Wealth, Power and the Development Agenda

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Introduction

In The Affluent Society, John Kenneth Galbraith argues that a wealthy economy will choose to sacrifice efficiency in favor of stability; it will thus maintain a stake in an industry where it is not competitive to avoid disruptions to incomes, employment, and production. The economy can afford the, "luxury of the inefficiencies [produced by distortionary policies]" because of the size of domestic demand and wealth of its people[1] (Stiglitz 2000). However, small developing economies, "cannot afford such economic distortions;" rather, "market oriented policies, including outward-oriented policies, provide the best hope for sustained growth" (Stiglitz 2000). Hence, a dichotomy exists, with the West trying to maintain stability by sacrificing global efficiency, and the third world trying to achieve any level of wealth above subsistence through free market efficiency.

It is in response to this dichotomy that the extreme imbalance of wealth and power in the global society exists and is sustained. Structured by the West, international law and governance fail to provide "good institutions," as defined by Acemoglu et al. (2005) as "ones providing secure property rights for a broad section of society." As a result, the majority of the world is disenfranchised. I hypothesize that the West will fail to commit to any action to alleviate the plight of third world poverty as a result.

I will first provide a brief survey of the current literature regarding this issue then offer a model illustrating the West's inability to commit to free or fair trade. Finally, I will conclude with considerations for future research in this area.

Literature Survey

Two Principles for the Next Round or, How to Bring Developing Countries inFrom the Cold, By Joseph E. Stiglitz (2000)

This paper was written following the failed[2] November 1999 World Trade Organization (WTO) Ministerial meeting in Seattle, in anticipation of the next WTO Round. The author begins by noting the widening gap between the rich and poor economies of the world and the shift of traditional development policies into "trade, not aid" policies. He is quick to point out that as, "developing countries take steps to open their economies and expand their exports, in too many sectors they find themselves confronting significant trade barriers… leaving them, in effect, with neither trade nor aid."

To remedy the obvious imbalances of the current trade institutions, the author proposes adherence to the principles of fairness (specifically to developing countries) and comprehensiveness (i.e. the inclusion of issues important to developing countries). Be it in principle or in practice, these principles are conspicuously absent in current trade negotiations. As evidence of this he cites the extreme tariffication of agriculture (where developing countries hold a comparative advantage) despite the resulting reduction in global welfare, flagrant abuse of anti-dumping laws and other non-tariff barriers (NTBs), and exclusion of developing countries from

[1] And the social safety nets associated with this wealth

[2] The author's term

negotiations (fifteen Sub-Saharan African WTO members have no representative in Geneva[3]). He emphasizes that the poor must be able to exploit their areas of comparative advantage if they are to pull themselves out of poverty.

He praises the free-trade, competitive model as a harbinger for sustained growth but does not offer it as a panacea for the third world. Certain attention to the unique challenges faced by developing nations must be paid; namely, the higher costs and urgent human need issues of liberalizing in the third world as well as their long term growth aspirations. In addition, trade must be complemented by development aid if its benefits are to expand beyond urban centers into, "the more isolated communities within a country."

Institutional Development in Developing Countries in a Historical Perspective Lesson from Developed Countries in Earlier Times, By Ha-Joon Chang (2001)

This author juxtaposes the institutional evolution of now developed countries (NDCs) during the 19th and 20th centuries and the current institutional state of developing countries. For example, he charts the development of democracy in the NDCs, where universal suffrage was not achieved until 1907 at the earliest (New Zealand) and 1977 at the latest (Spain). He notes that the process of democratization took decades or even as much a century between its initial conception and the final stage of universal suffrage, with many reversals throughout. He pursues a similar strategy in examining a number of other institutions deemed essential to "good governance."

From this exercise he concludes that today's developing countries are institutionally more advanced than NDCs were at similar stages of development and despite this deficiency the NDCs grew faster during these stages of development. In addition, he points out that today's "global standard" institutions were developed by the NDCs through a long process over decades and centuries, that included many reversions back into poor institutions. Based on his conclusions he criticizes the "good governance" agenda of western development policies. He calls for its proponents to gain awareness of the cost and time requirements of institutional reforms and to exercise humility in prescribing western specific institutions to developing nations, especially ones they cannot afford and are not a strict necessity for development.

Deconstructing Development, By Ruth E. Gordon and Jon H. Sylvester

This paper takes a critical look at the concept of development and the paradigm that defines it. The authors trace the evolution of development from its origins in the 1950s to its current state today, noting that, "even when measured in terms of its own stated goals and objectives, development has, for the most part, failed." They criticize development as a western construct that, "presumes a universal and superior way of ordering society… [and] justifies and supports the economic and political status quo and the imbalance of international power, and it renders the underdeveloped powerless." The authors are particularly disturbed by the ability of international institutions to determine policy of third world countries[4].

They set out not to glorify the third world's traditions and experiences but to give agency to the third world and to encourage the abdication the West's power over defining social progress and its ultimate goals. They encourage placing western aid in a

[3] As quoted by Stiglitz,(2000) from Blackhurst, Lyakurwa, and Oyejide (1999)

[4] They liken this ability to the colonizers of the past

cooperative role rather than the co-dependant role of developed versus developing.

I have identified three general conclusions related to western dominance and problems with the development agenda. First, the fundamental concept of development in its present state is biased towards the values and culture of the developed western nations. In its dominate position, the West accords itself the power to define the rules and objectives of the game and, of course, these rules serve to propagate its own wealth and stability at the expense of the rest of the world.

Second, as a corollary to my first point, greater sensitivity must be paid to the third world in the implementation of any development policies. This includes giving consideration to time constraints, costs, and the specifics of how development is defined. True "development" can only be achieved with a greater understanding of poor nations and genuinely interdependent relationships.

Finally, exhortations of the West to the poor world and their manifestations in international law and governance are mere platitudes outside the borders of western nations. The clear imbalance of power, abuse of anti-dumping rules[5] and other NTBs, ignorance of third-world issues, outright exclusion of the third world from trade negotiations and so on, create distortions and prejudices that run in clear contradiction with the values of capitalist and democratic societies.

The Model

The model considers two economies, A and B. Both are assumed to adhere to free market domestic policies and have similar populations.

Utility

Both economies derive utility from immediate stability and income. Stability is an increasing function of: protectionist policies, x_i, where $x_i \in [0,1]$ and $x_i=1$ implies total domestic protection; gains from trade net of protection distortions, $(1- x_j)t_i$, where t_i is gains from trade and x_j is foreign protectionism; and domestic per capita income less the domestic cost of total protection per capita (i.e. cost when $x_i=1$), $y_i - c_i$. I will model stability as a Cobb-Douglas function. Income is domestic per capita income, less the per capita domestic cost of protectionist policies, plus gains from trade net of protection distortions, $(y_i-c_i) + (1-x_j)t_i$. Therefore, both economies face the following instantaneous utility function: $u_i = (y_i - c_i)*x_i^a*((1-x_j)t_i)^{(1-a)} + (y_i-c_i) + (1-x_j)t_i$ (1) where $a \in [0,1]$ and represents the (perceived) importance of protectionist policies in maintaining stability. The parameter a is assumed to be equal across economies and both a and t are assumed to be greater than zero. Gains from trade are produced from an industry in which the economy has a comparative advantage.

Global Utility

I will model global utility as a Leontief function of income per capita of the two economies: $U_G = \min \{(y_A - c_A) + (1-x_B)t_A, (y_B - c_B) + (1-x_A)t_B\}$ (2)

I feel this is an appropriate specification of global utility for this model, since, with only two players, an increase in income for just the dominant economy cannot be considered an improvement of the global condition.

U_G is not considered in the utility maximization problems of either economy, but is a by-product of their choices. Therefore, the stability of either country plays no role in global utility and so it is maximized by setting $x_A=x_B=0$.

[5] See Dulleck (2005) for a game theoretic illustration of incumbent firm bias in GATT anti-dumping rules

Cost of Total Domestic Protection

The cost of total domestic protection, *c*, is the general per capita costs of maintaining inefficient trade policies, including the per capita costs of building and maintaining the institutions required for protectionist policies, and the loss of future trade gains from retaliatory protectionism. Therefore, *c* is an increasing function of future trade possibilities and its size will depend in part on the foreign economy. I will assume that *c* is always greater than zero.

Stability

The specification of stability emphasizes two ways to increase stability, one by increasing the current level of income in the economy through trade, and one by protecting the current level of income in the economy through trade restrictions. Trade is therefore viewed as an element of risk. An economy that is particularly xenophobic will have *a* close to one and perceive protectionist policies as the most important way to enhance stability or, equivalently, prefer to maintain the status quo rather than risk sacrificing stability through trade.

The Game

The decision maker in each economy is the governing body of that economy and cannot choose levels of y_i or t_i but can only set the level of x_i to maximize her utility[6]. I will consider the first period in a game with *N* trading periods where players choose to either commit to free trade ($x_A=x_B=0$) or not. Economies can retaliate to current protectionism by withholding future trade therefore *c* is an increasing function of *N*. In this way, N can be regarded as the size or importance future rewards.

Observation 1: if $y_i-c_i\leq 0$, then $x_i=0$, since x_i only enters (1) non-positively.

Observation 2: if $y_i-c_i>0$, then $x_i=1$, since x_i only enters (1) positively.

Proposition 1: if $y_A=y_B$, then, as *N* goes to infinity, $x_A=x_B=0$.

Proof: as N increases, potential gains from trade increase. This will increase c until $y_A-c_A=0$ and $y_B-c_B=0$. Therefore, by Observation 1, $x_A=x_B=0$.

Proposition 2: If $y_A>y_B$, then $x_A=1$ and $x_B=0$ as N goes to infinity.

Proof: As N increases, potential gains from trade increase. This will increase c_A and c_B until $y_B-c_B=0<y_A-c_A$. Therefore, by Observation 1, $x_B=0$ and by observation 2 $x_A=1$

Interpretation of Results

To maximize global utility between equal economies, proposition 1 states that one must maximize today's importance of future rewards[7]. However, proposition 2 tells us that no amount of potential future reward will be enough to maximize global utility if the two economies are unequal. Therefore, in order to maximize global utility, one must equalize the distribution of resources in *addition* to maximizing the importance of future rewards.

The dominate economy is able to fully restrict trade where it has no comparative advantage, while it fully exploits trade where it does have a comparative advantage. The dominated economy of course can do neither; it loses domestic production where it has no advantage and is restricted from gaining where it does have an advantage.

It is clear that when an economy is the least bit concerned by the risks to immediate domestic stability posed by trade, it will be unable to commit to free trade and the enhancement global utility unless it is trading with an equal or dominant partner. In addition, any aid package that will maximize global utility must redistribute incomes so that they are equal. Put differently, there is no economic

[6] Since both are capitalist

[7] Hence the role of institutions to tie future rewards to current actions (i.e. mitigate the fundamental problem of exchange, as specified in Grief, 2000)

incentive for a dominant economy to commit to maximizing global utility.

Contribution to Current Research

This model emphasizes the underlying cause of the development failures of the past 50 years as an imbalance of power and wealth, stemming from rich nations trying to protect their dominance. It states that any attempt at development will be compromised by the rich world's preference for stability and ability to dictate the terms of trade. While the current literature focuses on adjusting development policies or international law, I have emphasized that these adjustments will be fruitless, barring either a redistribution of wealth, or the introduction of a non-economic commitment mechanism for rich countries.

Data Considerations

To advance this research agenda, I would need more data on the interaction of stability, protection, and income in order to test my specification of utility and to improve its accuracy. In addition, I would need to further research levels and elements of protectionism to support (or refute) my assumptions and the model's implications. However, since this model is demonstrative rather than predictive or descriptive, it would be most prudent to research its implications for the solution to global poverty.

Further Areas of Consideration

A complete redistribution of wealth from the rich world to the poor world is clearly an unrealistic solution to poverty, but is there any sensible alternative? Wealth redistribution need not be total if international institutions can rebalance power equitably and somehow bind the richer nations to commit to free and fair trade in the absence of economic incentives[8]. But is a drastic *power* redistribution anymore realistic than a drastic *wealth* distribution? Either solution would require poor nations to solve their collective agency problem, but many struggle simply to feed, shelter, and protect themselves. Also, power is typically viewed as inseparable from wealth, specifically on a global scale; rich nations will be unlikely to willingly sacrifice power today if they believe it means sacrificing their wealth tomorrow.

Conclusion

Through this model, I do not wish to negate the value of development efforts or to advocate strict economy equality. Rather, I wish to illustrate that a dominate economy will never commit to improving global conditions in the absence of a legitimate commitment mechanism. While the West continues to advise and intervene in third-world policy and development, ultimately the West's own inability to commit[9] that will undermine these efforts, and worse, will breed apathy and distrust towards the free-market model. The present-day development agenda will continue to fail if this issue of the balance of wealth and power is not addressed.

[8] Such as a modern-day, global-scale "constitutional monarchy" where rich nations are bound to share their power

[9] To either sufficient aid or free trade

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