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## **GLOBAL INEQUALITIES: WHAT IS ALL THE FUSS ABOUT?**

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“A successful move to the market, including increased integration in the world economy, explains the success stories of the past two decades” (Martin Wolf, Financial Times)

“We just can’t tolerate a major wealth rearrangement of the sort we’ve had before” (Allan Greenspan, chairman of the Federal Reserve)<sup>1</sup>

What is there to make a fuss about? The world is moving in the right direction. World poverty—the number of people living in extreme poverty, on incomes of less than \$PPP 1/day—fell absolutely (as well as relative to total world population) in the period 1981-2001, for the first time in 200 years. World income distribution became more equal over the same period, again for the first time in 200 years. These reversals of long-run trends show that the current global “architecture” works well. Africa is the exception to the general amelioration.

The current era of globalization is generally taken to have begun around 1980. Economic integration across borders has increased quite rapidly since then (measured by the trade/GDP ratio, FDI/GDP and other such indicators). And national policy regimes have shifted markedly towards “free trade liberalism”—free movement of goods and services and finance across national borders, easy establishment and disestablishment of firms, and easy mergers and acquisitions. (Labor movement is more restricted.) “Globalization” embraces both trends, which are often presented as cause and effect: policy liberalization has caused higher economic integration.

Given that the world has become markedly more “globalized”, in both senses, during 1980-2005 than it was in the quarter century from 1950 to 1975, liberal economics confidently predicts that these changes would cause a reversal of the earlier trend towards worsening poverty and rising inequality. The facts of world poverty and inequality are generally

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<sup>1</sup> Quoted in Kevin Phillips, “Too much wealth, too little democracy”, Challenge, Sep-Oct 2002, p.17. The statement dates from the early 1990s.

interpreted, therefore, as legitimising the current structure of the “global market economy”. And since there is room for still more globalization, the “globalization works” camp says that the best way to accelerate the fall of poverty and inequality is to accelerate globalization--remove the remaining policy-induced market distortions, deregulate and privatize, and fortify private property rights. It says that the global economic multilaterals (GEMS) are right to promote this core economic agenda in their developing country clients, because the agenda yields mutual benefit—to the adopting developing country, to other developing countries, and to the rich countries.

Theories of international economic relations all address the general question of how different modes of global economic integration affect the distribution of the economic gains of integration. The liberal theories that have been most influential, most legitimate, most orthodox over the past 200 years conclude that free trade/investment maximizes the welfare of not only the productively strong economies but also that of the weaker—higher unit cost—economies. Other theories, such as those of Marxist, Keynesian or Kaldorian accent, conclude that free trade/investment often generates cumulative inequality, which can cause the weaker economies to disintegrate, and/or withdraw from the union, and/or insist on managed rather than free trade complete with import protection and other forms of infant industry support. These latter theories therefore predict and validate a very different mode of economic integration—a very different kind of world economic order—than the liberal theories.

These issues about the appropriate basic principles of the international economic order are in the background of the “facts” about trends in world poverty and inequality. This is what all the fuss is ultimately about. “Ultimately”, but not apparently. The debate in the literature—a debate which has come alive in the last decade mainly in international economics and sociology, not in political science or international relations--looks to be about more narrowly scientific considerations of statistical techniques, data sources, samples, time periods, and the like. Whole conferences are devoted to these issues, where alpha males (virtually all participants are male) sit around the table and argue about whose statistical tool is better than whose. Those who criticise the “facts” claimed by the liberal orthodoxy may themselves not champion alternative modes of economic integration—they may just happen to think that the Atkinson I index is better than the Atkinson II, or that the Theil is better than the Gini. But much of the passion of the defenders of the orthodox facts comes from the usefulness of these facts in validating a larger liberal vision of the world economic order and the

correctness of the efforts of such organizations as the US Treasury, the World Bank, the IMF, and the WTO to promote still more liberalism as the only valid reform direction at national and international levels (and not, for example, Keynesian principles or East Asian developmental state principles). They form part of a Gramscian hegemony strategy, to convince subordinate classes that the rulers rule in their interests as well as their own. Which may or may not be true.

In this paper I shall give a brief overview of the debate about the poverty and inequality facts. I then go on to talk about the larger debate about liberalism; not so much about its validity but about how the world has shifted so far towards liberal assumptions and away from New Deal/Keynesian/social democratic assumptions. It is this larger paradigm shift that has provided the context in which majority opinion accepts at face value the “fact” that world poverty and world income inequality have both fallen sharply since around 1980 for the first time in 200 years. And why challenges that go beyond the sort of technical ones just mentioned are commonly greeted by jeers like, “You are just throwing up statistical dust”, “your argument leads to the paralysis of policy-making”, and “this is unbelievably stupid”.<sup>2</sup>

There is indeed a lot at stake to defend. Martin Wolf, the *Financial Times* columnist who is arguably the most influential economic journalist in the world, accuses the critics whom he labels “anti-globalists” of preaching “the big lie”—the rhetorical technique of Nazi propagandists—an accusation all the more viperous for being made by a Jew whose parents fled to England from the Nazis.<sup>3</sup> Anti-globalists are, he says, “the enemies mustering both outside and inside the gates”. His recent book, *Why Globalization Works: The Case for the Global Market*

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<sup>2</sup> These comments were made about a paper setting out my challenge to the “facts” of poverty and inequality—the first two by Australian economists on my “Globalization, poverty and income distribution: does the liberal argument hold?”, in *Globalisation, Living Standards and Inequality*, (eds.) David Gruen, Terry O’Brien, Jeremy Lawson, Reserve Bank of Australia, 2002; the third by an anonymous reviewer commenting on my claim that incomes converted at market exchanger rates rather than PPP are relevant to questions of income inequality.

<sup>3</sup> Wolf describes his background at the start of *Why Globalization Works: The Case for the Global Market Economy* (Yale University Press, 2004). The “big lie” (emphasis on “big”) refers to the principle that even an outrageous falsehood, if repeated often and loudly enough, and all contrary evidence ignored, will eventually be believed by the masses. By describing the views of “anti-globalists” as “the big lie” Wolf puts their truth content in the same category as Hitler put the truth content of Jewish propaganda and as others have placed Hitler’s claims. Hitler was both theorist and practitioner of the big lie. As theorist he wrote, “. . . in the big lie there is always a certain force of credibility; because the broad masses of a nation are always more easily corrupted in the deeper strata of their emotional nature than consciously or voluntarily; and thus in the primitive simplicity of their minds they more readily fall victims to the big lie than the small lie, since they themselves often tell small lies in little matters but would be ashamed to resort to large-scale falsehoods.” (*Mein Kampf*, James Murphy translation, p. 134. REFC)

*Economy*, is a passionate wake-up call to the thinking public about the threat to the liberal world order from the growing ranks of “anti-globalists”. The echo of Nazi Germany is unmistakable; as also the echo of an apocalyptic outlook which elevates worldly conflicts into conflicts between good and evil that are resolvable not through gradual or subtle change but only through radical transformation to a state of salvation--in this case, to the sunny uplands of a society based on the free market and the framework state, one where (as Immanuel Kant satirized the Arcadian ideal) men would be “as good-natured as the sheep they tended.”

## **THE CASE THAT GLOBALIZATION WORKS**

Let us start with Wolf’s argument:

“The failure of our world is not that there is too much globalization, but that there is too little. The potential for greater economic integration has barely been tapped. We need more global markets, not fewer, if we want to raise the living standards of the poor of the world. Social democrats, classical liberals and democratic conservatives should unite to preserve and improve the liberal global economy against the enemies mustering both outside and inside the gates.” (4).

Wolf’s apocalyptic outlook is joined to an empirical method. He bases his conclusions about the need for “more global markets” in substantial part on empirical evidence that (a) the whole world economy has become markedly more integrated over the past 25 years or so; and (b) living standards in most of the world have also increased dramatically. The former is the prime cause of the latter, he says. In his words,

“globalization...has reduced [income inequality], just as it has reduced the incidence of poverty”.

He adduces further evidence in favour of globalization by comparing the economic performance of countries that have “globalized” more (in the sense of having a bigger increase in their trade/GDP ratio over a given period, and a bigger fall in tariffs) and those that have globalized less. The globalizers have had better economic performance than countries that have globalized less. By implication, had the lesser globalizers globalized more they too would have had better economic performance. It is that simple.

Wolf concludes:

“What the successful countries all share is a move towards the market economy, one in which private property rights, free enterprise and competition increasingly took the place of state ownership, planning and protection. They chose, however haltingly, the path of economic liberalization and international integration. This is the heart of the matter. All else is commentary.” (143-4)

Wolf thinks that the media is dominated by anti-globalist sentiment. He presents his story as an embattled minority view in danger of being swept aside by forces deploying false evidence and false arguments to gull the public; his is a morality play where the usual goodies and baddies have swapped roles.

## **IS GLOBALIZATION WORKING?**

First a caveat. Most people’s eyes glaze over when one starts to talk about how economic statistics are compiled; they just want to get on with the analysis. Yet some of the flaws in the liberal argument relate to how the poverty numbers and the inequality numbers are put together. “Objective” statistical facts are in fact artefacts, based on conventions that are debatable and in some cases flatly erroneous.<sup>4</sup> For example, the convention for measuring growth rates excludes “gains from trade” through improvements or deteriorations in the terms of trade. When gains from trade are included, the high US growth rates of the 1990s are “really” lower than they are, because the US experienced a deterioration in terms of trade; while the slow Swiss growth rates of the 1990s are “really” higher than they are, because Switzerland with its precision machinery and fine chemicals experienced terms of trade improvement. China’s high reported growth rates may be roughly right, but the Chinese proverb applies even more to Chinese statistics than to those of many other developing countries: “Officials make the figures and the figures make the officials.”

One should remember Goodhart’s Law. It states that when an indicator is used as a target its measurement will be distorted. Charles Goodhart was thinking of monetary indicators, but his point applies more generally. It certainly applies to the poverty and inequality numbers, because these numbers are used by globalization champions and critics as evidence for their cause.

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<sup>4</sup> Michael Ward, *Quantifying the World: UN Ideas and Statistics*, Bloomington: Indiana University Press, 2004.

I shall make five propositions about the evidence that Wolf and other globalization champions present.

1. The evidence on the trends in world extreme poverty is questionable.
2. The evidence on trends in world income distribution, likewise;
3. The growth performance of OECD and developing countries has deteriorated in the period since 1980 compared to the two decades before, and the median growth of developing countries has remained well below that of OECD countries;
4. The world economy has shifted in a “more globalized” (or more liberal) direction since 1980, but the predicted improvement in economic performance has either not occurred (median growth) or occurred, if at all, only because of China (poverty, income distribution);
5. There is no good evidence that developing countries that liberalized more have experienced better economic performance than those that liberalized less, when some very illiberal cases are excluded.

### *The shape of world income distribution*

Before we proceed, consider Figure 1. It shows the distribution of world population by per capita \$PPP income of each country (with the qualification that the two biggest countries, China and India, are divided into urban and rural, each treated as a separate country). The questions under debate are what has been happening at the bottom end—the poverty question, and what has been happening to the distance between top and bottom and to the inequality over the whole income range—the inequality question. And in the background are questions about the rightness of the distribution, and whether the trends are moving it in the right direction.

Most people would agree that the present distribution is far from meeting a Rawlsian principle of justice—far from the distribution that people would choose “behind a veil of ignorance”, if they knew that they could end up at any point in the distribution. Most people would presumably choose a bell-shaped curve. The question then is whether present trends will carry the world to a bell-shaped distribution, or whether there are structural “wedges” that block such an outcome, analogous to the wedges in male and female remuneration in the labor market or those in the income distribution of a feudal society. (Figure 1

does look rather like the income distribution of a feudal society or banana republic.)

## FIGURE 1

### *World poverty*

The World Bank, which is the near-monopoly supplier of figures on world poverty, claims that the absolute number of people living on a purchasing-power-parity (PPP) income of \$1/day or less fell from 1.5 bn in 1981 to 1.1 bn in 2001, from 33% of world population to 18%.<sup>5</sup>

In none of the Bank's many publications about the poverty numbers does it give any idea of confidence limits or likely direction of bias. In fact, the margin of uncertainty about the level and the trend of the extreme poverty headcount is large. Furthermore, examination of the method by which the World Bank makes the calculation suggests that the World Bank estimates are likely to be biased downwards—ie., the “true” figures are likely to be higher and the downwards trend less pronounced or even upwards.

Here I shall make just a few points that are part of a much larger case.<sup>6</sup>

First, the Bank's international poverty line is rather arbitrarily defined, and bears no close relationship to the income or consumption needed for an individual (or household) to avoid periods of food-clothing-shelter consumption too low to maintain health and wellbeing.<sup>7</sup> Nor does

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<sup>5</sup> S. Chen and M. Ravallion, “How have the world's poor fared since the early 1980s”, World Bank Policy Research WP 3341, June 2004. Also, “[Since 1980] the most rapid growth has occurred in poor locations. Consequently the number of poor has declined by 200 million since 1980” (Dollar & Kraay, 2002, p.125). REFC.

<sup>6</sup> See Sanjay Reddy and Thomas Pogge, “How not to count the poor”, Secember 2002, at [www.socialanalysis.org](http://www.socialanalysis.org); Wade, “Globalization, poverty and inequality”, in John Ravenhill (ed), *Global Political Economy*, OUP, 2005; Wade, “Is globalization reducing poverty and inequality?”, *World Development*, 32, 4, pp.567-589. These papers give source details for research findings cited below.

<sup>7</sup> To get the world extreme poverty headcount the Bank first defines an international poverty line for a given base year by using purchasing power parity conversion factors (PPPs) to convert the purchasing power of an average of the official national poverty lines of a set of low-income countries into the US dollar amount needed to have the same notional purchasing power in the United States in the same year. In its first global poverty estimation this procedure yielded a conveniently understandable US\$1 per day for the base year of 1985. Then the Bank uses PPP conversion factors to estimate the amount of local currency, country by country, needed to have the same purchasing power in the same year as in the US base case. This gives an international extreme poverty line equivalent to US\$1 per day expressed in domestic currency. By way of illustration, Rs.10 may have the same purchasing power in

it make allowance for unpriced public goods like clean water and access to basic healthcare. Yet the number of people beneath the poverty line is extremely sensitive to where in the income distribution the line is drawn. Recent research on China suggests that a 10 percent increase in the line brings a roughly 20 percent increase in the poverty headcount.

Second, the numbers are derived from household surveys of income and expenditure in each country. These surveys are of widely varying quality. And their results depend heavily on apparently small design details. For example, the length of the recall period makes a big difference to the rate of reported expenditure—the shorter the recall period the higher the expenditure. A recent study in India suggests that a switch from the standard 30 day reporting period to a 7 day reporting period lifts 175 million people from poverty, a nearly 50 percent fall (using the Indian official poverty line, which is lower than the Bank’s international extreme poverty line).

Third, the often-cited comparison between 1980 or 1981 and 1998 or 2001—around 1.5 billion in extreme poverty in 1981, 1.1 billion in 2001—is not valid. The Bank introduced a new methodology in the late 1990s which makes the figures non-comparable. The Bank has recalculated the poverty numbers with the new method only back to 1987.<sup>8</sup> Angus Deaton, an expert on these statistics, comments that “Changes of this size [due to changes in methodology] risk swamping real changes”, “and it seems impossible to make statements about changes in world poverty when the ground underneath one’s feet is changing in this way”.<sup>9</sup>

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India in 1985 as US\$1 in the US in the same year, in which case India’s international extreme poverty line is Rs.10 per day. From household surveys the Bank then estimates the number of people in the country living on less than this figure. It sums the country totals to get the world total. It uses national consumer price indices to keep real purchasing power constant across time, and adjusts the international poverty line for each country upwards with inflation.

<sup>8</sup> The change of method amounts to: (1) a change in the way the international poverty line was calculated from the official poverty lines of a sample of low- and middle-income countries (and a change in the sample countries), which resulted in, (2) a change in the international poverty line from \$PPP 1 per day to \$PPP 1.08 per day, and (3) a change in the procedure for aggregating, country by country, the relative price changes between 1985 and 1993 for a standard bundle of goods and services.

We do not know what the 1980 figure would be with the new method. However we do know that the new method caused a huge change in the poverty count even for the same country in the same year using the same survey data.

<sup>9</sup> Angus Deaton, “Counting the world’s poor: problems and possible solutions”, *The World Bank Research Observer*, 16, 2, 2001, 125-47, at 128.

As for the direction of bias in the World Bank poverty numbers, it is likely to be downwards, making the poverty numbers look smaller than they “really” are. For example, a recent study for Latin America by the Economic Commission for Latin America, uses poverty lines based on calorific and demographic characteristics. It finds extreme poverty headcounts commonly more than *twice* as high as those based on the World Bank’s \$1/day line. In the case of Brazil, the World Bank estimates the extreme poverty rate (using its international poverty line) at 5%, while ECLA, using a calories-and-demography poverty line, estimates it at 14%.<sup>10</sup>

Finally, even if one takes the Bank’s extreme poverty headcount at face value, the fall in 1981-2001 depends on just one country, China. Take out the China numbers and even the Bank shows an increase in the absolute number. So one cannot suggest that falling extreme poverty is a world-wide trend.<sup>11</sup> And if one keeps China in and uses the \$2/day line rather than \$1/day, even the Bank shows a substantial increase in the absolute number over this period.

On the other hand, it is likely that the *proportion* of the world’s population living in extreme poverty has “really” fallen. This constitutes a reversal of long-term trend, and is an achievement well worth celebrating.

### *World income distribution*

Wolf thinks the evidence is clear that income inequality has fallen over the past 25 years. It is not.

First, there are different (legitimate) measures of inequality, which measure different things. This is to make the contrast with “poverty”, which can also be measured in different ways but the different ways

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<sup>10</sup> Bolivia’s extreme poverty rate according to the World Bank line was 11%, according to the ECLA line, 23%; Chile, 4%, 8%; Colombia, 11%, 24%; Mexico, 18%, 21%. ECLA, 2001, *Panorama Social de America Latina 2000-01*, CEPAL, Santiago, p.51.

UNICEF’s *The State of the World’s Children 2005*, calculates the proportion of under-five-year-old children suffering “severe” food deprivation, defined by the stringent criterion of heights- and weights-for-age ratios of more than three standard deviations below the median of an international reference population. By this criterion, 27% of under-five year olds in South Asia, 19% of under-five year olds in sub-Saharan Africa and 12% of under five-year-olds in the Middle East and North Africa suffer severe food deprivation. Based on recent surveys covering almost half a million households in the developing world.

<sup>11</sup> Shaohua Chen and Martin Ravallion, “How did the world’s poorest fare in the 1990s”, World Bank Policy Research Working Paper, August 2000.

converge on the same concept (analogous to the Fahrenheit and Celsius temperature scales). In the case of inequality, the different measures measure different things and not surprisingly, produce different answers to the question, “What is happening to world income inequality?” The question does not permit a single answer, however much we demand one. Table 1 shows the choices that tip the answer towards falling inequality, and those that tip the answer towards rising inequality.

#### TABLE 1

Second, one measure that Wolf relies on—inequality between the per capita income of countries weighted by population, where incomes are measured in purchasing-power-parity (PPP) terms and inequality is measured with the Gini or other coefficient across the whole distribution—does show rising inequality up till around 1980 and falling inequality since then. But (as for the reversal in the poverty numbers) the reversal of the inequality trend depends entirely on one case, China. Take out China and the trend shows a sharp *increase* in inequality after 1980—even by the measure most favourable for “globalization works”. Falling inequality (in this sense) cannot be judged a general trend of the world system driven by the equally general trend of globalization. See Figure 2.

#### FIGURE 2

Third, other measures of inequality show increases in inequality over the past 25 years. These include income distribution with incomes converted at market exchange rates rather than with PPP conversion factors; inequality measured with a “polarization” measure, such as the ratio of the income of the bottom decile to the 10<sup>th</sup> decile; and inequality measured by comparing the per capita income of different regions (Latin America, etc.) with that of the Triad, or the US, or the bottom country of the Triad (eg Portugal). It is not obvious that these alternative measures should be rejected in favour of the one that shows falling inequality (when China is included). See Figure 3.

#### FIGURE 3

One measure of inequality across time uses the change in the ratio of each state’s per capita income relative to that of the US. Since 1980 there has been a pronounced *downward* movement in these ratios, with almost all states that move across income ranges moving down rather than up. In one study, in a sample of 150 countries in 1980 and 1999,

with income categories of “core” (70-100% of US), “semi-periphery” (40-69%), “periphery” (10-39%), “very low periphery” (0-9%), and incomes converted at market exchange rates, 31% of countries remained in the same income category, 10% went up, and 59% went down. Of the sub-set of countries that could have gone either up or down (that is, excluding the core and the very low periphery), 88% of the movers went down, only 12% went up.<sup>12</sup>

On these and several other grounds I take issue with Wolf’s sunny findings on poverty and inequality levels and trends.<sup>13</sup> The evidence is more uncertain and less favourable than he suggests.

### *Economic Growth*

One of the big facts of our age is the enormous slowdown in growth in both OECD countries and developing countries (LDCs). Between 1965-1979 and 1980-1998 the median growth rate of the OECD fell by around 1.5 percentage points, from 3.5% to 1.8%. The median growth rate of low- and middle-income countries fell by even more, around 2.5 percentage points, from 2.4% to about zero. The fast growth of East Asia in the 1980s and 1990s, plus India in the 1990s, is an exception to the general slow-down, though a very important one. In both periods the median growth rate of the OECD rich countries was substantial higher than that of the LDCs. See Table 1.

TABLE 1

The median developing country grew much more slowly than the median OECD country partly because LDCs have experienced much more frequent spells of growth stagnation; and the frequency of stagnation has risen during the era of globalization.<sup>14</sup> Stagnation is

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<sup>12</sup> Satoshi Ikeda, “Zonal structure and the trajectories of Canada, Mexico, Austria and Norway under neo-liberal globalization”, Marjorie Cohen and Stephen Clarkson (eds.), *Governing Under Stress*, London: Zed Books, 2004, p.263-290.

<sup>13</sup> See further, Abhijit Banerjee and Esther Duflo, “Inequality and growth: what can the data say?”, WP 7793, July 2000, National Bureau of Economic Research; Erik Thorbecke and Chutatong Charumilind, “Economic inequality and its socioeconomic impact”, *World Development* 30, 9, Sep 2002, 1477-1495.

<sup>14</sup> Sanjay Reddy and Camelia Minoiu, “Stagnation: patterns, causes and consequences”, typescript, June 2004, Economics Department, Barnard College, Columbia University. “The onset of a spell of stagnation is defined as a year in which a country’s per capita real income is lower than at any time in the previous two years and higher than at any time in the subsequent four years. At the onset of a spell of stagnation, a country’s per capita real income is both the lowest in the three-year interval concluding with it, and the highest in the five-year interval beginning with it. This criterion is made deliberately stringent, so as to avoid identifying brief interruptions of growth as spells of stagnation. A turning point is defined as a year in which a country’s real income is at least one percent higher than it was in the

defined as a spell of below-average growth that lasts for at least five years. More than 80% of Latin American and Sub-saharan African countries had at least one stagnation spell between 1960 and 2001, compared to only 17% of (core) OECD countries. The frequency of stagnation was roughly three times higher in 1980-2000 than in 1960-1980. Yet the liberal argument predicts that rising economic integration would lower the frequency and depth of stagnation.

More generally, LDC growth has typically been unstable; it yoyos back and forth between growth when commodity prices are high and world liquidity is ample, and stagnation or contraction when commodity prices turn down and when liquidity dries up. OECD growth is typically more stable as well as higher in median.

### *The role of globalization*

The world economy has shifted strongly towards liberal economic policies over the past 25 years, as Wolf says, and measures of economic integration have risen substantially. Liberal-globalization is real. The liberal argument predicts a resulting improvement in economic performance. In line with the prediction, Wolf sees the development performance of most of the non-OECD world as having been good with Africa as the exception. The evidence presented earlier suggests it is more plausible to see the development performance of most of the non-OECD world as poor, with Asia unusually good and Africa plain catastrophic.<sup>15</sup> (Median age of death in Sub-saharan Africa in 2000 was just 5 years, compared to 37 years in India and 70 years in Western Europe.) The dramatic growth slowdown in 1980-2000 compared to 1960-1980, and the persistently slower median growth of LDCs compared to the core, is more than uncomfortable for the liberal argument; it is a bloody nose.

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previous year, and at least one percent lower than it is in the subsequent year. This criterion is made permissive, so as to capture the resumption of sustained income growth, even at a low level. A spell of stagnation is defined as the period from the onset of stagnation to the first turning point after the onset. We define the length of a spell as the length of this period. Since the criterion for identifying the onset of stagnation is stringent and the criterion for identifying the turning point is permissive, spells defined in this way are defined stringently.” The frequency of stagnation increased from the 1960s to the 1970s to the 1980s, and then fell somewhat: 12% experienced a stagnation in the 1960s, 20% in the 1970s, 50% in the 1980s, and 32% in the 1990s. The average length of stagnation was around 5.5 to 6.8 years over these decades. The effects of stagnation persist for long periods afterwards: countries that experience stagnation episodes in one decade are much more likely to experience stagnation in subsequent decades; and also to experience slower increases in life expectancy and falls in child mortality.

<sup>15</sup> David Lindauer and Lant Pritchett, “What’s the big idea? The third generation of policies for economic growth”, *Economia*, 3, 1, 2002, 1-39.

What about the comparison between developing countries that have liberalized more and those that liberalized less? This is a key test of the liberal argument, which confidently expects that, holding other things constant, the liberalizers do better than the non-liberalizers. The World Bank tested the argument in its *World Development Report 1987*.<sup>16</sup>

The report took two time periods, 1963-73 and 1973-85, and classified 41 developing countries in terms of four categories of trade orientation: strongly outward oriented and moderately outward oriented, and strongly inward oriented and moderately inward oriented. It found that, just as expected, countries with “outward oriented” trade regimes showed much better performance on a range of indicators than countries with “inward oriented” trade regimes. And it concluded that the causality ran from trade regime to economic performance. This cross-sectional evidence bolstered the Bank’s confidence in the many trade liberalization conditionalities in its structural adjustment lending. It told its clients that they could confidently expect improved economic performance as a result of liberalizing their trade regimes.

But the Bank had its thumbs on the scales. It failed to draw attention to the obvious contrary finding, that the moderately *inward* oriented countries had better performance, by most measures, than the moderately *outward* oriented cases. It got the result it wanted by aggregating the two sub-categories. The “strongly outward oriented” cases have such good performance indicators, and the “strongly inward oriented” ones such bad indicators, as to reverse the results for the “moderately oriented” cases. Which are the “strongly outward oriented” cases? Just three, all East Asian: Hong Kong, Singapore and South Korea. Perhaps their outstanding performance has more to do with “East Asia” than with “liberal trade”? And since Hong Kong and Singapore are minnows, the performance of the sub-category is mostly the performance of one country, Korea. Without Korea, the overall conclusion about outward oriented regimes having better economic performance than inward oriented ones would not hold. That is a thin foundation for a universal prescription of free trade. And there is a further question: did Korea’s trade regime in 1963-73 and in 1973-85 meet the criteria of “strongly outward oriented”? Unambiguously not, given that the report defines the sub-category as one where “trade controls are either non-existence or very low....There is little or no use of direct controls and licensing arrangements”. The study added another criterion when defining the “moderately outward oriented” regime, namely, low

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<sup>16</sup> World Bank, *World Development Report 1987*, Washington DC, 1987.

variation of effective protection rates to different sectors of the economy; and we may presume that this criterion should also apply to the strongly outward oriented cases. There is abundant evidence that these criteria do not fit Korea's trade regime in either period.<sup>17</sup>

The *WDR 1987* used cross-sectional evidence. What about the time-series evidence on trade liberalization and growth? A lot of it runs counter to the liberal prediction that trade liberalization causes higher growth, and better fits the hypothesis that “as countries grow richer they liberalize trade”. In the cases of the East Asian NICs, China since the early 1980s, and India since the late 1980s, their transitions from slow growth to fast growth all came *before* substantial trade and FDI liberalization—though it is perfectly true that they all liberalized trade and FDI *in response* to fast growth. Studies of their and other growth transitions suggest that a step-up in investment is a nearly-necessary condition of a step-up in growth rates.<sup>18</sup>

As for China and India, they have been growing fast, but they remain relatively restricted economies. They could not be presented as models of liberal economies. China, it is true, has become a quite open economy in some ways, as in low average tariffs and few QRs. But it retains close state control on entry and exit from many sectors, a large public enterprise sector, extensive conditions on FDI within a generally welcoming stance, and controls on hot money. It retains a central industrial strategy, aimed above all at enhancing the competitiveness of local firms relative to foreign firms. When it gives up certain instruments in order to comply with WTO-type conditions it replaces them with substitutes. The government cut tax relief to exporters, in line with external demands, but compensated with subsidies elsewhere. It privatized the Bank of China in line with WTO accession conditions (aimed at limiting the ability of the state to underwrite Chinese exports through the development bank arm of the Bank of China), but it established a new set of regional development banks.

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<sup>17</sup> See Wade, *Governing the Market*, Princeton University Press, 2004, chapter 1 and 11.

<sup>18</sup> Ricardo Hausmann, Lant Pritchett, Dani Rodrik, 2004, “Growth transitions”, typescript, at [skghome.Harvard.edu/~drodrik](http://skghome.Harvard.edu/~drodrik). “The lesson from East Asia is clear”, says Rodrik. “[T]he three East Asian “dragons” with low investment rates in the early 1960s—South Korea, Taiwan and Singapore—would not have been nearly as successful had their governments not given capital accumulation a big push by subsidizing, cajoling and otherwise stimulating private investors. The evidence from East Asia and elsewhere shows that investment booms produce economic growth as well as greater export orientation” [and higher imports]”. Dani Rodrik, *The Global Economy and Developing Countries: Making Openness Work*, Overseas Development Council, Washington DC, 1999, p.63. World Bank, *World Development Report 1999/2000, Entering the 21st Century*, World Bank, 2000, figure 9.

Yet for all the continuing heavy state “intervention” in the market China and India increased their growth rate by more than 2 percentage points since the 1980s while the rest of the developing world reduced its growth rate by more than 2 percentage points. Not what liberal theory expects.

The egregious way that the *World Development Report 1987* massaged the presentation of evidence to bolster pre-formed conclusions, like Wolf’s “big lie”, shows the lengths to which partisans will go to discredit challenges to free market liberalism. To be fair, many subsequent studies of the link between trade liberalisation and economic performance come to much the same conclusions without thumbs on the scales in such an obvious way. But an impartial reading suggests that when the extreme countries are taken out there is no clear margin between countries that liberalize more and those that liberalize less, for all that the Bank has presented trade liberalization as the queen of policy reforms.<sup>19</sup>

A recent assessment of the literature concludes, “The results are weak: we find no robust evidence that inequality, or indeed growth, are determinants of cross-country variations in poverty....any claims regarding growth and poverty or trade liberalization (even globalization) and poverty should be interpreted with extreme caution.... If we achieve no more than to convince readers to interpret cross-country evidence on inequality, growth and poverty with extreme caution and to eschew generalizations based on such evidence, we would be content.”<sup>20</sup>

The point is more general. The vast literature on growth regressions has yielded little solid knowledge. We can be confident only that the empirical links are “fragile”. David Lindauer and Lance Pritchett conclude from a wide ranging study of growth regressions, “Estimates in the typical growth regressions are unstable over time and across countries.”<sup>21</sup> In other words, quicksand.

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<sup>19</sup> In state mobility matrices (showing relative movement of states by per capita income compared to that of a rich country or the OECD average) we find no correlation between the degree of liberalness of state policies (eg. the inward or outward orientation of the trade regime) and movement up or down.

<sup>20</sup> Jennifer Mbabzi, Oliver Morissey and Chris Milner, “The fragility of empirical links between inequality, trade liberalization, growth and poverty”, in Rolph van der Hoeven and Anthony Shorrocks (eds), *Perspectives on Growth and Poverty*, United Nations University Press, 2003, p.113, 137.

<sup>21</sup> David Lindauer and Lance Pritchett, “What’s the big idea? The third generation of policies for economic growth”, *Economia* 3, 1, 2002, 1-39, at 19.

Wolf says, “A successful move to the market, including increased integration in the world economy, explains the success stories of the past two decades” (p. \_\_\_\_\_)<sup>22</sup> But with such elastic standards of inference, confirming results can be pumped out as easily as bilge water. The liberal-globalization story is only fully persuasive in relation to counterfactuals of autarchy or West African-type predatory states.

## **THE UNDIMINISHED COMMITMENT TO LIBERAL ECONOMICS**

Yet since the early 1980s the G7 states have vigorously promoted free market liberalism both for themselves and for the rest of the world, on the grounds that it is best not only for enhancing the prosperity of the already wealthy countries but also for spreading global prosperity to developing countries. The World Bank and the IMF and the regional development banks have aggressively sought to apply liberal conditionalities to their borrowers.

The lengths to which they go are extraordinary. The IMF tried to force Ethiopia, one of the poorest countries in the world, to open its capital account. When Ethiopia refused (secretly advised by incoming World Bank vice-president for research Joe Stiglitz), the IMF refused to extend Ethiopia’s eligibility for a program under which very poor countries which undertook a raft of policy reforms got access to very cheap credit (not only IMF credit but also World Bank credit, Paris Club concessions, and the like), even though the Ethiopian government had amply met the other targets. This was in the period around 1996 and early 1997, when the Fund, backed by the US Treasury, wanted to send a strong message that all its member states, including the poorest, should move towards open capital accounts.<sup>23</sup>

In Sri Lanka the Bank and the Fund led a consortium of donors in holding out the carrot of a \$2 bn grant for civil-war reconstruction after the peace deal of 2003. The Bank’s country director informed the government—orally, not in writing--that it would have to stop work on its “interventionist” industrial strategy as a condition of the grant. Earlier, the government of 1989-1993 had formulated and implemented a remarkably successful industrial policy aimed especially at promoting

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<sup>22</sup> Wolf’s “move to the market” also underplays the role of education, including high emphasis on technical education at tertiary level. It underplays nationalistic motivation, intensified by sense of external threat, which helped produce elite cohesion in industrial policy and macro policy. See further *Governing the Market* (2004).

<sup>23</sup> Wade, “Capital and revenge: the IMF and Ethiopia”, *Challenge*, September/October, 2001, 67-75.

manufactured exports. The assassination of the prime minister in 1993 triggered the fall of the government, and the new government brought the whole pro-industrialization project to an end. But the government at the start of the new century restarted work on a pro-industrialisation strategy as an alternative to the Bank-Fund-sponsored Poverty Reduction Strategy Paper (that emphasised poverty alleviation, primary education, primary health care, and the like). The Bank and Fund wanted the government to abandon any notion of a pro-industrialization strategy and stick strictly to the PRSP. The prime minister faced a choice: to continue with the industrial development push, or win a sizable grant. His ministers and coalition partners would have mutinied had he chosen the former—for the grant would provide kick-backs aplenty. So the Industry Ministry reluctantly dismantled the cadre of experts who had been recruited to develop the alternative pro-industrialisation strategy.

Why and how has this powerful consensus about the rightness of market liberalism come about?

## **THE INTERNATIONAL POLITICAL ECONOMY OF GLOBALIZATION**

The claim that globalization has caused a fall in world poverty and inequality has an important role in legitimising the broad policy regime of liberalism. Proponents of the project of institutionalizing the liberal regime world-wide don't enquire much into the ambiguities of the evidence on growth, poverty and inequality, because the evidence—as they read it—fits a prior commitment to liberalism as the basis of the world economic order.

I now present three non-liberal chains of causation that help to explain the increase of between-country income inequality, and the increase in within-country income inequality within G7 countries (specifically, increase in the income shares of the top 5-10% of households). The first is a “real economy” mechanism, and centers on economies of scale and agglomeration. The second is a “financial economy” mechanism, and has to do with the international monetary system. Both mechanisms relate to the “structure” of the world system. The third chain of causation links structure and agency, via the role of G7 governments, specifically the Traid central banks, in pushing through a world-wide agenda of liberal economic reforms, whose aim is to maximize the scope for the owners and managers of capital to deploy their resources, and whose less cognised aim is to increase their already high share of national income and associated privileges.

## CORE-PERIPHERY RELATIONS AND ECONOMIES OF SCALE AND AGGLOMERATION

The first non-liberal chain of causation rests on economies of scale and agglomeration. Thanks to them, the wealthy core economies continue to be the site of high value-added and linkage-intensive operations able to support very high rates of profit and fairly high rates of labor remuneration.<sup>24</sup> Economies of scale and agglomeration make “wedges” in the world market, such that a bell-shaped curve of world income distribution is unlikely within the foreseeable future. They tend to undercut the admirable objectives that liberalism seeks, such as catch-up growth and elimination of extreme poverty.

In an open world economy, with free trade, flexible exchange rates, and private international capital flows, large parts of the structurally uncompetitive “periphery” are not able to generate sufficiently fast growth of export revenues to support catch-up growth. And most of those parts of the periphery that do from time to time generate fast growth of export revenues depend on exports of raw materials and other commodities. As such, they are hostage to commodity price volatility: when commodity prices boom, they boom, when commodity prices sink, they sink. In addition, their commodity production tends to be a poor basis for transformational and employment-generating growth, because low in linkages. All the more so because they tend to experience a “Dutch disease” rise in the exchange rate during commodity boom times, which erodes the ability of local industry to compete against imports, let alone to export.

This is the story currently unfolding in South Africa, where high Chinese demand for commodities has raised commodity revenues, raised the exchange rate, and thereby raised unemployment levels even higher than they were (now around 40%). Criminal activity flourishes, and the sinews of the state wither. The South African case, and many others, suggests that the alternative to an inefficient industrial sector is often not an efficient one, but no industrial sector, which is worse.

On the other hand, China has already begun to benefit from economies of scale and agglomeration, at cost to producers in much of the rest of the LDCs. Manufacturers of standard goods now say, “In

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<sup>24</sup> Robert Hunter Wade, “On the causes of rising world poverty and inequality, or why the Matthew Effect prevails”, above. E.A. Brett, *International Money and Capitalist Crisis*, London, Heinemann, 1983.

China I can get everything I need. Elsewhere I can't get everything I need in one place. So I have to be in China [and not in another LDC].”

The powerful tendencies towards cumulative causation in a liberal system of open markets and flexible exchange rates can only be offset by *non-liberal* intervention. The intervention might take the form of international sanction of a much stronger norm of “special & differential treatment” of LDCs in international agreements, which would give scope for transformational interventions of the East Asian developmental state kind; and massive purchasing power transfers from core to periphery. The sorts of ad hoc bilateral aid arrangements of today would not be sufficient.

The implication is that economic development is difficult, something that does not happen “automatically” provided that the state supplies a basic core of public goods and services and market institutions and does not otherwise obstruct market forces. A state with the capacity to act strategically is certainly a help, and may also be necessary, though not sufficient.

Indeed, the proposition that infant-industry support is a necessary but not sufficient condition of *catch-up* growth accommodates just about all the nineteenth and twentieth century cases of catch-up (such as Germany to Britain, the United States to Britain, Japan to the United States); while it also accommodates the fact that in many countries, including quite a few in Latin America, infant-industry support has helped to create a permanently inefficient home industry and no catch-up.

In short, there is a plausible alternative story to the liberal-globalization story of how to get economic development, which equally explains why there has not been much catch-up growth.

## **STRUCTURE OF THE INTERNATIONAL MONETARY SYSTEM**

The “real economy” effects of economies of scale and agglomeration are fortified by effects of the Post-Bretton Woods international monetary system (Peter Gowan calls it the Dollar-Wall Street regime).<sup>25</sup> Its main features are:

- (1) the US\$ as the main international currency (ie the national currency of the dominant economy/state);

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<sup>25</sup> Peter Gowan, *The Global Gamble*, London: Verso, 1999. I am grateful to Gowan for discussions about the argument made here.

- (2) no supply-side constraint on the supply of the main international currency (eg no link between the \$ and gold), so that the supply of the main international currency is limited only by the demand;
- (3) fluctuating exchange rates between the major currencies;
- (4) private international capital markets (rather than public ones via central banks);
- (5) free capital mobility between major economies.

### *Exchange rate volatility*

One consequence of this system is an enormous increase in the volatility of exchange rates (compared to its predecessor). The effects are captured in a remark by the president of Sony: dealing with currency fluctuations, he said, “is like changing the handicap in golf on every hole. Wouldn’t you lose interest in playing golf eventually? If money scale expands or shrinks every day in different countries, how can we make up our minds to invest?”<sup>26</sup> In effect, currency volatility imposes an overhead charge on international “real economy” activity, which presumably (I know of no quantitative evidence) helps to explain the dramatic world growth slowdown since 1980 reported earlier.

At the same time, the volatility generates a flow of resources to those who produce the financial instruments by which economic actors seek to reduce their exposure to the volatility—helping to boost the financial sector and the larger “financialization of the economy” and associated income polarization within the G7, the pulling up of the share of the top 1-2% of households (see below).

Also, the volatility raises governments’ *demand* for foreign exchange reserves (mainly in US\$), as a means of protection against volatility; hence the ratio of foreign exchange reserves to imports has risen sharply since the 1980s. This constitutes an additional cost to the national economy, because the high-powered money held in exchange reserves could be used for domestic purposes. On the other hand, it benefits the US, by enabling it to run large current account deficits while keeping interest rates below what they would otherwise have to be. The effect is to widen between-country income inequality. Moreover, the US and the other OECD countries have abundant multinational corporations, which can offset the effects of volatility by diversifying their production sites and their tax-paying sites; whereas most LDCs are locked into commodity exports, and bear the full brunt of the volatility. Again, the

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<sup>26</sup> Quoted in Wade, *Governing the Market*, 347.

effect is to widen growth differentials between the OECD and most LDCs.

### *The Triffin Dilemma*

The Post-Bretton Woods regime caused an explosive growth in central bank reserves not only because of the demand-side factors just noticed but also because of supply-side factors. The US discovered that it could run large and growing current account deficits and pay for the excess of imports over exports with debt in the form of US Treasury bills. It was as if my tailor (China) would go on supplying me (the US) with suits by offering me the credit with which to buy them. The US Treasury bills entered central bank reserves, world central bank reserves grew almost exponentially, and became the basis for a large expansion of global liquidity. This in turn boosted the financial sector in the OECD countries, and its share of claims on real resources. Money-managing organizations like pension funds, mutual funds, investment banks proliferated in the OECD countries, all trying to capture part of the growing pool of liquidity. On the other hand, the LDCs, with their tiny financial sectors, faced growing volatility from this source (among others), because marginal changes in the portfolio allocations of the money firms could make for big changes in key parameters in LDCs.

Then the Triffin Dilemma kicked in. The dilemma says that there is a tension between supplying enough of the main international currency for world markets to be kept liquid, and not supplying so much that the value of the currency unit becomes unstable. It is difficult to hit the balance, not least because the Federal Reserve attends primarily to national objectives, not to a world good. Paul Volker's interest rate shock of 1979 escaped from one horn of the dilemma by jacking up interest rates and stabilizing the (previously falling) dollar; only to impale the world on the other horn—the cost of borrowing went sky-high, debt problems proliferated, growth slowed world-wide. (Volker and I taught at the Woodrow Wilson School, Princeton University, in 1989/90. One day over lunch I asked him whether the Fed had analysed the likely impact of the interest rate hike on the rest of the world. “No”, he replied laconically, “we didn't really have the capacity”. )

### *Bond market capitalism*

When debt is rising fast, bondholders and potential bondholders become very important people. They come largely from the top of the wealth and income distribution. In the US, the top 1% of wealth holders

own about 50% of US financial assets; and they hold 2/3 of that 50% in bonds, including open-market paper and notes.<sup>27</sup> The problem from the point of view of the increasingly indebted state is how to secure sufficient demand for the bonds. The answer is some combination of higher returns (higher interest rates) and income redistribution upwards towards those at the top of the distribution who are likely to use additional income to purchase bonds.

Ever since the US deficit began to explode under Reagan US administrations have tried to redistribute upwards by, among other methods, cutting the top rates of income tax (eg from 70% on unearned income in 1980 to 28% in 1988). In line with this strategy, the Bush II administration has tried to stimulate demand for the bonds to cover its record-breaking deficits by tax breaks for the wealthy.

### *The transformation of banking*

The Post-Bretton Woods liberalization of private international capital markets made it easy to move funds across jurisdictions, and offered the possibility to making fortunes by shifting large volumes of funds across small price differences (eg in exchange rates or interest rates). US banks now depend largely on their trading income (not on the old-fashioned spread between the interest on deposits and the interest on loans).

### *The transformation of “real economy” companies*

In the late 1960s a new development began in the US that has since spread to other OECD countries: for the first time in the history of capitalism real economy companies began to focus on buying and selling other companies and bits of other companies.<sup>28</sup> In the “normal” pattern of capitalism companies develop in a sector and then diversify into linked sectors where they experience economies of scale and scope. Increasingly since the late 1960s US companies have diversified right outside their own sector, even outside industry, by mergers and acquisitions, and have pushed for regulatory changes to make hostile take-overs easy, not only in the US but also abroad. Stock market activity boomed, junk bond activity boomed. The remuneration of senior managers boomed via stock options. Huge fortunes were made, quite unconnected to the production of “useful” goods or services.

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<sup>27</sup> E. Ray Canterbery, *Wall Street Capitalism*, World Scientific Press, 2001, p.22

<sup>28</sup> Alfred Chandler, *Scale and Scope*, \_\_\_\_\_

As for why this new means of diversification happened, the answer presumably lies in rising competition in real economy markets from Europe and Japan (and the rest of East Asia), in addition to the facilitative changes in the Post Bretton Woods structure.

## **THE AGENTS OF LIBERAL TRANSFORMATION**

The two causal chains discussed so far both deal with changes in the “structure”. But structures do not make choices. What about “agency”? The process of financialization of the economy that is central to the growth slowdown and the widening of between-country inequality and top-end inequality within the OECD results from the interaction of structure and agency.

### *The US origin of the liberal project*

The “liberal project” has been about unravelling the New Deal/Cold War “social compact” between capitalists and wage-earners that prevailed in core western states during the post-Second World War decades (from the mid 1930s in the US). In its place the liberal project has aimed to institutionalize a regime that allows the owners and managers of capital maximum scope for deploying their capital and the returns on capital as they see fit, worldwide.

The owners and managers of capital who drive the project are the richest capitalists and the top-level salaried managers, in the top 1 or 2 percentiles of the OECD income distribution. Their ulterior—and less cognised aim—is to drive up their share of national income and wealth.

The US is the prime mover and shaker of this liberal project, both domestically and internationally; and it has been joined by Germany and Japan, though in a much more hesitant and contested way, with the forces committed to something like the older social compact between capitalists and wage-earners fighting back.

The political correlate of the liberal economic project is a concept of democracy as a means of expressing the “general interest” of consumers and voters, in contrast to the other concept of democracy as a means of balancing interest groups. The liberal project confidently says that it is superior to the other kind of “corporatist” democracy in terms of both voters’ rights and consumers’ welfare. Admitting trade unions into policy making—as in tripartite incomes policy—is the road to ruin, in this view. Better for the “general interest” to have Anglo-American labor

market flexibility with low unemployment benefit. Liberal champions accordingly seek to reject the EU's Constitutional Treaty, which would entrench collective bargaining and social partnerships as pillars of the Union.<sup>29</sup>

The economic project is being advanced internationally via a coalition of Triad actors, including importantly central banks. But this Triadic coalition is fragile, for reasons to do with the incentives and constraints on each pole of the Triad set by the structure of the international financial system, and by the fear of each that the other two will gang up on it.

The “What is all the fuss about?” of my title therefore refers not just to the dispute within a narrow intellectual community as to what the “real” trends in poverty and inequality are, and not just to the big issues about the appropriate shape of the global economic order, but also to the manoeuvring between the three Triadic poles that are party to the liberal coalition, and to the political backlash against the liberal project in Euroland, Japan, and elsewhere (Russia, China, New Zealand...). The constant emphasis on the *mutual* gains to all participants in a liberal economic order, supported by the best academic and journalistic brains, helps to keep the fragile Triadic coalition together via a common normative commitment.

*The squeeze at the top during the New Deal/Cold War social compact*

The ulterior—less cognised--purpose of the liberal project can be inferred from Figure 4. This shows the share of total US household income (excluding capital gains) accruing to the richest 0.01% of US households (currently around 270,000 individuals). These households receive their income and wealth largely from capital ownership rather than salaries. They are the top capitalists. Their share rose in the years up to 1929 to reach about 3%. With the onset of the Depression it fell sharply to about 1.4% by 1940. It continued to fall in the post-war decades right up to around 1970, at which time it was about 0.5%. The fall from 1930 to 1970 constituted a huge—roughly six-fold--cut in the relative income and privileges of the richest capitalists in America.<sup>30</sup>

FIGURE 4

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<sup>29</sup> Samuel Brittan, “Two different ideas of democracy”, Financial Times, 1 April 2005.

<sup>30</sup> Gerard Dumenil and Dominique Levy, “Neoliberal income trends: wealth, class and ownership in the USA”, New Left Review, 30, Nov/Dec 2004, 105-33.

The cut reflected the policies of the New Deal and the Cold War social compact. Through the 1930s Depression and the Second World War, on through the demobilization after the Second World War, and through the Cold War, the US capitalist elite felt under threat. Early on there was a widespread sense of weakness in the capitalist order over which it presided. The labor movement was on the rise. The Soviet Union was on the rise. The sky began to turn black with aliens—or would have if the flying saucer stories that began to appear in 1947 had been corroborated. (In recent times around 2% of the American population, around five million people, believe they have been abducted by aliens.)<sup>31</sup> In these circumstances of great tension the US elite felt constrained to strike a compromise with wage-earners in the form of extraordinary state intervention in setting politically-determined limits to the market principle, and extraordinary progressivity in the tax system. It acceded to demands for a system of social protection for wage earners, the expansion of public goods such as education (eg the GI Bill), progressive taxation, and close state regulation of finance (eg the Glass-Steagall Act limiting the territorial operations of banks within the United States). As *The Economist* put it, the penal taxation needed to finance the welfare state was an import from Marxism forced upon the rich by the Cold War.<sup>32</sup>

*The re-assertion of liberalism as a means to restore income share*

The post-war New Deal/Cold War social compact began to unravel around 1970. By then financial deregulation had already started with the growth of the Eurodollar and other offshore financial markets. The Bretton Woods regime of fixed exchange rates and limited private capital mobility ended in the early 1970s, ushering in the Post Bretton Woods regime of floating major currencies and free capital mobility.

At this time, in the early 1970s, the average profit rate in US industry began a long-term decline (it had been historically high in the post-war decades, and yet the income share to top capitalists fell because dividend payments were limited and much of the profit was reinvested). Structural unemployment went up, inflation went up.

In these conditions a new coalition of the richest capitalists and top salary earners began to shape public policy in a liberal direction. The 1979 Volker interest rate hike was a defining moment. It lifted interest rates worldwide to unprecedented levels, prompting a severe recession in

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<sup>31</sup> Bryan Appleyard, *Aliens: Why They Are Here*, Scribner, 2005.

<sup>32</sup> Quoted in Gowan, *The Global Gamble*, p.259.

the OECD world and a debt crisis in much of the developing world, especially Latin America. The interest rate hike dramatically raised the returns to lenders and stopped inflation, top priorities for capitalists. But the interest rate hike was just part of a wholesale reorientation of the macro and micro framework away from full employment as a top objective to low inflation as the top objective.<sup>33</sup> Higher levels of unemployment came to be seen as *desirable*, a way to increase labor market flexibility--and cut back wage demands so that more of the value-added would accrue to capitalists and top managers.

Other means of advancing the liberal project included a fast rise in dividend payments via change in the “norm” of profit allocation between dividends and other uses: dividend payments of non-financial corporations as a share of profits (post-tax and interest payments) rose from 40% in the 1970s to nearly 100% by 2000. The stock market boomed. Mutual funds, pension funds boomed. With these developments and the deregulation of banking, the financial sector’s share of the profits of American corporations boomed, doubling between 1970 and 2001. This was great news for financiers. See Table 3.

### TABLE 3

It is implausible that the financial sector’s doubling of its profits share between 1970 and 2001 reflected a doubling of the value of services to the rest of the economy. Much of the increase is more plausibly understood in terms of the financial sector’s ability to attract ever higher concentrations of brain power capable of devising ever more clever schemes for ripping off the rest of the population, or from shifting risk from those who can afford to bear it to those who cannot, as the quip has it.

By 2000 the microeconomic restructuring known as liberalism—the death of the New Deal/Cold War social compact—had brilliantly restored the income and privileges of the top capitalists. The income share of the top 0.01% of households rose from around 0.6% in 1980 to almost 3% in 2000—back to where it had been in 1929, before the Great Crash. See also Figure \_\_; note the income of the 100<sup>th</sup> highest paid CEO in the US relative to that of the average wage-earner across time. Between 1970 and 2002 the ratio rose from about 30 to 300.

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<sup>33</sup> E.A. Brett, *The World Economy Since the War*, Macmillan, 1985, chapter 6.

In this project the top capitalists have subordinate allies in the top managers; in fact the line between capitalists and managers blurred as top managers received a significant portion of their remuneration in the form of stock options and partnership income. Together the top capitalists and top managers comprise much of the top 1% of income recipients. Figure \_\_\_ shows how the income share of the top 1% took off after 1980, at the beginning of the current globalization.

FIGURE \_\_\_.

This top class has been supported in its push for liberal policies by a class of upper-salary earners, who comprise much of the households in the income percentiles from 99<sup>th</sup> to 90<sup>th</sup>. They receive income largely from salaries rather than return on capital until they retire around 65; thereafter they depend on pension fund income—on *capital* income. Their future dependence on capital income gives them a crucial common interest with the top elite of capitalist-managers, predisposing them to favour the boosting of capital income and the various policy means to boost it (enhance dividend payments, lower capital gains tax and inheritance tax).

Hence the US political economy is now dominated by a new social compact, quite different to the New Deal/Cold War one: it includes the top capitalist-managers and the upper salaried classes, much of the top 10% of the US income distribution. This coalition has gained income share since 1970 at the expense of the remaining 90% of the population. See Figure \_\_\_.

FIGURE \_\_\_

It is an interesting question why there has been so little backlash in the US. The answer includes the capitalist control of the media; high electoral absenteeism in the poorer half of the population; and the resurgence of a Republican party with a powerful organizational infrastructure (in contrast to the Democrats) able to harness a working class social base by appealing to conservative “social” values and nationalism, even as the party advances a liberal project that scarcely benefits economically the working class base.<sup>34</sup> The party has learned how to exploit the extraordinary power of terror management tactics (TMT): constantly reminding people of mortality—as by invoking 9/11—generates electoral support for a leader who has the status of president, a

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<sup>34</sup> CHECK Thomas Frank, *What’s Wrong With Kansas*

charismatic style, and who campaigns on the theme that aggressive military action overseas is the best homeland security. Moreover, journalists, intellectuals and academics for the most part take it for granted that liberal economics is the universal science of human behaviour--with the implication that other approaches, such as Keynesian, Marxist and Kaldorian, are rightly ignored.<sup>35</sup>

### *The internationalization of the liberal project*

The US state and its capitalist class led the way in promoting liberalism as a way to restore its income share and privileges; but the project required and obtained allies in other G7 countries, notably Germany and Japan.

Through the late 1970s and early 1980s, the G7 governments converged on the switch of the policy framework from full employment to “monetarism”, and an end to “national Keynesianism”, even an end to “national capitalisms”. They called for a radical opening of the G7 economies to trade, investment, and finance capital.<sup>36</sup>

A key force behind the internationalization of the liberal agenda was a loose triumvirate of the Triad central banks--the Federal Reserve, the Bank of Japan, and the Bundesbank/ECB. What united them was agreement that their control over macroeconomic outcomes could be used to force through microeconomic reforms; meaning, use deflationary macroeconomic policy to generate liberal “structural change” directly, and also to mobilize enough political support for liberal policy reforms that would usher in the structural changes more indirectly. The aim was to cement a thoroughly open world economy (except for labor). The US was already well along in this direction, so the Fed had less to do. The Bank of Japan and the B/ECB had a lot to do. They have coordinated monetary policy to a degree, and the US has applied pressure on the other two from time to time to bring them into line with its objectives. The Federal Reserve is the dominant one; the other two are second fiddles.

### *The Bank of Japan*

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<sup>35</sup> When George Bortz became editor of the American Economics Review in the early 1970s, he informed Paul Davidson, a leading Keynesian, that the AER under his editorship would no longer publish papers by Keynesians. Bortz advised Davidson to found a specialized journal for the Keynesians. Davidson and colleagues pressed ahead with the idea, to be called Journal of Keynesian Economics. Someone did the acronym --and the title was quickly changed to Journal of Post-Keynesian Economics. (Personal communication, Paul Davidson.)

<sup>36</sup> The key event may have been the Venice Summit of 1980. CHECK

Adam Posen, among others, argues that the protracted recession in Japan--1990 and continuing--is due primarily to the BOJ's refusal to reflate the economy (combined with a tight fiscal stance by MOF until 1998).<sup>37</sup> The BOJ's refusal to reflate follows from its strategy of using its macroeconomic control over credit to transform microeconomic relationships in a liberal direction. Richard Werner, in *Princes of the Yen*,<sup>38</sup> argues that a small group within the BOJ had formed an alliance to push this strategy from as early as the early 1980s. The group concluded that the restructuring had to be pushed because Japan was becoming too mercantilist, and too strong as a manufacturing and export-oriented powerhouse. Its strength was already, by the early 1980s, having damaging consequences for the US economy. The US was already beginning to strike back using an array of tools of economic warfare (such as Super 301 trade sanctions). Yet Japan depended heavily on the US for its military security. By the late 1980s [CHECK] the economic warfare reached the point where the US Commerce Department was imposing on MITI detailed monthly price lists for 19 types of semi-conductors, and maximum permitted investment levels in the Japanese semi-conductor industry, and MITI was complying.<sup>39</sup>

The chance of the BOJ strategists came especially in the wake of the collapse of the asset bubble that had blown up in the second half of the 1980s. (There is an interesting question about the extent of BOJ engineering of the bubble with a view to pushing its restructuring policy after the inevitable crash.<sup>40</sup>) They and other commentators blamed the crash on flaws in the microeconomic policy framework, and called for large-scale reforms as a necessary condition for recovery—while they maintained macroeconomic stringency via their control over credit.<sup>41</sup>

Just what was the role of US pressure on Japan is unclear. But it is clear that Japan has been far more vulnerable to US pressure than, say,

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<sup>37</sup> Adam Posen, "The political economy of deflationary monetary policy", in Ryoichi Mikityani and Adam Posen (eds.), *Japan's Financial Crisis and Its Parallels to US Experience*, IIE Special Report 13, September 2000, International Institute of Economics, Washington DC. See also Thomas Cargill, Michael Hitchinson and Takotoshi Ito, *Financial Policy and Central Banking in Japan*, MIT Press, 2000.

<sup>38</sup> Richard Werner, *Princes of the Yen: Japan's Central Bankers and the Transformation of the Economy*, London: M.E. Sharpe, 2003.

<sup>39</sup> Kenneth Flamm, *Mismanaged Trade? Strategic Policy in the Semi-Conductor Industry*, Brookings,

<sup>40</sup> Werner quotes a five-year plan, entitled "Toward consciousness and behaviour of a world nation", published in 1983 by the Japan Association of Corporate Executives chaired by Sasaki, the former governor of the Bank of Japan: "Such a bold market opening would not only help in solving the economic friction with Europe and the United States, but if the economic structure changes, this would also lead to a continued vitality of the Japanese economy" (Werner, p.168).

<sup>41</sup> See Werner, chapter 14, "The goal of monetary policy".

Germany: the security situation with China, North Korea, Taiwan, Russia; heavy dependence on exports to the US market; the sensitivity of the yen to US manipulation of the yen-dollar exchange rate; the absence of a regional currency shield (equivalent to the euro or the ERM). And the US focussed much more intensely on restructuring Japan through the 1980s and 1990s than it did on Germany. At some point the US Treasury discovered that each time it confronted Tokyo the yen went up and the dollar fell—against what the Japanese government wanted and in line with what the US government wanted; the Treasury then used this tactic repeatedly to bring the Japanese into line.

One can speak, then, of a coalition for Americanizing the Japanese economy, against opposition. It has included the BOJ, some large Japanese companies, with more qualified support from the MOF and MITI; and several agents on the US side, led by the US Treasury (especially during Clinton years), also State Department, Commerce Department, US Chamber of Commerce, and many US companies.

### *The Bundesbank/ECB*

There is a lot of evidence that European central bankers think that Germany and Europe need liberalizing microeconomic reforms, in particular more flexible labor markets. And the Bundesbank and ECB have tended to follow a high interest rate, tight money policy, justified in terms of the value of very low inflation. They do not officially say that they use macro-economic pressure to force governments, parliaments and social partners to comply with a microeconomic restructuring, because this would imply that the ECB should override democratic bodies. But it is at least plausible that this is why they have persistently tended to err on the side of very low inflation at the cost of low growth and high unemployment.

### *The glue of the Triad triumvirate*

The triumvirate of the Triad central banks is structurally unstable for several reasons. One is the problem of any triad—each fears the other two will gang up on it. A second is that two of them—BOJ and the ECB—face the constant problem of gyrations of the US dollar, the main international currency. This gives them a clear motive for trying to ensure that any flight from the dollar goes to the other and revalues the other's currency, not its own. They each seek to defend themselves by maintaining large foreign exchange reserves—which makes it more difficult for the other to do the same. Japan now has more than enough

reserves, and its problem is how far to intervene to bolster the dollar and lower the yen in the interests of its exporters, a move which could also bolster the euro—which the ECB does not want. [CHECK]

And a third reason for coalition fragility is that very slow economic growth in Europe and Japan—partly a consequence of past and present macroeconomic restraint in the case of Europe and past macroeconomic restraint in the case of Japan--generates political discontent at home. The central banks are therefore less free to cooperate with their counterparts, despite being “independent”. In Europe the preoccupation with immigration and the rise of the Far Right are indicators of discontent. In Japan, the LDP is making short-term gains out of nationalism, fuelled partly by discontent at negligible economic growth and relatively high unemployment and high insecurity of employment.

The fragility of the triumvirate was exposed during the Asian crisis of 1997-99. The Japanese government proposed an Asian Monetary Fund with \$100 billion (half from Japan, the rest from China, Hong Kong, Singapore and Taiwan, the countries with very large foreign exchange reserves), able to provide liquidity against speculative attacks on regional currencies. The loans were to be made without the conditionalities the IMF required—including rafts of liberal reforms. The US Treasury made it a top priority to sabotage the proposal, on grounds that it would undermine IMF authority and harm US interests in the region. Neither the US nor, later, China wanted to see Japan get leadership of economic governance in Asian economy.<sup>42</sup>

For all the fragility, the triumvirate has endured in the sense that all three central banks remain committed to pushing the liberal economic agenda via their own policy instruments and via the domestic political process. (The BOJ, though, has given up macroeconomic restraint—interest rates are now around zero and base money is going up at the rate of 20% p.a., achieving a mere 3% p.a. increase in money supply.)

The Triad extends its commitment to the rest of the world through multiple channels, including the IMF. Now that the IMF cannot, post Asian crisis, continue to demand that developing countries open their capital accounts, its catch-cry has become “flexible labor markets”. In the words of a newspaper report, the current managing director, Rodrigo de Rato, “can’t seem to stop off an airplane without urging the local government to introduce more flexibility into labor markets”—

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<sup>42</sup> Paul Blustein, *The Chastening: Inside the Crisis that Rocked the Global Financial System and Humbled the IMF*, New York: Public Affairs, 2001.

notwithstanding recent OECD research that shows that employment protection policies of the kind Mr Renato wants universally abolished have not only efficiency costs, but also social benefits which Renato ignores.<sup>43</sup>

One can presume that part of the glue that holds the wider liberal project together across the US, Japan and Europe is the attraction of a US style income distribution for capitalists and top managers in Japan and Europe. The US tells them: go our way and you too can become super-rich. “Our way” includes, particularly, corporate governance reforms that allow much easier hostile take-overs of Japanese and European (especially German) companies, and the use of stock options for the remuneration of top executives.

Another element in the movement of Japan and Europe towards the US system is the US requirement of US-style corporate governance law as a condition of listing on the US stock market. Also, within Europe, the German attachment to its model of corporate governance, which makes hostile take-overs difficult, is under pressure from the smaller EU states (Holland, Belgium), which see easier M&A activity within Europe as the path of their own expansion.

The other side of this focus on the liberal model is the almost complete occlusion of the Nordic countries as a model for others, including for the rest of the EU. By most of the important yardsticks—economic growth, labor productivity, research and development investment, product and service markets, performance in high technology and telecommunications sectors, rates of employment, physical and social infrastructure, and income equality—the Nordic countries perform better than the United States.<sup>44</sup> Yet the European Commission and the non-Nordic European governments remain fixated on the United States as the model of virile capitalism. This binds Europe to the United States in the stance of pupil to master, helping to stabilize the coalition.

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<sup>43</sup> John Schmitt, “Lessons for the IMF: sometimes efficiency is not the best measure”, *International Herald Tribune*, September 30, 2004. The OECD research is reported in the OECD’s *Employment Outlook*, 2004. Ciao Koch-Wieser, the senior civil servant in the German Finance Ministry, identified the key restraint on European growth as labor market rigidities (talk at LSE, September 2004). Asked what evidence he had that labor market rigidity mattered more than macroeconomic demand restraint, he disappeared in a cloud of smoke, saying that anyone who lived in Germany would agree that labor market rigidity was the key. His reply is a striking illustration of how far consensual thinking has moved away from Keynesian ideas, that would focus first on product markets and aggregate demand as source of mass unemployment and only then on labor markets.

<sup>44</sup> Nick Clegg, “Why Europe should look within for inspiration”, *Financial Times*, 31 March 2005.

*Income polarization and political backlash*

The liberal project faces the basic problem that it encourages “exit” of the top income recipients from the national economy—exit from concern to improve its overall performance, including its political stability and material well-being of the population at large. With free capital mobility and free M&A, the wealthy can hold their assets in all legs of the Triad, and elsewhere as well.

But the political backlash is real. The liberal project has not been translated into widely accepted norms for managing either the domestic economy or the international economy. There is strong resistance even within the business class of Germany and Japan to having their assets open to unlimited foreign ownership; and also in “emerging markets” like South Korea. South Korea has recently passed a law requiring directors to banks operating in the country to live in the country, to the anger of representatives of foreign-business organizations. **(CHECK)** If the US goes into recession and the stock market falls--so pension funds fall and pension payouts fall—the political backlash may unseat the top capitalists and top managers as the primary shaper of economic policy. Even without a serious recession, the continuing surge in income and wealth inequality at some point is likely to produce the same sort of reaction, one would suppose. (Wealth is much more unequally distributed than income. The Gini coefficient for US wealth—net worth—distribution in 2000 was 0.83, compared to 0.56 for income distribution.<sup>45</sup>)

If the liberal project does break down—perhaps in response to a US recession—we may see stronger policy moves toward “regionalism”. Europe would be better placed than Japan, having a more closely integrated periphery. But the British, on the margins of Europe, would be big losers of a stronger push towards European regionalism. Perhaps this helps to explain the special fervour of the UK Labour Government’s commitment to liberal globalization as the central principle for the world economy. Soon after the Labour Government came to office in 1997, the UK Treasury even led the US Treasury in pushing for the IMF to revise its Articles of Agreement to create a presumption that all Fund members should have open capital accounts as a condition of membership (free movement of capital in and out of the country). The Labour government is currently leading the effort to show that lagging Africa can be given a helping hand by the beneficiaries of globalization, in order to protect the globalization project itself.

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<sup>45</sup> Edward Wolff, “Changes in household wealth in the 1980s and 1990s in the U.S.”, in E. Wolff (ed.), *International Perspectives on Household Wealth*, Elgar Publishing, 2004.

Ironically, the same confident spirit of liberal-globalism prompted Gordon Brown, British Chancellor, to announce recently in Africa that Britain should stop apologizing for its colonial history; this followed his earlier remark that we should be proud of those who built the empire, which had been all about being “open, outward-looking and international”.<sup>46</sup> Tony Blair was planning to say during a major speech of the 1997 election campaign, “I am proud of the British empire”, until prevailed upon to delete it. There is an obvious congruence between the idea that colonial economic and political relationships worked to the net benefit of the colonies and the idea that liberal-globalization works to the net benefit of the weaker players—according to spokesmen for a former colonial power and a currently stronger player.

The British government is especially alarmed by any talk of Europe cohering as a pole in potential opposition to the US. Blair described the vision of the French government of Europe as a center of power rivalling the US as “dangerous” and “pathetic”. “I think we are best to congregate around one pole of common values. Europe and America should be an integral part of that together. They should not have separate and competing poles of power.”<sup>47</sup> Blair does not want European ideas of social democracy to gain traction over Anglo-American ideas of liberalism; rather, he wants the reverse, in line with New Labour.

## CONCLUSION

The claim that globalization over the past 25 years or so has been driving a reduction in global inequalities—including the absolute number of people in extreme poverty and the degree of inequality in the distribution of world income—is open to serious question. With plausible adjustments to the basis of calculation, it is more likely that the poverty headcount is higher than generally claimed and rising, and that world income distribution by plausible measures has becoming more unequal; and further, that globalization processes have an important role in these adverse outcomes. But it remains a matter of higher and lower probabilities, not certainties; the evidence is not clear enough to avoid a certain amount of pain to the backside from sitting on the fence.

The champions of liberal-globalization read the evidence on poverty and inequality with one-eyed certainty because the evidence matters for winning acceptance of the liberal world order. This world

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<sup>46</sup> Seumas Milne, “Barbarity is the inevitable consequence of foreign rule”, *Guardian*, 27 Jan 2005.

<sup>47</sup> Nicolas Watt, “PM attacks Chirac’s ‘pathetic’ power vision”, *Guardian*, 29 Jan, 2005.

order is in line with the interests of the top capitalists and top managers especially in the US (and the UK), who want a world in which they—and their mutual and pension funds--can move capital to and from wherever they wish. They want this freedom because in such a world order they are able hugely to increase their share of income and privileges relative to the rest of their societies.

On the other hand, if the benign outcomes, the mutual gains of liberal-globalization are in doubt, this would give grounds for much larger reforms to globalization architecture than the liberal argument approves (in fact, the liberal argument approves at most of redecoration and adjustments to the plumbing). The larger reforms would curb the mobility of capital, and thereby curb the ability of the people in the top few percentiles of the income distribution to maintain and increase their high share of national income. This may help explain the confidence with which the “globalization works” claims are asserted.

The process is similar to what happened with intelligence on Iraq. Richard Dearlove, the head of MI6, reported to Prime Minister Blair on his visit to Washington, July 2002, that the “facts and intelligence” were being “fixed” by the Americans “round the policy”, meaning not that the Americans were *inventing* the intelligence on WMD but that they were trawling around for intelligence to support the decision President Bush had already made to replace the Iraqi regime” (quotes from minutes taken by the prime minister’s private secretary). Having heard this, Blair subsequently refused to continue private or public conversations where he was invited to rethink his commitment to Bush. He shut his ears.<sup>48</sup>

No doubt my argument about the liberal project rests on too much intent, as though it is all an unfolding strategy, even a “conspiracy theory”. The invisible strings from “intent to maximize scope for capital mobility”, to “intent to increase share of national income”, to “embrace of liberal economics”, to belief in the proposition that “world poverty and inequality have fallen thanks to globalization” are no doubt complicated, and beg lots of questions about how they are organized (the funding of university and World Bank research, for example). But with whatever degree of intentionality and concertedness the fact is that these several components of structure, interest, belief and reading of evidence do resonate together to make a consistent whole.

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<sup>48</sup> John Ware, “MI6, Jack Straw, defence staff: Blair ignored them all”, Guardian, March 26, 2005.

My core argument, in contrast, is that free trade liberalism produces tendencies to polarization—both class polarization within countries and core-periphery polarization between countries—that undercut the admirable catch-up and poverty reduction objectives of liberalism. If the liberal objectives are to be realized we need a rather different set of theories of development, a different set of policy norms, and a different set of organizational arrangements at national and international levels. We need, above all, to make a clear distinction between a theory of how markets work where markets and their institutional framework are already well established, and a theory of how markets may be created where they are only weakly institutionalized—a distinction that liberal economics fudges to vanishing point. My book, *Governing the Market*, outlines some suggestions for this new approach, inferred from the successful state-led development experience of East Asia.

We have to consider seriously the possibility that the liberal-globalization route will generate more rounds of financial crises, which could even tip the world back into the fragmented nationalisms of the 1930s. (The stability of the current conjunction of the international monetary system is more apparent than real. The likelihood of financial crises is a non-linear function of interest rates and the dollar, both of which are currently unusually low.) On the other hand, the sort of global governance implied by my argument raises acute questions of democratic accountability, and of overcoming the resistance of the G7 states that are prime beneficiaries of the current liberal order.<sup>49</sup>

China will be the interesting case to watch. As noted, the Chinese government retains a powerful commitment to “governing the market”, which even includes some Chinese economists who have undergone PhD training in the United States. Numbers of Russian economists are now studying under Chinese economists, the Russian government under Putin having concluded that the drastic liberalization undertaken by an opportunistic Russian elite and a cadre of western lenders was a mistake. But will China attempt to “internationalize” its norms through, for example, the World Bank and the IMF? Will it help to organize a

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<sup>49</sup> The Bush II administration sees the United Nations as properly a quasi-arm of the US government. John Bolton, nominee as US ambassador to the UN, wrote that the US has no legal obligation to pay UN dues; and that “If I were redoing the Security Council today, I’d have one permanent member because that’s the real reflection of the distribution of power in the world...the United States.” (“John Bolton’s world”, editorial, International Herald Tribune, 10 March 2005). A Bolton champion says, “[Bolton]...will aggressively pursue the US national interest, which includes forcing accountability and transparency in the world body.... His views are in sync with the growing calls from Congress for the United Nations to be held accountable to the American taxpayer” (Nile Gardiner, “Bolton is a force for good”, International Herald Tribune, 10 March 2005).

coalition of LDCs to promote the institutionalization of a norm of special and differential treatment (SDT) in international economic governance?<sup>50</sup>

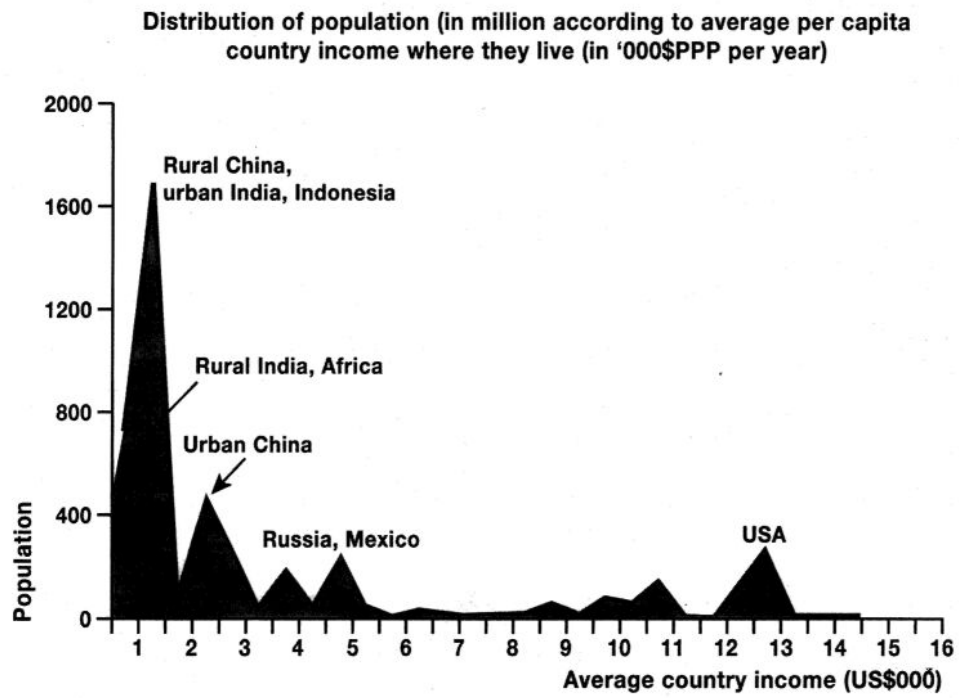
My epigraph from Allen Greenspan raises the question of the “we” who cannot tolerate a major wealth rearrangement. Certainly the people who live on Park Avenue could not tolerate it, but most of the rest of the population could tolerate it quite well. The liberal project helps to ensure that they do not get it, that the distressing experience of 1930-1970 is not repeated. One of its buttresses is a social science that encourages uncritical acceptance of findings that liberal-globalization brings improved economic conditions for the weaker as well as for the stronger; uncritical acceptance of consumerism as the leitmotif of the good society; and uncritical acceptance of the superiority of non-corporatist American-style democracy over more corporatist democracy. It is a social science whose methodology of formalization polishes the surface until icily dull, and all fire is lost. Those who question the evidence, who argue that “more choice” and “more market” pave the way for more insecurity, causing social fabrics to unravel further, and who campaign locally for better lives and globally for social justice and a sustainable environment, must be delegitimized. That is what the fuss is about, ultimately.

END

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<sup>50</sup> Wade, “What strategies are viable for developing countries today? The WTO and the shrinking of development space”, *Review of International Political Economy*, 4, 10, 2003, 621-44; Adrian Wood, John Roberts, Robert Hunter Wade, Sanjaya Lall, “Symposium on infant industries”, *Oxford Development Studies* 31, 1, 2003, 3-20; Wade, “US and European relations with developing countries: aid, trade, and investment”, in Samuel Wells and Ludger Kuhnhardt (eds), *The Crisis in Transatlantic Relations*, Center for European Integration Studies, Bonn, 2004, 43-56; Wade, “Failing states and cumulative causation in the world system”, *International Political Science Review* 26, 1, 2005, 17-36; Wade, “The invisible hand of the American empire”, *Ethics and International Affairs* 17, 2, 2003, 77-88; Wade, “Bringing the economics back in: comment on Michael Cox, ‘Empire by denial? Debating US power’”, *Security Dialogue*, 35, 2, 2004, 243-248.

**Figure  
1**



**FIGURE 2**

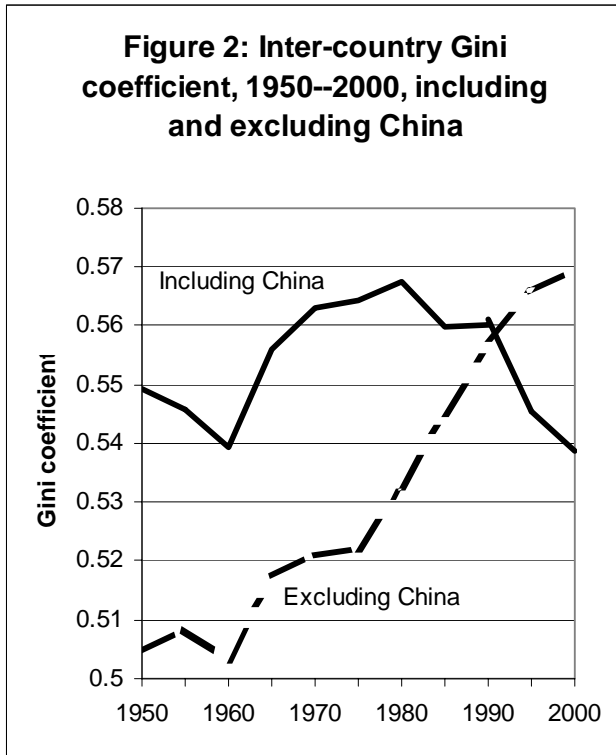


FIGURE 3

**Figure 3: Income per head as percentage of North**

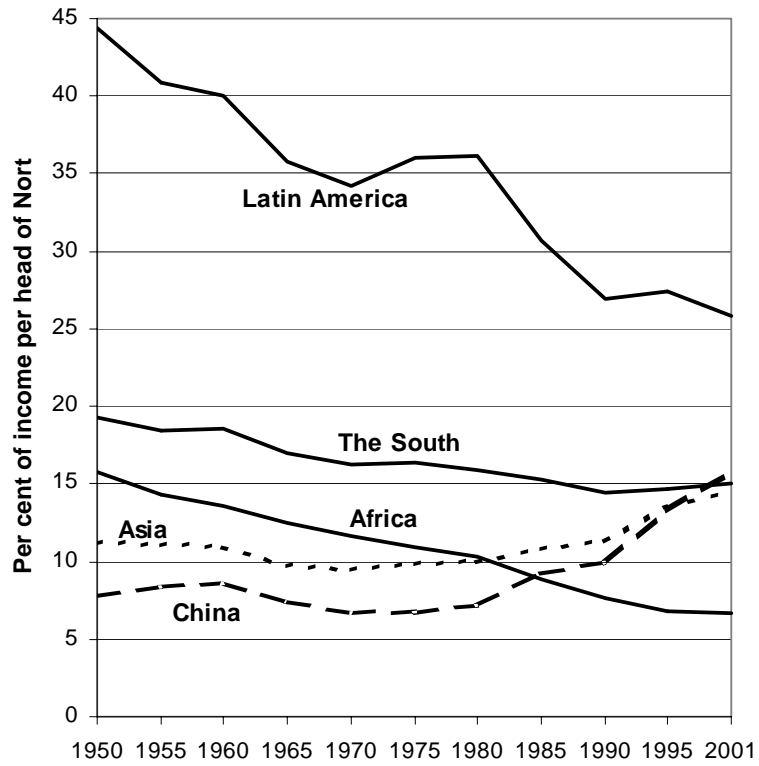


TABLE 1: MEASUREMENT CHOICES THAT AFFECT THE TREND OF WORLD INCOME INEQUALITY 1980-2000

CHOICES THAT BIAS TOWARDS A **FALL** IN INEQUALITY

- PER CAPITA INCOMES
- INCOMES CONVERTED AT \$PPP
- COUNTRIES WEIGHTED BY POPULATION
- GINI (OR OTHER AVERAGE) MEASURE OF INEQUALITY
- PENN WORLD TABLES OR WORLD BANK DATA ON \$PPP

CHOICES THAT BIAS TOWARDS AN **INCREASE** IN INEQUALITY

- INDIVIDUALS' INCOMES
- INCOMES CONVERTED AT MARKET EXCHANGE RATES
- COUNTRIES NOT WEIGHTED BY POPULATION
- POLARIZATION MEASURE OF INEQUALITY (eg top decile to bottom decile)
- ANGUS MADDISON DATA

Table 2 . Median GDPPC Growth Rates, 1965-1979, 1980-1990

	1965-1979	1980-1998
OECD	3.5	1.8
Developing countries	2.4	0.0

Source: William Easterly, The Elusive Quest for Growth, \_\_\_\_\_  
MER or PPP?

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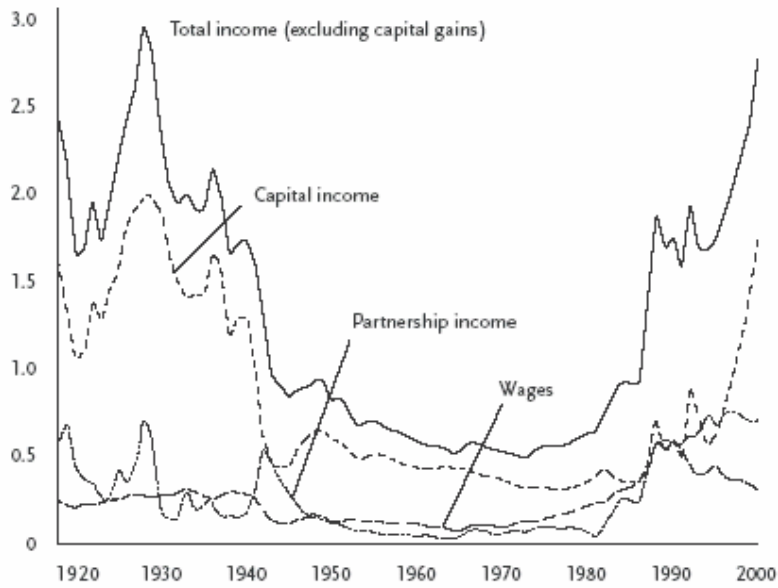
TABLE 3. PROFITS OF FINANCIAL CORPORATIONS AS A PERCENTAGE OF THE PROFITS OF ALL DOMESTIC AMERICAN CORPORATIONS (% net of capital consumption and inventory revaluation)

Year	1947	1960	1970	1986	2001	2002	2003
%	8	17	20	20	40	42	39

Source: US National Accounts Table 6.16.

FIGURE 4:

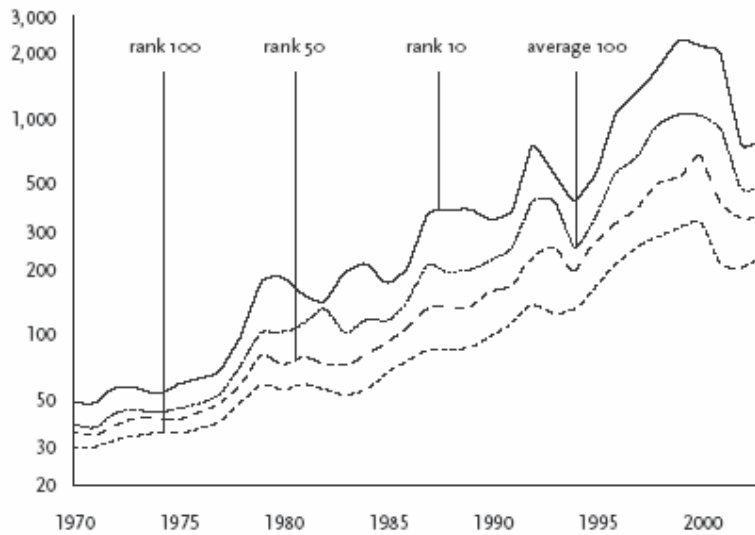
FIGURE 2: *The top 0.01 per cent income share in total household income: total income (excluding capital gains) and three components, 1918–2000*



Source: Kopczuk and Saez, 'Top Wealth Shares in the United States'.

FIGURE 5

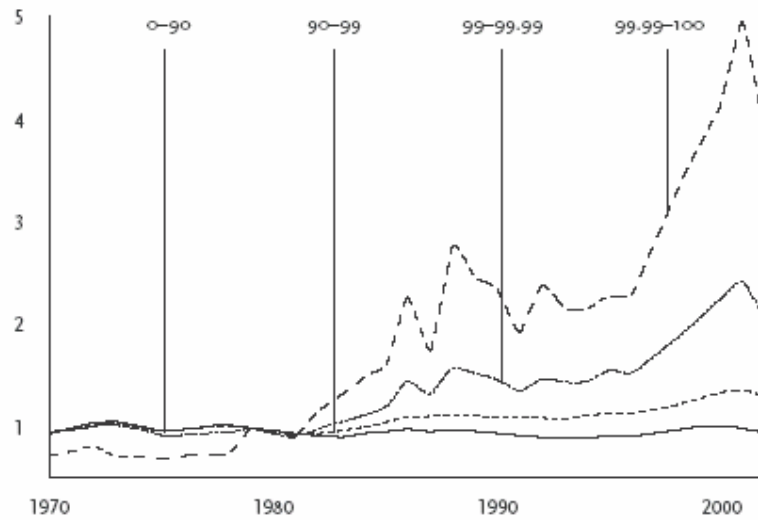
FIGURE 7. *Pay of CEOs of various rankings (ratio to the average salary of all wage-earners), 1970–2002*



The first three curves show the rise of the pay of CEOs according to their rank in the hierarchy of remunerations: 10th, 50th and 100th. The fourth curve corresponds to the average pay of the 100 CEOs with the highest remunerations. Note that 1,000 means 1,000 times the average salary. Source: Piketty and Saez, 'Income Inequality', table B4.

FIGURE 6.

FIGURE 10. *Average real income for four fractiles, including capital gains, 1970–2002*



All series are in 2001 dollars and have been normalized to 1 in 1979; series are deflated using the Consumer Price Index. In 1979 the values were: \$27,532 for the fractile 0-90; \$100,579 for 90-99; \$308,290 for 99-99.99; and \$3,387,913 for 99.99-100. Source: Piketty and Saez, 'Income Inequality', table A5.