp.100-101)

[5] As it has already been underlined the concept has dominated social theorising in the 1980s, replacing the previously fashionable terms 'industrialism' or 'industrial society' in the 1950s and 1960s and 'capitalism' in the 1970s. The underlying rationale of the shift to the term 'modernity' was to move attention away from what in Marxist terms would be called the forces of production or the social relations of production towards more cultural and political dimensions of modern societies. (Outhwaite 2000)

[6] It is noteworthy that the question of ethnic identities and the redefinition of the Turkish nationhood would continue to create political cleavages among the Turkish politicians as well as the intelligentsia in the aftermath of the EU's decision in October 2005 to start the accession negotiations with Turkey. Thereby, the nature of the Turkish state would be once again brought under scrutiny, if only, to reproduce the predicaments of the relativist outlook.

wanting in ending the subordination of the market and/or civil society by the 'strong state' (Kirkpatrick & Öniş 1991; Mosley et al.199: 147; Rodrik 1991).

The launching of the 24 January 1980 stabilisation programme had initially been hailed as signifying a radical change *both* in the mode of articulation of the Turkish economy with the world economy and in the nature of state-economy relationship prevalent within the social formation.[7] Interestingly enough, *ex post* analyses of this restructuring process have been regretting the fact that 'reforms tend to be initiated in a top-down fashion' (Öniş 2004). Once again, 'the residue of the past' would come into play to exercise significant influence on the nature of institutions, as the political elites continued to remain 'unresponsive to civil society' (Sunar 1996: 149; Heper & Keyman 1999: 261). Within such a framework, societal forces function, at best, as 'constraints' on the policy-making capabilities of the state elites. This gains critical importance in terms of policy-making analysis, for it, at least, provides a premise for the otherwise unjustifiable contention of the statist approach that the state as an institution generates and implements specific strategies and policies. Put differently, as change becomes endogenous to the state, a state-centred pespective is justified as the most suitable approach to tackle the question of policy choice. Consequently, there remains no reason to worry about how to make institutions endogenous. More importantly, while the society-centred approaches are dismissed for failing to account for the strong continuities present in national patterns of economic policy, any policy change becomes explicable in terms of elite choices, thereby discarding the impact of shifts in the forms of interest representations on policy outcomes. Indeed, almost as a corollary, it has been repeatedly asserted that the traditionally inferior status of the economic elites and/or groups make them oriented more towards individual manipulation at the implementation phase of the policies rather than getting constructively involved in the interest articulation and aggregation phases of the policymaking processes (Heper 1976; Heper 1985:104).

Such traits are also reflected in the studies undertaken in the current period which have perceived the need to initiate the project of Europeanisation in Turkey in order to put an end to the legacy of the state tradition. The process of Europeanisation, thus, takes on the role of the 'whip of external necessity' in compelling the accession countries to fulfill the EU membership criteria. It would thus be characterised as 'a process of enforced EU-ization' (Diez et al.2005). The last month of the year 1999 could be considered as an important landmark in this process since it would witness not only the granting of the candidate status to Turkey by the Helsinki European Council, but also the approval a three year stand-by agreement by the IMF.

> The Turkish economy in the post-1999 era has, in fact, been confronted with a double external anchor, namely simultaneous IMF and EU discipline, which has clearly been pushing Turkey rapidly in the direction of institutionalizing reforms and greater fiscal discipline. (Öniş 2004)

It is especially noteworthy that the EU Commission's *Accession Partnership for Turkey*, which is said to clarify 'a road map' in this regard would circumscribe its 'economic criteria' with the implementation the structural reform programme agreed with the IMF and the World Bank. Accordingly, the *2004 Regular Report on Turkey's Progress Towards Accession* would

[7] See Boratav 1994 and Yalman 2002 for critical accounts of this rather savage experiment of wholesale economic and political restructuring.

underline the significant role played by the EU's conditionalities in this regard when it contended that

> [t]he Pre-accession Economic Programmes presented since 2001 illustrate the transition from previously short-term oriented *ad hoc* policy decisions towards a more medium-term-oriented and rule-based policy approach. (EU 2004)

Reflecting the strong bias towards liberalisation and the regulation of the economy through markets and competition at the expense of the political control of the main directions of development which has been the underlying paradigm of the EU's Lisbon Strategy, the EU Commission's monitoring of the Turkish 'transition' in its annual regular progress reports has continued to repeat the standard bearers of the neoliberal reform agenda.[8]

In addition, the EU's role in the process of internal transformation has also been depicted as providing 'the critical external anchor' that will support the progressive domestic forces in their endeavours for democratization (Tocci 2004).

While the EU had initially been a state project for Turkey's elite, now it had become a platform for those who wanted to rein in the elite authoritarianism of Ankara. … Aware that they had neither the resources nor the ability to mobilize social forces to defeat the state, opposition groups came to see the candidacy [to the EU] process as the only way of winning support for greater democracy, rule of law and expanded pluralism, as depicted in Copenhagen criteria. (Keyder 2004)

> A credible and consistent policy of conditionality is thus [deemed] necessary to empower reformist elements in Turkish society. (Aydın & Keyman 2004)

Thereby, change ceases to be endogenous to the state as contended by the advocates of the state tradition argument, whilst the EU emerges as a 'powerful actor generating system-transforming impacts'. In other words, the EU will not only be celebrated for instigating changes 'in the nature of the state-society relations in Turkey', but its status would be clarified as an agent of globalisation. For the latter is to be characterised as 'generating important effects in the ways in which societal affairs in a given national setting are constructed, as well as in the mode in which they are analysed' (Keyman & İçduygu 2003).

Hence, the Europeanisation project gains an ontological as well as an epistemological significance, as it becomes not only an end in itself but also a means to an end, namely, to break the 'path dependency' of the Turkish social formation. Thus, it might as well be seen as a vivid example of what has been described as 'offensive projects' which have a 'foundational character' since they 'aim at overcoming lock-ins resulting from path dependency'(Von Haldenwang 2005). Ironically, such a portrayal of the EU implies, in realist terms, its characterisation as an 'emergent entity with sui generis causal powers', generating 'emergent spatio-temporalities' (Bhaskar 1993: 125, 275). No less significantly, it would signal the death knell of the state tradition as a particularistic epistemology to account for the distinctive features of the Turkish social formation.

[8] See as a recent example, the enumeration of the economic criteria in "Proposal for a Council Decision: On the Principles, Priorities, and Conditions contained in the Accession Partnership with Turkey", Commision of the European Communities, Brussels, 9 November 2005, COM (2005) 559.

While there is a clear reflection of the modernist inclination that the different must be resolved into the universal, an adherence to a statist-institutionalist analytical apparatus with its emphasis on institutional differences between states as an explanan of different developmental outcomes is maintained. In its post-modern version, this would be echoed as 'the emergence of alternative modernities' challenging 'the hegemony of the secular and state-centric nature of Turkish modernity'(Keyman & İçduygu 2003). However, it does not at all entail any acknowledgement of the possibility that 'national peculiarities' could well be the product of the workings of capitalism as a whole, developing unevenly as it expands across the globe. Put differently, this particular national tradition would not be portrayed as an element of extra-market coordination along the lines that the 'social market economy' in Germany or the 'strong state' in France would be depicted by the institutionalist comparative political economy. Rather, there is an apparent affinity with the so-called new institutionalism (North 1990: 42), to the extent that the emphasis would be on culture and cultural factors as *explanans* of historical peculiarities (Keyman & İçduygu 2003).

This will also be reflected by the portrayal of the EU conditionalities in the context of its pre-accession process as 'fostering "socialisation" with European norms and values'(Aydın & Keyman 2004). This is certainly in line with the so-called constructivist approach which underlined the salience of norms in shaping the interests and identity of states as a principle of explanation of the European integration process in general, that of EU's eastern enlargement in particular (Jileva 2004). However, there is hardly any acknowledgement of the relative neglect of the social and economic rights in the implicit hierarchy of rights consecrated by the EU's pattern of development (Schmid 2004). Thus, there remains no reason to contemplate the EU as a social-disciplinary force. Nor there remains any need, in fact, any methodological basis to come to terms with

> a world in which the actions of governments, as well as firms and workers, are internally and externally disciplined by market forces, or, put differently, by the power of capital. (Gill 1998)

5. CONCLUSION

This, incidentally, highlights an often disguised convergence of opinion between the orientalist discourse and the statist-institutionalism. It also tends to coincide with the increasingly unambiguous convergence of opinion among different schools of thought, that 'institutional capacity' is the key independent variable to determine the success of economic reforms. However, there is hardly any encouragement for the advocates of institutional change from the Turkish experience since the late 1980s. In particular, the latter provides a strong case to challenge the contention of the property rights approach about 'the structure of institutions and their restraining influence on behaviour' (Eggertson 1990: 68), thereby underlining the importance of power relations so as to come to terms with the developments taking place in the Turkish context in particular, and in a capitalist social formation in general. The establishment of a whole series of new institutions in financial markets as part of the process of financial liberalisation has simply reinforced, rather than changing the behaviour pattern of the market agents, namely, the prevalent short-termism and the lack of an industrial outlook, to use the terminology of the institutionalist analysis. So there was,

perhaps, a lesson to be learned from a comparative analysis of the so-called short-termist behaviour in a totally different institutional context. For the British advocates of an institutional change whose admiration - prior to the Asian crisis in the late 1990s - for the institutional structures of the East Asian states was equally astonishing, have been arguing in terms very similar to their Turkish counterparts, but with one radical difference. For they would single out dependence primarily on the market for the allocation of investment funds rather than dependence upon the state as the basic cause of ‘short-termism’ in Britain (Hutton 1995: 42, 114). Put differently, in the British case, the blame for the lack of an industrial strategy as well as ‘short-termism’ is said to result from the prevalence of ‘market rationality’. Oddly, for the advocates of the institutional approach, two radically different institutional structures were producing very similar ‘behavior’ - tendency to look for the highest returns in the shortest period of time - on the part of the ‘market agents’/investors, and similar outcomes - lack of investment in manufacturing. The lesson cannot be clearer : institutional structure cannot be the culprit on its own, nor a change in institutional structures would be enough to produce different outcomes.

There is also the potential danger of losing the sight of the actual struggles of power within and between societies which function as the determinants of development processes, if one is to attribute ‘causal powers’ to these institutional structures so that they would be perceived as preventing the countries from developing along the idealised paths of capitalist development. On the other hand, recognition of the constitutive role of the state in the formation of markets, historically, would not only confirm Marx’s contention about the centrality of the state power for the reproduction of capitalism, but would undermine the whole thrust of the uniqueness of the Turkish state argument. As pointed out, to invoke "the state" as a "moving force" in concrete historical analysis is to engage in a mystification (Jessop 1978: 280). Instead, one must examine its institutional forms, their role in shaping the political class struggle, and the impact of this struggle on the transformation of the state apparatus. In short, there is an imperative to counter the theoretical efforts which aim to keep out of sight the varying ways in which ‘states are constituted to reinforce capitalist class power’ (Panitch 2002: 97).

As for the futility of such attempts to invent theories or paradigms as ‘middle-range generalisations’ to deal with the ‘logic of particularity’, suffice it to say that to establish the state as an object of analysis does not necessitate the implicit assumption of envisaging the state as a *sui generis* reality. Certainly, it would not justify the use of the state as an ‘independent variable’ in providing explanations of either crises or policy change (or lack of it) within a comparative framework. A ‘theory of state’, in a sense, is a misnomer since at a certain level of abstraction, it is not possible to refer to ‘the state’ as an entity with a separable existence (Corrigan et al.1980, Sayer 1985; Poulantzas 1978: 19). Such a theory would only be plausible to the extent that it enhances our understanding of the relationships between the economic and the political, conceived as ‘forms’ of social relations, or in Gramsci’s terms, two ‘moments’ of reality, rather than distinct entities existing separately from each other. It is equally necessary to avoid contemplating them as mere forms of manifestation of one essential level (Geras 1973: 299). Nor are they already constituted essences, inherently autonomous or otherwise, which then enter into external relations with each other (Poulantzas 1973: 17; Anderson 1980: 69). Therefore, if one is to avoid this oft repeated theoretical cul-de sac, it is essential to approach the determination of social forms as an historical process whose dynamic is internal to it. Similarly, it is important to deny the existence of the state as an

ontologically distinct entity from the society and/or classes, either as an object or as a subject. The state is a reality as it is constitutive of the social relations, and yet not ontologically distinct from them, just as other 'forms of appearance' are 'real' (Poulantzas 1978; Vincent 1992). This is, we believe, an important principle in conceptualising the relations between the state and the economy as 'internal relations'. And this is what is entailed by the conception of the state as a form of social relations. This, in turn, underlines the need to treat concepts like 'the State' as 'empirically open-ended' so as to come to terms with the relational and the historical character of social reality (Corrigan et al. 1979: 9; Dyson 1980: 253; Sayer 1987: 23). Put differently, an understanding of the historically specific processes of class and state formation in different 'national' contexts, albeit conditioned by the changes in the capitalist world economy, could only be enhanced by employing such an empirically open methodology within a common explanatory framework.

On the other hand, the explanatory value of the governance approach for accounting the role played by the societal actors in shaping the process of European integration and/or accession negotiations remains to be tested. For, as it has been contended by the advocates of the institutionalist type of analysis themselves, the emergence of European modes of governance is essentially understood as an incremental process of institutional change instituting a new 'path dependency' for the actors concerned with the incorporation of the supranational ones. But, more fundamentally, the development of a critical perspective will be apposite since the dominant perspectives are not necessarily powerful in probing the ways in which different interests are structured (Van Apeldorn 2005), and the ways in which the generation of norms and rules play a part in the construction of hegemonic discourses. In this regard, the ideological significance attributed to the prospective membership in the Turkish context as part of an attempt to overcome a particular political and economic crisis that the country has been engulfed in at the turn of the millenium needs to be underlined.

By the same token, given the dominance of the norm-driven as well as the interest-based modes of explanation in regards to the recent round of EU's enlargement (Jileva 2004), the adoption of a more critical perspective will be desirable for the following reasons. Firstly, while the so-called multi-level governance approach tries to move the analysis of European integration beyond the dichotomy between intergovernmentalism and supranationalism, it is pertinent to query the extent to which it overcomes the deficiencies of a dualistic conception of the state and the market. Indeed, it has been contended that the characterisation of the EU with a system of multilevel governance tends to reproduce this dualism (Bieling & Schulten 2003).

Secondly, it is imperative to explore in different national contexts whether the turn to governance is to further the processes of democratization or to be part of a complex power struggle to continue the processes of social, economic and political exclusion, that is, to preclude popular-democratic control over decision-making processes at different scales, and/or continue socialising risks in favour of private capital (Jessop 2002a: 207; 2002b: 200). In short, the process of Europeanization should be scrutinised so as to test the proposition that the aim of the 'reforms' implemented is the reform of a state that is not only more efficacious but also more congenial with democracy. It is also essential to bring into light the question of rights as a fundamental premise of the democratic form of the state. Put differently, there is a need to unveil the changing conception of democracy and/or democratization over a period of time, as there seems to be a shift in the ways in which the priorities are determined to define political and economic coordinates of a democratic order while the EU itself undergoes

significant transformations. In particular, there is a need to highlight the relationship between the political, civil and social rights as envisaged by the Copenhagen criteria for new members.

In fact, a neglected dimension of the debate on EU's enlargement, perceived as a tool of Europeanisation, has been that of competitiveness. Yet, it is not simply to be treated as a purely economic phenomenon, since it is closely related with the question of rights, those of social and economic ones in particular. For an adherence, albeit rhetorical, to a policy stance which identifies competitiveness as a substantive purpose of the states concerned carries the potential risk of subordinating social policy to the demands of flexibility as policy-makers tend to focus on supply-side aspects of international competitiveness. In this regard, to develop an understanding of the perceptions of the local actors involved gains saliency as "regionality" becomes an important dimension of Europeanisation. Moreover, there is a need to question whether, or to what extent, various social forces involved in promoting or resisting the transformation process are all consciously concerned with an explicit project to construct a competition state in the context of the EU membership and/or accession to full membership.

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Chapter 13

THE NEO-LIBERAL PARADIGM AND SMALL ENTERPRISES: ACCUMULATION BY DISPOSSESSION IN THE CASE OF TURKEY

Şemsa Őzar

1. INTRODUCTION

Contemporary economic discourse on less developed countries is marked by a revival of interest in small enterprise and its role in the overall growth of the economy. It aims to modify, if not reverse, the dominant logic of the import substituting industrialisation era which favoured large scale production for the advantage entailed in the economies of scale. It was previously assumed therefore that the role of small enterprises in the economy, particularly in the manufacturing sector, will diminish gradually giving their way place to large Fordist enterprises. But, the persistent crisis of the capitalist economies on a global scale since the late 1960s has precipitated new economic processes and practices involving for the most part different modes of utilisation of labour. The trans-national expansion of capital and the subsequent relocation of manufacturing activities to the periphery proliferated the range of income-procuring activities, and at the same time laid the foundation for the emergence of new structural forces governing the complex relationship between the core and the peripheral economies. In this respect the possibility of dividing the process of production into distinct sub-processes and deploying each sub-process in most appropriate location proved particularly attractive to capital. For it provided capital with the opportunity to utilize labour more efficiently, that is, at the lower cost and more productive ways. Production has since been moved from one country to another, to different regions within the same country, from factories to workshops, and even to households in neighborhoods.[1] The spatial expansion of

[1]This point is covered extensively in recent economic literature; see for example Tabak (2000). He points out in relation to Hong Kong "…the constant growth in the subcontracting of production is clearly illustrated by the structuring of the manufacturing sector in Hong Kong: 57 percent of its exports originate in local companies with less than fifty employees and are marketed through fourteen thousand small import-export houses (Tabak, 2000:85-86).

the world economy has expanded capital's ability to deploy different forms of production and exchange, and altered associated configuration of the capital-labour relations.

Recently, the promotion of small enterprises has increasingly become the focus of neo-liberal policies but mainly in the context of attempts to integrate peripheral economies into the world capitalist system. Small enterprises have therefore been given a special role in economic growth that was not previously granted to them by international economic institutions such as the IMF, the OECD and the economic decision-making bodies in the EU. In line with this development governmental and non-governmental institutions both in the advanced industrialised countries of the core and the less developed peripheral countries have placed the promotion of small enterprises on their agenda expressing an increasing confidence in the capacity of these productive units to contribute to economic recovery and growth[2] (Kirchhoff, 1990; OECD, 2004; EC, 2004a, 2004b). Although their expression of interest in small enterprises seems to have a number of basic features in common, in reality however each of these institutions of economic policy and decision making has pursued a fundamentally different objective. In their vision advanced industrialised countries and less developed states both share the same rhetoric of growth, innovation and competitiveness. But in the case of the less developed countries it is becoming increasingly evident that the deployment of small enterprises has not always produced the intended results. This is because in this case the promotion of small enterprises has been affected by the prevailing economic conditions such as chronic poverty, high unemployment and low domestic demand. Consequently, small enterprises in less developed countries have failed to engender an internal economic dynamics of the type attributed to them by these institutions. They have been forced to operate in conditions defined by structural adjustment policies imposed on them by international economic and monetary institutions. The objective of growth and innovation has for the most part been replaced by strategies of survival. Where this kind of relationship with capital has been established, small enterprises in less developed countries have mostly been transferred into sources for provision of cheap labour, usually regulated by structural adjustment policies informed by neo-liberal orthodoxy. Despite the prevailing economic arrangements for the use of cheaper labour and the relatively more attractive investment environment established to support them, the economies of the periphery continue to suffer under high unemployment rates and growing poverty. The trans-national capital continues to move across economies in search of new methods to increase profit and expand accumulation.

This paper will attempt to analyse the process of reshaping of the periphery by economic strategies promoted by the contemporary neo-liberal orthodoxy. In so doing it will investigate the development of a subset of small enterprises that are currently being subject to the process of 'accumulation by dispossession'.[3] The investigation as such will be largely theoretical in nature, proceeding with general analytical arguments substantiated empirically with reference to Turkey when there is sufficient data available to do so.[4] A comprehensive empirical

[2] "Small businesses play a central role in the European economy. The average European enterprise employs no more than six people. In Europe, small businesses play a much more important role than in other parts of the world. These small businesses are a key source of job, business dynamism and innovation" (EC, 2004b).

[3] The concept of "accumulation by dispossession" is borrowed from Harvey (2003) and will be subsequently elaborated in the context of this essay.

[4] Evidence will be drawn from a field survey conducted in 2001 and 2002 on small enterprise in 19 provinces of Turkey. A representative sample of 5,000 entrepreneurs from small enterprises are interviewed in their workplaces. The small enterprises that are investigated in this field survey include the enterprises of own-

investigation yielding itself to systematic theoretical conclusions is not possible at present due mainly to the lack of primary field research and reliable data.

2. GLOBALIZATION AND RESHAPING OF THE PERIPHERY

Capitalist economic system is governed by the logic of endless accumulation. This constitutes the universal logic of capitalism as a world system. The process of capital accumulation, however, creates a growing polarization of distribution between capital and labour.[5] The causes of this polarization are successfully concealed by essential linkages created by trans-national capital in the processes of production in 'commodity chains' on the global level[6] (Wallerstein, 1999). Thus, the determinants of the distribution of rents/profits in the commodity chain are heavily influenced by the relative powers and positions of the participants in the chain of production. Within a chain, upper-tier participants enhance their incomes by constructing barriers to new entry and against competition. In Gereffi's words "profitability is greatest in the relatively concentrated segments of global commodity chains characterized by high barriers to the entry of new firms" (Gereffi, 1999:2). This argument suggests that the analytical framework provided by the commodity chains is particularly helpful to explain the causal relations underlying the ways in which global integration of production and trade is associated with the rising inequality within and between participant countries.

Neo-classical economic wisdom maintains that in free market conditions when an activity is receiving higher profits there will be new entries to the market thereby increasing the supply and reducing the price of the commodity in question. Hence fall in the rate of profit, which in effect is detrimental to the accumulation of capital. The only barrier the new entrants face, the neo-classical argument suggests is thus the efficiency of the existing producers. If the new entrants match this level of efficiency there will be no constraints to entry unless that which may be created by non-market relations, political or legal. Wallerstein (1999) expanding on the neo-classical argument maintains that returns to a producer must therefore be relative to its power in the market and should increase only to the extent to which it can prevent competition and monopolise the market. The rational of this argument is difficult to miss. It indicates in no ambiguous terms that political intervention in the market, the state's

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account workers and employers with up to 50 employees performing in the manufacturing, trade and the service sector. For the purpose of the present study I will use the qualitative findings of the survey which include 10 case studies with small enterprises and 6 focus groups with entrepreneurs from diverse backgrounds and activities. The field survey is conducted as a part of a research project coordinated and sponsored by the Economic Research Forum for Arab Countries, Iran and Turkey (ERF). The author is the principal investigator for the case of Turkey.

[5]"Over the last fifteen years, real income from work has risen by 2 per cent (practically not at all), while income from capital has soared by 59 per cent. This marks only the beginning of a phase in which the productivity of capital is growing without labour. In the global age, labour kept becoming cheaper and more plentiful, capital scarcer and more expensive. The declining return on labour and the increasing return on capital thus led to an ever sharper division between a world of the poor and a world of the rich" (Beck, 2002:152).

[6]'Commodity chains' identified also as 'value chains' are defined as follows: "The value chain describes the full range of activities which are required to bring a product or a service from conception, through the intermediary phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use" (Kaplinsky, 2000:119). Gereffi (1999) describes a commodity chain as "…the whole range of activities involved in the design, production, and marketing of a product" (Gereffi, 1999:1).

role in regulating market relations, and the multiplicity of the juridico-political relations which delimit competition should not be perceived as being detrimental to the working of the market. On the contrary, it is a necessary requirement of the reproduction and accumulation of capital on a global scale.

Viewed in this perspective, not only the neo-classical conception of free market conditions but also and more importantly the crucial relationship between the state and the market acquires an entirely different meaning. 'Free market' policies, are not only not free from juridico-political intervention by the state and associated international economic and financial institutions, but in reality, they assign significant powers to the state apparatus. Hodgson referring to Polanyi's incisive argument states that 'the creation and maintenance of private property rights and functioning market institutions require the sustained intervention of the state to eject economic forms and institutions that are antagonistic to the private market system" (Hodgson, 2002: 206). The capitalist state helps ensure the efficient working of the market in more than one way. It is in fact instrumental in maintaining the conditions of capitalist accumulation. The capitalist state is essentially an economic force on the global scene.

The economic function of the state has been subject of debate and controversy in the contemporary economic discourse on globalisation.[7] It is however clear that although the state may have been losing its command on national monetary and fiscal policies, in the process of globalisation it acquired a new and far more effective role in the economic policy and decision-making. This is particularly true of those aspects of economic policy and decision-making which govern the processes and the modalities of the political and economic integration of the nation state in expanding orbit of the global production and exchange. The primary logic underlying this process is not difficult to fathom. For the absence of regulation on the national and international levels can and does create a great risk to the accumulation of capital.

Wallerstein explains the functional necessity of the modern state to the effective working of the market succinctly in the following passage:

> "What are the services that capitalist need of the state? The first and greatest service they require is protection against the free market. The free market is the mortal enemy of capital accumulation. The hypothetical free market, so dear to the lucubration of economists, one with multiple buyers and sellers, all of whom share perfect information, would of course be a capitalist disaster. Who could make any money in it? The capitalist would be reduced to the income of the hypothetical proletarian of the nineteenth century, living off what might be called "iron law of profits in a free market, just enough barely to survive. We know that this is not how it works, but that is because the real existing market is by no means free." (Wallerstein, 1999:25).

Let us now consider this issue in a broader global perspective and relate it to the pivotal question of the analysis in this essay. In a global economic perspective, a direct and in most cases structural relationship could be discerned between the persistent economic crisis in the core and the quest for the implementation of neo-liberal policies in less developed countries since the early 1980's. To be more precise, the liberalisation of the economy in the periphery more often than not has been perceived as a means to help resolve the mounting crisis in the

[7] See for example, Beck (2002), Giddens (1999), Harvey (2000 and 2003), Hirst and Thompson (1996).

core. This holds true particularly when strategies of cost reduction and risk control by the economies of the advanced industrialised core have required the breakdown of production processes and their relocation in the periphery. The prevailing economic conditions in the peripheral countries, marked by large balance of payments deficits and high unemployment rates, forced the governments of peripheral countries to implement the structural adjustment policies of the IMF and the World Bank. These policies primarily aimed at reducing the economic role of the state in the periphery to enhance restructuring of their economies towards greater integration into the world markets. Worldwide free trade was thus praised as the universal means of generating growth and raising living standards throughout the world. But the implimentation of neo-liberal policies have since led to diverse consequences in the periphery which are for the most parts at odds with the prescriptions of their authors and practitioners in these international economic and financial institutions.

Kaplinsky's (2000) observations, substantiated by extensive empirical research, are particularly instructive in this respect. He argues that although the implimentation of neo-liberal economic policies in the periphery have led to a rise in economic activity in terms of output and in some cases in terms of employment, the overall economic returns in these countries have been falling owing to the declining trend in the terms of trade of a wide range of manufacturing exports since the mid-1980s. Kaplinsky further elaborates on the adverse effects of the decline in the terms of trade. His analysis indicates that, by contrast to upper tier enterprises of the advanced countries of the core, lower-tier enterprises of the periphery are not protected by high barriers to entry. Those stuck in activities with low barriers to entry are ultimately losers. This is because, in order to be able to link up in a commodity chain, they are forced to compete with each other to lower the cost of production (Kaplinsky, 2000). In a world of increasing poverty and high unemployment, low barrier activities inevitably attract new entries thus increasing the extent of losses over time. At the bottom of the commodity chain barriers to entry eventually become so low that the returns are increasingly less capable of providing for capital accumulation.

The low barrier activities are not only subject to entry by new enterprises, but also lead to the exit of 'losers', those enterprises which fail to stand the fierce competition by the new comers to the market. Capitalism, however, is not disturbed by these developments in the market. On the contrary, it readily welcomes the destruction of 'inefficient' enterprises, perceiving it as a natural outcome of a well-functioning free market driven by competition. It is thus argued that the process of 'creative destruction' enhances productivity directly by reallocating resources to more productive activities. Schumpeter has clearly referred to this specific feature of capitalist market relations and its outcomes in his seminal work *The Theory of Economic Development* (1934). Schumpeter argues that oligopolistic market structures could be destroyed through 'creative destruction' when innovation by new firms is the driving force of competition in the market. From Schumpeter's point of view, however, it is primarily the innovative entrepreneur who can supersede the existing oligopolistic barriers by generating higher returns and making more profit. But Schumpeter seems to have overlooked the fact that in reality many of the new enterprises which enter the market are not established by his innovative entrepreneurs. As Csaba argues in relation to Hungary, many of the new enterprises which enter the market are set up by those he terms 'forced entrepreneurs', that is, economic agents who do not have access to alternative sources of employment in the wage-earning sector, despite their avowed willingness to accept considerably less money for their labour (Csaba, 2003).

3. NEO-LIBERAL AGENDA AND SMALL ENTERPRISES IN THE PERIPHERY

A brief exposition of the neo-liberal agenda for the promotion of small enterprises in the periphery is now in order. Economic liberalization policies which have been imposed on the less developed economies of the periphery by international economic institutions such as the IMF, World Bank, and more recently by the WTO are meant to dismantle all institutional arrangements which are put in place to enable these economies to protect their domestic markets against imports. Policies designed to promote free trade, Pollin notes, have produced different outcomes in the peripheral economies. They have led to 'improvements in their exporting capacity' and at the same time created a 'corresponding increase in the penetration of their own domestic markets by foreign imports'. 'Firms in the relatively new export manufacturing countries', he further contends, 'have been forced to appropriate higher productivity production methods in order to compete in the global market. This has made their operations more efficient, but also entailed reducing the number of workers they employ (Pollin, 2003:158). Pollin's incisive comments are instructive in particular in relation to increasing unemployment and mounting poverty in the periphery.

In the specific case of Turkey, for example, liberalization policies have led to the intensification of volatility in the performance of the economy, a phenomenon which has in turn resulted in financial crises followed by higher unemployment, rising poverty and growing foreign debt. To be more precise, on the one hand Turkish economy has been unable to generate employment thus adding to the number of people who are abandoned to their own means to survive the adverse conditions. On the other hand, it has encountered a falling domestic demand for the goods and services produced by small enterprises. Moreover, imports from low wage economies such as China generated additional competition in the market which in turn affected the economic performance of the small enterprise. Falling returns has been the most common outcome of these conditions.

But the neo-liberal agenda provides a rather different view of the fate of small enterprise in peripheral economies. It is thus claimed that small enterprises do not only facilitate transition towards a more efficient and competitive market economy, but also help to generate employment and alleviate poverty in the developing countries[8]. In this framework, state regulation is required to play a supportive role in promoting entrepreneurship. Governments are therefore advised to establish a business environment conducive to stimulate entrepreneurial activities.

In so far as the economic performance of small enterprises in the periphery is concerned, the fundamental propositions underlying policies promoted by the neo-liberal agenda are for the most part incoherent and contradictory. This incoherence and internal contradiction however largely reflect the contradictory structural dynamics of global capital. Global capital, in order to ensure endless accumulation must enhance its ability to penetrate and govern economies of the less developed countries of the periphery. This is often achieved by

[8] The OECD Report on Small and Medium-Sized Enterprises in Turkey thus states: "The entry of large numbers of young people into the labour market, a huge shift of jobs from the farm sector to industry and services, and the swelling ranks of women in the labour market (women accounted for only 27% of the formal labour force in 2000) will require substantial new job creation in industry and services over the years ahead. Judging from the

'homogenizing' their institutions with those of the core, a process which is requisite to minimize the risks involved in production and exchange with the periphery (Fine, 2001). But homogenization of institutions in the periphery basically means the imposition of standards and regulations which eventually has a cost increasing and thus profit reducing effect.[9] Thus global capitalism on the one hand requires regulatory regimes to secure long-term interests and on the other has to deploy cost-reducing strategies in effect require a complex relationship with the unregulated sectors which can ensure the flow of low cost labour.[10]

This contradiction is clearly reflected in the neo-liberal discourse on the promotion of small enterprises in the periphery in two interrelated forms. First, in regard to those enterprises which are considered worth promoting in the wider process of homogenisation. These enterprises belong to the category that the upper-tier companies in the commodity chains may easily link up with without facing significant risks. Secondly, those enterprises which are not included in the regulatory practices mainly for two reasons: first, due to the need by the upper-tier enterprises to maintain flexible relations to the bottom-tier enterprises in the commodity chain in order to minimise costs and, secondly for generating employment for the unemployed poor and the provision of cheaper domestic commodities to the impoverished segments of the population. [11]

4. Small Enterprises and Accumulation by Dispossession

Small enterprises and their economic functions are categorized in a variety of ways in the contemporary economic discourse.[12] Small enterprises are not uniform. Despite this variation, small entrepreneurship is predominantly associated with 'personal autonomy', that is, a greater degree of independence. But this perception has been disputed by a number of recent studies. McIntyre's (2003) study of the conduct of Russian and Ukrainian economies in the post Soviet era is a case in point. McIntyre warns against the generalisation of notion of personal autonomy. Instead he argues that such personal autonomy may in fact involve a high level of self-exploitation. He thus states: "Russia and Ukraine provide examples of populations required to cope at the household level with the catastrophic collapse of the large

experience of a great many countries, the bulk of this job creation will be in SMEs [small and medium sized enterprise]" (OECD, 2004:10).

[9] Such as social security provisions, unemployment benefits, prohibitions on child labour, standards for better working conditions, etc.

[10] "Overall, the Turkish labour market has positive features for employers. It offers SMEs comparatively low labour costs and relatively little wage rigidity, the latter enhanced considerably by the existence of a large informal sector" (OECD, 2004:44).

[11] "In view of the very small average size of Turkey's industrial SMEs as compared to those in the European Union, government support should be concentrated on firms with good prospects of surviving without longer-term support in national and international markets. Many very small firms may be limited to competing only in local markets where they may more easily survive. This is particularly true for those in remote and less industrialised regions that are less exposed to competition from abroad or from bigger domestic firms" (OECD, 2004:53).

[12] Scase, while analysing the role of small business in the economic transformation of countries in Eastern Europe to the market economy, makes a conceptual distinction between "entrepreneurs" and "proprietors", where the former refers to a risk-taking person who is committed to long-term capital accumulation and the growth of his/her business and the latter refers to those who sustain a level of business not committed to re-investment and capital accumulation but rather to personal consumption (Scase, 1997). Ayata (1986) distinguishes

enterprise sector, with little or no effective state support for the rise of alternative forms of productive activity. Under these conditions, 'independent' economic life often emerged in forms involving a high level of self-exploitation, as well as physical conditions directly destructive to the health of the participants and their families" (McIntyre, 2003:13). It should however be noted that the forms of self-exploitation which are masked by the phenomenon of personal autonomy is far more wide spread. Worsley refers to the illusory character of the independence of the majority of small entrepreneurs, both producers and traders. He disputes the very notion of control over output, production decisions and prices, which is attributed to small enterprises (Worsley, 1984:212).

The neo-liberal agenda, driven by the motive to maintain and increase profit and to ensure the endless accumulation of capital, has since the 1970's been increasingly engaged, along with the expanded capital accumulation, in what Marx and Luxemburg termed the 'primitive accumulation'.

In the expanded capital accumulation surplus value is created by a series of economic exchanges which define the relationship between capital and the wage-labour in the process of production. But this process has undergone a significant change in recent times, that is, the process of production and accumulation of surplus value has been supplemented, to a considerable extent, by methods historically associated with the process of the primitive accumulation of capital. For accumulation is now also carried by reverting to coercion and force such as plundering and looting of the human and physical resources, either by overt use force or by the imposition of neo-liberal policies. The inability of capital to accumulate through expanded reproduction on a sustained basis, Harvey argues, has given rise to specific methods which he terms 'accumulation by dispossession'. He explains these methods that are deployed on a global scale in the following terms: "what accumulation by dispossession does is to release a set of assets (including labour power) at very low (and in some instances zero) cost. Over-accumulated capital can seize hold of such assets and immediately turn them to profitable use" (Harvey, 2003:149). This is achieved through diverse processes and practices at the disposal of capital such as privatization of public assets (electricity, water, communications, universities, etc.), imposition of intellectual property rights, the commoditisation of cultural forms, histories, and sources of intellectual labour and creativity.

Neo-liberal policies play an important role in this process by opening up new areas for accumulation by dispossession. Thus, in the specific case of Turkey it could be argued that small enterprises that are directly or indirectly linked to the commodity chains as well as those enterprises which sell finished products to the consumers but perform their activities under quasi free market conditions are both subject to accumulation by dispossession. Small enterprises as such perform their activities in an environment that is subject to minimum regulation by the state and therefore have almost no power to protect their own interests against high domestic and foreign competition. Barriers to entry among small enterprises, as was mentioned, are so low that the returns are not only incapable of providing for the accumulation of capital but also often lead to loss of assets. In this way, the global capital reaches to avenues where prices of the product are often lower than the cost of production itself.

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between petty commodity production and small capitalist enterprise on the grounds that the systematic use of wage labour by the latter is associated with capital accumulation.

The implications of these conditions for small enterprises in Turkey are clear. In so far as they are concerned mere survival rather than economic profit and expansion is the primary objective of the enterprise. But, given these unfavourable conditions surviving in the market is not always easy. In fact, for the most part it is only possible by self-exploitation, exploitation of their households' labour, liquidation of own or family assets and as well as by indulging in fraudulent activities to decrease cost of production and thus gain advantage in competition.

In Turkey, the deteriorating economic conditions in 2000 and the subsequent economic crisis of 2001 led to a dramatic shrinking of the domestic demand. A large number of small enterprises were affected thus quite severely by the falling demand. There is no reliable data on the actual number of the small enterprises that were closed down as a result of the economic crisis. But, our findings on the field suggest that actual cases of closure were less than initially anticipated for such a crisis. However, in most cases the lack of a viable alternative, a means to enable them to earn a living played an important role in their determination to continue in such adverse circumstances. Although in some cases small enterprises had in effect stopped their economic activities, they nonetheless continued to stay open due to a variety of reasons. From a pure economic perspective it is difficult to explain the persistence of these entrepreneurs in the market. A cellular phone shop owner in Trabzon put it very clearly:

> I have done no business, since when I don't remember anymore. My father is paying the rent for the shop. I come here everyday and sit idley, doing nothing. What can I do? There is no job in the outside. I am single, but who would want to marry a man without a job?

Contrary to the commonplace view, low demand and high competition do not lead to a fall in the entry of new enterprises to the market. A producer and exporter of slippers stated:

> In the past, there were auctions here. Everybody was coming and selling his goods here until the auctions disappeared. Goods were exhibited here and sellers coming from atolia and other markets were buying them. It was something like a fair in the past. It was nice then, but it is completely spoilt now as tea or egg sellers, instead turned to selling slipper and such a like. What happened? There is an excess production, but no buyers around.

Entrepreneurs that encounter low demand and high competition often ask for the imposition of regulation and control by the state, as is the case in Turkey. An entrepreneur owning a small enterprise stated his demand for regulation and control in the following terms:

> Everybody is opening up a business nowadays. I understand that there are lots of small enterprises in Bursa, but there are thousands of computer companies around... I'm talking about a thousand companies while there are also individual businessmen round. I think it's too much… A very high figure…. The Chamber of Commerce] must organize this. Where are the inspectors of the Chamber? No inspectors? Why? Let's use the state officers. Chambers have splendid structures, but it can be utilized in some ways... It can be stopped somewhere. The Chamber must specify the criteria. Some say $1000 for a computer, while the other says $900. Tell me who's making a 10% [profit] from such a sale which is good money for us. The margin in the market is around $50-60; we are making $10-20 from a computer while we make up for the rest by our own resources. The difference is 150 millions, it is made by the

> exchange rates, and by the sale of two computers which is equal to a minimum salary. Is there any other sector [in the economy] fluctuating like this? You couldn't see any like it. Is this free trade? Is this free market? I don't think so my friend, something must be done about it as from now on.

Evidently, under the conditions of high and persistent unemployment the failed entrepreneurs have no choice but to start new enterprises. They often begin by exploiting their personal networks for shifting from one business to another, and at times even without knowing the fundamentals of the business in question. A belt producer complaining about competition from unqualified producers stated:

> I made good money in 1994-96. Then it stopped. Why? This is because people sold their lands in their villages and came here to open workshops. The man, may be a butcher or a marble producer, starts a workshop producing belts. Now, I sell the same belt at half price.

Survival is maintained by the conduct of the entrepreneur himself/herself in the market place rather than by the economic functioning of the enterprise or its engagement in productive activity of one kind or another. The system is generally based on the personal ability to start-up a business usually from the scratch. Entrepreneurs of failed enterprises usually point to lack of information on the nature of their businesses. A failed entrepreneur said:

> We purchased 500-600 kg of milk, but failed to make yoghurt and cheese… And we were wasting our resources in this way. What could I do with milk, I am a mechanic? My business was about natural gas in Izmit, and I also failed in that in the same way.

But the European Union seems to see this phenomenon quite differently. The EU report on small enterprises in acceding and candidate countries considers the high birth rate of small enterprises in East European countries and Turkey as a positive sign in the process of the creation and consolidation of market economies.[13] The Report, however, overlooks the fact that such enterprises often could only survive in the market by engaging in self-exploitation, exploitation of the family labour and hired labour. Exploitation in small enterprises takes different forms. Most of the entrepreneurs work for long hours and use family labour including children, often far beyond the physical limits of an average human being. A garment producer who had gone out of business stated:

> I had a workshop. We were working together, the whole family, 3-4 people. I closed it 3 years ago. We were working on a subcontracting basis. I produced for exports; I also worked for the domestic market. I tried everything. We used to work until 3 o'clock in the morning. We wasted ourselves.

The small enterprises, particularly those involved in subcontracting business, usually face volatile demand and hire labour when family labour is incapable of producing the required amounts on time. Unemployed people are prepared to work hard and for long hours for very

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[13] "Compared to an EU rate fixed at 100, the net birth rate is 902 in the case of Romania, 602 for Poland, 492 for Estonia, 452 for Czech Republic, 403 for Hungary, 250 for Turkey" (EC, 2004c).

little or sometimes for no returns at all especially when they have to hold on to their jobs. A garment producer stated:

> We work on subcontracting basis. Here in Istanbul the wages are high for us. Our subcontractor started doing business with the Chinese. For that reason, a friend in the same subcontracting work moved to Samsun. There the wages are much lower.

Exploitation sometimes extends to financial means. Small enterprises on the whole have an extremely limited access to financial resources. Our findings show that very few small entrepreneurs relied on bank loans at the start-up stage. Only 2% of them reported that they obtained credit from formal sources. 71% used their own savings and 9% relied on informal loans. Informants were also asked whether they had obtained credit during the past 12 months. Only around 10% of entrepreneurs used formal bank credit as a source of finance. 14% of the small entrepreneurs had borrowed money from friends, family and relatives. In general, for banks giving loans to the small enterprise sector is too costly, and without sufficient collateral, simply too risky**.** Banks usually advance credit only to businesses which could fulfil the established legal requirements, specially those regarding the collateral. But majority of small entrepreneurs lack assets necessary for collateral requirements. Banks generally offer credits only to larger and more successful enterprises or to large family holding companies to which they are affiliated. It is estimated that in Turkey, small enterprises receive less than 4 per cent of the total credits in the banking sector. A belt producer who works with garment exporters on subcontracting basis thus stated:

> I want to grow my business, but I can’t see [any future in it]. I would like to hire 6-7 workers. There is machinery that I should buy. One costs 2 billion TL. In total I need 3.5 billion TL. But I can’t afford that much. This is why I am working with my hands, physically.

Consequently, small enterprises are almost entirely self-financed, with friends and relatives being the only other appreciable source of funds. In the last few years, only a very few enterprises have received credits from the banks and they have mostly suffered from high interest rates and inflexible repayment arrangements attached to these loans. This was particularly true of the economic crisis of 2001, when many small entrepreneurs ended up by selling their houses and other properties in order to pay back their loans. In another case it was stated:

> During the peak of the crisis 3 months long I could not make the payments to the bank. I had declared my flat in Tuzla as collateral. It was worth 25 billion TL. I sold it for 8 billion TL, to pay my debt. I have no good feelings for the banks.

Furthermore, the persistence of low demand and high competition with cheap imports has often led the owners of small enterprises to engage in different forms of illicit activities[14] including swindling. A sub-contractor stated:

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[14] Ozcan and Cokgezen (2003) gives a detailed account of this, they maintain that “… when living on the margins of legality and illegality becomes an accepted social norm, individuals aim to maximize their interests by circumventing regulations and formal contracts” (Ozcan and Cokgezen, 2003:2077-2078).

> Some enterprises do not pay the workers wages or move from one place to the other without paying the rent. There are firms that survive in principle in this way, cheating everybody.

These activities more often than not harm the business, and the consequences of business failure resulting from illicit practices are very contagious, spreading from one enterprise to another. Although this did not represent a general trend, in most cases business failures resulting from involvement in illicit practices affected relatively successful enterprises. Operating in those terms becomes a mode of survival for those who have no other alternatives. An entrepreneur working on subcontracting basis criticising the destructive competition stated:

> Everybody is trying to give lower prices. I am working for a subcontractor. He calls and tells me that another firm offered him a lower price than I had. There are now too many producers in the same sector. People sell their houses and come here to start a business.

But the other side of this grim story is that thousands of small enterprises which do not embark on illicit practices collapse facing the unhappy prospect of losing their entire assets. An informant who was running a textile workshop in Istanbul argued:

> In the past, there were neighbourhood groceries. Now, everywhere is workshop. Those who are able to get 3 pieces of machinery and 5 men feel like workshop owners. We suffered from a very severe crisis this year. Many closed down. I had saved 1.5 billion TL. I lost it all.

In a poignant passage in his incisive analysis Harvey argues that accumulation by dispossession is exactly analogous "with the creation of an industrial reserve army by throwing people out of work. Valuable assets are thrown out of circulation and devalued. They lie fallow and dormant until surplus capital seizes upon them to breathe new life into capital accumulation". It is as such "one of the prime functions of state interventions and of international institutions to orchestrate devaluations in ways that permit accumulation by dispossession to occur without sparking a general collapse. This is the essence of what a structural adjustment programme administered by the IMF is all about" (Harvey, 2003:151).

This general picture true as it is does not exclude exceptions. Here too there are exceptions to the rule. This is because the actual size of this subset of small enterprises may grow or shrink depending on the modality of its encounter with the global capital. To be more precise, in accordance to degree to which these enterprises they are assaulted and dominated by the global capital. Thus, the fact that capital accumulation is very difficult in this subset does not entirely eliminate the possibility for a single enterprise of moving up the value chain or earning an income that allows for re-investment. At times self-exploiting and illicit practices may provide a springboard for accumulating capital and moving to an upper-tier. On the other hand, other enterprises that were previously in the pool of enterprises that have the opportunity of accumulating capital may fall into this subset of losers. Thus, the enterprises in the subset may change but the subset itself, which provides for higher capital accumulation in the upper-tier enterprises, continues to survive.

5. Conclusion

This paper has argued that the contemporary neo-liberal orthodoxy on the role of the small enterprises in the process of economic growth in the less developed economies of the periphery is seriously flawed. The investigation of the economic performance of small enterprises in Turkey in the course of the 2001 crisis helps illustrate the discrepancy that exists between the theoretical assumptions of the neo-liberal orthodoxy and the reality of economic life in less developed countries. Drawing on the critical literature on the issue, the paper has further argued that there is a structural relationship between the actual performance of small enterprises in peripheral economies and the dynamics of extended reproduction and accumulation of capital on a global scale. The implementation of neo-liberal policies in the periphery more often than not have resulted in the reshaping of their structural dynamics subordinating them to the requirements of capitalist accumulation in the core. Peripheral economies have been subjected to new processes and practice defined as 'accumulation by dispossession'. This concept signifies developments resulting from the specific economic role played by the peripheral state in overcoming the structural pitfalls of accumulation thus facilitating the extended reproduction of capital. This paper has thus shown that small enterprises have been dispossessed of their human, physical and financial resources at the service of capital by processes and practices historically characteristic of the primitive accumulation of capital. On the theoretical terrain, the argument of this essay calls for further work on the diversity of the processes and practice which engender and reproduce accumulation by dispossession highlighting its dynamics in the structural contradiction of capitalism as a global system.

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