Regimes of Underdevelopment – Why is there almost no convergence in the world economy

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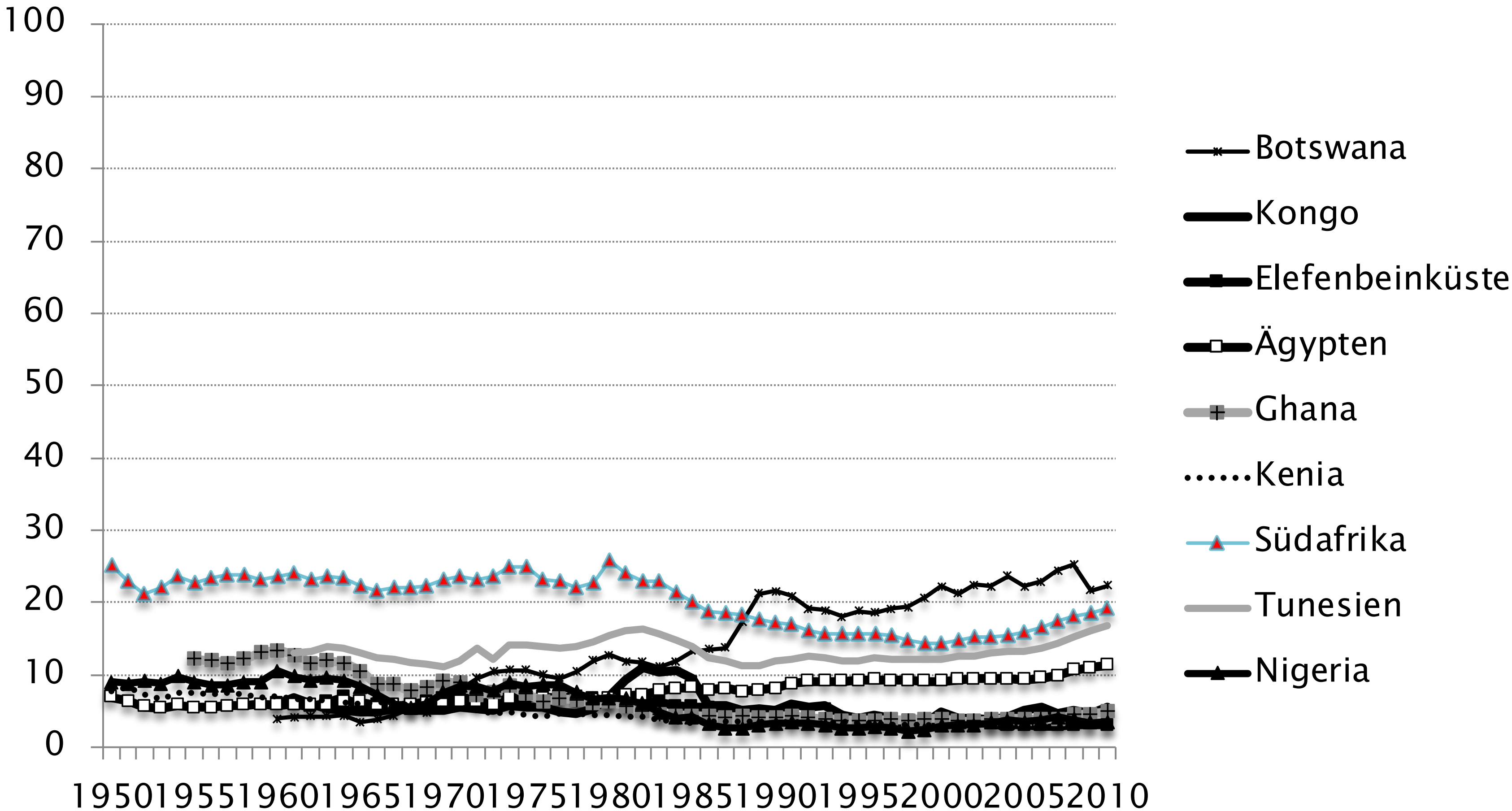
September 2017

A world of no convergence

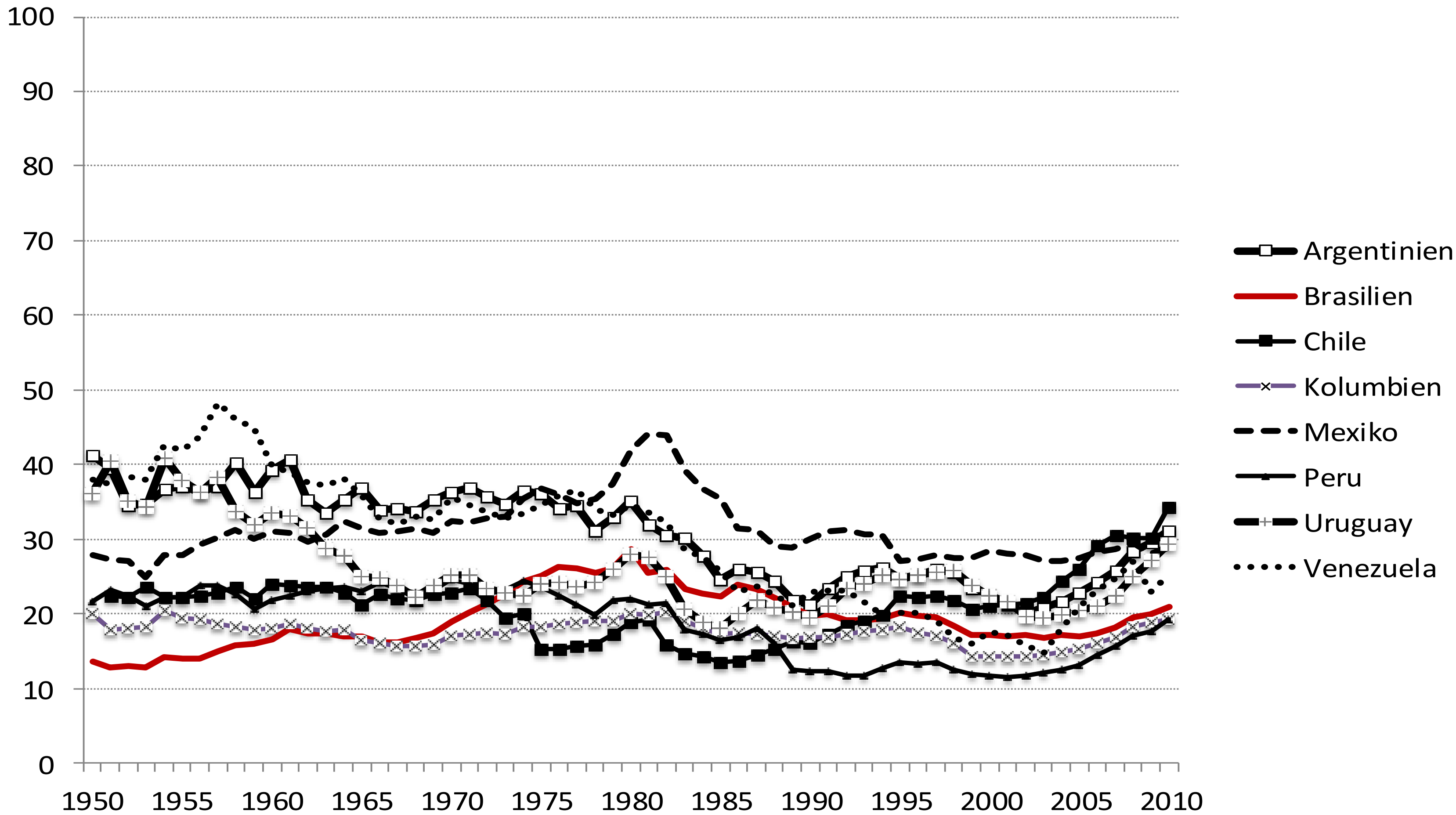
- Only a small number of countries managed to reach real GDP per capita levels comparable to developed countries
- Successful countries are: Japan, Taiwan, South Korea, Singapore, Hong Kong
- Why is there no convergence?

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



Source: Penn World Tables 7.1

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



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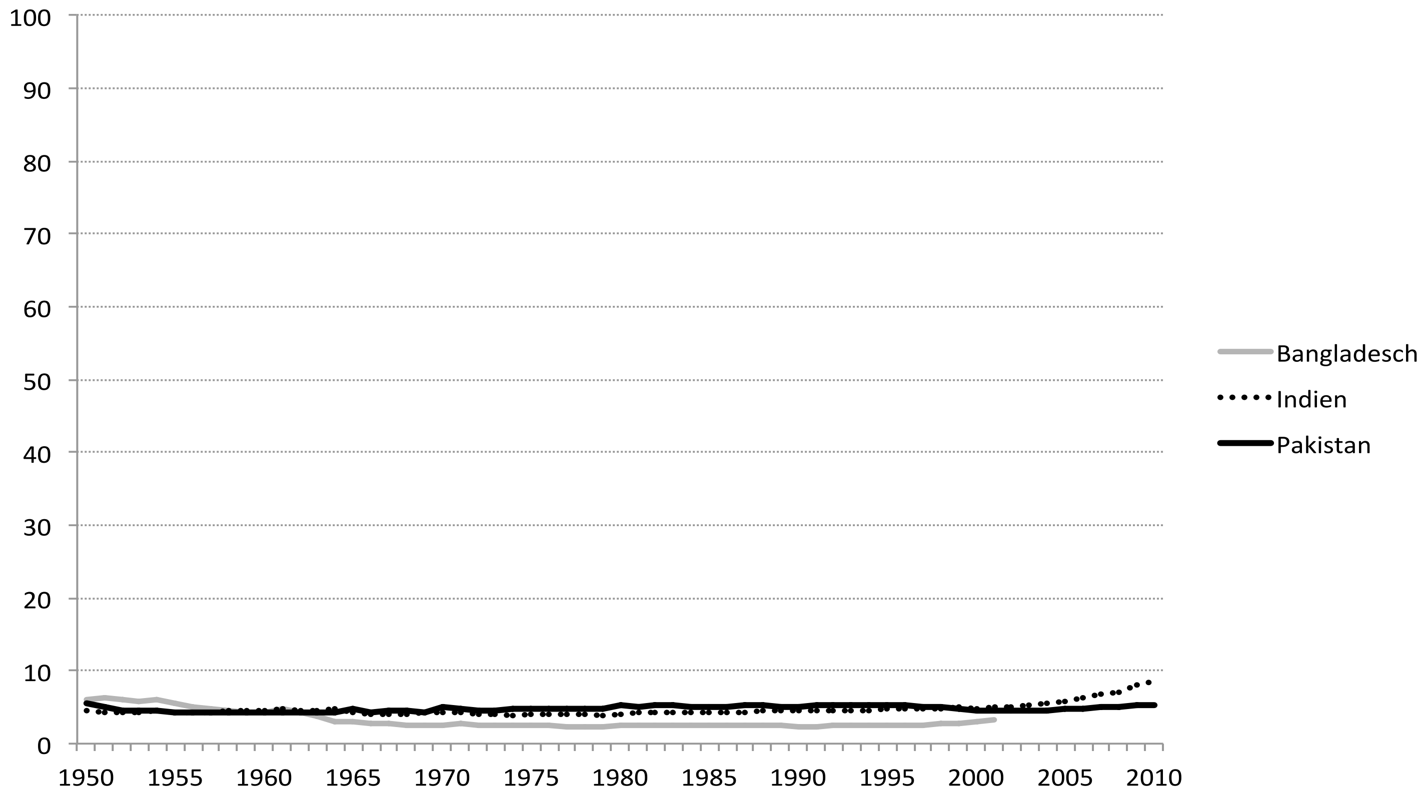

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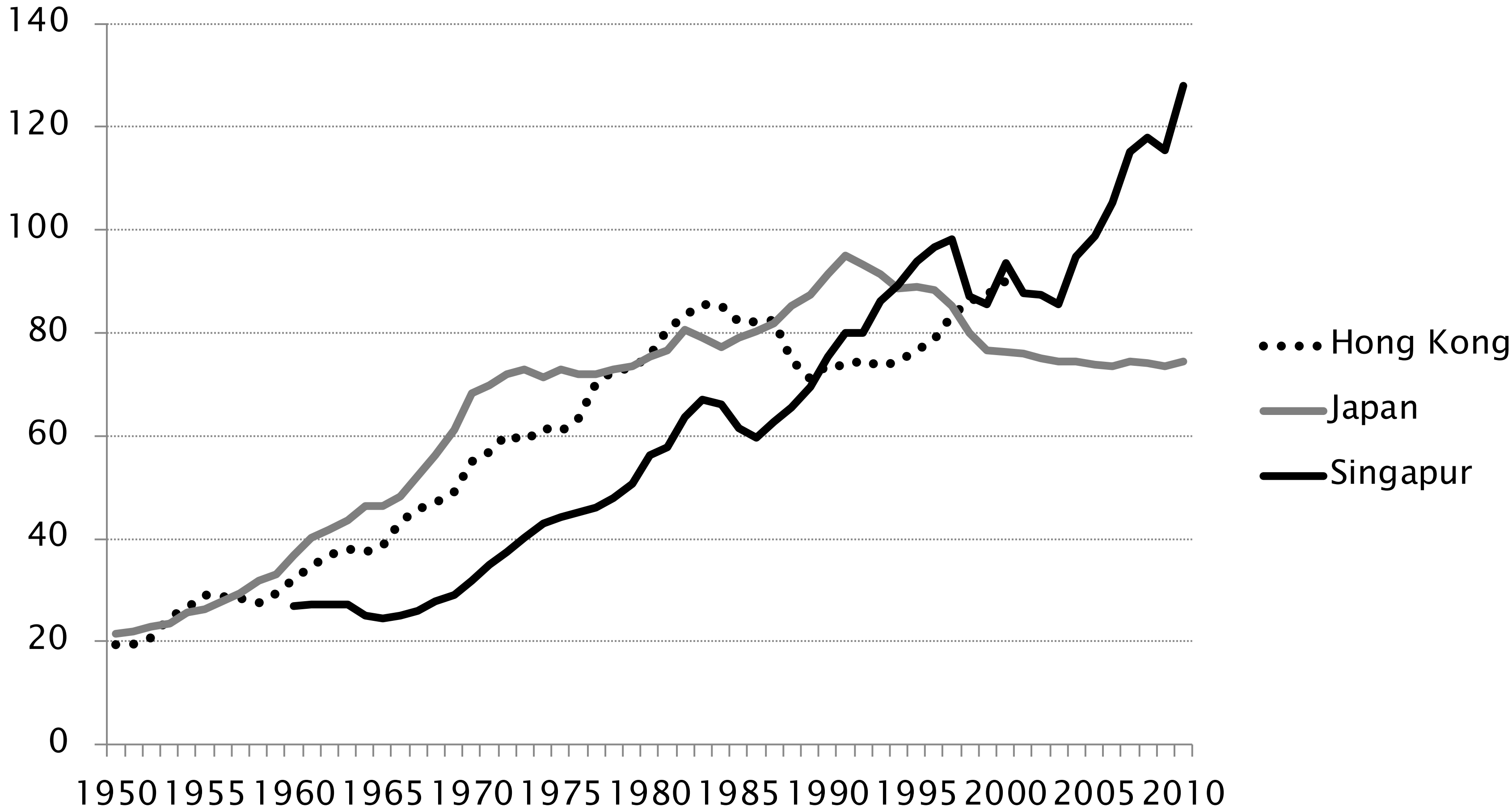

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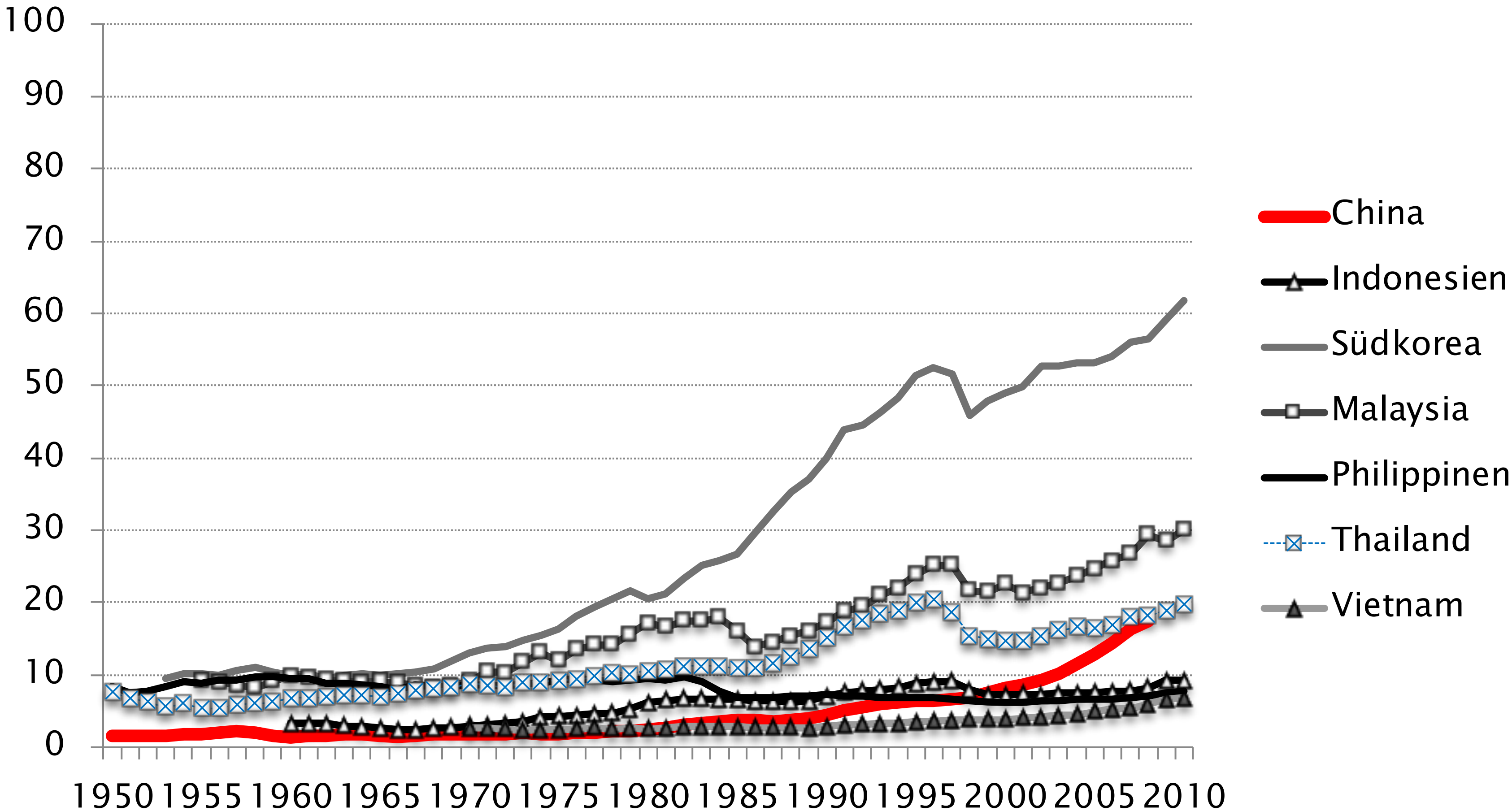


Source: Penn World Tables 7.1

How to explain the lack of convergence traditionally

- Friedrich List – free trade “kicking the ladder away”
- Prebisch–Singer Hypothesis – terms of trade
- Dutch disease and resource curse – the problem of natural resource rich countries

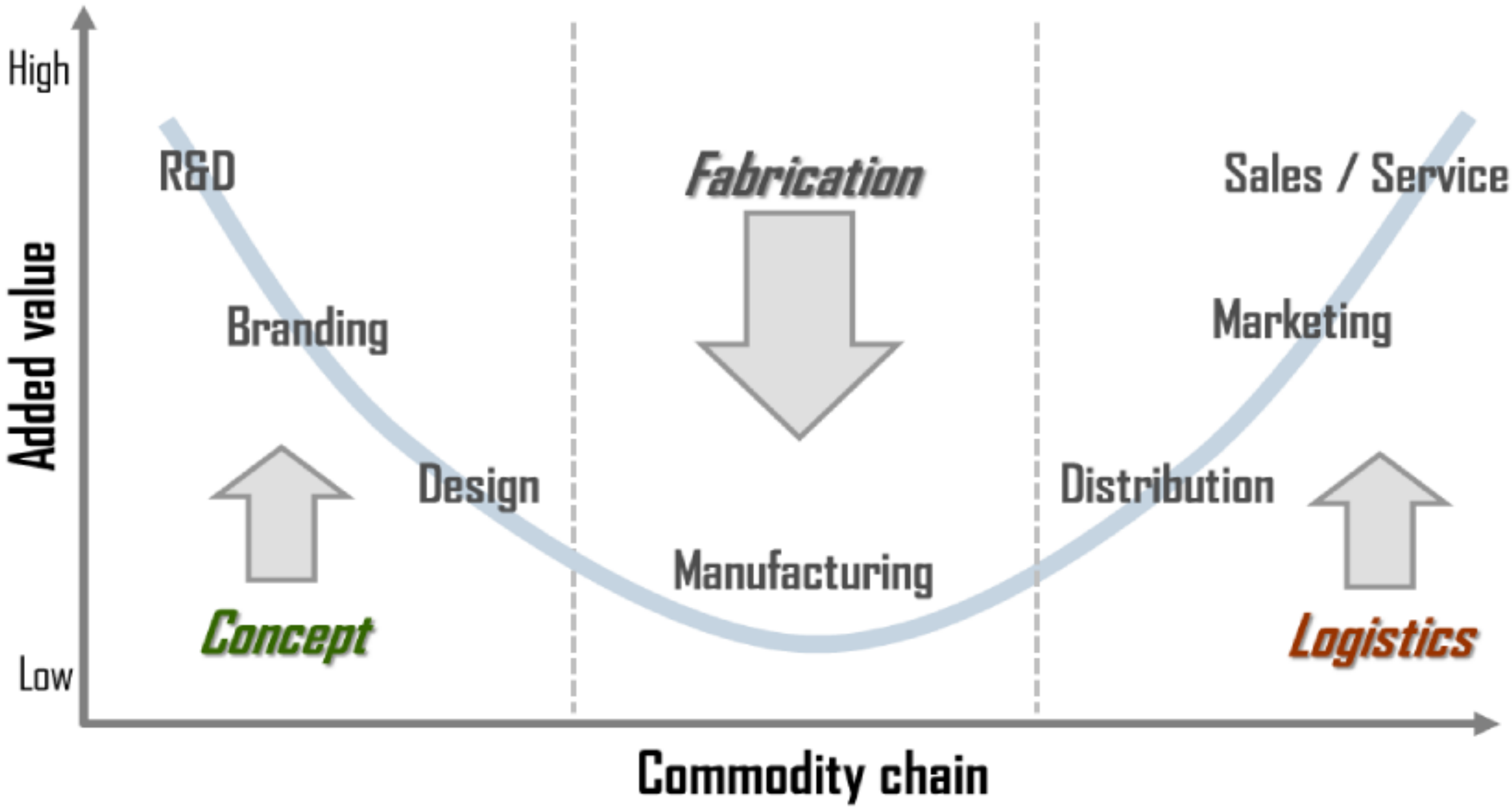
Do developments after the begin of the neoliberal area in the 1970s improve development chances?

Global value chains

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

- Key role of multinational companies

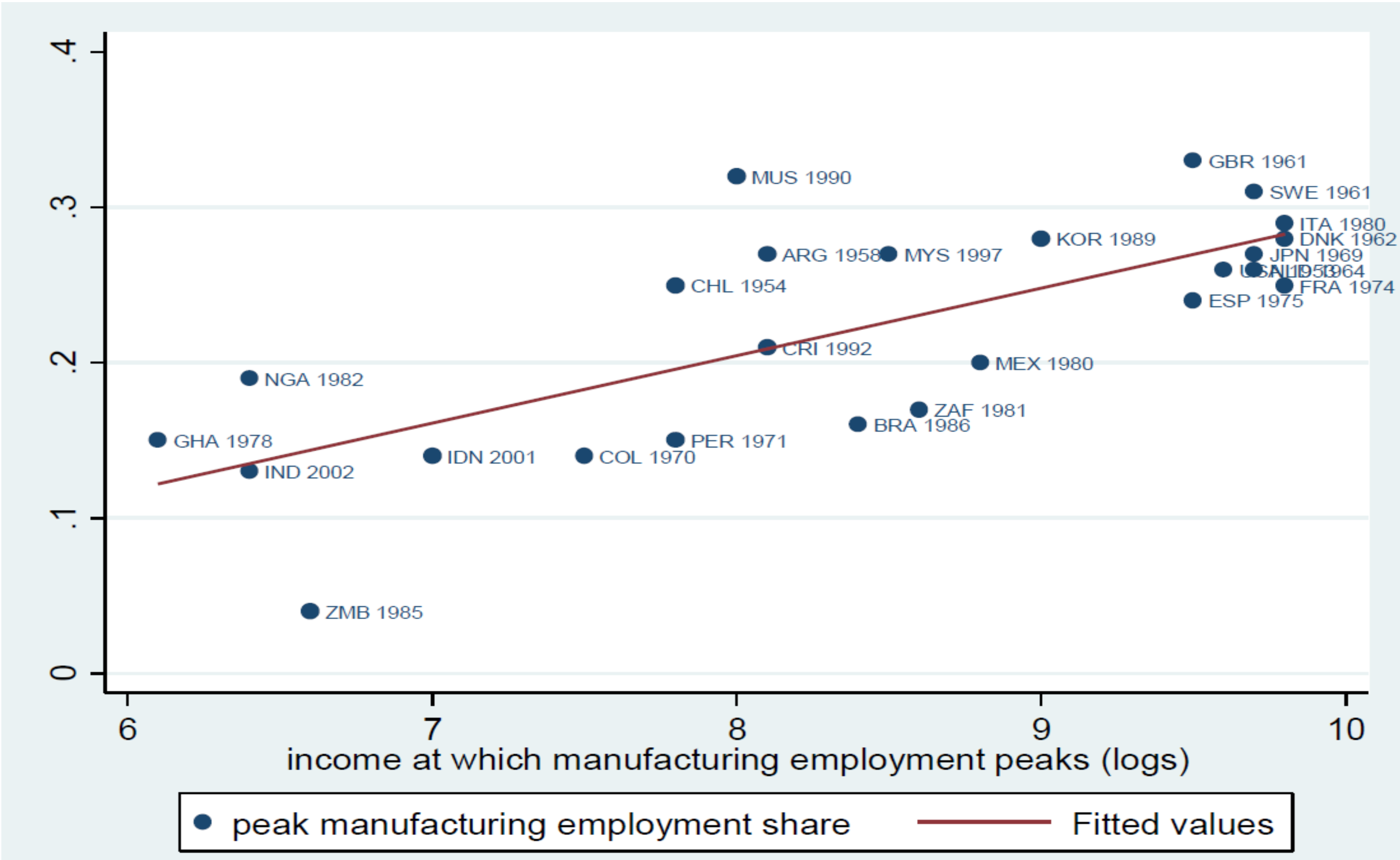
The exploitation curve



Over the last decades the smile curve became deeper
Over the last decades low value creating activities are outsourced to developing countries

Premature de-industrialisation (Dani Rodrick)

- Maximum share of industry is reached in developing countries much earlier than in now developed countries and successful developing countries
- Lack of a dynamic sector for development (Can the service sector take over this function in developing countries?)
- No traditional working class is created – no political power for more equal wages and welfare state



.4
.3
.2
.1
0
GBR 1961
MUS 1990
SWE 1961
ITA 1980
DNK 1962
KOR 1989
ARG 1958
MYS 1997
JPN 1969
FRA 1974
CHL 1954
ESP 1975
CRI 1992
MEX 1980
NGA 1982
ZAF 1981
BRA 1986
GHA 1978
PER 1971
IDN 2001
COL 1970
IND 2002
ZMB 1985
6
7
8
9
10
income at which manufacturing employment peaks (logs)
peak manufacturing employment share
Fitted values

Rodrik 2016

Low quality currencies and at the bottom of the currency hierarchy

- Deeper integration in international financial markets
- Portfolio diversification and capital flights by elites in developing countries and dollarisation
- Schumpeterian-Keynesian credit-investment-income-creation mechanism is stopped by capital exports
- Boom-bust cycles of international capital flows and original sin

Increasing and /or very high inequality

- Financialisation increases inequality also in developing countries
  - Developing countries have higher real interest rates
  - Shareholder value corporate governance
  - Weaker trade unions, informal sector, etc.

- High inequality prevents long growth periods
  - Negative demand effects
  - Negative supply effects

Foreign direct investment (FDI) as big hope

- FDI can transfer some technology, skills and export markets

- FDI without domestic forward and backward linkages and creating clusters has limited effects

- Other negative effects of FDI
  - Not in all sectors is FDI useful (for example real estate sector, financial sector, natural monopolies, ...)
  - Crowding out promising domestic companies
  - Transfer of profits abroad
  - Increasing inequality

Conclusion

- The neoliberal area has made anyway difficult catching up more difficult
- Only a small group of countries will be able to catch-up – probably only China and India have a chance
- Others will be integrated in the global economy at different levels of under-development
- And all of this without discussing domestic problems of many developing countries (rent-seeking elites, weak institutions, …) and that developing countries may be less able to protect themselves against ecological catastrophes

Ecological problems as a fourth development trap

- Developing countries are more affected by ecological problems than developed countries
- Developing countries have less capacity to compensate and fight against consequences of ecological changes

What to do?

- The precondition for development is the creation of institutions and the political will to solve the three traditional factors which lead to a development trap
- Comprehensive regulations of markets is needed including a regulated integration into the world economy
- Development aid has more negative than positive effects (Edward Webster: Give the man a fishing rod not a fish)
- Developing countries should follow a policy of ecological change with technical revolution and growth

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