

## Comment on Brett, International Inequality and the Global Crisis. [Part 1]



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(Guenther Schoenleitner writes here in an independent capacity and his comments do not necessarily reflect the views and opinions of his employer).

*This post is a response to Professor Teddy Brett's October Blog post entitled 'International Inequality and the Global Crisis – Managing Markets for Sustainable Growth'*

Many thanks for a very timely and insightful paper that I have read with great interest. I cannot add anything substantial to your theoretical arguments, but here are some empirical observations and arguments from policy discussions in national governments and the IFIs that I have been involved in that raise some problematic questions about the theoretical and practical implications of your analysis.

The paper perceives the world economy as being caught in an incessant process of divergence and exclusion where the strongest “old and new industrial countries” concentrate more and more wealth (based on their scale economies, superior innovation capacity and their resulting competitiveness) while destroying “weak states and firms” in the developing world. Such a diagnosis would indeed build a strong case for protectionism, but the empirical record of the past decades is mixed and does not fully support this notion, although this is not to deny that global imbalances do exist. I will first question some of your theoretical claims, then raise some of these countervailing arguments, then acknowledge the validity of some of your theoretical claims about uneven development and review the policy issues that have been generated by these imbalances.

### Challenging Some of Your Theoretical Propositions

1 I think there is a need to clarify/define the concepts “strong and weak states”. Do you mean surplus countries are strong and deficit countries weak? But then China would be strong and the US weak, and the resource transfers you advocate should flow from the former to the latter, or China should allow the US to protect “infant or declining industries”? I don't think either would be the right answer to the skewed trade balance between both countries. I will raise some of these alternative possibilities in the next section.

2 **Uneven development is not the product of the liberalizing reforms since the 1980s.** World development has been uneven ever since the Industrial Revolution. While western industrial economies pushed ahead, China, India, the ex-Soviet countries, and many pre-modern societies lagged behind, creating a highly uneven world before the liberal reforms of the 1980s set in. Those reforms then facilitated the integration of “emerging markets” with export-led growth strategies into the world economy. Without the dismantling of barriers to trade and investment, the NICs, China and others would probably not have been able to grow at the pace we have seen.

3 What struck me when I read the paper was that **it largely treats China, India, Brazil and other NICs as outliers** or exceptions to general rules (“all but the most successful MICs”). Yet these countries are home to a large share of humanity and their success is not just a stunning effect of unconventional, interventionist policies coupled with a global environment of liberalized trade and investment regimes; their rise is also causing the need for major adjustments in the rest of the global economy. The integration of the most populous countries into the world economy was never

expected to be a smooth process that leaves others unaffected. So I think the analysis of the development of the BRICs should take center stage rather than being treated as an exceptional phenomenon.


4 Regarding **the role of IFIs**: as far as I am aware it is not true that “the prescriptions of current orthodoxy” are “proscribed by the Articles of Agreement of the IFIs that almost all LDCs have now signed”. Generally the Articles charge the institutions with the pursuit of economic development in their countries of operation, but do not specify economic policies or strategies (with the exception of EBRD whose mandate is to help ex-socialist countries to transition to private-sector led market economies and liberal democratic systems). Moreover, most IFIs are no longer the center of neoliberal orthodoxy they used to be during the “Washington Consensus”.

### **The Positive Consequences of Globalisation for Developing Countries**

This success of the BRICs and other LDCs over the past 30 years has produced significant convergence processes both in Europe and at the global level. Europe’s growth model has been an engine for economic convergence during the past few decades and has delivered prosperity to hundreds of millions of people on the continent. However, as the World Bank argues, faced with adverse debt dynamics and unfavourable demographic trends, the model needs to be adapted, not abandoned (see Golden Growth report).

At the global level, a WB research paper points out, the world might have witnessed in 1988-2008 the first decline in global inequality between citizens since the Industrial Revolution. Some of the largest and most populous developing nations (China, India, Brazil...), as well as smaller ones, have grown very quickly lifting hundreds of millions out of poverty and creating a sizeable middle class. At the regional level we have seen a significant decrease in inequality in Latin America. Even in Sub-Saharan Africa growth has picked up in many countries. At the same time formerly dominant “core” economies have been running into troubles. The US has been building up huge trade deficits and levels of indebtedness, Japan has been mired in two decades of deflation and stagnation, the UK has experienced significant deindustrialization, and both France and Italy have suffered stagnation resulting from declining competitiveness. Even Germany was considered “the sick man of Europe” and the continent’s largest exporter of jobs only 10 years ago.

In fact, we are witnessing a crisis of the rich world that has a lot to do with the difficulties, and sometimes failure, of these economies to adapt to globalization, in particular to the intense competitive pressures from emerging economies in Asia and Latin America. The euro zone’s southern periphery may suffer as much from the “rise of the rest” as from Germany’s regained competitiveness; their competitive positions on the technology ladder may be even more exposed to the NICs than to Germany’s specialization in frontier technologies based on its highly innovative medium-sized firms. So overall, I am not sure that we can really assert that developing countries and their firms are being forced “to continue playing a game they necessarily lose”, at a time when we have witnessed a large-scale take-off in the developing world (even though this development process is certainly uneven).

The concentration effect resulting from economies of scale and scope has also a mixed record. In the 1970s many thought that a few ever larger MNCs and conglomerates would take over the world. But then the share of GDP produced by big industrial companies fell from 36% in 1974 to 17% in 1998. Many companies concentrated on core competencies, outsourcing other functions to other firms. Industrial production was increasingly organized in complex multinational supply chains rather than large multi-plant industrial firms. Liberalization and the lowering of trade barriers have diminished the importance of domestic market size for industrial firms in sectors with strong economies of scale. Technological change has also helped. The internet has significantly reduced information asymmetries, and while it is true that it has destroyed millions of jobs in “small shops and high streets”, it also has created millions of new ones, e.g. in services. In recent years, the trend may have shifted again towards larger firms, partly due to the financial crisis that hurts smaller firms more than bigger ones in terms of access to finance. But also the risks of subcontracting have become clearer. Future technological innovations such as 3D printing  may

reduce scale economies and change industrial organization profoundly. This is creative destruction in action, creating winners and losers.

My next post will consider the heterodox policy implications of global imbalances.

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