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Liberalization: A Critical View

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ABSTRACT

We now live in an era of Globalization; the new world order has made the liberalization, privatization and globalization (LPG) model of development almost irreversible with no escape for any country of or region at least in the present context. Liberalization of the Economy means to free it from direct or physical controls imposed by the government. This may similar to deregulation. Deregulation is the process removing or reducing state regulations, typically in the economic sphere. Liberalization- The removal of governmental interference in financial markets, capital markets, and of barriers of trade has many dimension. In this article critically described the adverse impact of liberalization on developing countries. This article is based on secondary resources.

Today, even the IMF agrees that liberalization has pushed that agenda too far that liberalizing capital and financial markets contributed to the global financial crises of the 1990s and can wreak havoc on a small emerging country. A closer look at how it has worked out in many developing countries serves to illustrate why it is so often so strongly opposed, as seen in the protests in Seattle, Prague and Washington D.C.

Keywords— liberalization, privatization and globalization (LPG)

I. TRADE LIBERALIZATION

Trade liberalization is supposed to enhance a country's income by forcing resources to move from less productive uses to more productive uses; as economists would say, utilizing comparative advantage. But moving resources from low-productivity uses to *zero* productivity does not enrich a country, and this is what happened all too often under IMF programs. It is easy to destroy jobs, and this is often the immediate impact of trade liberalization, as inefficient industries close down under pressure from international competition. IMF ideology holds that new, more productive jobs will be created as the old, inefficient jobs that have been created behind protectionist walls are eliminated. But that is simply not the case—and few economists have believed in instantaneous job creation, at least since the Great Depression. It takes capital and entrepreneurship to create new firms and jobs, and in developing countries there is often a shortage of the latter, due to lack of education, and of the former, due to lack of bank financing. The IMF in many countries has made matters worse, because its austerity programs often also entailed such high interest rates—sometimes exceeding 20 percent, sometimes exceeding 50 percent, sometimes even exceeding 100 percent-that job and enterprise creation would have been an impossibility even in a good economic environment such as the United States. The necessary capital for growth is simply too costly.

The fact that trade liberalization all too often fails to live up to its promise—but instead simply leads to more unemployment—is why it provokes strong opposition. But the *hypocrisy* of those pushing for trade liberalization-and the way they have pushed it—has no doubt reinforced hostility to trade liberalization. The Western countries pushed trade liberalization for the products that they exported, but at the same time continued to protect those sectors in which competition from developing countries might have threatened their economies. This was one of the bases of the opposition to the new round of trade negotiations that was supposed to be launched in Seattle; previous rounds of trade negotiations had protected the interests of the advanced industrial countries-or more accurately, special interests within those countries-without concomitant benefits for the lesser developed countries. Protestors pointed out, quite rightly, that the earlier rounds of trade negotiations had lowered trade barriers on industrial goods, from automobiles to machinery, exported by the advanced industrial countries. At the same time, negotiators for these countries maintained their nation's subsidies on agricultural goods and kept closed the markets for these goods and for textiles, where many developing countries have a comparative advantage.

In the Uruguay Round of trade negotiations, the subject of trade in services was introduced. In the end, however, markets were opened mainly for the services exported by the advanced countries-financial services and information technology-but not for maritime and construction services, where the developing countries might have been able to gain a toehold. The United States bragged about the benefits it received. But the developing countries did not get a proportionate share of the gains. One World Bank calculation showed that Sub-Saharan Africa, the poorest region in the world, saw its income decline by more than 2 percent as a result of the trade agreement.

II. FINANCIAL MARKET LIBERALIZATION

Even though an unfair trade agenda was pushed, at least there was a considerable body of theory and evidence that trade liberalization would, if implemented properly, be a good thing. The case for financial market liberalization was far more problematic. Many countries do have financial regulations that serve little purpose other than to impede the flow of capital and these should be stripped away. But all countries regulate their financial markets, and excessive zeal inderegulation has brought on massive problems in capital markets even in developed countries around the world. To cite one example, the infamous savings-and-loan debacle in the United States, while it was a key factor in precipitating the 1991 recession and cost American taxpayers upward of $200 billion, was one of the least expensive (as a percentage of GDP) bailouts that deregulation has brought on, just as the U.S. recession was one of the mildest compared to ones in other economies that suffered similar crises.

The consequences-economic recession-of banking crises brought on by capital market deregulation, while painful for developed countries, were much more serious for developing countries. The poor countries have no safety net to soften the impact of recession. In addition, the limited competition in financial markets meant that liberalization did not always bring the promised benefits of lower interest rates. Instead, farmers sometimes found that they had to pay higher interest rates, making it more difficult for them to buy the seed and fertilizer necessary to eke out their bare subsistence living.

III. CAPITAL MARKET LIBERALIZATION

And as bad as premature and badly managed trade liberalization was for developing countries, in many ways capital market liberalization was even worse. Capital market liberalization entails stripping away the regulations intended to control the flow of hot money in and out of the country-short-term loans and contracts that are usually no more than bets on exchange rate movements. This speculative money cannot be used to build factories or create jobs-companies don't make long-term investments using money that can be pulled out on a moment's notice-and indeed, the risk that such hot money brings with it makes long-term investments in a developing country even less attractive. The adverse effects on growth are even greater.

The IMF, in arguing for capital market liberalization, relied on simplistic reasoning: Free markets are more efficient, greater efficiency allowed for faster growth. It ignored arguments such as the one just given, and put forward some further specious contentions, for instance, that without liberalization, countries would not be able to attract foreign capital, and especially direct investment. The Fund's economists have never laid claim to being great theorists; its claim to expertise lay in its global experience and its mastery of the data. Yet strikingly, not even the data supported the Fund's conclusions. China, which received the largest amount of foreign investment, did not follow any of the Western prescriptions (other than macrostability)-prudently forestalling full capital market liberalization. Broader statistical studies confirmed the finding that using the IMF's own definitions of liberalization, it did not entail faster growth or higher investment.

The advocates of liberalization put another argument, one that looks particularly laughable in light of the global financial crisis that began in 1997, that liberalization would enhance stability by diversifying the sources of funding. The notion was that in times of downturn, countries could call upon foreigners to make up for a shortfall in domestic funds. The IMF economists were supposed to be practical people, well versed in the ways of the world. Surely, they must have known that bankers prefer to lend to those who do not need their funds; surely they must have seen how it is when countries face difficulties, that foreign lenders pull their money out—exacerbating the economic downturn.

While we shall take a closer look at why liberalization-especially when undertaken prematurely, before strong financial institutions are in place-increased instability, one fact remains clear: instability is not only bad for economic growth, but the costs of the instability are disproportionately borne by the poor.

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