Development in a Changing Landscape

(Tom Lines' speech at the opening plenary of IDS Alumni Reunion, June 29th, 2009. Reconstructed by him two days later from his notes.)

I feel like the odd one out on this panel, because I think I hardly qualify as a 'distinguished' person, as both Robert Chambers and Alison Evans were rightly described! However, I was kindly asked to appear on it and I did not want to let anyone down, so I will do my best.

A changing landscape, then. Like an old-fashioned history teacher, let me start with a few dates: August 1982, August 1987, August 2007. The first and last of these are important but the second is entirely trivial and self-referential. So I will start with it. I just happened to notice that it was exactly five years after the first date and exactly 20 years before the last. In August 1987 I completed and submitted my M.Phil. dissertation at IDS. It dealt with an important issue but I think the actual topic seemed rather obscure and technical to most people. However, when Stephany Griffith-Jones, my supervisor, suggested it, it seemed interesting and I decided to give it a try.

Last year I had reason to take another look at the dissertation and refresh my memory of what it was about. This was not just the nostalgia of advancing years, since its topic was banking regulations and the International Debt Crisis. That crisis was known then as the Third World Debt Crisis, and it started in August 1982 with Mexico's near-default on its bank debts; and now we are going through the First World Debt Crisis, according to the title of a book by Ann Pettifor which predicted it in 2006.[1] This crisis started in August 2007, when international banks suddenly stopped lending to one another because they took fright over repackaged US mortgage loans.

(It is an odd thing that banking crises seem to start in August. Along the way, so did the Russian banking crisis in August 1998. I do not know why that is. Stock market crashes, on the other hand, occur in October, as they did in 1929 and 1987.)

August 1982 to August 2007 is a convenient 25-year period to mark the era of global neo-liberal policies. In the 1960s and 1970s the recently liberated ex-colonies of the Third World pursued their own policies and in the 1970s they used their majority on the UN General Assembly to try to establish a New International Economic Order in their favour. However, the Debt Crisis was used by the rich creditor countries to impose their own views of the policies that developing countries ought to pursue. This is a matter of power balances, and the Mexican crisis in August 1982 was when the balance shifted. August 2007 marked another such shift because from then on it was impossible to declare that markets were always right. The basic tenet of neo-liberalism therefore crumbled, and now we are nearly two years into another era.

However, the policy conclusions which emerged from these two crises were very different. My dissertation looked at the institutions of debt renegotiation as well as bank regulations, and I followed it up with further work on other aspects of the rules of the banking game in my ensuing job as a lecturer at Edinburgh University. The different policy conclusions are reflected in the curious phrase 'moral hazard', which I learnt was an important part of the debate over the 1980s Debt Crisis. It took me a while to get to grips with it because I could not see how morality had

[1] A. Pettifor, *The Coming First World Debt Crisis*, London: Palgrave Macmillan, 2006.

anything to do with international finance. The idea was that if indebted countries managed to get away without meeting all their repayment obligations, it would provide a bad example to other debtors in the future. So they must not be permitted to have their debts written off. When I examined things further, it quickly became apparent that almost all the rules affecting international lending were similarly weighted in the interests of creditors.

This is how policy was made to change: from proud independent countries, the indebted states were turned into beggars pleading with their creditors for favours. As the price for debt relief, they had to undergo structural adjustment, liberalise their imports and international capital movements, and pursue a strategy of export orientation. In brief, they had to yield to what George Soros, the free-thinking financier, has called 'market fundamentalism' – an apt phrase in view of the almost religious intensity of its proponents. And yet the lenders themselves had made serious commercial mistakes in lending billions of dollars to borrowers which did not turn out to be able to repay them. But to admit that – and make them bear a major part of the costs of the crisis – could bring some of the biggest banks down, and that was not to be allowed.

One of the schools of thought which we studied on the M.Phil. course was Dependency Theory, which divides the world between a small group of rich countries at the 'core' of the world economy, and all the others on its 'periphery'. This seemed to me very apt, and the Debt Crisis well exemplified the power play between creditor countries in the Core and debtors on the Periphery.

But in the present crisis it is countries at the centre of the Core that are the worst affected: especially those which have preached neo-liberalism the most vociferously and have the most financialised economies, notably the US and the UK. And now – unlike the 1980s - the term 'moral hazard' is applied to the banks, whose behaviour is abhorred within the Core countries since it led to this crisis. Once again, the authorities have determined that the banks – or at least the biggest of them – must not fail, so the banks have been bailed out, at huge public cost. But some economists point to moral hazard in this outcome: it will encourage other banks and financiers in the future to behave irresponsibly, knowing that their institutions are considered too big to fail. The broader policy conclusion is also opposed to that of the 1980s Debt Crisis: not that free market policies must be pursued but that this crisis demonstrates their failure, so more regulation and a bigger role for government will be needed.

The wider landscape has also changed. The Core itself is in crisis. Beyond my own dissertation, I have gone back recently to two books which the M.Phil. course brought me to: Karl Polanyi's *The Great Transformation*[2] and Charles Kindleberger's *The World in Depression 1929-1939*.[3] Between them, these show that the Great Depression was part of an even greater crisis starting in 1914, when Polanyi explained that the 'Concert of Europe' failed to prevent a major European war for the first time for nearly 100 years. (European states did of course fight plenty of wars on other continents in that era of imperialism.) The pre-1914 era of globalisation, moderated by international banks and the Gold Standard and centred on London, broke down and never recovered. Kindleberger in turn explained the depth of the 1930s Depression by the UK's new-found inability to stabilise the global system, while no other country was able to take its place. The United States was an up-and-coming young country and the world's biggest creditor nation, but it

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[2] The edition I read was: K. Polanyi, *The Great Transformation: The political and economic origins of our time*, Boston (US): Beacon Press, 1957. The book was first published in England in 1944.

[3] C.P. Kindleberger, *The World in Depression 1929-1939*, London: Penguin, 1987 (first published by University of California Press in 1986).

was largely self-sufficient and inward-looking. It was not ready to take on a hegemonic role until 1945.

Now the US is the biggest *debtor* nation. Its capacity for economic hegemony has ended. Of the biggest creditors, only one (Germany) is part of the tradition which grew out of Europe. The others are China, Japan, Brazil, India and Russia (which is only partly European and lies outside that tradition for its own historical reasons). By far the biggest creditor is China: an up-and-coming country, self-sufficient and inward-looking (although hardly young), and unwilling to take on a dominant role at present. One thing is clear: whatever power relations may finally emerge, the previous Core:Periphery arrangement has been upset, probably for ever. If there is to be a new hegemony, it will almost certainly be assumed by a country or countries which were formerly on the Periphery.

I have two final thoughts. Currently the *Financial Times*' main economic commentator is Martin Wolf, an interesting choice as he worked previously at the World Bank, and even before the crisis he was not well-disposed towards commercial banks. Several times last year he wrote about some research on previous banking crises by two US economists, Carmen Reinhart and Kenneth Rogoff.[4] More than once he printed a chart based on their findings, which showed how many countries had faced banking crises year by year since 1950, yet he never mentioned what immediately struck me as the most remarkable feature of that chart: from 1950 until the 1970s there were no significant banking crises anywhere. Reinhart and Rogoff examined 18 bank-centred national crises since 1945, and the first of them chronologically was the Secondary Banking Crisis in the UK in 1974.[5] That was surely the only extended period without banking crises in the history of capitalism. This poses an intriguing question for future policy: what was it in the 1950s and 1960s that was done right? Some commentators, including Pettifor and the veteran Oxford economist Peter Oppenheimer, have hinted at answers, but the question needs to be examined fully and urgently.

My final, final thought is about the very widest landscape, and the extent of the hegemony crisis we might be facing. The banking crash of 2008 may well mark as big a turning point in world history as 1492, the year of Columbus' first voyage to America. This symbolically marked the start of 500 years in which European countries, and their offshoots like the US, dominated the world. If the US no longer has the economic power to control things, and that power is moving to China or Japan or India, it marks a far bigger cultural shift than that of the 20th Century from one English-speaking, Common Law country (the UK) to another (the US). Power relations are indeed changing, but in view of the horrific events in Europe between 1914 and 1945 it leaves me with some apprehension about where this crisis might lead before a new settlement is reached.

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[4] C.M. Reinhart and K.S. Rogoff, 'Is the 2007 U.S. Sub-Prime Financial Crisis So Different? An international historical comparison', February 2008 draft. This summary paper can be downloaded at www.economics.harvard.edu/files/faculty/51_Is_The_US_Subprime_Crisis_So_Different.pdf.

[5] The 18 crises, listed by Reinhard & Rogoff on p.3, include five 'big' ones: in Spain (starting in 1977), Norway (1987), Finland (1991), Sweden (1991) and Japan (1992); and 13 others: in Australia (1989), Canada (1983), Denmark (1987), France (1994), Germany (1977), Greece (1991), Iceland (1985), Italy (1990), New Zealand (1987), the United Kingdom (1974, 1991 and 1995) and the United States (1984).