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Eight Strategies for Development in Comparison

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Abstract. The article provides a broad-based overview on competing development strategies and the economic performance of developing countries, mainly since the year 2000. Four traditional mainstream development strategies are discussed (Washington Consensus, neo-liberalism, "good governance" and MDGs) and three long-debated key strategic issues are reconsidered (inward or outward development with export-led growth, industrialisation or growth with predominant primary goods exports, foreign-aid-based development). A heterodox approach to development with a focus on macroeconomic policies and structural change is added and discussed in more detail. Implicitly, this lays the groundwork for a macroeconomic theory of development. The rough empirical comparison finds that countries and areas with strong emphasis on macroeconomic policies, mainly in Asia, have performed unambiguously better than the mainstream approaches since 1980. From successful Asian countries, it can be learnt that a long-run continuous growth and development performance with more resilience against adverse shocks is key. Almost all larger middle-income countries have embarked on industrialisation; strategies based upon primary commodities or high current account deficits are unlikely to be successful in the long run. A stronger role of a package of six macroeconomic policies is advised, particularly for the larger economies. Size matters in this respect. Smaller countries depend stronger on market niches and idiosyncratic strategies. The global economic order, due to liberalisation of trade and finance, including the prevailing global currency system, sets harsh constraints for policy space towards implementing national strategies.
Keywords. Development, Macroeconomic policies, Developmental state, Economic growth, Good governance, International trade, Washington Consensus, Millennium development goals.
JEL. E60, O40, O11, O20, O23, O57.

1. Introduction: What is a strategy for development and why do we need one?

In our understanding, a development strategy is an economic conception that defines the priority goals, coherently explains how set goals can be reached, identifies the policy tools and explores trade-offs and the time frame. It is a kind of vision with normative goals, balanced against what is feasible. Such a strategy does not necessarily have to be explicit; rather, it can be implicit in the mind-set of policymakers or a tacit agenda of governments. Moreover, it does not need to be comprehensive, but it must address key issues for the medium to long term. If such a vision does not exist, it is likely that the policymakers in charge, including external advisers, will simply follow the historic track, with a focus on

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short-term issues barely related to long-term goals. Pragmatism without a compass might prevail with rather low ambitions.

A number of "guidelines" or blueprints for development are offered in academic economics and the political economy of development, which we will discuss and compare in this essay. They are often general, i.e. not country-specific, recommendations for economic development that can to some extent be adapted to the specific needs of a country. After the demise of guidelines of the *one-size-fits-all* type, a backlash occurred as if anything would go and nothing can be said in general. I will argue here that this is not the case; rather, there are clear success stories and clear stories of failure or stagnation.

After many of the old ideas for quick development success after World War II had failed, such as the "Big Push" or heavy aid-led development based upon "saving gap" concepts, or grand-scale import substitution policies as practised in many countries of the South until the 1980s, a transition to more simple recipe-like recommendations emerged. The (in)famous "Washington Consensus", often misunderstood as plain liberalisation and market fundamentalism, was promulgated in 1989, before later being complemented by cooking recipes for "good institutions" and "good governance". The plea for financial globalisation added an important part to the comprehensive liberalisation agenda, concentrating on free trade, free capital flows, the privatisation of state-owned enterprises and a small state in contrast to a developmental state (which is not necessarily large). Seemingly a backlash, the sudden about-face to the "Millennium Development Goals" (MDGs) was in part only a complement to the continuing neo-liberalism.

These concepts will be recapitulated in section I. The debates on inward or outward development will also be picked up, while the overdue debate on industrialisation versus commodity-led development will be addressed. In section II, a macroeconomic approach to development will be sketched, put forward by ideas stemming from adapted Keynesianism and dependencia theories. Section III reviews the stylised facts of developmental success or failure since 1980, before section IV concludes.

2. Traditional strategic concepts

2.1. Washington Consensus

As is well-known, John Williamson summarised in 1989 (Williamson, 1990) what he believed to be the consensus of four Washington-based institutions regarding economic policies in Latin America at the time: the State Department, the Treasury, the World Bank and the International Monetary Fund (IMF). Easily understandable, it was used as a set of ten commandments that were more or less applicable to the rest of the world, including the collapsing countries of the former Soviet Union and in Eastern Europe. It was a much-needed makeshift in the absence of sound and coherent strategies of western nations for development. The ten guidelines do not truly sound like a full-fledged neoliberal agenda. In hindsight, many postulates seem innocuous and not particularly controversial, yet sufficiently ambiguous for a broad range of interpretations:

- Reduction of budget deficits to a non-inflationary level.

- Redirection of public expenditure to areas such as education, infrastructure, etc. As tax increases are ruled out, lower marginal tax rates and a broadened tax base are advised, similar to what was practised in the United States of America (the United States) at the time.

- Domestic financial liberalisation towards "market-determined interest rates", with no mention that interest rates are largely determined by central banks, and hence tight monetary policy might be the key idea in disguise. Moreover, there is

no mention that domestically liberalised interest rates likely also trigger cross-border liberalisation of capital flows. Again, much discretion for interpretation remains.

- Sufficiently competitive exchange rates that induce rapid growth in non-traditional exports. In plain text, avoiding the over-valuation of exchange rates is demanded, which makes industrialisation difficult. Alternatively, it could be read as currency under-valuation, as well as a plea for market-determined flexible rates. Regarding trade, quantitative restrictions should be lifted and tariff reductions be instituted.

- The privatisation of state-owned enterprises. One of the few unequivocal quests, similar to the better protection of property rights and the liberalisation of foreign direct investment inflows.

- More competition for start-ups and other enterprises.

In hindsight, it is stunning how narrow the range of the consensus was and how much ambiguity can be found in the wording. Williamson, not a plain neoliberal, used a wording that left sufficient room for interpretation and hence risked strong misunderstanding. Carefully read, one cannot see a clear plea for free trade and free international capital flows or a minimalist state. It is interesting to see what is not addressed, either due to a missing consensus or lacking concern: import substitution or export promotion, poverty reduction or any kind of social spending, the choice of the exchange rate regime, external debt and the balance of payments, let alone environmental issues. Furthermore, time and sequencing are ignored; accordingly, the agenda can be seen as a shock therapy or Chinese-type of gradualism. From the viewpoint of neoclassical or endogenous growth theories, almost nothing is said about technological upgrading, while from a structuralist view structural change and industrial policy are unaddressed, let alone foreign aid. In retrospect, the most stunning characteristic of the "Washington Consensus" seems to be the simplicity and naivety, its selectivity and blindness vis-à-vis so many obvious economic problems (cp. Priewe & Herr 2005, 274ff.; Marangos 2012; Moreno-Brid et al. 2004-5).

In the early 2000s, John Williamson and others started to augment and renew the old Washington Consensus, coined "After the Washington Consensus", mainly by prescribing the policies in more detail, adding proposals for institutional change and including social policies (see Williamson & Kuczynski, 2003). The core of the old ideas was maintained, except that liberalisation of FDI and of interest rates had been already achieved in Latin America. Asian experiences were not thoroughly considered and included (cp. Marangos, 2012 for a critical review).

2.2. Neo-liberalism

The ambiguity of the Washington Consensus was often used to interpret it as plain neo-liberalism. The imperatives would then be to free all goods, labour and financial markets as much as possible from regulations, reducing the size of governments, avoiding counter-cyclical fiscal policies, giving priority to price stability over growth and employment objectives and keeping taxation low. The legal framework of economic systems has to be geared to securing property rights, including privatising public enterprises and promoting market-friendly institutions.

The implicit rationale of the neoliberal philosophy is the notion that developing countries suffer from manifold market distortions, similar to transition economies, whereby the unleashing of the invisible hands of markets could drive growth and development. From this perspective, the main drivers for development are seen in free trade and free cross-border financial flows, supported by institutional reforms towards what is considered as "good governance". Trade and capital flows follow the comparative advantage theory in the Heckscher-Ohlin form, where developing countries can exploit their cheap labour and natural resources while rich countries

provide capital, technology and knowledge. Openness for foreign direct investment and all other capital flows is a key ingredient of this conception (e.g. Mishkin, 2006). The classical view that capital accumulation and related technical progress are engines of growth is out of focus, as well as the Keynesian idea of active macroeconomic management. The notion of public goods, and particularly education, training, research and development, which are considered as key for development by endogenous growth theories, do not form the centrepiece of this concept. Nonetheless, this philosophy is sufficiently vague and flexible to adjust to special needs or combine it with other ingredients, as long as it remains the backbone for a growth and development strategy.

Some economists have pondered on the sequencing of this strategy. John Williamson and others have advised careful gradualism, with steps to freer trade such as dismantling quantitative restrictions as the first step and liberalised capital accounts for short-term financial flows as the last stage (Williamson, 1997). Others have called for quick sequencing or big-bang reforms to pressure countries into overcoming resistance against reforms (e.g. Ishii et al., 2002).

Using the *Fraser Economic Freedom Index* (FEFI, 2014), a composite indicator of the degree of economic liberalisation for a comparison of the FEFI of 71 low- and middle-income countries (LMICs) with the ranking of per capita gross domestic product (GDP) shows no clear linkage. The FEFI integrates more than 50 single indicators concerning the regulation of markets, protection of property rights, low inflation, free trade, good governance and small government, providing a grading from zero to ten (high liberalisation). The change of the FEFI over the period 1990-2011 does not correlate with per capita GDP growth, nor does the FEFI level in 2011 correlate with the level of per capita GDP (Figures 1 and 2). Advanced countries generally have a higher score in the FEFI compared with less developed countries, similar to often-used corruption indices or "good governance" indices. However, growth rates of GDP do not correlate with levels or changes of these indicators[2].

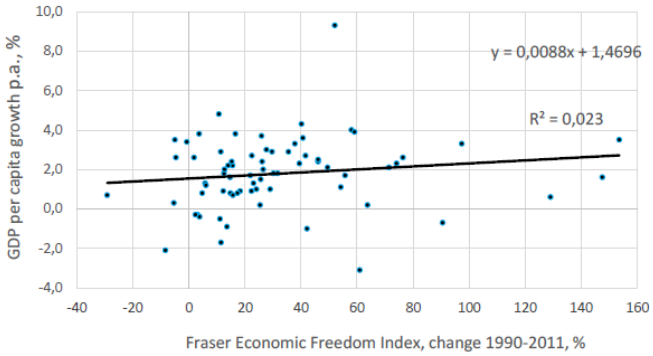

Figure 1. *Charge of Fraser Economic Freedom Index and GDP Per Capita Growth, Selected Economies, 1990-2011.*

Source: Author's calculations, based on World Bank, World Development Indicators (WDI) database, and Fraser Institute (2014), Economic Freedom of the World 2014 Annual Report.

Note: Selected economies refer to the 71 countries classified by the World Bank as developing for the year 1990 and with data available in the WDI database. All data refer to the changes between 1990 and 2011.

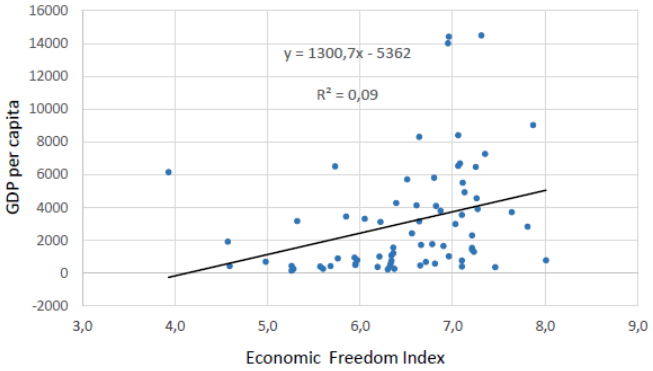

Figure 2. *Fraser Economic Freedom Index and per capita GDP, selected economies, 2011*
Source: See chart 1.
Note: Selected economies refer to the 71 countries classified by the World Bank as developing for the year 1990 and with data available in the WDI database. All data refer to the levels of 2011, GDP in constant 2005 dollars.

2.3. "Good governance"

Many mainstream economists argued that the weak nexus between the liberalisation of markets and development could be rooted in poor "institutions". The latter is often interpreted as "good governance", measured in six dimensions in the CPIA indicators of the World Bank ("Country Policy and Institutional Assessment"). These indicators were often criticised (being opaque, biased, without conceptual base, one-size-fits-all approach, etc.). In particular, the dimensions of "regulatory quality" and "government effectiveness" with an emphasis on "sound policies" are critical and biased (e.g. Langbein & Knack, 2010; Kaufmann et al., 2007; Wade, 2015)

What is more important is that *policies* are left out in favour of "governance" or simple neoliberal policies often return through the backdoor. The linkage between good governance in this sense and economic growth and development is weak. As with the FEFI, high income levels correlate with high CPIA scores across countries, although the level of CPIA scores do not correlate with per capita GDP growth and income growth does not significantly correlate with score changes. In most LMICs, the CPIA scores change very slowly, even when growth and structural change are booming. It seems that good governance, whatever it is in essence, is quite diverse and more a long-term *result* of development rather than a precondition. Many of the fast growing emerging economies are not winners of high CPIA score medals. It took developed countries more than a century to climb up to the score that they now have (e.g. Chang, 2003).

Some much debated institutionalists like Acemoglu & Robinson (2012) believe, following Douglas North, that the *fundamental* causes of weak or strong development are rooted in "economic institutions", while the *proximate* causes lie in the determinants of growth, as analysed in standard growth theories. It is unclear what development-friendly economic institutions really are, nor is it justified to exclude policies from the fundamental determinants of growth and development. An often-used broad understanding of institutions may leave the determinants of development in the darkness of black boxes. Besides this, basic, long-standing entrenched institutions are hard to change. Then, countries would be trapped in their heritage.

A wide-spread simple belief is that the main barrier to development and hence cause of under-development is the impact of corruption. If we accept the problem of properly defining corruption and follow the often-used Corruption Perception Index elaborated by Transparency International (2015), a strong direct relationship

between corruption and per capita growth cannot be detected (see Figure 3) even though the regression line is slightly sloping upwards. Obviously many fast growing countries have fairly high corruption, and many slow growing countries perform better in terms of corruption. Even if there were a strong relationship, the causality is unclear. And low or high corruption scores may be offset by other more important determinants of economic growth.

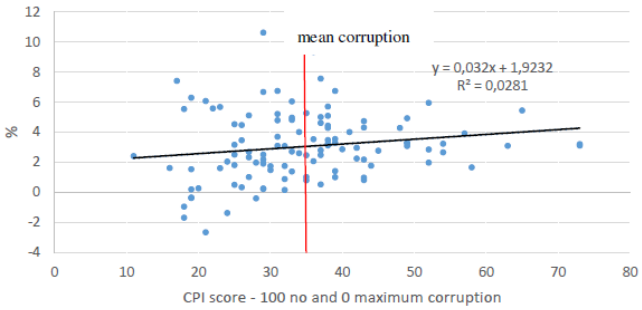

Figure 3. *GDP per capita growth 2000-2013 (% p.a.) and Corruption Perceptions Index (CPI, 2014) in 110 developing countries*

Source: Author's calculations, based on World Bank, World Development Indicators (WDI) database, and Transparency International (2015), Corruption Perceptions Index 2014.

2.4. Millennium Development Goals

The United Nations turning to the MDGs in 2000 signified a paradigm shift in the policies of supranational institutions (UN, 2014). Quantitative goals were set in great detail, with a fixed timeframe, identical for all developing countries and in conjunction with the support of developed countries, whereby income distribution was addressed in part for the first time. However, the MDGs, translated in poverty reduction strategy papers as medium-term national strategies, were confined to goal-setting, although they missed economic strategies, apart from the verbal commitment of donor countries to markedly increase official development aid. Perhaps strategies had been deliberately left out by the initiators of the MDGs to find global consent and delegate the choice of strategy to the respective country. Ironically, the usual set of policy advice as shown above was not really changed, with the exception of the IMF's initiative to include capital flow management (alias capital controls) into the official toolbox of the Fund from 2010. Hence, the MDGs can be considered as a social policy complement of the mainstream roadmap for broad-based liberalisation of markets in the "South". While setting proper goals is an important part of defining development strategies, the MDGs miss a *production view* on development so that the eradication of absolute poverty and the related other goals can be achieved sustainably and eventually self-reliantly. Development has often been interpreted and reduced to simply overcoming poverty, predominantly understood as absolute poverty, as well as reaching the other goals to enable "capabilities" (Sen, 2001) and open opportunities for individual freedom for all citizens. Accordingly, the MDGs can be understood as a reduced substitute for genuine, broader development as perceived in traditional development discourses (e.g. Chang, 2010). From this perspective, the advent of the MDGs was a reduction of developmental ambitions in disguise.

Nevertheless, the reduction of absolute poverty advanced towards a key benchmark for development. As shown in Table 1, the results thus far are mixed. Global poverty, relative to the population, was reduced remarkably, and other MDGs could be approached similarly. The share of absolute poverty (conceived as $1.25 in PPP per day in 2005 prices) fell from 43 per cent of the population in the "South" in 1990 to 21 per cent in 2010, and from 65 per cent to 41 per cent when

the margin for poverty is taken as $2 per day. If East Asia is excluded, the absolute number of poor was slightly higher in 2010 than 1990 and increased considerably when using the $2 margin, mainly due to strong population growth in Africa and India. Of course, it is questionable whether the progress made was really driven by MDG-related policies or owing to other factors.

Table 1. *Poverty headcount in low- and middle-income countries, 1990-2010*

(Per cent of the population, unless otherwise specified)

	Below $1.25 a day			Below $2 a day		
	1990	1999	2010	1990	1999	2010
East Asia & Pacific	56.2	35.6	12.5	81.0	61.7	29.7
Latin America & Caribbean	12.2	11.9	5.5	22.4	22.0	10.4
Middle East & North Africa	5.8	5.0	2.4	23.5	22.0	12.0
Sub-Saharan Africa	56.5	57.9	48.5	76.0	77.4	69.9
South Asia	53.8	45.1	31.0	83.6	77.8	66.7
All developing countries	43.1	34.1	20.6	64.6	57.4	40.7
All developing countries except East Asia	34.8	33.2	25.0	54.3	54.9	46.6
Memo item:						
All developing countries (in million)	1,782	1,642	1,153	2,674	2,767	2,276
All developing countries except East Asia (in million)	882	1,004	908	1,378	1,659	1,692

Source: Author's calculations, based on World Bank, World Development Indicators database.

The post-2015-Millenium-Goals Agenda is still unfinished at the time being (cp. [Retrieved from]). The proposals for a new agenda will continue with the eight goals of the 2000 agenda, but include sustainable development goals, focused on climate change and other environmental targets, address reduction of inequality within and between countries and include all countries, developing as well as developed. Whatever the outcome of the decision-making process will be, the underlying concept lends priority to the goal-setting while economic strategies for implementation are still missing or beyond the scope of the agenda. As mentioned, strategies need goals, but much more than goals.

2.5. Outward development and export-led growth

After the end of Latin American import substitutions strategies, the debate concerning whether import substitution or export orientation or inward or outward development is the right strategy approached an end, with outward orientation alias export promotion seen as the winner. The enormous growth of world trade, as well as the strong export orientation of many successful East Asian countries, seemed to endorse the defeat of the Latin American dependencia theories. However, it was overlooked that many Asian countries applied both import substitution *and* export promotion, mostly first the former and then the latter, but often concurrently (e.g. Bruton, 1998; Cypher, 2014), with the Republic of Korea, China and Vietnam being cases in point. In China and Vietnam, particularly state-owned enterprises or even joint ventures with multinational companies defended domestic market shares, while foreign funded enterprises and some domestic served the world market (e.g. Amsden, 2001: 190). With tariff and non-tariff barriers, the promotion of technological innovations and energy saving or domestic energies, developed countries also attempted to practice import substitution, or at least the defence and overt or hidden protection of domestic suppliers.

Outward orientation is a multifaceted concept. Interpreted as outright neo-mercantilism leaning towards trade surplus, there are hardly no surplus oriented developing countries, besides oil exporting countries and China. China turned to domestic demand-led growth after the great financial crisis and strongly reduced its bloated current account surplus in recent years. By contrast, there are some 15 high-income countries with current account surplus (average surplus 2000-2015), on top of them Singapore and Switzerland with 19 and 10% of GDP, respectively, also Germany with 4.4% and Japan with 2.9%. This club of countries together with

energy exporters are the counterparts of almost all developing countries and the USA with long-standing deficits. Yet, many countries, developing and developed, can be seen as export-led in the sense of promoting exports by constraining wages and other direct and indirect forms of export support, while refraining from import substitution. The export share in GDP and also trade openness, measured as exports plus imports as per cent of GDP, rose in almost all countries strongly. Often export-led growth triggered import growth (intermediate goods and final goods). The pressure to achieve price competitiveness forced many developing countries to repress domestic demand, which has contributed to large current account imbalances. Despite export-led growth, the vast majority of developing countries is stuck in massive trade and current account deficits (see Figures 4 and 5). It may have been a race to the bottom, or in the direction of the bottom. The achievement of this race was an increase of the world market shares of developing countries, predominantly from East Asia.

Regarding development strategies, the question of import substitution versus export promotion was posed incorrectly, given that neither are both mutually exclusive nor does development depend on exports regardless of *what* is exported or imported. Exports of low-value commodities with a low income and price elasticity of world demand and, conversely, imports with high income elasticity and low price elasticity contribute little to growth and development. Terms of trade, income elasticity of demand and technological sophistication of traded goods are key parameters for the nexus of exports and GDP growth. For instance, sub-Saharan Africa's share in world trade is marginal and remained so from 1990 to 2012, although its export to GDP ratio is similar to East Asia, whose share in world exports grew almost fourfold during this period, as can be seen in Table 2. However, Africa's exports were mainly commodities, while East Asia's were mainly manufactured goods. Moreover, South Asia, and predominantly India, also has a tiny world market share and – like Latin America – had a lower degree of trade openness than sub-Saharan Africa during the entire 1990-2012 period.

Table 2. *Exports of goods and services, selected groups of low- and middle-income countries*

	Per cent of world exports		Per cent of GDP	
	1990	2012	1990	2012
East Asia & Pacific	3.7	14.2	20.3	33.5
Europe & Central Asia	2.6	3.5	20.3	36.2
Latin America & Caribbean	3.8	5	17.3	23.7
South Asia	0.8	2.3	8.5	22.5
Sub-Saharan Africa	1.8	2.2	26.1	31.9
World	12.7	27.2	19.6	30.3

Source: World Bank, World Development Indicators database.
Note: Data include only low- and middle-income countries, except for the world. Data for Middle East & North Africa are not available.

Even though import substitution is still relevant and by no means outdated, economies of scale are extremely important for exporting manufactured goods. Besides a few huge domestic markets in large economies, structural change towards manufacturing compellingly requires exports. Increasing exports is imperative for importing those goods and services that are indispensable for technology upgrading if a current account balance (or a contained deficit) is envisaged. The feat of a successful development strategy is to combine export promotion with import substitution without jeopardising the balance of payment equilibrium and without restricting necessary imports of sophisticated goods produced in advanced countries.

Export-led growth is not a generic formula to spur growth in developing countries. More exports often trigger more imports, once trade is further liberalised. Furthermore, it is important what kind of trade takes place – the local value-added is important, and *what* is traded, regarding to the price and income elasticity of demand. As Figure 4 shows, even in the period 2000-13, characterised by improving terms of trade for many countries of the South, few countries achieved a positive trade balance. The mean trade deficit of a sample 115 countries (with data available), excluding oil exporters, was around 12% of GDP. There was only a weak relationship discernible between per capita growth of GDP and the trade balance. As shown further below, many of the poorer developing countries, especially in Africa, could bridge the gap in the current account with foreign aid, remittances of migrants and to some extent with FDI inflows, thus maintaining external financial dependence.

Figure 4. *GDP p.c. growth and trade balance, % of GDP, 2000-2013, in 115 developing countries (without oil exporters)*
Source: World Bank, World Development Indicators database.

The same problems are reflected in the relationship between the current account balance and GDP growth, as shown in Figure 5. Export-led growth strategies have not generally improved the problem of long-standing massive current account deficits by the majority of developing countries, as compared to the average in the 1990s (see Priewe & Herr 2005, 109f.). The mean deficit of a sample of 125 developing countries was 6% of GDP over the period 2000-13. While a big part of aid (if paid as grants) is booked in the current account, also remittances from migrant workers as well as profit transfers and debt service on external debt, the gap in the current account balance, to be covered by new debt and equity, is still huge and an impediment to growth.

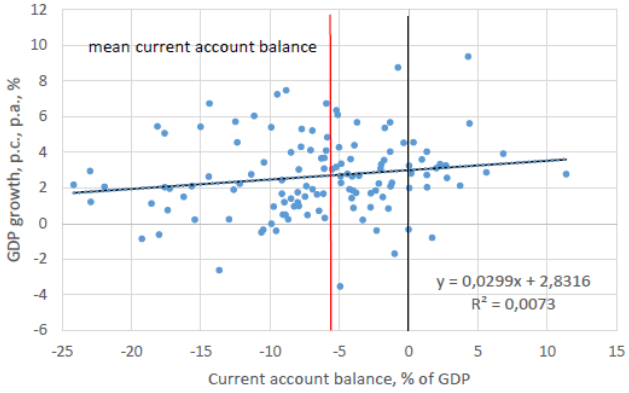

Figure 5. *Current account balance, % of GDP, and per capita GDP growth, 2000-13, in 125 developing countries (without 23 energy exporting economies)*
Source. IMF, WEO database 2015.

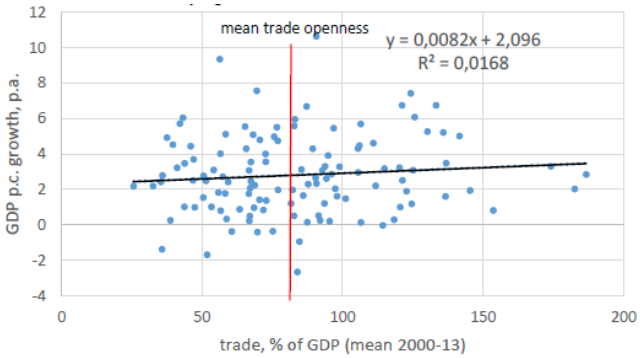

Figure 6. *Trade openness and GDP p.c. growth, 2000-13, 120 developing countries 2000-13*
Source: World Bank, World Development Indicators database. Author's calculations.

Liberalising trade and increasing trade relative to GDP, i.e. trade openness (indicated by exports plus imports relative to GDP), is considered as a key mainstream pillar for growth and development. However, the empirical evidence for trade-induced growth is scant, as noted by several observers (e.g. Rodriguez & Rodrik, 2001). As charts 6 shows, the relationship between trade openness and growth in a sample of 120 countries, is weak. As small countries normally have a higher degree of trade openness, the empirical evidence might be distorted. If the *change rate* in trade openness is taken, the bias is neutralised – but the results are the same. Our conclusion is, again, that it is important *what* is traded, rather than trade openness as such. The main issues in this regard are export strategies based on primary goods or manufactures.

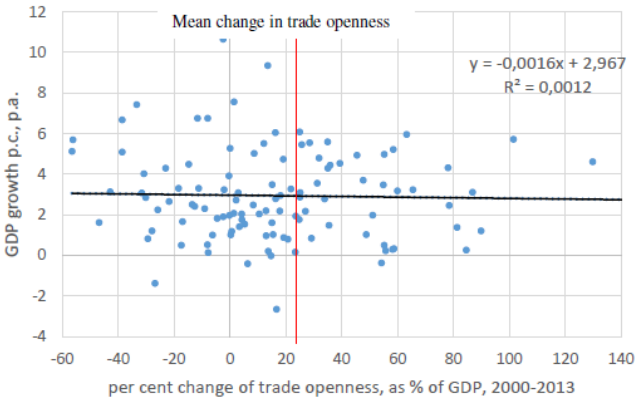

Figure 7. *Change in trade openness and GDP p.c. growth, 2000-13, in 109 developing countries*
Note: Without 3 outliers in a dataset of 112 countries (Dem. Rep. of Congo, Lebanon, Serbia) with very high change rates of trade openness.
Source: World Bank, World Development Indicators database. Author's calculations.

Another ingredient of mainstream thinking regarding development strategies is the notion that foreign direct investment spurs growth and development. Chart 8 displays evidence for 122 developing countries for the period 1995-2013 that seems to support this notion. However, there is a large number of countries with a high share of FDI and below-average growth, and vice versa. A closer look at FDI would reveal that the type of FDI, the degree of integration into local value chains and the technology-content play an important role, among other factors. FDI are not always and everywhere growth enhancing, and unconditional welcoming of FDI by full liberalisation is not conducive to development (cp. Chang & Grabel 2004, 135ff.).

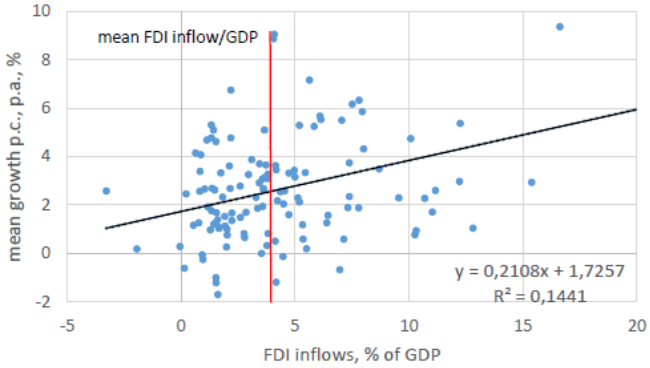

Figure 8. *FDI inflow and GDP p.c., growth 1995-2013 p.a., in 122 developing countries*
Note: one outlier excluded (FDI/GDP > 20%); developing countries: low and middle income countries
Source: World Bank, World Development Indicators database. Author's calculations.

Export-led growth and a general outward orientation need to be reconsidered as cornerstones of the predominant development strategy (cp. UNCTAD 2013, 62ff.). Neglecting domestic demand based on increases of wages and other domestic incomes, in line with continuous growth of productivity, leads to a lopsided pattern of economic growth. What seems plausible for one country might not work multilaterally. Despite all efforts towards export-led growth the vast majority of the poorer developing countries is permanently trapped in unsustainable current account deficits which increase external indebtedness and financial dependence. Moreover, they have to open their capital accounts for financing deficits, thereby exposing themselves to boom-bust-cycles of capital in- and outflows. Thus trade liberalisation comes all too often in lockstep with premature financial liberalisation. Trade policy including infant industry protection and industrial policy, in the framework of a balanced outward- and inward orientation would be the alternative to blanket export-led growth strategy.

After the Asian crisis most emerging economies, especially upper middle-income countries, but also India and Vietnam, have learnt keeping their current account under control, i.e. allowing only small deficits. There are only few middle income countries which follow a growth-cum-(commercial) -debt strategy, with deficits in the current account up to 4-5% of GDP, notably Costa Rica, Turkey, Mauritius, Hungary and Poland.

2.6. Structural change: towards industrialisation or commodities and services?

Orthodox theories on growth and development do not care much for structural change and hence sector-specific policies. Market forces determine what is produced, whereby market-determined optimal allocation of resources should be aligned to static comparative advantage. This would guide developing countries towards the production of commodities and developed ones to manufactures and knowledge-intensive goods and services. Those who believe that this might corroborate underdevelopment will plea for policies for structural change towards *dynamic* comparative advantages, overcoming the confines of nature and the historic role of developing countries as latecomers.

Amazingly, most mainstream concepts bypass this issue. In East Asia, industrialisation -understood here as manufacturing, excluding mining and construction- is strongly promoted by governments, whereas in sub-Saharan Africa it has hardly started, and in almost all Latin American countries value added in manufacturing as a share of GDP is shrinking after the high values achieved in the

1970s and early-1980s. In India, as the core of South Asia, the level reached by 1980 was maintained until the mid-1990s and shrank gradually thereafter.[1]

Despite a trend of deindustrialisation in many developing countries, a quick look at the data shows that almost all middle-income countries, except oil exporters, have a higher share of manufacturing value added than most Organisation for Economic Co-operation and Development (OECD) high-income countries, which have a level of 15.7 per cent of GDP in 2010 (Figure 3). In contrast to advanced OECD countries, the structural change regarding employment in middle-income countries has usually led directly from low-income agriculture, often subsistence farming, to low-income services, often petty trade and other petty services, with a small share of the high-value service sector, which is prevalent in OECD countries. With few exceptions, almost all rapidly growing economies have de facto embarked on industrialisation. Therefore, calling developed countries industrialised in contrast to developing ones has long been outdated.

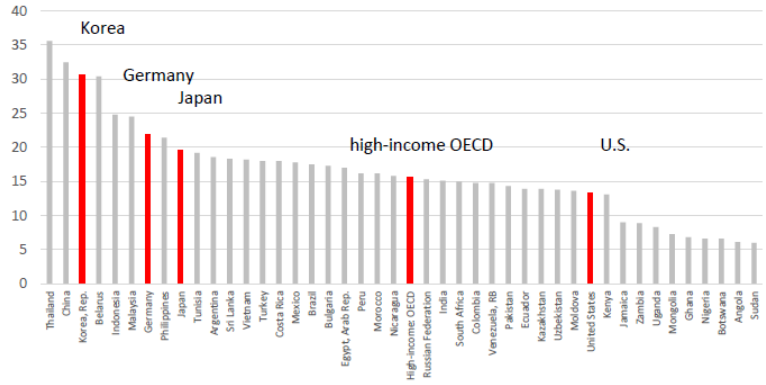

Figure 9. *Manufacturing value added as percent of GDP, selected countries, 2010*
Source: Author's calculations, based on World Bank, World Development Indicators (WDI) database.
Note: For comparison, the average of the high income OECD economies is also reported.

For a number of reasons, manufacturing has been key for development in economic history, for both now developed countries – only a handful of them developed with primary goods rather than industrialisation, such as Canada, Australia and New Zealand (e.g. Taft & Adelman, 1989) – and successful emerging economies after World War II. Manufacturing used to be the epicentre of applied technical progress in economic history: while inventions may be made in the service sector, product and process innovation pertain to mainly manufactured goods, while primary merchandise largely stems from nature-made resources, with technical progress in extraction or land use generated in either the service sector or manufacturing. Manufactured goods are tradables with increasing value added, based upon productive employment, while primary goods involve – if profitably sold – rents. Strong demand surges for primary goods, with supply constraints due to natural scarcity or long gestation periods, risk Dutch disease or even resource curse problems, which hamper manufacturing. The extent to which services can be rendered tradable is uncertain. For most LMICs, service exports have not increased above a ten percent share of total exports, with the exception of India (see Table 3). Future developments may differ from history, but to date there is very little evidence that services can substitute manufactured exports on the road to economic development, apart from small countries that can live from niches in the world market.

Table 3. *Composition of exports of goods and services, selected country groups, 2013*

(per cent of total group exports)

	East Asia	South Asia	Latin America & Caribbean	Sub-Saharan Africa	High Income OECD
Merchandise goods	89.2	68.2	88.0	83.0	77.7
of which:					
Manufactured goods	73.7	45.1	45.6	21.4	55.4
Services	10.6	31.4	10.7	11.0	23.5
Errors*	0.2	0.4	1.3	6.0	-1.2

Source: Author's calculations, based on World Bank, World Development Indicators database.
Note: *Data errors prevent that merchandise goods and services add to 100. All country groups, but the high-income OECD, only include low- and middle-income countries.

The share of service exports has been on the rise in recent decades, having reached 23.5 per cent of all exports in high-income OECD countries, mainly driven by the United States. A great portion of these services pertains to either merchandise goods, such as transportation, or high-end knowledge, such as patents, trademarks or similar, where LMICs have a competitive disadvantage.

2.7. Foreign-aid-based strategies

Following the old saving-gap theory (cp. Priewe & Herr, 2005) poor countries need foreign aid inflows, i.e. foreign saving, in order to purchase those imports of manufactured goods and natural resources which they cannot produce yet or do not have as natural endowments. The rationale is that the saving to income ratio is too small, and could only be increased by lowering the living standard below the poverty line. Exchange rate devaluation is not possible in this situation, as real incomes would fall, the price and income elasticities of exports might be small. Private capital inflows or borrowing are suspected to be unlikely or unaffordable. If foreign aid or Official Development Assistance, as coined by the OECD, is given as loans under preferential conditions, development-cum-debt will enable the countries to repay official loans by achieving current account surplus in the next stage of development. Mainly low income countries are considered candidates for this strategy. Without discussing here the long-standing concepts pro and contra aid-based development, evidence shows that there is a slightly negative relationship between aid and per capital growth (see Figure 10 for 120 developing countries for the period 2000-13), but the variance is high. Although there are clearly more countries with above-average ODA inflows which have below average growth, there is a dozen of ODA-heavy countries (>10% of GNI) with comparatively high growth (>3%) in the period considered, most notably Mozambique, Ruanda and Ethiopia. The latter reached amazing 6% growth per capita while receiving ODA at a magnitude of almost 13% of GNI (Table 4). Only with bulky aid inflows these countries were able finance their trade deficits, in the case of Ethiopia around 17% of GDP.

Few of the heavy aid recipients received strong inflows of remittances; some could attract a considerable amount of foreign direct investors, relative to GDP, such as Mozambique. The efficiency of high ODA inflows depends largely on their productive usage, especially for infrastructure, export promotion or import substitution, and on avoidance of negative side effects and distortions. Massive aid hikes could cause effects similar to Dutch disease, either by appreciating exchange rates or by inflationary effects, including wage increases and increased imports of consumer goods. Gains of foreign exchange via aid (similarly heavy remittance influx) could also crowd out the use of domestic currency (dollarization); or the central bank might pile up reserves (i.e. increasing money supply in local currency in exchange for aid), an unintended side effect of aid. Whether this strategy leads to sustainable growth, enabling the phasing out of aid, is an experiment. There had been only few positive experiences in the past decades (cp. Priewe & Herr 2005,

183ff.), most notably Korea in the 1950s and 1960s. At the same time, Korea delivers also the blueprint for industrial policy with import substitution and later export promotion, coupled with prudent macroeconomic policies.

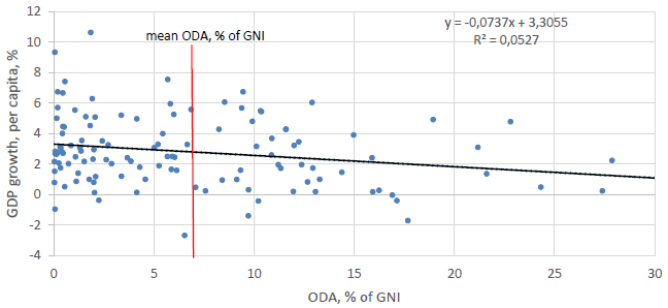

Figure 10. *ODA inflows (% of GNI) and GDP p.c. growth, mean 2000-13 (without 7 outliers ODA/GNI > 30%) in 120 developing countries*
Source: World Bank, World Development Indicators database. Author's calculations.

Table 4. *12 ODA-heavy countries* with fast growth per capita (> 3.0% p.a.)*

	Net ODA, average 2000-13, % of GNI	remittances, % of GDP	FDI, % of GDP	trade balance, % of GDP	current account balance, % of GDP	GDP p.c. growth, 2000-13	GDP p.c., in current USD (2015)
Mozambique	22.8	1.2	12.3	-12.8	-17.6	4.8	605
Rwanda	18.9	1.4	1.1	-16.8	-5.8	4.9	696
Sierra Leone	21.2	1.4	6.0	-16.4	-14.3	3.1	803
Ethiopia	12.9	1.1	2.4	-16.9	-5.2	6.0	525
Tanzania	10.9	0.1	4.	-9.4	-6.3	3.7	945
Zambia	11.6	0.4	5.9	-1.9	-5.0	4.3	1,845
Cabo Verde	15.0	11.3	6.6	-30.0	-10.5	3.9	3,632
Bhutan	10.4	0.5	1.8	-19.4	-12.5	5.4	2,633
Uganda	12.2	4.5	4.3	-11.8	-6.1	3.5	694
Lao PDR	10.3	0.3	3.1	-9.6	-18.1	5.5	1,594
Burkina Faso	12.0	1.4	1.0	-14.4	-7.9	3.2	720
Kyrgyz Republic	10.1	16.1	5.1	-23.7	-5.2	3.2	1,299

Note: * > 10% ODA/GNI **ODA and remittances
Source: World Bank, World Development Indicators database. Author's calculations.

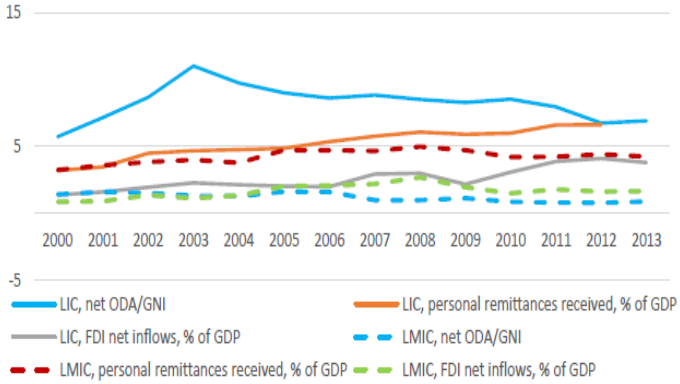

Figure 11. *ODA, remittances and FDI inflows in low and lower middle income countries (LIC and LMIC), 2000-2013*
Source: World Bank, World Development Indicators database. Author's calculations.

3. Strategic concepts based on macroeconomic policies

In the strategic concepts sketched above, macroeconomic policies were only marginally mentioned. In general, the belief prevails that "sound money" for low inflation requires sovereign independent monetary policy, independent from monetary policy in advanced countries by having flexible exchange rate regimes.

Strong swings in exchange rates have to be accepted. Since overly expansionary fiscal policy, and particularly monetised budget deficits, is seen as the main culprit for inflation, tight fiscal policy is advisable most of the time, since developing countries generally suffer from greater inflationary pressures than advanced economies. Free capital flows, especially for private equity flows, allow the financing of current account deficits. Structural adjustments are advised when the current account deficit becomes too great and if the competitiveness of enterprises is at risk due to overly high inflation or over-valued exchange rates. Free capital mobility, it is contended, sanctions fiscal profligacy and bad governance with capital outflows and depreciation, and rewards the economy if the opposite prevails. Thus, the policy space for potential misbehaviour of governments is narrowed to the benefit of the country. Macroeconomic policy of this kind, mostly restrictive and geared towards priority for low inflation and a flexible exchange rate, is considered quite relevant in this view, although the long-run growth is determined by the private sector, first and foremost by the ability to make profits and invest them profitably and innovatively to generate technical progress in the sense of technology transfer from more advanced countries. This is by and large the standard application of neoclassical thinking.

Keynesian concepts, blended with structuralist ideas borne in Latin America in the tradition of dependencia theories, believe that cyclical or chronic shortage of aggregate demand can influence medium- to long-run growth. Abundant labour is available in developing countries and skills could be provided by concomitant policies. Representative for this macroeconomic view on development is Bresser-Pereira's "New Developmentalism" (e.g. Fundação, 2014; Bresser-Pereira, 2010) or similar macroeconomic views on development in Priewe & Herr (2005), but also a number of post-Keynesian authors (Marangos, 2012, Chang & Grabel 2004; D'Arista 2008; Davidson 2004-5; Ocampo, 2002; 2004-5; Saad-Filho, 2007). Empirical evidence for the characteristics of the best growth performers in comparison can be found in the report of the Spence-Commission (Growth Commission, 2008), in line with the reasoning put forward here.

One of the main roots of underdevelopment is the low ranking of the local currency in the global currency hierarchy, led by the leading reserve currencies. Domestic money may not fulfil all of its functions properly, and particularly not the store of value and medium of credit function, while the rating of the currency and the respective domestic financial sector tends to be poor. Wealth owners have a higher propensity to hold part of their wealth in other currencies compared with advanced countries. By and large, the preference to hold financial wealth in liquidity or short-term assets is higher, which effectuates higher lending rates (including a country risk premium), but also central bank policy rates tend to be higher. Poor collateral and risks of depreciation make long-term loans impossible or very dear. Hence, the virtuous cycle of money and credit creation, inducing investment and employment, aggregate demand and GDP growth, can be impeded. External credit in foreign currency can substitute weak domestic finance, although it generates "original sin", i.e. long-term exchange rate risks that can paralyse the use of the exchange rate to devalue if necessary for the balance of payments; hence, a fear of depreciation arises.

Furthermore, countries that wish to catch-up with advanced economies encounter balance-of-payments constraints, as they tend to have a faster growth of imports than exports (e.g. Thirlwall, 2011). In principle, this predicament can be overcome by a structural change of exports towards merchandise that is more income and price elastic and hence more competitive. However, this is a difficult and long process of innovation. Devaluations of the local currency may be contractionary in the short to medium term (see Krugman & Taylor, 1978; Blecker

& Razmi, 2008). Even worse, not only might devaluations be difficult, but the currency might tend to be appreciated by natural resource price booms (Dutch disease) or similar capital inflow surges. As a result, many developing countries struggle with balance-of-payments constraints, which require containing current account deficits by tight fiscal policies and often also be as tight fiscal policy.

Achieving competitiveness of trade might subsequently require reducing wages and other incomes relative to productivity, although this can weaken domestic demand and may drive people in partial subsistence or a working poor status with normally low productivity. Repressed wage increases and high unemployment or under-employment in the subsistence or informal sector, which are prevalent features in many developing countries at all stages of development, tend to keep domestic demand low. Thus, monetary and fiscal policies, alongside exchange rate policy, tend to follow a permanently restrictive stance. This does not allow for counter-cyclical policies and is likely to impede the growth trend in the long run.

Finally, in an open economy context, monetary, fiscal and exchange rate policies are less efficient than in most developed countries. The notion that expansionary monetary policy can function efficiently under flexible exchange rates, as stipulated by the standard Mundell-Fleming model, obfuscates that strong depreciation with massive capital outflows might follow, triggering inflation and an increased burden of external debt. Instead, the truth seems to be that monetary policy in most developing countries with an open capital account is strongly dependent on the policy rates of central banks of the leading currency areas. Although monetary policy does not follow strictly the interest rate setting of the US-Fed or the ECB, deviations risk strong exchange rate fluctuations. The country risk premia are far too high in most countries, although quite diverse (and not well explored). Furthermore, the transmission of monetary policy to investment and aggregate demand might be much looser than in highly monetised advanced countries. Fiscal policy is facing a smaller fiscal multiplier in small and very open economies, as most developing economies are nowadays.

Figure 12 shows the movements of nominal and real short- and medium lending rates[3] in a large sample of diverse developing countries. Nominal interest rates came down in developing countries, due to moderation of inflation rates and the trend to lower rates in advanced countries, especially the USA. The wedge between US-rates and developing countries is still very high, but the trend is falling. A similar spread can be observed between the real lending rates, whose mean spread amounted to 4.4 percentage points (2000-13). The two hikes of real lending rates in developing countries (2001 and 2009) result from reduced inflation rates, due to recession. Since capital flows moved suddenly out of developing countries, causing depreciation of exchange rates, an inflation hike followed which again reduced real lending rates. The two hikes were pro-cyclical and undermined the functioning of monetary policy. There is no clear parallel movement of interest rates, neither of nominal nor real ones. Unfortunately, there are no time series for policy interest rates for a large number of countries available. For emerging economies with data, some parallelism exists, but the relationship is not very close. It seems that many central banks accept a strong dose of exchange rate volatility in order to gain some monetary policy autonomy, as presumed in inflation targeting as the often prevailing monetary policy strategy.

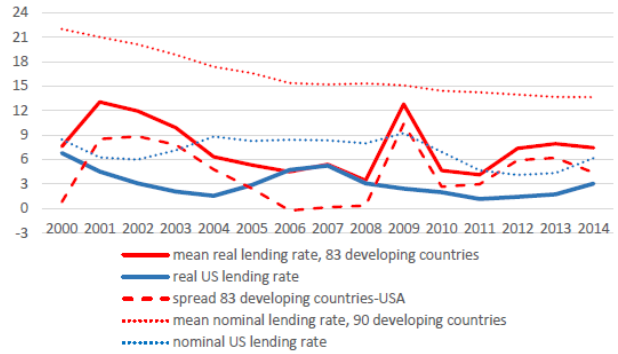

Figure 12. *Nominal and real lending interest rates, for 83/90 developing countries*
Source: World Bank, WDI, author's calculations.
Note: Short- and medium term bank lending interest rates to private borrowers; deflated with GDP deflators.

Real lending rates differ strongly between countries in the sample of 83 economies. More than a quarter of these countries have, on average in the period 2000-13, real lending rates above 10%, and 71% of them above 4%., with US mean rate of 3.0% in this period. Only few countries had negative real rates, often due to high inflation episodes. High real lending rates seem to be a prime hindrance for investment, and at the same time a benchmark for high profit rates which reinforce income inequality.

Table 5. *Mean real lending rates 2000-2014, in 83 developing countries*

Real lending rates	
22 countries	> 10%
16 countries	> mean, > 7,5 % < 10 %
21 countries	> 4 %, < 7,5 %
18 countries	> 0 %, < 4 %
6 countries	< 0 %
83 total	

Source: See chart 12.

Real monetary policy interest rates are also considerable higher, on average, than in the prime reserve currency country, the USA. A spotlight on real interest rates (deflated with estimated consumer price inflation for the year 2015 by the IMF) for June 2015 (Figure 13) shows an average spread of 165 basis points; many developing countries (in the sample of 53 countries) have real policy rates around 4% and above, including Brazil in the top group and China with almost 4%.

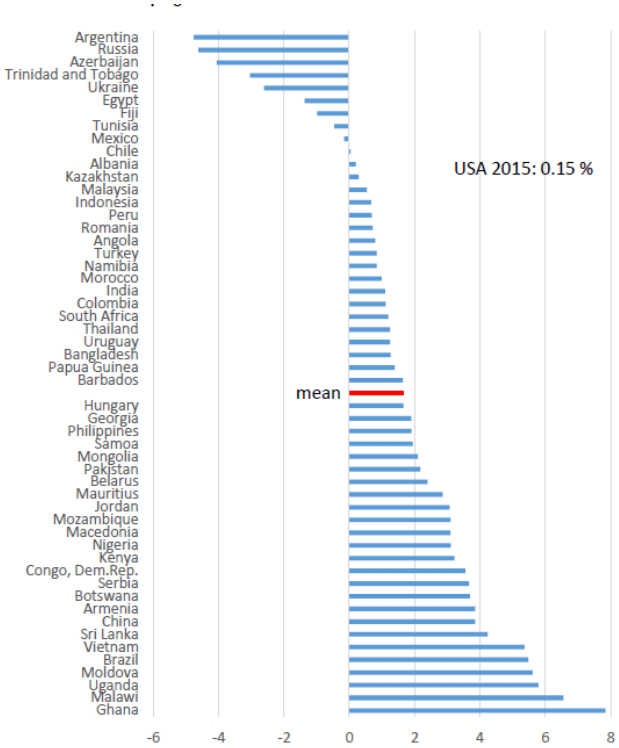

Figure 13. *Real central bank policy rates (%), June 2015, in 53 developing countries*
Source: [Retrieved from].
Note: deflated with CPI estimates from IMF, WEO 2015.

Exchange rate misalignment and volatility are another key macroeconomic problem of developing countries, markedly different from developed. Firstly, the main underlying difference is the inferiority of the currency within the global currency hierarchy, as already mentioned. Secondly, these countries fear depreciations more than most advanced countries, as the value of external debt would rise, counted in local currencies. Emerging economies, that are stable enough for foreign financial inflows, equity and debt, face waves of strong inflows, attracted by higher nominal interest rates than in advanced countries, and pushed by temporary risk appetite of wealth owners from abroad which tends to fluctuate cyclically (cp. Rey, 2013). Therefore developing countries with an open capital account face boom and bust cycles of capital in- and outflows which push exchange rates up and down, often excessively. Thirdly, volatile commodity prices trigger a cyclical movement of terms of trade which tend to impact exchange rates. Fourthly, countries with rich natural resources often face strong price fluctuations (with rather inelastic supply) or they may discover new resources that increase primary revenues in strong waves. This can lead to strong real appreciation hikes in boom phases and depreciations in ebbs. Often real exchange rates remain over-valued and hinder other exports, especially of manufactures and agricultural commodities (Dutch disease). This disease that looks like a blessing of nature, can be temporary or lead to chronicle overvaluation, thus inhibiting structural change towards modern sectors. The extraordinary comparative advantage of rich natural resources involves the mirror image of comparative disadvantages for other goods which are for the majority of the population of utmost importance for their employment and their living standards.

Most developing countries do not cope well with fully flexible exchange rates, but attempt to smooth fluctuations by temporary unilateral central bank interventions or by adjusting central bank policy interest rates in order follow,

more or less, the interest rates of developed countries. Despite these policy responses, those countries fully exposed to global financial markets face strong volatility of nominal exchange rates. As shown in Figure 14 and 15 for select emerging economies and for other developed countries, there is also strong volatility of real effective exchange rates for most countries, since nominal exchange rate changes go far beyond inflation differentials. The volatility implicates strong and permanent exogenous shocks for the real economy. Stabilising exchange rates at a competitive level, in line with fundamentals that fit the real economy, is a challenge for most developing countries, which would require multilateral actions and rules, namely a new global currency system.

Volatile commodity prices, exchange rates, cross-border capital flows and sector-specific shocks due to a lower degree of diversification of the production structure expose developing countries to manifold shocks. Therefore, shock absorption and macroeconomic stabilisation is more important in developing countries but more difficult to achieve. Uncertainties seem to be much greater, let alone the problems with political instability, poor governance, etc.

While Keynes envisaged the necessity to stabilise the fundamentally unstable capitalist economies, mainly with the means of monetary, fiscal and exchange rate polices, predominantly conducted by the central banks and the treasuries, besides coordinated multilateral governance, this need for stabilisation might be even more urgent, but more difficult to implement, in developing economies.

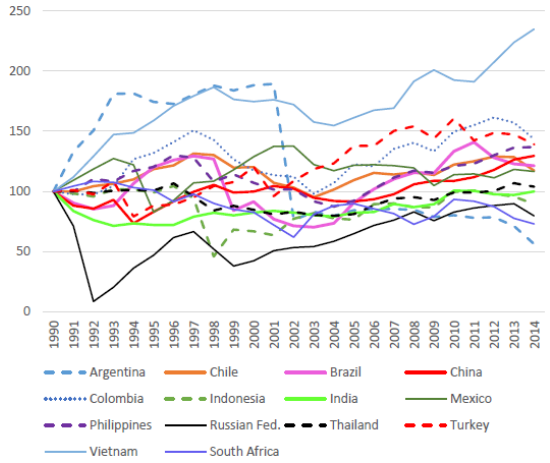

Figure 14. *Real effective exchange rates of 14 emerging economies, 1990-2014*, index 1990=100*

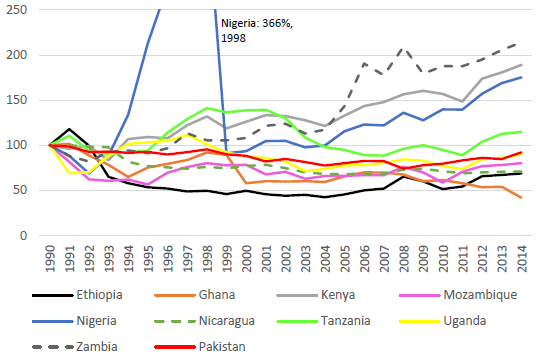

Figure 15. *Real effective exchange rates* of 10 developing countries, 1990-2013, index 1990=100*

Note for charts 14 and 15: *against 67 trading partners. Annual values, calculated with CPI.
Source of charts 14 and 15: Bruegel 2015; author's calculations

In contrast to the problems and disadvantages of developing countries in this regard, they are also privileged in a number of aspects compared to developed countries. The most important ones are the potential access to advanced knowledge and technologies – the "advantage of backwardness", as Gerschenkron (1962) christened it long ago. Furthermore, even the salaries of people with equal skills as in developed countries are much lower and hence reflect a competitive edge, let alone unskilled workers, available in great abundance. Revenues from abundant natural resources can help, beyond the shadows of Dutch disease, to kick-start productive development and finance infrastructure and other public goods, if used prudently.

The outcome of this brief analysis is that macroeconomic policies do matter for the short and long run, and hence for development strategies. Adverse macroeconomic conditions, especially the prices with macro impact like wages, interest and profit rates, exchange rates, as well as taxes, tariffs, fiscal deficits and public debt, depress growth and can hardly be offset by the utmost business-friendly policies as favoured by the neoliberal approaches to development.

The conclusion from this analysis is a package of seven policies (e.g. Priewe & Herr, 2005):[4]

- *Monetary and exchange rate policy*: to enable sovereign monetary policy geared to the needs of the country, a managed exchange rate regime with either permanent or occasional use of capital flow controls might be necessary, whereby the central bank should be committed to low inflation, as well as supporting growth with low real interest rates. This implies that the inflation control has to use either a nominal wage anchor or an exchange rate anchor. Occasional exchange rate adjustments must not be excluded. Low inflation is necessary for financial stability and contains unexpected inflation and uncertainty. Overly high inflation likely induces overshooting currency depreciations and possibly capital flight, whereby macro uncertainty rises and triggers interest rate hikes. A mild under-valuation of the real exchange rate can support net exports, if embedded in a set of other policies and multilaterally acceptable. Real exchange rates should be in line with fundamentals that enable competitiveness (cp. Frenkel & Rapetti, 2015).

- *Fiscal policy*: some degree of counter-cyclical fiscal policy with deficits in local currency, including the usage of automatic stabilisers, would be conducive to support both inflation control and growth (cp. (cp. Neto & Vernengo, 2004-5). Stabilisation of investment, also public investment for infrastructure is key. Nonetheless, debt sustainability is imperative. The provision of public goods, such as education, health services, research and development, traffic and communication infrastructure, among others, is a key supply-side prerequisite for growth and development. This requires a tax system with much higher revenues than in most developing countries exists and favoured by neoliberal policies.

- *Balance-of-payments management*: the avoidance of current account deficits and ever-increasing net international debtor position is necessary. This may require capital inflow and outflow controls, or general import taxes, apart from orderly devaluations. Mild exchange rate under-valuation over a longer period can help to promote exports.

- *Financial sector development*: key for avoiding excessive external finance is the unfolding of local credit and – with lower priority – equity markets, preferably credit markets with long-term maturity for promoting fixed investment. A bank-based financial system with mild repressed finance can be conducive to growth and structural change. This implies that the credit to GDP ratio as well as the broad money to GDP ratio rise in the process of development. Small, medium and micro enterprises need to be addressed by the credit system, going beyond microfinance. Development banks can complement the banking system.

- *Industrial policy*: for the promotion of non-traditional tradables and import substitution, targeted industrial policy bound to the performance of enterprises should be conducted with a broad variety of tools. This should support structural change and alleviate pressures in the balance of payments. While industrial policy is rather of a micro and sector policy nature, since it is targeting economic growth and balance of payments equilibrium it is strongly intertwined with macroeconomic policies, similar to those regarding financial sector development (cp. Calcagno et al. 2015; Chang, 2003, 257 ff.; Chang & Grabel, 2004, 55 ff.; Wade, 2015).

- *Labour market policies*: wages should rise, on average, in line with increases in aggregate productivity plus the target inflation rate to avoid price-wage-spirals. This is easier to implement with a centralised wage bargaining system, strongly in contrast to deregulated labour markets. Dynamic minimum wages and indexed salaries in the civil service can help to shape institutions for productivity-led wages.

- *Pro-poor income redistribution*: In countries with high income and wealth inequality, profits and rents are saved abroad to a greater extent (free capital outflows presumed), thus dampening domestic financial intermediation and aggregate demand. Redistribution policies could curb such leakages and channel purchasing power to lower income groups with a high propensity to consume; it helps to raise tax revenues to provide more public goods, and capital outflow controls could contain leakages and improve tax collection. This might increase domestic aggregate demand to a permanently higher level, thus supporting employment and growth and thereby changing the Kuznets curve.

As Asian countries have shown, policy space and an experimental, gradualist approach can help to optimise the package of policies. Macroeconomic policies play a stronger role in this concept compared to developed countries, although they are often more difficult to implement.

Table 6. *Developing country groupings, selected by economic size and population, 2013*

A. GDP

	Number of countries*	Aggregate GDP as percentage of total developing countries' GDP	Aggregate GDP as percentage of world GDP
Above $100 billion	21	87.5	22.7
$20–100 billion	27	9.2	2.3
$10–20 billion	19	2.0	0.5
Below $10 billion	63	1.5	0.4
All	130	100.0	25.9

B. Population

	Number of countries*	Aggregate population *(billion)*	Per cent of all developing countries' population	Per cent of world population
Above 50 million	18	4.452	76.5	62.5
20–50 million	26	0.820	14.1	11.5
10–20 million	24	0.325	5.6	4.6
Below 10 million	71	0.221	3.8	3.1
All	139	5.818	100.0	81.7

Note: Developing countries refer to country with a GNI per capita up to $12,745. *Data refer only to the numbers of country for which data are available in the WDI database

Source: Author's calculations, based on World Bank, World Development Indicators (WDI) database.

When checking the applicability of macroeconomic policy packages as outlined above, one has to bear in mind the small size of the majority of LMICs, measured in terms of both GDP and population (see Table 6). 87 per cent of the GDP of those

130 LMICs listed by the WDI database for 2013 stems from only 21 countries. For example, rank 21 is held by Hungary with a GDP of 113 billion dollars, while India is ranked second and has a GDP half of Germany's, which ranks behind China; the latter has a size of one-third of the United States GDP. All LMICs' GDP together has the magnitude of the United States GDP. Regarding population, the size structure is similar, whereby only 18 LMICs have a population of 50 million and more, together comprising around 76 per cent of the populace of LMICs. This size structure poses great differences for the choice of strategies, as independent macro policies are more difficult to apply in smaller countries. In these countries, probably only few macro polices out of the package are applicable, while industrial policy for strategic sectors becomes more important.

4. Learning from success and failure - growth performance in the long run

While per capita GDP growth is certainly not a synonym for development, many development indicators such as life expectancy, absolute poverty, health, etc. require higher per capita GDP and hence GDP growth as a necessary yet not sufficient precondition. The well-known Human Development Indicator from the United Nations Development Programme, comprising GDP growth as well as other components, shows that the per capita GDP component and others strongly correlate (cp. Figure 14). Per capita GDP, counted in purchasing power parity (PPP) dollars, might be, at first glance, the more appropriate measure for assessing real incomes[5], although the data are not very reliable due to different consumption baskets; moreover, PPP-based income data only exist for few years, meaning that time series cannot sensibly be used. Therefore, in the following we use constant 2005 dollars to measure and compare incomes across nations. We only consider rough performance indicators, due to space limitations.

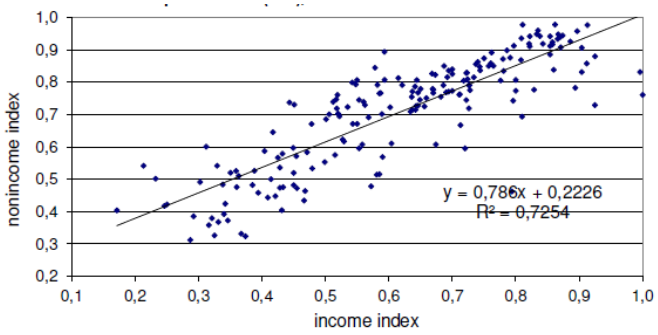

Figure 16. *Income and non-income components in the Human Development Index (HDI), 2012*

Source: UNDP Human Development Report 2013, http://hdr.undp.org. Author's calculations.

Comparing annual per capita GDP growth, there are stunning differences between the main regions in the "South": sub-Saharan Africa grew on average by only 0.2 per cent per annum during the 1980-2012 period, with higher growth during 2000-2012 and negative growth in the lost 1980s and 1990s. Latin America accomplished overall 1.0 per cent growth during 1980-2012, in contrast to South Asia, mainly India, with 3.9 per cent and East Asia, driven by China and neighbouring countries, with 7.0 per cent (Table 7). Growth acceleration in the 2000s in all regions, especially in Africa, was backed by improved barter terms of trade in many countries (see below, cp. UNCTAD, 2013, 50).

Table 7. *Average annual growth of per capita GDP, selected country groups, 1980-2013*

	1980-1990	1990-2000	2000-2013	1980-2013	1990-2013
East Asia & Pacific	6.0	6.7	7.9	7.0	7.4
Europe & Central Asia	1.9	-0.7	3.8	1.9	1.8
Latin America & Caribbean	-0.7	1.4	1.9	1.0	1.7
Sub-Saharan Africa	-1.3	-0.7	2.2	0.2	0.9
South Asia	3.1	3.3	5.1	3.9	4.3
Middle East & North Africa	-0.1	1.5	2.2	1.3	1.9

Source: Author's calculations, based on World Bank, World Development Indicators database.
Note: Data only include low- and middle-income countries, except for the world. Calculations are based on constant 2005 dollars.

Comparing the population growth ranking of 45 medium and large LMICs (defined here as having a population above 20 million) shows that 10 countries grew more slowly from 1990 until 2013 than the OECD high-income country group, while 29 grew faster, most prominently China, Vietnam and India (no data are available for six countries in this group) (see Figure 15). Ranks 12 and after are occupied by Uganda and some other African countries, whereas Brazil, the Russian Federation and South Africa rank low while Mexico, the Bolivarian Republic of Venezuela and Kenya join the group of poor performers. It becomes evident that the top runner group mainly comprises Asian countries that more or less continuously performed well, whereas a few African countries only picked up after the turn of the millennium (e.g. Growth Commission, 2008).

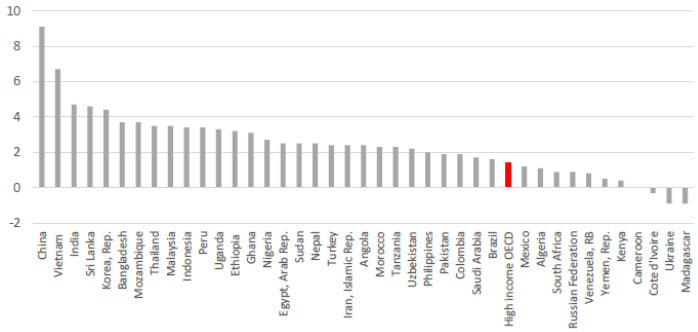

Figure 17. *Medium and large* developing countries' per capita GDP growth, 1990-2013*
Source: Author's calculations, based on World Bank, World Development Indicators (WDI) database.
Note: Medium and large developing countries refer to economies with more than 20 million people in 2013. The following medium and large developing countries are not reported because GDP per capita data for 2013 was not available: Afghanistan, Argentina, Congo (Dem. Rep.), Iraq, Korea (Dem. Rep.), Myanmar, and Syria. For comparison, the average of the high income OECD economies is also reported.

Looking at the long period from 1980 until 2013 for selected emerging economies (chart 18), we see China's outstanding growth, clearly beating the Republic of Korea and all others. However, China follows a growth track similar to the Republic of Korea, Taiwan and Hong Kong which started 10 to 20 years earlier. From this perspective, China has a speed similar to the first "Tiger" generation of catching-up countries in Asia. By contrast, Brazil, Mexico and South Africa have not gained so much since 1980. Here, we clearly see the diversity of growth and development. Success is not necessarily accomplished by maximising growth, but rather by continuous growth without severe and long-lasting setbacks.

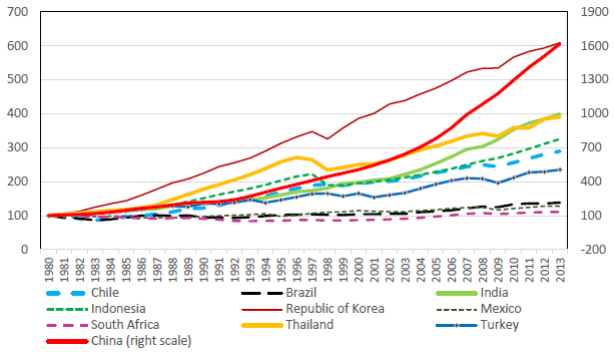

Figure 18. *Per capita GDP, selected emerging economies, 1980-2013 (index 1980 = 100)*
Source: Author's calculations, based on World Bank, World Development Indicators (WDI) database.

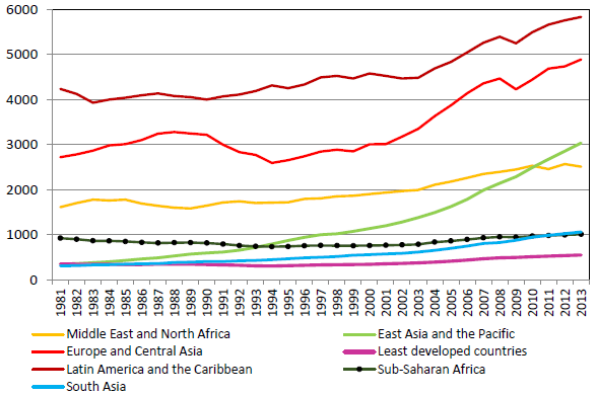

Figure 19. *Per capita GDP, selected developing regions, 1981-2013*
Source: Author's calculations, based on World Bank, World Development Indicators (WDI) database.

Despite high growth in Asia, the *level* of per capita GDP achieved in Latin America is almost twice as high compared to East Asia, as well as six times higher than in sub-Saharan Africa (Figure 19).[6] One of the basic reasons for higher growth in Asia is the degree of monetisation of the economies, measured roughly by the domestic credit to GDP ratio (see Table 8). Broad money and credit largely grow in tandem. In all regions analysed, credit picked up relative to GDP. In 2012 East Asia had reached the level of high-income OECD countries of 1990, although this may have driven their credit volume relative to GDP in some countries into an excessive dimension after 2000. The strong credit growth within a bank-centred financial system backed the financing of investment dynamics and thus avoided dependence on foreign finance.

Table 8. *Domestic credit provided by the financial sector, 1990-2012, % of GDP*

	1990	2000	2012
East Asia & Pacific	76.3	110.9	141.5
Europe & Central Asia	51.7*	34.1	64.3
Latin America & Caribbean	58.0	42.3	71.7
Middle East & North Africa	74.4	61.3	31.5**
Sub-Saharan Africa	55.3	67.8	66.4
South Asia	47.6	48.4	71.1
South Asia	47.6	48.4	71.1
High income OECD	141.3	179.2	213.1

Source: Author's calculations, based on World Bank, World Development Indicators database.
Note: Data only include low- and middle-income countries, except for the high-income OECD group.
*Data refer to 1992. **Data refer to 2010

Credit growth and fixed investment-to-GDP ratios (see Tables 9 and 10) show the same hierarchy across regions. East Asia invested on average almost twice as much of GDP in fixed capital compared to sub-Saharan Africa and Latin America, and South Asia remarkably more so than the latter. This reflects the strong role of fixed investment for growth and embodied technical progress when complemented with human capital formation (e.g. Growth Commission, 2008).

Table 9. *Gross capital formation in developing countries, 1990-2013, % of GDP*

	1990-1999	2000-2013
East Asia & Pacific	36.7	38.9
South Asia	23.1	29.8
Middle East & North Africa	27	26.6
Least developed countries	19.4	23.3
Europe & Central Asia	23.7	22
Latin America & Caribbean	19.5	20.2
Sub-Saharan Africa	16.4	18.4

Source: Author's calculations, based on World Bank, World Development Indicators database.
Note: Data refer to the average of 153 low- and middle-income countries.

The majority of developing countries, and especially the smaller and less developed ones, struggle with high current account deficits. Of the 153 LMICs listed in the World Economic Outlook Database from the IMF (2014), 113 faced current account deficits on average during the 2000-2013 period, whereby 70 countries (46 per cent of all LMICs listed) had deficits higher than 5 per cent of GDP and 22 up to 5 per cent. The median deficit was -7.0 per cent of GDP, in most cases far beyond sustainability. 39 countries had surpluses, headed by top oil exporters. Despite conspicuously higher growth in the 2000s, the current account deficits were on average somewhat smaller in the 1990s, with a median deficit of 4.9 per cent and 124 countries in deficit. The reasons for the increased deficit in the 2000s are, among others, the increased imports dependent on higher growth, as well as higher energy prices.

Rising terms of trade are often seen as growth enhancing, and vice versa. Although the barter terms of trade improved in the period 2000-13 by almost 19 per cent for developing due to rising commodity prices, roughly half of the countries for which data are available experienced falling terms of trade, as they are net commodity importers. Besides this, rising terms of trade have often contributed to rising exchange rates which hampered growth. As Figure 20 shows, there was only a weak positive relationship between improving terms of trade and per capita growth. This holds true especially for the majority of oil exporting countries which suffer from Dutch disease especially in episodes of sharp oil price spikes.

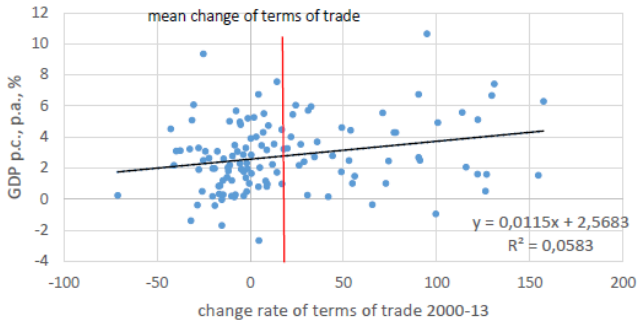

Figure 20. *Barter terms of trade, p.c. growth, p.a. 2000-13 in 123 developing countries*
Source: World Bank, WDI; author's calculations

Our brief overview of a few key economic indicators unequivocally shows the distinct differences between Asian countries, despite all the differences between China, India and others on the one hand and sub-Saharan Africa and Latin America and the Caribbean on the other, and despite the latter's marked difference in the level of development. China is not as unique as it might appear, since the country sails in the same class as Japan, Hong Kong, Singapore, Taiwan and the Republic of Korea previously did. Within Latin America, Chile, a copper-heavy economy, striving with little success to overcome its monoculture, is the spearhead of enduring growth since the 1990s, while Brazil and Argentina accelerated in the 2000s, until growth petered out recently. Whether the few fast growing African economies can sustain their speed in the future is questionable, not least due to a huge backlog in industrialisation and the fact that commodity prices will not rise forever.

In the rough picture that we have painted, we have neglected income distribution, among many other indicators. The high level of income and wealth inequality in Latin America has been somewhat reduced in the 2000s, whereas it strongly increased in many Asian countries, particularly in China, as well as in sub-Saharan Africa, facing commodity windfall profits; however, Asia comes from a much lower level of inequality than in Latin America whereas sub-Saharan Africa could reduce inequality until 1990 clearly below Latin America's level, apart from South Africa and Namibia (see UNCTAD 2012, 51; data apply for unweighted averages in personal income distribution).

5. Conclusions

While few governments or policy-making elites have clear explicit development strategies, many have explicit or tacit ideas on the proper economic rationale for their future development, often provided by various economic advisers within and outside the country. Our short review of the original "Washington Consensus" and even more so the neoliberal interpretation that followed has shown that these visions are far too narrow, neglect important points, especially active macroeconomic policies, have no sound theoretical base or are rooted in abstract neoclassical thinking that does not stand up to the challenges of reality. The successful developing countries de facto do not follow this line and rank relatively poorly on the "Fraser Economic Freedom Index". Similar applies to the "good governance" approach to development; even if the respective indicators were clear and unbiased, "good governance" cannot be achieved quickly (and could not be in the history of now developed countries); thus it is more a result of development rather than precondition. Moreover, many countries develop consummately in many aspects with low indicator values, even for corruption and rule of law. Nonetheless, the latter deserve strong ethical and distributional appreciation.

Regarding the old debates on inward or outward development, export orientation and import substitution do not show a black and white divide in either theory or reality; rather, countries have implemented both. Indeed, it is the prudence of the mix that counts for growth and development. Export promotion in the often-propelled sense of export-led growth, with preferences for exporters regardless *what* is exported, is neither in line with the experience of advanced countries that seek systematically new comparative economic advantages, nor with the reality of successful emerging economies. At least for the larger developing countries, a thorough export orientation requires a strong commitment to industrialisation, fully in line with the ideas of the pioneers of development economics. Almost all middle-income countries are nowadays more industrialised than high-income OECD countries; the latter have embarked more strongly on

high-value services as inputs to industrial exporters or increasingly to direct high-value service exports. Developmental strategies primarily focusing on agricultural and mineral commodities may flourish in times of commodity price hikes, but hardly in the long run, and they are at risk to infection by Dutch disease, which over-appreciates the currency and hampers net exports of goods that are not subject to price booms. Hence, industrial policies are required to promote non-traditional exports and prudent import substitutions; moreover, a focus on few sectors is unavoidable for small economies, while macroeconomic policies are largely less efficiently applicable.

The orthodox development strategies neglect macroeconomic policies, as they narrow the latter to the goal of achieving price stability, mainly with tight monetary and fiscal policy. Instead, money, interest and exchange rates are not neutral for the growth of output and employment, neither in the short nor the long run. Strong dynamics of domestic aggregate demand matters and can be fired by growth-enhancing macroeconomic policies, not only for short-term stimulus to overcome recessions. Macroeconomic policies comprise a package of seven policies that can be blended according to the conditions and constraints in specific countries. This not only requires respective policies, but also focused institution building, for instance, for the management of the balance of payments, exchange rate management, wage bargaining or income redistribution, aside from establishing a central bank committed to more than price stability and capable of cooperating with other institutions. In this sense, "good governance" means a "developmental state" – active state interventions which support and correct markets, especially with respect to macroeconomic policies, industrial policy, provision of public goods and distribution of income. "Good governance" and respective institution building would be limited in scope and effectiveness if not matched by new multilateral rules, in particular in the field of global monetary reform.

The brief overview of basic macroeconomic performance indicators shows a distinct competitive advantage for East and South Asian countries, led by the giant economies of China and India. They strongly liberalised their economies in select areas in the past decades, but in a gradualist approach and in key aspects, they refrained from taking the full-fledged free-market-road of strong macroeconomic policies, maintaining capital inflow and outflow controls to some extent, as well as the usage of some kind of industrial policies. Financial sector development is a backbone for both economies, much more so in China compared to India, with the former having maintained state-ownership in commercial banking and a number of important sectors.

In sub-Saharan Africa and many Latin American economies, a higher degree of liberalising goods, labour and financial markets has taken place, with little success in the 1980s and 1990s but growth acceleration in the 2000s, partly caused by commodity price booms that reversed the trend of terms of trade. In Africa, the hesitation to embark on industrialisation beyond mining continues, while in Latin America deindustrialisation has occurred since the early 1980s regarding manufacturing. The challenge of finding a development pattern with continuous growth, resilience to inflation and financial crises and growth enabling macroeconomic conditions, especially pertaining to competitive exchange rates and low real interest rates, is still awaiting a sound policy response.

The lessons that can be learnt from emerging Asian countries have not found a full echo in Latin America, let alone Africa. If both China and India as well as their neighbours embarked on full liberalisation, they would most likely jeopardise the factors that have led them to where they are now. In particular, the Indian sub-continent seems to have reached a critical juncture. Countries with relatively poor performance (relative to GDP per capita growth of OECD countries) over a longer

period, among large nations especially Brazil, the Russian Federation, South Africa and Mexico, need special consideration – they suffer often from severe and long-standing flaws in their macroeconomic setting, let alone other problems. Brazil faces since long far too high interest rates and too often an over-valued exchange rate that hinder industrial diversification and investment. Russia is severely infected by Dutch disease, seemingly incapable to cope with it. South Africa suffers from a neoliberal macroeconomic regime adopted in the early 1990s, especially regarding the flexible exchange rate regime, capital account liberalisation, inflation targeting and decentralised wage bargaining. Mexico's low growth trend has more complex causes. Here is not the place to delve into these countries' specificities.

Our tour d'horizon on development strategies has left out three increasingly important aspects that lie beyond this analysis, namely: the rising inequality of income and wealth, as well as the difficulties in reducing inequalities once they have reached high levels; environmental issues; and the necessity of more global governance in the face of rapidly increasing globalisation of trade, finance, labour and pollution. Limited global governance makes developing countries very vulnerable to negative external shocks. They would be forced to limit their exposure to global markets when their policy space shrinks to an extent that render governments impotent in coping with the ensuing problems, while emerging democracies would be impeded.

Notes

1 According to the WDI, for the 1960-2012 period, Argentina reached a peak –in terms of value added of manufacturing as a share of GDP - of 41 per cent in 1966, compared to 21.7 per cent in 2012. Brazil reached 34.0 per cent in 1982 compared to 13.3per cent in 2012. Mexico reached 28.8 per cent in 1987, compared to 18.3 per cent in 2012. Chile reached 29.9 per cent in 1974, compared to 14.1 per cent in 2012. India reached 17.3 per cent in 1979 and stood at 13.5 per cent in 2012.

2 These and the following scatter charts must not be over-interpreted. They do not pretend to show a causal relationship. What is true for the whole dataset may not be true for each individual country. What can be definitely be deduced is that a high FEFI-score is not a necessary precondition for growth in all countries and cannot, in general and across countries, promote growth, neither a low score. More elaborate analyses could use multivariate regressions or panel data analysis. These techniques involve their own problems of interpretation, especially when many independent variables are involved.

3 Unfortunately, lending rates in the IMF database are not uniformly defined across countries. Thus data have to be interpreted with caution.

4 A similar approach regarding developed countries is used by Herr & Kazandziska (2011).

5 This notion could be questioned: lower prices of non-tradable goods and services imply lower income for their producers, regarding the purchase of tradables. These households often have to live, mostly partially, in subsistence.

6 Counted in current dollars, Latin America ranks first with $9,617, with Chile as the top runner, East Asia ranks second with $5,690, followed by sub-Saharan Africa with $1,701 and South Asia bringing up the rear with only $1,409, and the 49 least developed countries at $863.All the data refer to 2013 (WDI, 2014).

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