<u>The political economy of globalization:</u>

Factoring in politics & ideology to understand socio-economic development in an age of globalization

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"With new understanding we witness the battle of ideologies around the inexorably growing economy, some blindly opposing, some seeking to retard its more ruthless thrusts into the social fabric, some single-mindedly - or simple-mindedly - hailing its every advance. (...)

But the advancing front leaves ruin in its train, and the hastily built defences crumble before it. We see how with a new liberation went a new servitude, and we measure the challenge that now faces our own age."

- Robert M. MacIver, Foreword to *The Great Transformation*, by Karl Polanyi (1944)

In the last decade of the twentieth century, the collapse of the Soviet Union resulted in profound changes in global power balances and geopolitical dynamics which in turn served as a powerful catalyst for a critical paradigm shift in the fields of political and economic policy. After having gradually gained traction during the late stages of the Cold War, throughout the 1990's the proponents of neoliberal and free market policies swiftly rose –under the aegis of the 'Washington consensus' - to become the most influential forces behind international political and economic policy making. The result was, during a period that some have called the "heyday of the neoliberal doctrines (1990-1997)" (Stiglitz, 2001: xv), an erosion of state power in favor of markets, primarily through extensive trade and financial liberalization as many developing countries quickly became closely integrated into the global capitalist system.

This transition, along with the complexities of its lasting structural impact on the international system, have generated a wealth of heated and polarized debate within academic and policy circles – debates which, importantly, often remain unresolved until today.[1]At the heart of these debates lies the balance between states and markets, and the importance of articulating the role of the state in a globalizing economy. To be sure, many basic elements of these debates are far from new, generally stretching back to the first period of liberal economics in the 19th century. However, the rapid technological innovation that has characterized the most recent surge of globalization has brought an unprecedented depth and scale to – and therefore associated new stakes and new levels of risk with - the systemic transformations tied with the fluctuating balance between the liberalization and regulation of market forces.[2]

The overarching objective of the following paper is an examination into whether globalization serves as a positive force for sustainable social and economic development. Our focus will be on highlighting the importance of politics (power structures, ideologies) in shaping the direction and ultimate outcomes of what otherwise largely constitutes a broad wave of technological change.[3] We will look at how these political factors manifest themselves through an influence over both policy formulation and policy/results evaluation. In order to illustrate our argument, we will adopt a political economy approach to the vast and multi-faceted topic of globalization, and conduct an analysis that, while remaining schematic given the scope of this paper, will look at how the rise of the 'Washington consensus' during the early 1990s influenced a specific dimension of economic globalization - the integration of developing countries into

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[1] "Few issues have stirred such passionate debate among development researchers and policymakers as the merits of financial globalization, including integration of equity, bond and money markets, as well as direct ownership of foreign capital or "foreign direct investment" (FDI)." (Kose, Prasad, Rogoff, Wei, 2006:1)

[2] Goldin and Reinert stipulate a third historical wave of globalization, starting in the late 1970's, characterized by a "regulatory race to the bottom and acceleration of technological tools, [that] has highlighted the new dangers associated with globalization in terms of complexity and systemic risk." (2012: 7)

[3] It is important to note that "new technologies [are] understood as both hardware <u>and</u> the software of organizational forms." (Harvey, 2000: 18)

the international system. We will see how the exogenous forces of globalization are re-formulated as they are processed through the prism of socio-political order, harnessed and exploited by particular interest groups as tools to either protect an existing status quo or further a given ideological transformational agenda.

Theoretical framework

> *-Capitalism does have an essential inner logic, but it is also a constructed system, and this means that the logic will unfold in ways that are shaped by the nature of those constructions. Water runs downhill, but the course of the river will be shaped by the contours and the geology of the land, as well as by the existence of man-made barriers and diversions, though the latter may undergo radical change under extraordinary circumstances. (Bienefeld, 2005: 20)*

In light of the complexity implied when trying to define the process of 'globalization', and especially when addressing the globalization-development nexus, this section will attempt to provide a clear articulation of the theoretical framework required for this exercise.

Our principal axis of reflection, as stated earlier, focuses on how political ideology and interests can influence key actors' approach to understanding, and then dealing with, the forces of globalization. This influence plays out through a constant dialectic between an *ex-ante* influence on policy formulation, and an *ex-post* influence on the interpretation and evaluation of the successes and failures of policies. The circular and cumulative causation between these two elements is critically important for a process (managing international affairs in the interest of equitable long-term development) that requires constant learning and adjustment.

Clearly, given the overwhelmingly economic nature of globalization, it would be difficult to deny the importance of steady advances in the understanding of economic processes and mechanisms through focused research firmly grounded in empirical studies and supported by theoretical models. Introducing their assessment of *The social impact of globalization in the developing countries,* Lee and Vivarelli argue for an evaluation on strictly economic terms, reminding us that "the debate is often confused from a methodological point of view by the interactions between history, economics, political science and other social sciences" (2006: 168). This confusion too often prevents the objective assessment of a highly contested and controversial topic.

However, it is also just as important to recognize that "globalization is not a process proceeding neutrally in a policy vacuum; it rather is a policy-induced condition. Globalization is not purely driven by new technological innovations and progress or by 'neutral' market forces and other inescapable sociopolitical forces." (Nissanke and Thorbecke, 2007: 5) Of course, reaching a clear and unadulterated appreciation of the forces and outcomes of globalization is key - but the resulting knowledge will be of limited use if it does not translate into adequate policy due to (un)conscious distortion by ideology or manipulation for political ends.

The risk of the latter occurring is reinforced by the difficulty of reaching unique and universally accepted conclusions about a world that "is made up of dynamic space that is the product of a constant negotiation and contestation over time; [a global economy that is] always in the process of becoming, rather than completed and produced." (Yeung, 1998: 296) Nissanke and Thorbecke, looking at the relationship between globalization and poverty/inequality, observe that the various social and especially economic processes and mechanisms that need to be understood are generally "complex, non-linear, and heterogeneous, involving multi-faceted channels." (2007: 5)

As a result, leading researchers in the field of development economics have cautioned that the results of data-based studies (especially cross-country statistical analyses) can be unclear, ambiguous, or at worse misleading. In relation to the phenomenon of financial globalization, for instance, Rodrik and Subramanian state that "far from clinching the case for capital-account liberalization, [studies on the subject] paint quite a mixed and paradoxical picture" (2008:1) while Kose, Pasad, Rogoff and Wei indicate that "The literature on the benefits and costs of financial globalization for developing countries has exploded in recent years, but along many disparate channels with a variety of apparently conflicting results." (2006: 1)[4]

Trying to make sense of globalization, to balance between the arguments of its advocates and its critics, requires adopting a flexible and multi-faceted analytical framework that combines the insights of different disciplines to reach a comprehensive and nuanced understanding of the broad spectrum of stakes and outcomes inherent in the process. The purpose of a 'political economy' analysis, in this context, is to better discern the particular political context in which society is evolving, and to identify the actors, interests, and institutional/structural forces that are influencing policy formulation as well as outcome assessment. For instance, a particular assessment model's focus on the gains accrued by one group (e.g.

[4] And again, "The typically turbulent initial environment and complex mix of financial and nonfinancial policy reforms that characterize the liberalization episodes combine to make it exceedingly difficult to arrive at an empirical estimate of the net economic welfare gains from financial liberalization." (Caprio, Hanson, and Honohan, 2001:10)

aggregate economic indicators showing growth) can too easily preclude from gaging the losses suffered by another (e.g. unequal distribution and rising inequality). Joseph Stiglitz, Nobel Prize winner and former senior vice president and chief economist of the World Bank, warns against "ideology and special interests masquerading as economic science and good policy. The recent push for financial and capital market liberalization in developing countries (spearheaded by the IMF and the U.S. Treasury) is a case in point." (2001: *ix*) As mentioned, it is precisely this particular sequence of events that we will use to illustrate our argument.

From liberalism to neoliberalism: the state-market dialectic since the 19th century

The following section will look at the convergence of particular political elements and interests that, on the ascendancy during the 1980s and reaching a peak during the 1990s, exerted considerable influence over the design and implementation of international economic policy. This political agenda is often referred to as the 'Washington Consensus,' in light of the leading role played by the United States government as well as the Washington-based Bretton Woods Institutions, the World Bank and the International Monetary Fund (IMF). Our argument – far from new - will be that the political forces represented by the Washington Consensus influenced what was otherwise a necessary and potentially beneficial economic process – the liberalization, structural adjustments and integration into world markets of many national economies – through a set of policies that served the interests of certain groups at the (often dramatic) expense of others. These policies were legitimized via an ideological platform loosely founded on neoliberal and free-market principles - even though in practice the basic tenets of these doctrines were consistently violated. The objective is to illustrate the critical role that political projects and power hierarchies can play in shaping the dynamics of the globalization-economic development nexus.[5]

Many of the issues at the heart of the polemic surrounding the political and economic policies that characterized the Washington consensus - concerns about the tripartite dialectic between states, markets and society, or the idea that the forces and dynamics of international capital flows constitute a cardinal factor in the development of interstate affairs - can hardly be considered as a new, or even recent. After all, *neo*liberalism and the *neo*classical school of economics bear the prefix of *neo* precisely because many

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[5] The aim is not to essentialize or uniformly lay the blame on certain actors (U.S government, IMF, World Bank), nor is it to designate a particular vector of political interests as the single explanatory factor behind such complex socio-economic processes that by their very nature evolve over time, at times taking a life of their own, becoming disconnected from the original impulse from which they emerged, often usurped by new actors for the sake of particular interests.

of their fundamental principles and postulates were already predominant throughout most the 19th century. Hannah Arendt points to the critical importance and long-term socio-political impacts of capitalist forces at work during the late 19th and early 20th centuries, writing in Part II (Imperialism) of her seminal work *On the Origins of Totalitarianism*:

> Here, in backward regions without industries or political organizations, where violence was given more latitude than in any Western country, the so-called laws of capitalism were actually allowed to create realities. (...) Money could finally beget money because power, with complete disregard for all laws – economic as well as ethical – could appropriate wealth. Only when exported money could succeed in stimulating the export of power could it accomplish its owners' designs. Only the unlimited accumulation of power could bring along the unlimited accumulation of capital. (1973: 135)

Writing a few years earlier than Hannah Arendt, at the close of World War II, Karl Polanyi developed in *The Great Transformation* a similarly powerful narrative tracing the profound systemic transformations that occurred in the balance of power between states, societies and markets throughout the 19th century and the first half of the 20th century. "For a century," Polanyi writes, "the dynamics of modern society was governed by a double movement: the market expanded continuously but this movement was met by a countermovement [by the state] checking its expansion in definite directions." (1944:130) The gradual erosion of state-society regulation over market forces, the growing power of *disembedded* market forces (unchecked by socio-political institutions), Polanyi holds, contributed to rise of both unsustainable economic practices and the closely connected rise of nationalist-fascist ideologies - eventually culminating in what he saw as the abrupt and cataclysmic collapse of 'nineteenth-century civilization' in the form of the two World Wars and the Great Depression.

As it turns out, many historical parallels can be found between Polanyi's analysis and the increasingly pressing challenges which could determine the product of the interplay between globalization and development today. Throughout the decades since the end of WW II, the tension between state power (alternatively portrayed as protective - of society - or repressive - of markets) and market forces (either perceived as a channel for greed and the relentless accumulation of wealth and capital, or as the key driver of economic growth) has remained one of, if not the, constitutive factors behind shifts in international economic and political policy making. Several decades characterized by statist policies, Keynesianism, and forceful government interventionism in many countries gradually gave way, starting in the mid-1970's, to rising pressures for economic liberalization, de-regulation and a minimalist role for public institutions. In each case, the economic policies can best be understood both as the result of particular historical circumstances and as the tools serving a particular political agenda.

Following the dramatic events of the Great Depression and World War II, Keynesian policies supported the rise of welfare states and the drive for socio-economic reconstruction in industrialized countries.

Meanwhile, often authoritative regimes in many newly independent 'developing' states embraced statism, nationalism and populism in an attempt to reverse the structural and social legacies of colonialist pasts. Direct intervention into the allocation of credit and industrial development (Import-Substitution Industrialization policies), combined with tight controls on interest rates, bank reserve requirements, and external trade and capital flows,[6] were intended to "avoid excessive concentrations of power in a few private hands, or to ensure that the domestic financial system was not controlled by foreigners who would be insensitive to long-term national goals." (Caprio, Hanson, and Honohan – hereafter CHH, 2001:4) From an economic perspective the results of these policies, however, quickly proved to be very poor if not ruinous for many developing countries. The distortionary effect of government intervention created conditions (information asymmetry, moral hazard) conducive to chronic economic weaknesses and imbalances, rooted in a combination of mutually reinforcing factors: widespread abuse, corruption, and inefficiency. For example,

> the availability of large subsidies from eligibility for directed credit created incentives for wasteful rent-seeking behavior. (...) With credit from normal channels becoming scarcer and relatively more expensive, would-be borrowers turned more and more to political channels thereby increasing the political pressures for nonmarket allocation of credit." (CHH, 2001:6-7)

On the one hand, critics of this period found that government policies engendered too many negative externalities and imposed too many distortions, impeding both social and economic development by preventing the realization of what potential economic growth could come from the competitive pressures of market dynamics and "unfettered market-based financial intermediation." (CHH, 2001:7) It is on the basis of this criticism of the existing overarching political and economic order that a growing number of voices began calling for deep policy reforms based on a platform founded on neoliberal, free-market principles. And yet, from another perspective, others have also seen the same period (1948-1973) as the "Golden Age (...) of managed capitalism" during which "not only was growth faster and productive investment higher, but human and social progress were more equally shared between capital, labor, and other social interests. [This] showed that the logic of capital could be reconciled with the human need for security and leisure and with the social need for stability and equity." (Bienefeld, 2005: 20) These diverging evaluations show differently similar events can be interpreted depending on ideology and priorities.

[6] For a brief discussion of these policies see Barbara Stallings, 2006: 1-4.

Emergence of the Washington Consensus – Priming the markets

Throughout the 1980's and into the 1990's, various economic and political factors converged to allow the proponents of liberalization to take control and implement the many reforms dictated by their political agenda. In developed, industrialized countries, an increasingly de-regulated, centralized and consolidated private sector (financial institutions and multinational corporations) gained political influence and was consistently backed by pro-market administrations (starting with Reagan in the U.S, Thatcher in the U.K, Kohl in Germany). This political bias seeking to liberate market forces and work in favor of private financial interests took shape domestically (exemplified by the repeal of the Glass-Steagall Act under Clinton) but more importantly manifested itself prominently at an international level through a sharp influence over international organizations. (Harvey, 2010: 19-20).

Throughout this period, and especially following the collapse of the Soviet Union, the United States enjoyed unparalleled sway over international political and economic policy. The development policies that came to define not only IMF and World Bank practices and programs, but also those of many other institutions such as Regional Development Banks (RDBs),[7] have become known as the Washington Consensus. The general economic paradigm that emerged championed "trade and financial liberalization – along with other market-based institutional reforms such as privatization, legal and other regulatory systems – as the *sine qua non* of a successful integration into a globalization world economy." (Nissanke and Thorbecke, 2007: 4) In practice, these policies placed a clear emphasis on macro-economic stability over societal concerns, and have been criticized for lack of attention to "shared growth, the central need to focus on eliminating absolute poverty to achieve development in any meaninful sense, or of reducing inequality." (Todaro and Smith, 2011: 530) The processes of domestic financial liberalization and opening up of capital accounts (increased access of foreign capital to domestic markets) were particularly important because the "financial sector is generally regarded as the most fragile part of the economy, subject to dramatic swings stemming from changes in economic and political variables or even shifts in market psychology."(Stallings, 2006:4)

As mentioned earlier, in light of the failures of previous 'state-centric' economic policies, a number of these structural reforms were indeed necessary in developing countries. But much like the political factors that had tainted the statist economic programs of prior decades, the policies implemented under the

[7] In a paper for the UN Research Institute for Social Development which broadly discusses the interrelationship between inequality, globalization and economic liberalization, Roy Culpeper offers a nuanced comparative analysis of policies advanced by most prominent international institutions, ranging from the Bretton Woods Institutions to the ILO, various UN agencies, and Regional Development Banks. He also shows how shifting power relations between these actors have affected the extent to which they influence each other, helping to understand the underlying institutional dynamics behind the rise of the Washington Consensus. (2005: 20-26)

authority of the Washington Consensus were too often selectively crafted to protect the financial interests of certain groups at the expense of others. (Stiglitz, 2001: *viii*) Neoliberalism was adopted selectively – it served to legitimize the rapid liberalization and de-regulation that gave foreign investors access to developing markets, even though "there was ample evidence that such liberalization could impose enormous risks on a country, and that those risks were borne disproportionately by the poor, while the evidence that such liberalization promoted growth was scanty at best." (Stiglitz, 2001:*x*) At the same time, the same actors were quick to ignore neoliberal principles when government intervention was necessary to protect these same investors in times of crises.

In contrast to the relative stability of the preceding decades, the wave of economic liberalization and integration was turbulent, characterized by escalating volatility and a sharp rise in the number of financial crises. Early waves of foreign capital flowing into developing country markets in the early 1980's were often commercial bank lending, and "the procyclical and highly volatile nature of (...) short-term bank loans (...) can magnify the adverse impact of negative shocks on economic growth." (Goldin and Reinert, 2012: 85) As a matter of fact, "between 1948 and 1973 (...) there was not a single 'major banking crisis' as defined by the World Bank, whereas the early stages of the neoliberal era, from 1974 to 1992, witnessed no fewer than 69 such crises, each imposing heavy costs and burdens on their respective societies." (Bienefeld, 2005: 21) Indeed, starting with the Mexican and Chilean crises of the early 1980's, all the way through to the Mexican peso crisis of 1994-1995 and the East Asian financial crisis of 1997-1998, a number of developing countries (especially in Latin America and East Asia) faced devastating nation-wide crises. These crises were generally combined products of the failed economic policies of the past and the often ill-designed or precipitated liberalization policies.[8]

However, once again, there were broad divergences in the way these crises – and the general impacts of liberalization - were explained or interpreted. On the one hand, these divergences resulted from the complexity of the social and economic processes involved - and the nuances and ambiguities of their outcomes. However, it is important to note that distinct political agendas also led given actors to draw differing conclusions from experience, therefore making it more difficult to unequivocally identify successes and failures and draw lessons for future policies. In *Financial Liberalization, Crisis, and the Aftermath*, Barbara Stallings identifies the emergence two separate explanatory approaches: one "domestically oriented approach" which identified the internal weaknesses and systemic failures of emerging markets as the key reason behind their adverse reaction to liberalizing reforms, and a second

[8] Caprio, Hanson and Honohan write that most crises can be explained by the fact that the "liberalized environment laid bare the previous inefficiencies and failures in credit allocation, and partly by the poor handling of liberalization, in particular the failure to correct the weaknesses of the initial conditions in the banking sector and to develop strong legal, regulatory, and supervisory frameworks." (2001:15)

approach which focused on international factors and contagion, stipulating that "the liberation of the balance of payments in developing countries had enabled banks and corporations to borrow large amounts of capital from abroad, but these same flows could easily be reversed if a political, economic, or psychological shock occurred." (Stallings, 2006:34-35) Each one, not surprisingly, fit with the narrative and interests of a given side within the debate between the critics and defenders of liberalization policies generally, and IMF Structural Adjustment Programs more specifically.

We have spoken earlier of the importance of learning from experience, acknowledging that the policies driving socio-economic development – often based on imperfect information and constituting first-time responses to new challenges – are inherently risky and experimental. However, given that the many crises that struck developing countries served as first indications of the potential risks and high structural and human costs associated with rapid financial liberalization and the transition to a more integrated and market-based economy, it is very important to note that the policy reactions prescribed by developed countries (primarily through the IMF's Structural Adjustment Programs and other forms of IFI conditional lending) were too often politically-biased projects that actually deepened the crisis for large parts of developing-country populations. Looking at East Asia, Joseph Stiglitz claims that, faced with the national-regional crises of 1997-1998, "market ideologues (...) took this opportunity to push for more market flexibility: code word for eliminating the kind of social contracts that provided an economic security that had enhanced social and political stability – a stability that was the sine qua non of the East Asian miracle." (2001: *xiv*)

Concluding remarks

Throughout this paper, therefore, we have sought to better understand the relationship between globalization, this "complex process of interrelated tendencies," (Yeung, 1998: 292) and the general outcomes and sustainability of social and economic development. It is important to highlight what our analysis has shown to have been one of the most critical rifts in political and economic policy making over the past two centuries – the evolving interrelationship and balance of power between states and markets. The constant tension between these two elements has played, and will continue to play, a cardinal role in determining the social outcomes and systemic sustainability of development. As illustrated by our brief mention of Hannah Arendt and Karl Polanyi, there exists a long tradition of prominent thinkers committed to understanding which balance should be struck between the supervisory-regulatory role of states and the forcefully innovative impulse of capital accumulation. Today, interest in the subject of global and national governance is rising steadily as the powerful centrifugal forces of

globalization continue to generate increasing levels of technological and procedural complexity and therefore concomitantly higher levels of systemic risk (c.f. Goldin and Vogel, 2010). One of the most fundamental cleavages between states and markets revolves around time horizons – while markets focused on short-term results are driven by "the impulse to accelerate turn over time, to speed up the circulation of capital and consequently to the revolutionize time horizons of development" (Harvey, 2001: 19), states ideally act as oppositional structures "capable of exerting influences on the activities of capital" (Yeung, 1998: 292) within national borders. The rapid escalation of time-space compression due to the pressures of technological progress and globalization has served to make this one of the defining issues of our time.

Exploring these arguments offers reasons for optimism. Following the crises and volatility of early financial globalization, international financial flows to developing countries have predominantly transitioned to Foreign Direct Investment (FDI), which is generally recognized as a more long-term form of investment with more potential positive externalities, and therefore both more conducive to comprehensive socio-economic development and less likely to generate systemic volatility. (Goldin and Reinert, 2012: 84-99) Moreover, the theories, policies, practice of economic development today have evolved considerably over the past two decades, away from a purely technical focus on economic liberalization and increasingly focused on the proper sequencing of reforms that include long-term goals focused on targeted controls, governance and institutional development. (Rodrik and Subramanian, 2008) Nobel Prize winning economist and thinker Amartya Sen explains: "As has been amply established in empirical studies, market outcomes are massively influenced by public policies in education, epidemiology, land reform, microcredit facilities, appropriate legal protections, et cetera; and in each of these fields, there is work to be done through public action that can radically alter the outcome of local and global economic relations." (2002: 34)

However, the lessons drawn from this paper also encourage caution in light of how the interpretation of reality and the formulation of policies can be distorted by political forces. Our particular approach has implied adopting a political economy framework in order to explore the powerful influence that political ideologies and structural-institutional forces can have over the dynamics of the globalization-development nexus. Through our brief and admittedly schematic study of both the build-up to, and the formulation and implementation of, the vast wave of economic liberalization that has characterized international political economy in the three decades since the 1980's, we have found clear signs of the potentially distortionary effects that political interests and projects can have on both the *ex-ante* design and the *ex-post* evaluation of critical development policies. In spite of the many positive economic impacts of economic

liberalization and integration on developing countries, the forceful influence of the Washington Consensus proved to be a significant factor behind, first the poor sequencing of policies, and second a tendency to react to initial crises through reform packages designed to protect certain interest groups while considerably aggravating the situation for large segments of society. “In each of these cases, not only did economic policies contribute to a breakdown in long-standing (albeit in some cases, fragile) social relations: the breakdown in social relations itself had a very adverse economic effects.” (Stiglitz, 2001: *xi*)

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