

The age of capital and inequality

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Fact 1

Globalization II vs. Globalization I:
More trade, greater capital
interconnectedness, less movement
of people

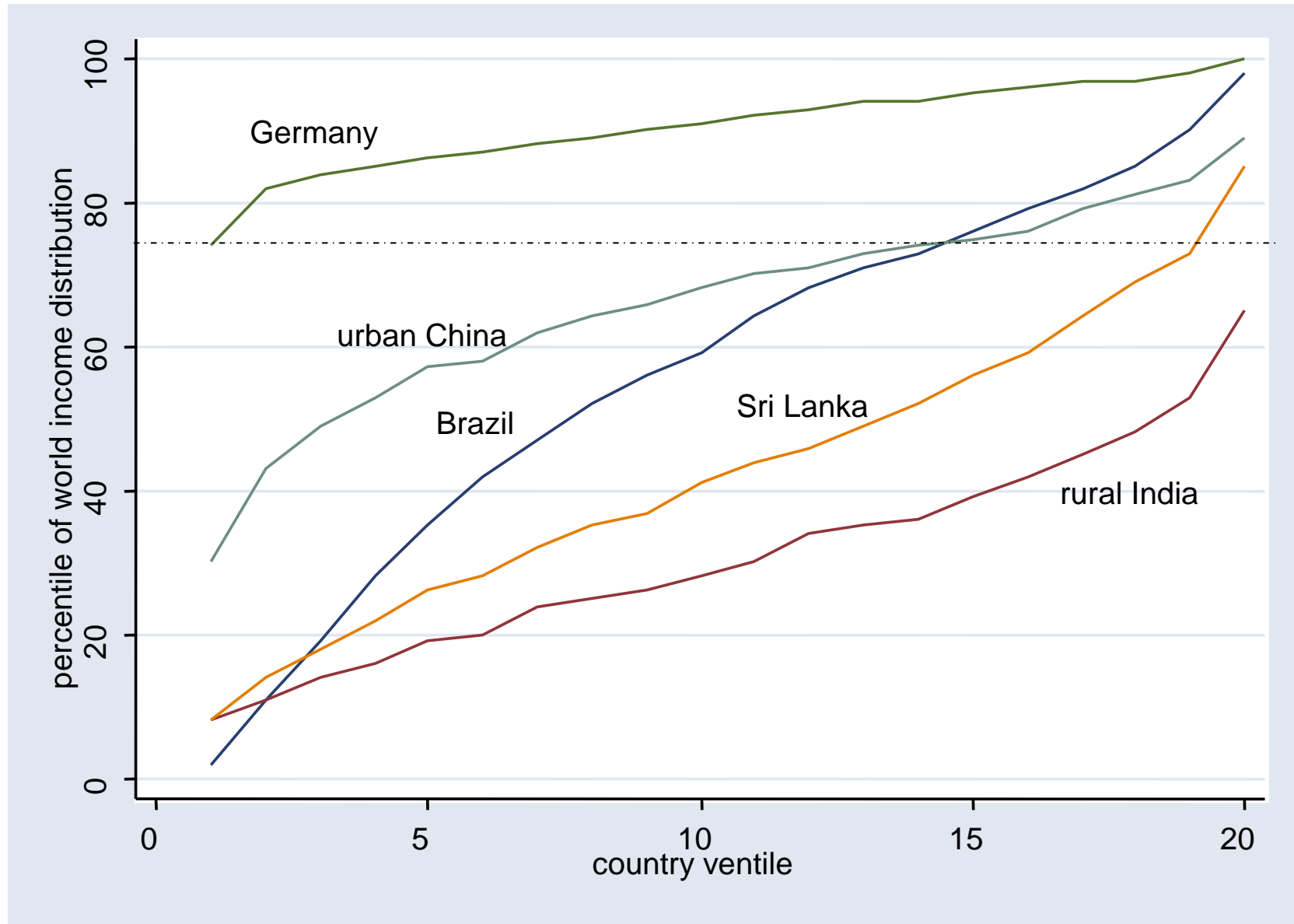
Trade, capital flows and migration in Globalizations I and II

	Estimated foreign assets/world GDP (%)	US Immigrant rate per 1000 population	Exports/world GDI (in %)	Third world share in total DFI (%)
1870	6.9	6.4	6.0	
1910-3	17.5	10.4	9.0	63
1990's	56.8	2.6	22.3*	28

Sources: Craft (2000, p.26, 27, 30), Baldwin and Martin (1999). * = year 2002.

Fact 2

An unequal world where most of inequality is due to income differences between nations



twoway (line Y02_c group if contcod=="BRA") (line Y02_c group if contcod=="IDN-R") (line Y02_c group if contcod=="DEU") (line Y02_c group if contcod=="LKA") (line Y02_c group if contcod=="CHN-U"), legend(off) xtitle(country ventile) ytitle(percentile of world income distribution) text(90 3 "Germany") text(62 5 "urban China") text(50 6 "Brazil") text(52 12 "Sri Lanka") text(40 18 "rural India")

Globalization in rich countries

- Trade, outsourcing, foreign L inflows place a pressure on employment
- In all cases, the pressure is greater on low- and medium-skilled jobs
- Leads to the questioning of the basic premises on which post-War Welfare State was created

Welfare state under stress

- The premises: class (social) and ethnic homogeneity
- With increasing national inequality, classes become more dissimilar => affects decision about social policies (unemployment insurance, private pensions, private vs. public schooling and health)
- Privatization of social services is reflection of social polarization

Kapital vs. labor

- Asymmetric relationship between capital and labor (noted already by Adam Smith; collective action problem).
- Unevenness of power, exacerbated by free mobility of capital and lower tax rates on capital, end of socialism, single ideology (*pensée unique*)
- Not surprising that the slogan is *Another world is possible* (no definition of what *another* means)

Migration

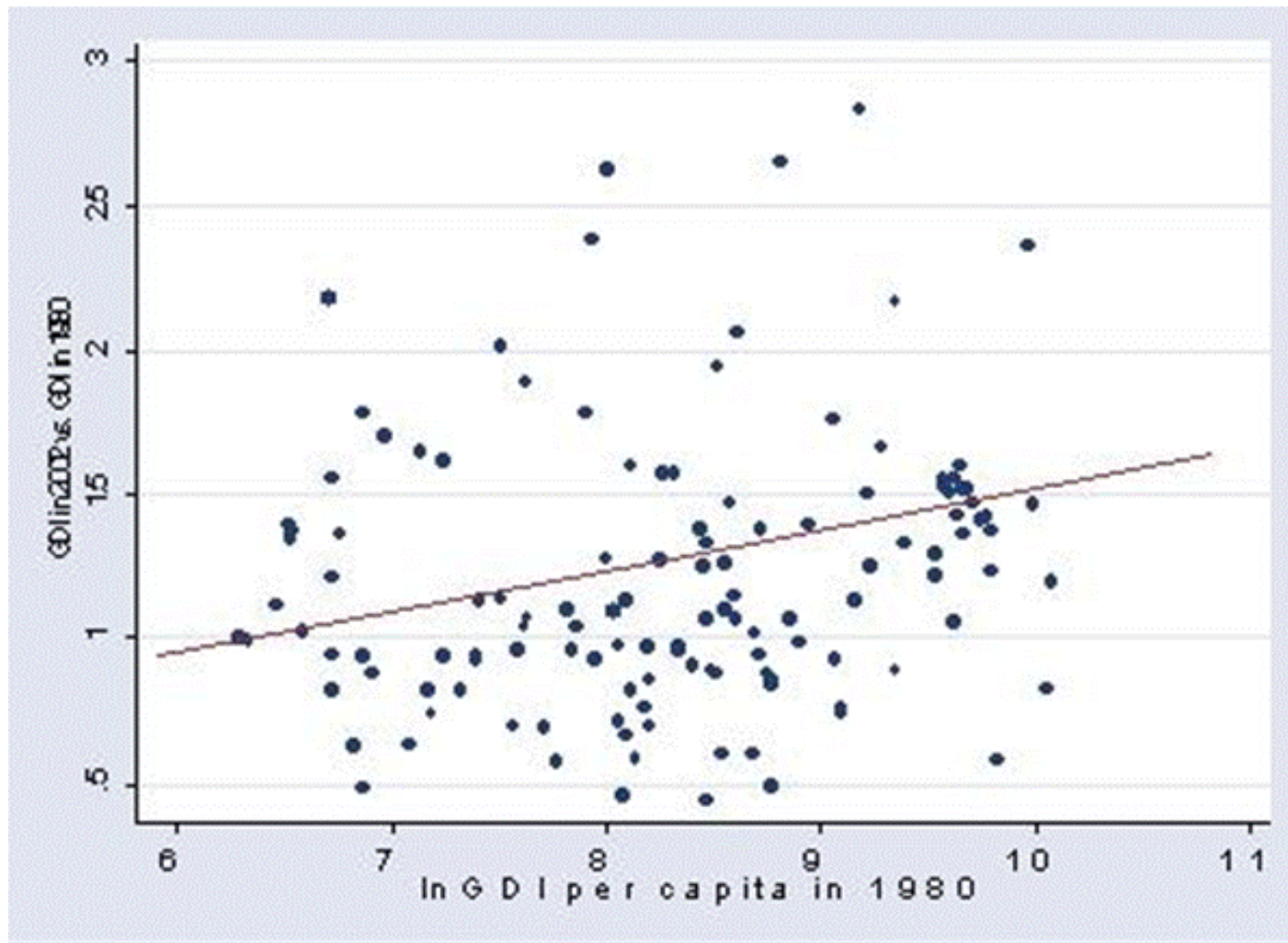
- Migration more popular among better educated in rich countries (*World values survey*; Source: Anna Maria Mayda)
- Do interests of the rich in rich countries and very poor in poor countries coincide?
- Inability of welfare state to survive in the present shape with even very modest migratory flows leads to the creation of Fortress America and Fortress Europe

- Paradoxical situation: fall of the Berlin Wall; but now we have the Brussels velvet wall, or the US-Mexico wall, or interdiction of Europe to Africans
- But **migration** does not come out of nowhere. Is it a reflection of **failed globalization** and policies associated with it in large parts of the world
- More liberal migration policies would make the largest contribution to reducing world poverty (static gains from free migration \$150b per year). All current aid is dwarfed by gains from migration

Fact 3

Failed promises of globalization in
many parts of the world =>
income divergence during the last
quarter century=>
migration

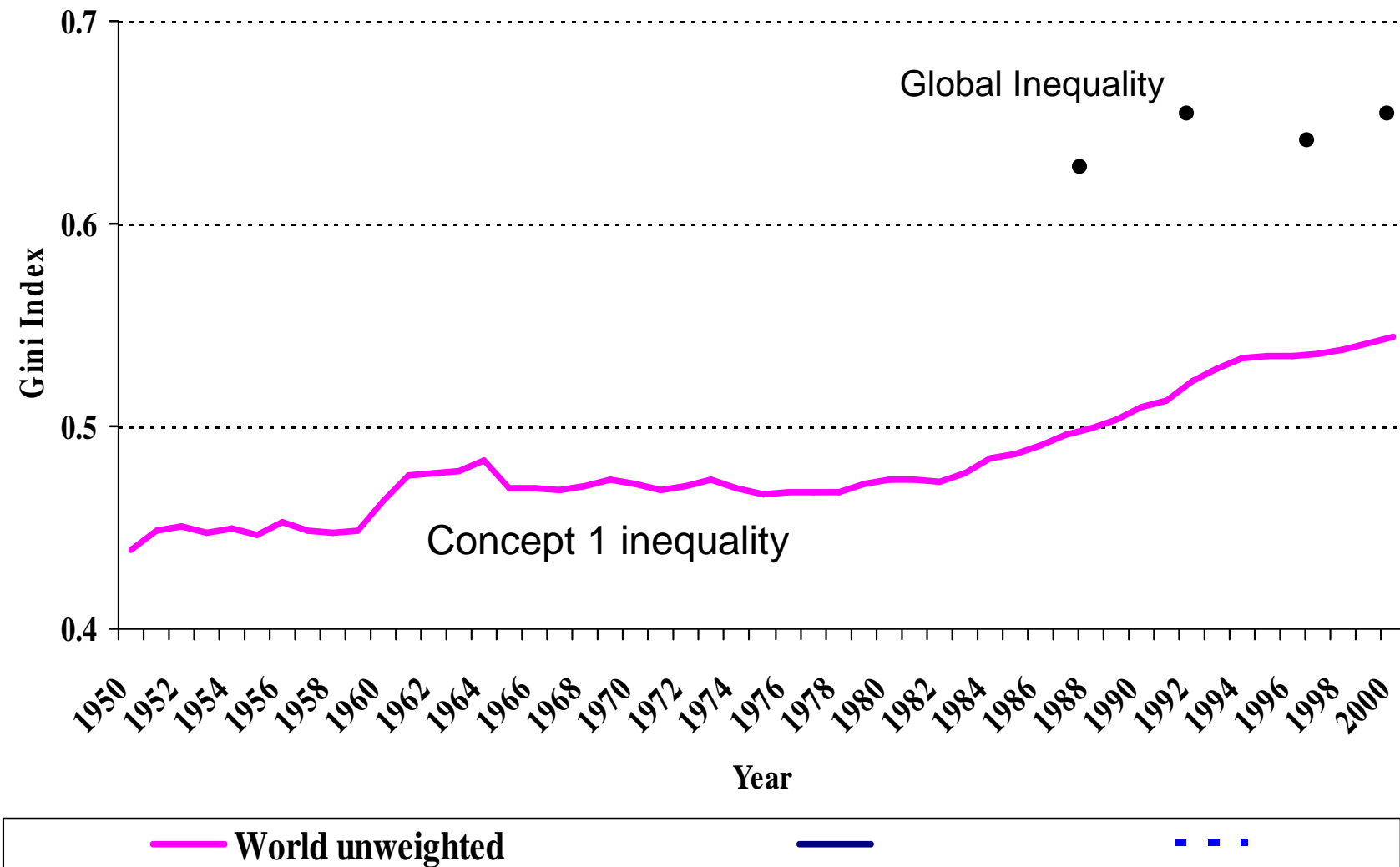
Growth over 1980-2002 period as function of initial (1980) income



Annual per capita growth rates 1980-2002

	Mean	Median	Percentage negative	
“Old OECD”	1.9	2.0	17	
Middle income countries	1.0	1.8	33	
LLDC	0.1	0.8	43	

Income divergence, 1950-2002



The key borders today

- **First to fourth world:** Greece vs. Macedonia and Albania; Spain vs. Morocco (25km); Malaysia vs. Indonesia (3km)
- **First to third world:** US vs. Mexico; Germany vs. Poland; Austria vs. Hungary

In 1960, the only key borders were Argentina and Uruguay (first) vs. Brazil, Paraguay and Bolivia (third world), and Australia (first) vs. Indonesia (fourth)

		Year 2002	Year 1960
	Approximate % of foreign workers in labor force	Ratio of real GDI per capita	
Greece (Albanians)	7.5	4 to 1	2.2 to 1
Spain (Moroccans)	12.0	4.5 to 1	2.3 to 1
United States (Mexicans)	>10.0	4.3 to 1	3.6 to 1
Austria (former Yugoslavs)	10.0	2.7 to 1	2.6 to 1
Malaysia (Indonesians)	>10.0	5.3 to 1	1.5 to 1

Fact 4

Divergence means that location
trumps the class

Rawls' global “original position”

- Assume Rawls'-like veil of ignorance for all citizens of the world where citizenship and social class are “allocated” to each individual
- 60% of one's income position in the world will be determined by one's location
- Major difference from the situation two centuries ago (Marx would have been surprised)

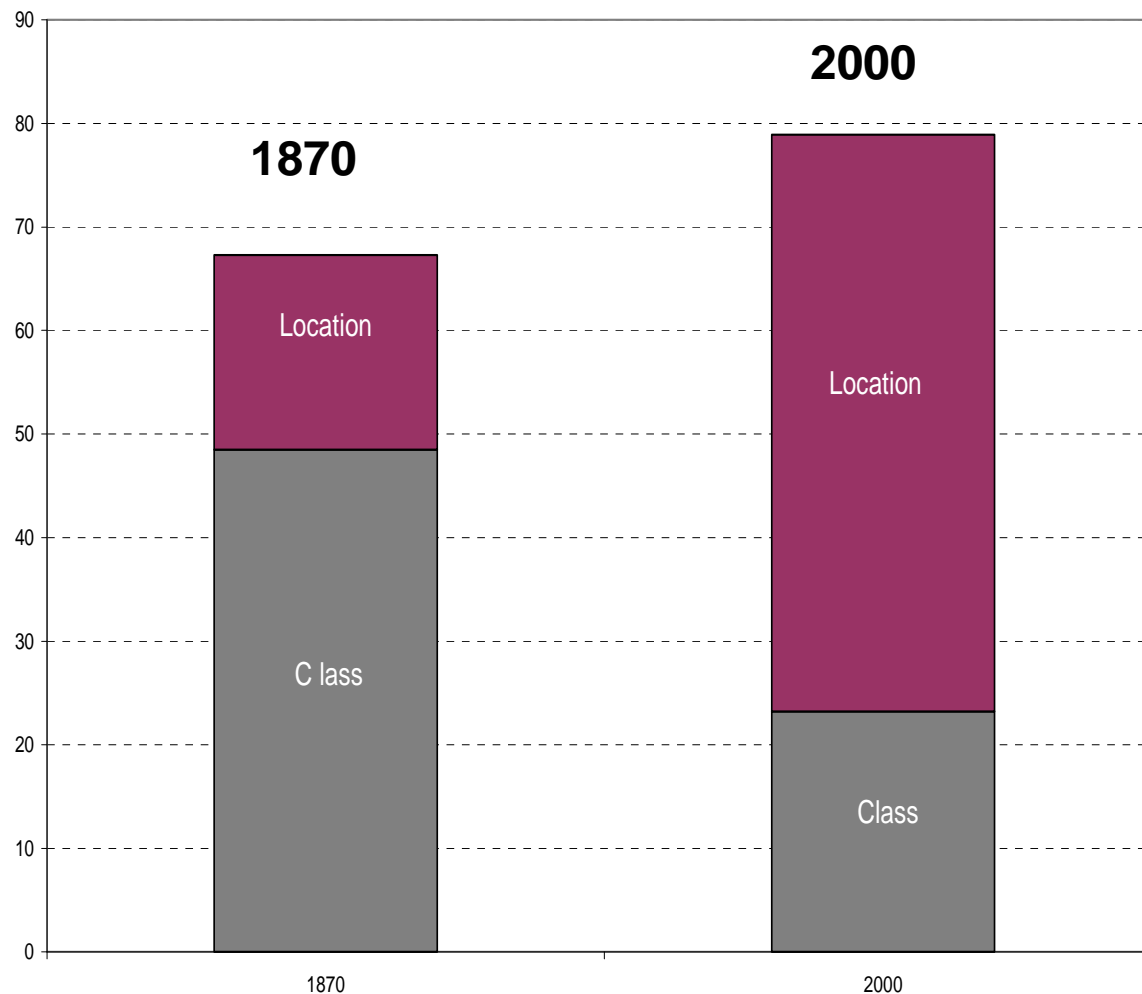
Explaining person's income position in the world

Circumstance	Ln(GDI per capita) of his/her country	+23.00***	+23.00***
	Gini of his/her country	-0.33***	-0.33***
Circumstance + effort	His/her social class within country		+2.88**
	R ²	0.59	0.89

- ***Citizenship premium.*** If mean income of country where you live increases by 10%, your position in the world goes up by 2 percentiles
- ***Trade-off.*** If through effort and luck you jump ahead 5 social classes (e.g. in the US, going from the median household per capita income of \$14,000 to \$22,000) this is equivalent to a citizenship premium of 60% (e.g. being born in Mexico rather than in China^{*})

^{*} China is at the median (unweighted) world income

Composition of global inequality changed: from being mostly due to “class” (**within**-national), today it is mostly due to “location” (where people live; **between**-national)

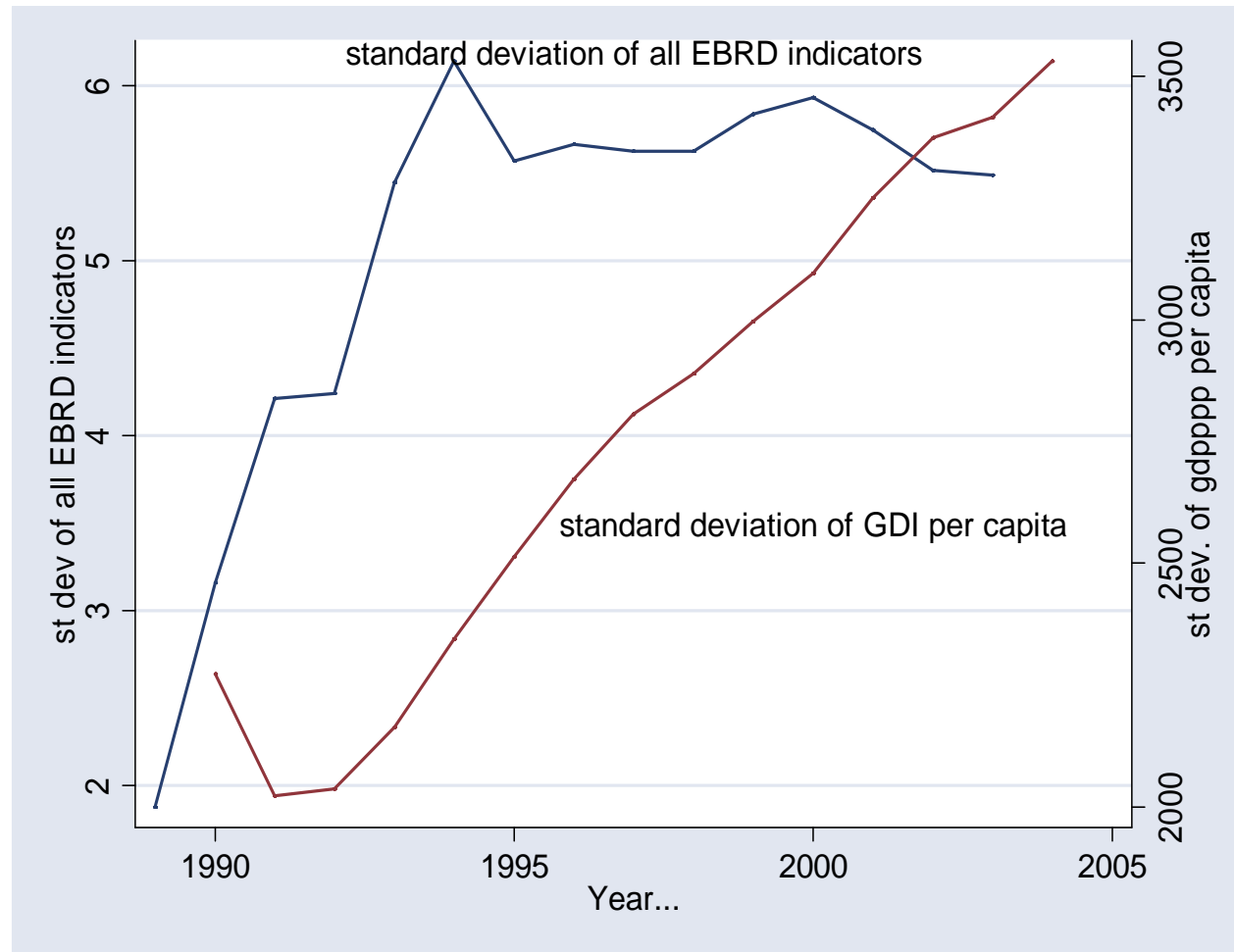


Source: Bourguignon and Morrisson (2002) and Milanovic (2005)

Globalization in poor countries

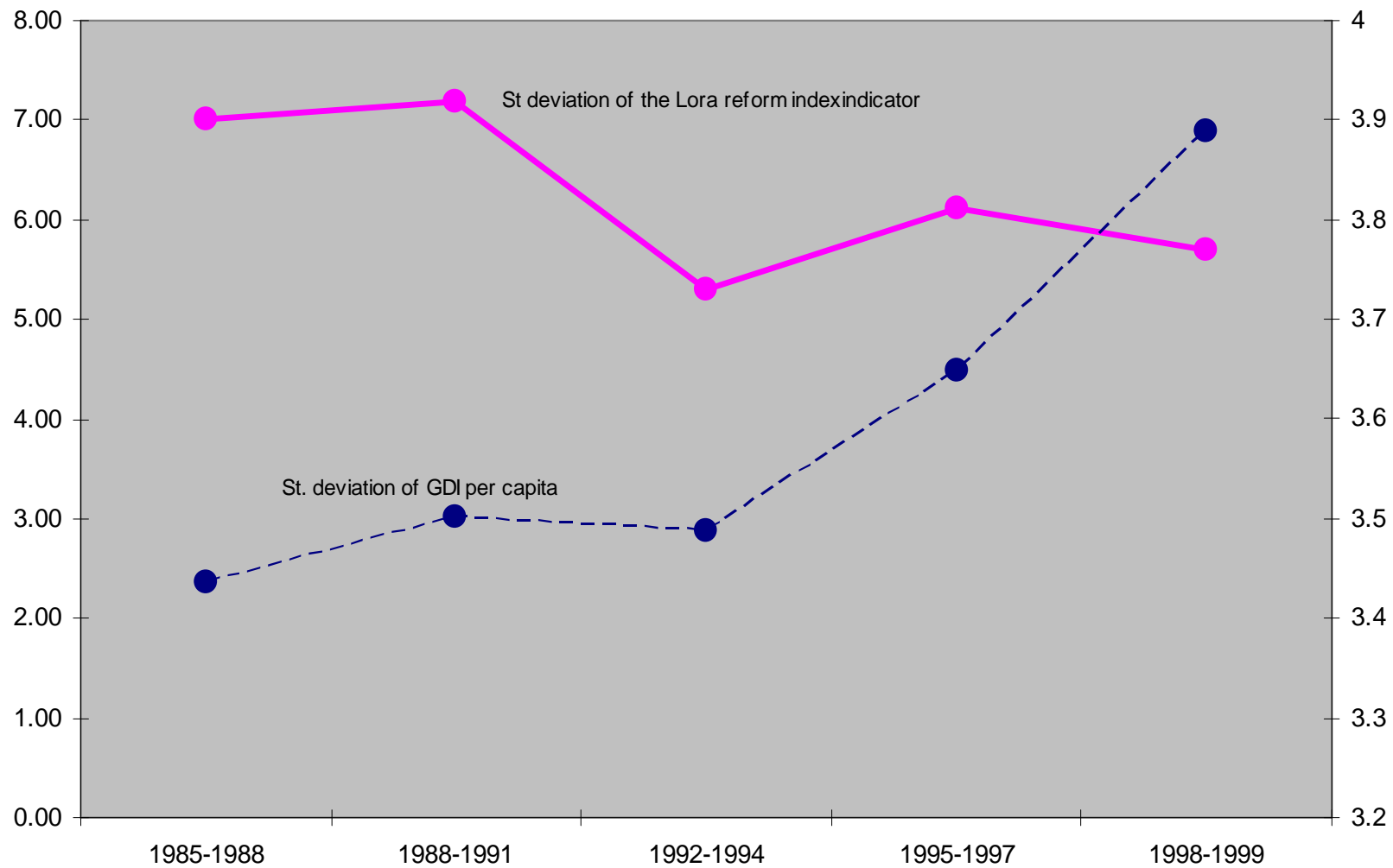
- The end of the Third World and all non-capitalist ideologies
- The fissure between those that did well (China, India, Indonesia => immensely important for the world because of their sizes) and most of others that did very poorly
- Countries at the frontline between capitalism and communism (Ethiopia, Congo, Somalia, Afghanistan, Yugoslavia) affected the most
- Promises of globalization did not materialize **despite** convergence of economic policies

Transition countries: continued output divergence despite policy convergence



twoway (line EBRD_sd year) (line gdp_ppp_sd year, yaxis(2)), legend(off) text(6.2 1997 "standard deviation of all > EBRD indicators") text(3.5 2000 "standard deviation of GDI per capita")

LAC countries: continued output divergence despite policy convergence



Speculation

- Loss of self respect among those who failed (Africa in particular)
- Insistence that economic success denotes moral superiority
- Hobsbawn (*Age of Capital*): “Since success was due to personal merit, failure was clearly due to lack of personal merit. The traditional bourgeois ethic, puritan or secular, has ascribed this to moral or spiritual feebleness...”
- Danger of that approach noted by –none other than– Hayek: capitalism is not just; no more than the outcome of a game of soccer can be called just or unjust

Causal links between globalization
and global inequality are very hard
to determine

Causal effect of globalization (openness) on global inequality

- **Channel 1.** Different effect on within-national income distributions (difference between poor and rich countries; HOS and revisions)
- **Channel 2.** Different effect on growth rates of poor and rich countries (the openness premium should be higher for poor countries)
- **Channel 3.** Different effect on populous and small countries
- Depends on history: are populous countries rich or poor at a given point in time?

- Assume globalization is good for poor, populous countries, no effect on within-national distribution
- In the current constellation, India and China grow faster => global inequality ↓ (mean income convergence, lower global inequality)
- Decouple poor and populous; let China and India be rich
- No change in individual effects of globalization; mean convergence continues but global inequality may now go ↑
- Conclusion. Even if effects are **known** and **unchanged**, the outcome may differ.

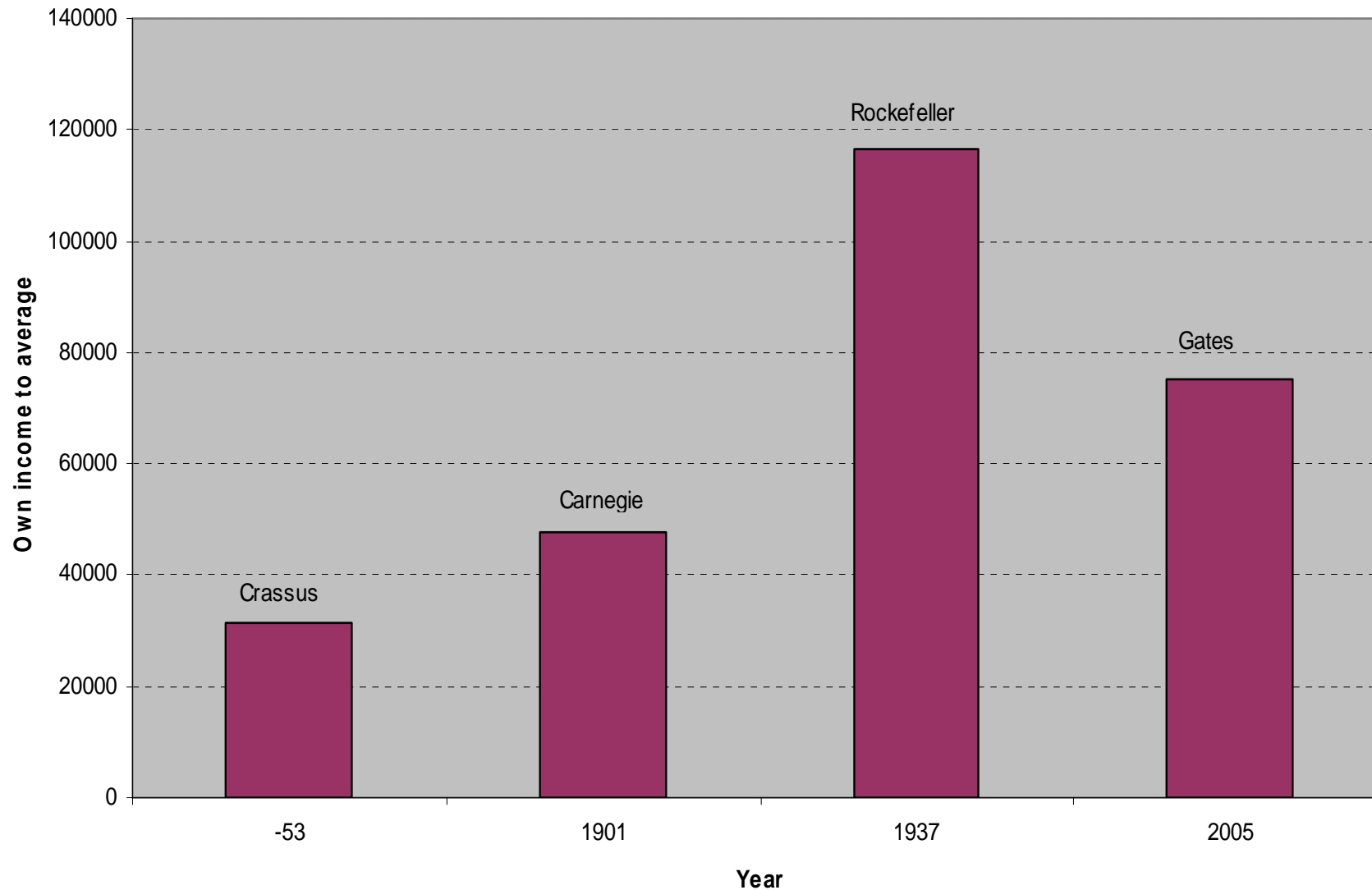
What to do?

Sensible reaction

- Not nationalist, claustrophillic or xenophobic
- Take a global perspective
- Unchecked global capitalism produces the same outcomes that capitalism produced at national levels in Globalization I
- We need global social infrastructure to make globalization sustainable by mitigating its most deleterious effects

- Global redistribution (*GWA*). Cash grants, funded by global taxes and delivered to the poor people directly
- *Acquis humanitaire*: freedom of association, child labor (ILO) etc.
- Less pro-rich rules of the game (intellectual property rights, rich country subsidization, changed voting in IO)
- Freer migration
- **Modest redistribution** and **greater migration** would alleviate the pressure of inequality brought about by Globalization II (both actual and perceived inequality)

Richest man's income expressed as number of average incomes of the country and year where and when he lived



In the US today, there are 21 people richer than Crassus was in Rome.

How GWA would function?

Tobin tax on highly income elastic goods paid by rich countries' residents (TT)



GWA: operating costs: x percent of TT



$(1-x)TT$ of categorically targeted transfers delivered in cash to the poor people in poor countries
(no repeated aid)