Final response: International Inequality and the Global Crisis – Managing Markets for Sustainable Growth

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This post is the final response to Professor Brett's original blog post: 'International Inequality and the Global Crisis – Managing Markets for Sustainable Growth'

This post was followed by comments from Guenther Schoenleitner, Director, International Financial Institutions Division, Federal Ministry of Finance, Austria. Part 1 of his response can be found here, and part 2 here.

Dr Jean-Paul Faguet of the Department of International Development, LSE also provided his views here.

Krugman: States as totalities do in a strong sense compete in that the relative strength or weakness of their total productive capacity determines whether they run BoP and fiscal surpluses or deficits, and this in turn determines their ability to sustain and improve the welfare of individual citizens. This in turn depends on the ability of all their individual firms to compete with individual foreign firms, but this is not just a function of their individual resources but of location specific economies of aggregation determined by state provided infrastructure and the benefits of clustering. Greece does have to compete with Germany for new investments by individual firms, but is at a structural disadvantage in doing so because Germany offers those firms far better opportunities to make a profit. Hence the Eurozone crisis.

1 & 3 The fact that existing technologies are constantly being undermined by Schumperterian creative destruction, as a massive volume of evolutionary theorists following Marx and Schumpeter, (Nelson and Winter, Dopfner, etc) show, has ambiguous but generally speaking scale-increasing effects. This is primarily because the capacity to innovate, and to apply innovations, is heavily dependent on the heavy investments that only the most successful companies can afford, and that they can then exploit through patenting etc. Hence BMW and Glaxo retain their overall dominance and few if any new potential giants have emerged for a long time. However, innovation can have the opposite effect, as I point out very clearly in the paper, by enabling small businesses to reduce overheads and out-compete larger ones. My son's business importing solar dried fruit from the south would not have survived but for its ability to use computer systems to control their international transactions. These 'countervailing tendencies' as Marx called them do have important consequences but are far less powerful than scale economies – in Africa for eg. this is what confines the great majority of workers to semi-subsistence survivalist activities in the informal sector.

2 Firm size can be constrained by managerial capacity, and the increased costs of supervision. However, this is more than offset by increased capacity to manage transaction costs, malfeasance and opportunism (Coase and Williamson) and all of the innovations in management structures ranging from centralised Fordism through to decentralised contracting that we deal with in the Development Management course at LSE. More important, neo-classical theory ignores the massive advantages accruing to large firms through favoured access to credit, R&D, advertising and marketing. Hence the continuing dominance of Coca Cola, Volkswagen and Tesco.

4 The link between scale economies and transfers between (and also *within*)

countries is the critical issue ignored by theorists and practitioners living in a fantasy world governed by comparative advantage and perfect competition between individual firms that automatically respond to technical change by redistributing resources from strong firms and states and regions to weak ones as neo-classical theory implies.

Suppose that South Africa has a small high-cost footwear industry and China has a large low-cost one; South Africa eliminates tariffs and Chinese exports wipe out the South African industry. These workers cannot shift to other high cost sectors since these are also being wiped out by Chinese or Korean exporters. Exports and BoP deficits increase, wages, domestic consumption and tax returns fall in SA but rise in China. China's factories invest in new and better equipment increasing barriers to the entry of new firms in SA. SA deindustrialises, moves into a deflationary downturn, inequality increases the state has to cut services.

This is a summary of the findings of the Sociology of Work and LSE Crisis States research project at Witwatersrand University in South Africa ten years ago, and explains many aspects of the intensifying crisis in SA. Its continuing importance is attested to by Robert Wade blog on this website summarising the failure of the orthodox policy community to take any account of these critical problems that once dominated development policy theory at a recent high level UNCTAD Conference in Geneva devising a trade policy for the 2015 post-millennium goals.

Neo-classical theory tells us that export growth should rapidly increase costs in China and thus enable SA to invest and grow: my analysis tells us that this will not happen when Chinese plants, firms and regions can exploit scale-economies to stop it from doing so. This produces what I (and Trotsky) call combined and uneven development. The only way this can be overcome is through *anti*-market interventions that compensate losers for the loss of their livelihoods, and/or make it possible for them to invest despite their inherent un-competitiveness.

During the structuralist period up to the 1960s these took the form of protectionism and state monopolies; now they take the form of welfare transfers, tax based infrastructure projects, business development projects in DCs and LDCs, supplemented by (minimal) aid transfers to LDCs. I am not setting out any particular project of this type at this stage, though I am arguing that current interventions are seriously inadequate and for the most part becoming worse. Once we can show that the need for redistribution is caused by the 'natural' failure of markets to guaranteed stability and equity, we can sit down to think through the implications of doing this

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