Potentials for Economic Development in the Third World: A look to Theoretical Views and an Empirical Study

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ABSTRACT

This paper examines the Third World economic crisis. It first discusses the historical setting of colonialism and dependence. Next, it compares competing explanations from conservative and Marxist camps regarding the present crisis. Ironically, both sides of the debate concur on the theoretical conclusion that investments should flow from the industrialized to the developing world. Most scholars dispute these conclusions, arguing that investment in fact flows northward.

The study then begins its own analysis of the crisis. Data seem to show that the conservative and Marxist models may have been correct. Investment may flow from the center to the periphery.

Assuming investment does flow from the industrialized nations, it remains uncertain why the developing nations have failed to improve their situation. The paper tries to explain this contradiction by looking to theories on the new international labor relations as a justification for the lack of third world development.

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I. Summary of the Article

The era of Colonialism set the stage for the modern post-colonial era. Under Imperialism, it was hoped that developed nations could aid their territories in economic development. While some benefits were bestowed upon the dependant states, on balance, many scholars believe the financial relationship favored the Imperialist power. As this era came to a close, some scholars believe that the economic relationship of dependance continued.

There are differing perspectives and models which can be applied to the post-colonial era to aid in judging whether the poorer nations of the world will be able to escape domination by their more affluent neighbors. Marxist and conservative models appear to project a flow of investment from the center to the periphery, although these theories do so for different reasons. If this is the case, we might expect that the third world would be able to throw off the yoke of economic dependancy and develop into a more mature economic condition. However, other scholars believe this is too optimistic. They instead affirm that the old colonial relationships die hard and investments flow from the poor to the rich, leading to a more pessimistic result.

I set forth to discover in which direction in fact investments flowed, believing this to be a crucial ingrediant of the progress towards modernization in the periphery. Using World Bank data, which incorporates International Monetary Fund data, I

found that the average periphery nation experiences an inflow of capital. Further, the poorer the nation was, on average, the more capital that state received.

While the results of my study appear quite optimistic, we must look to other factors which may prevent capital from generating the desired effects of modernization. Here, the influence of the multinational corporations and the New Industrial Relations comes into play, retarding or in some cases reversing the expectations of the periphery economies. To deal with this dilemma, I suggest that the periphery states attempt to learn more for themselves about the new technologies. In this way they will be in a better position to minimize the negative effects of investment by multinational corporations through governmental regulation, while retaining the benefits. Further, this learning and regulation process should become easier for the state over time.

II. Introduction--the Age of Colonialism

A contemporary view of third world development begins with an examination of the past. Much is known about the period of "Colonialization" in our history. The British Empire, at its apogee, included sections of Africa, the Indian Sub-continent, and China. Nearly as impressive was the French Empire, which controlled territories spanning Africa and Indochina. Spain dominated Latin America, the Netherlands ruled over Indonesia, Japan controlled Korea, the United States governed the Phillipines, Belgium ruled the Congo, and Portugal retained power over Brazil and parts of Africa. In short, the "first world" nations ruled over the developing ones.

Because of the diversity of "ruling nations," it is difficult to lump them all into one group. Each colonial power exersized its power for varying objectives and with different motives. Thus, developing nations were not uniformly affected by "Imperialism." Yet, the developed countries did have one element in common--their search for economic gain through their territorial possessions.

Imperialism has been justified on several bases. Originally, third world nations had feudalistic economies. By introduction of industrialized methods, it was hoped that an organized, market regulated labor system could be established in the poor nations which could in turn help pull the rural population out of its backward condition. Further, based on the principal of comparative advantage, the developing nations could

produce raw materials and agricultural products in return for manufactured goods. Through exchange, in theory, it was possible for both industrialized and agrarian-based economies to become wealthier through specialization. Finally, and perhaps most importantly for this study, it was argued that unrestricted free market capital would be invested into the underdeveloped world, allowing those nations to experience economic growth, instead of remaining in a stagnant economy. In short, national income and production would increase as the allocative efficiency of capital increased. Further, growth would come as the rate of the accumulation of capital quickened.(1)

Unfortunately, as Griffin and Gurley note, "Economic power and political power usually go hand in hand."(2) Historically, the age of Imperialism did not usher in a period of global harmony and transition from the backward to the progressive, but instead laid the groundwork for manipulation and exploitation. The labor force in the third world was subjugated to low wages, decreased mobility and occupational hazzards. As documented by Wolff(3), the labor market operated under conditions far from the goals of the laissez-fair economic system. Through labor laws and shear monopsony power, colonial governments were able to coerce workers to accept harsh conditions. These laws coexisted with the regulation of slavery which this discussion leaves aside.

Yet, the lack of free trade was not the only problem resulting from Imperialism. Bagchi has argued that growth in the resource sector of the economy came at the expense of the

industrial sector.(4) The end result was a movement away from food crops to cash crops and an overall decline in the standard of living for poor peoples in both urban and rural settings.(5) This manipulation has been termed "Export-led exploitation" by some leftist scholars.

There is disagreement between modern scholars regarding the influence of colonialism on investment in the third world. Leftists maintain that economic returns for the agrarian produce of the poorer nations were transferred back to the Colonial powers. The money was then used to increase consumption in those nations or alternatively used for reinvestment back in the colonized economy. While this reinvestment in turn lead to increases in subsequent production and thus economic surplus, leftists assert that the net flow of resources went from the Colonies to their controlling power.(6) These scholars note that Spanish consumption, for example, rose with increases in export surplus in Latin America. British income likewise rose 8 to 10% at the expense of the West Indies at the end of the eighteenth century.(7) Similar transactions occurred between Indonesia and Holland and between Bengal and Britain.(8)

On the other hand, conservatives would discount these examples. To be fair, they contend, there is no authoritative documentation of the comprehensive effects of Imperialism in this area.(9) These specific incidents may well have been the results of monopolistic and monopsonistic behavior by the Colonial powers. Yet that does not mean these practices were the norm.

The significance of this debate is important. If we accept the leftist perspective, the economic surplus which could have

been used for domestic investment in the third world was instead consumed in the industrialized nations, or was used to pay for armed forces and the governmental administration of territories within the protectorate. Money flowed from the capital-scarce underdeveloped nations to the capital-rich industrialized world.

With the political independence of the third world colonies, the debate now shifts to the current world economic order. Both conservatives and leftists have adapted their views to the changes taking place in the political arena, the field of labor relations, and more generally the new economic crisis of the third world. In this manner, the debate over the flow of investments takes on a new degree of importance.

III. Post-Colonial Developments

Now that political imperialism has been all but eliminated from the developing nations, we can examine whether the economic aspects of the era of Colonialism will persist. As expected, differing political groups offer differing explanations. In this next section, each of these views will be examined individually, begining with the Marxist vantage, followed by a conservative view and finally the position of economists Amin and Griffin.

a. The Leftist Standpoint

Ironically, the Marxist and conservative models converge in their conclusions. Yet their reasoning process is significantly different. In short, the Marxist position can be capsulized by the assumption that in the long run, the rate of profit declines. This leads industry to search for new areas of increased profit and thus a flow of net investment from the "center," or the industrialized nations, to the "periphery," or developing nations.(10) To see exactly how this works, we can examine the reasoning process step by step.

According to Amin,(11) Marx viewed technical progress as capital-consuming by increasing the "organic composition of capital" or in other terms, the ratio of constant to variable capital. Amin notes that in the short run, this has held true due to increased production per capita through capital savings methods.(12) Yet, better utilization of labor and equipment will

at some point reach a natural limit beyond which there can be no increase in productivity without increased technology.

Marx attempted to quantify the relationship by measuring production's capital intensity. The formulation, called the "organic composition of capital" looks to the ratio of purchase of raw materials to labor. As technical progress increases, so does the ratio. This occurrs because there is a decrease in the velocity of turnovers as organic compostion rises along with a corresponding stability with respect to the quotient of wages.(13) This turnover of capital affects the organic composition via the ratio of fixed capital to circulating capital. As would seem logical, a "heavier" industry, like the auto industry for example, would have a slower turnover and thus a higher ratio, as compared to a "lighter" industry, assuming constant credit conditions.(14) Assuming further a relatively constant rate of surplus value, or in other terms the profit-wages quotient, it follows that progress will produce a falling rate of profit.

On theoretical grounds, this position has been attacked for being inadequate. Part of the rise in organic composition will be the result of increases in real productivity. This in turn will lead to a rise in the rate of surplus value. Ultimately, this will translate into increasing profits, the theory's antithesis.

Yet, Marxists are not left without a counter position. While acknowledging the market force that would tend to lift profits, they maintain that the overall, net effect is diminishing profitability. Two arguments are used to support

this claim. First, the increment in productivity is stronger in the subsistance industries. While the rate of surplus value may be increasing, it is not enough to offset the change in organic composition. Second, or perhaps better said, in the alternative, productivity increases may fall within other industries. If this occurs, neither of the two ratios is altered.(15)

To conclude, the Marxist view forsees several important developments. Capital will flow from areas of falling profitability, in our case the center, to areas of better profitability, or the periphery, using the Marxist terminology. Thus, there should emerge an export of capital to the developing world. This will allow those capital-scarce nations to modernize. Interestingly, a conservative analysis comes to this same basic result.

b. Conservative Approaches

John Meynard Keynes set the stage for a new view of economic growth. Decoupling supply and demand--a link earlier made explicit by Say's Law, and the Classical School--Keynes established his own monetary transmission mechanism, where savings was linked to the rate of interest. With his ingenious assertion of a "liquidity trap," Keynes was able to establish the framework for later growth modeling.

Harrod and Domar built on the Keynesian theory to describe the dynamics of internal growth and investment. Harrod assumed any advance in technical progress which did not alter the

capital-income ratio to be "neutral." In this, he implicitly assumed a stable organic composition and a constant rate of surplus value. According to Harrod's model, to preserve steady and continuous growth, savings would have to increase at exactly the same rate as income. In other terms, the marginal propensity to save must remain constant even as the level of total income augments. To do this, the interest rate must fall steadily. Further, as the population increases, so does the trend for further savings on a national level. Thus, to induce this level of savings, the rate must be lower still.

The floor to the falling rate of interest would become the Keynesian liquidity trap, where savers are indifferent to holding liquidity of investing their savings due to the low rate of return. In this way, savings, which for Keynes was by definition independant of investment, would drop to zero, and the developed countries would be just that, "developed." No further investment would occur. Rather, higher returns could be sought in economies which still maintained a relatively high rate of return on investment above the liquidity trap.(16) Thus, rather than hold unproductive liquidity, rational savers would invest their money overseas, causing a net outflow from the industrialized world to the developing world.

c. The works of Griffin and Amin

Both Griffin and Amin have faulted the Marxist and Conservative vantages. They both believe that investment