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Book Reviews

Industrialisation and Globalisation: Theory and Evidence from Developing Countries *John Weiss, Routledge,* London and New York, 2002, pages 222.

Industrialisation has often been identified as the cornerstone in the tradition of 'modern economic growth' *a la* Kuznets and Clark. However, the development experience of a large number of developing countries including India runs counter to this conventional wisdom. The preponderance of services ahead of industry remains a major contrast to the development experience of the developed world, giving rise to the phenomenon of *industry-less growth*. When the obituary on industry is slowly gaining currency, while services sector is increasingly becoming important even among the academia and the policy makers, the present pursuit by John Weiss comes as a refresher and re-invents the role of industrialisation. The central message of Weiss is indeed powerful: the future of the developing world lies in industrialisation in this age of integration and globalisation. The issue is all the more appealing when the Indian industry is currently reeling under the WTO bogey and is desperately seeking a way out of the on-going slowdown.

In a pithily presented opening survey, John Weiss takes stock of the industrialisation process in the developing world since 1960 and comes up with the central inquiry why the manufacturing performance has varied widely across the spectrum of countries. What follows in the rest is an attempt to link the different aspects of policy towards manufacturing and performance. In an intellectually challenging discourse, Weiss goes on to juxtapose the cross-country experiences to the predominant theories of industrial growth and asks, "Are there different paths to industrialisation?" Finally, he classifies different countries on the basis of policies pursued. The discussion runs in terms of dichotomies in policies such as 'open' versus 'closed' trade policies; 'dependent' versus 'independent' policies particularly in relation to foreign countries; and 'capitalist' versus 'socialist' policies on industrial ownership. Interestingly, India is indicated as one of the fully closed economies during 1960-92 in terms of Sachs-Warner openness index. However, post-1985, India is placed as one of the tariff-reforming economies with the average import tariff down to 38.3 per cent in the late 1990s from 99.4 per cent in the mid-1980s. What transpires is that relatively closed, often highly distorted economies have not, in general, done well in growth terms. FDI has emerged as an important engine for growth particularly for those countries where the mix of policy and the education base is supportive. The most important observation has been only the limited scope for choosing different paths to industrialisation. At present, it is squarely unrealistic to practice autarky and achieve industrialisation, given the need for both foreign finance and technology. While public ownership in a socialist path to industrialisation cannot be ruled out, the State in developing countries lacks the capacity to provide the material base necessary for a socialist transformation of the societies. At the end, the developing countries seem to be left with no choice but to join the process of integration and globalisation for sustained economic growth. It is in this context, the opening up of the Indian economy in the 1990s seems to be in the right direction.

Next, Weiss moves on to elaborate the dominant neoclassical orthodoxy in terms of the role of market forces and pricing mechanism in the process of industrialisation. Specifically, State intervention stifles the functioning of markets and contributes to an inefficient form of industrialisation. Besides, the trade policy of import substitution has stunted the growth of exports, ignored specialisation on the basis of comparative advantage and resulted in misallocation of resources. The neoclassical paradigm, however, does not rule out the case that import substitution may bring in efficiency provided it arises from market-based decisions. The neoclassical paradigm, which became popular during 1970s and 1980s, has come to be linked with the broader stabilisation and adjustment programmes undertaken in many developing countries including India. In the wake of such liberalisation measures, the impact of trade liberalisation on the manufacturing performance has been examined in terms of employment, exports and total factor productivity. While the overall effect on employment differs across countries, surprisingly there is little evidence of more adverse effect on employment in smaller firms. Such counter-intuitive finding also contradicts the Indian experience in the 1990s when the small firms' share in total employment has indicated a decline. Weiss, however, does not proceed beyond this stylised fact. On the front of export, while higher export and higher productivity were found to move in tandem with trade liberalisation, the evidence is not sufficient on the direction of causality. While a positive relation is obtained between trade liberalisation and total factor productivity (TFP), Weiss is clueless on extracting the right factor out of the omnibus TFP. On the whole, the impact of trade policy reform does not sound as dramatic as the neoclassical reasoning might suggest.

In continuing his search for a plausible approach to industrialisation, Weiss turns to examine the applicability of the structuralist approach in terms of the role of the state and of the manufacturing sector coupled with the possibilities offered by participation in world trade and investment. In contrast to the neoclassical orthodoxy, the structuralist approach believes that due to low price elasticity of demand and supply, the price mechanism cannot be relied upon for allocating resources in developing countries. Instead, the State is assigned the task of resource allocation as also effecting a shift from primary exports to new industries. State should also protect them until they are mature enough to compete in the international market. Weiss has pieced together ample empirical evidences, most recently from the NIEs (*i.e.*, Newly Industrialised Economies) to show that the State does have a positive role to play in industrialisation or development. The East Asian crisis of 1997-98 has, however, demonstrated that the State may overstretch itself. A pragmatic Weiss believes that it will be ideal to have a policy mix that uses the market, wherever appropriate, but is not wholly subservient to it. As regards the special place of manufacturing in development, it is felt that whether the country produces potato chips or computer chips they matter for long-term growth prospects. The cumulative gains from manufacturing are argued to be higher in an open competitive trading environment through exports. The best policy is to explore the possibilities to encourage new activities and diversify exports instead of delinking from world trade and investment. Finally, the developing economies have much to gain from participation in the world economy. However, Weiss rightly refrains from prescribing any specific form of intervention to encourage new activities and a diversified export.

In order to identify the essential constituents of the pragmatic approach to industrialisation, Weiss cross-checks the role of small-scale industry in the developing world. Small-scale industry is shown to be appropriate in terms of low capital-labour ratios, and low shares of imports in total cost. Besides, it targets the low income segment with simple products and acts as a household survival strategy. However, Weiss warns, the recent, rapid employment growth in small-scale industry of the developing world is not due to its economic dynamism but an outcome of job retrenchment in the public sector at large. Weiss also attempts to test the relationship between size and economic efficiency and finds that wherever technological indivisibility is important, small-scale industry is at a disadvantage. On the other hand, small-scale industry may have competitive advantage in terms of better knowledge of particular local and niche markets. In the opinion of Weiss, only few small firms graduate to the ranks of the medium scale. Such a phenomenon is not surprising in the Indian context of small-scale industry reservation. However, the limited graduation, Weiss reads, is due to the market distortions against the small-scale industry. It is in this context, adequate provision of credit, foreign exchange for import of inputs, and flexible specialisation to respond to the changing market conditions on the part of small-scale industry, deserves a serious attention. In the Indian context too, credit flow to the small-scale sector has dried up with the financial liberalisation in the 1990s.

Technology and technical change having the central role in industrialisation. Weiss gathers evidence on the same in respect of the NIEs and developing economies. Research and Development (R&D) expenditure and technology exports are used to gauge a country's technological development. R&D activities in the developing countries are very limited as compared to the NIEs and most of such R&D expenditure is made on applied, production-oriented type of activities. Interestingly, R&D expenditure in India is quoted to be 1 per cent of GDP in 1992, which is considered high by international standards. While role of the State in ensuring the availability of infrastructure and minimum critical mass of technological capabilities is acknowledged, Weiss feels that high R&D expenditure in an environment of economic inefficiency and distortions may not work towards technological dynamism as illustrated by the experience of ex-Soviet bloc economies. Most technology exports originating from the developing countries like India, Brazil and Argentina are of adaptation of known technologies to the local market and are, therefore, suitable for factor conditions and markets in other low income economies. The process of globalisation and increasing transnational activity are expected to facilitate adaptation of imported technologies by the latecomers. However, State intervention of some form is essential and welcome in both the orthodoxies - neoclassical or structuralist as it is widely believed that markets will under-provide the supply of technology.

On the whole, the book is a substantial contribution to the literature on industrialisation in the developing world. Setting aside the extremes of industrial policy (*laissez faire* and central plan), Weiss has thrown his weight for the time-tested golden mean: 'market friendly' and/or 'interventionist' industrial policy for the developing world. The 'market friendly' policy is directed at offsetting the externalities through taxes and subsidies while the 'interventionist' policy mainly operates through the directed and subsidised lending, differential import tariffs and licensing. The 'interventionist' policy appears to have worked in the East Asian countries during the initial phase of industrialisation. The long-term success, however, requires a more flexible and market friendly approach as has been the case in Japan, Korea and Taiwan. A reliable test to judge the industrial policy performance is to examine comparative efficiency of the domestic firms in relation to import competition. The comparative advantage if based on low wage rate may evaporate with success. In contrast, the comparative advantage based on brand name and technological capability is long lasting but requires sustained investment. Moreover, competitiveness has to be a dynamic process not only in terms of mastering production but also other points in the value chain like support facilities and marketing channels. As it is difficult to achieve success at all stages of the value chain, late movers will have to rely substantially on sub-contracting links with the MNCs.

Weiss's advocacy of a flexible specialisation within the small-scale industry, however, does not sound practical. Besides, the role of small-scale industry in fuelling the domestic demand for large manufacturers seems to be overstated. However, Weiss's central message stands: if the developing countries can improve their competitiveness even with the help of short-run State intervention in industrialisation, they have a better future to look forward. Such a possibility does not seem to be far off when the Doha Development Agenda under the aegis of the WTO is focused upon improving the market access for the developing world. However, as Weiss rightly reminds us, the crux lies in improving the competitiveness. Quite often, inefficiencies in key infrastructure sectors like telecommunications, transport, and financial services add more to these countries' export costs than foreign trade barriers. Further trade policy reforms and improved investment environment in the developing world could be necessary complements to better market access.

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***Global Regulation of Foreign Direct Investment,* by Sherif H. Seid, Ashgate Publishing Limited, Hampshire, England, Year of Publication: 2002**

Foreign Direct Investment (FDI) plays a significant role in the development process of most economies through the transfer of technology and technological spill-over, increased productive efficiency, production of exportable goods and services which generate foreign exchange, infrastructure development, increase in saving and investment, and faster growth of output and employment. Tremendous rise in national regulatory changes in favour of FDI in the last decade, globalisation and successive trade negotiations within the GATT/WTO led to a significant rise in the global FDI flow in the 1990s. This book examines the issues surrounding the theories and regulation of FDI, weaknesses of current national and international rules on FDI, strategy of key international players and finally it proposes that in the light of diversified national and international preferences and unsatisfactory current regulatory framework, there is a need for a new international regulatory regimes based on the premises of "regulated openness".

Two schools of thought on the theory of FDI are discussed in the book - neo-classical theory and dependency theory. While neo-classical gave importance to the beneficial effects of FDI, at the same time recognised the associated costs on balance of payment (BOP), but this cost of FDI does not imply that FDI is bad for the country as Dependency Theorist claim. A regime of unrestricted FDI flow may not be invariably beneficial for the host country but in the era of reduced official assistance, FDI has become the major source of funding development projects. In order to realise the full potential of FDI, government's interventionist role and adopting selective policy measures might be necessary. The challenge lies in identifying the best methods of selective intervention in the economy and deciding their limit. This book analyses these issues in detail and suggests a new framework of "*Regulated Openness*" where systematic wisdom for choosing the best methods might prosper.

This book has been divided into three parts. The first part discusses the theoretical aspects of FDI, which has major impact on the regulation on investment nationally and internationally. The current national and international regulatory framework on FDI is discussed in this part. Notably, it is pointed out that though the successful conclusion of successive trade negotiations within the GATT/WTO framework reduced trade barriers and stimulated global FDI flows, the current regulatory framework for FDI is unsatisfactory. The diversity of national and international legal regimes governing FDI introduces excessive distortions as between countries and sectors. There appears to exist an opportunity for further negotiation and the emergence of global investment rules as the host countries are increasingly realising that FDI can contribute positively to their development.

The second part of the book, comprising of four chapters, examines the strategies and positions of the key global players (OECD countries, developing countries, public interest groups and inter-government organisations) on a global investment regime. Among the OECD countries there are three major players, the United States, the European Commission, and Japan. The overall strategy of the OECD and its members has been greater liberalisation of investment rules and higher standard of treatment for foreign investors and security for their foreign investment around the world. It was expected that the Multilateral Agreement on Investment (MAI) would remove the barriers to the market access and stimulate the multilateral trading system, however, each of the three main players preferred playing their own priorities. They wanted other markets to be opened for their own investors but tried to keep their own market as close as possible in the name of national security and cultural security. The agenda of MAI, liberalisation and protection of investor's right ignored the concerns of non-OECD countries as well as other issues of regulation of FDI.

On the other hand, the developing countries were very keen for foreign capital but they were not very sure about their strategy. Their views were unclear on rationale and nature of regulatory regime. Moreover, they were not in favour of extension of MAI to non-OECD countries as they found it to be a threat to their economic and political sovereignty and the fact that the standardised investment rules would leave very little room for countries to manoeuvre their investment policies according to their developmental objectives. There is a concern that when the major interest of MNC's and host States are in conflicts, MNC's may use muscle as well as the influence of their home countries to interfere in the domestic affairs of the weaker host countries. There is also a genuine fear that many developing countries would not be in the position to defend their case in international adjustment successfully and pay the required legal and other bills. Moreover, it is felt that all types of FDI flowing in all sectors of an economy may not necessarily constitute a necessary condition for achieving rapid growth and sustainable development. It is, therefore, argued that FDI could only be beneficial to the host economies if host countries can regulate it according to their development objectives. Among the developing countries the venue and forum also had been the major point of discussion that whether they should negotiate in the framework of WTO or UNCTAD.

At the micro level, there are at least four players *viz*. Consumer Group, Labour Group, Environmental Group, and Business Group. Despite their vested interest, the majority coalitions of all four groups agree on the benefits of FDI for the host country and the need for a global investment regime. These groups not only help in forming the regulation but to disseminate the information also. Although, all the four agents favour for the international investment regime according to their own interest, while the interest of first three are social and collective in nature, the business representative are in favour of international regime to get greater market access and better predictability of the rules so that they may have more and free choice of locations for investments and operational autonomy. Consumer groups supports the regulatory power of governments, competition policy and consumer protection. They believe that the national democratic process can adopt the policy measure, which is more conducive to the consumer and the country's welfare. Labour unions believe that international investment regime is required as the growing policy competition between governments to attract more FDI may suppress the standard of labour welfare. Environmentalist also believes in the similar line and argues that some countries may get tempted to reduce environmental standard in the situation of intense competition to attract FDI. They advocate a comprehensive international investment framework, which can ensure investment supports and sustainable development.

The international organisations *viz.* the UN, the World Bank, the WTO, and regional economic blocs play a major role in framing the international regulatory regime. There has, however, not been enough success in developing a comprehensive investment regime acceptable at the global level, although some success at regional level has been achieved. The mistrust between developed and developing countries and between foreign investors and host countries resulted in failure of several attempts in the past including the recent WTO ministerial Conference at Seattle. Developing countries find themselves at loss to influence the events. In this situation some kind of coalition may help them to make the forum in their favour.

The third part of the book tries to explore and evaluates the possible strategies like more liberalisation or more regulation or the combination of these two. The author proposes a new regime of investment namely "regulated openness" at both the global and national level. Regulated openness aims at bringing development with justice. Development with justice requires both procedural justice and credible commitment to continuous improvement of investment policy, investment security, sustainable development, core labour standards, consumer protection, business ethics and good governance. Regulated openness implies a pragmatic balance between regulation and liberalisation in the major issues of investment regulation and a platform where all major stakeholder will have an input and role in the preparation and implementation of FDI rules and meaningful participation of powerless constituencies and credible dispute resolutions. The rule should be compilation of those core principles on which agreement could be reached and international regime could be formed. Each country should be empowered to use and introduce their own rules according to their priorities and situations. This kind of principle will be able to facilitate the individual country's own affairs and the recognition of the need for economic pluralism in international economic agreement.

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The Economics of Public Spending - Debt, Deficits and Economic Performance by *Hassan Bourgrine, Edward Publishing Ltd.*, UK and USA, 2000, Pages 177, Price £49.95

The post second world war period is often seen as the golden era of capitalism when most of the economies experienced sustained high economic growth while pursuing demand management strategy in the Keynesian framework. The initial euphoria, however, was replaced by strong recessionary pressure that swept through the world economy in the 1970s leaving its lasting impact on macroeconomic policy prescriptions. Fiscal profligacy became the standard explanation for the ills that afflicted the global economy and tight monetary and fiscal policies became the inherent part of strategy to stabilise the economy and revitalising growth through downsizing the public sector and privatisation. The balanced budgets, downsizing of the public sector and privatisation became the widely accepted way to prosperity.

Hassan Bourgrine and colleagues, through eight challenging essays in his book, endeavour to explain that the strategy supported by these principles is based on the misleading conception of the public finances, and the budget deficits, in fact, improve the private sector performance.

The author begins with the argument that the nature of the role and causes of the budget deficits depend on the type of the theory one relies on. The neoclassical theory states that government should follow the principle followed by the individual and should not spend beyond means. The Keynesian theory dwelled upon the capital budgeting supporting the view that government can and should borrow to spend on assets creation for the investments purposes. The macroeconomic models assume that investment in the economy depends on the savings of the private as well as the public sector. The higher budget deficits increase the demand of the funds and rate of interest. The high rate of interest leads to fall in the level of investment and growth rate of the economy.

In order to understand the book, it is necessary to revisit some fundamental propositions of Keynes and Kalecki. Keynes, as is well known, argues that to increase the output, the level of effective demand is the crucial factor. Kalecki has shown that in capitalism the tendency to raise the level of profits through increase in the cost-margins may actually result in decline in level of profits, income and employment. The book also takes the propositions of the circuit theory which states that the financing of the investment and the initiation of the production process is made through borrowings from the banks. The money taken from the banks is distributed to factors of production as payments to their services and the factors of production spend this income on consumption of goods and services to generate income to the firms. To the extent the factors of production save their income, the firms will not be able to get sufficient income to repay all the loans. A part of the debt will be rolled over and fresh borrowings will be made to maintain the cycle of production. It is shown in the book that deficit in the government sector compensates the portion of the income saved by the households which reduces the income of the firms. Thus, the budget deficits increase performance of the private sector. The balanced budget on the other hand, rule out the government role to respond to the cyclical downturns. The author argues that the slowdown during 1990s was the result of low inflation and high nominal rate of interest caused by tight monetary and fiscal policies which led to a decline in the private investment and consequent fall in the effective demand. In this event it becomes necessary for the government to run deficit. The higher debt - GDP ratio due to the deficit should not be considered as destabilising factor as the policy was designed to counter the slowdown. The stability of the debt-GDP ratio would depend on the differential between the rate of interest and growth rate of real GDP.

Philip O'Hara presented the analysis of the institutional aspects of the production process to show that the economic growth depends on a suitable set of institutions which form a social structure of accumulation (SSA). The SSA approach assumes that there are some institutions conducive for growth which help the economic cycle to take an upward swing and degeneration of these institutions causes the downswing in the economic cycle. Any suitable SSA needs following conditions to be fulfilled - the institutions should contribute to economic stability, they should contribute to class and intra-class resolution of conflict, and they should enhance the profitability. In the post war II era, the Keynesian Welfare State (KWS) was the basis of SSA in the US and it provided a suitable set of institutions as State tried to balance the interests of workers and business, and sought to stabilise the trade cycle. The workers interests were ensured through unemployment insurance and safety net. But it failed to contribute to productivity and also the cost of welfare programmes rose steeply. Consequently, the KWS was replaced by Reagan during 1970s and 1980s. The neo-liberal State emerged with increased privatisation, flexible labour markets and free trade. The four basic tenets of the neo-liberal approach were balanced budget, privatisation, inflation-first strategy, and globalisation. It is shown in the book that neo-liberalism cannot constitute a viable social structure of accumulation because, along with other contradictions, it places constraints on the effective demand through austere fiscal and monetary policies.

The book addresses the issue of resuscitation of demand management policies by tracing the progress of capitalism since the second world war and concludes that the golden age of capitalism was achieved during 1950s and 1960s because of a compromise maintained between the capitalists and labour interests. The slowdown set in the 1970s, after a good economic performance during the 1950s and 1960s, has its roots in the break down of the institutions which enabled the compromise between competing interest groups in the capitalist economy. This is wrongly perceived as the failure of the demand management policies. In the monetary production system the money supply, inflation and the interest rate have different implications for the business and the financiers. The financial wealth owners loose due to high inflation rate and low interest rate and the producers gain on account of rising prices and falling interest rate. The remedy to the problem is the middle path of maintaining the demand pressure through fiscal policy and adequate money supply to keep the real interest rate low but not negative. Thus, the compromise attained during the 1950s and 1960s, broken by the rentiers in what is called the revenge of rentiers, should be restored.

One redeeming feature of the book is its critical assessment of the Asian debacle. The Asian crisis is examined in different perspective to conclude that it was a real crisis and not a financial one as argued by many analysts. The major cause of the crisis was the lack of effective demand and not the Ponzi finance as explained by several corners. The fiscal deflation by the rich as well as emerging countries resulted in the long-run shortage of the aggregate demand. It is shown in the book that the fiscal austerity will cause poverty and demise of democracy. The alternative is to develop a welfare State based on general theory of dynamic monetary accumulation, where public deficit enhances the profitability and the production.

One of the major problem perceived to be associated with budget deficits is inflation. The book, however, denies that budget deficit is the major cause of inflation. The authors dwell on empirical studies to deny the positive relationship between public deficit and inflation. The budget deficit can be inflationary if debt becomes unsustainable in Domar sense or in terms of Barro's rate of growth of government bonds exceeding the output growth. It is found from the data from G-7 countries that there is no relationship between deficit and inflation. The results, instead, provide strong support for those who call for greater provision of government finance at low real rate of interest as means of moving the world economy along a sustained growth path. Even in the long-run, the deficit is shown to have positive effects on profits so far the growth rate of economy is sufficiently higher relative to the real rate of interest.

The impact of the public investment on the growth is examined with the help of the modified version of Domar model. It is shown that expansion in the public investment will bring the economy on a higher growth path. A comparison is made between the economy with and without public sector to show that the economy with public sector will grow at faster growth. The crucial element here is the difference between the private propensity to consume and the share of public total revenue devoted to current spending.

Finally the book elucidates that the fiscal policy is more effective than the monetary policy in attaining the full employment state. The deficit financing and the direct state intervention should be used to attain the goal of full employment. It is shown that the national debt does not pose any hindrance in the achievement of full employment but maintaining the same becomes a political matter as the full employment state is incompatible with capitalist system, because it strengthens the working class and in the struggle of capitalist and workers former get weakened.

The book provides convincing arguments for the policy makers in favour of active fiscal policy to revive and stabilise the economic activity. The fundamental propositions of Keynes and Kalecki is restated in the context of the new economic developments. An illuminating critique of public sector downsizing and privatisation is relevant in the context of the debate on disinvestment in India. The book attempts to redefine the role of budget deficit in modern economies particularly in meeting social welfare objectives.

The book, however, is not without limitations. Most of the arguments in the book are based on the circuit theory which assumes some beginning point of the production process. In practice, however, the production process is continuous and it cannot be judged at what point the budget deficit will contribute to private sector profits. Secondly, the deficit is assumed to be financed through creation of new money by the central bank. In the present world, however, the Government is borrowing from the market to finance its expenditures. This causes large outgo on account of interest payments inevitably leading to reduction of social spending and the resultant effect on distribution of income. Thus, the book pays scant attention to the debt financing versus money financing debate in the conduct of fiscal policy. Again, it is argued in the book that capital flows will ultimately bring equilibrium and stability in the system. But the experience of South-East Asian countries with capital flows is completely ignored in the book. The impact of money supply on the prices and external balance needs to be examined more carefully and thoroughly before agreeing to the fiscal expansion. Another aspect which does not receive the due space in the book is the efficiency or cost of production. The book does not discuss how the public sector can ensure the use of resources more efficiently than the private sector. Finally, the stability of Debt/GDP ratio is dealt with in a passing manner only. The GDP growth rate higher than interest rate does not necessarily implies or ensures the sustainability of debt. Neither does the book prescribe the policy measures to deal with unsustainable levels of public finances. In retrospect, even as the book deviates from run-off-the mill economics, it is thought-provoking and challanging to the reader.

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