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DEVELOPMENT POLICY AND PRACTICE

THE OPEN UNIVERSITY

THEORIES OF FINANCE AND THE THIRD WORLD

by

Laurence Harris

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The central economic problem faced by the Third World is how to raise the standard of living, people's income, wealth and welfare by significant amounts. At a minimum this is necessary for both socialist and capitalist countries, in order to overcome mass poverty, hunger and disease, but the more ambitious objective of attempting to reach or surpass the living standards of the advanced industrial countries is implicitly on the agenda for many. These questions have received ever-increasing attention in the last four decades. They were given their impetus by the break up of the British Empire and other European colonial systems,and the challenges that national liberation wars and socialist victories in the Third World posed to the old order The rise of new capitalist classes and new classes of industrial workers and farmers both in long independent countries (Latin America for example) and in newly industrialising former colonies (South East Asia for example) intensified the debates and conflicts over how to achieve growth. From one perspective, the increased prominence of these questions can be traced to the accelerated pace of the internationalisation of capital in the modern age, the changes in its character and the transformations, contradictions and conflicts which have accompanied it.

Finance has had a major part to play in that process, an importance which is symbolized by the fact that the two international agencies most embroiled with and dominating development issues are now the International Monetary Fund and the World Bank which are, at root, financial institutions. Nevertheless, for many years the literature of 'development economics' contained relatively few analyses of the role of finance; despite its significance in reality, in academic circles it was a neglected area compared to studies of trade, labour and 'physical' planning. Since the mid 1970s that situation has changed and a substantial body of theoretical and empirical literature now exists on aspects of finance and the Third World. Much of it has been stimulated by the large research output of the International Monetary Fund, the World Bank and scholars associated with them, and it is firmly within either the Keynesian or the neo-classical framework of orthodox Western economies. This paper outlines these orthodox theories, critically evaluates them, and presents an alternative approach to finance and the Third World which is based on the Marxist paradigm debated by radical economists in advanced capitalist countries since 1970. An aim of the paper is to show that, although Marxist work on this subject is relatively rare it does constitute a valuable basis for the study of Finance and the Third World.

KEYNESIAN AND NEO-CLASSICAL PERSPECTIVES

The orthodox treatments of finance and development are formally organised around one central issue: how to increase the amount of capital employed in Third World countries' production. This does not refer to capital in the Marxist sense; the problem relates to capital as a factor of production complementing labour and other inputs, to 'physical capital' in the form of plant, machinery and inventories or, in other words, to categories with similarities to (but different from) Marx's 'constant capital'. Moreover, by concentrating on capital in this physical sense rather than as a concept tied up with property relations and control of production, the central issue of orthodox writings is not automatically concerned with whether the increase in the amount of capital is foreign owned or national, although specific theories do have a variety of implications for that question.

An early contribution to this type of analysis was the 'two-gap model' developed in the early 1960s by Hollis Chenery and his collaborators (Chenery and Strout, 1966; Chenery and Bruno, 1962). It is a limited and simplified model formulated principally as a tool for development planners; for this reason it has been very influential in subsequent years and for a period was the foundation for much of the World Bank's development finance. The theory adopts the basic assumption of the Harrod-Domar growth model that there is a fixed relation between growth of output and growth of the capital stock, in other words, the incremental capital output ratio is constant. Similarly, aggregate saving within the economy is treated as a function of national income given by a constant average propensity to save. For the economy to grow at some target rate the required rate of growth of capital (that is, the required level of physical investment) will exceed the level of saving for many years if plausible assumptions about the size of the incremental capital output ratio and the propensity to save are made. There is, therefore, a 'savings gap' which has to be filled by foreign finance if Third World economies are to grow at rates commensurate with industrialization. At the same time, there is a 'foreign exchange gap' which arises because accelerated growth is directly connected to import expansion but is assumed not to generate commensurate exports in the relevant period, and foreign finance also serves to bridge this gap. In the classic formulation of the model, these two gaps are not identical in any one period and a definite sequence is postulated under which an economy's accelerated growth involves a savings gap which is first larger and then smaller than the foreign exchange gap (Fei and Ranis 1968); foreign finance equal to the larger of the two gaps is seen as essential to growth.

The original formulation of this theory treated foreign finance as aid or, implicitly, grants to the state from abroad. Subsequent academic literature within this framework reflected the relative decline of official development aid and the rise of loans and credit as sources of Third World finance in the 1970s; its theories of the dynamics of foreign finance in development incorporated the effects of interest payments and debt amortization on the contribution foreign finance can make to capital formation and were thereby able to relate the analysis to the debt crisis that had arisen by the 1980s (McDonald 1982). Within this class of models differences in the initial assumptions, concerning, for example, whether domestic saving is a function of Gross Domestic Product (GDP) or Gross National Product (GDP minus net foreign interest payments), yield significantly different conclusions on what level of foreign debt countries should incur and whether foreign finance is sustainable.

Even with that reformulation of the two-gap model in terms of foreign debt its role as a theory of *finance* in development is limited, for it does not incorporate any financial institutions in its system. A related aspect is that only one role is envisaged for interest rates, acting as a channel for savings out of the country, so that, following a Keynesian tradition, interest rates are not assumed to affect the capital output ratio or the average propensity to consume by influencing the decisions of savers and investors. Therefore, mechanisms which may link finance with the processes and decisions of production and trade are absent. Two seminal works by Ronald Mckinnon (1973) and Edward Shaw (1973) introduced a more neoclassical perspective which put the links between finance and those 'real' processes at the centre of the analysis and laid the basis for a great expansion of studies on the role of finance.

The McKinnon-Shaw approach is a theory of the role that banks, essentially indigenous national banking systems, play in enabling finance to be channelled from savers within the country to investment in profitable capital projects. Its essence is an assumption that people's saving will be higher at higher rates of interest and that, if interest rates are relatively high, enterprises only invest in highly profitable capital projects (capital with a high marginal productivity) and will therefore use relatively labour-intensive processes rather than over expand their mechanisation. High interest rates which result in increased saving and labour intensive production are seen as appropriate for Third World countries characterised by capital shortage. These authors also argue that high interest rates stimulate the growth of financial institutions (banks) which are necessary for development, since if the rate of interest banks pay to depositors is raised a greater proportion of (the increased) saving will be accumulated as bank deposits. As bank deposits grow banks are able to expand their loans to enterprises (in Shaw's model) or the depositors themselves find it easier to finance their own investment in fixed capital (according to McKinnon). In emphasising the role that banks can play in the process of development for today's Third World countries writers in the McKinnon-Shaw school draw parallels with the historical research of Rondo Cameron (Cameron 1972; Cameron, Crisp, Patrick and Tilly, 1967) which claims to have established the importance of banks' role in the industrialization of Europe. Support from present day experience is claimed on the basis of econometric estimates of the determinants of saving, the demand for money (including time deposits at banks) and of the relation between interest rate policy and growth in Third World countries (Fry, 1988).

Policies based on the McKinnon-Shaw theory promote high interest rates as one element in a package of financial liberalization which removes state ceilings from interest rates,abolishes the direction of credit and the allocation of foreign exchange by the state and introduces flexibility to the exchange rate (for example, in the form of a controlled 'crawling peg' devaluation). They have become increasingly prominent and frequent elements in the adjustment programs implemented by countries under the tutelage of the IMF and World Bank or promoted by the US aid agency, USAID. Some of the greatest controversy over these policies has concerned their application to the 'southern cone' countries of Latin America (especially Chile and Argentina) where their long-term development intentions have been combined with the use of high interest rates as a restrictive monetary policy for short-term correction of balance of payments deficits and inflation (Diaz-Alejandro 1985, Foxley, 1983).

Both the two-gap model and the neoclassical model of McKinnon and Shaw place finance in the context of an economy with marked structural rigidities and constraints. In its original formulation the former considers the effect of a structural shortage of managerial and technical skill on the rate of investment and, hence, on financial requirements (Chenery and Strout, 1966); however this is not an integral or essential feature of that model. For McKinnon, by contrast, the structural feature of Third World economies that he calls 'fragmentation' is central to his analysis. Fragmentation means an absence of integrated markets so that exchange of commodities, labour power and finance on a national basis and internationally, which enables price differences to be reduced by arbitrage, is precluded in favour of local and separated markets. The power McKinnon attributes to high interest rates and financial liberalization is based on the view that they overcome fragmentation in the financial market by channelling savings into a nationally integrated banking system and that the mobility of financial capital that results gives a strong impetus to overcoming fragmentation in other markets.

In contrast to the belief that financial policy can sweep away structural constraints the structuralist school of economists that originated in Latin America in the 1950s and 1960s argue that the persistence of structural constraints limits the effectiveness of orthodox financial policies and makes them more likely to cause 'stagflation' - slow growth, high unemployment and inflation - than to generate accelerated development. In its modern formulation, synthesized by Lance Taylor (1983), structuralism is essentially a short-run macroeconomic model rather than analysis of growth processes. In it the operation of policies affecting aggregate demand is shaped by persistent structural features, two of which are particularly relevant to financial policy The first is the assumption that banks are not the only nationally integrated financial network and are, in fact, less efficient and more costly than the informal or 'curb' financial markets that exist in Latin America, South East Asia and elsewhere (van Wijnbergen, 1985). The second is the assumption that because of the structural disarticulation of Third World economies, enterprises require a high level of finance for 'working capital' (that is, the inventories, advances of wages and advances of other costs necessary for the production process) so that the costs of working capital influence enterprises' selling prices which are set on the basis of variable costs plus a percentage 'mark-up' (Cavallo, 1977). The existence of informal financial markets implies that high bank interest rates may generate an expansion of bank deposits and loans only by drawing funds away to banks from the informal market so that there is no net increase in the availability or integration of finance and there may, in fact, be a decrease. The existence of working-capital costs' connection to the prices of finished commodities implies that increases in the interest rate which firms pay for working capital can generate inflation by causing them to raise the prices of their products.

Evaluation

Those analyses of Third World finance within the orthodox traditions of Keynesian and neo-classical economics have considerable power but substantial limitations.

One weakness is that they are not able to engage fully with the dynamic processes of economic and social change that affect all Third World countries. Even many sub-Saharan African countries whose development appears blocked and stagnant in the 1980s are going through major social changes, and countries which have experienced growth, whether in Asia or Latin America, have gone through major social upheavals in the process. The orthodox theories do make an attempt to recognise the significance of these dynamic leaps, unlike most orthodox models of advanced capitalist economies, but it is necessarily a limited attempt. The two-gap model, instead of assuming that growth is a smooth linear process, sometimes employs an assumption that it requires an initial 'big-push' or acceleration analogous to that postulated by the economic historian Walt Rostow (1960) as a precondition for 'take-off' to sustained growth. But the dynamics of that push are not analysed apart from the fact that it requires foreign finance and is limited by availability of skills. Therefore the interaction between finance and the processes of change such as changes in the labour process, the shift from agriculture to industry, the changing class structure, and changes in the legal, political and cultural framework are not explored.

The neo-classical models especially McKinnon's are more directly concerned with the connection between finance and the transformation of economic relations, but, again, they have only a limited analysis. Production is seen as being in the hands of entrepreneurial households which do not change in the process of economic growth except insofar as they choose to use greater or lesser proportions of physical capital. The only change that is considered systematically is the construction of efficient markets (particularly the market for credit) for economic change is seen as deriving from changes in exchange relations rather than production. In a different context Robert Brenner (1977) has contrasted the view that exchange relations determine economic change, a view deriving from Adam Smith, with the Marxian view that production relations are more fundamental. In the case of McKinnon and Shaw's followers, the limitation is worsened by the fact that the manner in which changes in market relations affect other economic relations are not explored in detail.

A second problem with these orthodox analyses is that they are not able to consider international finance in its own right as an influence on the third world. This limitation arises because the national boundary is the focus of orthodox economics which, in effect, conducts its analysis on a country by country, one by one approach. These writers are, therefore, only able to analyse international finance from the point of view of how internal developments within an individual country affect its own international trade, foreign exchange reserves and foreign debt,and are mediated by the interaction between these quantities and the exchange rate and money supply. They do not generally integrate their analysis of Third World economies with a conception of international banking and finance as a multinational system with its own dynamic which impacts upon those economies. One aspect of this weakness is evident in the two-gap models of a country's foreign debt, for these are usually treated as debt 'requirements' without any attention being paid to the international banks' willingness or reluctance to supply finance, an omission that became more obviously serious in the 1970s when multinational banks, with a dynamic of their own organised around expanding Euro-currency markets, took the initiative in pushing credit onto Third World states.

Finally, the orthodox approach has a limited perspective on the state's role in finance. Public finance, taxation and state spending,is seen only from a negative perspective. Emphasis is placedon the idea that public sector deficits can deprive private enterprises of finance needed for investment and can worsen the country's balance of payments while state regulation of banking (often induced by a desire to lower the interest cost of financing the state deficit) causes distortions and the fragmentation of financial markets. The underlying assumption is that free (private sector) markets are beneficial while state deficits and regulation prevent their potential from materializing, and this is the general basis of the liberalization policy proposed by neoclassical writers. Its faultiness on the undesirability of state regulation of finance is suggested by the fact that such writers argue that South Korea's financial reforms of 1965 were a liberalisation which led to rapid industrialization and growth, but they fail to recognise that, instead of producing free financial markets, the reforms involved a new system of state control of finance under which the state took responsibility for directing finance toward export-oriented industrialization and capital investment in economic infrastructure (Harris, 1988c). And, on the question of whether budget deficits harm growth, it is histroically the case that in many countries state borrowing has been the foundation for vigorous capital markets and private investment instead of restricting it. Moreover, public sector deficits may finance productive investment by the state itself.

MARXIST ANALYSES

Marxist economic theory has been vigorously debated within a section of the economics profession in Western Europe, the USA and Japan in the past two decades. Its main concerns have been the theory of value, crisis theory, the labour process and class srtructure in capitalist accumulation (Fine and Harris, 1979;Foley,1986;Lipietz,1987). In the context of the economics of the Third World, the main disputes and advances have been in the theory of imperialism and the analysis of class formation in the transformation of modes of production. Western Marxism has had little to say directly on the role of finance in the Third World and has certainly produced nothing to compare with the writings of Preobrazhensky (1926) on the role of money and finance in a poor country's socialist development. Nevertheless, the principles applied by Western Marxists to other economic problems can yield a distinctively Marxist theory of the role of finance in the Third World. It incorporates but goes beyond traditional Marxist concepts such as imperialism, original (primitive) accumulation and finance capital and it does not share the limitations of the orthodox theories I have summarized above. Let me organize the presentation of this Marxist theory under the same three heads as the evaluation I presented of orthodox theories: finance and the transformation of economic relations; the role of international finance and the relation between finance and the state.

Finance and the Transformation of Economic Relations

The pre-requisite for sustained growth in any country is a far-reaching transformation of economic relations in production and associated changes in the economy's trading and commercial system. The system of money, credit and public finance contribute significantly to these changes, either promoting or retarding them.

From a Marxist perspective the most studied transformation of this type is the birth of capitalism in Britain which involved a historical transition from one mode of production to another;. and other well studied transitions to a new, capitalist mode of production include the Japanese in the late nineteenth century. The role of finance in such cases of the transition to a capitalist mode of production is partly captured by Marx's concept of primitive accumulation (or original accumulation). For Marx this meant the destruction of the producers' and exploiting classes' pre-capitalist rights to the possession and control of land, means of production and the conditions of labour itself. In Britain the dispossession of the peasantry created a class of 'free' labourers with no property except their own labour-power and it simultaneously transformed land into capital concentrated into the hands of a new exploiting class; in other words, it created the twin conditions for capitalism, capital and the material of a proletariat. This mechanism, the land 'enclosures', was complemented by financial (and other) developments further promoting the accumulation of capital which could be turned into productive capital as the new mode of production became established. Usury was one and colonial plunder by merchants, backed by the financial devices of the City of London, was another. In the case of Japan, the original accumulation that helped to found the capitalist mode of production depended to a large extent on another financial mechanism to build concentrations of resources as capital; the land tax of the Meiji regime was a powerful engine which transferred resources from the countryside toward the state and urban classes able to initiate capitalist industrialization

However, the role of finance in British or Japanese original accumulation cannot be applied directly to today's Third World economies, for their position is quite different from those two countries'.The major difference is that the capitalist industrialization of poor countries today has to take place in the context of a world market created and dominated by already advanced capitalist countries. By contrast, capitalism in Britain was the early foundation for the modern world market rather than struggling for a place within it and Japan's transformation took place behind barriers which insulated it. Some writers, particularly Chih-Ming Ka and Mark Selden (1986), argue that, nevertheless, the concept of original accumulation is relevant to today's 'late industrializing' countries and that financial mechanisms play an important role within it. Those authors use the concept fruitfully to analyse the state-led capitalist industrialization of Taiwan in its early stages during the 1950s (and socialist industrialization in China during the 1953-1957 five year plan). They argue that Taiwanese original accumulation involved the state appropriating the agricultural surplus (in kind) and using it to finance the development of industrial capital in import-substitution industries initially. The two main mechanisms for this were the land tax and the state's system of bartering fertilizer for rice at rates of exchange which were unfavourable to the peasant. That system was a form of taxation which enabled the state both to profit from its exports of rice and imports of fertilizer and to accumulate foreign exchange from this trade in order to finance industry. Nevertheless, a Marxist approach to the development of capitalism in today's Newly Industrializing Countries should place it in the context of the existing capitalist world market in commodities and financial capital (as we do below) so that the concept of original accumulation cannot be applied without some amendment.

Another limitation of the concept of primitive acumulation for analysing the transition to new modes of production in today's Third World is that the development of capitalism is not the only path forward for poor countries today; for some states development on the basis of socialist relations of production is possible while, in many, 'intermediate' systems are sustainable. But, although the concept of primitive accumulation was formulated with respect to capitalist development, in the early years of the Soviet Union Preobrazhensky (1926) developed a concept of 'original socialist accumulation' from it. For him the problem of the transition to socialism was how to appropriate resources from the private, petty commodity, agricultural sector for accumulation in the state controlled, socialist, industrial sector, and he analysed the financial mechanisms that would effect this. Apart from taxation of private producers, Preobrazhensky particularly emphasised the significance of state pricing policies which act as an 'invisible' but easily effective tax on private agriculture through manipulation of the terms of trade between agriculture and industry, and he argues that socialist accumulation can also be financed through the creation of money.

However, financing a transition to a socialist development path by expanding the money supply carries dangers which arise from the complex role money and finance have in mixed economies. This is illustrated by two countries which attempted development along a socialist path while retaining a large private sector: Chile under its Popular Unity government of 1970 to 1973, and Mozambique under Frelimo since 1975. Each pursued financial policies which raised the question of whether inappropriate policies toward money and finance may actively destabilize the transition to socialism and ultimately prevent it.

In a seminal book, Griffith Jones (1981) argued that the Popular Unity government's socialist experiment failed partly because it did not take into account the active role money plays in an economy which is not completely centrally planned. In her view the strategy involved 'financial disequilibrium' which focussed on the state's budget deficit and at times were associated with transfers of income to state employees and private capitalists (rather than to accumulation). They led to an excessive growth of the money supply to finance the deficits and to other factors which eventually led to a high rate of inflation. High inflation, in turn, destabilized the role of money by reducing its usefulness as a unit of account and store of value, and the way that different groups experienced gains and losses in this process helped to undermine the political stability needed to carry through a transformation. Wuyts (1986) examined the financial policies of Frelimo and concluded, similarly, that state deficit financing and monetary expansion plays an active role in a society attempting to follow a socialist path. In the difficult circumstances of transition, that role may at times be positive (for example, subsidies may be necessary at crucial times to prevent a complete collapse of production) but will also have a strong ability to undermine the government's strategy. To show how the latter occurred in Mozambique he follows a Marxist approach of examining how relations of prodution were affected by excess liquidity. He demonstrates that the excess money stimulated the growth of parallel markets (black markets) in commodities, and, most significantly, enabled entrepreneurs to accumulate the money as capital and employ it actively as capitalists on these markets. Excess money creation by the state facilitated the growth of capitalist trading and production for the parallel markets, changing the class structure and ultimately undermining the attempt to develop socialism. These examples illustrate the complexity of the role that money and finance can play in original socialist accumulation; their powerful effects can work to destabilise the attempt at socialist development.

Finally, the concept of original accumulation cannot be applied to all cases of financing the transformation of economic relations, for in many countries that transformation is less radical than abolishing an old mode of production and constructing a dominant new one. Developing economies are often characterised by a mixture of capitalist and 'traditional' economic relations, regulation by a state which partly preserves and partly breaks up old relations, and overall domination by the global capitalist markets in commodities and finance. Under these circumstances, accumulation and development can occur as a result of some significant changes in particular relations even without any that could be called a change in the dominant mode of production. The notion of original accumulation relates to the inauguration of a new mode; it is concerned with rapid accumulation by means which are not sustainable or normal features of the new mode of production once it is established. Therefore it cannot be applied directly to this type of case. Nevertheless, even in such countries accelerated growth and the partial transformation of the economy require accumulation on a greater scale than previously, and there is no sharp dividing line in practice between the mechanisms used to finance it and those which have been used to finance the more fundamental transformations inaugurating a new mode of production.

An interesting example of the financing problems thrown up by such partial transformations is the changing character of 'working capital'. In capitalist accounting this category refers to the finance required for the inventories held by the firm and the trade credit advanced by it to initiate and realise a complete circuit of production. In the classical economics of David Ricardo it consists of the inventories and wages the capitalist has to advance in order to carry through the production circuit and therefore, in Marxist terms, includes variable capital and part of constant capital. Modern orthodox economists, using the accounting concept, have sometimes argued that industrialization and rural transformation lead to a reduction in the economy's need for working capital since the average level of inventories are reduced by the diminution of agriculture's relative position in the economy (Kindleberger, 1958, p.38). By contrast, Marxist theory implies that such a tendency would be counteracted by changing economic relations within agriculture. As agriculture moves from being based on the household labour of peasant farmers toward a more capitalistic system based on wage labour, it requires increased working capital in the clasical economic sense since it has to finance the advance of wages before the completion and realisation of production. On this basis Amartya Sen (1964) developed an interesting critique of the financing projections of India's Third Five Year Plan.

In addition to the role finance plays in the transition to a new mode of production and in partial transformations of economic relations, it also has a role in maintaining and consolidating 'backward' economic relations. Changes in class structure or preservation of class positions are at the heart of such transformation or stagnation, and finance is both an 'effect' of the class structure and an instrument causing its transformation or preservation. Amit Bhaduri (1977) applies these considerations very fruitfully in his classic analysis of a problem long recognised as a key problem of finance in the Third World, explaining the existence of usurious interest rates charged by rural moneylenders on loans to peasants.

Previous writers, within a neoclassical orthodox framework, had emphasised the idea that such interest rates are high because the moneylenders require a premium to compensate them for the risk of default inherent in loans to peasants. Bhaduri's formal analysis, by contrast, recognises the asymmetry in the relationship which results from the different class positions of the moneylender and the peasant borrower. This class relation is encapsulated in one of its effects, the unequal valuation of commodities required as collateral, and the moneylenders' ability to exploit this asymmetry through monopoly power and personal relations. High interest rates are based on these class relations in a way which reinforces and reproduces them. The unequal valuation of collateral, moneylenders' monopoly power and personal relations with the peasants creates conditions under which the moneylenders are not faced with an exogenously determined default risk but, instead, have the power to influence the default rate by setting the interest rate. An incentive can exist to set high interest rates in order to provoke high defaults because this form of exploitation enables the moneylenders to appropriate the land, crops or labour-power pledged as collateral. In that way, high interest rates are the basis for accumulation by the landowning, merchant or rich peasant class that acts as moneylenders and is a mechanism for consolidating the dominance of those exploiting classes within a stagnant system of backward agriculture.

The Role of International Finance.

Marxist writings on the Third World give a key role to international finance which is very different from the orthodox conception of it. The roots of this tradition lie in the writings of Rudolf Hilferding (1910), Lenin (1916), and Nikolai Bukharin (1917-18), where a particular concept of imperialism was developed.

Despite the differences among those writers their writings constituted a 'Leninist' conception of imperialism as a new stage of capitalism. This stage was seen as characterised by a 'merger' of financial capital with industrial capital in giant trusts or monopolies; the unification of these two types of capital created a new form, 'finance-capital'. Finance-capital intensified the international expansion of capital from its metropolitan centres in Europe (and the United States) into the Third World, and it gave it a new character, for the capital exported at this stage was seen as dominated by capital in the financial form of bonds, loans and other financial investments. This type of capital export at this stage of capitalism constituted capitalist 'imperialism', which implied an essentially parasitic relation between international capital and the Third World. Supported by colonial apparatuses, it enabled finance capital in the metropolitan countries to draw super-profits from poor countries.

Modern Marxist writings have followed two different lines regarding the implications of such imperialist relations for Third World countries themselves. The most prevalent view has been that capitalist foreign investment in Third World countries is exploitative in a way which retards their growth. A strong expression of this is located within the writings of the 'dependency school' where Third World countries' foreign debt is seen as a mechanism which complements unequal exchange in trade to draw out of poor countries the surpluses that would otherwise promote accumulation within them (Frank 1964). Empirically such writers point to long periods when interest and amortization payments from the Third World to advanced capitalist countries exceed new lending to them, a phenomenon which has become acute in the 1980s. Block, (1977), Payer, (1974) and other writers argue that the International Monetary Fund and the World Bank are agents of imperialism's financial system promoting, in particular, United States capital's ability to profit from it Alternatively, they can be seen as using financial relations to create and regulate the broad framework of global capitalist market relations thereby strengthening the internationalization of capitalist enterprises(Harris, 1986, 1988a).

Another Marxist perspective, by contrast, treats imperialism's investment in Third World countries and its trade relations with them as creating the conditions for capitalism within them and as the source in many cases of capitalist accumulation and growth in the Third World (Warren 1980; ; Sender and Smith 1986). This view, associated with the work of Bill Warren, sees the export of capital as the export of capitalism which, under certain conditions, can generate growth.

The impetus behind the financial links between the Third World and advanced capitalist countries undoubtedly lies in the outward expansionary tendencies of capital in the latter economies, and that is a key element in the theory of imperialism. But there are both theoretical and empirical grounds for doubting whether this capital necessarily has the character of finance-capital, or, in other words, a unified form of financial and industrial capital. Historically, financial capital has been strongly linked with merchant capital instead of industrial capital in the exploitation of the Third World and this phenomenon has persisted until recently in many areas (Kay 1975). Since the early 1970s, a different phenomenon has been still more prominent, the internationalisation of financial capital separated from merchant and industrial capital, and its investment in Third World countries through media such as Eurodollar credits and bonds. This phenomenon appears to some writers to be more in line with Marx's conception of the high degree of autonomy that financial capital has (particularly in relation to his theory of fictitious capital) and to represent a general historical tendency of capitalism while the fusion of capitals into finance-capital exists only at particular conjunctures (Harris 1988b, Harvey 1982).

The Role of the State.

Marxist writers give the state and state power, including their role in finance, a central place in the economics of development. This has two dimensions : direct financial flows through the state by means of taxation and state spending, and state financial initiatives that strengthen the system of banks and credit markets.

In a classic essay 'Problems of Financing Economic Development in a Mixed Economy' the Polish economist Michal Kalecki (1976) related the state's taxation policy to the problem of securing the 'real' resources for investment goods and basic consumption goods; the mobilization of finance by tax policy is seen as being conditioned by the real constraints on the production of food instead of being within an autonomous financial sphere. In his model the growth rate can only be raised (in the absence of foreign trade) if a transformation of economic relations in agriculture enables the supply of food to grow at a faster rate than previously. The state has to have a central role in that transformation (through land reform, rural tax policy and other means), and, whatever rate of growth of food production is achieved, the state's fiscal policies have to be adjusted to ensure enough real resources are released to meet the required rate of growth of physical capital. Kalecki imposes the condition that increased taxation should not fall upon the poor or basic consumption goods, so fiscal policies to increase real savings involve taxation of luxury consumption or of the incomes of the wealthy. The emphasis this model places on constraints in food supply is similar to the role that the 'bottleneck' in food supply plays in the Latin American 'structuralist' theory of inflation (Edel 1969),but Kalecki draws the implications for public finance.

Kalecki's concern with changing production relations in agriculture to improve food supply is distinctly Marxian and so is his discussion of the problems class interests may cause for the state's attempts to concentrate taxes on the rich. Victor Lippit (1974) carries further the analysis of how class interests affect the state's ability to finance economic development. He studied the impact China's land reform of 1950 to 1952 had on the provision of finance for capital accumulation using the concepts of economic surplus and class relations as the basis of a detailed empirical study.

Lippit's study concerns the same issue as Kalecki's model, the finance of development in a mixed economy with a significant capitalist sector since the land reform in China did not directly inaugurate a socialist system in agriculture: the land reform program redistributed land to poor and middle peasants but it remained private land and collectivization did not occur until 1955. Lippit argues that the land reform led to a major rise in China's saving rate (in other words, the real resources to finance investment) before the collectivization of agriculture. One difference between Lippit's work and Kalecki's model is that Lippit concentrates on the ways in which, as a result of land reform, the income from agricultural output was able to be redirected toward financing development (through taxation and other means) without assuming that agricultural output itself was increased by the reform, in contrast to Kalecki who saw the rate of growth of food production as a fundamental constraint on development finance.

Lippit follows the general approach of Baran and Sweezy (1966) in referring to 'surplus' as the difference between output and the amount necessary for maintining 'normal non-luxury' living standards, but in practice he equated China's agricultural rural surplus with property income in the rural sector so it is similar to the classical Marxian concept of the 'surplus value' produced in agriculture. His study led to the conclusion that the 'surplus' which property owners and the producers of luxury items previously received directly or indirectly from agriculture was transferred by the land reform to poor and middle peasants; from their increased income resources were channelled into increased saving which financed industrialisation and other capital investment. The phenomenon of redistribution from the rich to the poor leading to increased national saving is surprising since the poor have a lower propensity to save out of increases in income than the rich (they have a lower marginal propensity to save), a fact which underpins one of the key assumptions of structuralist economics; if $100 is taken from the rich their saving is reduced by a high proportion of that sum but when it is given to the poor they increase their consumption by a high proportion of the $100 and their saving increases by less than the saving of the rich decreases. Lippit shows that the land reform overcame this problem because it enabled the state to use two instruments to channel agriculture's surplus into national saving and investment: taxation of agriculture and worsening agriculture's terms of trade by raising the relative price of manufactured goods.

The quantitative significance of these financial channels was confirmed by Ka and Selden's (1986) analysis of original accumulation during China's 1953 to 1957 Five Year Plan. In addition to quantifying the effects Lippit's book presents a strong analysis of social relations, based on Marxist class concepts, to explain why the state was able to impose these taxes and terms of trade as a result of the land reform. The landlord class that existed previously resisted any increases in tax rates, and their evasion of existing taxes caused the amount yielded by rural taxes to be a low proportion of the potential. Previous governments had relied on the landlord class for political support and local administration so could not alienate them by raising taxes more effectively, but the land reform swept that class away from its privileged position and created the political conditions which facilitated higher tax yields. The poor and middle peasantry were able to bear the taxes and also the high relative prices of manufactured goods because the land reform had substantially increased their incomes, ensuring that their standard of living was higher than previously even after payments of taxes and industry's high relative prices were taken into acount.

Lippit's study is a good example of a Marxist approach which sees the interests of different classes as determining the state's ability to finance economic development. Another example is Fitzgerald (1978) who discusses the impact class interests had in in Latin America during the twenty five years following 1950; he argues that working class (and capitalist) demands for increased state spending on the one hand and specific classes' resistance to increased taxation on the other combined to generate a 'fiscal crisis of the state' in Latin America. From a Marxist perspective, state taxation and expenditure is dependent on class forces; Marxist economics argues that the state is a focus of class forces and can be an instrument of class power and that public finance is dependent on its class character. This contrasts with orthodox economic theory which treats the state as the embodiment of a neutral rationality or the product of individual voters' choices. At most, orthodox theory sees the Third World state as supporting and supported by a set of client groups (who benefit from import licences and other monopolies conferred by the state) but the absence of a concept of social relations of production in most orthodox theories means that these client groups could come from anywhere instead of having specific class roots (Krueger 1974). In Marxist analysis public finance is constrained by whether the state is dominated by one class or another,with each having a particular position in existing modes of production: traditional big landowners, comprador bourgeoisie or merchant capitalists, national bourgeoisie based on domestic industry, the working class or various peasant classes.

However, the Marxist conception of the state which underlies its approach to public finance has difficulties of its own. In Third World societies in particular the class structure is not static; the balance of forces between classes changes but, more important, new class groups are in the process of formation and the state is actively involved in this. In post-colonial states where a functioning capitalist class is small (and where other classes' political power is weak), the state frequently becomes the vehicle for a new class to gain economic power by occupying positions in the state and controlling its economic levers. A related problem arises when the national state is completely dominatd by the forces of international capital and is articulated only weakly with the country's classes. Under such conditions, foreign powers' aid agencies, foreign bankers or the International Monetary Fund may play the leading role in dictating the country's public finance strategy.

The state's role with respect to banking and the credit system is subject to considerations similar to those that apply in public finance: it acts in relation to particular class interests. One dimension of this appears in the impact state policy on interest rates and the direction of credit has on the distribution of surplus value among different class groups; for example,the direction of credit toward export industries assists accumulation by that section of the bourgeoisie. Similarly, expansion of the money supply to generate or accomodate high inflation rates can be a powerful engine to redistribute value from workers to capitalists by cutting real wages. Alternatively, the state may give financial privileges to particular classes, enabling them to build up banking capital under their control or to build conglomerate monopolies in which banks, commerce and industry are united. This occurred, for example, in Chile (Diaz-Alejandro 1985).

The state's role in banking and credit markets is not contingent; its involvement in money and credit is necessary for their functioning. The state is necessary as the ultimate guarantor of money and the credit system;. a classic conception of this is expressed in the dictum that the state's central bank has to act as lender of last resort, but the state's function as guarantor is wider than that. In addition, the national state necessarily has responsibility for regulating the boundary and connection between the national monetary system and the international system. Finally, the manner in which the state finances its own expenditure has a fundamental influence on the financial system as a whole. On the basis of its inevitable involvement in the country's money and finance, the state implements financial policies and within a Marxist framework these are seen as having particular class orientations; they promote particular class interests and they are constrained by the relative power of different class groupings. This is a strength of Marxist conceptions of finance, in principle, for it provides a two-way link between financial policy and the structure and development of the economy instead of viewing the state's financial policy as autonomous. In practice, however, its main weakness is that it is dificult to identify empirically the changing class forces existing in Third World countries or the class character of Third World states.

CONCLUSION

The two dimensions of finance, public finance (taxation and state expenditure) and banking and credit, have been central to the processes of development and underdevelopment in the Third World. In recent years that has been reflected by financial policy being given a prominent position in development strategies. At the same time orthodox economic theory in the West has developed a large body of theoretical and empirical work on this subject. On the other hand, Marxist economists have written little on it although there is a significant body of Marxist writing on other aspects of economic development. Nevertheless, as this paper is intended to show, the principles of Marxist political economy can yield a scientific analysis of the role of finance in the Third World which is different from orthodox analysis. Although there are unsolved problems within the Marxist approach, these are a sign of its vitality and its openness to debate and further work.

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