Emerging Economies and Market Oriented Development Policy

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The classification of countries has been very dynamic over history due to changing economic situations as well as relationships between countries changing. Since the beginning of the Cold War during the 1940s, countries have become categorized under three main categories: First World, that are capitalist states such as the US; Second World including communist states in Eastern Europe with their allies including China; and Third World countries, referring to Non-Aligned Movement members and underdeveloped poor countries in Africa, Middle East, Asia and Latin America (Harris et al., 2009; Haynes, 2008).

By the 1990s, as a consequence of the collapse of the Soviet Union this categorization became no longer valid (Haynes, 2008). Thus, the terms ‘developed’ and ‘developing’ countries became widely used (Harris et al., 2009; Haynes, 2008). The relationship between developed and developing countries used to be regarded as rich countries and poor countries. This relationship started to undergo some changes when some Asian countries, such as China and India, started to have remarkable rapid economic growth, that gave them considerable political and economic power on regional and international levels (Harris et al., 2009). After this, a new term has appeared – ‘Emerging economies’ – to describe low-income countries with rapid growth that include developing countries in Asia, Latin America, the Middle East and Africa as well as transition economies in Eastern Europe (Hoskisson et al., 2000). These emerging economies have become active players globally, and they can have impact on the world economy, aid and other spheres, as will be discussed herein.

This paper intends to find out to what extent some emerging economies are challenging the certainties of market-oriented policies through state intervention in markets and the application of protectionism, and how they have changed the nature of aid relationships when some of them have emerged as new donors competing with traditional donors. This paper is divided into two main sections. The first section will discuss the emerging economies and market oriented development policies, and will include a case study from South Korea, while the second section will talk about emerging donors and their role in changing the aid relationships, with a case study from China. Finally the conclusion will be presented.

There is no one package of economic models that can be entirely applied. In other words, countries cannot be labelled as totally free market or state-led, as countries can adopt policies from both models at the same time. All economic models consist of a number of policies that can be adopted in some countries widely while in others in a more limited pattern (Gills, 1996).

A comparison was made between two groups of emerging economies: the first group relies more on state industrial policy, such as Taiwan and South Korea (East Asia) while the second group widely apply free market approaches such as Chile (Latin America). By reviewing the growth level achieved by Chile in comparison with South Korea and Taiwan it is found out that there is a large disparity between them. For example, unlike Taiwan and Korea, imports in Chile became a substitute for domestic production. Figures show that Chile’s domestic production contribution to industry is around 33% while in Taiwan and Korea it reached more than 60% (Albala-Bertrand, 1999). Another comparison shows that the least market-oriented countries with poor resources like Korea became more industrialized than market oriented rich countries with resources like Brazil (Auty, 1994).

It is argued that East Asian countries have made such high achievements through free markets without intervention from the state. Nevertheless, obstacles have stood against the growth of international division of labour because of a lack of infrastructure and weakness of financial markets that were tackled by the state (Chang, 2006). Accordingly, the emerging economies of East Asia challenged the free market approach through achieving high economic growth and development when they relied on state intervention in the market and applied state industrialized policy, unlike emerging economies in Latin America.

South Korea was chosen to be an example of the emerging economies that challenge the certainties of market-oriented development policy through achieving high economic growth despite the strong role of the state in markets. It is necessary to clarify that the Korean case was not 100% state-led nor was it a 100% market-based economy, as it has passed through several transition stages since 1961. There have been obvious state interventions and protectionism policies in most of these stages – the most challenging issue for market-oriented policy – on the other hand, there was also a recent gradual orientation towards trade liberalization and globalization due to internal and external pressure (Gills, 1996).

A number of claims consider that the South Korean miracle of development and rapid growth is based on free-market development policy. Since the 1960s the state has applied several free market policies, such as cutting tariffs and trade liberalization that remarkably contributed to the economic growth (Chang, 1993). However, Luedde-Neurath (cited in Chang, 1993, p.132) strongly argues that these reforms were partially applied, which in turn ensures the invalidity of the previous claims. He supported his argument with the facts that tariffs are still high, different types of restriction are still exercised over imports and there is state intervention in supporting domestic products through offering subsidies when people purchase domestic products. For example, there has been considerable state control over importing machines and the state offers subsided credits for those who purchase domestic made machines.

There are obvious examples of state intervention during the industrialization period of Korea such as the state's instructions to the private sector to invest in heavy industry. For example, Hyundai in Korea was forced to accept the instructions of the state to invest in the shipbuilding industry. Then, the industry grew and it became the second biggest manufacturer of ships in the world. Furthermore, there was full state control on the price of products from the beginning of the industrialization period until 1973. Afterwards, the restrictions on the products were reduced but the state still controlled the price ceiling (Chang, 1993).

It is worth mentioning that the World Bank has praised the state role in the economic growth in Korea (Gills, 1996). Then, when economic crisis occurred in Korea in 1997-1998 the Free-market IMF claimed that the state industrial policies were the reason behind the crisis. However, the rapid growth in Korea was achieved under the state industrial policies, while the crisis occurred a few years after the liberalization of the financial system in the 1990s (Hart-Landsberg, 2001).

New donors are not really new, as they were presenting aid in the period between the 1960s and 1980s. After this, their role decreased and DAC (Development Assistance Committee) donors dominated aid provision since 1990s. Then recently, number of emerging economies became donors known as emerging donors or non-DAC donors who started to play an active role in aid provision and to challenge the traditional donors' dominance (Meyer, 2010).

The role of emerging donors has increased recently, when developed countries have pledged to increase aid to developing countries. However, none of these pledges were kept. The US wars in Afghanistan and Iraq had impact on aid flows. Moreover, these wars led to a reallocation of aid. For example, the UK has changed the percentage of aid provided to Iraq from 0.39 to 16.4. This situation was quite encouraging to emerging donors to increase their aid flow to poor countries that were very depressed (Woods, 2008). The growing role of emerging donors met with increasing concerns from DAC-donors but at the same time there was a kind of recognition of the role of emerging donors (Tan-Mullins, 2010).

It is expected that the emerging donors will change the aid relationships in a way that will harm both poor countries and DAC-donors, as such kinds of assistance will push the traditional aid institutions like the World Bank aside with their regulations that aim at protecting the environment of the aid system. The prevalence of emerging donors' aid programmes will contribute to the collapse of the conditionalities associated with aid that have been set by established donors that include adaptation of economic reforms and adjustment, other issues related to achieving good governance, environmental protection and human rights protection.

Additionally, developing countries' willingness to make economic reforms will be reduced due to fewer conditionalities on aid being imposed by emerging donors, and this would extend to increasing their debts and wasting resources (Woods, 2008). Nevertheless, corruption as a hindrance to aid effectiveness and a path to wasting funds still exists, despite imposing conditionalities, Cooksey argues that staff from the World Bank who are working on monitoring and evaluation aid projects know about corruption occurring in aid and they do not act at a time that the WB is calling for global anti-corruption (Cooksey, 1999).

The nature of aid is also changing due to competition that never existed before the expansion of the emerging donors' activities, as the emerging donors – in particular China – are offering different kinds of assistance, including grant aid, zero-interest loans, soft loans and commercial loans to the countries that recently had debt relief from traditional donors (Woods, 2008).

The reason for choosing China as a case study is that China is the most active member among emerging donors, and has had a notable impact on changing the nature of aid. (Weston et al., 2011). China is not a new donor, as it started aid programmes during the 1960s in order to gain support in the United Nations. Recently, the objective of Chinese aid has changed. It is believed that China's current extraordinary economic growth and development process needs to secure sources of natural resources, that can be achieved through providing aid. There is another reason behind China provision's of aid, connected with the Taiwan recognition issue (Lancaster, 2007). Nevertheless, the biggest established donors use aid to serve their interests as well (McCormic, 2008).

Chinese aid is very attractive to developing countries due to the high flexibility and fewer conditionalities offered by China. Unlike established donors, China does not require recipients to achieve global standards of human rights, environmental protection, good governance or even economic reforms (Lancaster, 2007). For example, China agreed to assist Indonesia to construct power plants based on highly polluting technology, while other aid agencies did not agree to contribute to such projects (Woods, 2008).

Furthermore, a considerable amount of Chinese aid has been allocated to infrastructure projects that are considered in the top of priorities of recipients, but in which the established donors are not very interested (Lancaster, 2007). However, infrastructure projects are preferred by China, as they serve Chinese interests such as easy access to raw materials and helping increasing Chinese product distribution in the markets of developing countries (Weston et al., 2011).

As for Chinese aid management, unlike established donors China does not have an aid agency. The Ministry of Commerce is the main governor of the aid, as Chinese aid is offered as a comprehensive package of investments and trade along with aid (Lancaster, 2007). Accordingly, the process of Chinese aid provision and monitoring and evaluation system would be different.

Regarding aid transparency, in contrast to DA donors China does not announce the annual amount of foreign aid flow (Lancaster, 2007). The only report was released in 2011, and it was criticized for not referring to the criteria of providing aid, and it does not give details (Weston et al., 2011).

Finally, Mitchell (DFID, 2011), the UK International Development Secretary's described China's impact on changing the map of donors:

'It just wouldn't have made sense for a global deal on aid effectiveness to go ahead without the involvement of China and other major players in international development'. He added, 'Their continued presence at the table, alongside other emerging economies, ensures this deal reflects the reality of today's development landscape'

This paper has discussed how some of the emerging economies have proved that the value of a market-oriented development policy is not totally certain and state intervention can help in achieving and sustaining economic growth. South Korea was reviewed as an example of challenging the free market by applying state industrial policies and in the later stages some of free market approaches were presented and state intervention in market was also retained. It seems that the adoption of one model of development is not always sufficient, while a 'Mix and Match' technique could be more helpful to achieve the best economic performance.

As for emerging economies and aid relationships, the role of new donors from the emerging economies in changing the aid relationship has discussed as well. It is obvious that emerging economies wanted to take part in aid provision for several reasons, topped by securing their access to natural resources. Emerging economies became preferable to poor countries due to being perceived as the good man who comes to save poor countries from the evil of aid conditionalities. It seems that emerging donors could weaken the role of established donors in the long run if the emerging donors retain their flexibility and established donors keep all their conditionalities, unless they reshape their own aid provision policies.

Finally, the increasing role of emerging economies tends to challenge the myth that the West's prescription is the best to follow. However, one question remains unanswered, Will emerging economies take over the role of the established donors or will they be complementary to the established donors?

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