



WORKING PAPER SERIES
THE MULTILATERAL DEVELOPMENT BANKS
AND THE GLOBAL FINANCIAL CRISIS

WORKING PAPER 2
THE ASIAN DEVELOPMENT BANK BETWEEN THE CRISES:
PURSUIT OF COMPETITIVENESS, 2001-2007

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Abstract

This is the second of three linked working papers which analyse the discourse produced by the Asian Development Bank, principally in successive *Asian Development Outlooks*, from 1996-7 onwards. Very extensive use is made of direct quotation, in order to provide substantial illustration of the analysis offered. The papers will serve as a point of reference for more synthetic analysis to be developed elsewhere. It may be, too, that they will serve a purpose to other researchers interested in the arguments developed by the Bank over the period. An identical common introduction, setting out briefly the analytical framework adopted, appears in each of the three papers. It situates the analysis in a classical Marxist framework which interprets the production of discourse and ideas in its material context, presenting the ADB as a representative of 'Asian capital in general', committed to the development of capitalism on a global scale, and adapting its discourse from moment to moment in accordance with the changing material context in the global economy, and in Asia. This second paper covers the period from 2001 to 2007, a period that sees the articulation by the Bank of a programme for the transformation of production and social relations across Asia, with the objective of achieving competitiveness in the global capitalist economy. Within this programme, the expansion of trade and the attraction of foreign direct investment were seen as important because they were sources of competition and of access to advanced methods of production. At the same time, the Bank promoted reforms to financial systems, and continued to press for a wider programme of structural reform, in particular in relation to labour flexibility and social protection. As a consequence, the region was well placed when the global financial crisis broke in 2007.

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**THE ASIAN DEVELOPMENT BANK BETWEEN THE CRISES: THE PURSUIT OF
COMPETITIVENESS, 2001-2007**

ANALYTICAL FRAMEWORK

The analytical framework employed here applies the historical materialist method outlined by Marx and Engels between 1845 and 1859 to the contemporary world, and in particular to the relationship between the state of development of global capitalism and the discourse produced by the Asian Development Bank. As detailed elsewhere (Cammack, 2012a), it principally draws and builds upon the *Critique of the German Ideology*, the *Manifesto of the Communist Party*, and the *Preface to the Contribution to the Critique of Political Economy*. Here the framework is presented in summary form, without direct reference to the sources, as a context for the analysis that follows.

The starting point is the 'economic structure of society,' or the totality of the relations of production that individuals enter into in the social production of their existence, and the insistence not only that the history of humanity must be studied in relation to the history of industry and exchange, but also that the development of the capitalist world market on a genuinely global scale is an essential step towards the realization of human freedom through the abolition of private property. Production and foreign trade are the sources of ever-intensifying competition through which the intercourse of individuals with one another beyond national boundaries is shaped. The advent of large scale industrial production plays a particularly crucial role, launching a constant revolution in labour productivity, transforming relations between capital and labour and setting in motion the processes that will eventually create the global proletariat. I place particular weight upon Marx's assertion, in the *Preface to the Contribution to the Critique of Political Economy*, that successive social orders, the modern bourgeois order (or capitalism) included, do not collapse under the weight of internal contradictions until their potential to develop the forces of production further is exhausted, and I suggest on this basis that the late 1980s and early 1990s mark the *beginning* of the transition to global capitalism as Marx and Engels imagined it. Only in the last twenty-five years or so have we begun to see the development on a global scale of the productive forces and social relations proper to capitalism, and only in the last five years has Asia become the 'centre' of the global capitalist economy.

This has clear implications for 'products of consciousness' - conceptions, thoughts, narratives, ideas - in general, but particularly for those associated with international organizations concerned with the governance of the global economy. Marx and Engels rejected the idea that such phenomena could exist independently of the material circumstances in which people found themselves, arguing that the mode of production

of material life *conditions* the general process of social, political and intellectual life. At the same time, the question of what kinds of ideas are produced, when, how and by whom, especially in direct relation to the mode of production of material life and the processes describe above that attend it, is of crucial significance. Here, the essential methodological requirement is that conflicts and transformations at the level of ideas or discourse must be understood not in terms of a dynamic internal to ideas and discourse themselves and in detachment from material circumstances, but on the contrary in terms of the material circumstances from which they spring and from which the impetus for change derives. In particular, Marx follows the suggestion that successive social orders do not disappear until their potential to develop the forces of production further is exhausted with the thought that 'Mankind thus inevitably sets itself only such tasks as it is able to solve, since closer examination will always show that the problem itself arises only when the material conditions for its solution are already present or at least in the course of formation'. I take this as a cue to suggest that in the governance of the global economy, relevant organizations should be expected to address the problems which present themselves, but not necessarily to identify them in advance of their appearance. This bears on my treatment of crises.

Finally, following the model of the 1864 International Working Men's Association with which Marx was directly involved, I see international organizations whose objectives are addressed to the global political economy as seeking to advance projects that transcend the immediate perspectives of determinate material interests in particular national locations, and enable them to pursue jointly a programme, consistent with the current state of development of forces and relations of production, that advances their shared class interests. In the case of the contemporary international organizations concerned with the global economy, and the Asian Development Bank in particular, this project can be expressed as seeking the completion of the world market, and the real subsumption of labour to capital on a global scale. In short, the emergence and development of an ADB narrative relating to global capitalism should *follow* and *reflect* material developments in the regional and global political economy itself.

THE DISCOURSE OF THE ADB: PURSUING COMPETITIVENESS, 2001-2007

In each of the three working papers that cover ADB discourse from 1997 to 2012, my principle focus is on the thematic chapters published as part of successive annual *Asian Development Outlooks*. These chapters supplement the review of the current situation and the brief commentaries on each individual member country that are the other standard elements of each *Outlook*, generally addressing a theme of strategic significance, often reporting on research carried out by the Bank itself, and providing both analysis and comparative data aimed directly at policy makers across the region. they are strongly didactic in character, often spelling out basic principles in textbook style. they can be

said, therefore, to reflect the Bank's sense of itself as a 'knowledge' bank - a source of authoritative guidance on development policy, backed by the provision and analysis of comparative data. These annual essays - some more and some less significant in terms of their scope and orientation - are supplemented by other analytical and programmatic work - such as the current strategy document, *Strategy 2020*, and reference is made to these as appropriate.

THE PURSUIT OF COMPETITIVENESS

Between 2001 and 2007, the focus turned to a systematic examination of the links between the external economic environment (regional and global trade, and foreign direct investment) and the agenda of domestic reform that had emerged in the period of the Asian financial crisis in relation to flexible labour markets and competitiveness. Successive thematic chapters in the *Asian Development Outlook* set out a post-crisis agenda for the reform of financial institutions, but also developed a broader agenda promoting social and industrial transformation in pursuit of global competitiveness, and incorporated into it the contributions that might come from increased trade and direct foreign investment (Box 1, below). There are two developments of note in the period, both representing an intensification of characteristics already in place. The first is the focus on competitiveness, for which the 2003 *Outlook* was a landmark document. The second concerned the didactic character of the material produced - making the designation *Competitiveness 101* particularly apt for this period.

Asian Development Outlook 2001: Asia's Globalization Challenge

The considered response of the Asian Development Bank to the Asian financial crisis came with the 2001 *Outlook*, which embraced the project of integration into the global capitalist economy with renewed vigour in what was a significant statement of intent. In broad terms, it returned to the classical political economy conception that linked free trade with greater competition and therefore efficiency (precisely to approach adopted by Marx and Engels in the debates on free trade 150 years earlier). The 2001 essay began with a reference back to the case for openness and inclusion made in 1999, and immediately made the link back to efficiency and competitiveness:

As argued in Asian Development Outlook 1999 (Part 3), economic development theory suggests that openness allows an economy to make better use of its resources through greater specialization in production of the goods and services that it produces relatively cheaply, which it can trade for goods and services produced more efficiently abroad. In particular, trade enables developing countries to import capital and other intermediate inputs that are critical to long-run growth. These critical inputs bring with them new technology. A more open trade regime also encourages competition between local and foreign firms, thereby raising the level of efficiency of domestic firms (ADB, 2001: 160).

Box 1. Asian Development Outlook Thematic Essays, 2001-2007	
2001	Asia's Globalization Challenge
As DMCs continue to close the gap with the technological leaders, however, they will have to “graduate” from a growth model based on accumulation to one based on innovation. They will have to adapt their institutions accordingly. And they will have to do so in a manner consistent with the opportunities and constraints of globalization	
2002	Preferential Trade Agreements in Asia and the Pacific
Trade openness is widely recognized as a cornerstone of economic development and growth, and, ultimately, poverty reduction. Open borders have been linked with the stimulation of economic growth, with microeconomic improvements in the efficiency of resource allocation, and with increases in the level of competition among industries.	
2003	Competitiveness in Developing Asia
The key to success in the coming years is that governments and firms across Asia devise strategies to take full advantage of the potential benefits that globalization, technology, and competition offer	
2004	Foreign Direct Investment in Developing Asia
With efficiency-seeking FDI, a liberal trade regime, and a competitive commercial environment, FDI can remain a win-win proposition for developing Asia	
2005	Promoting Competition for Long-term Development
The tension between the objectives of competition law (promoting rivalry) and industrial policy (promoting the growth industries of tomorrow) is more apparent than real	
2006	Routes for Asia's Trade
The movement toward regional and bilateral agreements is a reality and is motivated by noneconomic, as well as commercial, considerations. Asia’s agreements tend to be very young, but during the time that they are implemented they will start making their mark on regional and global trade and investment flows. Therefore, it is essential that the dynamics of bilateralism are guided in such a way that they support, rather than contradict, the openness that to date has been a hallmark of Asia’s trade expansion and integration.	
2007	Growth amid Change
Developing Asia has an unrivalled record of growth and economic catch-up. It has, compared to other parts of the developing world, deftly navigated difficult changes and transformations. Yet this aggregate picture masks individual country examples of stunted growth, reversals, and weak performance. Such a record can also breed a sense of complacency among economic decision makers about the future. Even where countries are catching up, there is no guarantee that the process will continue indefinitely, and the gaps to be closed are daunting. Much more is still to be done in terms of the transfer of labour and other resources across sectors; technological upgrading; and building a competitive edge in new activities. Change will be needed to sustain and accelerate momentum, and complexity is likely to increase. These linked evolutions will not happen automatically. They require societies to develop and deploy effectively a broad range of capabilities.	
Source: <i>Asian Development Outlook</i> , various years	

Against this background, the Bank now urged upon its developing member countries

(DMCs) the need to graduate from a growth model based upon accumulation to one based on innovation (ADB, 2001: 166); and to adopt policy frameworks that would maximize the benefits of globalization while minimizing risks 'by managing the volatility that results from a more integrated global economy, and by protecting the most vulnerable groups of society from them' (ADB 2001: 172). Skilled labour, export promotion and the fact that 'restraints on entry and other policy interventions were guided by well-defined rules and ... technocrats enjoyed the bureaucratic autonomy necessary to avoid "capture" by domestic industry' (175) were key aspects of the 'Asian model', but that model had now to be reformed:

This is not to say that the Asian approach will become indistinguishable from that of its counterparts elsewhere. On the contrary, certain features of the Asian approach such as sound macroeconomic management, fiscal discipline, and maintenance of a low-inflation environment, are eminently well suited to a globalized, technically fluid world. These are strengths on which the Asian approach in the 21st century can build. Export orientation and the emphasis on export competitiveness remain admirable characteristics of economic systems faced with rapidly changing technologies and the globalization of production. Governments should still encourage and actively support collaboration between universities, technical institutes, and private-sector firms, as well as promote the commercialization of new technologies (ibid: 176).

At the same time (in part in response to the Asia crisis), the ADB outlined 'policies aimed at limiting volatility and minimizing its adverse social consequences' (179). It singled out adverse impacts on productivity and investment, and income distribution, poverty and educational attainment, and declared 'The most damaging forms of volatility are financial crises. These crises are incompatible with growth: they lead to stop-go policies, interfere with the operation of the domestic financial system, cause distress to the corporate sector, and force governments to curtail public investment' (ibid). As a consequence, they recommended that capital account liberalization should follow rather than precede recapitalization of the banking sector, the reinforcement of prudential supervision and regulation, and the removal of blanket guarantees (181), and noting the corollary, that 'capital account restrictions should remain in place until prudential supervision is strengthened and implicit guarantees are removed', they concluded that financial sector reform should proceed 'quickly but prudently'.

Unfortunately, maintaining barriers to capital flows and foreign financial competition may diminish the pressure for restructuring; developing countries may never achieve the state where their domestic financial system has been strengthened enough to allow the capital account to be liberalized. This suggests using capital account liberalization to force the issue. But recent experience in Asia and elsewhere casts doubt on the notion that external liberalization that increases the urgency of complementary financial reforms will necessarily deliver

the needed reforms before crisis strikes. The lesson from the Asian financial crisis is that the process of financial sector reform should proceed quickly, yet prudently' (ibid. 181).

FDI was to be welcomed, but it was appropriate to phase it in if the domestic financial system was not initially strong enough to compete (182); bond markets and stock markets should be developed (183); excessively large foreign reserves holdings, popular after the crisis, are discouraged.

The character of the Bank as a partner of countries pursuing reform is clearest when it comes to the issue of minimizing the costs of globalization to the poor:

Globalization will be accepted most readily if its benefits are widely shared. The fact that economies that are more deeply integrated into global markets tend to have larger public sectors can be understood as providing social protection for those who cannot protect themselves from the volatility and pressures of globalization. Such protection helps support the broad-based political coalition needed to sustain a commitment to openness. In addition, it facilitates the quick policy adjustments needed to absorb globalization-related shocks, since people will see that the immediate costs of adjustment, like the benefits, are being equitably shared (ibid: 186)

However, in what followed the analysis went beyond the 'static' objective of protecting the poor already integrated into the market economy to the 'dynamic' objective of extending its reach. So 'For the short term, insurance against shocks is needed. For the long term, measures are required to foster the accumulation of forms of human capital that are useful in an economically globalized world, *specifically among socio-economic groups that have not traditionally possessed them* (ibid: 187, emphasis mine). Advancing on the analysis offered a year before, the Bank now differentiated between a short-term safety net providing employment for those able to work (workfare), and 'lasting social infrastructure protection' of the kind required by globalization, the fundamental postulate being that because globalization exposes national economies to external shocks, 'it requires workers as well as firms to act quickly' (ibid: 188).

From 'Reform in Crisis' to 'Reform Without Crisis'

It had taken three years for the Bank to formulate a comprehensive response to the Asian financial crisis. Now, in a key section entitled 'Institutional Options in a Globalizing Environment', it set out a multi-level (global, regional, national) approach to further integration into the 'global economic system'; one that was supported by a theory of institutions, and that demanded of governments new approaches, and new institutions and policies, in a broader framework of regional and global cooperation. First,

Institutions can be understood as coordinating mechanisms - as coordinating the actions of different economic and social agents. They do so by providing standards for socially constructive behavior. Because they function as standards,

they are a source of network externalities. And like any technology that throws off network externalities, once established they tend to become locked in (ibid: 189)

However, because institutions have an inertial character, 'radical institutional change is the exception, not the rule'. Crises, therefore, presented significant opportunities:

Wholesale change requires the political and economic system to be displaced from its equilibrium. It follows that radical change often occurs in response to major shocks – crises, for example. (A model of the linkage is provided by Drazen and Grilli 1993.) By definition, crises disrupt the operation of existing institutions. That disruption creates a vacuum in which new arrangements can develop. This is the story told in Olson (1982) of institutional change in the wake of war and crisis. More generally, *the suboptimal performance of existing institutions that has been made clear by a crisis can foster the consensus needed for agreement on changes in prevailing arrangements* (ibid: 189, emphasis mine, references as in the original).

One such moment followed the crisis of the 1940s and 1950s. Another presented itself now:

Powerful urban interests were induced to acquiesce to government programs that were designed to develop the rural infrastructure necessary for balanced growth. Regime leaders had the political autonomy to develop independent technocracies and performance-based civil service systems. These institutional ingredients of Asia's "miracle" are by now well understood. The point here is that their development should be seen as a social response to this crisis of national survival. In the wake of the Asian financial crisis of 1997/98, it is again clear that a crisis can catalyze reform (ibid).

Against this background, the Bank reviewed the impressive progress made in financial reform in the region - strengthened prudential supervision and regulation, new rules for arm's-length dealing, the development of bond markets, liberalization of foreign investment, action to facilitate mergers and acquisitions, and new bankruptcy laws. Then, commenting that 'while crisis can breed reform, reform without crisis is to be preferred,' it turned to global, regional and national initiatives for 'reform without crisis'. Global markets demanded regulation through global institutions, and global initiatives to influence national practices through the setting of standards, along with 'a combination of IMF surveillance, peer pressure, and market discipline', could produce global public goods while remaining responsive to different local traditions, in ways that would improve on past experience:

The complaint that IMF's structural interventions are arbitrary and capricious at least partly explains the backlash that they have provoked; with the promulgation of standards, objective criteria will exist to which IMF can refer when it demands structural reforms (ibid: 190).

There were however intrinsic limitations to a regime of international standards, and the agents charged with the task of managing it, such that the approach raised 'compelling objections'. First,

The official donor community as a whole does not possess the resources to design and monitor compliance with detailed international standards in all the relevant areas. In its early country reports on the observance of standards and codes, IMF has been forced to rely on self-evaluations by the subject countries, a practice that threatens the objectivity of the process. For IMF to carry out this function in a satisfactory way would require a very significant increase in its staff and a radical change in expertise, both of which are unlikely for the foreseeable future (ibid).

In addition, an international regime of standards would inevitably be pushed towards the lowest common denominator, and thereby weaken the incentive for individual countries to do better. The 1988 Basle Accord was a case in point, and since then banks had 'discovered ways of shifting assets subject to high capital charges off their balance sheets through securitization and the use of derivative securities without modifying the underlying risks,' a development that should 'serve as a warning of the danger that the standards setters will always be one step behind the markets' (ibid: 191).

There was a place, therefore, for regional initiatives, and heightened interest in such arrangements in Asia since the financial crisis, where it was 'a reflection of the perception that the advice and conditionality of the international financial institutions were inadequately tailored to the particulars of the crisis and that these institutions failed to capture the distinctive features of the Asian approach to growth and economic learning' - hence the Chiang Mai initiative, and talk of an Asian Monetary Fund, and a possible regional free trade zone (though this was not a priority for many member countries, as they did not want to endanger their US trade or jeopardize extra-Asian market access) (ibid).

'Globalization has considerably further to go'

The chapter concluded with a 'framework for globalization' which set national policies in the global and regional context on the premise that 'globalization has considerably further to go' (ibid: 193). Barriers, especially non-tariff barriers, to further integration in trade remained in many developing countries, 'inhibiting the efficient allocation of resources in each country, and impeding economic growth and structural reforms in many countries'. At the same time, Asia's developing countries were facing an important change in the sources of economic growth:

As Asia's high-growth economies mature, the source of their growth will progressively shift from factor accumulation to TFP growth. This will require changes in policies and institutions. In addition, low-income DMCs that wish to

follow their high-income predecessors down the path of labor-intensive, export-oriented manufacturing using technologies imported via licensing will find their task complicated by globalization. Countries like the PRC and India are attempting to implement this strategy. Competition is intense. Selling the products of low-wage manufacturing industries in global markets will become increasingly cutthroat. And as more countries compete for foreign investment, their ability to acquire technology via licensing will be correspondingly curtailed. Sustaining growth in this setting will require telescoping the transition from accumulation- to innovation-based growth. In turn, this will require accelerating the evolution of policies and the renovation of policy-making institutions (ibid).

Recommendations followed for stable macroeconomic policies, sound regulatory arrangements, and good governance; trade liberalization; public investment in human and physical capital; radical changes to policies and institutions supporting systems of innovation, to favour more flexible and innovative smaller firms, with greater reliance on securities markets for venture capital for new technology start-ups; strengthened monetary and financial institutions; floating or 'hard peg' exchange rates, with the appropriate disciplines observed; and in relation to capital account liberalization, strengthened regulation, priority for FDI, the phasing in of greater competition in the banking sector, the use of market-based initiatives to regulate capital flows (on the lines of the Chilean year-length deposit system), and the steady development of well-regulated stock and bond markets. Finally, under the by-now conventional heading of 'poverty measures', the Bank argued for a combination of short-term safety nets, and longer-term measures 'to foster the accumulation of forms of human capital that are useful in a globalized world' (ibid: 196). Throughout, this essay gave ample evidence of the strategic orientation of the Bank in relation to its reform agenda.

Asian Development Outlook 2002: Preferential Trade Agreements in Asia and the Pacific

The importance attached to trade as a source of pressure towards competitiveness and the unhappiness of the ADB at the slow rate of progress of trade liberalization through the WTO were both much in evidence in 2001 and earlier. In this context, the 2002 thematic essay took up the controversial theme of preferential trade agreements in Asia and the Pacific. It confronted head on the argument that bilateral and regional deals can work against liberalization on a global but argued that if properly pursued, regional agreements could force the pace of both liberalization and structural change. The chapter opens with the statement that

Trade openness is widely recognized as a cornerstone of economic development and growth, and, ultimately, poverty reduction. Open borders have been linked with the stimulation of economic growth, with microeconomic improvements in the efficiency of resource allocation, and with increases in the level of competition among industries. Trade increases the variety of intermediate

products and capital goods that are available and opens up communication channels for exchange of production methods and business practices. Economic integration has also been shown to have an important impact on reducing corruption, increasing government responsiveness, and improving the quality of economic policies ADB, 2002: 157).

This led into a discussion of PTAs as 'a second-best means of promoting trade liberalization in a context where multilateral negotiations proceed slowly,' and a stated objective 'to identify the specific features of PTAs that are worrisome and those that are more likely to contribute to improved economic performance' (ibid; 161-2). Significantly, the analysis began with up-dated figures on world and regional trade (following on previous discussions in 1997 and 1998) showing that the rate of growth of world exports continued to outpace that of world GDP, and that the share of developing economies in Asia and the Pacific had gone from 6.4 per cent in 1973 to 9.7 per cent in 1983, and 14.8 per cent in 1993, to reach 17.8 per cent by 2000 - a steadily growing share of a rapidly rising whole (ibid, Table 3.4, p. 165). The Bank also noted APEC's commitment to 'open regionalism', and the high export orientation of the region, and of Southeast Asia in particular (Figure 3.3, p. 167 and Table 3.7, p. 172). In addition it remarked on the significance of Subregional Economic Zones (SREZ), whether 'growth zones', intended to 'take advantage of the differential mobility of capital and labour to reduce the cost of manufacturing', or 'corridors', which seek 'to create infrastructure links to bring together areas with economic complementarities between labour, land, and other factors' (ibid: 173).

As to whether Asia-Pacific PTAs were building blocks or impediments to the realization of global free trade, the Bank set itself to extract 'concrete and realistic policy guidelines from the theoretical analysis' (ibid: 173). Its principal focus was on the impacts of increased competition in domestic markets, increased market size, inflow of FDI, overall levels of trade (trade creation versus trade diversion), and the distribution of welfare gains, where the picture was mixed. The Bank also noted strongly positive non-trade characteristics of PTAs as 'institutional mechanisms for broader cooperation': efficiency gains as PTAs function as forums for 'negotiation of deeper integration and wider policy reform'; enhanced regional security arising from trust-building; technology transfer and information sharing, and the locking in and accelerating of economic reforms: 'membership of a PTA can commit policymakers to reform and prevent them from backtracking on reforms once they are implemented' (ibid: 177-8). Overall, the Bank argued, PTAs can complement global (WTO) initiatives, as a space for experimentation and testing, for example, or a training ground for officials; but at the same time they may reduce the authority or appeal of multilateral liberalization, set up perverse dynamics of change (for example where regional and global comparative advantage are at variance), and lead to a 'spaghetti bowl' of mutually inconsistent restrictions (ibid: 181).

On this basis, the Bank concluded that PTAs in Asia and the Pacific had led to quite high levels of cooperation in trade facilitation and non-trade areas, particularly among ASEAN countries. As regards the trade effects that were the principal objective, it noted that both the volume of trade and the number of rose rapidly in the 1990s, but also cautioned that for most PTAs the proportion of intra-bloc trade was low - 75 per cent for APEC, where it had been high before the organization was founded, 25 per cent for AFTA, but 12 per cent or less for the other four considered. A gravity model analysis suggested that APEC, not surprisingly given its commitment to open regionalism, had expanded both intra-bloc trade and trade with the rest of the world, while the results for AFTA suggested an inverse relationship but were particularly difficult to interpret given the combination of changing membership and the financial crisis (ibid: 188). On the whole, the Bank concluded from this that PTAs in Asia and the Pacific were trade-creating rather than trade-diverting, and noted that there was some but by no means general support for this view from computable general equilibrium models, which however also showed multilateral liberalization to be clearly superior in both trade and welfare terms.

In its conclusions, the Bank expressed a firm first preference for expanding the world market, because of its superior productivity- and efficiency-enhancing effects (ibid: 190). PTAs could create incentives for 'inefficient specialization', especially if outer tariff walls were high, or rules of origin inappropriate. On the other hand, they had 'several potentially beneficial effects as instruments for structural change,' and as mechanisms to assure that previous reforms will not be reversed and therefore strong signs of commitment. It was this, above all, that the Bank highlighted as the major benefit, while it was 'encouraging, at least, to know that PTAs do not appear to have limited trade' (ibid: 191). In sum, then, the PTAs in Asia and the Pacific were a suboptimal route to free trade with potential benefits. But three major reforms were needed - extension of trade facilitation and non-trade cooperation; more progress towards free trade, especially in excluded sectors such as agriculture; and reduction in the differences between PTA members' external policies, to reduce the importance of rules of origin and the scope they provided for inefficient specialization and rent-seeking (ibid: 191-2). In addition, the PTAs could focus more on discussing regional priorities and on preparing for negotiations in larger forums such as the WTO; and 'the potential role of PTAs as enhancing commitment to policy reforms in member countries could also be strengthened' (ibid: 192).

In sum, the Bank wished to see the PTAs play a strategic role as part of a larger project - as a stepping stone to genuinely free trade, and a resource for the consolidation of policy reform. This conclusion was reinforced by the accession of China and Taiwan (PRC and Taipei, China in ADB's terms) and to the WTO:

The trade growth that will emerge from the PRC over the next few years will present an adjustment challenge in the short term for other DMCs in the region. Nonetheless, the medium- to long-term prospect is for more efficient location of production in industry in general and thus for accelerated trade and economic growth ... The proposed ASEAN-PRC Free Trade Area and the moves toward economic partnership between ASEAN and Australia and New Zealand have the potential to make similar contributions to boosting trade growth and increasing competition and economic efficiency (ibid: 193).

The spirit reflected here of a positive embrace of the challenge of global competition, a constant feature of the approach of the Bank in its relations with member countries, was the central theme of the following *Outlook*. When the Bank turned its attention directly to the theme of competitiveness in 2003, it produced a major synthetic statement that established some of the key points of what would become its guiding narrative after the global financial crisis: the new industrial revolution, the turning point in the development of the global economy, and the future centrality of Asia, providing the right policies were pursued.

Asian Development Outlook 2003: Competitiveness in Developing Asia

The exposition of the politics of competitiveness in the 2003 *Outlook* was systematic, and based on first principles. First, taking cognizance of recent and current debates, it was explicit in equating competitiveness with labour productivity:

Unfortunately, national competitiveness has become something of a buzzword: in common parlance, competitiveness is used to cover almost any aspect of market performance and its overuse may detract from its importance. In fact, the key variable for the economic analysis of competitiveness is the growth of labour productivity since this, ultimately, is the main determinant in raising living standards. This is what competitiveness is about (ADB, 2003: 206).

For this reason, it continued, it was 'crucial to provide a grounded explanation of the microeconomic foundations of competitiveness and growth of labour productivity' (ibid); and it identified the moment quite explicitly as one of a new phase of expansion of the global economy: 'Today's combination of the new industrial revolution and globalization is similar to that of the late nineteenth century when, for example, the United States (US) emerged as a major economic power; or earlier when the United Kingdom emerged as a colonial and manufacturing power' (ibid). So when the Bank elaborated on the issue of labour productivity in this context, it went back to classical principles:

Why does raising firm-level labour productivity matter? Because this is how the profit motive is put into practice at that level. In order to increase profits, firms must increase labour productivity, and it is for this purpose that new machines and methods of production are introduced, leading to an increase in the capital/labour ratio. Increasing labour productivity is the key to ensuring survival

and long-run growth both at the firm and national levels, and this is the essence of competitiveness (ibid: 215).

In short, 'giving workers more capital to work with raises their productivity' (ibid). In turn, this analysis was set in a macro-structural framework of Schumpeterian 'creative destruction. In this context, the role of the government was to shape the competitive environment facing firms, as set out at length in a section entitled 'Institutions, the State and the Market: A Partnership for Development' (ibid: 224-236). In summary, following Stern and Stiglitz (1997) throughout, 'a development strategy requires a working partnership between the state and the market', whose objective is to create '*a well-functioning market economy*' (ibid: 224, emphasis in the original). In this partnership, the role of the state was to provide the institutional infrastructure in which markets can function – providing a basic legal framework that enforces product market competition and a stable macro-economic environment.

The Bank then discussed the merits of tax incentives for foreign direct investment, the creation of export processing zones, and the promotion of industrial clusters (ibid: 229). In doing so, it stuck to liberal principles. On FDI it reviewed and dismissed artificial incentives, and advised that

public policy to attract FDI to the Asia-Pacific region should aim at improving the macro- and microeconomic fundamentals of the economy, including infrastructure and education, and at strengthening institutions, such as the legal system. Attempts at incorporating domestic-content and joint-venture requirements into FDI agreements will have negative effects. ... From a microeconomic point of view, governments must tackle the impediments to competition and entrepreneurship if they are to encourage FDI, and should direct efforts to reduce any excessively complex administrative procedures (e.g., business and tax registration, land access, site development, import procedures, and inspections) required to establish and operate a business. These discourage inflows of FDI (ibid: 232).

On Export Processing Zones, it was even less enthusiastic, but noted that they could be used as transitional schemes in order to initiate export-led production, produce spillover effects and improve competitiveness: 'The question is how to transform low-skill export enclaves, which is what EPZs tend to start from, into higher-skill and higher-productivity areas that are better linked to the rest of the economy, so triggering a sequence of beneficial changes throughout the economy' (ibid). On industrial clusters, it was also dismissive, cautioning against the idea that they could easily be established by government decision. Governments could at best act as a catalyst, to complement private sector efforts, and interventionist policies worked best 'when they are implemented in conjunction with broad reform packages. Even here, they were second-best to efforts to improve the 'broader business environment' (ibid: 234).

This conclusion led directly into a broader consideration of the 'area of shared responsibility between the state and the market' - education, physical infrastructure, and technology and innovation. Primary and secondary education, was 'clearly the role of the state,' (along with guaranteeing and enforcing the legal system, providing macroeconomic stability, and correcting market failures), and there could be sharing in higher education and in the provision of infrastructure, but beyond this it was 'less clear what the role of public policy should be'. In part this was because the evidence was inconclusive with regard to incentives to attract FDI, create EPZs, and promote clusters, but in part, too, it was because of 'two related dynamic competitive factors' that were already making developing Asia 'a formidable producer and exporter of technology-intensive goods', and 'inducing a shift in the location of the world's knowledge-based work' - the shifting investment strategies of MNCs and the importance of global value chains, and the availability of skilled labour (ibid: 236).

These two topics formed the centre-piece of the chapter, clearly signalling that the Bank saw them, in combination, as the way forward, in a way that was specific to Asia. Global value chains could be 'an important catalyst in learning and adapting advanced technologies,' and could greatly magnify the benefits of trade liberalization, delivering three further benefits arising from the broadening of the scope for gains from trade: providing opportunities to specialize in labour-intensive stages of manufacturing, rendering protectionist, import-substitution, or anti-foreign investment policies 'even less effective', and giving 'added impetus to the need to improve the efficiency of transport and communications infrastructure and for a stable business environment' (ibid: 237). There are two notable features here. The first is that the Bank clearly saw the development of global value chains in strategic terms, as a means of driving not only trade liberalization but also global capitalism forward; and second, it drew directly on World Bank and ADB-commissioned research to make the case, at a point when the phenomenon of global value chains was only beginning to be discussed in the academic literature.¹

The discussion that followed identified the benefits of GVCs to firms in terms of climbing the technology ladder and gaining wider access to international markets, noted the difficulty of entry, and identified ten latecomer entry strategies (FDI; joint ventures; foreign and local buyers (contract manufacturing); licensing; subcontracting; informal means such as overseas training, hiring and returnees; original equipment manufacture; own design and manufacture; strategic partnerships for technology; and overseas acquisition of equity). Each of these was then discussed in detail, with an emphasis on

¹ The Bank relies here on two sources: Theodore H. Moran, *Strategy and Tactics for the Doha Round. Capturing the Benefits of Foreign Direct Investment* (Manila, ADB, 2002); and Alexander Yeats, 'Just How Big is Global Production Sharing?', *Policy Research Working Paper*, No. 1871, 1998.

successful examples from Hong Kong, Taiwan (Taipei, China) (Acer), and Korea (Samsung, LG) (ibid: 237-242). The discussion then broadened into areas of marketing, distribution and brand development skills, in a form exactly captured by the notion of 'Competitiveness 101' set out above - a how-to guide, backed by selected academic references, and an emphasis on the fact that some Korean and Taiwanese firms are now 'indistinguishable from world market leaders and compete at the technological frontier' (ibid: 244), a development barely imagined two decades earlier. In summary, the benefits of GVCs include

the ability of local enterprises to (i) begin production with its existing level of capability, (ii) access technological knowledge, (iii) access large export markets, (iv) exploit economies of scale, (v) progressively upgrade capabilities in manufacturing with the help of foreign enterprises, (vi) learn process and product innovation skills, and (vii) eventually catch up with advanced firms. Within the GVC, there is pressure to adapt to market demand in industrial countries, resulting in more flexible and competitive enterprises. The willingness and ability of latecomers to learn rapidly from leading GVC players are essential (ibid: 244-5).

The didactic pay-off or teaching point follows. After outlining the danger of GVCs in which firms are restricted to a dead-end assembly role, the Bank concludes the section with the statement that

it is clear that firms wishing to enter GVCs need to be operating in an environment in which the right institutional fundamentals are in place, including a stable macroeconomic environment for business investment, a reliable business infrastructure, and widely available basic and technical education. Policies are required to reward entrepreneurial risk taking, otherwise firms will not enter GVCs and clusters of suppliers will be unable to form. Policy makers may wish to consider the barriers facing firms that wish to enter a GVC. Sometimes, it is over-regulation of companies or high taxation; sometimes, bureaucratic rules concerning FDI, joint ventures, and company start-ups. Also, skilled workers and technicians may be lacking in some areas. Resolving these constraints may help provide a conducive environment for firms to join a GVC (ibid: 245).

A lengthy section on education and skill follows (246-256). The focus is on 'demands for more innovative and creative workers,' and takes off from the assertion, from a World Bank study on the capacity of Asia to compete and innovate, that high school and tertiary education in much of East Asia is 'mediocre and uncompetitive at best'.² Precisely because East and Southeast Asian countries are in transition from labour-intensive to technology-intensive manufacturing, if not there already, they need to

² Shahid Yusuf and Simon J. Evenett, *Can Asia Compete? Innovation for Global Markets* (World Bank, 2002), p. 40.

improve the quality of education to cope with new FDI inflows, and the generation of domestic R&D - which means 'an emphasis on the relevance to the needs of a modern economy of the curriculum and style of education' (ibid: 249). Predictably, the focus in what follows is on science, technology and engineering, and the need for *all* countries in the region to invest in it to avoid being caught in a 'cycle of low skills, low wages, depressed productivity, and low levels of technology' (ibid: 250, and Box 3.8, p. 251). In sum, education policy can enhance the productivity of labour in two important ways: 'First, it facilitates and encourages the accumulation of human capital via direct investment by the government. Second, it makes investment in schooling profitable to households' (ibid: 255).

Five 'key policy messages' are then distilled (from a World Bank, East Asia and Pacific Region draft working paper):³ while basic education remains the bedrock, 'many schools need to shift the focus away from mere rote learning of facts toward a more critical understanding of analytical concepts and technical knowledge'; 'pedagogy should encourage more experimental learning as well as group learning and teamwork, the cornerstone of skills in the modern workplace'; 'the modern workplace requires employees who are inherently "trainable" and can learn rapidly'; 'there may well be a case in several countries for increasing public investment in higher education to expand provision and make it more affordable to a greater number of students'; and 'governments in several less developed countries may need to improve the supply and quality of lifetime learning' (ibid).

The section that followed, *Catch-Up Competitiveness: Some Lessons* (ibid: 257-63) made the ambitions of the Bank for its member countries clear. Its focus was on what the 'less developed' states could learn from the NIEs (new industrial economies) that would allow them too not only to progress, but to 'catch up, rather than merely keep up with (at a certain distance behind) the leaders' (ibid: 257). The basics, as always, were entrepreneurship, educational provision, market-friendly institutions and sound macro-economic management. But

catch-up competitiveness is a dynamic concept. Catch up cannot occur if a country does not create new resources or restructure its industries toward more productive, higher-value-added products. This is achieved by the country absorbing, adapting and improving on the technologies that underpin new products, services, and processes. Dynamic competitiveness also relies on the infrastructure needed for sustained industrial development (ibid).

³ C. S. Ihm, 'Part C: Skills that Matter in the Workplace', in *Korea: How Firms Use Knowledge*. Poverty Reduction and Economic Management Unit (East Asia and Pacific Region), draft paper, January 2002. Washington, DC: World Bank.

Crucially, the Bank embraced unreservedly here a model of global competitiveness as a perpetual revolution of the means of production, in a spirit that echoed (uncritically) the vision of global capitalism of the *Manifesto of the Communist Party*, and expressed at the same time the developmental twist given by the Bank to its classical liberalism:

Mere imitation is insufficient, because the more advanced countries will constantly be moving the technology frontier outward and generating new technologies and product types. In addition, other industrializing countries will be entering, competing, and changing the competitive landscape. This implies that each developing country needs to overcome its own particular disadvantages in terms of resources and its stage of development. But this is not sufficient. It also needs to build up its own distinctive advantages and resources to prevent itself from falling behind, and to go beyond merely keeping up in order to catch up (ibid: 257).

In keeping with this perspective, the bank stressed the 'variety in policy and industrial structure' in the East and Southeast Asian electronics industry, drawing on Hobday (1995). The mix of policies that had led to rapid development across the region varied quite significantly in institutional terms, with the level of policy intervention ranging from high (Korea; Singapore, Malaysia, Thailand) to low (Taiwan, Hong Kong), the degree of openness to FDI and imports similarly from high (Singapore, Malaysia, Thailand; Hong Kong) to low (Korea, Taiwan), while four different industrial structures could be observed: locally owned large firms in Korea; locally owned small firms in Taiwan; foreign owned large firms in Singapore, Malaysia and Thailand; and a mix of locally owned small firms and foreign-owned large firms in Hong Kong (ibid: figure 3.4, p. 261).

In the light of this, the ADB produces its own (again, uncritical) version of the Marxist theory of *combined and uneven development*:

Each country must develop its own policies, based on its own resources and given its particular level of development. The stages of development are endogenously determined and not simply and automatically passed through.

This qualification applies both to early developers who followed existing new paths and to latecomers. The latter respond, adapt, and act on the new conditions facing them as a result of new technology and market conditions created by earlier developers. Countries wishing to improve competitiveness need to focus on and develop their own distinctive capabilities and resources. ... The experience of the NIEs strongly suggests that the mere imitation of the paths followed by the leading countries would be unsuccessful because the latter group constantly moves the competitive frontier forward by generating new technologies and new markets (ibid: 262-3).

For ease of consultation, the conclusions, running over two pages, are copied in their virtual entirety in Box 3 on the following page.

Box 2: The Asian Development Bank's Ten Theses on Competitiveness

Globalization, technological progress, and competition are the main drivers of change in today's world, where knowledge is the most important resource. .. The key to success in the coming years is that governments and firms across Asia devise strategies so as to take full advantage of the potential benefits that globalization, technology, and competition offer.

Competitiveness is a firm-level issue and hence its analysis requires a firm-level approach. It is, therefore, essential to provide a grounded explanation of the microeconomic foundations of competitiveness. An important implication is that the term national competitiveness, especially if used in the context of nations competing for market shares in exports, as some scholars and governments have taken it, is elusive and even misleading.

Competition and the quest for profits are the driving forces of firms in a market economy. Competition among firms forces the adoption of the cheapest methods of production and the improvement in the quality of products. In the process of introducing better technologies, new lower-cost methods become available, which allows for increases in labour productivity. Increasing productivity is critical for firms because this is how the profit motive that drives them is put into practice. Labour productivity grows through the interplay of two complementary mechanisms – increases in efficiency and the rate of technical progress. The latter is the result of both investment and the development of entrepreneurial and technological capabilities. ... In other words: firms become more competitive not only by reducing costs but also by improving existing products and developing new technologically intensive products.

The debate over whether national competitiveness has any meaning has its roots in the discussion about what the appropriate role for government policy to enhance firms' competitiveness is. Firms compete in an increasingly global market and government policies can either help or hinder their efforts. The goal of governments in this context can be summarized in the idea of creating a well-functioning market economy, which is what is meant by a competitive economy.

A well-functioning market economy is the result of a partnership between the state and firms. The ultimate objective of this partnership is for developing countries to increase living standards and to catch up with the countries at the income and technological frontier. Increases in labor productivity are the key to achieving sustained long-run growth in living standards. The other component of a well-functioning market economy is the development of institutions, which are determined by historical and cultural factors as well as by government actions. Institutions are an immobile factor of production and consequently each country has to experiment and set up the institutions that work in its particular context.

The role of firms in this partnership is to try to be as competitive as possible. Governments have a very important role to play with a view to building a well-functioning market economy, and toward enhancing firms' competitiveness. They have to provide the institutional infrastructure and make available myriad services to facilitate competition among firms by providing a level playing field. Specifically, governments' main functions are to provide macroeconomic stability; set up the necessary legal system, including competition and entry and exit laws; and address market failures. Likewise, there are three major areas where there is room for state and markets to share responsibilities: education, technology and innovation, and physical infrastructure.

Certain aspects of government intervention that aim to enhance competitiveness are **more controversial when they are used as competitiveness policies** and, in particular, if they cloak what is in effect industrial policy and an exercise in picking the winners. These are the provision of financial incentives to attract FDI, the creation of EPZs, and the creation of clusters and industrial parks.

Two related dynamic competitive factors are making developing Asia a formidable producer and exporter of technology-intensive goods. Among the variety of possibilities for firms to enhance their entrepreneurial and technological capabilities, **GVCs offer significant opportunities to many Asian firms to take advantage of the potential benefits of globalization.** There are many ways for a firm to enter a GVC and these largely depend on the firm's level of development. The NIE firms successfully entered GVCs three decades ago and it was in this way that they climbed the development ladder. Their experience can be very useful to the firms in less developed countries of the region.

The availability of skilled labor is another dynamic competitive force. Education is an area of shared responsibility between government and market, especially at the tertiary level. The East and Southeast Asian economies now provide basic education for all those who are eligible. However, in recent years they have realized that their educational systems need important reforms, in particular regarding the mismatch between the type of education supplied by universities and the skills demanded by the firms. There is no unique solution to this problem and countries in the region will have to experiment.

Finally, **firms in less developed countries in the region can learn a great deal from the experience of the firms in the NIEs,** which reduced substantially the technological gap with firms at the frontier during the last two decades. They did this not by undertaking R&D, but through behind-the-frontier innovation, which involved constant improvements to processes and products. This has been referred to as catch-up competitiveness, which depends on entrepreneurship, provision of education as well as market-friendly institutions, and sound macroeconomic management. The discussion has argued that exactly replicating the NIEs' experience will be impossible, mainly because the global economic environment has changed, and because the specific resources and capabilities of today's developing economies differ from those of the NIEs.

Source: *Asian Development Outlook*, 2003, pp. 257-263.

They show, in the way they bring themes together under the unifying idea of competitiveness, how the Bank worked to a comprehensive long-term vision which started from first principles and developed a practical programme for the region as a whole - here as elsewhere, in a form consistent with the application of the same principles on a regional and global scale.

Asian Development Outlook 2004: Foreign Direct Investment in Developing Asia

The 2004, 2005 and 2006 *Outlooks* built on the framework set out in the 2003 *Outlook* discussed above. Taking the theme of FDI, the 2004 edition reviewed in its familiar didactic textbook style the general arguments for and against FDI, and recent developments in such areas as international investment agreements, bilateral treaties and

TRIMs. Overall, noting areas of debate while insisting that there had been a qualitative change in its character and the implications for developing countries: 'The contemporary challenge for developing countries is to develop a new approach to managing FDI. In a globalizing world, competition for FDI is no longer about rents but instead *focuses on the establishment of an enabling, business-friendly commercial environment, consistent with national development objectives* (ADB, 2004: 215, emphasis in the original). It recognised that if badly managed or poorly controlled, FDI could have negative consequences, as for example when a combination of abundant natural resources and weak institutions led to excessive and uncontrolled extraction and environmental harm (ibid: 221), but insisted throughout that the proper response in all cases was for governments to develop the capacity to manage FDI well.

The centre-piece of the chapter was a comparative case study of China, India, Korea, Malaysia, Thailand and Vietnam, organized around the ideas that 'trade reform alters the incentive of production for the domestic market relative to exports, resulting in a fundamental shift in the behavior of MNEs and in the FDI cost-benefit calculation,' and that 'as economies open up, governments have to make the transition from protectionist/regulatory regimes to a new emphasis on investment promotion and efficiency,' with emphasis on microeconomic or 'second-generation' reforms, or 'competitiveness' variables (ibid: 244, and Table 3.4, p. 245).⁴

According to the Bank, the key points emerging from the study were that

Notwithstanding their diversity, almost all developing Asian economies have adopted progressively more open policies toward FDI during the past decade or two, and this trend appears likely to continue. This more open posture has been accompanied by the adoption of more liberal trade regimes, a process that has had profound implications for the motives for, and impact of, foreign investment. These changes have been so rapid in some cases that the policy framework has been unable to keep pace (ibid: 259).

Whether or not benefits accrued from FDI, the Bank firmly concluded, depended upon 'host country policy regimes and institutional capacities' (ibid: 261). The seven policy recommendations were (1) maintain a flexible and adaptable regulatory environment, with particular regard for the quality of incentives, institutions and infrastructure; (2) complete the unfinished reform agenda, especially with regard to the liberalization of services; (3) tailor specific micro-interventions to the level and character of development, and extent of FDI; (4) create a unified investment regime that treats foreign and domestic firms equally; (5) beware the discriminatory effect of preferential trading arrangements; (6) encourage decentralization for its competitive potential, but ensure national

⁴ Published as D.H. Brooks and H. Hill, eds, *Managing FDI in a Globalizing Economy*, Palgrave, London, 2012.

developmental objectives are observed; (7) prefer the provision of a commercially profitable and politically stable environment to a regime of 'second-best' fiscal incentives. In short,

With efficiency-seeking FDI, a liberal trade regime, and a competitive commercial environment, FDI can remain a win-win proposition for developing Asia (ibid: 263).

Asian Development Outlook 2005: Promoting Competition for Long-term Development

Building again on the 2003 *Outlook*, the 2005 issue complemented the 2004 focus of foreign direct investment by addressing, through a focus on competition policy, the *domestic* regimes required in order to secure competition in domestic product and factor markets, with its presumed benefits in relation to prices, consumer choice, innovation and 'production efficiency,' or the selection of more efficient firms from less efficient ones over time (ABD 2005: 237). As always, the approach of the Bank is strategic, focused in general on making institutional reforms in order to increase the impact of global competition in the domestic arena, and in particular on reconciling competition policy on the one hand and industrial policy on the the other:

In the past two decades, many countries in the region have adopted market-based reforms and reduced government intervention in their economies in response to heightened competition resulting from regional and global integration. Trade barriers have been lowered, foreign investment encouraged, exchange rate pegs removed, protection of domestic industries withdrawn, and government enterprises privatized. These changes reflect confidence that open-market forces will strengthen firm-level productivity and competitiveness, and will contribute more to growth and development than a closed, centralized orientation would. As a result, policies to promote competition have climbed up the domestic and trade agenda in Asia, just as they have in the rest of the world. However, Asian countries have been slow to adopt and implement comprehensive competition policies, reflecting a debate between the pros (who point to efficiency gains from greater competition, lower prices, etc) and the antis (who are concerned about compromising industrial policy, cost of enforcement, etc).

The position taken by the Bank in this context is first that effective competition policy is an essential complement to other reforms: 'liberalization and privatization policies cannot be expected to automatically contribute to economic growth if competition policy and institutional infrastructure are lacking' (ibid: 238); and second that it is not only compatible with but in fact an essential part of an industrial strategy that seeks to achieve global competitiveness. Having set out introductory guidance on 'the benefits of competition' (ibid: 238-42) and 'competition policy regimes' (242-46), the latter highlighting the need for competition advocacy in line with concurrent OECD-led

initiatives, it continued with sections on 'consistency with other development objectives' before coming to 'industrial policy, competition and competition policy', with the focus always on context-sensitive competition policy and the end goal of achieving competitiveness in the global economy. In its usual style, it offers case studies (China, India, Korea, Malaysia, Thailand and Vietnam) to illustrate arguments, and document good and bad practice. On the crucial issue of industrial policy, the Bank argues that insofar as this is intended to bring about structural transformation in the economy, it requires a robust competition policy at an early stage, and quotes policy documents from both Japan and Korea in support (ibid: 250-51). At the same time, however, it is careful to preserve a space for an appropriate industrial strategy. The issue is not whether governments should promote national champions; rather, it is 'whether, in order to promote national champions, governments need, or are well-advised, to relax the enforcement of competition law' (ibid: 257); and the answer proposed is that the *'tension between the objectives of competition law (promoting rivalry) and industrial policy (promoting the growth industries of tomorrow) is more apparent than real'* (ibid: 258; emphasis in the original).

In the light of this analysis, an extended section discusses the relationship between competition policy and regional and global integration, starting from the impeccably liberal premise that 'contestability of markets in a foreign country requires either freedom of trade or the establishment of an affiliate in a foreign country and national treatment in order to compete on equal terms with domestic producers' (ibid: 260). In addition, it points out after a review that highlights widespread shortcomings in this context across its case study countries, 'appropriate enforcement of competition law both enhances the attractiveness of an economy as a location for foreign investment and is important for maximizing the benefits that flow from such investment' (ibid: 270); the two should therefore operate in concert. Again, shortcomings across the region are highlighted, with the conclusion drawn that while the six countries have been open to FDI in recent years, *'this has not always resulted in increased competition in their domestic markets,'* because other government regulations and policies have created barriers to the development of free competition (ibid: 275; emphasis in the original).

Overall, the Bank argues, 'effectively enforced competition law discourages the wrong sort of FDI without placing inordinate burdens on efficiency-enhancing foreign investments .. In a competitive environment without distortions, FDI can contribute substantially to growth and development' (ibid: 276). A pointer to why this should be so comes in the following section:

Competition is central to the process of globalization. Competition benefits the economy since domestic factors of production are able to maximize their returns, subject to the institutional constraints they face. Competition is also presumed to

constitute a spur to better economic policy, to the extent that the option of 'exit' for investors exerts a policy discipline on governments (ibid: 280)

After pointing out the potential savings to governments from the closer scrutiny of bid-rigging on government contracts, the chapter closes with a forward-looking section entitled 'Towards a competitive future'. This spells out the benefits of a strong competition policy and an appropriate intellectual property regime for the promotion of innovation, as 'even firms that are not currently competing with each other in existing product markets may be competitors in markets for future innovations' (ibid: 283-3); and 'the more stringent competition is among firms, the stronger the incentive to innovate' (ibid: 284). Similarly, providing a proper balance is kept, '*IPRs generally strengthen competition in the economy over the long run, by providing incentives for the development of new products and production processes*' Ibid: 287; emphasis in the original).

In conclusion, the Bank draws from its analysis and case studies lessons 'that may benefit other developing countries' (ibid: 288). Competition is beneficial, but short-term static efficiency improvements still need to be balanced against long-term, dynamic efficiency and development; the technological characteristics of some markets must be taken into account; competition policy and industrial policy in this perspective are complementary; along with liberalization, competition plays a key role in enhancing the international competitiveness of firms; 'participating in international organizations such as WTO or OECD is an effective way to bring the pressures of international competition to bear on promoting competition in domestic markets;' during economic transition or reforms, 'the benefits of an open market economy cannot be fully realized unless restrictions on competition are removed;' as firms 'will still find incentives to engage in anti-competitive practices;' the existence of a competition policy assures foreign firms of a level playing field; competition policy is affordable because savings direct to government outweigh the costs of implementing the policy; and appropriate enforcement preserves the ability of innovative firms to enter markets; and the earlier competition policy is introduced, the better (ibid: 289-90). In sum

The general conclusion is that competition confers net benefits on an economy. Productivity rises, choice expands, and some (generally the bulk) of the increased benefits are appropriated by domestic consumers and factors of production. These benefits appear to be especially important in connecting the country to the global economy and ensuring the international competitiveness of its firms as the country develops. At the same time, the discipline of participating in a globalizing economy reinforces the importance of competition. Of particular relevance is the fact that, while many countries are moving to implement or strengthen their competition policies, none appears to be moving towards repealing them (ibid: 290).

Asian Development Outlook 2006: Routes for Asia's Trade

The 2006 *Outlook*, unusually, included additional sections on the textile and clothing sectors after the removal of quotas, and the (dim) prospects for the Doha round. The thematic chapter, on 'Routes for Asia's Trade', complemented these and elaborated further on the discussion of trade that had been prominent in previous years. In doing so, it returned to the issue of the relationship between bilateral and multilateral trade liberalization, on which it had offered a positive view in 2002. It set out to illustrate the 'risks and opportunities of bilateralism,' and to seek out 'means to ensure that the rising tide of bilateral free trade agreements leaves, in its wake, building blocks to global trade liberalization, not stumbling blocks' (ADB 2006: 267). By and large, the analysis reiterated arguments made before. It stressed the growing insertion of the region into world trade and the rising proportion of regional exports in total exports, with (a ten-fold expansion of exports from 1984 to 2004, to reach 21.3 per cent of world exports, with 40 per cent of the total within the region, compared to 22 per cent in 1980 (ibid: 269); it credited technological advances, reduced transportation costs, institutional innovation, foreign investment and resulting greater trade efficiency as much as liberalization *per se* for this outcome; it highlighted in particular the significance of 'international production sharing' or fragmentation, noting that 'developing Asia's share of world trade in parts and components rose from 16% in 1992 to 32% in 2003' (ibid: 273); and it noted its reservations with regard to PTAs. In summary, 'technological changes and market forces unleashed by policy initiatives to unilaterally open up Asia to foreign investment and trade have thus far played the crucial role in deepening regional economic integration and in linking Asia to the largest global markets of the EU and US' (ibid: 275).

The Bank then turned to the proliferation of bilateral agreements since the mid-1990s (it identifies well over 100 in various stages of formalization), and recognizes the various positive motives behind them, but warns that while bilateral agreements have the potential to act as catalysts for deeper integration, 'the global tide of bilateralism on which Asian countries are being carried could pose significant risks to the multilateral trading system' (ibid: 280). It therefore sets out to establish how a favourable outcome might be achieved, by way of a general equilibrium model analysis of four scenarios for the period to 2025 – status quo, complete free trade, an Asian free trade area (open regionalism), and continued bilateral initiatives (hubs and spokes). First of all, the analysis brings out the consequences of Asia's dynamic growth – even on the status quo scenario, its share of world GDP increases from 28 per cent to 40 per cent (though Japan and (marginally) the NIEs lose share). Under free trade, 'Southeast Asian economies such as Malaysia, Singapore, Thailand, and Viet Nam (sic) are major winners'. South Asia does less well, which 'illustrates some fundamental weakness of exporting sectors in these countries, suggesting the importance of structural and institutional reforms (as well

as international development cooperation) in gearing them to trade and increasing their openness' (ibid: 285). Significantly, the Asian free trade scenario delivers benefits 'nearly as large as those from global free trade', while 'no country or global region loses under the assumptions of Asian free trade' (ibid: 286). China and India do less well, however, than the Southeast Asian states. And in the final scenario (bilateralism), the China hub as a whole does rather worse than the ASEAN hub, and both fare considerably less well than under Asian free trade, but China individually does well, as might be expected for a hub.

The Bank then offers an 'agenda for trade and integration in Asia', in response to the 'practical question' of 'how bilateral FTAs might be best designed so as to maximize their potential leverage on the growth of trade and economic integration' (ibid: 289). The emphasis is on ancillary measures to increase trade efficiency, and the conclusion notes that 'agreements that attempt "deep integration" - by reducing trade costs through behind-the-border reforms - could be potentially much more beneficial than traditional PTAs' (ibid: 296). The PTA principles themselves (Box 3.8), ask for wide coverage, symmetrical and simple rules of origin, and even-handed and transparent customs procedures, procurement rules, competition laws and technical codes; and the Bank urges Asia to take a global lead. And in doing so, it again places the focus on the least-developed countries, for whom full exposure to the world market is seen as essential:

Asia could play a significant leadership role by adopting these principles and by incorporating them in its bilateral and regional trade agreements. Leading by example would not only have significant economic benefits but would also strengthen the profile of Asia in the global trading system. The least-developed countries in Asia have, perhaps, the most at stake in this process. As they move forward with economic reform and commercial policy liberalization, it is of the essence that international markets remain open to them. If market access is effectively closed off by a web of preferences favoring others, it will be extremely difficult for them to succeed in their reform process. It is also important that the poorest countries are helped in developing the technical and physical capacity to take advantage of global markets. Many low-income countries remain at a competitive disadvantage in getting their goods to market. Assistance for trade facilitation and the easing of behind-the-border trade barriers will likely prove critical to their success (ibid, emphasis mine).

Asian Development Outlook 2007: Growth Amid Change

The Foreword to the 2007 *Outlook* did not anticipate the coming global financial crisis: ('The outlook for the international economy remains broadly favorable, although growth will slow in 2007';) and it predicted growth for developing Asia of 7.6 per cent in 2007 and 7.7 per cent in 2008, compared to 'exceptional' growth of 8.3 per cent in 2006 (ADB 2007: iii). It did warn that risk was ever present, noting that 'as always, events could

evolve in surprising and unexpected ways, and derail projections. Risks remain tilted down. Markets have moved to reprice risks, but calm could yet give way to less settled conditions. If asset prices get badly punctured and reversals occur, the chill would be widely felt' (ibid: iv), but it went on to mention only the possibility that oil prices might rise rather than fall, the risk of protectionism as time ran out for the Doha Round, the threat of a human flu pandemic, and the potential for instability around elections.⁵ It introduced the theme of growth amid change with the striking thought that 'over the *next few decades*, developing Asia's prospects will depend critically on its ability to adapt to a constantly changing environment' (emphasis mine), and went on to enumerate the policies that would be required:

While prescriptions and priorities need to be country specific, the following elements are crucial: high investment rates that over time build, expand, and upgrade the range of economic activities; funds for infrastructure services that are vital for economies of scale and other benefits; relevant and purposeful education; markets that support labour mobility and flexibility, alongside affordable social protection; arrangements that lower risks and uncertainty for businesses, and that allow new firms to enter and old firms to exit; and removal of at- and behind-the-border impediments to integration (ibid)

As this summary suggests, the perspective of the Bank was *long-term*, and *region-wide*; it did not predict the coming crisis, but it did assume that *crises would happen*; it took a *highly positive* view of the prospects for Asia, based upon a recent history of dynamic expansion, swift recovery from a regional crisis, and high rates of growth; and it recommended a policy package, perfectly familiar from previous *Outlooks*, that would in principle bring about dynamic capitalist development over the long term.

Embracing the challenge of globalization

The general approach of the Bank to the inevitability of crises and the manner in which to address them was also set out in a separate section of the *Outlook*, in which the Bank reported that growth in Indonesia, Malaysia, Philippines, Thailand and Korea had resumed from 1998, on a steady trajectory but at a slower rate than before the crisis. Investigating possible reasons for the output gap, it identified a move towards 'precautionary behaviour' on the part of firms and investors, and concluded that lighter but more effective regulation, improved governance, the exposure of sheltered activities to more competition and the building of modern and efficient financial systems would lead to greater investment and growth (ibid: 46-65). Following that, a detailed analysis of

⁵ 'Growth in the major industrial economies is set to slow, but growth in the euro zone and Japan is close to potential. Inflationary pressures seem to be slowly dissipating in the United States (US). Corrections in the housing market there have been sharp, but not disorderly. There is now less dissonance about the outlook, and the chances of a recession are receding (though not completely), and so far markets have absorbed risks. As investment spending pulls back, US growth is expected to slow in 2007. In Europe, the outcome in 2006 was the best in 6 years and momentum' (ibid: 3)

Box 3: Regionalization as a transmission channel for global shocks

Regionalization that is tied to globalization is potentially a transmission channel for a global shock. Increased trade openness and economic integration with the global economy could induce greater business cycle synchronization among the regional economies by exposing them all to a common global shock. Further, strong regional economic integration could propagate a shock rapidly across regional economies.

To the extent that Asian business cycles are sensitive to the vagaries of external demand, it is important for Asian economies to maintain sound macroeconomic conditions and ensure coherent policy management. A stable macroeconomic environment of low inflation and prudent fiscal balances with modest levels of debt provides an important backdrop for sustaining high growth. It also allows room for policy makers to take measures of macroeconomic stabilization when necessary.

Greater economic interdependence and tighter trade linkages between Asian economies also require greater cooperation in trade, finance, and exchange rate policies at the regional level. As economic and financial shocks travel rapidly from a country to its trading partners through increased trade and financial linkages, it is to all Asian economies' benefit that, nationally, they maintain sound macroeconomic conditions with prudent economic management. Synchronization of real growth and inflation in the region should also generate regional common interests to ensure close cooperation in macroeconomic and exchange rate policies.

Globalization, including the rapid relocation of production networks across borders, underscores the region's need for greater economic flexibility. Along with increasing openness to trade, globalization has allowed greater factor mobility, particularly MNCs that can choose the most cost-efficient locations, facilitating both vertical specialization and a tightly webbed regional production network across borders. The rise in intra-industry trade and trade integration has a positive impact on economic growth by promoting efficiency and productivity growth. But easier relocation of production and greater factor mobility imply that Asian economies should ensure a high degree of flexibility in both product and factor markets to maintain their regional and global competitiveness. Further structural reforms will have to move forward to improve overall economic flexibility and competitiveness.

Such reforms should include the successful completion of corporate and financial sector restructuring by deepening the reforms on governance and legal infrastructure, creating an investment-friendly environment through minimizing unnecessary regulatory barriers in business activities, encouraging private incentives toward more dynamic market economies, opening domestic markets to international competition, and creating a level playing field across all sectors. This will also help attract FDI.

Continued rapid growth of the PRC, and its deeper integration with the regional and global economies, will continue to shape opportunities and challenges for other countries. For those competing head to head with the PRC, and who are now seeing their market shares (and/or terms of trade) eroded, sustaining growth will depend on their success in promoting economic agility and carving out new areas of competitive advantage (see Part 3, *Growth amid Change*). For primary commodity producers that sell to the PRC, or for those countries that can profitably manufacture the consumer durables demanded by the PRC's quickly expanding middle class or the equipment needed to support its industrialization, the PRC's growth is likely to prove directly beneficial. Likewise, further fragmentation and refinement of supply chain activities should ultimately strengthen complementarities among the economies of East and Southeast Asia, though the gains are unlikely to be automatic and will depend on the capacity to adjust and to develop new capabilities. Finally, the logic of fast growth in a country as vast as the PRC, as well as a rebalancing of spending towards domestic consumption, foreshadows not just a more prominent role for regional incomes in forging closer regional integration but also the emergence of developing Asia as an additional engine of global demand.

Source: Asian Development Outlook 2007, pp. 78-79.

the question of whether Asia was decoupling from the West found emphatically that it was not: 'Increased vertical specialization and the rise in intra-industry trade have led to strong ties among Asian economies, but this regional integration remains structurally linked to final demand from major industrial countries' (ibid: 78). It went on to draw a number of lessons, starting from the proposition that policies intended to open the region up to the forces of globalization would inevitably create a transmission channel for global shocks (Box 3, above). As we have seen earlier, the Bank took the view that opening to the world market was essential, and shocks were inevitable. It followed that the countries in the region should maintain a commitment a stable macroeconomic environment of low inflation, prudent fiscal balances and low levels of debt, while ensuring 'a high degree of flexibility in both product and factor markets to maintain their regional and global competitiveness'; and the Bank noted that looking ahead, the prospect of increasing complementarity of economies across the region as China switched towards domestic consumption foreshadowed 'the emergence of developing Asia as an additional engine of global demand'. Although the Bank did not predict the crisis, then, it did produce on its eve a detailed analysis of investment and growth in the region ten years on from the Asian financial crisis, a parallel assessment of the extent of regional and global integration, a general orientation towards the inevitability of crises and the way to turn them to advantage, and a glimpse of the possible future of the region as China's economy developed and regional integration changed in character. These provide an essential backdrop to the analysis provided in the thematic chapter on 'growth amid change', and explain why the Bank was so quick to move, after the crisis, to identify the region as *the* engine of global demand.

This analysis was reinforced by a complementary summary of trade and structural change in East and Southeast Asia which again centred on the connections between trade, domestic reform and competitiveness, all revolving around the consistent theme that open-economy policies 'impart market discipline to firms and investors':

- Market access to third country markets, especially in North America and Europe, is vital to further export expansion in East and Southeast Asia and this means a successful and ambitious Doha Round is in the interest of the region.
- Globalization, technological change and competition requires the East and Southeast Asian economies to employ resources flexibly with ease of entry and exit.
- Countries may initiate the process of structural change by adopting or simulating open-economy policies that impart market discipline to firms and investors.

- Liberalization of trade and investment on a unilateral basis is still the most important route for reaping the gains from trade in the region and bilateral initiatives have not had much impact.
- Productivity improvements at the firm level have helped to ensure competitiveness and will continue to be essential to further develop global and regional integration through trade.
- Second generation reforms aimed at developing markets and institutions that are missing, incomplete, or inefficient are necessary to generalize open economy policies in the PRC and Southeast Asian economies (ibid: 96)

Against this background, the thematic chapter on 'growth amid change' developed this analysis, calling for profound structural change: 'The thesis of this chapter is that arrangements that instigate and propagate changes in an economy's shape are instrumental for growth and the creation of jobs' (ibid: 270). Its retrospective element took a classical focus on changes in the composition of output and employment, the speed and breakdown of labour productivity growth; the pace of technological transformation; and developing patterns of specialization and diversification. It then looked ahead, to identify ways in which *productivity gaps* with OECD countries might be closed over two decades, with a focus on the complementarity of improved productivity in industry and services, and the need for the market to be supplemented by policies of a 'catalytic' character, taking as the point of departure the realization that 'markets do a better job at allocation than they do in creating demands and providing incentives for experimentation and creation' (ibid: 270).

In relation to labour productivity, it noted the significance of composition effect gains in aggregate productivity due to transfers of labour direct from agriculture to services, but stressed at the same time the intrinsic limits to this process without a revolution in productivity in the service sector itself (ibid: 278). The conclusion of the retrospective analysis was that 'developing Asia has enormous potential for catch-up growth':

Some countries have come close to bridging the gap with the OECD frontier, others have made considerable progress, and yet others are now showing promise. But there are also countries where productivity is stagnant and where the gaps with OECD – and with other countries in developing Asia – are getting wider. At a sector level, gaps are biggest in services and least in manufacturing. Advances in productivity have been largest in industry and least in agriculture. The reallocation of workers from agriculture to industry and services has indeed provided a “structural bonus,” but to date it has been modest (ibid: 284)

The ensuing analysis laid stress, as always, on the continuing need for reform:

Developing Asia has an unrivalled record of growth and economic catch-up. It has, compared to other parts of the developing world, deftly navigated difficult changes and transformations. Yet this aggregate picture masks individual country examples of stunted growth, reversals, and weak performance. Such a

record can also breed a sense of complacency among economic decision makers about the future. Even where countries are catching up, there is no guarantee that the process will continue indefinitely, and the gaps to be closed are daunting. Much more is still to be done in terms of the transfer of labor and other resources across sectors; technological upgrading; and building a competitive edge in new activities. Change will be needed to sustain and accelerate momentum, and complexity is likely to increase. These linked evolutions will not happen automatically. They require societies to develop and deploy effectively a broad range of capabilities (ibid: 285).

How then was developing Asia to achieve both job creation and increases in labour productivity sufficient to reduce the 'yawning gap' with the OECD average? First, the optimistic assessment was given that 'developing Asia should be able to create sufficient jobs for new workers, *provided that growth does not stall and that growth continues to create jobs as it has in the past*' (ibid: 289; emphasis in the original). The Bank then moved to propose a joint focus on industry and services - 'walking on two legs' (ibid: 292-311). It noted the dominance of low-productivity personal services, and points to the importance of the modern service sector (banking, finance, transportation, wholesale and retail trade), along with the specialized area of business process outsourcing. This in turn gave rise to consideration of the skills of the workforce (addressed in complementary chapter on schooling).

Familiar policy advice followed. There were 'hundreds of millions of agricultural workers who will move to more productive activities in industry and services;' and despite the importance of high-end activity, for those with limited education and skills, 'it is the creation of low- and medium productivity jobs in industry and services that will make the difference' (ibid 312).

Five general principles followed, all familiar: 'mechanisms to mobilize savings and translate them into high rates of investment are needed', as are 'high levels of investment ..to provide the physical infrastructure that supports business and improvements in the quality of life'. Then 'a versatile labor force equipped with relevant skills is also part of the recipe', so 'markets need to be complemented by affordable social protection programs and opportunities for new learning'. Next, 'as it is business that creates wealth, impediments to business shrink (potential) wealth'. And finally, 'imitation is an important part of success. The celebrated "flying geese" model of development is based on leader-follower principles. But to be a successful follower, countries have to be receptive to ideas, to new arrangements and designs, and to new ways of organizing and producing' (ibid: 312-3).

The period ended, then, as it began - with a focus on the need to create a productive working class capable of playing its part in the future in the continuous revolution of the productive structure.

CONCLUSION

There is a consistent theme running through the thematic chapters in successive *Asian Development Outlooks* between 2001 and 2007 that is continued from the previous period - that all the ADB's member countries without exception should pursue full integration into the global economy, and should do so principally by welcoming external forces that promoted the process, and by reforming their domestic institutions to create a productive labour force. But there was also a qualitative shift, that followed upon the macroeconomic reforms implemented in the wake of the Asian financial crisis. The Bank urged its members to manage the process actively, in accordance with their current resources and circumstances, in order to make the transition from a domestic economy based on accumulation to one based on innovation. This included the whole-hearted embrace of the disciplines transmitted via trade and foreign direct investment, and acceptance of the inevitable transmission of any global crisis to the region and its individual economies. But it also required the active pursuit of competitiveness, principally by taking advantage of and building upon a phenomenon peculiar to the region - the emergence of 'fragmented production,' or global value chains. This was the material underpinning that created the opportunity for a particular strategy of regional integration, and it took pride of place in the 2003 discussion of an Asian path to global competitiveness.

The ADB in this period, then, retains its character as a partner of states engaged in the political economy of reform, and a provider of knowledge of a kind best summarized as *Competitiveness 101*. As noted in the previous paper, it did not anticipate the Asian financial crisis; and in this period it did not anticipate the global crisis that was about to break. But its activity did bear out strongly Marx's insight that 'mankind sets itself only problems that it can solve'. In other words, although it did not anticipate the crisis, it very quickly assessed the new situation to which it gave rise, and produced a narrative justifying a continued commitment to capitalist development, and a detailed programme aimed at achieving competitiveness in the global economy. In 2001 it identified crisis periods as opportunities for accelerated reform, but argued at the same time that it was best where possible to develop a positive and pro-active practice of 'reform without crisis'; and within five years it had developed a comprehensive framework to orient policy-makers in the event of a global crisis, on the assumption that the same channels that promoted integration into the global economy would expose the Asian economy to the shock of an external crisis.

As in the previous period, the Bank stuck consistently to its commitment to global developmental liberalism. In doing so, it positioned itself precisely as a partner of governments in the political economy of reform'. As before, it remained attentive to the short-term challenges faced by governments committed to global developmental

liberalism. But what is particularly striking in this period, is the scale of its vision in space and time. It particularly sought the adoption of its preferred policies in the least developed countries of the region. And it looked ahead to processes of change that would take place over decades. In doing so, it envisioned a comprehensive transformation of the region as a whole over decades. Only after the 'global financial crisis', though, would it possible to envisage that Asia might become the centre of the global economy.

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