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Underdevelopment and unregulated markets- seven reasons why unregulated markets reproduce underdevelopment

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Underdevelopment and Unregulated Markets – Seven Reasons Why Unregulated Markets Reproduce Underdevelopment

Hansjörg Herr

Abstract

After World War II, only a few developing countries were able to catch up to real GDP per capita levels prevailing in developed countries. These successful countries in almost all cases came from Asia and did not follow the free market doctrine in the tradition of the Washington Consensus. There must be theoretical explanations as to why underdevelopment is reproduced and most countries in the world do not catch up. This essay reviews different economic approaches which attempt to explain the lack of convergence. A first group of approaches focuses on the lack of sufficient productivity development (free trade, global value chains, negative terms of trade effects, abundance of scarce resources, premature deindustrialisation); the second group focuses on problems to trigger sufficient growth (distorted financial systems, high inequality, restrictions on macroeconomic demand management). Countries can suffer from several of these factors, which can explain why development is only possible with the support of comprehensive government policies.

Key words: underdevelopment, financial system, free trade, inequality, Keynesian paradigm, Washington Consensus.

JEL classification: B50, F40, O11

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1. Introduction

The neoliberal globalisation model, starting in the 1980s, promised a catching-up of developing countries.¹ The neoliberal model included policies to deregulate national and international financial markets, push for free trade, make labour markets more flexible, privatise state-owned banks and enterprises, change corporate governance towards a shareholder value system, allow for stronger, and increasingly dominant, multinational companies (national champions) and so on. These policies led, among other things, to financialisation, including a more important role of financial markets in the economy and a stronger position of agents in financial markets. These developments took place alongside the weakening of trade unions. Higher economic instability, higher inequality of income and wealth distribution and increasing precariousness of living conditions in large segments of society became a brand mark of the new type of capitalism. International institutions recommended – and in many cases forced – developing countries to follow policies in line with the neoliberal globalisation model. These policies were summarised under the label Washington Consensus (Williamson 1990). Paul Krugman (1995: 29) explained the Consensus in the following way: “It is the belief that Victorian virtue in economic policy - free markets and sound money - is the key to economic development. Liberalize trade, privatize state enterprises, balance the budget, peg the exchange rate, and one will have laid the foundations for an economic take-off.” Successful countries which managed to reduce the gap with developed countries did not follow Washington Consensus policies. It has to be admitted that convergence was limited, just as in the decades prior to World War II. It seems that there are very basic reasons to prevent convergence, which go beyond specific versions of capitalism. In the second section, an overview of empirical developments is given.

In the third section, theoretical economic approaches are presented which explain the lack of economic convergence. There are two broad groups of explanations. In the first group, the lack of economic convergence is explained by insufficient productivity development. Here, the effects of free trade, global value chains, natural resource exports, reproducible primary good exports and pre-mature deindustrialisation, are discussed. In the second group of explanations, the inability of developing countries to stimulate sufficient demand and sustainable high GDP growth are analysed. Here, the distorted financial systems which characterise many developing

¹ This paper partly draws on Herr and Ruoff (2018).

countries, the high level of inequality and the restrictions for comprehensive macroeconomic demand management are the key features. The theoretical explanations in the two groups cannot be strictly separated, as some factors influence productivity development and GDP growth at the same time and – according to Verdoorn's (1933) law – there is a close relationship between GDP growth and productivity development (see also Kaldor 1966; Thirlwall 2014). In the final section, conclusions are drawn.

2. Empirical developments

In this paper, economic convergence refers to convergences in real GDP per capita. Real GDP per capita of the different countries will be compared with real US GDP per capita. GDP per capita reflects mainly productivity levels and the innovative power of countries. Real GDPs per capita are very rough indicators of economic development as they do not include income distribution, ecological dimensions, or the significance of the non-market sector in an economy. However, they give an indication of the unequal development of the world economy over the last decades. Economic catch up in a developing country is only possible if productivity increases are higher than in the developed world over a long period of time. Of course, economic upgrading does not imply automatic social upgrading. There are good arguments that a lack of social upgrading will sooner or later lead to a lack of economic upgrading (see below).

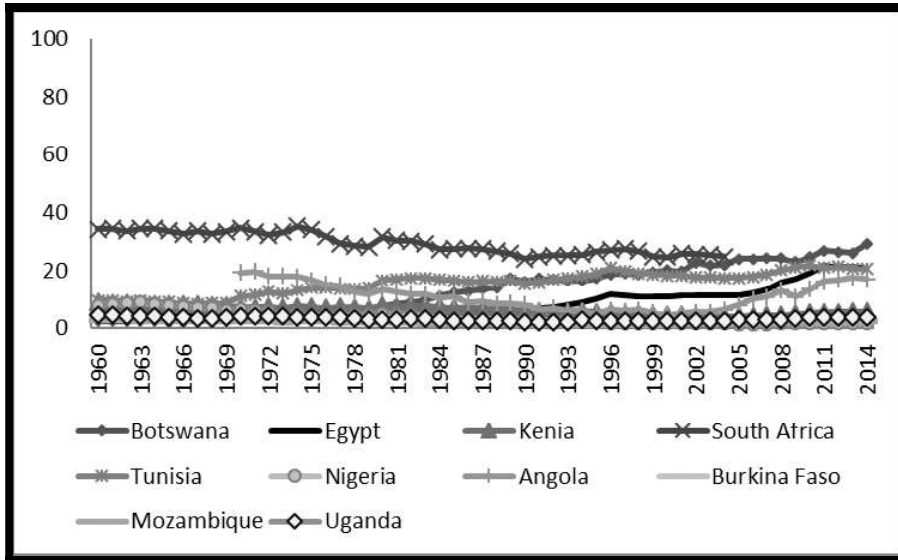
The following figures, keeping the limitations of real GDP per capita as an indicator of unequal development in mind, show a worrying picture about economic convergence in the world economy. In Figures 1, it is shown that in African countries there was very limited convergence.² There was some positive development in Botswana, Tunisia and Egypt, including developments to levels of around 20% of US real GDP per capita. South Africa reduced its real GDP per capita in relation to the US. In countries like Uganda or Nigeria, there was no convergence, in spite of their very low real GDP per capital level. Convergence in Latin America was overall higher than in Africa and reached levels of 30 to 40% of real US GDP per capita (Figure 2). In the long-run perspective, Argentina and Venezuela stagnated at the level reached after World War II. Very slow convergence is shown in countries like Brazil and Chile. In many countries, there were small improvements in the first decade of this millennium after a very bad development over the

² It should be kept in mind that the absolute difference between a country and the US increases when the percentage of convergence remains the same.

two decades before. Economic crises after 2012 reduced convergence levels again in many Latin American countries. Figure 3 shows the development in the South Asia, including India, Pakistan and Bangladesh. In these countries, the real GDP per capita level stagnated around 10% of real US GDP per capita. The development of a selection of countries in South East Asia is shown in Figure 4. In these countries, increased levels of economic development can be observed. Starting from a low level in the 1960s, Malaysia reached a level of around 40% of real US GDP per capita, followed by Thailand (around 30%) and Indonesia (below 20%). The Philippines has been stagnating at a 10%-level. Vietnam also reached the 10%-level, however starting later and at a very low level. The “development stars” are shown in Figure 5; Singapore and Hong Kong reached real US per capita levels. However, these are city states and special cases. Taiwan and South Korea, starting at below 20%, reached around 80% of real US GDP per capita. Japan, with phenomenal development after World War II, has been stagnating from the 1990s on. China, together with India – the country with the highest population in the world –, has reached around 20% of real US GDP per capita, however, starting at a very low level.³

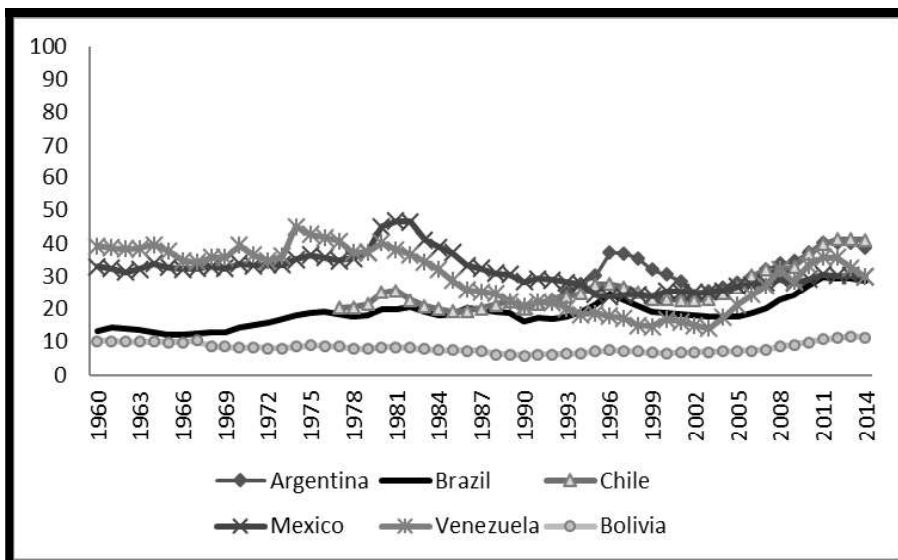
³ There also are resource rich countries with small populations, like for example Saudi Arabia or Qatar. These countries have high real GDP per capita values based on high revenues from exporting scarce natural resources.

Figure 1: Real GDP per capita in percent of US real GDP per capita, selection of African countries



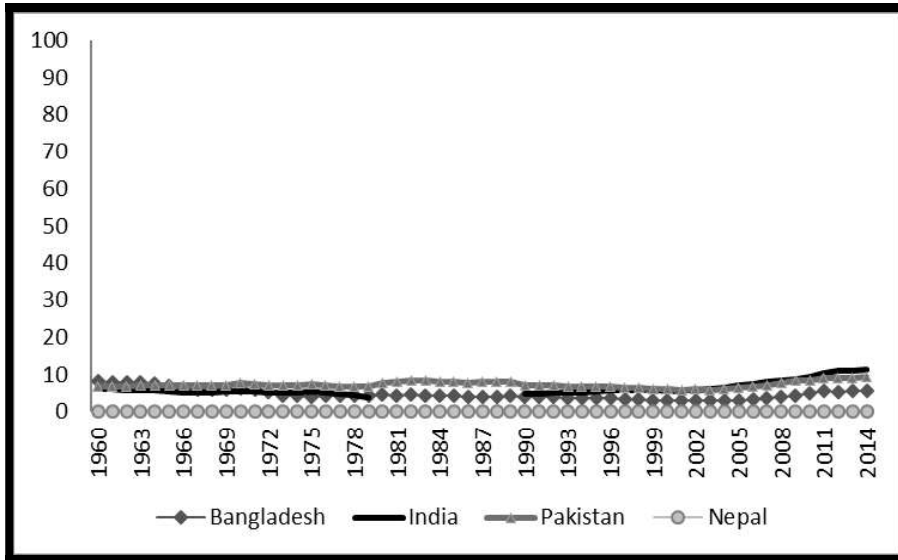
Source: Penn World Table version 9.0 (2017), calculating per capita real GDP (output-side real GDP at chained purchasing power parities (in mil. 2011 US\$) divided by population (in millions). See for an explanation of variables Feenstra et al. (2015).

Figure 2: Real GDP per capita in percent of US real GDP per capita, selection of Latin American countries



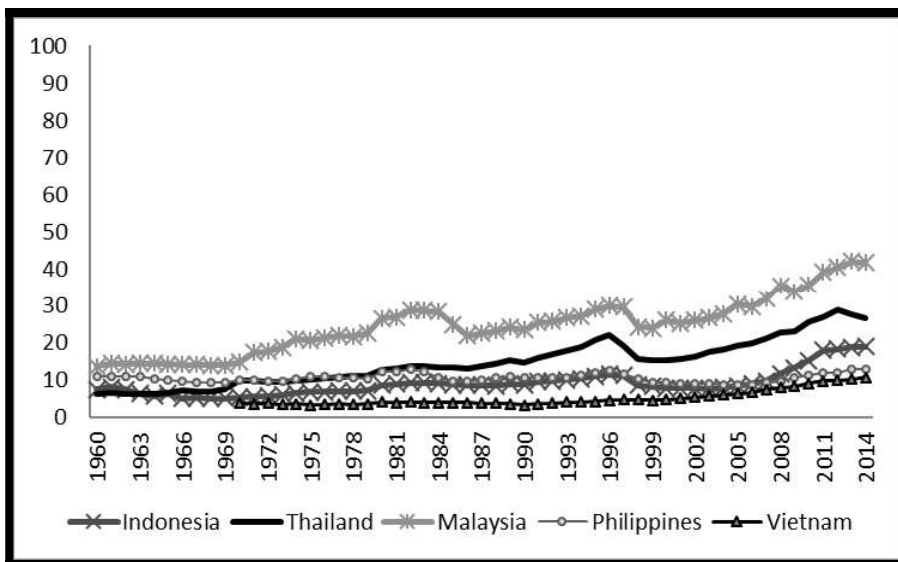
Source: See Figure 1.

Figure 3: Real GDP per capita in percent of US real GDP per capita, selection of South Asian countries



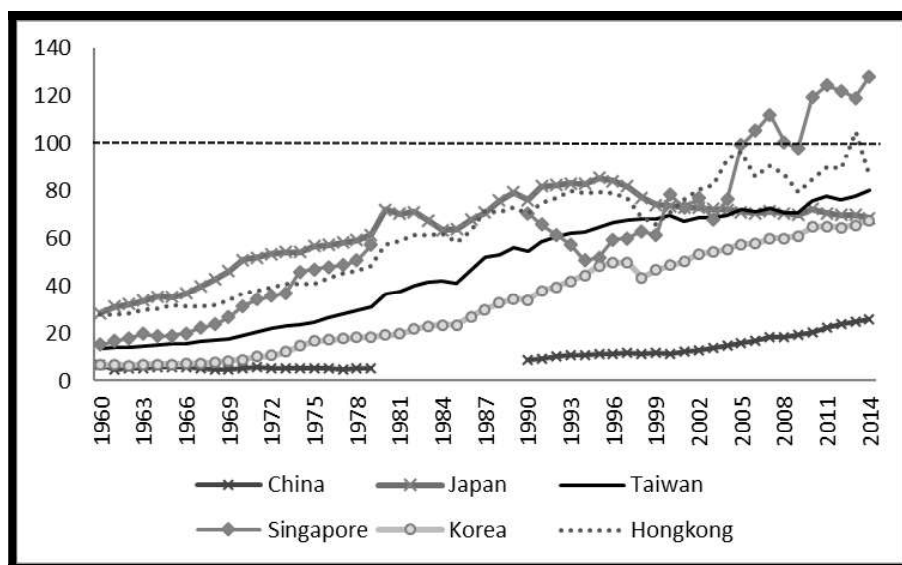
Source: See Figure 1.

Figure 4: Real GDP per capita in per cent of US real GDP per capita, selection of South East Asian countries



Source: See Figure 1.

Figure 5: Real GDP per capita in per cent of US real GDP per capita, selection of countries with successful convergence



Source: See Figure 1.

Given the lack of convergence, it is no surprise that inequality in the world is very high. Global inequality, which compares disposable income of people across the world irrespective of their nationality, can be measured with the global Gini Coefficient. The global Gini Coefficient for disposable income increased from 50 to 69.7 from 1820 to 1988, and dropped to 66.8 in 2008 and 62.5 in 2013 (World Bank 2016: 80f.; Milanović 2014). The global Gini Coefficient depends on income differences between countries and inequalities within countries. Data shows that the reduction of the global Gini Coefficient in recent years is based on the positive average income development of populous countries, like China and, to a lesser extent, India. However, within-country inequality substantially increased. The World Bank calculated the population-weighted average national Gini Coefficient to show this effect. This Gini rose sharply between 1988 and 1998 from 34 to 40, and then declined to 39 until 2013 (World Bank 2016: 82). Looking at the relative winners and losers in the world economy between 1988 and 2008, the middle classes in successful Asian countries, especially China, were the main winners. The main losers were the lower middle classes in developed countries. If the global increase of world real GDP per capita between 1988 and 2008 is set 100, the top 1% of the world received a share of 19%, the top 2–5% received 25%. Furthermore, measured in 2005 US dollars, in 2008 the top 1% of the world had an annual income of 71 000 US dollars, median income (around the income of the middle

class in China) was 1400 US dollars and the income of the lowest decile was below 450 US dollars (Milanović 2016: chapter 1).

Inequality in a typical developing country is substantially higher than in developed countries. In 2013, in the group of industrial countries, the unweighted Gini Coefficient was around 30. In East Asia and the Pacific, it had about the same level. In Eastern Europe and Central Asia, the Middle East and North Africa, it had values around 37. In Sub-Saharan Africa, it was around 42 and 49 in Latin America and the Caribbean (World Bank 2016: 11).

3. Theoretical explanation why unregulated markets reproduce underdevelopment

In the following, the different approaches to explain the lack of convergence in so many countries are discussed.

Free trade and underdevelopment

Adam Smith (1776) explained the benefits of trade through the concept of absolute advantages, for example based on natural resource richness or specific climate. If one country is more efficient in producing one thing and the other country in producing another, than the resulting trade patterns are obvious. Beyond this, there are three basic approaches to explain trade: the Ricardo model, the Heckscher-Ohlin model, and the New Trade Theory, which follows the tradition of Paul Krugman.

David Ricardo (1817) developed his model of comparative advantages under the assumption that a country has a lower productivity level in all industries. At the same time, it is assumed that there is a large productivity gap between different industries between countries. Welfare in both countries, so the argument goes, can be increased when free trade is established. The more developed country concentrates on sectors of production with the highest technological advancement and the less developed country on sectors of production with the lowest technological advancement. Eli Heckscher (1919) and Bertil Ohlin (1933) assumed the same technology in all countries, but different factor endowments. The typical developing country has a relatively high stock of low-skilled workers and a low stock of capital, whereas the developed country has a relatively high stock of capital and a higher proportion of skilled workers. Based

on the usual neoclassical marginal productivity assumptions, the developed country has a comparative advantage in capital intensive productions with skilled labour and the developing country has a comparative advantage in labour intensive productions with low skills.

Coming from a situation with no trade and switching to free trade in both the Ricardo model and the Heckscher-Ohlin model, far reaching permanent distributional effects occur. In the developing country, unskilled workers benefit as the relative demand of unskilled workers increases; capital owners and skilled workers lose. In the developed country, the unskilled workers lose as their relative demand goes down, whereas capital owners and skilled workers win.⁴ In addition, structural problems can cause underutilization of capital and unemployment for a long time. That the losers of globalization are unskilled workers in the developed world fits to the empirical development in many countries. But in developing countries the unskilled did not gain from globalization – as predicted by the model. We come back to this point later (see below).⁵

The Heckscher-Ohlin model has only limited relevance for explaining trade between developed and developing countries, as it misses the key difference between these countries, namely the different levels of productivity and innovative power. The Ricardo model of comparative advantages cannot explain all types of international trade, but it delivers a powerful analysis of how the market mechanism works in the field of international trade. Two conclusions of the model are important. First, the market mechanism leads to a concentration of low-tech and low-skilled productions in countries with a low level of technological knowledge. Second, the exchange rate protects countries with a low level of technological development and allows them

⁴ There is no doubt that globalization reduced the demand for low-skilled labour in some segments of the labour market in developed countries. In addition, it is argued that a specific type of technological development reduced the demand for low-skilled labour. But to which extent the change in the structure of labour demand changes wage dispersion depends to a large extent on labour market institutions. Deregulations of labour markets, which became widespread in Western countries from the 1980s on, play at least an as big role for changing wage dispersion than globalization. In some countries, for example France, wage dispersion over the last decades did not change because institutions were in place to prevent it (Herr and Ruoff 2016).

⁵ How can be argued that free trade is welfare enhancing when so many can lose? This question has to be asked as Vilfredo Pareto (1906) made clear that utility comparisons between individuals are not possible. A trick is used to overcome this problem. To defend that free trade is welfare enhancing it is assumed that winners always and completely compensate losers. However, to compensate losers is in many cases politically complicated and probably even economically costly, for example when tax collection from winners is difficult.

to take part in international trade. But the welfare implications of the model are a different story altogether, since they neglect particularly the consequences of free trade for the long-term development of productivity and the innovative power of nations.

The problem of the market mechanism under free trade is that developing countries concentrate on low-tech and unskilled labour-intensive productions. The switch to free trade can reduce productivity in the developing country as promising industries with higher productivity do not have the opportunity to develop and end up being transferred to developed countries. And the concentration on low-tech productions takes away the chance for *dynamic* productivity development. All the positive learning effects, technological advances, including research and development, become concentrated in developed countries. This increases the innovative power in the developed world and leaves the developing countries lagging behind. Thus, developing countries are constricted by their specialization in low-productivity sectors.

It is very unlikely that the market mechanism will lead to new industries in developing countries to allow catching-up (Rodrik 2004). First, there are information externalities. New products and new technologies or innovations involve a process of discovery. From its very character, new productions are risky, which makes it difficult for private investors to invest in them. To make matters worse, if a firm is successful, follower firms can, in many cases, easily imitate the successful firm. Secondly, there are coordination externalities. Most innovations need a high level of investment. Economies of scale and scope prevent small scale innovative firms. In many cases, a whole bundle of investment is needed, which goes far beyond the capacity of a single firm. A new product or technology may need new infrastructure (from transportation to new communication technologies) which cannot be handled by a single firm. Specific skills of employees and firms producing complementary goods or inputs may be needed.

Mainstream dogmas regarding free trade recommend a specialized division of labour amongst countries based on their comparative advantages. However, this recommendation does not match the lessons and conclusions from empirical data. For example, Jean Imbs and Romain Wacziarg (2003: 64) found that successful countries “diversify most of their development path”. Different industries create synergies and increase the likelihood of successful entrepreneurship and innovations in new areas. Development has a lot to do with random self-discovery, which cannot

be explained by comparative advantage (Rodrik 2004). In a similar direction, Mario Cimoli, Giovanni Dosi and Joseph Stiglitz (2009: 544) argue that emulation, as an important element of catching up, “is the purposeful effort of imitation of ‘frontier’ technologies and production activities irrespectively of the incumbent profile of ‘comparative advantages’. It often involves explicit public policies aimed at ‘doing what rich countries are doing’ in terms of production profile of the economy”. Furthermore, it is important to note that, historically, the rise of the now developed countries was not a result of free trade (Chang 2002).

Friedrich List (1841), influenced by Alexander Hamilton during his exile in the United States, argued that free trade would kick away the ladder of development in Germany, which, at that time, was less developed than England. List recommended a package of three policies to avoid this: first, tariffs or other instruments to protect infant industries; second, state-owned or state-supported companies serving as role models; and third, efforts to attract qualified foreign migrants. These recommendations remain valid today.

A third approach, besides the Ricardo and Heckscher-Ohlin model, is the New Trade Theory, which is closely connected with the work of Paul Krugman (1979). In this approach, the usual neoclassical assumption of constant returns to scale is substituted by the assumption of economies of scale (and scope), which are typical for industrial production. Economies of scale can be internal and firm-specific or external and caused by synergy effects in economic clusters.⁶ Economies of scale justify large trade among developed countries even within the same industry. Assuming product differentiation and consumers' preference for diversity economies of scale, this will lead to a trade pattern in which for example one type of car is produced and exported in one country and another type of car is produced and exported in another country. External economies also explain geographical concentration of production, high growth of clusters and low growth in peripheral regions.

⁶ Economies of scale are especially strong when network effects exist. Modern examples of network companies are Google, Facebook, Instagram or Netflix.

The New Trade Theory leads to undesirable consequences for the neoclassical paradigm. One of the consequences is that the model of pure competition no longer holds.⁷ Internal economies of scale imply that big firms can produce more efficiently than small firms. This leads to big companies and oligopolistic – or even monopolistic – structures and rent-seeking of powerful firms. In many cases in the New Trade Theory, the problem of oligopolistic and monopolistic firms is ignored by assuming monopolistic competition. Monopolistic competition is defined by product differentiation and low entry barriers. Under this assumption, international trade produces the usual results known from the Heckscher-Ohlin model. Monopolistic competition, however, is not compatible with the assumption of internal economies of scale.⁸

In an early paper, Krugman (1981) discusses the consequences of economies of scale for economic development. When, for example, there are economies of scale in manufacturing and free trade between two countries, development becomes path-dependent. If one of the countries has an advantage in manufacturing, for whatever reason, that country will develop a large industrial sector, and benefit from economies of scale. The country with the original disadvantage, however, will end up producing primary goods, and will have no chance to develop, as economies of scale will prevent the establishment of a productive industrial sector. Based on this analysis, it makes a lot of sense for governments to help domestic companies to exploit economies of scale, support technological developments that strengthen economies of scale and create technological monopolies, which then are protected with strict international patent laws. Such policies increase national welfare by building a strong industrial sector, creating even stronger external economies of scale, and improving the terms of trade for the own country by charging high export prices. This is all done to a large extent in developed countries, at the detriment, however, of development in the rest of the world.⁹

⁷ Economies of scale also destroy the marginal productivity theory of distribution because following the rules of this model lead to a situation in which more is distributed than income produced. Also, the usual demand function for labour is not guaranteed any longer.

⁸ Even Krugman et al. (2017) in their textbook avoid an explicit analysis of the consequences of economies of scale for the outcome of international trade.

⁹ Krugman did not so much like these consequences. In a review of the book *Trade Policy and Market Structure* by Helpman and Krugman (1989) Robert Lucas (1990: 666) writes: “Throughout *Trade Policy and Market Structure*, Helpman and Krugman exhibit what strikes a reader as extreme discomfort with the policy implications of the new trade theory (...). Helpman and Krugman seem not so much to be defending the validity of what they are calling ‘the central economic tenet’ of free trade as trying to avoid the blame for being the first to expose its emptiness.”

A last argument has to be discussed here. In traditional trade theory, more international trade increases world efficiency and thus leads automatically to higher production. The integration in the world market, the argument goes, also creates in developing countries higher production and more jobs. According to this argument, it is assumed that workers and production facilities that are no longer relevant due to higher efficiency are automatically employed again. This argument is based on Say's law that supply creates its own demand. From a Keynesian perspective, such a mechanism is not guaranteed. Higher efficiency can lead to unemployment and unused production capacities. Only when sufficient aggregate demand, which is principally independent of efficiency, is created will higher efficiency lead to higher production. It is a different story, however, when a country is able to realize higher export surpluses. In such a case, it can increase domestic demand and production. The problem, of course, is that not all countries in the world can have export surpluses and increase their production and employment in this way.

Low-tech tasks in global value chains (GVCs) and a new global exploitation model

Since the 1990s, the characteristics of globalization changed with the revolution in information and communication technology, reductions in transportation costs, and deregulation of international trade and capital flows. These developments allowed multinational companies to break down their production processes into different *tasks* and allocate these tasks all over the world, in line with their profit motives. Offshoring in the form of subsidiaries or subcontracting is not a new phenomenon, but never in history has it happen to such an extent.

Pure domestic value-adding production activities – for example, a haircut – dropped from 85 to 80% of world GDP between 1995 and 2014. Value-adding in traditional trade – for goods such as oil or a machine which is completely produced in one country and sold to another one – increased from 6 to 7% of world GDP in the same period. Productions in simple GVCs with goods only crossing borders during the production process increased from around 5 to 8% of world GDP. Complex GVCs with more than one border crossing during the production process increased from around 3 to 5% of world GDP (Dollar 2017: 2f.). According to UNCTAD (2013), around 60% of global trade is trade in intermediate goods, and developing countries' share in global value added trade is 40%. Moreover, the role of transnational companies (TNCs) is enormous. UNCTAD (2013: X) finds that “TNC-coordinated GVCs account for some 80% of

global trade.” Similar findings are observed by the WTO (2013: 5), noting that “the ten largest merchandise traders constitute nearly 60% of world trade and about half of world trade in intermediate goods. Many of these global value or production chains are organized by a multinational enterprise. For US multinationals, one-third of their exchanges take place within the multinational.”

GVCs have several effects on developing countries. First, GVC lead firms (or intermediate firms acting for lead firms) allocate tasks all over the world according to the comparative advantages of countries. Comparable with traditional trade theory, developing countries tend to have a comparative advantage in low-tech and low-skilled sectors, while developed countries have a comparative advantage in high-tech and high-skilled sectors (Feenstra 2010). In GVC developing countries do not only produce low-tech goods as in traditional trade, they produce possibly the low-tech tasks in the production of low-tech goods. For example, in garment production, countries like Bangladesh or Vietnam take over low value-adding activities, such as trimming and cutting, whereas high-value activities like design, research for new material, branding, or logistics are taken over by foreign lead firms or foreign intermediate traders (Chi 2016). GVCs can result in a further reduction in the productivity level, narrower specialisation and can intensify the above discussed lack of dynamic industrial development.

Second, GVC also have positive effects for developing countries. They provide them with the possibility to exploit economies of scale in manufacturing, which would be difficult in the production of complete goods. And there is the hope that lead firms will transfer skills and technology to developing countries. For example, employees in GVC with some higher technical and managerial skills can rotate to domestic firms. In addition, domestic firms that are under pressure to adjust to remain competitive, may be able to copy technologies from foreign firms. Sometimes domestic firms are also used as domestic suppliers in GVC and are trained by lead firms to reach a sufficient standard. However, even if the lead firm transfers technology to developing countries, this will only be technology that is associated with the production of low-tech tasks. If the producer in the developing country produces the task in a satisfactory way, there is no incentive for the lead firm to improve further the technology or skill-level in developing countries. In traditional manufacturing sectors (e.g. garment, footwear) and natural resource-based sectors (e.g. fruits, wood processing, coffee), local firms benefit from GVCs

usually in terms of product upgrading (better or new tasks close to the old task) and process upgrading (new technologies or management methods to improve production in this sector), as these firms are often forced to comply with overseas quality and social standards. Functional upgrading (shifting or extending the position in GVCs to more skilled activities) is rare, as the lead firms tend to keep the ‘know-how’ of their operations to themselves. Global buyers in GVCs tend to divide their innovation activities between strategic ones with highest value-added performed in home locations and non-strategic ones outsourced to various locations in developing countries. Upgrading in complex product sectors (e.g. automobiles, electronics) is usually small, and functional upgrading very unlikely (Humphrey and Schmitz 2002; Pietrobelli and Rabellotti 2004; Giuliani et al. 2005; Schmitz 2007; Herr and Scherrer 2017).

Third, it is argued that transferring GVC to developing countries creates jobs. For example, since 2009 the Korean multinational Samsung has been transferring assembly tasks in the electronic industry to Vietnam, and in 2017 employed over 100 000 persons, mainly women (Samsung 2017; Chi 2017). The Taiwan-based Hon Hai Precision Industry Co. (also known as Foxconn) employs more than 1.2 million workers in China mainly in simple manufacturing to produce iPhones, iPads, Play Stations, etc. (Facing Finance 2018). That being said, one should be careful when drawing conclusions regarding the macroeconomic employment effects associated with GVC. Only when increasing production in GVC increase export surpluses (reduce import surpluses) positive employment effects can be realised. Otherwise, and this is the rule, GVC only change the structure of trade and employment. There are countries integrated intensively in GVC that have, at the same time, current account deficits – as for example Vietnam in many years during the past two decades.

Fourth, GVCs lead to another conclusion regarding wage dispersion in developing countries. When tasks are classified from very low-skilled ones to very high-skilled ones, developing countries at a certain point of time take over certain low-skilled tasks and developed countries certain high-skilled tasks. If now, based on improvements in transportation, communication or management techniques, developing countries take over more tasks, in *both* developed and developing countries, the relative demand for skilled workers increases and the unskilled are the relative losers (Feenstra and Taylor 2014: 199ff.). This model fits to the reality that wage

dispersion worldwide increases or remains – especially in developing countries – at very high levels.

Fifth, power asymmetries are vital. In GVCs, monopsonistic or oligopsonistic structures are dominant.¹⁰ The concentration of the world leading companies in a few countries is impressive.¹¹ Due to intense competition in these sectors, buyers of tasks in developing countries have the market power to sharply reduce prices to a minimum. Suppliers are pushed to almost profitless production, whereas the lion's share of profits along the value chain is pocketed by the lead firm. "Value grabbing" in GVCs, the concentration of profits in lead firms, must be seen as an important factor for increasing profits of multinationals and increasing the profit share in developed countries. At the same time, profits in developing countries are downgraded and the pressure on wages, working conditions and ecological standards increased (Milberg and Winkler 2013). In this context, a new global exploitation model developed (Azarhoushang et al. 2015). Paul Krugman (1981) argues in this direction. As mentioned above, in case of economies of scale, the market mechanism concentrates manufacturing in developed countries, in bigger and bigger companies, and developing countries produce and export low-tech products with no or low economies of scale. In the second step of the analysis, Krugman allowed for foreign direct investment (FDI). Now big firms in developed countries have the incentive to transfer some productions to developing countries to cut costs. Of course, profits earned in developing countries are transferred to developed countries. As acknowledged by Krugman (1981), there are many similarities between this analysis and Vladimir Lenin's (1939) analysis on imperialism.

The control of GVCs by a small number of multinational companies, the concentration of low-skilled tasks in developing countries and the value grabbing of multinational companies push developing countries in a market constellation to deliver cheap low-tech products and tasks for

¹⁰ GVC or production networks also are important among the group of developed countries. They are based on economies of scale and technological expertise. In this case power asymmetries are weaker or do not exist. An example is the manufacturing of engines by Rolls Royce for Airbus and Boeing.

¹¹ Using annual revenue as an indicator, in 2017 from the 500 biggest companies 132 are located in the US, 109 in China, 51 in Japan, 29 in Germany and France each. The top five countries account also for 350 of the 500 biggest companies. Countries like Britain have 20, South Korea 15 or India 7 (Fortune 500 2017). Looking at capital market capitalization from the top 100 firms in 2017 55 come from the US, 11 from China, 5 from Great Britain, 4 each from Germany, France and Japan, 3 each from Switzerland and Australia, 3 each from Canada and Spain, 1 each from Netherlands, Brazil, South Korea, Taiwan, Belgium, Ireland and Denmark (PwC 2017). From the developing world only, China managed to become a big player in the world economy. Within OECD countries the US play by far the biggest role.

low prices. This benefits especially owners of multinational companies and consumers in developed countries. The only relevant exception is China which, supported and protected by strong government interventions, build-up its own big companies and at the beginning of the millennium started to push its own outward FDI towards Africa, less developed Asian countries and other regions.

Natural resources, Dutch disease and rent-seeking

Developing countries are not only deliverers of low-tech products and tasks, many of them have an absolute advantage in the extraction and export of natural scarce resources like oil, gas or rare minerals. These resources are usually sold for prices much higher than their production costs and earn a rent which is not based on any merit principle, but solely on the ownership of the geographical location that the natural resources are extracted from. The richness of such natural resources very easily becomes a burden for development and not an advantage. One problem of natural resource richness is the so called “Dutch disease”. The term was coined in the 1970s, when in the North Sea off-shore oil was found, and the export of oil in the Netherlands led to poor development of the previously dynamic Dutch manufacturing sector. Max Corden and Peter Neary (1982) argued that the discovery of natural resources and their extraction and export leads to a real appreciation and a loss of competitiveness for the manufacturing sector. This cannot be a surprise, as countries exporting a lot of scarce natural resources cannot at the same time export a lot of manufactured goods. For the manufacturing sector, the exchange rate is then overvalued to such an extent that manufacturing sectors have no chance to develop. At the same time, employment and technological spill-overs of natural resource extraction are rather low. Growth may be high as long as natural resource prices are high, as the domestic non-tradable sector is stimulated by high revenues from natural resources. But the country is in danger of suffering in the long-term from low productivity growth. Lastly, when the natural resources are used up, the resource-based development model collapses.

There are more problems for countries with natural resources (Humphreys et al. 2007; Herr 2016). Natural resource prices are traditionally volatile, especially since the tendency towards financialisation and speculation in the last decades (Evans and Herr 2016). This exposes natural resource rich countries to frequent shocks. Even when natural resource revenues are usefully spent, there is the danger that projects associated with industrial or social welfare purposes

cannot be finished if revenues suddenly run dry. Usually, natural resource rich countries have poor tax systems. This implies that losses incurred from declining oil revenues cannot be quickly compensated. Last but not least, natural resource rich countries suffer from rent-seeking and high levels of corruption in many cases. In a number of resource-rich countries, the firms that extract the natural resources are owned by foreign firms. In such cases, rents earned are directly transferred to foreign countries. In the light of these problems, it becomes understandable why so many resource rich countries suffer from the Dutch disease and a resource curse – from Nigeria, Angola, Venezuela, to Iran or Russia. Norway, of course, is the big exception in this regard. Norway's success as an exporter of natural resources, however, is due to its good institutional framework and its policy to invest all its oil revenues abroad to prevent overvaluation.

Extensive development aid in the form of money inflows can lead to similar effects in developing countries as Dutch disease, that is, an overvalued exchange rate and rent-seeking behaviour (Rajan and Subramanian 2005). High capital inflows and high remittances can also lead to Dutch disease effects.

Secular negative terms of trade effects for primary goods – the Prebisch-Singer hypothesis

Another area of absolute advantages of developing countries can be found in the production and export of primary commodities like cotton, rice, sugar cane, fruits, flowers, etc., which are sold in very competitive markets and have prices largely regulated by production costs. Hans Singer (1949) and Raul Prebisch (1950) have made the argument that the production of such commodities leads in the long-run to negative terms of trade effects for developing countries. In the case of developing countries, the Prebisch-Singer hypothesis implies that they must export quantitatively more primary commodities to get the same quantity of high-tech products produced in developed countries. This makes it more difficult to reach income levels comparable with developed countries.

Following Singer and Prebisch, there are four reasons why the terms of trade tends to deteriorate in developing countries. First, primary commodities have lower price elasticities than manufactured goods. For primary commodities, if prices decrease, for example the price of coffee, the demand for these goods does not necessarily increase, particularly when compared to manufactured goods. Second, income elasticity for primary products is also relatively low. For

example, the demand for rice does not substantially increase when income increases; rice may be an inferior good, which implies that a relatively lower demand is associated with a higher income. Third, technological developments in the field of synthetic substitutes and efficiency gains in reducing inputs of primary commodities, for example caoutchouc, tend to reduce the demand for primary commodities. Fourth, primary commodities usually are produced and sold in highly competitive markets, while manufacturing products are produced by multinational corporations which in many cases have monopsonistic and/or oligopolistic positions. Singer (2003), looking at long-term trends, found that prices for primary commodities dropped in relation to manufactured goods.

Pre-mature de-industrialisation

Deindustrialisation can be defined as the fall in the share of manufacturing employment or manufacturing GDP. Deindustrialisation, in this sense, is historically a normal phenomenon and reflects the fast increase of productivity in manufacturing and consumer preferences (Lawrence and Edwards 2013). This process of deindustrialisation happens in a number of developing countries at very low GDP per capita levels. According to Rodrik (2015), in the 1960s and 1970s, manufacturing employment in the United States, Japan, Germany, Britain, Italy, France, and other Western European countries peaked at income levels of around USD 14,000 (in 1990 USD) and employment shares of around 25% or more of total employment. Countries like Germany or Sweden reached around 30% of total employment. In contrast, in many developing countries, manufacturing peaks at income levels of USD 700 (in 1990 UDS) and at maximum employment levels of only around 15%. For example, industrial employment in India peaked at around 12% of total employment in 2002, in Indonesia at around 13% in 2001, in Ghana at around 15% in 1978, or in Zimbabwe at 5% in 1985. Rodrik (2015) calls this phenomenon premature deindustrialisation. In many developing countries, the market mechanism leads to a specialisation away from manufacturing. Developed countries, and a small number of developing countries, such as the Asian tigers or China, obviously have comparative advantages and the capacity to produce manufactured goods for the whole world.

Following Nicholas Kaldor (1966; 1967), industrialisation is at the core of economic development. The industrial sector, as mentioned above, is usually the most dynamic sector and of key importance for the long-run productivity development of a country. It is questionable

whether other sectors in developing countries could have the capacity to ensure development to the same extent. Theoretically, high-quality services could take over this function. But service-led growth in high-value-adding activities is very skill-intensive and does not engage a substantial amount of low-skilled labour. In addition, it is questionable whether the employment dynamic of high-skilled services is sufficient to create the needed employment (Dasgupta and Singh 2006).

There are other negative effects of premature deindustrialisation (Rodrik 2015). Industrialization is crucial for the development of big or medium-sized companies which offer employment for different skill-levels. Without sufficient industrialisation, there is the danger that the economy remains dominated by only small and micro enterprises, which are – to a large extent – in the informal sector. These enterprises are no “Schumpeterian enterprises” with high innovative power but tend to remain – to a large extent – “poverty enterprise”, with low productivity and minimal prospects for meaningful development (Herr and Nettekoven 2018). For such a sector, the enforcement of labour laws, like minimum wages, establishment of strong trade unions and employers’ associations and collective bargaining, economic and social upgrading etc., remains difficult. The development of a working class and other modern mass organisations pushing for social reforms, including political reforms and democracy, becomes unlikely. To sum up, if countries are not able to industrialise, there is the danger that productivity increases, and innovation performs poorly. Informality remains a big problem, even if a small modern sector in the economy develops. And there is no social basis in the form of a working class for creating acceptable equal living conditions.

Until now, we have mainly discussed factors which prevent sufficient productivity development. The factors discussed below consider why developing countries have – in addition to these issues – problems in stimulating sufficient aggregate demand.

Low quality of domestic currencies and distorted financial systems

The approximately 180 currencies in the world have different qualities and take over different functions. The quality of a currency depends on the trust that wealth owners (rich and poor households, firms, financial institutions) have in a currency. Trust depends on past, and more so expected, stability of the currency, which is expressed in a low inflation rate and stable exchange

rate. Other important factors are the size of the currency area, the disposability of the currencies, and the political and social stability up to the military power of the money-issuing country.

A currency hierarchy can roughly be divided in three layers. On top of the hierarchy there are only one or a few currencies, presently the US Dollar and the Euro. These currencies take over all national *and* almost all international money functions, but also domestic money functions in countries with low-quality currencies. In the middle layer of the hierarchy, there are approximately 20 currencies, such as presently the Australian Dollar or the Swedish Krona, that take over all domestic money functions, but no other functions. Thus, the majority of currencies are in the lowest layer of the currency hierarchy. These low-quality currencies only partly take over national money functions. Monetary wealth denominated in these currencies only to a very limited extent serves the needs of wealth owners.

The low quality of currencies is shown by the degree of dollarization (including euroization, etc.). A common indicator for dollarization is the share of domestic foreign currency deposits on total domestic deposits in a country. Median deposit dollarization of all emerging market economies in 2015 was somewhat over 17% (Catão and Terrones 2016). This does not sound very high, but it must be added that in many countries, dollarization is legally prohibited, restricted or policies are followed to keep dollarization low, as in Brazil, Chile or China. There are big differences in the degree of dollarization. In the period 2007–11, deposit dollarization in Sub-Saharan Africa was 21.8 %, in Latin America and the Caribbean 25.2%, East Asia and Pacific 19.0%, emerging European countries and Central Asia 45.7%, Middle East and North Africa 11.4%, and South Asia 24.0%. In high-income OECD countries, it was 7.2% and in high-income non-OECD countries, 21.0% (Mecagni et al. 2015). There are many countries with very high deposit dollarization, with shares of 50% or higher. Several countries only use foreign currencies, for example El Salvador, Panama or Zimbabwe.

Dollarization is the capital flight of the small wealth owners acting on a national level. Big wealth owners in developing countries keep their monetary wealth outside their country. The amount of monetary wealth kept outside the country is statistically not known. One can imagine that, in most developing countries, especially the ones following market-radical policies, much more than 50% of monetary wealth is kept in foreign currency.

There are many severe disadvantages when a country is not able to produce a currency which is sufficiently accepted by domestic and, consequently, foreign wealth owners (De Paula et al. 2017). First, with increasing dollarization, the possibility of countries to earn seigniorage, which is based on profits made by the central bank, shrinks. Second, and more important, the low quality of a currency leads to currency mismatch. Currency mismatch is caused by dollarization, as there is a high correlation between deposit dollarization and domestic credits given in foreign currency (Chițu 2012). Domestic financial institutions use domestic foreign currency deposits to give domestic foreign currency loans. In many countries, what is even more relevant, is that currency mismatch is also caused by foreign credit. In developing countries, the latter is almost exclusively dominated by foreign currencies (Eichengreen et al. 2007). Currency mismatch implies that a real depreciation of the domestic currency increases the real debt burden of those who are indebted in a foreign currency. A sharp depreciation then leads to severe financial crises, which have become so frequent in developing countries after the liberalisation of capital flows in the 1970s. It is also no surprise that Chițu (2012) found that dollarization was an important contributor to the severity of the crisis that hit many developing countries after the outbreak of the US-subprime crisis in 2007.

Third, monetary policy is severely restricted in countries with low-quality currencies. In these countries, real interest rates must be increased by Central Banks to compensate for the low quality of their currencies. High interest rates reduce domestic investment and increase income inequality. High currency mismatch also restricts the use of the exchange rate to defend international competitiveness via real depreciation. Countries can be caught in a constellation of high current account deficits, overvaluation of their currencies, and a policy of very high interest rates by their Central Banks, who fear that depreciation may provoke a domestic financial crisis. A spectacular example is the currency board in Argentina during the 1990s, which collapsed in 2001 after a long fight by economic policy makers to prevent depreciation. In addition, in countries with high currency mismatch, the ability for the Central Bank to act as a lender of last resort is extremely limited. The importance of this function of Central Banks can be observed, for example, in developed countries hit by the Great Recession crisis 2008/09 and the following years. In a currency crisis caused by liquidity and solvency problems of foreign debt denominated in foreign currency, countries have to go to international institutions or foreign

countries to beg for help. In doing this, they lose their national sovereignty and usually are forced to follow policies which are not necessarily in their interest.

Fourth, and probably most important, is the break-down of a sustainable Keynesian-Schumpeterian credit-investment-income-creation-saving mechanism which is at the centre of economic development. Joseph Schumpeter (1934: 107) stresses that money and credit is created “out of nothing” to finance investment and the “creation of purchasing power characterises, in principle, the method by which development is carried out in a system with private property and division of labour.” And Keynes (1937a: 221) stressed the income creation mechanism: “The theory can be summed up by saying that, given the psychology of the public, the level of output and employment as a whole depends on the amount of investment.” The psychology of the public determines how much of income is consumed and how much saved. This implies that investment creates savings via stimulating production and income. One consequence of this analysis is that developing countries do not need foreign capital to develop. At least theoretically, all capital which is needed for development can be created by the domestic banking system when credits are invested in productive production processes. Developing countries need knowledge and new technologies, but they do not need foreign financial means to finance domestic investment.

When a Central Bank in a typical developing country refinances a stable domestically financed healthy expansion process by financing productive investment, monetary wealth in the domestic currency is endogenously created. This is due to the fact that credit expansion automatically extends banks’ balance sheets on the asset *and* liability side. The problem is that in a typical developing country, 50% or more of monetary wealth creation is exchanged in foreign currency by wealth owners. This leads to an unacceptable depreciation of the domestic currency and, finally, a monetary policy which stops the economic expansion very early. By this process, long-term high GDP growth rates in developing countries and convergence are suppressed. A domestic credit expansion can continue for some time, as long as the country can attract sufficient foreign capital inflows to finance the demand for foreign currency by domestic wealth owners during such an expansion.

It becomes understandable that successful countries like South Korea or Taiwan developed under a regime of strict capital controls, including highly regulated domestic financial markets, which delivered long-term credits and kept real interest rates low (Stiglitz and Uy 1996; Dullien 2009). China, after the start of reforms in 1978, to give another example, was able to establish a largely state controlled credit-investment-income process protected by a comprehensively regulated financial system, including strict capital outflow and inflow controls (Herr 2010). These countries also managed to check inflationary processes and avoid the erosion of confidence in domestic monetary wealth.

Fifth, financial markets tend to have boom phases with high credit expansions and asset price bubbles, sudden stops of credit expansion, and busts with credit contraction, asset price deflations and financial crises (Minsky 1982; Detzer and Herr 2015). Following the same logic, especially with respect to developing countries, economies are regularly afflicted by international boom-bust cycles. In such cycles, during the boom phase, high capital inflows are usually combined with high domestic growth, asset price inflation and current account deficits. Typically, high capital inflows create high currency and maturity mismatch. When capital inflows come to a sudden stop, the exchange rate comes under pressure and depreciation, with its effect on the real debt burden, is almost unavoidable. This results in twin-crises: domestic financial system crises and exchange rate crises. Typical are even triple crises with an additional collapse of share and real estate prices (Kaminsky and Reinhart 1999). Such boom-bust cycles can become very costly for developing countries and undermine long-term stable development. The most suitable instrument to avoid boom-bust cycles are capital controls or measures which do not allow the development of currency mismatch (Stiglitz 2004; Williamson 2005).

Sixth, even when developing countries manage to trigger a period of high GDP growth, it is likely that the growth process leads to increasing imports and current account deficits. Such deficits can only be financed by capital inflows and can lead to financial crises. If stable long-term capital inflows cannot be attracted and current account deficits evolve, there is the possibility of a real depreciation to balance the current account. However, a real depreciation can be very difficult for developing countries. Above, it was mentioned that high currency mismatch can be an obstacle for depreciation. But there are more difficulties to overcome. In case of low price elasticities of exports and imports, the Marshall-Lerner condition might not be fulfilled and

in turn a real depreciation could increase the trade deficit.¹² A nominal depreciation can trigger a depreciation-wage-price spiral. And the negative terms of trade effect of a real depreciation often result in cuts in real income and can cause political instability. In short, real depreciations may not work. In such a case, growth of developing countries is constrained by the balance of payment (Thirlwall 2014).

High inequality and lack of development

Heather Boushey and Carter Price (2014: 16), in a review of recent research, summarise their findings as follows: “This most recent work provides strong evidence that higher levels of income inequality are detrimental to long-term economic growth and that the policies some nations have taken to redress inequality not only do not adversely impact growth, but, instead, spur faster growth. Notably, this finding applies to both developed and developing countries.” Among others, Andrew Berg and Jonathan Ostry (2017) found in their econometric work that longer periods of high growth become unlikely if inequality becomes too high (see also Ostry et al. 2014; Ostry 2015). In a comprehensive meta-analysis, Petro Neves et al. (2016) concluded that there is a negative relationship between higher inequality and growth, especially in developing countries. It seems that short periods of growth are compatible with high or increasing inequality, but not long-term sustainable development. Furthermore, inequality at the bottom of society seems to be more problematic than at the top.

During the last decades, neoliberal policies increased inequality – or at least kept it very high – in developed and developing countries. Inequality in developing countries is usually very high, as all factors which influence income distribution stimulate high inequality: the profit share is high, wealth concentration is high, wage dispersion is high, and governments do not adopt policies aimed at redistribution. Inequality becomes a serious obstacle for sustainable development (Gallas et al. 2015).

Already Gunnar Myrdal (1972: 102f.) stressed the positive supply side effects of a more equal income distribution. First, if the reproduction of the power of labour for the poorer is improved (better health care, better housing and sanitation, better education), productivity will increase.

¹² The Marshall-Lerner condition shows that real depreciations only improve the trade balance if the absolute sum of export and import demand elasticities is greater than unity.

Second, mobility in society will increase with more equal income distribution, which will have positive productivity and social effects. Third, the rich are not always the best entrepreneurs; they tend to become a parasite class. Fourth, higher equality adds to social coherence and national consolidation. According to him, the build-up of welfare states in Western countries after World War II must be considered as one of the most profitable investments of societies, even though the gestation period of this kind of investment is long-term (see also Ostry et al. 2014).

From the demand side, high inequality and high insecurity, which is connected with inequality, reduce consumption demand. High-income groups have a lower propensity to consume in comparison with low-income groups. Without sufficient consumption demand, which is by far the biggest demand element in almost all countries, overall demand, including investment demand, will suffer. A relatively equal income distribution and the inclusion of all societal groups in economic progress becomes a precondition for sustainable growth, including from the demand side. For some countries, it might be possible to overcome the negative demand effects of inequality through high current account surpluses, high indebtedness of private households or high fiscal deficits. But all these strategies are problematic for the sustainability of the growth model, difficult to achieve for developing countries, and destabilising for the world economy (Hein and Dodig 2015).

Classical and neoclassical economists argue that higher inequality can stimulate growth. They base their belief on the arguments that higher inequality leads to higher savings and, following Say's Law, higher investment. But Say's Law does not hold. There is no market which creates equilibrium between *ex ante* saving and *ex ante* investment; investment is financed by credits created by the banking system and savings are the result of income creation depending on aggregate demand. *Ex ante* saving is not needed and logically cannot provide the funds for investment – actually *ex ante* savings reduce aggregate demand and can suppress investment (Keynes 1937b). A further argument is that higher inequality gives better incentives for growth. This argument has several dimensions. Higher inequality can be combined with a higher profit share. Profits, if they are not distributed, can become a source of investment, as they ease financing constraints on firms. But the link between profits and investment in the era of financialisation has become weak. Financialisation, also in developing countries, means –

among other things – that a large part of profits is distributed to wealth owners, and high undistributed profits may be invested in financial markets and not in productive capital (Hein 2014: chapter 10). The lion's share of non-work income is not based on entrepreneurship or any effort which needs a positive reward; it stems from inherited wealth and violates the ideology of meritocracy. Finally, certain wage dispersion might be needed, but not at a level found in the typical developing countries in which wage dispersion is the main factor for income inequality (Herr and Ruoff 2016).

Lack of aggregate demand management

The volume of aggregate demand, as well as its structure, can lead to crises, lack of development, and unemployment. Developing countries suffer typically from a lack of aggregate demand; they could produce more and employ more people if demand were higher. It is not a surprise that developing countries suffer from a lack of demand. First, investment demand in many developing countries is suppressed by a distorted financial system, which is not able to deliver sufficient credit for a high investment dynamic. Second, high inequality in typical developing countries keeps consumption demand too low. Insufficient consumption demand also depresses investment, given that it makes no sense to build up production capacities when they cannot be used.

The conclusion from this analysis is clear. Developing countries have to find institutions and mechanisms to finance and stimulate investment and push for more equality to increase consumption demand. Keynes (1936: 325) argued: “Moreover, I should readily concede that the wisest course is to advance on both fronts at once. Whilst aiming at a socially controlled rate of investment...I should support at the same time all sorts of policies for increasing the propensity to consume... There is room, therefore, for both policies to operate together; to promote investment and, at the same time, to promote consumption.” In the countries which show successful convergence, governments massively intervened in the investment process via state-owned enterprises, state-owned banks or supporting private companies to invest. In addition, income inequality in the successful East Asian miracle countries was relatively moderate (Stiglitz 1996).

Developing countries also suffer from relatively low government demand, particularly compared with developed countries. In many developing countries, the tax system does not work. There might be a big informal sector which is difficult to tax; there might be the power of the elites which prevents a sufficient taxation of them. Low tax revenues lead to small government demand. A low government demand in per cent of GDP fully financed by taxes has a restrictive aggregate demand effect compared with a high government demand in relation to GDP fully financed by taxes. Higher government expenditures fully financed by higher taxes have an expansionary effect as tax payers finance tax partly out of their consumption and partly out of savings (Haavelmo 1945).

For developing countries, the room for expansionary fiscal policy via higher budget deficits is smaller than for developed countries. In many cases, high budget deficits in developing countries have to be financed by direct credits from the Central Bank or indirectly by banks which refinance themselves through the Central Bank. In both cases, additional monetary wealth is created. As big parts of additional monetary wealth are exchanged in foreign currency, the room for fiscal expansion is usually small. In many cases, hyperinflation in developing countries is triggered by high budget deficits which lead to a cumulative depreciation-wage-price spiral with even higher budget deficits. Joan Robinson (1938) in detail analyses such a process.

The last demand element is net foreign demand. Current account surpluses support domestic demand and can lead to export-led growth. Current account deficits reduce domestic demand and output. For this reason, developing countries should avoid current account deficits. In addition, it should be kept in mind that current account deficits can lead to foreign over-indebtedness. Many of the successful developing countries followed active policies to avoid current account deficits or even pushed for current account surpluses. It is obvious that not all countries in the world can have current account surpluses. It would be a great support for developing countries if the developed world would allow them to have permanent current account surpluses.

4. Conclusions

Economic thinking has produced a whole set of theoretical approaches to explain why unregulated markets do not lead to convergence between developed and developing countries. An important point is that countries can suffer from *several* of these drawbacks, showing how

difficult a task it is for a developing country to develop. The conclusion is that without heavy government interventions, development is not possible. This conclusion is not a plea for a planned economy or suppression of markets. It is a plea for a combination of government interventions and institutions *and* markets. What is suitable for development is a form of development that is oriented towards a highly regulated type of capitalism in the tradition of John Maynard Keynes and Karl Polanyi. In such an approach, markets can play an important role, but they have to be embedded in comprehensive government regulations and institutions.¹³

To give some examples: International trade and export orientation is recommendable for development, but not free trade and unregulated capital flows. A high level of trade can be reached even with development-oriented trade regulations. An example is the first globalisation wave before World War I (Chang 2002). Also, certain capital flows can support development, but unregulated capital flows become a serious problem for development. The support of entrepreneurship is important for development, but without comprehensive industrial policy, development is difficult to achieve. The challenge for industrial policy is to create an information flow and coordination mechanism between government and the enterprise sector, including civil society, to shape industrial policy and adjust it in case of mistakes (Rodrik 2004).

This leads to one more obstacle for development which has not been mentioned yet. Good government interventions imply the political will and ability to promote meaningful development policies. However, the political constellation in many developing countries does not allow such policies. Elites in many countries may not be interested or capable of implementing policies which lead to convergence. They may be part of an international community with similar living styles, fashions, and values. For them, a needed national project of development (including inclusive growth) may sound like an alien adventure, neither realistic nor preferable. Also, developed countries as well as international institutions may prevent or at least make it difficult for developing countries to follow policies which are in their interest. And there is one more important point. Developing countries are, on average, more severely affected by the impact of global warming and other ecological problems than developed countries. Moreover, they have less means to protect themselves against these developments.

¹³ There are many blueprints how an alternative development model could look like and what developed countries could do to do to support it (see for example Stiglitz 2006; also see Dullien et al., 2011)

Looking at all these problems, in the current global constellation, it seems to be realistic that especially some of the Asian countries will be able to catch up, but many countries in the global South will be left behind. For many countries, the barriers to catch up are very high. Of course, a fundamentally other globalisation model could improve the chances of creating a more coherent world economy.

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