Chapter 9

SPOTLIGHT: THE STATE, GLOBALIZATION, AND DEVELOPMENT

Article 9.1

WHAT EVER HAPPENED TO DEVELOPMENT?

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Introduction

Since World War II, if we count the number of countries which can been be considered to have moved from being "Third World" (or "developing") countries to being developed countries, how many countries make the list? By my count it would be five: South Korea, Taiwan, Singapore, Hong Kong, and Qatar. China is on its way and certain regions of China are already fit to be termed "developed." In Africa, out of the 54 countries, we cannot confidently tally any to have attained developed status (South Africa is termed an "Emerging Market Economy"). Latin America has had several more decades since independence to build an industrial base. (Most of Latin America, not including the Caribbean, nominally gained independence between the 1820s and 1880s, 80-150 years before most of Africa, the Caribbean (outside of Haiti), and most of Asia.) However, the region's industry has not reached globally competitive levels compared to the Asian "Tigers." Latin America and the Caribbean's share of world income grew from about 5.8% in 1985 to about 7.2% in 2010. Meanwhile, East Asia and Pacific's (excluding Japan) grew from 4.1% in 1985 to 11.6% in 2010.

An increasing share of total world income has been going to the developing part of the world. In 1995, about 17.5% of world income went to 83% of the world population (developing countries); by 2010, the figure had increased to about 30.3% (mostly because of East Asia). But that means that about 70% of the income still went to the richest 17% of the world population (the developed world) down from about 83%.

What Is the "Third World"?

The term "Third World" refers to a wide array of countries which have wide living standard differences today but that share a common colonial historical background. They are predominately countries of Asia, Africa, and Latin America/Caribbean that have gained formal political independence since World War II and that were part of a non-alignment movement during the Cold War. The non-alignment movement originated with the intention to chart a third path of political and economic development for the newly independent countries, different from either the U.S. model of capitalism or the Soviet model of communism. (Since they were not part of the "Western World" or the "Eastern World" in the previous "two world" division of the globe, the term "Third World" was coined.) In that spirit, they struggled to protect their political sovereignty and formulate approaches to development which would not be dominated by the leading powers. Today, these same countries (about 125 of them) are struggling against the onslaught of neoliberalism. Thus, "Third World" is not just a geographic designation of countries of the Global South nor an economic category but rather a conceptual project of newly independent countries who have struggled to develop their own economic and political systems without being dominated by the big colonial/neocolonial powers.

This distribution is still starkly uneven: About 3 billion people, out of a world population of 7 billion, live on less than $2.50 a day, and about half of them (1.5 billion) live on less than $1.25, experiencing what international development agencies call "extreme poverty." Out of those living in extreme poverty, 800-900 million (depending how we count) experience hunger or what the UN terms chronic undernourishment. Out of these hundreds of millions of hungry people, one million children die yearly from malnourishment. So why have so few countries—out of about 120 newly independent countries that have emerged since WWII—achieved successful development?

The Optimism of Decolonization and Hope of Development

This question poses a challenge to mainstream economics, which has theorized that less-developed countries enjoy certain "advantages of backwardness" (like being able to copy technologies already developed elsewhere). If they simply have high rates of saving and investment in physical capital, within one to two generations they should be able to reach income parity with the developed world. So why haven't they?

After World War II, with the struggles of de-colonization movements, the concept of "growth and development" for Third World countries became an ideological battle ground. The industrialized capitalist countries, engaged in postwar reconstruction, experienced an economic boom that is today considered "the golden era of capitalism." Meanwhile, the Third World countries that had gained political independence remained mired in poverty and destitution. And because of the fear for the

spread of the socialist system, the governments of the advanced capitalist West constantly pushed Third World governments, even to the point of using covert and overt physical force, to adopt to the laws of the "free" market and "free" trade. The capitalist market system, they assured the Third World leaders, would surely move their countries out of poverty and towards prosperity and progress.

What had to happen, according to probably the most influential and famous modernist theorist, Walt Whitman Rostow, was for so-called backward countries to emulate Western ways. Rostow believed that development was a linear path through five stages along which all countries travel. The five stages were traditional society, the preconditions for take-off, the take-off, the drive to maturity, and the age of high mass-consumption. Of course, the West had traveled these paths and reached the ultimate destination, which is the mature capitalist economic system and high-mass consumption. All that had to happen now was for the West to share its technology, capital, educational systems, form of governments, and most especially their value system, with those traditional countries. Then the latter, too, would be able to achieve the preconditions that would propel them into economic takeoff. This assumes the "advantage" of the newly independent countries of not having to reinvent the wheel of how to develop.

Keynesian policies—especially government management of total demand, with the aim of maintaining economic growth and high employment—were used in the West to help reconstruct their economies after World War II. So the core Western international institutions and mainstream economics field, between the 1950s and 1960s, tolerated or even encouraged a more central role for the state in the economic development for the newly independent countries. However, the modernist theories and the mainstream economic theories did not have a sophisticated understanding of the legacies of colonialism and their role in the Third World countries' impoverished economies and lack of proper developmental institutions. Their equations assumed all states to be the same (just like the dominant model of economic growth assumed that all countries had access to the same level of technology). Thus, they did not differentiate between the newly independent countries and the developed Western states in terms of state effectiveness.

Unfortunately, colonialism had forcefully incorporated the Third World countries as subordinate economies, solely producing primary (raw materials) commodities for advanced capitalist markets. The diversity, scope, and technological sophistication of local industry was suppressed. In the years following independence, these asymmetric trade relations resulted in further disadvantages for Third World countries, in the form of deteriorating "terms of trade" of their primary commodities for the manufactured goods of the developed economies. Raul Prebisch and Hans Singer's empirical studies showed how the prices of the Third World countries' primary products steadily declined relative to those of the manufactured products they purchased from the advanced developed countries—a pattern that continued from the 1950s to the late 1990s. As economist Louis Putterman put it:

> It takes more and more cocoa, rubber, coffee, tea, bananas, tin or copper to buy an automobile, a truck or a piece of heavy equipment. When an index

> of the prices of non-fuel primary commodities is divided by an index of the unit value of manufactured goods constructed so their ratio is 100 in 1960, this ratio is found to have fallen from 131 in 1900, and it continues falling to reach 67 in 1986.

By the early 1970s it had become clear that this was leading the developing countries into balance of payments problems: They were importing much more than exporting, which left little capital for investing into the advancement of their economies, kept them dependent on manufactured parts and goods from the developed world, and resulted in a major debt crisis. Data from the World Bank show the continuing falling prices of non-fuel commodities up to 1999.

On the political level, most of the new independent countries—mostly in Africa and Asia, some in Latin America—lacked state institutions which were linked to and dependent on the population for the majority of their revenues. Instead, these countries were saddled with colonial state institutions which were designed by the colonizing powers to extract resources through despotic power. The term "despotic power," as used by sociologist Michael Mann, means having coercive power over society. In states with "despotic power" policing and military capabilities are emphasized, but administrative capacity for complex projects (like building rural roads, electrical power grids, public housing and transportation, public education, etc.) remains limited. Postcolonial states, with only very rare exceptions, did not have built-in professionalized bureaucracies which were accountable to the masses of the people. The postcolonial state was not open to the influence of civil society institutions—like labor unions that advocate for safer work conditions, rural farmers who want local rural roads, or a legal system independent from the coercive powers of the state. Since the postcolonial states were forcefully grafted onto indigenous societies, the governing elites were not challenged to build what Mann terms infrastructural power—power through society instead of over society.

The states which emerged from the post-World War II independence struggles exhibited the characteristics of either predatory or intermediate states. Governing elites were mainly from the landed class, part of the oligarchy which controlled the resources of the country. Alternately, if there emerged a political elite ideologically committed to the country's national development, it was not able to gain sufficient autonomy from the oligarchy to direct an independent course for the country's economy on behalf of the majority of its population. Instead, the states that emerged were dependent upon international sources for financial and military support and not sufficiently embedded with their own populations.

Neoliberalism: Shift from State-Led to Market-Led Development and Declining Growth Rates

By the 1970s, the economies of the Third World had not shown significant results in converging towards the economies of the developed countries. Meanwhile, inside

the United States and other developed economies, there was a counter-reaction to Keynesian policies, which business and government elites blamed for slow growth and high inflation (known as "stagflation"). This created the intellectual and political climate for a backlash against the role of the state in the economy. The argument was that "government is too big," stifling private entrepreneurship and investment—thus, there was a need to privatize state services and deregulate private industries. The state was viewed as creating opportunities for corruption and distorting the market's efficient allocation of resources. This was the start of so-called "free market" (or "neoliberal") policies, which were pushed on the Third World by international financial institutions like the World Bank and International Monetary Fund. Starting in the 1970s, they started placing policy conditions on loans and other forms of assistance for developing countries much more explicitly than previous decades.

Preventing states from intervening in the economy and unleashing the disciplining pressures of market competition, the argument went, would make the developing countries' economies perform more efficiently and productively. According to neoliberal theory (or the "Washington Consensus") the behavior of individuals in the market, due to self-interested motivations, was also capable of explaining public official malfeasance. As economist Ha-Joon Chang described the Washington Consensus in his article "The Economic Theory of the Developmental State":

> Its contention was that the universally valid assumption of self-seeking motives by individuals should also be applied to politics as well as to economics and that it is therefore wrong to believe that the objective of the state, which is ultimately determined by certain individuals, will be commensurate with what is good for society. On this premise, various models of neo-liberal political economy characterized the state as an organization controlled by interest group, politicians or bureaucrats who utilize it for their own self-interest, producing socially undesirable outcomes. The possibility that at least some state may be run and influenced by groups whose objectives are not mere self-enrichment or personal aggrandizement but less personal things such as welfare statism or economic modernization was not even seriously contemplated on the grounds of the alleged self-seeking motives behind all human actions.

For the neoliberals, the solution was to deregulate private industries and privatize industries owned by Third World governments. Both government regulation and government ownership, it was believed, allowed officials to enrich themselves—demanding kick-backs and engaging in other "rent-seeking" behavior. Privatization would force these inefficient and subsidized industries to become disciplined, to adopt reforms and boost efficiency or else be punished by the competitive pressures of the market system. Competition would determine whether any particular industry or firm would swim or sink, depending on whether the proper reforms were made or not, and hence, indirectly benefit society with cheaper and higher-quality goods and services, and higher tax revenues.

The problem with the neoliberal theory of the state is that it does not distinguish between the various types of states that have existed in the capitalist world. Clearly, during the 1970s, the states of the developed world could not be considered to be as corrupt or inept as the newly independent states of the Third World. The characteristics of the minimalist state is assumed in neoliberal theory as if it is an automatic evolution of state institutions in all nation-states, however it is in these very basic bureaucratic functions that many developing nations have a critical shortage. It would have made sense to help the latter states become more institutionally effective, to build their infrastructural power so that they could perform at least the minimal state functions that neoliberalism delegated to the state. Instead, the World Bank/IMF complex, with their neoliberal policies, further weakened the already institutionally limited developmental aspects of these states, while helping to strengthen some of their policing powers. The developing countries were nudged, cajoled, even strong-armed to abandon the state-led model of development and adopt the market-led development model.

Listing the various roles of the state and the state's degree of involvement in the economy, moving from the most basic functions to the most extensive interventions:

1. Legal protection of private property, contract enforcement, and regulation
2. Defense of the state's sovereignty and territorial integrity (essentially policing the workers and the population at large)
3. Provision of public goods and services (schools, infrastructure, health, clean water, sanitation, rural and urban services)
4. Counter-cyclical policies (monetary and fiscal) due to the instability of the market system
5. Welfare services: unemployment, retirement, poverty programs
6. Coordination of development projects (indicative planning thru public-private cooperation)

The neoliberal advice to governments was and is to basically focus on functions 1-2, while delegating functions 3-6 as much as possible to a private sector exposed to the disciplinary pressures of competitive markets. The prediction was that private firms would do a much better job than the state in providing affordable private schools, clean water, health clinics, infrastructure like roads and bridges (with tolls), and private financial services for everyone from small farmers in the villages to large firms in the cities.

One would assume that, if the World Bank/IMF complex was advising the developing countries to downsize the state role in the economy, the total government expenditure (federal, state, and local) as the share of the economy would shrink in the advanced capitalist economies as well. In fact, as political economist, Atilio Boron argues, the developed countries do not practice what they preach to the developing world. Between 1970 and 1995, Boron shows, the core capitalist countries' average government expenditures grew from about 35% to 49%) Furthermore, in the 1990s "the proportion of public employees over the total population was 7.2% in the United States, 8.3% in Germany,

8.5% in England, 9.7% in France." Comparatively, in Latin America, public employees represented 3.5% of the population in Brazil and 2.8% in Chile and Argentina. Despite these numbers, Boron observes, the "pundits at the World Bank or the IMF have successfully insisted that Latin American states are 'too big' and should be downsized."

Even when we look at the financial press, we don't find much evidence that the economies with the least state involvement are the best performing economies for businesses to invest in. On the contrary, Forbes magazine, today one of the foremost publications in defense of the "free market" and "free enterprise," in 2016 ranked Sweden number one on its list of the top countries in which to do business. If we scroll down the same list, the top ten countries include Denmark, Holland, Finland, Norway, Ireland, England, and Canada. On average, their states account for 30-45% of GDP. Ironically, the very countries that are bastions of so-called welfare states (derogatorily called "nanny states") are considered by the pro-capitalist press to be the best places for business investors.

In almost all developing countries (Latin American and Caribbean, Africa, Middle East, South East Asia) the state contribution to GDP is much lower. For example, Mexico's is about 15% and Chile's is a little more than 20%. They are examples of the developing countries which arguably have insufficient government involvement as a percentage of their economies GDPs. Furthermore, these states rely overwhelmingly on indirect taxation like sales taxes and value added taxes (VAT), so their tax structures tend to be regressive (the poor and middle-class pay more). In contrast, the developed countries tend to rely on income and property taxes (direct taxes), and so have more progressive taxation (the higher income classes pay more), .

While neoliberalism was able to push the developing world away from state-led development toward more market-oriented policies, these latter policies have not shown positive results either. Economists Mark Weisbrot and Rebecca Ray have surveyed the scorecard on development between 1960 and 2010: The developing countries had higher growth rates during the years of government-led development, from 1960 to 1980, averaging about 2.5% per year, compared to 1.1% between 1980 and 2000—the high years of neoliberal policy. Latin America's average annual real GDP per capita growth rate in the era of "too big" government, 1960-1980, was 3.3%; during the height of the neoliberal era, 1980-2000, just 0.3%.

Bringing Back the State in Economic Development

During the 1980s, while the majority of the developing world (and even the developed world) was experiencing declining growth rates, the East Asian countries were experiencing high growth. The institutions of the World Bank/IMF complex attempted to credit the East Asian economies' high growth rates to their adoptions of market policies. Scholars such as Chalmers Johnson, Alice Amsden, Robert Wade, Peter Evans, and others (together, I term them the Role of the State in Economic Development, or RSED, school) critically responded to the neoliberal assumptions of efficient markets and government malfeasance as too simplistic and without sufficient historical depth. They were able to empirically establish that state intervention in rapidly industrializing countries of

East Asia was, "characterized by market-reinforcing behavior, understood in the sense of supporting profitability for private investors …. The state versus market mind-set thus is simply not very helpful for understanding how the interaction of states and markets has served to produce a range of economic outcomes." So, instead of blanket generalizations—whether they come from the left, which views the state as nothing more than the executive committee of the bourgeoisie, or from the right, which argues that state intervention necessarily hinders economic growth and development—the real question is what kind of administrative structure do states need in order to enable growth and development within a market economy?

To the RSED school, this question required detailed study of each state. Why did some states perform as developmental states—guiding their economies to high living standards—while other states became predatory and impoverished their people? The fundamental characteristics of a developmental state are a determined elite which seeks their country's rapid development; relative autonomy of the state from powerful landed and industrial elites; a rational bureaucracy which is competent, powerful, and insulated from political swings; a somewhat authoritarian character which ensures that competing interests are subordinated to states' developmental goals of industrialization; and the capacity to manage effectively the economic sector through a broad range of policies. (The most important economic policies include tariffs, financial credit controls, technological promotion, human capital training, and competency in selecting which market signals to deliberately distort. Yes, states can promote development by deliberately altering market signals and incentives, for example, by using subsidies to help infant-industries become competitive in the international market. The developmental state, in short, is the highest authority committed to economic development through growth, productivity, and competitiveness.

The relationship between the state and market need not be a zero-sum relationship, but rather can be one of synergy. The argument of the RSED school was that market society could not be what it is without the role of the state. The active role of the state has been clear at least as far back as economic historian Karl Polanyi's masterpiece, *The Great Transformation: The Political and Economic Origins of Our Time* (1944). In the words of economist and Noble laureate Joseph Stilitz, Polanyi's analysis "exposes the myth of the free market: there never was a truly free, self-regulating market system. In their transformations, the governments of today's industrialized countries took an active role, not only in protecting their industries through tariffs, but also in promoting new technologies."

Theories of development have two axes around which they revolve: state-led development versus market-led development. Economic theories can be distinguished conceptually by the centrality of the state's role in "governing the market." Some theories envision a limited and passive role for the state because they view the market as an efficient mechanism for allocating resources to meet society's developmental needs. Government intervention, in this view, distorts prices and throws the market system into disequilibrium. In contrast, developmental economists like

Ragnar Nurske, Paul Rosentein-Rodan, Albert Hirschman, Gunnar Myrdal, and Arthur Lewis—whose influence within academia and international institutions was at its height from the 1940s to late 1960s—viewed the state the one institution that could lead the "big-push" out of the poverty traps that ensnared the Third World. Unfortunately, by the 1970s, neoliberal/neoclassical economists rejected the theories of state-led development economists and excluded them from the policy calculations of the World Bank/IMF complex as well as the United Nations Development Program (UNDP). After about twenty years of neoliberal dominance in academia and international institutions (from 1980 to 2000), the RSED school and their state-led theories of development made a comeback. They undermined the intellectual hegemony of the neoliberal paradigm, demonstrating in their own original works the administrative and regulatory importance of the developmental state. They showed that economic development requires a state that is effective in managing the monetary system, protecting private property laws, setting taxes, funding public goods such as infrastructure and education, coordinating between industries, and promoting long-term investment—that is, in all six functions of the state listed above.

Return to the 1950s Spirit of Development

If we are serious about solving the problem of development, we must bring back mass development projects through the developmental state. In the last 30 or 40 years, parallel to the downsizing of the states in the Third World, there has been a shift towards micro-oriented development projects. Such projects give non-government organizations (NGOs) and other charity aid organizations a central role, supported by the international institutions as well as mainstream economic theory. We have to make the case to returning international institutions to developmental policies—to what political scientist Eric Helleiner calls the "Forgotten Legacy of Bretton Woods"—infant industry tariffs protections, commodity price stabilization, international debt restructuring, short-term capital movement restrictions, and long-term development lending. In the spirit of the 1950s and 1960s, we must bring back the socially transforming aims of development policy—which include building the institutional capacity of states to collect taxes on a progressive basis, redistributing wealth through policies like radical land reforms, etc. Last but not least, the Third World needs to revive the planning and execution of their own regionally based and environmentally sustainable industrial policies. For these projects to be realized we need to build the developmental capacity of the Third World states. ❑

Sources: Nina Bandelj and Elizabeth Sowers, *Economy and State: A Sociological Perspective* (Polity Press, 2010); Nancy Birdsall, Augusto De La Torre, and Rachel Menezes, *Fair Growth: Economic Policies for Latin America's Poor and Middle-Income Majority* (Center for Global Development and Inter-American Dialogue, 2008); A. Atilio Boron, "Latin American Thinking on the State and Development: From Statelessness to Statelessness," in Sam Moyo and Paris Yeros (eds), *Reclaiming*

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Article 10.2

DOES U.S. PROSPERITY *DEPEND* ON EXPLOITATION?

BY ARTHUR MACEWAN
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> Dear Dr. Dollar:
> *I regularly hear the claim that U.S. prosperity* depends *on exploiting poorer countries, but I have never once seen an actual argument for it. What is the support for this claim?*
>
> —Ryan Cooper, via Twitter

Let's start with the two congenital bloodstains on the cheek of U.S. economic development—slavery and the genocide/taking-of-lands of Native American peoples.

Certainly, the prosperity of the United States has depended to a substantial degree on the labor of slaves, based on stealing people from poor societies, disrupting the social order, and depleting the labor force of those societies. In the decade leading up to the Civil War, for example, the value of raw cotton exports accounted for over half of the value of all U.S. exports. Then there were the direct profits from the slave trade, which built the fortunes of several northern U.S. and European families. And the initial phase of U.S. industrialization, the cotton textile industry, was based on low-cost slave-produced cotton.

As to the economic role of lands taken from Native Americans, the value, though incalculable, was immense. Indeed, some historians have argued that a major pillar of U.S. economic success was the availability of "open land"—the so-called "frontier thesis." Not to mention that a large part of that "frontier" was the huge tract of land taken from Mexico after the Mexican-American War.

U.S. economic success—from slavery, "open land," and other aspects of exploiting people of low-income societies—meant different things for different groups. Clearly, for example, southern plantation owners, financiers of the slave trade, and owners of northern cotton mills reaped major gains. Yet, the economic growth that these activities generated seeped down to a broad spectrum of society, benefiting others less than elites, but benefiting many nonetheless—of course, not including the slaves themselves. Likewise, while large-scale ranchers and land speculators gained disproportionately from stealing the lands of Native Americans, many homesteaders also benefited from "opening" the West. The Native Americans themselves, like the slaves, did not share in the prosperity.

U.S. Economic Interests and Military Action

Excerpt from a speech delivered in 1933 by retired Major General Smedley Butler, USMC.

"I spent 33 years and four months in active military service and during that period I spent most of my time as a high-class muscle man for Big Business, for Wall Street, and the bankers. In short, I was a racketeer, a gangster for capitalism. I helped make Mexico and especially Tampico safe for American oil interests in 1914. I helped make Haiti and Cuba a decent place for the National City Bank boys to collect revenues in. I helped in the raping of half a dozen Central American republics for the benefit of Wall Street. I helped purify Nicaragua for the International Banking House of Brown Brothers in 1902–1912. I brought light to the Dominican Republic for the American sugar interests in 1916. I helped make Honduras right for the American fruit companies in 1903. In China in 1927 I helped see to it that Standard Oil went on its way unmolested. Looking back on it, I might have given Al Capone a few hints. The best he could do was to operate his racket in three districts. I operated on three continents."

Dependence on Government Support

As with slavery and the decimation of the Native American nations, economic activity beyond the current boundaries of the United States depended on government support, importantly including military support. This was especially evident in the "Gunboat Diplomacy" era in the early decades of the 20th century, when military action abroad was explicitly tied to economic interests, as was famously described and denounced by retired U.S. Marine Corps (USMC) Major General Smedley Butler (see box).

As Butler's statement makes clear, the activities being protected were often those of particular U.S. firms, not the prosperity of the U.S. economy in general. Indeed, in many cases, though the firms benefited, the military costs of the actions outweighed the direct benefits to the U.S. economy. Yet, by protecting the activities of particular firms, the U.S. government was protecting the access of U.S. firms to global markets and resources—that is, protecting the firms' ability to exploit the people and resources in many parts of the world. This access was driven by U.S. firms' search for profits and the firms' owners were the primary beneficiaries. Access, however, also provided low-cost goods—everything from bananas to oil—and markets for U.S. products to the benefit of the U.S. population generally.

At the outset of World War II in late 1939, working with the private, elite Council on Foreign Relations, the U.S. government began planning for the post-war era. According to Laurence H. Shoup and William Minter, in their 1977 book *Imperial Brain Trust*:

> The main issue for consideration [in this planning] was whether America could be self-sufficient and do without the markets and raw materials of the British Empire, Western hemisphere, and Asia. The Council thought that the answer was no and that, therefore, the United States had to enter the war and organize a new world order satisfactory to the United States.

For the United States, the outcome of the war was successful, of course, not only in its immediate military goal of defeating the Axis Powers, but also in establishing U.S. dominance and relatively unfettered access to the markets and raw materials of what the U.S. government referred to as the "Grand Area."

Among the concerns of the planners' efforts to secure the "Grand Area" was Southeast Asia. In one of their memoranda, they wrote, "the Philippine Islands, the Dutch East Indies, and British Malaya are prime sources of raw materials very important to the United States in peace and war; control of these lands by a potentially hostile power would greatly limit our freedom of action." Vietnam would later become the focal point of securing this area from a "hostile power."

The Issue Is Access

The issue in all of this is not the value of some particular resource or raw material. The issue is always access—access that is unfettered by a hostile local government or by costly regulations designed to promote local economic expansion. Since early in the 20th century, access to oil has been a dominant factor in the foundation of U.S. prosperity, and access to oil has often meant the political-military dominance of lower-income countries. Access to oil, however, has not meant simply that the United States would be able to purchase the oil produced in other countries, but that U.S. oil companies would be able to play the central role in controlling that oil and reaping the associated profits. Whatever other motivations were involved in the U.S. invasion of Iraq and the more recent actions against Venezuela, oil was certainly a major factor.

The dominance by U.S. companies of the global oil industry certainly brought profits to the companies. Yet, as the economy became increasingly oil-dependent, oil was relatively inexpensive, providing a major element in the foundation of U.S. prosperity. And much of this oil came from low-income countries. The formation of the Organization of Petroleum Exporting Countries (OPEC) in 1960 did bring about some change, forcing up the price of oil.

Varied Impacts: Countries or Classes?

However, the major oil companies have been able to maintain a great deal of power through sharing more with the elites of some of the oil-source countries. This "sharing" experience with oil, which is common in much of the relationships between U.S. firms and the low-income countries in which they operated, underscores the point that it is not quite accurate to say that *countries* are exploited by U.S. operations. Different social groups—different classes—in the countries are affected quite differently by these operations, some are thoroughly exploited while others benefit.

In the 21st century, the focus of U.S. economic connections to poor countries has shifted somewhat. Markets and raw materials remain important, but low-cost labor and lax (or lack of) environmental regulations have become important as well. All along, financial activity has played a role (see the Smedley Butler box). Access to

low-cost labor and avoidance of environmental regulations have often been obtained indirectly, through reliance on local contractors supplying goods to U.S. firms (subcontracting). Walmart is a prime example, but many other firms have also been able to provide U.S. consumers with inexpensive items produced by low-wage labor.

It is true that many of the workers supplying goods to the United States have better jobs than they had had prior to engagement with the U.S. market. And, on a broader level, some countries have attained economic growth (though its benefits often go disproportionally to elites) from their connection to the U.S. economy. Nonetheless, U.S. prosperity at least in part depends on those workers receiving low wages, often working in unsafe or unclean environments, and denied basic rights.

Moreover, in examining the impact of U.S. firms' operations in low-income countries, a distinction needs to be made between the immediate and direct impact and the longer run and more general impact. The former may carry benefits, as the trade and investment created by these operations can generate some economic expansion and much-needed jobs in the low-income countries. Over the longer run, however, U.S. engagement tends to support unequal social structures and a weakening of an internal foundation for long run prosperity in these countries. Furthermore, the U.S. government, in its role as a supporter of U.S. firms' operations around the world, has often intervened to prevent social change that might have led to real improvements in the lives of people in low-income countries. (The list of interventions that Smedley Butler gives only begins to tell the story.)

Pillars of Prosperity

In addition to the international economic relations between the United States and low-income countries, the United States also has extensive economic relations with high-income countries as well. Indeed, the majority of U.S. global trade and the majority of foreign investment by U.S. firms is with other high-income countries. This activity does not generally have the same exploitive characteristics as U.S. firms' penetration of low-income parts of the world. Both are pillars on which U.S. prosperity has depended.

There are other pillars as well. For example, the relatively high degree of education among the U.S. population and the skills that many immigrants brought with them to this country are also pillars of prosperity. But, surely, the exploitation of people in low-income countries has been an important pillar. ❑

Sources: Smedley D. Butler, *War is a Racket: The Antiwar Classic by America's Most Decorated Soldier* (Feral House, 2003); Walter Rodney, *How Europe Underdeveloped Africa* (Black Classic Press, 2011); Andre Gunder Frank, *The Development of Underdevelopment* (Monthly Review Press, 1966); Arthur MacEwan, "Capitalist Expansion, Ideology and Intervention," *Review of Radical Political Economics*, Vol. 4, No. 1, Winter 1972; John Miller, "After Horror, Apologetics: Sweatshop apologists cover for intransigent U.S. retail giants," *Dollars & Sense*, September/October 2013; Arthur MacEwan, "Is It Oil?" *Dollars & Sense*, May/June 2003; Arthur MacEwan, "Is It Oil?—The Issue Revisited," *Dollars & Sense*, March/April 2017.

Article 10.3

PUERTO RICO'S COLONIAL ECONOMY

BY ARTHUR MACEWAN
November/December 2015

> Dear Dr. Dollar:
> It seems like Puerto Rico's economic and financial mess came out of nowhere. Until recently, there wasn't much about Puerto Rico in the press, but what there was seemed to portray things as fine, with a generous amount of funds going to the island from Washington. Sometimes, Puerto Rico was held up as a model for economic development. So where did the current mess come from? —*Janet Sands, Chicago, Ill.*

Puerto Rico is a colony of the United States. Colonial status, with some exceptions, is not a good basis for economic progress.

Recently, the details of the Puerto Rican economic mess, and especially the financial crisis, have become almost daily fodder for the U.S. press. Yet, the island's colonial status and the economic impact of that status, which lie at the foundation of the current debacle, have been largely ignored.

Puerto Rico, like other colonies, has been administered in the interests of the "mother country." For example, for many years, a provision of the U.S. tax code, Section 936, let U.S. firms operate on the island without incurring taxes on their Puerto Rican profits (as long as those profits were not moved back to the states). This program was portrayed as a job creator for Puerto Rico. Yet the principal beneficiaries were U.S. firms—especially pharmaceutical firms. When this tax provision was in full-force in the late 1980s and early 1990s, it cost the U.S. government on average more than $3.00 in lost tax revenue for each $1.00 in wages paid in Puerto Rico by the pharmaceuticals. (What's more, the pharmaceuticals, while they did produce in Puerto Rico, also located many of their patents with their Puerto Rican subsidiaries, thus avoiding taxes on the profits from these patents.)

Puerto Ricans are U.S. citizens, but residents of the island have no voting representatives in Congress and do not participate in presidential elections. The Puerto Rican government does have a good deal of autonomy, but is ultimately under U.S. law. And without voting representatives in Congress, Puerto Rico is unable to obtain equal status in federal programs or full inclusion in important legislation. A good example of the latter, which has become especially important in the ongoing financial crisis, is that U.S. law excludes the Puerto Rican government from declaring bankruptcy, an option available to U.S. states and their cities.

It is often asserted that the U.S. government provides "generous" benefits to Puerto Rico. Perhaps the largest federal payment to Puerto Ricans is Social Security. Yet Puerto Ricans on the island pay Social Security taxes just like residents of states

and the District of Columbia. Likewise, Puerto Ricans pay Medicare taxes just like residents of the states, but, unlike residents of the states, their Medicare benefits are capped at a lower level. Among the important programs from which residents of Puerto Rico are excluded, a big one is the earned income tax credit (EITC). As a result, a two-parent, two-child family in Puerto Rico earning $25,000 a year ends up, after federal taxes and credits, with about $6,000 less income than a family in the states with the same earnings and family structure.

Opponents of extending the EITC to residents of Puerto Rico argue that they should not get the EITC because they are not liable for federal income taxes. Yet many EITC recipients in the states pay no federal income taxes simply because their incomes are so low (e.g., the family in the above example). Moreover, the EITC was established to offset the burden on low-income families of Social Security and Medicare taxes, which Puerto Rico residents do pay, and to reduce poverty, of which Puerto Ricans have more than their share.

If Puerto Rico gets "generous" benefits from Washington, several states are treated more generously. In particular, if states are ranked in terms of their "net receipts" per capita from the federal government—that is, funds received from the federal government minus federal taxes—in a typical year about one-third of the states rank above Puerto Rico (though the number varies somewhat in different years). In 2010, for example, West Virginia received $8,365 per capita more in federal expenditures than were paid from the state in federal taxes; Kentucky $7,812 more; Vermont $6,713 more; and Alaska and Hawaii topped the list with $11,123 per capita and $10,733 per capita more respectively from the federal government than they paid to the federal government. That year Puerto Rico received on net $4,697 per capita.

Beyond these particular disadvantages of colonial status, Puerto Rico suffers from a pervaisive condition of "dependency." In setting economic policy, the Puerto Rican government has continually looked beyond the island, to investments by U.S. firms and favors from Washington. As James Dietz has usefully summed up the situation in his 2003 book Puerto Rico: Negotiating Development and Change: "...Puerto Rico's strategy of development lacked a focus on the systematic support or fostering of local entrepreneurs and local sources of finance." As a consequence "the central role of domestic entrepreneurs, skilled workers and technological progress that underlies sustained economic progress" has been weaker in Puerto Rico than in sovereign nations where sustained economic progress has proceeded more rapidly. Moreover, government policy and decisions by investors tend to be short-sighted, failing to build the foundation for long-term economic progress. The poor condition of the public schools and the weak physical infrastructure are examples of the consequences.

All of these factors have retarded the Puerto Rican economy for decades. The island did experience a burst of economic activity in the post-World War II period, heavily dependent on low-wage labor, privileged access to the U.S. market, and federal and local tax breaks for U.S. firms. As wages rose and other parts of the world

gained access to the U.S. market, the economy faltered. From the mid-1970s into the early 2000s, Puerto Rico lost economic ground compared to the states.

The severe recession that then emerged in 2006 and that Puerto Rico has suffered under for the past decade, only partially attenuated by heavy government borrowing on the bond market, was an outcome to be expected from the economy's long-term weakness and, in fact, was precipitated by that heavy government borrowing.

By 2006, the Puerto Rican public debt was 70% as large as GNP. (Now it is slightly more than 100%.) Under this debt pressure, in an effort to cut its expenditures, the government temporarily laid off without pay 100,000 workers (almost 10% of the total work force). Had the Puerto Rican economy not been so weak and had the U.S. economy not soon entered the Great Recession, perhaps the downturn from this layoff shock would have been brief. But the weak economy and then recession in the states undercut any basis for quick recovery. In 2009 and 2010, Puerto Rico did receive a share of the funds in the American Recovery and Reinvestment Act (ARRA), which attenuated but did not end the island's recession. The boost from the ARRA funds was too small and too short-lived.

Many commentators and Puerto Rican government officials try to explain the emergence of Puerto Rico's recession by the termination of the Section 936 tax breaks and call for a renewal of 936 provisions to aid the economy. However, for the firms, the tax breaks did not end, but were maintained under other tax code provisions, and there was virtually no decline of employment in 936 firms as the tax provision was being phased out between 1996 and 2006. After 2006, however, the employment provisions of Section 936, as weak as they were, did collapse. As a result, while exports of pharmaceuticals have grown apace in subsequent year, for example, employment in the industry has dropped sharply. Perhaps the termination of 936 contributed to the continuation of the downturn, through its impact on employment, but it was not the primary or major causal factor. Most important, a renewal of 936 provisions is not a solution to Puerto Rico's economic difficulties.

Controversy over Puerto Rico's status has been a dominating theme of the island's politics for decades. Various polls have shown a rough split between maintaining the current status and statehood, with the latter gaining an edge in the 2012 poll associated with the election. The polls show support for independence far behind.

The current colonial status, in addition to its negative economic impact, involves a fundamental violation of human rights and democracy. Puerto Ricans should be given a clear choice between independence and statehood; maintenance of the current colonial status (or a somewhat different colonial status that has some support) should be off the table. Beyond the interests of the Puerto Ricans, how can those of us in the states make a claim to democracy while we hold Puerto Rico as our colony? ❑

Article 10.4

"TIED" FOREIGN AID

BY ARTHUR MACEWAN

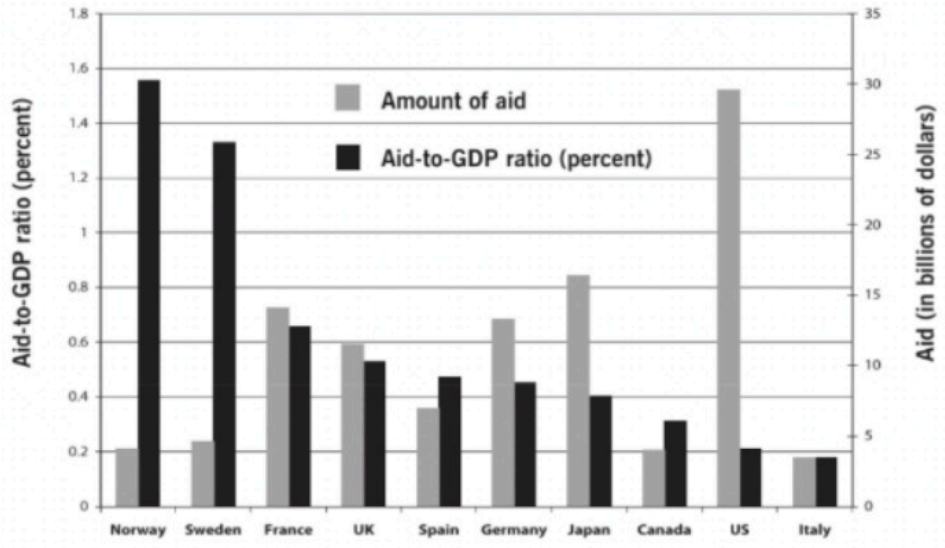
January/February 2012

> Dear Dr. Dollar:
> People complaining about the ungrateful world often talk about the "huge" U.S. foreign aid budget.In fact, isn't U.S. foreign aid relatively small compared to other countries?What's worse, I understand that a lot of economic aid comes with strings attached, requiring that goods and services purchased with the aid be purchased from firms in the aid-giving country.This channels much of the money back out of the recipient country.That sounds nuts!What's going on? —*Katharine Rylaarsdam, Baltimore, Md.*

The U.S. government does provide a "huge" amount of development aid, far more than any of the other rich countries.In 2009, the United States provided $29.6 billion, in development aid—Japan was number two, at $16.4 billion.

But wait a minute.What appears huge may not be so huge. The graph below shows the amount of foreign development aid provided by ten high-income countries *and* that amount as a share of the countries' gross domestic products (GDP).Yes, the graph shows that the United States gives far more than any of these other countries.But the graph also shows the United States gives a small amount relative to its GDP.In 2009, U.S. foreign development aid was two-tenths of 1% of the country's GDP.Only Italy gave a lesser amount relative to its GDP.

DEVELOPMENT AID, AMOUNT AND PERCENT OF GDP, 2009



Source: OECD, Official Development Assistance by Donor (stats.oecd.org).

The world's rich countries have long committed to providing 0.7% of GDP to foreign development aid.In 2009, only Norway and Sweden met this goal. The U.S. government did not come close.

Moreover, a large share of U.S. foreign aid is "tied aid"; governments that receive the aid must spend the funds by buying goods and services from U.S. firms. Generally the recipient countries could get more goods and services if they could spend the money without this restriction.So the economic development impact of the aid is less than it appears. Also, whatever the "foreign aid" does for the recipient country, it is a way of channeling money to U.S. firms.

Not only must the recipient country pay more for the goods and services, but the "multiplier impact" is much less.That is, since the money goes to U.S. companies rather than local suppliers, fewer local jobs and salary payments are created; so less is re-spent in the local economy.A 2009 report on aid to Afghanistan by the Peace Dividend Trust notes: "By using Afghan goods and services to carry out development projects in Afghanistan, the international community has the opportunity to spend a development dollar twice. How? Local procurement creates jobs, increases incomes, generates revenue and develops the Afghan marketplace —all of which support economic recovery and stability."Yet most of the aid "for Afghanistan" went to foreign "experts," foreign construction firms, and foreign suppliers of goods.

The U.S. government ties much more of its aid than do most other donor countries.A report by the Organization for Economic Cooperation and Development (OECD) estimated that in the mid-2000s, 54.5% of U.S. aid was tied.Of the 22 donor countries listed in the report (including the United States), the average share of tied aid was only 28.4%.The report notes a "widespread movement to untying [aid], with the exception of the United States."

It is important to recognize that U.S. foreign aid is an instrument of U.S. foreign policy, and is thus highly concentrated in countries where the U.S. government has what it views as "strategic interests." For example, in 2008 almost 16% of U.S. development assistance went to Afghanistan and Iraq, while the top 20 recipient countries received over 50%.

So, yes, the U.S. government provides a "huge" amount of foreign development aid—or not so much.It depends on how you look at things. ❑