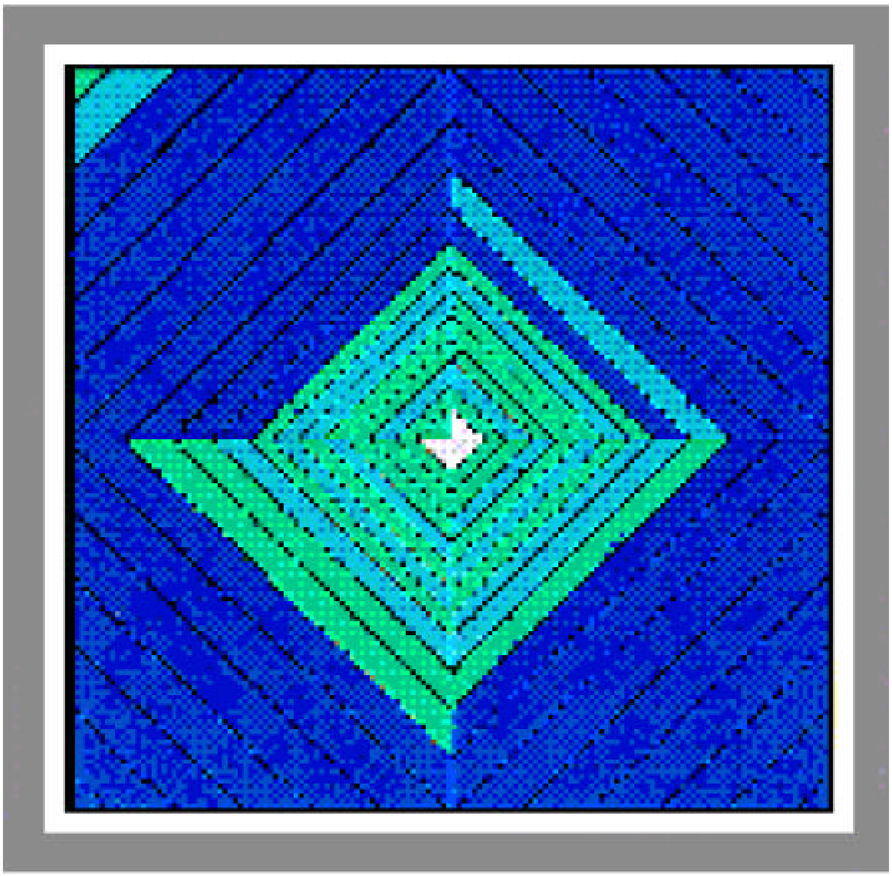
GLOBALIZATION, DISTRIBUTION AND GROWTH



Chapter I

THE ISSUES AT STAKE

Since the late 1970s there has been a fundamental change in economic policy, first in the industrial countries, and then in the developing countries. In the latter this change has affected not only macroeconomic policy, but also development strategy. Emphasis has increasingly been placed on a minimal role for the State, greater reliance on private initiative and market forces, and increased openness and greater integration into the world economy. It was thought that such a reorientation of policy was needed not only to attain a stable macroeconomic environment, but also to accelerate growth and more generally to raise living standards. Price distortions due to government interventions and resistance to opening up were assumed to be responsible for slow growth, unequal income distribution and widespread poverty. Growth based on global market forces, it was thought, would thus be more rapid and widely shared, allowing developing countries to catch up with the industrial countries, and the poor with the rich.

The world economy is in many respects more closely integrated today than at any time in history. However, integration has not proceeded at a uniform pace on all fronts. Among the asymmetries of globalization is the fact that liberalization of the world economy has proceeded so far in a lopsided way. For example, trade liberalization has proceeded more slowly in products where developing countries are more competitive. By contrast, many restrictions have been removed on the freedom of movement of capital, where industrialized countries have a comparative advantage. Likewise, unskilled labour where the South has comparative advantage, has far fewer employment options than labour embodying capital (i.e. skilled labour).

The outcome of unleashing market forces in combination with asymmetries in liberalization raises a number of concerns. There are a number of trends suggesting that in many respects national economies are polarizing rather than growing closer together. Marginalization and poverty are perhaps the most evident feature, but the tendency towards polarization affects more deeply the socio-economic fabric:

- Taken as a whole, the world economy is growing too slowly to generate sufficient employment with adequate pay or to alleviate poverty;

- This has accentuated longstanding tendencies for divergence between developed and developing countries. Moreover, greater gaps between them have been accompanied by widening gaps within the South as a handful of newly industrialized economies have pushed ahead of other developing countries;

- Finance has been gaining an upper hand over industry, and rentiers over investors. Trading in existing assets is often a much more lucrative business than creating wealth through new investment;

- Capital has gained in comparison with labour, and profit shares have risen in developed and developing countries alike;

- Growing wage inequality between skilled and unskilled labour is becoming a global problem;

- The hollowing out of the middle class has become a prominent feature of income distribution in many countries;
- There is almost everywhere increased job and income insecurity.

These seven "stylized facts", documented and analysed in the following chapters, pose a serious challenge for policymakers. Some of these features of the global economy may simply represent temporary dislocations associated with a rapid shift towards market forces and closer integration. Others may be of a more permanent nature. However, unless action is taken to counter these tendencies for a widening of gaps between poor and rich countries, and between the poor and the rich within countries, there is a risk of a serious political backlash that may nullify the gains from several positive elements of recent economic reforms in developed and developing countries alike. History shows that growing inequality under conditions of stagnation is a recipe for socio-political instability. The challenge at the close of the 20th century is thus, to paraphrase the Austrian economist Joseph Schumpeter, not to allow the destructive forces of modern capitalism to gain an upper hand over its creative forces.

The increasing gap between the poor and the rich cannot be bridged unless growth is accelerated. Recent experience has demonstrated that there are limits to redistribution without growth. Capital accumulation must consequently be put at the top of the policy agenda. The association of increased profits with stagnant investment, rising unemployment and reduced pay is already widely resented and threatens to raise questions about the acceptability of placing an ever-increasing share of national product in the hands of a few. Unless incomes of this minority are used to create more general prosperity, they may lose their social justification.

The idea that unfettered global market forces will generate a process of catching up by developing countries which is accompanied by improved income distribution has little historical or theoretical support. A much greater role needs to be played by governments in the South in accelerating growth and reconciling it with greater equality. This role should be fundamentally different from the kind of misguided interventions that pervaded many developing countries in the past. Despite increased pressures arising from the advent of new technologies, transnational corporations and global market forces, there remain many options for governments to influence accumulation and growth as well as the distribution of their benefits. Significant disparities in economic performance among developing countries today indeed reflect, in part, differences in how these policy options are exercised.

A realistic discussion of growth, distribution and development should start from the recognition that, in a market economy based on private property, most resources are concentrated in the hands of a minority, whose spending behaviour determines capital accumulation and growth. The main policy challenge in the South is how to translate rising profits into investment at a pace sufficient to underpin a wider social contract in which inequalities are justified by the extent to which they result in rising living standards for the mass of the population, leading eventually to reduced inequality. The challenge is particularly daunting in the many countries where the rich take more than half of the national product, but spend very little on activities contributing to general prosperity. In meeting this challenge it will be necessary for most developing countries to phase carefully integration into the world economy, tailoring the process, in each case, to the level of economic development and the capacity of existing institutions and industries. In these respects, governments of developing countries can draw valuable policy lessons from the experience of the successful late industrializers in East Asia.

However, if biased patterns of liberalization and globalization continue to prejudice growth prospects in developing countries by discriminating against sectors where they can build comparative advantage, the task will be a very difficult one. It would also be difficult to redress the balance between labour and capital, industry and finance, skilled and unskilled labour, or the poor and the rich. Attaining greater symmetry in liberalization remains a major challenge for the global community.

An essential concomitant of a more open world economy is the resolution of labour market problems in the major industrial countries. As examined in detail in *TDR 1995*, without faster growth policymakers are faced with an unpalatable choice between high and rising unemployment and growing wage inequality, or between open and disguised unemployment. Thus, faster growth in the North is essential not only to address these domestic problems, but also to remove systemic biases in the current process of liberalization. Solution of these problems depends on the acceleration of investment through both demand and supply-side measures.

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The next chapter examines global growth and convergence dynamics in a historical context, drawing on the experience before the First World War, when similar globalization pressures were at work, as well as the more recent trends. Evidence shows that divergence and polarization have been the dominant trends in the world economy over the past 120 years, and that convergence has taken place only within a small group of industrial economies. Global market forces do not spontaneously create the pattern of differential growth rates needed to achieve economic convergence between poorer and richer countries. Catching up by the former depends on the success of national policies in accelerating accumulation and growth, and on the management and phasing of integration into the world economy, a task which is greatly facilitated when the world economy grows faster. However, the considerably increased mobility of capital that characterizes the current process of globalization has not resulted in higher investment and faster growth, but rather in higher profit shares at the expense of labour.

Chapter III turns to income inequality within countries. It reviews the evidence on patterns and trends in income distribution, examines factors accounting for differences therein among countries, and analyses why growth is associated sometimes with rising and sometimes with falling inequality. It concludes that it is very difficult to generalize about how income distribution changes in the course of economic development. The crude stereotype of East Asia as a region of low and decreasing inequality is a misleading description, not only because some countries of the region have relatively high levels of inequality, but also because even in more successful cases, inequality increased during various episodes of their industrialization. Two tendencies have been identified regarding the more recent trends in income distribution in developing countries. First, there has been an increased concentration of income in the hands of the richest 20 per cent of the population at the expense of the middle class. Second, the growth-inequality relationship appears to have changed in the 1980s in most developing countries in ways which imply that growth now is more unequalizing. However, successful experiences of postwar industrialization show that government policies can shift the balance of forces towards those making for lesser inequality.

Chapter IV discusses the impact of trade and financial liberalization in developing countries on income distribution. Attention is focused on the evolution of wage differentials between skilled and unskilled workers, the distribution of manufacturing value added between labour and capital, the impact of agricultural price reforms on domestic terms of trade and agricultural incomes, and the sources of increases in the share of interest and other financial incomes. The evidence suggests that the "big bang" approach to liberalization has shifted the balance of forces towards those making for greater inequality without always generating additional stimuli for growth.

Chapter V reviews the effects of income distribution on accumulation and growth. It is first argued that unequal income distribution can slow both human capital formation, by reducing the capacity of the poor to invest in education, and physical capital formation, by generating social and political instability and uncertainty. The proposition is then examined that unequal income distribution is essential for rapid growth because the rich save and invest a greater proportion of their incomes than the poor. It is shown that the relationship between inequality and growth is greatly influenced by the extent to which profits are saved and invested. High reinvestment of profits fosters growth with lower inequality in terms of personal income distribution. Indeed, what distinguishes the East Asian NIEs from other developing countries is a considerably higher propensity to save and invest from profits.

The final chapter draws on the East Asian experience and examines how governments have influenced the emergence of a dynamic capitalist class with high "animal spirits". It first discusses the key policy instruments and institutions used in animating the investment-profits nexus - that is, the dynamic interactions between profits and investment whereby profits constitute simultaneously an incentive for investment, a source of investment and an outcome of investment. This is followed by a discussion of policies aiming at discouraging luxury consumption by the rich. The chapter concludes with an examination of the role of profit-related payments to labour in reconciling distributional and growth objectives. While some of the policies reviewed in the chapter were introduced at a time when globalization forces were less dominant, they nevertheless hold lessons which remain relevant and in varying degrees applicable to many developing countries today. ■