Economic Liberalization as Development Policy: the Contemporary Debate

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The essay argues that the influential neoliberal economic philosophers assume that market and price mechanisms should be promoted to achieve economic development and calls for economic liberalization undermining the role of policy instruments. The essay challenges the presuppositions of these arguments. It maintains that Selective liberalization should be pursued by governments after development of regulatory and institutional frameworks that enable governments to monitor market operation and intervene if need arises. Economic Liberalization must be interpreted in the historical and social context of the society. It then contends that economic liberalization is neither essentially evil nor good. Liberalization is better seen as following from recognitions of its deontological processes and teleological perspectives than as an ideal limit on government intervention.

Key words: *liberalization, economic liberalization, political liberalization, contemporary debate.*

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Introduction

The paper brings together issues arising from research and theoretical developments on liberalization in the disciplines of political philosophy, economic philosophy, economics and the social sciences. It looks particularly at the subjects of economic liberalization, and of the impact that it brings in the process of economic transformation. In this paper, I present the following argument. Selective liberalization should be pursued by governments after development of regulatory and institutional frameworks that enable governments to monitor market operation and intervene if need arises. To defend this argument, I first explore the relationship between the state/politics and economy and assess that relationship exploiting insights from contemporary philosophy of political and economic sciences. I also examine and critique the specific foundations and commitments underlying neoliberal/neoclassical economic theory, using contemporary philosophy of political and economic sciences. The conventional and traditional liberalization theory which was developed as the Washington consensus with the works of James Williamson (1972) calls for strengthening market and price mechanisms subordinating the role of policies for development and economic progress. However, this prescription is hardly workable for under developing economies because of institutional and technological problems. In developing economies markets (factor, goods and services and financial markets) are imperfect and financial markets are non existent in some of the developing countries. Hence, the author elucidates the way forward for developing economies to liberalize their economies raising such questions as can we separate politics/state and economy? Is the individual right based capitalist economic policy absolute? Is individual interest compatible with collective interest? Is there single path to economic prosperity? Is it economic liberalization or political liberalization which proceeds? How social cultural, economic and historical experiences affect development policy? What are the major impacts of economic liberalization? The author answered these questions from the perspective of critical argument analysis providing evidences from research, theory and practices. The focus of a body of research that has been done on economic liberalization was on the impacts of economic liberalization and little attention has been given to the liberalization processes and procedures that will lead to the maximization of the benefits out of it reducing the consequential risks. Finally, the intent of this paper is not to engage in suggestions of state intervention and controls or to praise non interventionist policy but to explore the changing foundation of economic development methodology; for the aim of this paper is to motivate discussion concerning economics that takes into consideration the social, cultural, historical and economic resource dimensions, in terms of raising awareness about the foundation that informs formal economic development models and not necessarily in terms of developing these models. Thus, the goal of this paper is not to degrade the power or even to deride the importance of the notion of neoliberal economic development policy prescriptions or to offer an alternative economic development methodology; rather, it is to review and discuss the recent changes in economic development methodology vis-à-vis contemporary philosophy of political and economic science and the practical realities. The paper is organized in to five sections. The first section examines the philosophical and theoretical foundations of liberalization theory and provides an analysis of the pragmatic realities in line with the theories. The second section examines the issues of precedence between political liberalization and economic liberalization which attracted focus of contemporary development policy as a result of Asia's raising economic stars (china, Singapore, Taiwan and Korea) postponing political liberalization. The third section looks at the justifications for the state—intervention in economic operation providing through and critical analysis of evidences from research and practice. The fourth section examines the impacts of economic liberalization on the basis of the assessments in earlier sections. Finally, a few observations were concluded.

Philosophical Foundations of Liberalization Theory

Liberal economic theory has got profound origin in classical economic thought of whom the forerunner was Adam smith; the classical liberalist. Adam smith (1776) suggested policy tool which limit the role of the state to public works, issuing of regulatory frame works and law enforcement arguing that government intervention in the economy in the form of ownership, production and sale of goods and services leads to inefficiency of economic operation and management. Liberal economic theory in turn is associated to liberal political philosophy. Neo liberal economic philosophers like Friedrich August von Hayek *in the Use of Knowledge in Society (1945),* claimed that the price mechanism serves to share and synchronize local and personal knowledge, allowing society's members to achieve diverse, complicated ends through a principle of spontaneous self organization. Hayek coined the term catallaxy to describe a self organizing system of voluntary co-operation. For Polanyi (Wittman, P.M, 1999), it was fears of totalitarianism that led him to a belief in the importance of the free market in preserving liberty and exploiting the tacit knowledge of society as a whole. Like Hayek, he believed that such markets were not conscious inventions but evolved habits, sharing and synchronizing local and personal knowledge in achieving diverse ends among society's members through a principle of self-organization. Hayek viewed the price mechanism, not as a conscious invention (that which is intentionally designed by man), but as spontaneous order, or what is referred to as that which is human action but not of human design. Milton Friedman in his monetary theory rejected the use of fiscal policy of Keynesians as a tool of demand management; and he held that the government's role in the guidance of the economy should be restricted severely. Friedman's essay; *The Methodology of Positive Economics (1953)* provided the epistemological pattern for his own subsequent research and argued that economics as science should be free of value judgments for it to be objective. Moreover, a useful economic theory should be judged not by its descriptive realism but by its simplicity and fruitfulness as an engine of prediction according to Friedman. Theses economic thinkers tried to separate politics or state and economics which are in fact according to my view hardly possible. Neo liberals of the extreme right wing in political ideologies think of an economy as though operating in a vacuum not under political decisions which involve complex set of evaluations and games of choosing the evil from the most evil. Neo liberal economic thinkers have been preaching demarcation between politics and an economy though they failed to pass the clinical test of practical economic operations. This fact has been evident with the major economic crisis of the recent past (1930's, 1990's and 2007's) the wave of which begun from the major liberalized economies. Here, I would like to pose questions: can we think of an economy without politics/state? Why or why not? I would like to argue that politics and economy are two faces of a coin and it is hardly possible to separate the two as they are mutually reinforcing phenomenon. Political decisions significant impact on economic policies and political economy of countries. Ayn rand (1982), an American philosopher argues that politics is the brain of any economy. Means, if the politics is active and dynamic so does the economy and otherwise if the politics is static the same is true for the economy. Vibrant political system could have the power to make the society which is an engine for economic development vibrant Aren't critical economic policy decision political decisions? Ended, the economic reality is that economic policy decisions and macro-economic policy frame work decisions are political decisions involving bureaucratic deliberations by congress or parliament, council of ministers of ministers (i.e. parliamentary systems) and senate(i.e. presidential system). Political parts primarily use economic policy as their basic tool to beat the hearts of voters while running for congressional elections. In a majority Vote lead political system whatever smart policy is developed by economic advisors or professionals, it is pragmatically subject to the discretion of political decision makers to approve and authorize its implementation. It is seldom possible to have stable society and stable economy with government hands limited as suggested by neo liberal thinkers. Keynesian economic philosophers reaffirmed this fact and suggested interventionism policies as desirable through the manipulation of monetary and fiscal policies for stabilization. The Keynesian argument that refers to a market as not self correcting has been consistent with the pragmatic economic realities. When it comes to human rights neo liberal thinkers pronounce equality of human beings but in their economic philosophy the same people advocate inequality which might result in social welfare loss and crisis. So isn't political action important to at least reduce such welfare loss if not to eradicate? I answer ended it is not only important but also imperative. Economic inequality and welfare crisis could lead to the prevalence of crime, robbery which is basis of social crisis. Political economists with this respect dictate that minimization of welfare loss is the basic reason for government intervention with policy tools that can fairly distribute income or wealth among citizens. If we understand modern state with the camera of Thomas Hobbes and John Locke we might wonder whether we can separate politics from economy. According to this philosophers state is the product of conflict, war and competition that lead to social contract by societies to have protection or security from third party which is government. A society in natural state according to these philosophers employs physical force to surpass the competition and to win the wars involved. In such a state the power of reason is undermined to the supremacy of physical force in relationship of members of the society. Life in this social system is savage life with full of misery. Government collective/common interest of different social groups is likely to diverge than it converges specially in a society characterized by diversity in culture, language, religion and life style. Here, I can cite the Ethiopian economic history which was under very long period of feudal political decisions then followed by the pure socialist regime from 1974 up to 1991 which totally crippled the Ethiopians hope of having powerful nation in all aspects including the economy. Government therefore, should establish limits to the freedom or rights for protection public interest through well defined legal jurisdictions to avoid arbitrary action. Good laws emanate from good people and vise-versa. Good laws are not simple blue prints rather they are practical in serving the society out of which they originate through independent judiciary system. Thomas Hobbes and john Locke with this respect were pragmatic liberal political philosophers for they preached freedom of speech, freedom of opinion and of writing and suggested that limits to such rights are important for protection of collective interest. Collective interest is much elaborated in the philosophy of Bentham who was utilitarian. Bentham's philosophy has assumed significant position in the development of welfare economic thought and in modern law making augmented with the liberal political philosophy which based its fundamental unit of analysis on individual rights where economic rights are 2nd generation rights next to the liberty of life. Using Inductive reasoning liberal political philosophers argue that individual rights protected amounts to collective rights protected. Is this argument universally valid? This argument has been the subject of argument. The preachers of liberal theory had no doubt in its validity as they have been defending it. The Marxist-Leninists socialists argued that the proposition — individual rights respected amounts to common rights protected is invalid and capitalist system which rested on the basic philosophy of individual right is inherently evil. The explanations of both camps were subject to the social system to which they refer. These arguments are hardly possible for one to reconcile but we can think of their practicality in different social contexts though the west –east divide was finalized by the victory of the western capitalist system. In societies where homogeneity (i.e. in culture, language, history, religion, and lifestyle) supersedes heterogeneity, individual sentiments could be closer to uniformity and hence the argument is appealing to be valid. However, in a society where the reverse order of the above situation prevails, individual sentiments could be uniform among a given group of the society and hunder this situation the argument may not be equally appealing to be valid. The socialist based excessive intervention and government control in the economy prove to be inefficient resulting in wastage and miss-use of resources. The neo liberal based non-interventionist economic policy has lead to repeated global crisis. These experiences, therefore, signal the fact that the political economic platform determines the efficiency of an economy. My point here is political decisions should critically identity economic sectors that could best serve the common interest without government intervention and those in which government intervention best serves the common good. For this decision the economic, historical, social and cultural system of the public should be properly synchronized.

Which Precedes? Economic Liberalization or Political Liberalization

Starting from the recent past there has been controversial debate concerning the precedence of political liberalization and economic liberalization another attempt to demarcate politics from economy. China's and Singapore emergence followed by brazil as the economic stars with their policy of market liberalization before democratization, in the early stage of a country's development resulted in the debatable idea of market liberalization preceding political liberalization. Though this policy is opposed to the unpredictable reform path experienced by Central and Eastern European countries of the former socialist bloc, which predominantly chose rapid and simultaneous political and economic liberalization in the 1990's (Claudia Senik and Pauline Grosjean, 2008 and Stiglitz, 2006) they has proved to the most successful emerging economies. According to Claudia Senik and Pauline Grosjean, and Stiglitz, Latin America also illustrated that political liberalization can bean obstacle to the development of the market when leaders need to impose unpopular reforms while being responsible to their constituencies. This theory concludes that the optimal route is to develop market institutions in a first stage of development, and consider democratization at a later stage. Developmental state policy advocators (Lipset, 1959; Miller et al.1994,

1996) post pone political liberalization and believed in precedence of economic liberalization arguing that the desire for political freedom and democratic institutions does not arise until countries reach a certain degree of material comfort and market liberalization. They claimed that this sequence also meets citizens' preferences. This is the lee's hypothesis of closed politics and open economy for development policy and it worked for the current Asian economic stars. This argument is not acceptable to neo liberal economic thinkers who inclined to the parallel liberalization of both politics and economy. Most of the liberals however argue that political liberalization precedes economic liberalization. Their arguments are that promotion of investment both local and direct foreign investment is easy with political liberalization which builds the confidence of investors in the governance system of a state. For liberals wealth accumulation if any under developmental state political and economic models is at the cost of human rights and with intimidation. Developmental state governments are viewed as non democrats by the liberal thinkers. It is evident that developmental state principles support state capitalism and strong hands of the government in the economy. The democratic state versus the developmental state is a false dichotomy for by Ebrahim Fakir (2005). He argued that the Developmental State on the hand and the Democratic State on the other hand are not compatible. The debate on these two terms has been cast in largely mutually exclusive terms, with a tendency to confuse managerially, public sector performance and delivery as synonymous with the developmental state. Of course the developmental state is this, but it is much more. On the other hand, there is the tendency to conflate and confuse the idea of the democratic state with the classic notions of democratic indicators – in all their guises, from the liberal to the radical. But as radical as the conceptualization of the democratic state may be, its exclusive focus on rights, responsiveness, representation, consultation, accountability, oversight, participation and voice is perhaps its weakness, as the democratic state is all of these things, but also much more. Liberals argue that investors feel secured in liberalized and democratic political systems. The argument of the liberals also passed the test of practicality for it was the path followed by the current globally known as industrially advanced countries with the forerunner the United States of America and Western Europe. So what lesson could the least developed countries consider from this experiences? Can we think of single universal path to development? I would like to subscribe to the historical school thinking, structuralism and institutionalism to answer this question. Historical school thinkers argue that policy tools and models that worked somewhere may not prove the case in other social and historical contexts. They questioned the validity of the universal application of economic and governance models paying special tribute to the variability of history, culture and social systems of states. They advise states to look in to their internal affairs when they try to import models and policies the effectiveness of which is tested somewhere else. For structuralism and institutionalism the structural and institutional arrangements as well as institutional capacity are of paramount importance for development of governance and economic development policy models (Michael P. Todaro and Stephen C. Smith (2005). According to North (1990), institutions are defined as the "rules of the game in a society, or, more formally, humanly devised constraints that shape human intervention. Among the institutions that are most crucial to economic growth are those that enable a country to allocate capital to its most productive uses. Such institutions establish and maintain strong property rights, an effective legal system, and a sound and efficient financial system. In recent years, the field of economic development has come to the conclusion that nstitutions rule and is critical to economic growth. Therefore, the issue of precedence between political liberalization and economic liberalization should be determined case specific based on the reality of economic, institutional, historical, structural and social phenomenon in states. For institutional thinkers institutional capacity development is the way for ward for achievements of remarkable economic growth and development. Democratic leadership also needs the development of institutions capable to deal with the social, economic and legal matters. Therefore, parallel liberalization is possible subject to the scrutiny of the social system. Democratic political system fosters hard work and achievements and mobilization of resources for economic development. Under such leadership style is easy and hence, political liberalization along with economic liberalization can accelerate economic growth and development. Developing countries should protect their democratization process from those nations obsessed with exporting what they call democracy, good governance, and ideal political ideology for themselves. Political ideology, for instance is the matter of thought and intellect that should be developed in a given social system. It does not by any means qualify to be a commodity to be exported by producers of it and imported by consumers. The neo liberal open market philosophy has in fact contributed to the dominance of the power full economies enabling them to gain at the cost developing economies where production technology and skill were far behind those developed economies. This resulted in unjust global trade system where one group (i.e. the developed world) controls the production mechanisms and others (i.e. the developing) remain as huge market for unloading the produce of the others. This is the hidden objective but fact which most of developing economies policy makers did not realize for long as fundamental reason for developed economies policy makers to demand the free trade and open market as preconditions in provision of aid and bilateral relation ship with the weakest elements of the global system. The reality is, however, Development policy should emerge from the nation's historical, economic, social and cultural paths. Policy freedom is fundamental for developing economies to be free from acting as an agent of exporters of democracy and political as well as economic ideologies.

Why Government Intervention Is Justifiable?

Some liberal thinkers view market liberalization as a radical shift in policies of regulation to deregulation to bring effective economic development and growth. Such thinkers argue that it is not the benevolent act of stake holders in an economy which brings economic efficiency rather it is the self interest and motive. That is, if every one has freedom of action would strive to maximize his/her own motive and hence maximize common interest. I would like to raise here the following question: are individual interest and collative interest compatible? If yes how? If no why not? To answer this question firstly one need to understand the nature of individuals and collective interest. Liberal moral theory (utilitarianism and deontology) assume that human material nature is the seat of desire, and that desire is essentially unsociable. Mandeville and Bentham argued that individuals are selfish or egoistic. Hence, their action driven towards maximization of ones interest may be at the cost of the common interest. Epistemological perspective philosophers (Ay nrand 1964, 1982,) argue that human beings are selfish but rational and therefore they do not destruct collective interest for their action is dependent on reason and only reason. According to my view this may be the case where welfare social thinking and ethical actions of the public are at advanced level and engraved in thinking of members of the society. It may prove the case in a society where ethical actions are standardized and unwritten article in their constitution. Even in such societies people would inevitably try to distort the public interest for personal gain (true for the super egos). Secondly, if individual interest and collective interest are compatible why do governments exist? Political philosophers in their state formation theory argue that existence of government is justifiable for stateless life is characterized by war, competition and conflict which are savage life. Therefore, I argue that individual interest and collective interests are rarely compatible. Government intervention with appropriate policies and tools can make collective interest and individual interest protected. Policy tools that regulate individual behaviors are important for this purpose. Liberal thinkers argue that market liberalization promotes investment both local and foreign direct investment. My question here is does mere market liberalization suffices for attraction of investors? Do inventors need nations to accept neoliberal orthodox theory as political ideology? The answer is that investors need open economy which is properly managed with stable macroeconomic variables matched with peace and security, political stability, congenial investment policy environment, suitable infrastructural facilities (i.e. transport, communication and power), strong institutions to establish and enforce private property laws and regulations. That is the breakthrough the world came to know from the experiences of Asian raising giants. My point is, first for nations which are in the take-off and preconditions for take-off in economic development, state action in infrastructure development is imperative. Although dreaming economic development without private sector development is just expecting gold from the sky, Private investors with their intension of making return from their investment are not willing to construct high way roads, street lights, police protection, and other infrastructures which are key for investment promotion but non excludable by their nature and hence unprofitable to the private investor. For the excludable infrastructural facility development even government can not force investors to go to the geographical area of government's choice but infrastructure is important. In Such situations, governments may have strong hands in an economy because of investment in to infrastructure development. Secondly, in case demand for goods and services exceed the supply and lack of industrial education may expose the public/consumers to exploitation by few producers that could enjoy monopoly or oligopoly power in production and pricing decisions. Again government intervention in provision of goods and services could reduce the burden of public exploitation by few. I argue here that demand and supply management is critical in such economies until relatively large producers come to the market and the public gain industrial education to the level where producers are compelled to think of social welfare in their business decisions. Generally speaking, government intervention is important for correction of market failures even in advanced economies let alone in developing economies where the market is imperfect, monopoly power prevails, technological progress is low and weak institutional and structural problems are the essence in their governance and administration systems. Government intervention could alleviate the market imperfection problems (Paul R. Krugman and Maurice Obstfeld (2005), but bigger government could lead to inefficiency. Hence active government in all spheres of government operation is important for economic, social and political transformation. Nero liberal Economic theory as preached by academics has dissociated itself from economic reality and has been trying to disentangle economy from politics or state. Evidence, however, proved that state and economy can not be separated and hence comprehensive knowledge of the social system, economic and political conditions is fundamental for economic administration and development policy making.

Economic Liberalization Implications

Financial market liberalization opens the local capital markets of a country to foreign ownership and operation. It is well recognized that strong domestic financial markets can play a key role in economic growth and development (Peter Blair Henry, 1999). Theoretical literature proved that liberalization reduces the cost of capital as foreign investors obtain diversification benefits from investing in emerging markets. Consistent with the reduction in the cost of equity, liberalization events are associated with substantial positive abnormal returns that are related to the diversification benefits provided by local stocks (see: Chari and Henry, 2004). The reduction in the cost of capital provides investors with financial resources at low cot and therefore promotes growth and investment. Well structured, properly functioning sound financial markets provides congenial environment for mobilization and allocation of saving contributing to improved productivity and growth. However there is booming literature with the argument that financial market liberalization may not bring the desired out come but adverse results. Kwan Chowand. Et al (2007) argued that unless the process of liberalization is properly managed, it could provoke destabilizing capital flows and lead to volatile exchange rates potentially increasing the vulnerability of individual countries to external financial shocks. Frederic S Mishkin (2007) argued that the following six preconditions are important in financial market liberalization practices to reduce the negative consequences: 1) develop strong property rights 2) Strengthen the legal system3) Reduce corruption 4) Improve the quality of financial information 5) Improve corporate governance 6) Develop sound, prudential regulation and supervision of the banking system. What does the mixed outcome of literature about the effects of financial liberalization tell us? Is that mere liberalization which results in adverse effects or the liberalization process and procedures foreword by countries? My answer is that it is not liberalization which produces evil results but the failure of the institutional and regulatory processes used. Emerging economies that opened their economy to foreign investors has achieved a remarkable improvement in economic growth though not without shocks to their financial markets. The experience of the Asian financial crisis of the 90's proved that strong regulatory framework and independent supervisory agency is mandatory for healthy financial market operations and since then the IMF incorporated this to its policy advice to developing economies though it has advocated liberalization with loose state action for very long period of time (Joseph E. Stiglitz 2004). Official liberalization of local markets, therefore, should be based on critical investigation of the benefits, the costs and its implication on the stability of the economy. Liberalization should be the subject of concern after the development of the necessary regulatory and institutional frameworks accomplishment. This is the case because mere liberalization is not sufficient for economic growth as it would lead to chaos if not properly administered. Proper policy tools and institutional systems should be in place to minimize the financial risk and volatility that could emerge as the consequence of liberalization. Precedence should be given to development of strong institutional and regulatory frameworks in such away that they can be workable and operational in the process of economic management and administration. Liberalization could lead to domination of foreign firms and investors in local markets at early stages and this would result in failure to develop strong local firms. Therefore, regulatory provisions that could restrict 50% plus ownership for foreign firms in local financial markets, for instance, are vital for development of local firms and financial markets.

Concluding remarks

Neo liberal economic philosophers have been preaching non interventionist policy as the way out of poverty and backwardness for developing economies. That is, liberalization of both politics and economy. Pragmatic economic operation, however, proved that government intervention is important for reasons such as correction of market failures and imperfect market operation and, minimization of monopoly power, as well as problems of technological progress, weak institutional and structural systems. It has also been evidenced that market left to itself leads to economic and financial crisis which repeatedly shocked economies of those nations appealing neo liberalists and forced their policy makers to intervene in economic operations. Neo liberal economic philosophy is based on individual as unit of analysis with the presumption that individual interest driven action produces better result for the whole society. But the reality is that the selfish interest of individuals is not compatible with collective interest. Adam smith the forerunner of free market economic philosophers clearly dictated that moral and ethical actions of market actors are of paramount importance for success of free market economic system. Neo liberal economic philosophers, however, committed moral crime by distorting Adam smith's thought simply picking only the skeleton of his free market hypothesis which is perfect market competition and interpreting it in their own ways. What neo liberal philosophers missed is the fact that human beings are egoistic and could act immorally to gain at the cost of others and this result in economic operation which is non Pareto optimal. Hence, Selective liberalization should be pursued by governments after development of regulatory and institutional frameworks that enable governments to monitor market operation and intervene if need arises. Concerning the debatable issue of precedence between political liberalization and economic liberalization, empirical evidence is inconclusive so far for the very reason that both paths were proved successful by different countries with different social, economic and historical experience. But those countries that pursued the path of economic liberalization postponing political liberalization to latter periods have recorded economic and social transformation at faster rate (Marcia Burdette 1992, Paulin Grosjan and Claudio Senic 2007, Fransisco Giavazzi and Gudio jebellin 2005)) than those economies that postponed economic liberalization. Hence, the issue of precedence between the two as development policy options should be determined case sensitive on due account of the political, social, economic and historical experience. To sum up, the origin of development policy should be the nation's historical, economic, social and cultural paths and countries can pursue parallel reforms in economic and political systems if compatibility problem is determined insignificant.

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