International Inequality and the Global Crisis
Managing Markets for Sustainable Growth

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While in our view the concept of a self-regulating market was utopian, and its progress was stopped by the realistic self-protection of society, in their [liberal] view all protectionism was a mistake due to impatience, greed or shortsightedness, but for which, the market would have resolved its difficulties. The question of which of these two views is correct is perhaps the most important problem of recent social history, involving as it does no less than a decision on the claim of economic liberalism to be the basic organising principle in society. Karl Polanyi, (1944: 148)

SUMMARY

The on-going crisis, like earlier great depressions, has occurred in a world governed by liberal, market-based institutions that are supposed to maximise global growth, equity and stability and thus solve the 'central problem of depression prevention'[1] They have actually produced rapid but uneven development, this time fuelled by a credit boom that collapsed in 2007/8, followed by an economic crisis marked by over-extended banks, over-indebted countries, firms and households, and falling investment, wages, and tax revenue. This has produced 'a variety of vicious cycles' that are devastating the weakest economies and reducing growth in the strongest.[2]

Policy makers have responded by forcing deficit countries to cut public spending, reduce labour costs, and improve the regulations needed to make markets work better. Unlike the 1930s,however, even policy makers on the left rarely question the role of markets themselves in generating the inequalities and unemployment that created and are perpetuating the crisis. Instead the liberal claim that free markets will automatically move resources from stronger to weaker economies and classes in the absence of inappropriate policy interventionist policies are rarely questioned, nor are their corresponding demand for austerity programmes and deregulated labour markets that are supposed to solve the problem, but are actually increasing deflationary pressures, global inequalities and political and social tensions in weak states and regions.

This paper[3] tells us why our failure to resolve the crisis has less to do with poor policy management in weak states, than with the inherent tendency for free markets to promote uneven development and instability because strong countries and firms outcompete and marginalise weak ones when they can exploit scale economies that their competitors cannot match. We show that orthodox economists ignore this problem, but that serious radical theorists have shown that it must destabilise open systems by reducing investment and consumption in deficit countries and lead to generalised deflation by reducing the export markets of their strong competitors as well. This technical proposition has crucial political and policy implications because it *justifies the need for collective interventions that not only regulate markets, but also correct them by redistributing resources from strong firms and countries to weak ones.*

The paper then looks at the theoretical, policy and political implications of this proposition.

It shows that the classical trade and balance of payments theories developed by Say, Hume, Ricardo and Arthur Lewis, no longer hold when scale economies enable successful firms, countries and regions to outcompete weaker ones, producing the inequalities and instability that have dominated the modern era. We also show that technological change facilitated by competitive markets is indispensable and can also benefit less successful players, but only when redistributive policy regimes enable them to survive and prosper by importing new technologies from, and exploiting market opportunities in, strong states.

It then shows that the inequality and crises generated by free trade have always produced a corresponding need for redistributive policies that now include banking bail-outs, Eurozone and IMF credits, negative interest rates, money creation and international aid. It emphasises the critical but unsustainable role of deficit spending in the USA sustained by its central role in the world economy and monetary system, and the counter-productive and asymmetrical nature of the pressures now being imposed on deficit countries in the absence of any reciprocal pressure on surplus countries to reduce their exports and thus enable deficit countries to invest and grow. We also show that it was structuralist, not liberal, policies that enabled deficit countries to overcome these problems and generate the long boom in the post-war era, policies that their successors can no longer adopt.

[1] Robert Lucas, Presidential Address to the American Economics Association, 2003. "Macroeconomic priorities", *American Economic Review*, 93 (1), 1-14.
[2] Bank for International Settlements, *Annual Report,* 2011/2: 7.
[3] 'International Inequality and the Global Crisis: Managing Markets for Sustainable Growth,' ID Website

It concludes by attributing the failure to challenge the existing orthodoxy to the ability of the strong states, firms and communities that benefit from it to oblige weaker states to accept it in exchange for credit and investment, and to their ability to manage elections and public debate by financing political parties, interest groups, lobbyists and the media. But we also show that current counter-productive policies will continue to discredit the liberal model and should enable radical movements to demand far greater concessions from the established elite in exchange for their continued compliance, and more especially, that the long-term prosperity of the winners as well as losers depends on their willingness to accept far more radical redistributive policies than are now on the political agenda. eab10viii13lse

Managing the Economic Crisis
The Theoretical and Policy Challenge

The global crisis is forcing states to reduce public spending and firms to cut wages and jobs, thus accelerating a global deflationary spiral by reducing demand, investment, and tax capacity. Radicals demand more deficit spending to stimulate growth, but weaker economies tried this after the banking crisis in 2007/8 and increased their debts without producing the growth needed to finance them. Rising interest rates have forced them to implement austerity programmes in exchange for short-term financial support from the EU and/or IMF. The USA has run deficits since 1970, but can still borrow at favourable rates by exploiting the 'exorbitant privilege' it enjoys as the largest economy and issuer of the dominant currency, and as an outlet for the surpluses of the strong economies. However, its ability to do this is increasingly constrained because further quantitative easing could increase inflation and devalue the dollar; while spending cuts would intensify the deflationary spiral. The Bank for International Settlements (BIS) identified the threats that these solutions now pose to the stability of the global system:

> A look at the economy as a whole shows that three groups need to adjust: the financial sector needs to recognise losses and recapitalise; governments must put fiscal trajectories on a sustainable path; and households and firms need to deleverage. As things stand, each sector's burdens and efforts to adjust are worsening the position of the other two. The financial sector is putting pressure on the government as well as slowing deleveraging by households and firms. Governments, with their deteriorating creditworthiness and need for fiscal consolidation, are hurting the ability of the other sectors to right themselves. And as households and firms work to reduce their debt levels, they hamper the recovery of governments and banks. All of these linkages are creating a variety of vicious cycles.' (BIS, *Annual Report*, 2011/2: 8)

These imbalances are being caused by policy interventions that break the liberal rules that govern the market-based global economic system that has prevailed since the 1980s, but, like the regulatory reforms of the 1870s and 1930s, they were introduced by conservatives, not socialists, forced to do so to avert a more serious breakdown caused by 'the weaknesses and perils inherent in a self-regulating market system' (Polanyi, 1944: 152). However, they are also having perverse effects because they have been introduced in a peace-meal way to address immediate problems and have ignored the role of free markets in generating the growing imbalances that continue to destabilise the world economy.

This article will substantiate this claim by questioning the theoretical coherence of the liberal assertion that free markets must produce equitable and stable growth by eliminating the 'distortions' generated by the state-led or 'structuralist' policies that had dominated the previous era. Instead liberalisation has actually produced uneven development by generating rapid growth in some regions, but reducing investment opportunities and increasing inequality in others. The destabilising effects of this process were initially concealed by the credit bubble fuelled by an unregulated and irresponsible financial sector, but this burst in 2007/8 that was followed by a generalised attempt to sustain growth through an expansion in public sector borrowing. However, this soon became unsustainable as growth failed to recover, reducing tax receipts and increased safety net costs. Thus the BIS (*Ibid*., 4) therefore 'directed the authorities' attention with new force to the underlying menace that no longer seemed so far away: the gross underfunding of governments' health care and pension obligations and an unmanageably large public sector' that has pro-

duced the spending cuts and falling wages and consumption that have produced the 'vicious cycles that are impoverishing the weakest economies and people, simultaneously compressing their imports from the strongest ones, thus globalising the crisis and perpetuating the deflationary spiral.

There is now a growing awareness in the policy community of the inadequacy of these responses, but a deeply entrenched inability to recognise the role of laissez faire in creating and perpetuating the crisis, or of the need for interventionist policies comparable to those introduced to address earlier crises. Conservatives blame the crisis on irresponsible governments in weak states, and regulatory failures and perverse incentives in financial markets. Social democrats have jettisoned their old commitment to statist solutions, and call for more spending in opposition but have to adopt austerity programmes in office because they cannot protect their own producers from foreign competition and can only borrow from the financial market at unsustainable interest rates, but no alternative projects that offer equitable and economically viable alternatives to the current system.

We will argue that we can only reverse these vicious cycles and develop sustainable policies by recognises the limitations of the current system by returning to the theories of market failure and uneven development generated by the radical structuralist tradition stretching from Marx and List, to Schumpeter, Keynes, Gerschenkron, and Stiglitz. They recognised that competitive markets generate rapid technological and social progress in some parts of the global system but also intensify inequality and marginalisation in others, unless their destabilising effects are offset by redistributive political and social interventions. This article reprises the contribution I made to this tradition during the crisis of the early 1980s, when I claimed that that the on-going neo-liberal response must intensify inequalities and instability at both national and global levels. (Brett, 1983; 1985) These pessimistic predictions were initially falsified by rapid growth in East Asia, and the credit bubble generated by deregulated financial markets, but they have now been vindicated by the intractable nature of the current crisis.

Substantiating these heavily contested claims raises theoretical, policy and political issues that we will take up in the rest of this article. We will first outline the classical liberal theories that tell us why open markets should automatically generate equitable or *even development* by shifting resources from strong to weak economic systems, then demonstrate that this does not hold in open systems when scale economies derived from technological change offset these processes and produce uneven development by creating structural inequalities between the most and least successful firms, countries and regions. We will then review the policy implications of this claim by showing that weaker societies have always had to adopt structuralist policies to deal with market failures; that this is also true now, but that current responses fail to recognise the need to impose the primary responsibility for adjustment on surplus rather than deficit countries. We will conclude by reviewing the difficulties involved in generating the political will to introduce viable redistributive policies in a global context dominated by the interests of the strongest states, firms, and communities.

The Logic of Even and Uneven Development

The stability of the global system depends on the ability of each national economy to balance its imports and exports over the long term; deficit economies can only continue to import by increasing their exports to or borrowing money from surplus countries, or by cutting their imports from them. The stability of the world economy therefore depends on the ability of firms in deficit economies to outcompete firms in surplus countries pushing the latter into deficit; failure will lead to import compression and impose deflationary pressures on the system as a whole. Thus the survival of a *liberal* system depends on the extent to which free trade actually generates what I call *even development,* or a 'natural' tendency for weaker economies to move from deficit into surplus without resorting to protectionist interventions that 'distort' the play of uncontrolled competition. If free trade creates *uneven development* because strong economies constantly outcompete weak ones, import compression will first reduce consumption and increase conflict in deficit countries, then undermine the integrity of the whole system. According to Hager (1980: 15):

> there is an incompatibility between the extraordinary performance of one or more members in a system and the maintenance of a voluntary rule-based order. The strong tend to believe that a system which allows others the freedom to emulate them is the best of all possible worlds. In the real world, however, the weak have to be bribed to continue playing a game they lose.

This proposition has crucial political and technical implications, since it implies that growing inequality is a technical as well as a normative issue, since the system must break down unless the weak as well as the strong can survive and prosper. Thus the hegemonic status of laissez faire depends on two key claims - first, that markets will maximise freedom and efficiency and political constraints will suppress them, and second, that free trade will also automatically generate full employment, fair wages and equilibrate demand and supply at the national and global levels. Serious liberals recognise that viable markets depend on strong states to guarantee property rights, overcome externalities, and provide public and merit goods, but believe that they should create regulatory regimes that do not distort them but enable them to operate better. The collapse of command planning in the East

and authoritarian structuralism in the South validated the first claim; unprecedented growth in the East and in South Asia facilitated by tariff reductions in the 1970s and 1980s has partially validated the second.

These are serious claims since markets do play an indispensable role in modern society, and because many current problems are a function of weak governance and opportunistic behaviour that could have been avoided through better governance and stronger regulatory regimes. Thus we can only continue to benefit from open markets if we make full use of the political and economic insights of liberal theory, but only if they are supplemented by a more realistic analysis of the tendency for even well regulated markets to produce inequality and instability without the redistributive transfers referred to in the last section. We will outline the key claims of liberal theory in the next section, and the logic of the structuralist critique in the one that follows.

Accounting for Even Development and Economic Stability: The Liberal Case

The ability of modern neo-classical theory's to assume that free trade would automatically produce full employment and even development rests on the work of classical theorists who challenged previously dominant mercantilist arguments that had justified the need for protectionist policies. Instead, Say's theory of supply and demand, Hume's theory of the balance of payments, Ricardo's theory of comparative advantage, and Lewis' theory of surplus labour demonstrated open competition would not only maximise growth, but also an equitable and sustainable distribution of the resulting gains.

- **S**ay showed that that 'supply creates its own demand', since money spent on wages and inputs by firms must reappear as enough demand to buy the goods that they produce; and that competition will actually produce full employment and growth by forcing firms to reinvest their profits in more efficient technology, guaranteeing rising wages in the long term. (See Keynes, 1973: 18-21)
- **H**ume showed that countries with a chronic trade surplus would have to reinvest this income and incur rising costs while deficit countries would experience falling wages and costs that would soon enable them to move back into surplus. (Hume, 1955: 63)
- **R**icardo's showed that even poor countries where the costs of production are higher in all sectors than in rich ones, would still benefit from free trade by importing the goods where their costs are highest and exporting those where they are lowest. (See Haberler, 1961: 7-8)
- And **L**ewis's showed that capital would flow from developed regions where capital was plentiful and labour fully employed and expensive to t less developed ones where it was scarce and labour was plentiful until full employment and comparable wages existed in both. (Lewis, 1954)

These models have been subjected to rigorous analytical scrutiny, and can also be used to demonstrate that most structuralist policies - protectionism, subsidies and state-enforced monopolies everywhere and punitive taxation, nationalisation, wage and price controls and unaffordable welfare spending in socialist countries – would block these beneficial processes and intensify political conflict and economic breakdowns. The IFIs used these arguments to explain the generalised balance of payments and fiscal crises in the south and east that destabilised the global economy in the 1980s and 1990s, and used their structural adjustment policies to oblige these countries to liberalise in exchange for financial support. The subsequent boom and shift of industry from rich to poor countries that followed seemed to validate their claims and enabled a Nobel prizewinning economist to claim that that they had solved the 'central problem of depression prevention ... for all practical purposes … for many decades.'[4]

Scale Economies, Market Failures and Economic Crises

The emergence of the latest crisis *after* most of these 'distortions' had been eliminated, clearly undermines the optimistic claims of what I will call SHRL theory, and forces us to return to the analyses of market failure that do explain why free trade has not produced equitable and sustainable development as it predicts. Instead it has produced growing inequality and unemployment within most countries, and long-term surpluses in the strongest economies like Germany, China and the Asian NICs, and long-term deficits in the USA, the European periphery and in the weaker LDCs that have not benefitted from recent increases in raw material prices. Rapid industrialisation has increased wealth as well as inequality in the BRICs, but destroyed jobs and cut real wages in all but the most successful developed and middle income countries. This has reduced investment despite the fact that the world's leading corporations are hoarding trillions of dollars of cash reserves, and can borrow at negative interest rates. Further, successful industrialisation in East Asia and China benefitted from lower tariffs in DCs, but also depended on state-led export-oriented development and not laissez faire. Instead, as Chang (2002: 19) has shown, virtually all early industrialisers have

[4] Robert Lucas, Presidential Address to the American Economics Association, 2003. "Macroeconomic priorities", *American Economic Review*, 93 (1), 1-14.

used ‘a wide variety of industrial, trade and technology policies’ that contradict most of the prescriptions of current orthodoxy, and are proscribed by the Articles of Agreements of the IFIs that almost all LDCs have now signed.

These contradictory processes clearly challenge the empirical claims of SHRL theory. The radical theorists who explain this failure do not question the analytical coherence of their models, but do question the validity of their empirical assumptions, and especially their *failure to recognise the disruptive effects of economies of scale generated by technological and organisational innovation*. This seemingly abstract and technical proposition actually has radical economic, social and political consequences, because, as Schumpeter shows, (1943: 84) scale economies suppress the redistributive processes that would prevail where competition operates ‘within a rigid pattern of invariant conditions, methods of production and forms of industrial organisation’. Instead as he also shows, ‘the essential fact about capitalism’ is its tendency to revolutionise technology and therefore produce oligopolistic competition and ‘creative destruction’, not equitable and stable growth:

> … in capitalist reality as distinguished from its textbook picture, it is not … competition [within invariant conditions, methods of production and forms of industrial organisation] which counts, but the competition from the new commodity, the new technology, the new source of supply the new type of organisation (the largest-scale unit of control for instance) – competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the output of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door. (84)

These processes enable strong firms and regions to reduce their costs and prices, employ fewer workers and still increase their output and prices, by investing in technical and/or organisational innovations that enable them to destroy weaker firms, raise barriers to the entry of new ones, reduce employment and tax capacity in weaker regions and impose deflationary pressures on the whole system. They operate at every level - the plant, the firm and the region – and produce effects that do explain the depth, persistence and pervasiveness of the current crisis. These are some of their most disruptive consequences:

- Automation has eliminated ‘fordist’ manufacturing and the mass working class in the north, and marginalises everyone without the skills that these complex systems require; the internet is destroying millions of jobs and small shops.
- Multi-plant industrial, banking and retail firms dominate international markets, undermine small independent firms in the north and south, and raise high barriers to new entrants.
- Liberalisation and lower wages has transferred new industries and jobs to some developing countries, but its benefits are concentrated in a few centres with good infrastructure and strong states, and exclude the rural and urban poor. It has destroyed jobs in the North, in weaker economies in the South, and in weaker regions in successful countries too.
- Strong economies like Germany and China provide firms with excellent state services that generate external economies, or ‘economies of aggregation’, that offset rising wage costs that their weaker competitors cannot match.

These processes explain growing inequalities between and within nations, the dominant role of global corporations in the world economy, the expansion of an increasingly marginalised informal’ sector in LDCs, a growing under-class and falling wages in de-industrialised DCs, and the co-existence of long-term export surpluses and deficits that are destroying investment opportunities in weak economics and perpetuating the deflationary spiral that continues at the global level.

Liberal theorists recognise the disruptive effects of scale economies but ignore their consequences or deny their existence. Thus Knight saw that they must, ‘eventuate in monopoly’ unless the ‘normal relation of increasing costs with increasing size’ could be re-established; (Knight, 1924: 51) while Hicks claimed that monopoly will replace competition, ‘stability conditions become indeterminate; and the basis of which economic laws can be constructed is therefore shorn away,’ unless the ‘supposition’ that ‘*marginal* costs do generally increase with output at the point of equilibrium’ holds, (Hicks, 1946: 84-85) The ‘supposition’ that diminishing returns are dominant in late capitalism clearly ignores the powerful processes identified above, and forces neoclassical theory to depend on a ‘scholastic’ approach to policy theory that deduces ‘real world behaviour from highly abstract arguments that have little or no empirical content’. (Lipsey et al, 2005: 385)

This wishful thinking imposes heavy burdens on the weakest members of the global community, because it blames them for their own poverty, forces them to bear the heavy burden of reconstruction, and it denies the need for interventions that do not just regulate markets to allow them to operate better, but that redistribute resources to correct these disequilibrating effects. This clearly demands a fundamental shift in the policy agenda, but one that also takes account of the positive consequences of technological change that we turn to now.

Competitive Markets, Scale Economies and Social Progress

The hegemonic influence of market theory is sustained by the ability of the leading countries and corporations to silence the voices of competing paradigms and social movements, but its continuing authority actually depends on our inability to manage the complex global exchanges on which our survival depends without them. The neo-liberal revolution in the 1980s was validated by a generalised popular revolt against Stalinism, Fascism and statist structuralism, and by unprecedented growth in once poor economies that discredited the claims of dependency theorist who argued that the capitalism was incompatible with third-world industrialisation. Further, scale economies, do have disruptive effects, but are crucial to human progress. Thus the problem that confronts us now is to find better ways to control its disruptive effects with sacrificing its manifest advantages. To do this we need to start by identifying the creative consequences of market systems, and the variables that confirm the claims of SDRL theory.

- First, while continuous innovation transforms many production processes, many inherently labour intensive activities remain that continue to generate employment, while some innovations, like improved seeds or mobile phones, advantage small rather than large producers and enable them to survive and even create new sectors.
- Second, industrialisation in the BRICS has created new investment opportunities there and increased demand for high technology exports from the North, and for raw material exports and labour intensive services in the South. Capitalists in the BRICSs are responding to rising wages by investing in poorer LDCs, and particularly in raw material production in Africa. China's ability to finance the American deficit continues to stabilise the global monetary system.
- Third, scale economies are responsible for the productivity gains that have contributed most to human progress were not generated by small firms working in fully competitive markets, but by 'large concerns' operating under 'Monopoly Competition' as Schumpeter noted,. (82/79) This has two key implications – first, that oligopolistic competition does impose real disciplines on even the most powerful corporations, and second, that attempts to restrict the destructive effects of scale economies in the interests of stability or redistribution need to be offset against the positive effects of science-based technological change.
- And, fourth, it is these productivity gains that have generated the surpluses that have allowed modern states to provide public goods and safety nets, produce the automated technologies and information systems that have rescued humanity from lives of unremitting toil, facilitated a massive increase in leisure and creative activities, and institutionalised the large-scale resource transfers that have stabilised and legitimised modern capitalism.

Political Intervention, Managed Markets and Equitable Development

This analysis provides a technical and normative justification for collective interventions that restructure rather than simply regulate markets by obliging winners to compensate losers and thus offset the inequalities and instability that stem from their tendency to destroy the economic capacity of their consumers. The long slump has validated this claim, but also confronted those who accept it with a technical and political challenge since they must do this without disrupting the complex problems involved in producing the food, clothing, shelter, and communication systems for seven billion people, and also generate the political support needed to capture state power and then to manage the transaction and contestation costs involved in transferring scarce resources from dominant to excluded groups.

Now it is far easier to prove the existence of uneven development and the need for systemic interventions to control it than to overcome the technical difficulties and contestation costs involved in dealing with them. Liberals rightly claim that planners can never acquire all the information needed to solve these technical problems, and that only markets can reduce these contestation costs by depoliticising the allocations of scarce resources that must otherwise generate zero-sum conflicts between individuals, classes and nations. Much history attests to the strength of this claim. Mercantilist policies led to the territorial wars and imperialist expansionism that dominated the early modern period; authoritarian socialism in the east and fascism in the west led to beggar-thy-neighbour policies and war in the 1920s and 1930s; authoritarian statism destroyed state capacity and impoverished whole nations in many post-colonial states. Thus the world would indeed by a safer and less challenging place if competition did indeed produce economic systems 'which self-adjust so well that no superior authority (the state) is needed to provide more than a framework of rules and infrastructure not providable by private profit-seeking', as liberal theorists claim. (Wade, 2013)

However, the fact that states can also fail does not alter the fact that markets cannot survive without them, so we do need to address the intractable problems, generated by the need for redistributive interventions, however difficult they may be. Thus we will first look at the impact to the anomalous policy interventions that have been introduced to contain the crisis, then at the technical and political issues raised by the need to manage a more equitable and sustainable global order.

Perverse Policies and the Intensifying Crisis

Crises occur when the rules and organisational systems that govern an existing social order no longer meet the challenges created by the changing demands it is generating, and must therefore be 'systematically modified if [the paradigm that sustains it] is to be reconstituted and put back to use'. (Brett, 2009: 16) The current combination of open markets and austerity is clearly producing counter-productive results, but has not yet produced a conscious paradigm shift like the one that occurred between the wars.[5] However, it has forced a reluctant policy community to adopt a number of non-market solutions to avert an even greater catastrophe whose causes and consequences must be clearly understood since they not only demonstrate the weaknesses of the dominant paradigm, but are also modifying the institutional arrangements and implicit assumptions that govern the system and the policy debate that sustains it.

The non-market interventions introduced by right and left-leaning governments in the USA and Europe to protect the system from the effects of the current crisis are well known. They rescued and partially nationalised major banks in 2007/8, and are now looking for ways to subsidise credit and develop 'industrial policies' that were de rigeur ten years ago. Central banks are maintaining negative interest rates and printing money to stimulate growth. Full-scale Keynesian deficit financing, supported by the IFIs, was introduced in weaker centres immediately after the crisis that provided a temporary stimulus, and was only halted by unsustainable increases in debt and interest payments. However the resulting double-dip recession that destabilised the weaker states in the EU forced the Eurozone and the IMF to finance bankrupt regimes to safeguard the banks and rescue the currency union, even though falling output and tax revenues means that these debts may never be repaid. It has also forced the Eurozone countries, including Germany at its centre, to recognise the need to strengthen its capacity to finance its weakest members to enable them to stay in the Union, and to take on more of the characteristics of a fully-fledged state in order to do so.

However, the banking and Eurozone crises are only a symptom of the much deeper systemic anomalies stemming from the long-term structural changes that are threatening the US economy's role as the primary source of global liquidity and provider of the world's main reserve currency. The USA's economic dominance and reserves enabled it to facilitate post-war reconstruction from the 1940s onwards. It played the key role in creating the IFIs that sustain the liberal rules that govern the global economy, and it also financed the post-war reconstruction processes that enabled the world to enjoy a long period of relatively even development. It ensured that the IFIs institutionalised a liberal global order, but also used Marshall Aid and its own international defence spending to facilitated post-war reconstruction, and allowed the war-damaged states to use protectionism, state controls and high redistributive taxation to build new industries and create welfare states. (Brett 1983; 1985)

Thus it was interventionist, not liberal policies that allowed the successful industrialisers - the EU and Japan, the East Asian dragons, then China and Vietnam - to catch up with the USA and in doing so, to introduce new structural inequalities that the Bretton Woods arrangements have been unable to control. Their achievements have been used to justify SHRL theory, but their actual history tells a very different story. Their state-assisted breakthroughs enabled them to combine cheap labour with best-practice technology and take advantage of lower tariffs to penetrate the US and other markets and generate unprecedented levels of export-led growth. However, their surpluses did not then turn into deficits as Hume claimed, but have continued over the long term, so their exports have destroyed millions of jobs in the north and less successful middle-income countries in the south, and imposed chronic deficits on many of them, most notably the USA. Its deficits in the 1950s began with defence spending and foreign aid, but were then compounded by the competitiveness of high technology producers in the north, and low wage and now increasingly high technology competitors in the south.[6] Thus global liquidity and the stability of the dollar has depended for many years on the ability of the USA to borrow on an unprecedented scale, because the surplus countries have had 'to finance indefinitely US deficits through unpredictable accumulations of dollar claims', or produce a 'long-run shortage of liquidity', with serious deflationary consequences for themselves and the rest of the world.[7]

This experience is uncannily similar to the history of the long upward wave before the first world war that enabled the now advanced countries to industrialise behind protective barriers financed by British loans and with free access to British markets until Britain's growing deficit stopped it from playing its traditional role thereafter. Thus the current crisis will only end when the deficit countries are able to penetrate surplus country's markets, or protect their own markets from their exports. Their inability to do this, as the BIS points out, (AR 2011/2: 3) is also creating a 'slowdown' in successful 'market economies … whose success has depended on exports' and suggests that they 'would do well to speed their efforts to build capacity for internal growth'. However, liberalisation means that the political mechanism needed to balance investment in deficit and surplus countries are no longer comparable to those that existed after the war, and this is intensifying the deflationary pressures on deficit countries, and also on

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[5] A major British Academy Conference that asked why economists had failed to predict the crisis ignored the effects of unequal competition produced by 'free' markets, and attributed it to failures of regulation, risk-management and foresight, and their oversight to 'a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole'. Besley & Henderson, *Letter to the Queen*, 17/6/2009.
[6] Deindustrialisation has turned the once-great automobile producing city of Detroit, birthplace of 'Fordism' into a ghost town that has been forced to sue for bankruptcy with $18-20 billion debts. *New York Times* 18/7/2013.
[7] The quotation is from Robert Triffin whose analysis of the contradictory nature of an international monetary system based on the strength of a single national currency is more relevant today than it was in the 1960s when it was formulated. (1966:288,290; see also Triffin, 1960)

the USA where the crisis has now reached a point where it has to choose between balancing its books, or continuing to borrow and print money in an unsustainable way.

The unstable nature of a global system that was generating chronic deficits in weak centres and chronic surpluses in strong ones first became clear when Nixon was forced to repudiate the gold standard and devalue the dollar in the 1970s, followed by a series of banking and fiscal crises in the 1980s and 1990s in the South and East that were only contained by the widespread structural adjustment programmes financed by the IFIs. The ability of the US to continue to sustain global demand and the value of the dollar has depended on the ability US Treasury to borrow on favourable terms and an increase in fiscal discipline after the 1980s. It also responded to the crisis in 2007 with a massive increase in borrowing that has averted a full-scale depression, but only produced very limited growth, together with falling wages and escalating welfare payments.[8] Thus the stability of the international monetary and financial system now depends on its ability to indulge in levels of fiscal indiscipline denied to less privileged debtor countries because 'the markets' have few other outlets for their savings, and because withdrawing support would initiate a global depression and devalue trillions of dollars they hold in US debt, and as their own international reserves.[9] Indeed a Wall Street commentator recently described the operation of 'the U.S. Treasury market' as 'a Ponzi market', and also noted that it 'has reached levels that wouldn't be sustainable if free market forces were allowed to prevail'.[10]

The late 1970s initiated a long period of recession that produced balance of payments, fiscal and debt crises across the South and East; Serious financial and debt crises occurred in Latin America in the 1980s and in East Asia, the post-communist countries and Africa in the 1990s that were only averted by emergency interventions by the IFIs. These crises were closely linked to badly managed structuralist controls that enabled rulers to adopt unsustainable policies that destroyed state capacity, marginalised whole communities, but also by falling raw materials prices and their inability to compete on domestic and foreign markets with established surplus economies. These crises also created generalised donor-dependence that enabled the IFIs to introduce the structural adjustment and good governance programmes that then produced an almost universal transition to market based systems the region.

Now these controversial reforms have had very mixed outcomes – they have certainly improved governance and have also removed many irrational monopolies and state controls that blocked investment and entrepreneurship and encouraged unproductive rent-seeking from rulers, crony corporations, and foreign corporations during the structuralist period. Higher levels of fiscal and financial discipline have enabled them to avoid the worst effects of the credit crisis, and the most successful of them have enjoyed significant levels of growth, heavily dependent on increased demand for food and raw materials from the new NICs. These successes do attest to the importance of free markets, and the destructive consequences of bad governance in encouraging growth and freedom, but they cannot be used to justify neo-liberal claims, because they, too, have depended on extensive external transfers, and are producing jobless growth that is increasing internal inequalities and social tensions.

In fact the willingness and ability of the countries to 'adjust' their economic and political structures has depended on extensive financial and technical support from the donor community in all of the LDCs without access to resource rents. There were widespread defaults during the debt crisis in Latin America in the 1980s, and most of the poorest countries have depended on significant levels of balance of payments and budgetary support since the 1980s, and had their debts forgiven in the 1990s through the Heavily Indebted Poor Counties Initiative. Further, increased demand for their raw materials from the NICs is offset by the destruction of local investment opportunities from their cheap exports producing a classic 'infant industry problem' and re-establishing the old-style colonial exchange of raw materials for consumer goods whose limiting effects have produced protectionist policies in the north in the 19th century and the south and east in the 20th. These gains, even in the African countries enjoying rapid growth are heavily concentrated in capital intensive extractive industries, mainly benefit politically connected domestic and foreign elites and a small labour aristocracy, confining the overwhelming majority of the population to survivalist activities in informal economies because they cannot compete with low wage high technology imports from Asia.

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[8] One in six Americans now dependt on foodstamps. (Channel 4 News, 11/7/2013)

[9] These risks are huge, as the BIS points out:. 'Today, long-term bond yields in major advanced economies are around 2% ….. When interest rates and bond yields start to rise, investors holding government bonds stand to lose huge amounts of money.

Consider what would happen to holders of US Treasury securities (excluding the Federal Reserve) if yields were to rise by 3 percentage points…: they would lose more than $1 trillion, or almost 8% of US GDP …. Yields are not likely to jump by 300 basis points overnight; but the experience from 1994, when long-term bond yields in a number of advanced economies rose by around 200 basis points …. shows that a big upward move can happen relatively fast.' (*Annual Report*, 2012/13: 8).

[10] Scott Minerd, global chief investment officer at Guggenheim Partners, (Wall Street Journal, *Market Watch*, 21/6/2013), 'U.S. Treasurys are a 'Ponzi market', Guggenheim's Minerd, June 13, 2013. 'A Ponzi scheme involves the fraudulent act of repaying one investor's money with the principal of another, thereby over-inflating the value of assets until the bubble finally pops. (If you need a refresher, we suggest you check out Market Watch's recent interview with infamous Ponzi schemer Bernie Madoff.'

From Laissez Faire to Managed Markets

The inability of poor people in deficit economies to find the decent jobs or create the businesses that allow them to pay their taxes and repay their loans is not caused by their individual deficiencies but by the uneven development generated by uncontrolled competition. This cannot be corrected by old-style command planning or statist socialism, but it does mean that global and national markets need to be supplemented by far stronger redistributive as well as regulatory processes that offset the asymmetrical nature of the rewards that they now offer to the strongest states and firms, and the austerity they impose on weak ones. Current orthodoxy attributes economic failures to bad governance or excessive wages and fiscal deficits in weak states, and thus imposes the primary responsibility for adjustment on the losers; attributing it to unequal competition transfers it to the winners and justifies the right of losers to use their political power to protect themselves from its consequences in the absence of some form of compensation for their losses. Command planning and/or beggar-thy-neighbour protectionism would make matters worse for both, but free trade has also created a lose-lose situation that can only be overcome by developing new syntheses that build on the positive structuralist policies that produced far better results after the war.

The current system deploys one-size-fits-all solutions that would succeed if markets did produce a natural tendency to even development as SHRL theory claims, but their failure to so means that we need different policies for societies at different stages of development with different needs and capacities stemming from the success or failure of their earlier developmental experiences. These processes have to be managed at the global level, and must oblige strong states to open their markets to weaker ones, and to facilitate private and public credit mechanisms that transfer resources to them on favourable terms and allow them to adopt structuralist policies until they can compete on world markets on relatively equal terms.

This demand was clearly articulated by deficit countries at the Bretton Woods Conference in 1944 that established the IFIs, and is as relevant and justified now as it was then. Keynes, spoke for these countries at Bretton Woods, and attributed the inter-war depression to the chronic surpluses generated by the USA, and the corresponding inability of deficit countries to invest and grow. He argued that allowing the creditor country 'to remain entirely passive … [must put] an intolerably heavy task … on the debtor country,' (1943: 28) whose problems could only be resolved without destructive protectionism if the IMF and World Bank could be turned into agencies that would automatically recycle surpluses to deficit countries, by creating:

> a general and collective responsibility, applying to all countries alike, that a country finding itself in a creditor position *against the rest of the world as a whole* should enter into an arrangement not to allow this credit balance to exercise a contractionist pressure against world economy and, by repercussion, against the economy of the creditor country itself. (Keynes: *Clearing Union Proposals*, 1943: 27)

Unsurprisingly, the USA then, and other surplus countries now, have been unwilling to transfer control more than a tiny fraction of their savings to an international agency, and therefore turned the IFIs into agencies that persuaded deficit countries to remain in an open liberal system by giving them just enough credit to enable them to 'adjust' without resorting to anti-market measures. Debtors attempted to impose some limits on surplus countries by introducing a 'scarce currency clause' into the IMF's Articles of Agreement that would have enabled them to close their borders to countries in chronic surplus, but American resistance ensured that this clause was so weak that it could never be used, and it soon became a dead letter. This has produced an asymmetrical system that obliges deficit countries to give up the interventionist policies that their predecessors used during their industrial transitions, while absolving surplus countries from any obligation to compensate them for their losses.

Membership of this international system also imposes serious constraints on the domestic policy options available to deficit governments and on left-wing regimes in particular since it imposes serious constraints on the ability of their states to adopt the structuralist policies to protect weaker firms, workers and regions from the effects of unequal competition from dominant firms and regions within their own countries and in the world as a whole. They were introduced by the radical social democratic and corporatist political movement that sustained the post-war boom, but are incompatible with the liberal rules enforced by the IFIs and in free trade areas like the Eurozone. Free trade therefore has radical political consequences because governments can no longer protect high-cost enterprises, trade unions can no longer demand better wages or working conditions without bankrupting their firms and losing their jobs, and states cannot use Keynesian deficit financing to stimulate investment, since much of their spending will finance imports not investment and undermine their capacity to repay their loans, as we have seen.

Thus it was structuralist policies that sustained the post-war boom by limiting the consequences of uncontrolled competition, while inequalities and instability generated by free markets would be far worse now, but for the emergency measures described earlier. They also depend on the survival of the redistributive mechanisms established during the social democratic era that include universal access to safety nets and essential social services, and basic economic infrastructure. The quality of these services depends on the strength of the private sector, but the ability of the state to invest the surplus capital and labour generated

by scale economies has been essential to sustain effective demand and full employment and thus guarantee economic stability and the political and social inclusion needed to sustain a moral social order.

Our ability to maintain these symbiotic relationships between welfare states and managed markets has been progressively eroded during the neo-liberal era. Deindustrialisation and declining investment opportunities in all but the most successful developed and middle income countries is forcing them to cut wages and services; in some like Egypt and South Africa the resulting tensions are producing mass unemployment is threatening undermining the social order; in weak states in Africa and elsewhere a minority has benefitted from rising demand from the new NICs, but the majority are trapped in survivalist occupations in informal economies. The strong surplus countries continue to grow but more slowly as demand for their exports and investment opportunities for their surpluses decline. A serious attempt to reduce borrowing in the USA could further destabilise the system.

These problems cannot be resolved without fundamental reforms of the institutional arrangements that govern the world economy. They do not give the IFIs the resources and power they need to solve the problems of deficit countries, and impose serious limits on the policies that they can use to help themselves. We cannot provide detailed policy prescriptions for the different kinds of countries confronting these problems; only call for a return to more interventionist systems that strengthen rather than weaken the mechanisms that enable states to regulate markets and redistribute resources, and that oblige stronger states to give weaker ones the right to give more support to their own infant or declining industries and easier access to their markets.

In Conclusion
Political Agency and Economic Reform

Thus the need for fundamental policy changes to avert an intensification of the crisis is manifestly clear, but the political obstacles to introducing them are daunting because of problems of conflicting interests, political agency, ideology and organisation that we can only outline here.

The continuing dominance of the neo-liberal paradigm is sustained by the political leverage exercised by its well organised beneficiaries - capitalist and managerial elites, skilled workers in successful corporations, and strong states that benefit from their investment and taxes. It has given them immense gains and obscured the costs it has imposed on the losers. They make the investment decisions and credit transfers that create or destroy jobs and services, and thus determine the fate of countries, classes and individuals. Open markets enable them to move to the most favourable locations, and the inability of the IFIs to oblige all states to impose comparable controls over them means that no government or group of workers can ask more from than any other, producing a race to the bottom. Strong states control the surpluses needed to fund structural adjustment and austerity programmes, and this has enabled them to oblige recipients to jettison structuralist policies and universalise the liberal policy agenda. These powerful and largely hidden political levers co-exist with their ability to influence political and policy programmes and manage public opinion because they own the global media and fund research agendas, university programmes and cultural events and thus exclude competing views from public debate. They also finance political parties and election campaigns, and create and support interest groups and lobbying agencies with direct access to senior politicians and officials. (Wade, 2012)

These structural advantages are offset by the growing gap between the liberal social order's need to maximise freedom, equity and stability and its tendency to concentrate power and increase inequality and crises This is giving more and more people - marginalised and unemployed workers, less competitive capitalists threatened by unequal competition, an under-class dependent on declining welfare benefits in the north, and on insecure survivalist activities in the south - an interest in collective interventions to protect them from these destructive effects. However, they are socially fragmented, under-resourced, and dependent on the jobs and services provided by the state and capitalist economy, so their capacity for effective political action is highly constrained. A small minority may participate in demonstrations that challenge weak regimes, but protest movements motivated by discontent and linked by little more than mobile phones and social media cannot build the complex political and economic organisations needed to articulate their interests, translate them into viable policies, win mass support, and manage the conflicts and compromises involved in redistributing significant amounts of resources between classes, communities and states when they take power. All radical regimes that capture power have to come to terms with the dominant economic, bureaucratic and military elites that run the current system; expropriation or populist policies destroy crucial assets, intensify zero-sum conflicts and impoverish everyone in the short run at least.

Thus credible attempts to resolve the crisis depend on the ability of old or new political parties and the interest groups that support them to devise more equitable programmes, mobilise support, capture political power, and negotiate difficult compromises between winners and losers. This raises very different problems in DCs and different kinds of LDCs.

In DCs the crisis has forced the conservative parties that represent the dominant economic elites to adopt some redistributive policies as se have seen, but has yet to challenge their hegemonic authority because of the socio-economic changes that have transformed the interests and identities of the groups that support their social democratic opponents. The parties, trade unions and civic organisations that took power after the war were built over generations by leaders, intellectuals and activists, and supported by the mass working class because structuralist policies protected their jobs and wages, and redistributive taxation sustained the welfare state. However, liberalisation and international competition reduced their ability to defend these gains and de-industrialisation and automation has now virtually eliminated this class, and its ability to sustain old style statist programmes. Most of the people who saw themselves as an exploited underclass with collective interests have been replaced by professional or technical classes with personalised skills, individualised identities and high expectations. They no longer perform routinized tasks, but make informed decisions for their enterprises, or work in small or micro enterprises and would oppose a return to the hierarchical structures that dominated the statist project. They coexist with a marginalised, atomised, and often foreign underclass dependent on welfare benefits, but it lacks the resources needed to organise politically to overcome its own weaknesses.

These radical socio-economic changes forced social democratic movements to jettison structuralism in the 1990s, and look for a 'third way' that would allow them to combine open markets with better services and social protection. The crisis intensified the inevitable contradiction between the need to maximise profits and increase taxation that confronts all regimes attempting to find a sustainable balance between these two needs. Conservatives as well as social democrats need to find ways to resolve this tension, but have failed to do so in all but the most successful economies, producing a political impasse that has led to popular disaffection on the left, and an intensification of racism and economic nationalism on the right.

The problems of political agency confronting reformers are even more complex in LDCs than in DCs. They range from strong states with dynamic export economies at one extreme to fragile states with embryonic capitalist economies at the other. In most many people cannot operate as 'free' individuals because they are locked into dependency relationships with patrimonial elites or marginalised in segregated informal economies. They have only recently made transitions from authoritarian structuralist regimes, and therefore lack the state capacity needed to regulate open markets, and the democratic traditions and organisations needed to limit the corruption and incompetence that still dominates many political systems. Social systems are often riven by sectarian or ethnic antagonisms that can be exacerbated by the competition and economic inequalities generated by liberalisation. They all adopted structuralist policies after the war, producing predatory authoritarianism and economic failure in the weakest, and successful developmental transitions in the strongest states. Donor dependency then forced weak states to liberalise long before they have solved their infant industry and infant state problems; strong states have only begun to liberalise after their interventionist policies had successfully overcome them.

These experiences suggest that well managed structuralism rather than liberalisation represents the first best policy choice for late developing countries, but the challenges involved in mobilising support for it and more especially of creating the political organisations and state capacity needed to implement it are daunting. The demand for structuralist policies came from uncompetitive local capitalists and workers attempting to defend themselves from foreign competition, while their need for subsidies imposed additional costs on exporters and consumers. The regime's ability to tax and allocate subsidies and monopoly privileges has crucial political implications, since favoured capitalists succeed while others fail; rulers extract rents from allocating these favours and use them for personal enrichment or to finance the patronage networks that sustain their political organisations.

Structuralism failed in some contexts and succeeded in others for reasons we have discussed elsewhere. (Brett, 2009, Chs. 13 & 14) What determines these outcomes as Kohli shows, (2004) is not the existence of structuralism per se, but the ability to manage the zero-sum conflicts involved in developmental transitions of this kind. Donors and opposition movements now assume that democratisation will increase political accountability and encourage inclusive solutions, but the ability to elect or remove governments does not eliminate these conflicts of interest, and these processes are regularly manipulated by patrimonial elites and intensify sectarian, ethnic or class conflict, as we know. (Brett, 2012) Liberalisation alters the ability of regimes to access and manipulate rents, but does not eliminate the ability of the state to allocate of favours, so successful solutions continue to depend on the ability of competing classes, factions, activists and leaders, to build the ideological and organisational frameworks and political coalitions needed to produce effective and equitable policy regimes.

We live in an era that expects growth to continue indefinitely, and that the periodic crises that we confront will always produce new and more progressive solutions. This analysis suggests that our ability to do this after the war was not a foregone conclusion, but the result of exceptionally favourable circumstances that persuaded dominant elites and marginalised classes and communities to produce viable compromises that are no capable of guaranteeing a return to prosperity. We will need far greater concessions from beneficiaries, and far more effective action from losers if we are to build the economic, social and political networks that enable them to demand programmes that offset the disruptive effects of uneven development, networks that will have to operate at the global level. I have outlined the basic principles that should govern these reforms in more detail elsewhere (Brett 1983; 1985; 2009), the problem confronting radical political activists now is to recognise the dangers of political apathy and the

limits of protest politics and to join and strengthen the ability of radical organisations to reconstruct an equitable and sustainable social democratic order. The decline of the mass working class and increasing competition for jobs and markets means that it will be very hard to create cohesive movements and unified programmes, but even to discover 'the terrain on which these battles have to be fought'. However, a failure to do so will also 'lead to a period of dissolution which will have devastating effects upon everything which has been created over the past generation', as I argued during an earlier crisis 30 years ago. (1983, p.245)

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Eab 5viii13