Rethinking the world economy as a two bloc hierarchy

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Abstract

It is now widely recognized that the enormous differences in conditions of life between the world's territories destabilises our globalised existence, making a threat almost as existential as climate change and unsustainable use of resources. In everyday speech we talk of rich and poor countries; but in analytical discussion we generally assume that the distinction between rich and poor, developed and less developed, North and South, core and periphery, is obsolete, too broad to be meaningful. So studies of global income inequality normally use a statistic like the Gini to calculate average inequality across all countries and all households.

This essay argues that (1) global income inequality is structured in a two bloc hierarchy of developed and less developed countries (China and the transitional economies taken out); (2) there has been little movement of countries between the blocs; (3) far from being "accidental", the two bloc structure is the result of specific causes spelt out here – including the ability of the holders of capital to chose among many legal systems where they incorporate their assets to find the one that offers them the best benefits in terms of taxes, regulation, shareholder benefits, profit repatriation, entry and exit – without having to move themselves or their business there. They are analytically like "roving bandits" looking for legal protection from suitable states. The essay also discusses, more briefly, some effects of this inequality structure – including another existential threat for the twenty first century, persistent migration of people from South to North. The conclusion for development studies is that the study of development should retire the long-running metaphor of development as marathon race, and – with a Copernican jump – embed itself in the study of international relations.

> "Even if economists did not use terms like purchasing power, bargaining power, and monopoly power, it ought to be obvious that the market or price system is a *power system*" Charles Lindblom, 1966, emphasis added.

I begin with a letter to the *Financial Times*, 2-3 May 2020. The writer, a professor of psychiatry, says:

> "The early spread of Covid-19 outside China clearly tracked flight paths, chiefly to rich countries. Despite the substantial problems that the virus presents in these settings, rich countries are still better placed to contain it: better sanitation, better nutrition, better healthcare.
>
> "The picture will be very different in poor countries where most people who die of the virus will, in truth, die of a combination of poverty and Covid-19" (Kelly, 2020).

The writer uses our everyday distinction between "rich" countries and "poor" countries, treating them as roughly homogeneous groupings in terms of characteristics relevant to disease. "Rich and poor" maps to everyday language of developed and less developed countries, core and periphery, and North and South.

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What is strange is that our main sources of data about the world economy hardly use this breakdown into two big polarized groupings.

1. Statistical and theoretical occlusion of the north-south dualism

In 2010 the president of the World Bank, Robert Zoellick, declared the distinction between developed and developing countries to be obsolete.

> "If 1989 saw the end of the 'Second World' with Communism's demise, then 2009 saw the end of what was known as the 'Third World'. We are now in a new, fast-evolving multipolar world economy – in which some developing countries are emerging as economic powers; others are moving towards becoming additional poles of growth; and some are struggling to attain their potential within this new system" (Zoellick, 2010).

The World Bank often uses a four-fold classification by average income: high income countries; upper middle income countries; lower middle income countries; and low income countries – with fairly arbitrary US dollar thresholds. It also uses categories like "Poor and Indebted", and "Poor, Struggling, Converging, and Affluent". And various geographical categories like "Middle East and North Africa".

The IMF identifies "Advanced Countries" (a category which includes the ones commonly understood to be developed/the North/the core); and for the rest, categories that blend geographical and development criteria, such as "Emerging Developing Europe" and "Middle East, North Africa, Pakistan, Afghanistan".

What we don't find from these organizations is data which illuminates the internal coherence of North and South and the size and trend in gaps between them. That inattention in turn sustains the core mainstream understanding that less developed countries are in that category because of *their delay in adopting fully capitalist institutions and policies* – Walt Rostow's *The Stages of Economic Growth* (1959) being a famous early example.

The ur-image is development as a marathon race: all runners could conceivably cross the finish line at the same time, and their finishing order reflects differences in conditions internal to each runner; *there is no structure to the race such that some run faster on account of the fact that some run slower.*

Globalization theory, which became "hegemonic" in the 1980s, turbo-charged this understanding, with its implication that less developed countries can (eventually) catch up, each on their own, by adopting fully capitalist institutions and policies in the image of the developed countries. Globalization theory is a sub-set of neoliberal theory, which advances an agenda of low taxes, low public spending, and capital and labour free to be bought and sold in global markets, because this freedom will maximize material prosperity and liberty for all.

Three quotes bring out the core idea. First, a New York Times journalist covering the 2002 World Economic Forum meeting summarized the prevailing wisdom among the Davos elite: "A nation that opens its economy and keeps government's role to a minimum invariably experiences more rapid economic growth and rising incomes" (Uchitelle, 2002).

Second, Martin Wolf, distinguished columnist for the *Financial Times* and author of *Why Globalization Works,* declared:

> "It cannot make sense to fragment the world economy more than it already is but rather to make the world economy work as if it were the United States, or at least the European Union…. 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 is barely tapped" (Wolf, 2004: 4).

Third, John Williamson, who coined the phrase and gave the content of the Washington Consensus, asserted: "in the long run, countries' progress is primarily dependent on their own efforts rather than on the [passive] international environment" (Williamson, 2004:197).

The northern states – and the international organisations they largely control – give financial aid and technical assistance to developing countries in order, they say, to reduce the delay in the latter adopting fully capitalist regimes, with conditionalities in line with the Washington Consensus about "best practice" institutions and policies. For example, the World Bank has long deployed the Country Policy and Institutional Assessment (CPIA) formula to score countries by the "goodness-for-development" of their policies and institutions, and then factors the score into its lending decisions and country dialogues. The scoring criteria for the trade regime imply that a completely free trade regime is best for development. The criteria for labour markets give the highest score to countries with maximum employer flexibility and minimum worker security (Wade, 2010).

And in fact, "globalization" has vastly increased over the past several decades. World trade rose from 39 per cent of world GDP in 1990 to 58 per cent in 2018. International assets and liabilities rocketed from 128 per cent to 401 per cent of GDP. On both measures the world is far more integrated than it was in 1914, the last peak of globalization (*Economist,* 2019). *Yet the promised catching-up of the South has barely occurred*, except for a short period from around 2002 to 2012, when fast growth in the South was driven mainly by surging Chinese demand for commodities. (For purposes of the statistical comparison of the two blocs, the South excludes China and the transitional economies.)

The Swahili proverb says, "Until the lions have their own historians the history of hunting will always glorify the hunters". The mainstream's explanation for the slowness of catching-up – due to slowness of southern governments and businesses to adopt the institutions and policies of advanced capitalism – illustrates history being written, rules set, by the winners. It is in line with what could be called a "law" of modern-era power hierarchies: elites legitimize their success in terms of universalistic and meritocratic qualities, like initiative, hard work, commitment to the scientific method, and legitimize others' lower rank in terms of their failure to match these qualities, their excessive dedication to identity politics, corruption, leisure (and white populations have long used the non-universalistic criterion of skin colour to claim superiority). In Max Weber's words from 1915:

> "The fortunate man is seldom satisfied with the fact of being fortunate…. He needs to know that he has a right to his good fortune. He wants to be convinced that he 'deserves' it…in comparison with others …. *[G]ood fortune thus wants to be legitimate fortune*" (emphasis added).

In short, the mainstream view of development does not see the world economy in terms of two encompassing and hierarchically-ordered blocs, with internal coherence and with mechanisms (instrumental and structural) linking them which tend to sustain the hierarchy. And not just the mainstream; many analysts who consider themselves broadly on the left and sympathetic to the idea of "combined and uneven development", originally coined by Trotsky, also consider that the developed/less developed distinction too broad to be meaningful.

This essay aims to bring out the internal coherence of the two blocs and the mechanisms that tend to perpetuate the hierarchy. It suggests that seeing the world order in this way helps us to understand many contemporary trends as -- in part -- effects of the two bloc structure: such as the persistence of high levels of national (vertical) inequality, immigration from South to North, rise of illiberal democracies in North and South, northern countries' wars in the South, and more. The shift in perspective is akin – if a slight exaggeration be permitted – to the jump Copernicus made in formulating a model that placed Sun rather than Earth at the center of the universe.

2. Indicators of the North-South duality

Here are several indicators of the North-South duality.

2.1 How much catch-up?

First, an impressionistic measure of the Great Divergence : the number of non-western countries that have become "developed" in the past two centuries. The number depends on how broadly we categorize "non-western", "countries", and "developed". *Even stretching them out (to include Russia as non-western, Hong Kong as a country), we get maybe seven*: Japan, Russia, Hong Kong, Taiwan, South Korea, Singapore and Israel. This "fact" should be but is not front and center to the whole discipline of "development studies".

Notice that most of the countries had small populations during their fast-industrialization phase, and also one or more powerful external enemies threatening the state's existence. The common threat produced a "fellowship of the lifeboat", without which state incumbents might have taken a more cavalier approach to defrauding the state and used their power to suppress opponents ("enemies") rather than promote a national development project able to create a unified- enough polity to dissuade an external enemy. And Japan, Taiwan, South Korea and Israel – four of the seven – received very large amounts of American financial, technical and military aid in the post-war decades to keep them firmly within the US geopolitical orbit; while Hong Kong was an outpost of British rule and British business until 1997 (Wade, 2019).

Another pointer to low upward mobility comes from a World Bank study (2013), which finds that *in 1960 there were 101 "middle-income" countries, using the Bank's absolute income thresholds in US dollars. Only 13 had risen to "high-income" by 2008, four on the periphery of western Europe, five in East Asia.* Most of them have populations less than 20 million; they account for an insignificant fraction of the world's population. [2]

[2] Cherif and Hasanov (2019) take 182 countries and classify them by the percentage of their average income relative to that of the US in 2005, and cut the distribution at 50% of US average income to give the threshold of "high income". They find that between 1970 and 2014 only 13 out of 148 low and middle

2.2 The North-South income gap across time

The size of the income gap across time can be measured by the ratio of the North's average GDP to the South's GDP. GDP is measured at market exchange rates, not at purchasing power parity exchange rates, because the former gives a more accurate measure of the ability of residents of a country to buy goods and services in other countries, and hence is a better measure of *relative structural power* in the inter-state system (Wade, 2017, Box 12.1). Alan Freeman (2020) defines the ratio of the North's GDP per capita in market exchange rates to that of the South as the Monetary Inequality Index (MII). [3]

The MII has risen substantially from 1950 till today, meaning that the North-South gap has widened substantially. *From 1954 to 2000 it rose three times, from 7 to 21, and especially fast during the 1980s (coinciding with the full-force application in the South of the Washington Consensus liberalisation recipe). Then it fell from 21 to around 11 in 2012, when it flatted out and started to rise again.* This fall in MII – or "catch up" for the South in ability to purchase goods and services from the North – was the effect of the commodity price boom for commodity exporters largely to China, which raised southern "price times output" growth rates well above those in the North, but locked the South more firmly into commodity specialization.

Another gap measure is the density distribution of global employment by value-added per worker or per hour. This too shows a pronounced two hump structure. The high labour productivity hump covers the North, with about 15% of world employment, the low labour productivity hump covers the South, with around 60-70 of world employment (here including China) (Gomulka 2006).

Another measure of the North-South gap: *the average income of the wealthiest quartile of the population of the South ($8,700 in 2015) was only about a quarter of that of the poorest quartile of the North ($30,400).*

2.3 Internal income coherence

The two blocs are relatively coherent in terms of their internal income distribution, in the sense that within the blocs, inter-country income inequality is much less than between the blocs. Countries of the North have converged together in GDPPC over 1970-2015, and not converged with the South.

Drawing again on Alan Freeman (2020), we can divide the South into six geographical regions: "East Asia of the South" (excluding Northeast Asia and Singapore), Pacific, South Asia, Middle East and North Africa, Sub-Saharan Africa, and Latin America and Caribbean.

Over almost half a century, *from 1970 to 2016, the average incomes of these southern regions remain within 50% and 250% of the average of the South, with no region "breaking free" towards the North and no trend towards divergence within the South.* The average income rank order in 2016 was: Latin America and Caribbean, Middle East and North Africa, East Asia of the South, Pacific, and Sub-saharan Africa equal with South Asia. Over the half century from 1970, East Asia of the South rose in the rank order, and Sub-saharan Africa fell.

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income countries reached the high income threshold; of which 6 peripheral Europe, 3 tiny oil exporters, and 4 East Asian. (They use PPP 2011, Penn World Tables 9.0).
[3] My account of the income gaps draws heavily on Freeman 2020.

The others kept the same rank order in 2016 as in 1970. A remarkable continuity. The gap between the six regions is smaller than the gap between them and the North.

2.4 Income inequality between North and South in relation to global income inequality

Income inequality between North and South (average income of both at market exchange rates) accounts for most of the inequality between all countries. And income inequality between countries accounts for more of global income inequality (between all people regardless of country) than income inequality within countries. Inter-bloc inequality (now four blocs: North, South, China, transitional economies) contributes between 4 and 7 times more to global inequality than intra-bloc inequality, over the whole period from 1970 to 2015 (Freeman 2020).

2.5 Conclusion

The bottom line is that North and South are coherent blocs in important ways. The income gap between the North-South blocs is – persistently – larger than the income gaps within them. If we plot the share of world population living in countries arranged by average income we see a pronounced bimodal distribution, with not much population in between.

Countries of the North enjoy common economic benefits from their superior position in the world hierarchy, making for common interests in protecting their position from challengers. They translate common interests into political treaties, such as free trade agreements (e.g. NAFTA), political federations (eg European Union), and security agreements (eg NATO); and into common agreements linking groups of northern countries with regions of the South (e.g. Lome Convention, a trade and aid agreement between the European Economic Commission and 71 African, Caribbean and Pacific countries, signed in 1975). The seven leading economies of the North have concerted their actions through the G7 summits, claiming to be the top table of governance for the world (though not replacing the UN Security Council on security issues); and supported by tiers of other G7 coordination forums.

Countries of the South have broadly similar income levels and are subject to broadly similar pressures from the world economy. But they are much less organized in collective action organizations than countries of the North – whether regional or cross-regional (e.g. G77, and G24 which coordinates developing countries in the World Bank and IMF, with a tiny budget). For example, the Chiang Mai Initiative was created after the Asian financial crisis of 1997-99 to organize currency swaps within Northeast and Southeast Asia, so as to reduce the reliance on emergency financing from the western-dominated IMF. But it has barely functioned, owing partly to deep suspicion between the two countries with the biggest foreign exchange reserves, China and Japan (Wade 2013).

We can see the North-South difference in the contrast between G7 and G20. *The G7 includes only the major northern economies, which share high rank in GDP and in GDP per capita, with a correlation coefficient of around 0.7* – suggesting strong common interests and relatively high ability to concert their actions. The G20 (formed at finance minister level after the Asian financial crash of 1997-99 and at summit level after the North Atlantic financial crash of 2008-09) includes 11 developing countries, and *the corresponding correlation coefficient is around 0.3* – suggesting much less common interest among the member states (Vestergaard and Wade, 2012a; 2012b).

3. Effects of the North-South dualism

The North-South dualism is the starting point for understanding key trends:

1) high and/or rising inequality *in the North*, as cheap labour in the South puts downward pressure on wages in the North;
2) high and/or rising inequality *in the South*, as southern elites aim for northern elite consumption levels. (Milanovic [2019] reports that the average income of the bottom five percent of Chile equals the bottom five percent of Mongolia, one of the poorest countries in the world; the average income of the top two percent in Chile equals the average of the top two percent in Germany);
3) migration waves from South to North, which roil the politics of the North;
4) shift towards "illiberal democracy", "identitarian politics" in the North as right-wing political leaders build support on the back of voters' "left-behind" grievances by blaming migrants, Jews, Muslims or still Others for shortages of housing, health care and employment;
5) reinforcement of authoritarian rule and repression in the South as elites defend against social unrest fuelled by relative deprivation, amped up by social media images;
6) the main states of the North act semi-concertedly to prevent or selectively channel the rise of countries of the South, which might challenge the market and technological dominance of northern corporations and challenge the ability of northern states to set global agendas. The North-South income hierarchy looks pleasing and "natural" to the North, as Max Weber would expect. Some of the techniques used to split the South and hinder upward income mobility of most of its members include: war (think Iraq, 2003); economic sanctions; anti-communist rhetoric to camouflage actions to block economic/technological challenges from the South; and the economic liberalization plus poverty focus of the Washington Consensus.

4. Mechanisms of structural power of North over South

The techniques just mentioned are techniques of "instrumental" power used by northern states to restrain the rise of the South. I now turn to the mechanisms of "structural" power by which the hierarchy came into existence and is sustained. Structural power is the kind of power that business gets over states when it can exit from a jurisdiction whose government intends to do something business does not want, something that curbs its profits; or when the government actually does it and then faces a capital exit, with a hit to employment, incomes, and tax revenue, inducing the government to back off. Structural power is also the power the IMF has over heavily indebted countries (what we in the North commonly call "the Asian crisis" of 1997-99 is commonly called "the IMF crisis" in South Korea). China gets structural power over many countries which depend heavily on export revenues from China, including Australia and New Zealand. The Chinese government doesn't need to warn them belligerently not to criticise China's revanchism in the South China Sea or repression in Xinjiang, and not to hinder its influence campaigns in Australian and New Zealand politics (Brady 2017). As of the past few years, however, the Australian government has pushed back, leading to frequent flare-ups.

4.1 Origin

Let us start with the origin of the modern core-periphery or North-South system. From before the Industrial (Energy) Revolution the northern countries have typically tried to prevent developing countries from entering or remaining in dynamic sectors or segments of value chains with *increasing* returns to scale, limiting them to sectors with diminishing returns to scale; they recognized, as neoclassical economists did not, that *economic development is activity-specific*. Building the skill- and linkage-intensive activities within the national territory is what being a structurally dominant country is all about.

During colonial times, actors in the European colonial project – governments, militaries, companies – created dependent colonial and slave economies to which they outsourced land-intensive production. This structure delivered an "agricultural windfall", which allowed labour at home to be used for industrialization and provided an export market for manufactures. The British government or its agents ensured that British colonies or dependencies – by the early twentieth century accounting for an area 125 times the area of Britain, about one quarter of the Earth's habited area and almost a quarter of its population, the biggest empire in world history by far – specialized in commodity production for export to the core. For example, soon after the English government conquered Ireland by 1691 it closed down the prosperous Irish woollen industry; and the British East India Company closed down production of cotton textiles in its (effective) colony of Bengal in the early nineteenth century, so that Bengali farmers exported raw cotton to the textile mills of Manchester. Textiles was the technologically leading sector of the day – relatively capital intensive, with economies of scale, learning economies, linkages to other sectors, and demand for organizational innovations (e.g. factories).

No nation of size became developed without a coercive system of this kind and/or a prolonged Listian phase of infant industry protection (after Friedrich List, *The National System of Political Economy,* 1841). And once a nation was at or near the frontier of development, it switched to articulating a simplified version of Adam Smith and "free trade for all" (Reinert 1994). The English economist-financier-politician David Ricardo (1772–1823) developed the theory of comparative advantage and the derived policy of free trade to legitimize such a switch for all. In his famous example, if England specializes in textiles and Portugal in wine and they trade their surpluses, they can each consume more of both than if they both produce textiles and wine. He forgot to mention that this gave England the sector with skill requirements and growth potential and Portugal the one with stagnation, and that English families owned a good part of Portugal's wine exporting business.

Generations of mainstream economists have subscribed to the theory of comparative advantage and the policy of free trade on grounds not much more sophisticated than this; and especially after the neoliberal turn in the 1980s, have urged developing countries to practice free trade with memes like "Why throw rocks in your own harbour?" Recall the Swahili proverb, and Max Weber on the drive to make good fortune legitimate fortune.

The globalization literature tends to slight the point that the dramatically increased market integration in the past several decades has occurred in the context of a hierarchically structured world economy, in which northern countries have more activity in increasing return, high profit, high wage activities, and able to set the rules to give themselves competitive advantages and generous rewards of profits and rents (Wade, 2003a; 2003b).

Starting from the structure of the 19th century world economy, path dependence and cumulative causation along well-institutionalized power relations have produced "combined and uneven" development between the two blocs over the past several decades, through mechanisms including the following:

First, the tendency for supply to exceed demand in the core (a point emphasized by the classical economists and later by John Maynard Keynes), making the North dependent on the South as a source of demand for its industrial, service and agricultural exports.

Second, the North's dependence on imports of natural resources and cheap-labour manufactured goods from the periphery.

Third, the core's dependence on people of varying skill levels coming to work there.

Fourth, the tendency for the periphery to run trade and current account deficits, financed by credit from the core (and by aid, foreign investment, and US spending on military bases, around 700 in 130 countries in 2003, according to Defence Department reports: Johnson 2004). The deficits reflect the high-income elasticity of demand for industrial and service imports in the periphery and typically lower income elasticity of demand for commodities in the core. The periphery's foreign debt – which must be repaid in reserve currencies, generally US dollars (Africa's foreign debt is 70 per cent denominated in US dollars) – easily rises above its capacity to repay, resulting in debt traps, followed by emergency loans from core-controlled international organizations and core banks freighted with tough neo-liberal – privatizing and market-opening – conditionalities.

Fifth, the tendency to deficits and debt traps is part of a larger tendency to *highly volatile growth in the periphery*, resulting from (a) dependence on commodity exports, (b) dependence on tourism and remittances, and (c) easy entry and exit of capital from the North. *Dependence on commodity exports has been higher since the 1990s than before, because of "premature de-industrialization". Commodity prices and capital inflows to the South are strongly correlated, yielding twin booms and twin busts; and stronger in recent decades because large financial firms have come to dominate commodity markets* (Akuz 2020).

Aiyer at al. (2013) find that *middle-income countries tend to experience more volatile growth than either low- or high-income countries*, with periods of super-fast growth (GDP growth at 6 per cent a year or more) followed by protracted slowdowns. Indeed, using evidence going back several centuries, two economic historians find that: "improved long run economic performance has occurred primarily through a decline in the rate and frequency of shrinking, rather than through an increase in the rate of growing" (Broadberry and Wallis, 2016).

More recently yet another polarizing mechanism has come into play: *peripheral states protect themselves from shocks coming from core economies by building up foreign exchange reserves, mainly in low-return assets such as US Treasury bills, while opening the economy to higher-return foreign investment by core country firms, resulting in a large resource transfer from periphery to core* (see below).

Through these several mechanisms the core–periphery structure tends to reproduce itself. Of course, this is a highly simplified picture, which omits major real-world complexities – including rivalries within the core, the position of the US as large-scale international debtor, and China as a major source of demand for the South and a challenger to existing great-powers, including through "infrastructure alliances" in place of military ones, like the Belt and Road Initiative. China is now a bigger creditor to developing countries than the IMF and the World Bank.

In what follows I elaborate briefly on some of these structural mechanisms, starting with the most fundamental of all, not so far mentioned.

4.2 The free market in choice of legal systems enables capital owners to be footloose, pocket profits anywhere, and escape social costs

The state needs capital, and capital needs the state. The state needs capital to generate wealth within its territory and enough prosperity for the population to sustain the state and its provision of public goods. Capital needs the state to enforce the legal contracts which enable the holders of capital to create wealth and enjoy exclusive returns on it. (Capital includes land, machinery, and – especially important today – intangibles that exist only in legal code, like corporate shares and bonds.) Capital can exercise rule behind the state, not through force but through ensuring that the state vindicates the claims of capital holders in law, including claims for protection against the state and claims for state protection against other interests. The latter include protection of shareholders' claims to future profits against workers' expectations to future income, for example (Pistor 2019). This mechanism is a powerful driver of trickle-up in North and South, and from South to North, thanks to the way the law enables capital to privilege its interests ahead of the state's achievement of other social goals.

Note the contrast with the eighteenth century mechanism identified by Adam Smith and his "invisible hand", by which capitalists' pursuit of self-interest invisibly generates social betterment. It depended less on the state and more on local knowledge.

> "Every individual endeavours to employ his capital as near home as he can, and consequently as much as he can in support of domestic industry …. [Why? Because] *he can know better the character and situation of the persons whom he trusts, and if he should happen to be deceived, he knows better the laws of the country from which he must seek redress"* (Smith, 1776, book IV, chapter 2, p.475, quoted in Pistor, 2019, p.7, emphasis to "deceived" added, remainder added by Pistor).

Globalization, including of law, has fundamentally changed Smith's equation. *Capital owners can now choose among many legal systems where they incorporate their assets, to find the one that offers them the best benefits in terms of taxes, regulation, shareholder benefits, profit repatriation, entry and exit – without having to move themselves or their business there. They are analytically like "roving bandits" looking for legal backup from suitable states. States which intervene to help the less advantaged in their populations can easily be punished by capital exit.*

Katharina Pistor explains the consequences of states competing to attract capital.

> "States have actively torn down legal barriers to entry and offered their laws to willing takers and have thereby made it easier for asset holders to pick and choose the law of their liking. Most states recognize foreign law not only for contracts but also for (financial) collateral, corporations, and the assets they issue; they use their coercive powers to enforce it, and they allow domestic

> parties to opt into foreign law without losing the protections of local courts. The phenomenal expansion of trade, commerce, and finance globally would have been impossible without legal rules that enable asset holders to carry their local rules with them, or, if they prefer, to opt into foreign law…. *For the global capitalists, this is the best of all worlds, because they get to pick and choose the laws that are most favourable to them without having to invest heavily in politics to bend the law their way*" (Pistor, 2019, pp.7–9, emphasis added).

It need hardly be added that "global capitalists" are in large part based in the North.

4.3 Global value chains (GVSs), trade agreements, and patents, facilitate large resource transfers from South to **North**

World trade increased by five times between 1993 and 2013, and the IMF estimates that almost three quarters of the increase was due to the growth of global supply chains. Mainstream eyes see increased southern firms' and economies' participation in GVCs as almost synonymous with industrialization, thanks to gains from specialization in line with comparative advantage and opportunities for knowledge spillovers (as compared to arms-length and full-product trade). The resulting productivity growth generates higher profits and investment, higher wages and tax collections, and more development. The process can continue over the long term in the form of moving up the value-added chain, or "climbing the value-added ladder" (Gupta, 2017). The argument has become especially popular in international organizations and northern aid agencies since the 1990s, as an addition to the core Washington Consensus. It is complemented by the argument for developing countries to enter formal trade treaties with developed countries to mutual benefit.

But this rosy view obscures power. Lead firms in GVCs, generally northern firms, commonly construct the value chains with command mechanisms through which they capture higher profits for themselves through several mechanisms, including: transfer pricing along the chain (Nike based in the US transferring value from producers in Bangladesh, for example); or barriers to entry; or product standards and intellectual property rights. The common denominator is the ability to extract rents from foreign (southern) firms (Milberg and Winkler, 2013; Hopkins and Wallerstein, 1977). A study of 59 countries in 1995 and 2011 found that *of the top ten countries in terms of gains from participation in GVC trade, nine were northern in both years* (Turkey was in the top ten in 1995, China in 2011) (Smichowski et al., 2018). Here the measure of gain is the exports of non-primary products divided by total GVC-related trade (exports plus intermediate imports).

Many developing countries have been stuck in the low value-added parts of global value chains, under intense competitive pressure to "run faster in order to stand still" – to produce more pairs of jeans for the same revenue as before, under threat that if the producer declines the buyer will simply find a more compliant producer elsewhere (Kaplinsky and Morris, 2001; Selwyn, 2019). Lower prices per unit of output can offset increases in quality or quantity, resulting in lower value capture on the part of southern firms. Workers may benefit little without increases in wages or tax-funded public goods. In particular, middle-income countries are prone to get stuck in a "middle-income" or "middle-capability trap", their manufacturing and service firms unable to break into innovation-intensive activities or the market for branded products where the high profits are to be made, and outcompeted by firms based in China and Southeast Asia.

Legitimized by the Washington Consensus, most developing country governments have sought to accelerate their integration with developed economies by signing bilateral or regional trade and investment agreements – yet these agreements restrict their ability to complement improved market access with the macroeconomic and industrial policies needed to intensify input-output linkages within the domestic economy. *The agreements typically contain "rules of origin" and tariff escalation clauses which tend to lock low-cost economies into low-value added segments of value chains as a condition of tariff-free access to the dominant economies*. The agreements even restrict developing countries' access to life-saving medications thanks to the way US, European and Japanese pharmaceutical companies use them to boost their profits (Wade, 2003a; 2003b).

Many of these agreements also require "investor-state dispute settlement" (more accurately, investor-*versus*-state dispute settlement) by which foreign corporations can sue host governments for actions which threaten the corporation's *expected future* profits (even including regulations to curb cigarette smoking or protect rainforests). They sue governments at an international arbitration panel, which operates in secrecy with a pool of lawyers and arbitrators drawn mostly from western countries, who face obvious conflicts of interest (today's prosecutor for a corporation may be tomorrow's arbitrator for a case prosecuted by today's arbitrator). The panel cannot adjudicate *governments suing corporations* for failure to fulfil their responsibilities. ISDS panels have awarded damages against governments running into billions of US dollars, and even just a corporation's threat to bring a suit has been enough to chill socially responsible regulation. Since the 2008 Crash a sizable industry has arisen of "third party financiers", money firms which agree to finance a company's case at the arbitration panel in return for a share of the winnings. The money firm makes a bet on the decision of a judge. This is not only very profitable (commonly eight to ten times upfront costs), but also the winnings are not closely correlated with fluctuations in returns in other financial markets.

Whatever the specific causes case by case, the global effect is that the price of the South's products have been falling for decades, with the commodity boom of 2002-12 as the main exception. The South's average real rate of output growth has been higher than the North's for most of the time since the 1960s, but the South earns less and less on this rising output as prices of its products trend down – keeping wages and incomes low. The North enjoys the opposite configuration (Freeman 2020).

The North enjoys the opposite configuration not least because *firms and organizations from the top 10 northern countries hold more than 90% of patents granted by US Patent and Trademark Office (USPTO) in 1997-2004* (Shadlen, 2009). A chart of countries' internationally registered patents against GDP divided by labour inputs (working hours) shows a single big hump at the countries classed as developed (Gomulka, 2006). Since the 1980s northern states have pushed to harmonize the international governance of intellectual property in line with northern-style IP protection; for example, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) in the WTO. The North justifies global application of northern-style IP protection on grounds that strong IP protection is an important cause of economic development, at all income levels.

4.4 Financial integration facilitates huge resource transfers from South to North

The North has operated since the 1990s with a "hyper-globalist" model of progress, in which financial capital is set free from national control and economic growth depends increasingly on rising levels of debt – on asset bubbles at home or, for Germany, Japan and China, asset bubbles and current account deficits elsewhere.

The owners of financial capital seek yield in high-risk, high-return assets globally. This produced, pre-C19, the combination of northern stock markets at record levels, and global debt at record levels relative to GDP.

Northern agents have pressed emerging economies to integrate fully into the global financial system, lifting restrictions on the inflow and outflow of finance and on the establishment of financial corporations (Wade, 2003a; 2003b; 2017).

As emerging economies integrate into the global financial system they become vulnerable to changes in Western (especially US) interest rates, exchange rates, asset prices, to swings in capital inflows and outflows, and to swings in the value of their stocks of international assets and liabilities.

Not only are they vulnerable to external (Western) instabilities, they also transfer huge amounts of resources to the core countries. Some are from equities, in the form of capital (or wealth) losses and yield losses (payments on liabilities minus income from assets). The South's capital losses and yield differentials on equities go mainly to the private sector in the North, boosting income inequality in the North. As for debt, a large part of the transfers goes to international lenders (banks and bond holders) in the North. Another large part goes to northern governments, mainly the US, through purchases of US Treasuries as foreign exchange reserves, which in effect gives a subsidy to the US government.

The upshot is that *nine emerging economies in the G20 have transferred around 2.3 per cent of their combined GDP per year through 2000–16, almost all to advanced countries, especially US, Japan, Germany, and the UK; and 2.7 per cent in 2016* (Akyuz 2018). The combination of low-yielding assets in their reserves and high-yielding liabilities generates what looks to be "protection money" paid to the core – the source of the shocks. It is still another mechanism for maintaining the hierarchical core-periphery structure of the world economy, dressed as "win-win".

5. The pinnacle of global corporate power

What is the private corporate power hierarchy behind contemporary globalization? At the pinnacle of global corporate power is a *super-cluster of around 150 densely linked firms accounting for a high share of global corporate revenues. It is itself dominated by finance: all of the top fifty except one are financial firms, headquartered in developed countries* (Coghalan and MacKenzie, 2011). Oligopolistic financial firms, at the intersection of the investment, credit, savings processes of the global economy, are able to reap the bulk of the returns from production. This helps to explain how *the value of international financial transactions to global GDP rose from about 14 in 1997 to almost 70 today, so that the realm of finance now swamps the realm of GDP (the "real economy").*

The hub of global financial transactions is in the North, specifically New York and London,[4] not to forget South Dakota, now one of the most profitable places for the global super-rich to hide their billions (Bullough, 2019b).

Profits too are concentrated in the North. Of the biggest 2,000 publicly traded companies compiled by *Forbes Global 2000*, *US companies had the biggest share of global profits in eighteen out of twenty-five sectors across 2006-2017* (sectors such as electronics, heavy machinery, aerospace, banking, health equipment and services, media) — 72 per cent of the total – including the technologically most sophisticated (Starrs 2019). China is the only developing country with even a toehold in the distribution of global profits.

6. Conclusion

I started with statistical evidence that – contrary to both neoclassical and some dependency theories – the world economy can plausibly be seen as a two bloc income hierarchy, with more equal income distribution within each bloc than between them, remarkably little movement up or down between the blocs even over the past two centuries – despite the existence of a "development" industry in the past seven decades devoted, apparently, to the aim of promoting the catch-up of "developing countries". This division of rich and poor countries is no surprise in terms of everyday speech; but it is a surprise in terms of its lack of salience in the prevailing macro understanding of the world economy, as in the picture from the IMF, the World Bank, OECD and other such (northern-dominated) inter-state organizations.

If I were running the world from the North I would not want my social scientists to highlight the North-South division. I would not want them to bring out that the prosperity of northern populations rests on their ability to buy goods and services made by much poorer people (even as those northern populations would be quite prepared to accept that the prosperity of the "free" two thirds of the population of ancient Rome rested on the labour of the enslaved one third). I would not want my social scientists to highlight that in the *past two centuries only around seven non-western, mostly small-population countries have become developed* like the North. I would not want them to bring out that specialization in commodities, tourism and remittances, plus full financial integration with the North, is a recipe for volatility, and that this volatility, especially long periods of shrinkage, is a big help in maintaining the North-South hierarchy. On the other hand, I would want them to emphasise disaggregations, divisions, especially within the South. I would want them to justify, legitimize, the prosperity of the North by affirming the truth of the law of modern-era power hierarchies and the theory of comparative advantage and policy of free trade (and say no to anything that sanctioned the

[4] The UK has 26 organizations tasked as anti-money laundering regulators. Of them, 14 are tasked with regulating accountants; of these, *12 also act as accountants' trade bodies in charge of promoting the interests of their members.* Anyone can set up business and call themselves an accountant, unlike "lawyers" or "barristers". One of the 26 regulators regulates "notaries public", who specialize in authenticating documents, a key nodal point in money laundering. This agency is called the Faculty Office of the Archbishop of Canterbury, established in 1533. It is meant to do a lot of other things as well as regulate notaries public, such as issue marriage certificates in the case of unusual weddings. Each notary public gets inspected on average once every 35 years. The UK government says "we are very concerned to stop money laundering, look at all the agencies we have." In fact, the system is designed to "fail". It allows UK to be "… one of the most attractive destinations for laundering the proceeds of grand corruption", said a government report in 2017 on its anti-corruption strategy (Bullough, 2019a).

state imparting “directional thrust” to the economy, especially in industry). I would want them to find that the main reasons for southern countries not catching up are to do with their delays in adopting modern capitalist institutions – not to do with relations with the North. I would want countries of the South to see themselves as having very different interests in their dealings with the North. The model would be the European Union during the North Atlantic Financial Crisis and its eurozone ramifications: crisis states of the European south each talked first to Brussels and Berlin and Paris, and only later, maybe, to each other, with next to no concerting of actions.

The North was clearly in economic trouble long before C19: sluggish investment and growth, high income inequality, low wage growth (*across 25 developed countries in 2014, two thirds of households had lower or equal real market incomes than in 2005*), low inflation, low interest rates, high debt. The basic causes have been (a) wage suppression (real wage growth less than productivity growth, falling share of wages in national income) and (b) concentration of wealth at the top of the distribution. In addition, (c) cheap and tax deductible debt has encouraged company managers to use leverage to game earnings per share and performance targets – helping the managers to “earn” Croesus-like wealth while they skimp on productivity-raising investment.

In the South, the kindling for another big debt crisis has been building for years, and is now aflame. Thanks to two decades of very low interest rates, governments and businesses loaded up on debt from mostly western sources and China, and are now on the hook for billions of dollars in interest and principal repayments, just when their currencies have steeply devalued. Until recently the IMF was opposed to governments using capital controls to stem inflows and outflows; and even now sanctions them only when a country is already in or on the edge of crisis, not as a legitimate tool of normal macroeconomic management. The South now faces a more extensive stalling of economic development even than Latin America did in its debt crisis of the 1980s, the period known as Decada Perdida, the Lost Decade.

Meanwhile, eight out of ten common measures of global integration fell or remained constant between 2007 and 2018, including trade to world GDP, long-term cross-border investment (FDI), cross-border bank loans, and gross capital flows. The trend has been dubbed “slobalisation” (*Economist,* 2019). The C19 pandemic is causing another turn in the ratchet of slobalisation.

The central point is that dysfunctional performance in both North and South is intensified by the underlying, long-institutionalized income and wealth inequality between the two blocs. In the face of the financial crises in developed countries in 2007–12 and the “rise” of a few developing countries in the past several decades (China above all), and in the face of the steady aging of their societies, the developed countries have become jealously protective of their present privileged position. Indeed, the two hegemonic states of the past 150 years, the UK and the US, have become intensely *assertive* (not just protective) of their sovereignty since 2016, as in “take back control” – which seems to offer a solution to diminished status and democratic deficit, especially for those who see themselves most hit by automation and foreign workers. Emerging powers, on the other hand, have become jealously assertive of their sovereignty in a multilateral order they have never really felt part of, because designed and dominated by the North, and worried that they will become old before they become wealthy. Global cooperation in most fields is gridlocked just when we need it most. See the G20.

Irrespective of climate change, migration pressure from South to North – from Africa and Asia across a narrow sea to Europe, from Latin America across the long land border with the US – will only intensify in the face of the North-South income gap, amped up by social media, and will push northern politics towards "illiberal democracy" and "identitarian" politics ("rule by law" edging out "rule of law") for many decades ahead.

We have seen an impressive level of international cooperation in the hunt for a C19 vaccine, as earlier for Ebola, whose vaccine was discovered in Canada, developed in the US and manufactured in Germany. But we have also seen a broken inter-state order on full display in the battles between nations over supplies of tests and personal equipment, and in the undermining of the WHO by leading states, notably the US and China.[5] The great question for when a vaccine is discovered is whether the global governance system will treat it as a global public good and make it available to the world's poor as well as to the rich (Pilling 2020).

The C19 crisis is likely to intensify the inequalities within the blocs over the next decade. (For example, northern central bank actions support bond and equity prices, which benefits the rich, since they own these assets.) My point is that *to understand trends within countries or within blocs we must understand – contrary to general understanding – that inequalities between the North-South blocs help to drive the internal inequalities on both sides.* Which implies that the study of development be embedded in the study of international relations, and freed from the metaphor of the marathon race.

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[5] Through January 2020 WHO statements about C19 to the world echoed China's official statements, which denied evidence of human-to-human transmission. Even in late January as China began to include caveats like, "the possibility of limited human-to-human transmission cannot be excluded", WHO statements did not include the caveats. In late January WHO director-general Tedros – appointed with strong backing of China – visited China and praised the leadership for "setting a new standard for outbreak response", even as evidence of cover-up in Wuhan was clear (Gilsinan, 2020). The US and Trump were hostile to the WHO long before C19 and more so after.

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