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Did globalisation stimulate increased inequality? A heterodox perspective

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1. Introduction

Global income inequality has been steadily rising since the 1980s. The sensational success of Thomas Piketty's "Capital" shows that the topic resonates well with the global population. Many have argued that this has been the result of "globalisation" (Palma, 2006), another concept which is widely discussed but rarely defined. Most divide globalisation into economic globalisation, focusing on international trade and foreign direct investments, and political globalisation, focusing on institutional arrangements. This division hinges on the existence of a conceptual separation between political logic from economic policy, which seems untenable. The contour of the global economy, the structure of the global market, who can participate in it and how they can engage in exchange are seldom apolitical choices.

This paper showcases four scenarios to show that the "political economy" aspect of globalisation is important, and posits that the "neoliberal version of globalisation" has contributed significantly towards increased inequality rather than just globalization. This detrimental and pervasive effect of neoliberalism has been carried out through dismantling the welfare state, reduced power of trade unions, massive industrial consolidation, deregulation of the economy, increased financialization of the international economy and the belief in the primacy of "self-regulating" market. The author believes it is critical to specify that a specific form of globalisation is at fault rather than the whole idea of globalisation; otherwise many may wrongly associate increasing inequality as a necessary consequence of engaging with the global economy and thereby decide to disengage their country and move towards autarky, which might be detrimental. Also unless we define the form of globalisation that is damaging, the debate wrongly focuses on merits and demerits of globalisation rather than what form of global engagement suits an individual country the best. The challenge is to take advantage of globalisation while limiting its offsetting costs.

Some degree of income inequality is constructive and empirical research shows that increased exposure to international trade does have distributional effect through increasing return to education, skilled based technological change, and urban rural migration among others (Goldberg and Pavcnik, 2007). The author's emphasis is that neoliberal ideology, based on market fundamentalism and a priori belief in the efficacy of neoliberal policies, exacerbates the situations significantly rather than countervailing the within-country inequality pressure stemming from increased integration to global economy.

At the onset the author wishes to clarify that the paper does not posit that neoliberal policies were the only cause of increased inequality. The fact that inequality has existed in societies since time immemorial is a sufficient proof that such notion is untenable. The key hypothesis is that dealing with inequality is a policy choice, and as such widespread use of neoliberal policies has contributed to increased inequality. If shown to be true this implies that rectifying the situation entails better policies and rather than blaming globalisation. The hypothesis is

[1] The article is written on a personal level and views expressed are strictly those of the author.

not a new one; others have also tried to show that neoliberal policies, rather than globalisation, have led to increased inequality (Quiggin, 1999; Schneider, 2003; Fiorentini and Montani, 2012; Evan and Sewell, 2013). Unfortunately it is often difficult to disentangle the impact of globalisation on inequality from the associated political and institutional reforms, in this case neoliberal reforms, accompanying the globalisation process. The key addition in this paper is that the author will use selected country-specific case studies using counterfactual analysis to offer stronger evidence of this proposition.

The paper is divided into five sections. The first defines the concepts of globalisation and inequality, as used in this paper. The second section explains how neoliberal globalisation became a dominant force intellectually and politically. The third and fourth sections show how such forms of globalisation further exacerbated inequality. The paper concludes with a summary of the overall exercise and a general explanation of how we can promote a non-neoliberal form of globalisation.

2. What's in a word?

Given the plethora of definitions it is difficult to say comprehensively what the term "globalization" means. Some have defined it broadly like Giddens (1991) "the intensification of worldwide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa". Others have focused narrowly on the increased interdependence and integration of national economies. Norris (2000) looks to the social, cultural and economic dimensions of globalisation and defines it as a process that "erodes national boundaries, integrates national economies, cultures, technologies and governance, and produces complex relations of mutual interdependence".

Martin Wolf (2004) defines "liberal globalisation" (which we may consider as the neoliberal position) on a narrow economic terms as "integration of economics activities, across borders, through markets". According to him the salient feature of neoliberal globalisation is increasing market integration of goods and services globally, reduction of trade barriers, free flow of capital, and technology, and finally use of market friendly policies both in domestic and international sphere (Wolf, 2004). According to Wolf the salient feature of neoliberal globalisation is increasing market integration of goods and services across economies, reduction of trade barriers, free flow of capital, technology and investment, and finally use of market friendly policies both in domestic and international sphere (Wolf, 2004). Thus to him it is a journey we have embarked upon with a vision that in future we will have a single unified market of goods and services, factor inputs with unrestricted flow. This vision may be commendable but we have to ask, is global integration best brought about by following the "market friendly" neoliberal principle?

All these definitions share in common the concepts of greater interdependence and integration. Countries today are no doubt more interdependent than before, but their fates are not "determined" by others. Asian financial crisis did not affect Taiwan as much as South Korea. The Global Financial crises of 2007-08, have had asymmetric effects, ranging from worst hit OECD countries like UK and US, to less impacted emerging economies like China or even Least Developed Countries like Bangladesh, whose GDP is still growing at the pre-crisis rate of 6% per annum. The same can be said about integration. Countries are still not fully integrated and so the process of engaging the global economy is path dependent and the pace can be adjusted, albeit within a limited and shrinking policy space (Wade, 2003). One can undertake rapid liberalisation and economic integration using shock therapy like Pinochet's Chile or countries of former Soviet Union post 1991. Others may take a gradual path like China, which joined WTO only in 2001.

The vision of a globalised world may be singular, but the route a country takes can be different and context specific; the neoliberal approach is but one such route towards attaining a globalised world. In this paper, "neoliberal globalisation" is defined from the perspective of a country which believes in market fundamentalism and undertakes neoliberal policies to integrate with the global economy. Boas and Morse (2009) identified three sets of policies that typifies neoliberal policy reforms : (1) market reforms through financial and trade liberalization of the economy, price control elimination, trade barriers reduction; (2) limiting role of state in the economy, privatization of state-owned enterprises (SOEs); (3) reduction of the size of government through fiscal austerity and macroeconomic stabilization, and, among others, elimination of budget deficits, and curtailment of government subsidies.

Regarding inequality there are multiple concepts which are often interrelated. Social inequality may look at education or gender inequality while economic inequality may look at wage, land, income or wealth inequality. Furthermore pre-existing economic inequality (e.g. wealth or land) can perpetuate or reinforce social inequality (e.g. education) or vice versa, and they are often self-reinforcing (Galor and Zeira, 1993). Piketty's (2014) argument about inequality and its relation to the return on wealth (r) being greater than the growth of labour income (g) i.e. r>g is a formalization of this phenomenon.

The present paper focuses primarily on income inequality. Research shows that what is true for it is often also true for wealth inequality, but with the latter operating on a longer time scale (Piketty, 2014; Atkinson, et al , 2011; Davies et al, 2011; ILO, 2008). The paper also focuses primarily on within-country inequality rather than between countries, since globalisation has an asymmetric impact on countries in terms of income inequality. The paper argues that this has depended substantially on the political choices and institutional settings of those countries. In the next section we look in to how the neoliberal ideology became dominant in the late 70s.

3. The rise of neoliberal ideology

From the mid-twentieth century to the early 1970s the state played a dominant role. For industrialized countries public expenditure as a proportion of GDP was around 12% before the First World War and increased to around 27% by 1960 and to about 47% by 1985 (Tanzi 1997; Batley, 2002). Meanwhile many colonies gained independence after World War Two. These post-colonial developing countries had weak institutions and in many cases the State was the only significant and legitimate institution (Alavi, 1972; Saul, 1974). This engagement with the State was also given theoretical justification from growth theories of post-war era. During this era international trade expanded significantly, especially among advanced nations, but within countries inequality remained stable (Fiorentini and Montani, 2012).

In the 1970s there were two oil shocks, and developed economies faced stagflation, which could not be reconciled with the Keynesian approach. There were spectacular election defeats of political forces who espoused regulated capitalism, particularly in the English speaking developed economies, by conservative political parties who advocated a "neoliberal" approach (Steger, 2010). With the resurgence of neoliberal doctrine, the role of the state was significantly cut back and massive deregulation took place with tax cuts being given to the rich. The Thatcher and Reagan governments in UK and US, and other major economies initiated austerity programs. Consequently global export demand fell, resulting in trade deficits in the developing countries. Since the developing countries mostly pursued industrialization through debt financing, with international recession their national debts grew. They then approached the World Bank and IMF for loans. Meanwhile, drawing on the researches of Anne Krueger, Bela Balassa, Jagdish Bhagwati, World Bank economists criticised state interventions for causing market inefficiency, rent-seeking, draining government revenues, etc (Stein, 2008). This led to the development of structural adjustment programmes, which were imposed as conditions for developing countries receiving loans. Prescriptions entailed balanced budget, trade and financial liberalization, privatization of state owned enterprise, very much in line with the Washington consensus (Williamson, 2000; Tabellini, 2005). Thus by the late 70s the global dominance of the neoliberal ideology was well established.

4. Impact of neoliberal ideology

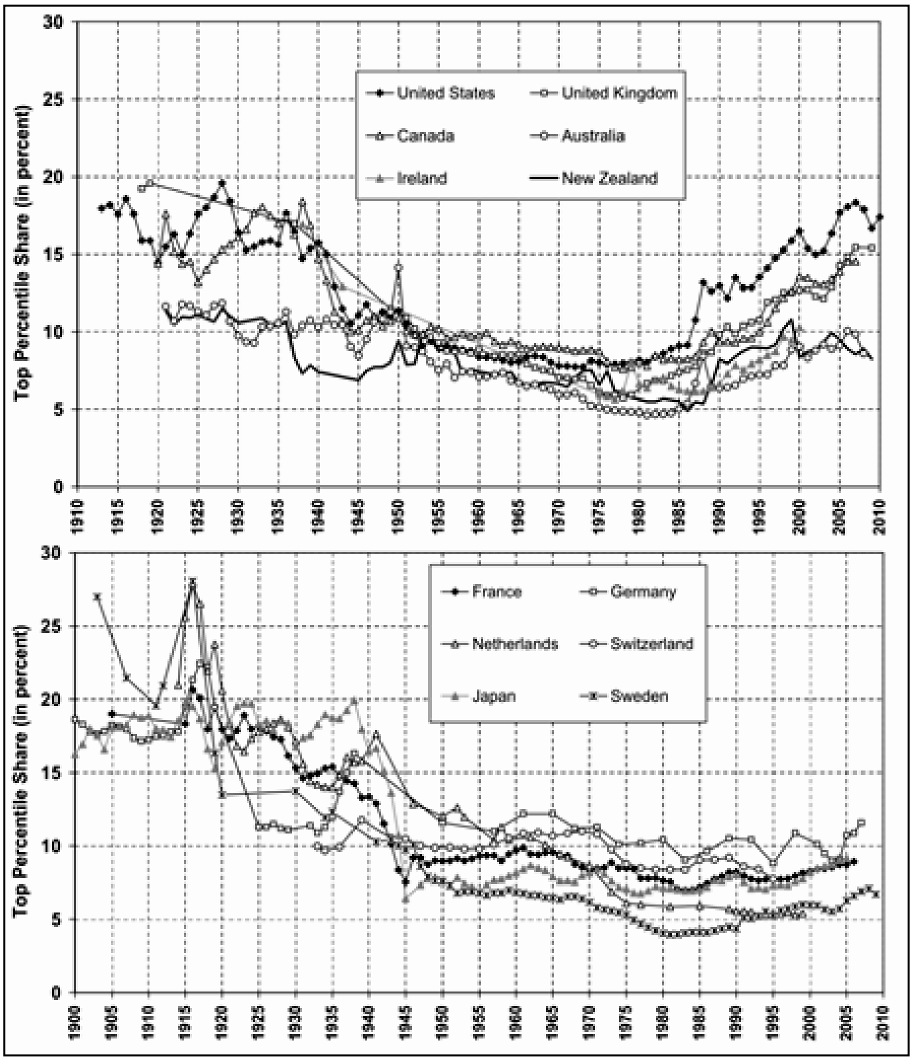
Countries, both developed and developing, which followed neoliberal policies experienced higher levels of inequality.

4.1 Anglo-American neo-liberalism

Polanyi discussed in great detail how the pre First World War era (1870-1914) was the first experimentation with laissez-faire economics by major European powers, the “golden age of liberalism” (Chang 2003).Many have argued that Globalisation as a concept is nothing new and that there are significant similarities between the two eras of globalization, i.e. pre 1914 and post 1970, in terms of trade integration, FDI flow, capital mobility, etc. (Quiggin, 1999; Sachs, et al 1995; IMF 1994). However the present author believes, like others, that there are qualitative differences between the two eras of globalisation in terms of technology involvement, composition of trade and FDI, financial instruments involved, etc. (O’Rourke, 2001; Bairoch, et al, 1996). But there is broad agreement that the two periods were very similar in terms of liberal ethos, and in many respects the pre-1914 world was much closer to the idealized “Washington consensus” view of neo-liberalism. Colonies like China, India were forced through gunboat diplomacy to open up to trade with their Colonial masters (O’Rourke, 2001), more extreme than the supposed subtle arm twisting by WTO at present. Governments were smaller in the developed world, with government spending as percentage of GDP averaging 13% where as in the late 1990s it stood at an average of 45% (Tanzi, and Schuknecht, 2000). There were fewer regulations, no antitrust laws, environmental or child labor regulations, etc; thus capitalism was much less constrained than today.

Polanyi (1944) argued that there was then an unprecedented level of inequality; a fact that is borne out by current research showing that the top 1% of the population had nearly 20% of the total income (Atkinson, et al, 2011; Piketty and Saez, 2013). In the early 20th century most European countries followed neoliberal policies and had high inequality (Figure 1). But in the second phase of globalisation during the 1970s, the Anglo-American countries adhered to neoliberal ethos more closely through massive tax cuts, financial market deregulation, privatization of SOEs, etc. Thus we see English speaking countries had much higher level of inequality in comparison to non-English speaking developed countries, even approaching the ones of pre 1914 level (Figure 1). Unlike the 1960s during the “golden age of capitalism”, when both English and non-English speaking OECD countries were highly integrated to the world economy and yet had low inequality.

Figure 1: Historical trend of Top 1 percent share in selected OECD countries



Source: Piketty & Saez, (2013).

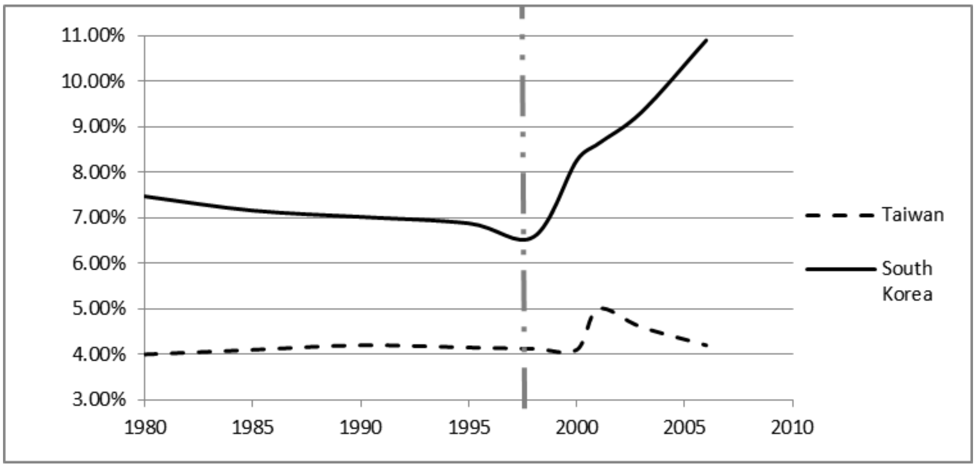
Inequality in these English speaking countries has continued to increase even after the global economic recession of 2008-09; in US alone 95% of all income gains since 2009 have gone to the top 1% (Stiglitz, 2013). Therefore it seems neoliberal globalization stimulated high levels of inequality, like it did in the laissez faire world of pre 1914.

Research also shows that over the last 30 years the wage differential, ratio between the 90th and 10th percentiles, have increased most in UK, US and Australia, and where they were already very high in the 80s. Whereas Sweden, France and Finland have had the lowest increases, and in France it has actually decreased (Hills, 2010). Similarly the difference in inequality, measured in terms of gini-coefficient, between the English-speaking and non-English speaking OECD countries persist, with median ginis of 36.0 and 27.1, respectively (Palma 2006). Germany, France, Netherlands and the other Scandanevian countries standout among the OECD countries as having significantly large number of SOEs, with Norway having nearly 10% of employees in the SOE sector (Christiansen, 2011). Similarly, in government spending these countries spend much more than their English speaking counterparts[2]. Thus based on this comparative and historical study, a strong case can be made that neoliberal policy leading globalisation was a significant factor in stiumalting comparatively higher levels of inequality in English speaking OECD countries.

4.2 South Korea and Taiwan

Much has been written about the state led industrial policy and export led development approach of South Korea and Taiwan. In both these countries early land reform ensured that there were no large land holders (Amsden, 1989) so that these countries had a low income inequality to begin with. These countries experienced miraculous growth, mostly export led, but with relatively low levels of inequality, giving rise to the concept 'growth with equity' (Wood, 1999). One difference between the Taiwanese and South Korean industrial policy was that the former was based on protecting large SOEs while in South Korea the government played a key role in nurturing large privately owned conglomerates "chaebol" (Chang, 2003; Amsden 1989). This might explain why income inequality was slightly higher in South Korea than Taiwan (Figure 2). Both these countries introduced a state welfare regime, which has been termed as "East Asian Welfare Regime" (Dostal, 2010). In essence both these countries for a significant period of time followed a similar 'non-neoliberal' policy framework of state led interventionist industrial policy to support their export led growth (Chang, 2011).

Figure 2: Income share of top 1% (Taiwan and South Korea)



Source: Constructed by author based on data from Kim et al (2013) and Cheng et al (2008)

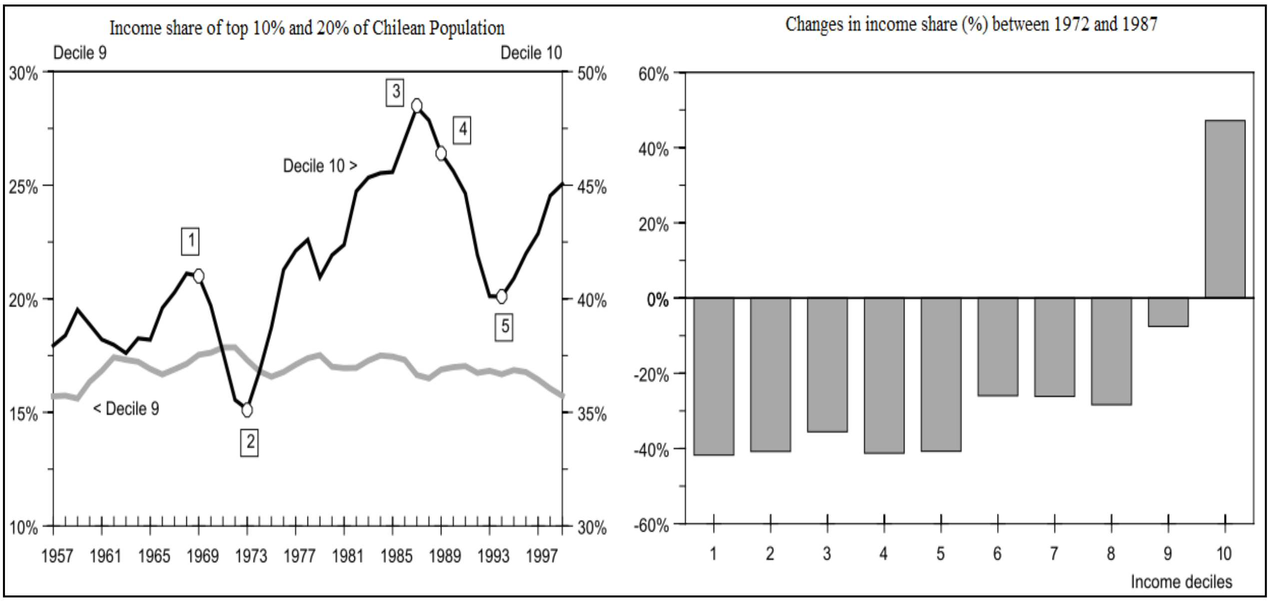
However their paths diverged after the Asian financial crisis (1997-98) when Taiwan passed through it relatively unscathed (Wu, 2007) but South Korea suffered severely. The Korean government, faced with foreign exchange crisis, introduced radical reforms at the behest of IMF, reducing the role of state in the economy, and increasing focus on market liberalisation. As Daeyong Choi, Director General, Office of the Prime Minister, Republic of Korea said, on a self-congratulatory note, the government "launched drastic structural reform policies" by "massive abolishment of existing regulations" to "shift for Korea from a highly interventionist model for compressed economic development to a market oriented and open model" (Choi, 2001). The net result of these "neoliberal policies" in South Korea has been that inequality

[2] Based on the data from 2014 Index of Economic Freedom by The Heritage Foundation, the governments of Scandinavian and the aforesaid selected continental European countries spent nearly an average of 7-8% more than their English-speaking counterparts like the US and Australia, as measured by government spending as a percentage of gross domestic product (GDP).

has increased significantly from the figures in 1997-98, while in case of Taiwan it has remained relatively stable (Figure 2). This result is especially startling given the fact that both Taiwan and South Korea initially had low income inequality and followed 'unorthodox' industrial policies; but after one country introduced neoliberal policies its inequality rose sharply in a relatively short span of time. This implies that the pernicious effect of the neoliberal policies can take root even in countries where there is very little historical precedence of such policies.

4.3 Pinochet's Chile

Although Chile joined OECD in 2010, Pinochet's Chile between 1973 and the early 1990s was a low income country and even today remains a developing country. It is well documented how in Chile after Pinochet took power the so called "Chicago boys" initiated a shock therapy of neoliberal policies focusing on rapid trade liberalisation, deregulation and privatization of SOEs, similar to the one carried out in Eastern Europe after 1991. In the first wave of reform (1974-79) the government eliminated all quantitative restrictions and exchange controls, and reduced import tariffs from an average in excess of 100% to a uniform 10% tariff (Edwards & Lederman, 1998). Milton Friedman also visited the country and met Pinochet in mid 70s. Margaret Thatcher has also been an advocate of Pinochet's policies and his "success" in transforming Chile's economy. Thus Pinochet's Chile followed the textbook neoliberal approach to integrate the country with the global economy; the result on inequality is shown below:



Notes: Three-year moving averages. [1] = election of President Allende; [2] = Augusto Pinochet's *coup d'état*; [3] = the year before President Pinochet's plebiscite (seeking a mandate to remain in power for another 8 years); [4] = First democratic government after President Pinochet lost his plebiscite; [5] = second democratic government which returned to 'market-led' distributed policies.

Source: Palma (2006)

As we see from graph, during Pinochet's regime income of the top 10% increased from 15% to nearly 50% share of total income. This was the only income group which improved their relative income position, thus absorbing almost all the benefit from economic integration (Palma, 2006). So we see yet another case of how economic integration through neoliberal policies can increase income inequality.

Chile is unfortunately not a unique case in Latin America; during the early 90s the IMF provided policy prescriptions to numerous other Latin American countries, among them Argentina, very much in the orthodox Washington consensus line. President Menem of Argentina then initiated a massive drive towards privatization of SOEs, opening domestic market to imports, abolishing all price controls, freeing exchange control, and removing government wage controls (Pang, 2002). The idea was to improve competition, increase the flow of FDI, remove market distortion and hence integrate with the global economy. The result was between 1992 and 2002, before the financial crisis, the gini coefficient rose by 8.2%, which was one of the highest in Latin America (Lustig et al, 2013).

Neoliberal policy reforms were often implemented with "messianic attitude" in Latin America (Palma, 2010). Lustig et al, (2013) found that between 2002 and 2010, inequality declined in major Latin American countries, and attributed it to progressive government interventions, among others. In Argentina, where gini coefficient fell by 9% during the period, state intervention became more pervasive with social protection schemes being introduced to redistribute income and with labour market institutions becoming stronger (Lustig et al, 2013). Latin America in general illustrates how adoption of neoliberal ideologies can stimulate high level of inequality.

4.4 India after neoliberal reforms in the 90s

It is worth noting that India remains a lower middle income country, with over 250 million living in extreme poverty and with average life expectancy of 66 years, which is 4 years lower than that of its LDC neighbour Bangladesh (World Bank, 2014). In 1991 India introduced its own set of neoliberal policies, at the behest of IMF, focusing on short terms stabilisation and long term structural adjustment programmes (SAP). SAP entailed financial and trade liberalization, significant curtailment of government expenditures such as reduced expenditure in rural development, significant cuts in fertiliser subsidies and in public investment in irrigation (Chandrasekhar, and Ghosh, 2002). SAP policy choices were not inevitable but rather political ones, deciding which section of the public would bear the brunt of the cost of reforms. The following table shows the impact of these policies on inequality:

Table 1: India's inequality post 1971 reforms

Parameters	Pre Reform (1990s)	Post Reform (2000s)
Number of Billionaires	**2** (mid 1990)	**46** (2008)
Total billionaire wealth to gross domestic product (GDP)	**1%** (mid 1990)	**22%** (2008)
Share of Income of top 0.1%	**1.80%** (1994)	**3.60%** (2000)
Share of Income of top 10%	**26%** (1994)	**28%** (2005)
% of per capita State Domestic Product (SDP) of the richest State (Punjab) to the poorest (Bihar)	**312%** (1991)	**452%** (2001)

Source: Constructed by author based on Chandrasekhar, and Ghosh, 2002; Banerjee, &Piketty, 2005; Walton and Gandhi, 2012; World Bank, 2014

Two additional points are worth noting, the first is that the income share of top 10% has stabilised at 28% (World Bank, 2014), which implies that almost 90% increase in income share (i.e. 1.8% of 2%) of top 10% between 1994-2005 periods was accrued to top 0.1% of the income group. Second point is that the percentage of Punjab's per capita SDP to Bihar's per capita SDP in 1981 was 292%, very close to the figure in 1991 (Chandrasekhar, and Ghosh, 2002). This implies that the gap between the poorest and richest state since the reforms has widened rather exponentially. This is to be expected considering government reduction of agricultural support negatively impacted on the poorer sections of the country while financial liberalisation disproportionately benefited the rich. As Walton and Gandhi (2012) pointed out, 20 out of the 46 billionaires of India "had their primary sources of wealth from rent-thick sectors".

5. Why neoliberal globalisation increases inequality?

So far we have presented four case studies, all of which offer counterfactuals to show that implementation of neoliberal policies was a major reason for increased inequality. In section 4.1 and 4.2 there were paired comparisons between countries using neoliberal policies and those which chose not to do so, the second group of countries acting as counterfactual or control for the first. In section 4.3 and 4.4 we have emulated a discontinuity design using a cut-off point around when neoliberal reforms were introduced, to show how inequality parameters increased in value almost immediately, against historical trends after introduction of reforms. Our choice of countries included, developing countries, developed western democracies, newly industrialized countries, and even a lower middle income country, spanning five continents. Given this evidence one can reasonably and robustly say that implementation of neoliberal policies was the key to increased income inequality rather than globalisation per-se, after all some of these countries were already very well integrated with the world economy before introduction of reforms.

Axtell and Epstein (1996) in their seminal paper developed a computer simulation model of an economy populated by agents, who follow basic microeconomic theories, to investigate the distribution pattern that emerges when these agents interact; the simulated agents had the ability to move, eat, reproduce, fight, trade, and suffer disease. In essence Axtell and Epstein assessed what would be the distribution pattern of wealth if the economy was perfectly competitive with minimal rules and populated by "homo-economicus" agents. The result was, even if the original resource endowment was normally distributed, after several cycles of simulation a highly skewed unequal income distribution emerged. This meant that left itself a perfectly competitive economy generates inequality which is thus an "emergent" property of the market system (Axtell and Epstein, 1996; Beinhocker, 2007). This powerful conclusion suggests that without countervailing forces inequality will emerge in any market economy, independent of integration to global economy, therefore policies matter. Blaming globalisation for inequality thus becomes akin to blaming capitalism.

This is exemplified by China, whose market reforms were initially launched out of necessity rather than from a neoliberal ideological point of view, even though some call Deng Xiao Ping, a "neoliberal" (Harvey, 2005). During 1978 and 1985, the ratio between urban and rural household in per-capita income significantly narrowed from 2.57 in 1978 to 1.85 in 1985 (NBSC, 2014), mainly because farmers gained through the household responsibility system and increased state procurement prices. However in recent decades the government's focus on urban areas in terms of educational and healthcare spending, coupled with reduced investment in agriculture, rural healthcare and education, lack of policies towards redistributing asset income, and abandonment of egalitarian distribution policies has led to ever increasing inequality (Sincular, 2011). By 2009 the ratio between rural per-capita income to urban per-capita income stood at 3.33 times (NBSC, 2014), higher than pre-reform era. Thus without proper countervailing interventions from the government, inequality will emerge in a free market economy.

6. Non neoliberal globalisation – a way forward

It is not necessarily globalisation or integration with the world market that creates inequality but how one integrates and what policies are applied that matters. Neoliberal globalisation worsens the situation, as it often entails reduction of states role in the economy through curtailment of agricultural subsidies and welfare costs and offers free reign to the capital market increasing its return, thus making the poor poorer and the rich richer. Therefore we should think about how governments can actively engage in redistributive effort through increased agricultural support and stronger welfare systems. Unfettered markets are not self-correcting and efficient as many believed; the recent financial crisis is a testament to that (Stiglitz et al, 2009).

Sustainable equitable economic growth requires the state to take an active role in how it wishes to engage and integrate with the global economy. Currently the rules of the game of international trade are heavily influenced by the transnational corporations and the global financial organizations supported by the political clout ("regulatory capture") of their industrialized country of origin, through the medium of multilateral institutions like IMF, World Bank and WTO (Nayyar, 2003). Therefore international governance institutions have to be made more democratic and accountable, policy prescriptions, conditionalities and the rules of such global institutions should be revised to allow a greater diversity of policy approaches (Chang, 2003). But it is worth noting that even within current global policy space, developing countries can do a lot; they can implement well-defined industrial policies focused on industrial development and technological upgrading, with strong and targeted investments in capacity building and competitiveness initiatives, emulating the successful East Asian economies (OECD, 2013; Warwick 2013). As Chang (2003) states:

> "The current literature tends to regard the process of globalisation and the rise of TNCs as an unstoppable process that no one can control and in which nations, especially developing nations, are passive agents that will have to fully embrace this process or perish. However, such a view is misleading, since there is a lot of room for maneuver for national government."

Therefore state can be a forceful agent in steering how a country gets integrated with the global economy. As we have seen East Asian countries like Korea and Taiwan initiated land reforms, and introduced welfare system in the very early stages of their development process ensuring growth with relative equity (Dostal, 2010; Chang, 2006); other developing countries can emulate such processes.

Globalisation is something that is useful and beneficial, and has improved the life of millions over the last thirty years; our focus should be making it better by implementing effective policies and discarding the ones which have proven to be disastrous. It is not globalisation that stimulates inequality but bad policies that let it run amok. Stiglitz et al (2009) state in regards to our global economy, which is organized under the neoliberal framework:

> "… our multiple crises are not the result of a failure or failures of the system. Rather, the system itself – its organization and principles, and its distorted and flawed institutional mechanisms – is the cause of many these failures…. our global economy is but one of many possible economies, and, unlike the laws of physics, we have a political choice to determine when, where, and to what degree the so-called laws of economic behavior should be allowed to hold sway."

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