1 Introduction

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1 Globalization and the effects of neoliberalism

The world has become a human laboratory for the momentous social experiment called neoliberalism. Its proclaimed purpose is to reduce global poverty. Its protocols are derived from the orthodox theory of competitive free markets. And its policies are enforced by the full weight of the rich countries and global institutions such as the World Trade Organization (WTO), the World Bank (WB), and the International Monetary Fund (IMF). This book is a critical examination of this ongoing enterprise, of its history, theory, practise and most of all, of its outcomes.

The annual Gross National Income per capita of the richest countries was about $27,000 in 2001, whereas that of the poorest countries was about $430 (World Bank 2003: 235, Table 1). But even the latter sum is misleading, because the distribution of income in poorer countries is appallingly skewed. Even according to World Bank estimates, some 1.2 billion people, one in every five people on Earth, are forced to live on less than $370 per year, that is, on less than $1 a day. Almost *half* the world's population lives on less than $2 a day (World Bank 2001: 3).

Neoliberalism insists that unrestricted international trade and capital flows provide the best way to overcome such problems. It sees markets as self-regulating social structures that optimally serve all economic needs, efficiently utilize all economic resources, and automatically generate full employment for all persons who truly wish to work. Poverty, unemployment, and periodic economic crises in the world are thought to exist because markets have been constrained by labor unions, the state, and a host of social practices rooted in culture and history. Overcoming poverty therefore requires creating "market friendly" social structures in the poorer countries and strengthening existing ones in the richer countries. This involves curtailing union strength so that employers could hire and fire whom they choose, privatizing state enterprises so that their workers would fall under the purview of domestic capital, and opening up domestic markets to foreign capital and foreign goods (Friedman 2002, Stiglitz 2002). The job of international institutions is to oversee this task, for the good of the world, and particularly for the good of the poor. To quote Mike Moore, former Director General of the WTO, "the surest way to do more to help the [world's] poor is to continue to open markets" (cited in Agosin and Tussie 1993: 9).

Neoliberal globalization began to be implemented in the 1980s, and gathered great force in the 1990s. Yet in most countries, this latter period has been associated with increased poverty and hunger. Over this interval, more than 13 million children died from diarrhoeal disease. Even today, over half a million women die each year in pregnancy and childbirth, one for each minute of the day. More than 800 million suffer from malnutrition (UNDP 2003: 5–8, 40). Of the 50 countries with the lowest per capita GDP in 1990, 23 suffered declines, whereas the other 27 grew so modestly that it would take them almost 80 years just to achieve the level attained by Greece, which in 2002 was the poorest member of the EU (Friedman 2002: 1). In Latin America and the Caribbean, GDP per capita grew by a total of 75 percent in the two decades from 1960 to 1980, and only 7 percent in the subsequent two decades under neoliberalism. In Africa, the first period yielded a total growth of 34 percent, whereas in the second per capita GDP *fell* by 15 percent (Weisbrot 2002: 1). Only certain Asian countries escaped this pattern, and they did so by channeling the market mechanism rather than by following its dictates (see Chapter 2 of this book). Finally, international inequality also rose in the two decades of neoliberalism: in 1980, the richest countries had median incomes 77 times as great as the poorest but by 1999 this tremendous inequality had *increased* to 122:1 (Weller and Hersh 2002: 1).

The current debate is not about the need to utilize international resources in the effort to reduce global poverty. It is about the *manner* in which resources should be brought to bear. Neoliberalism provides one possible answer. Because it is also the dominant practise, the debate has focused on neoliberalism. Defenders of neoliberalism make a variety of points. They point to history, to the indisputable fact that the rich countries are market-based economies that developed in-and-through the world market (Norberg 2004: 1). They point to standard economic theory, to "the virtual unanimity among economists, whatever their ideological position on other issues, that international free trade is in the best interests of trading countries and of the world" (Friedman and Friedman 2004: 1; see also Bhagwati 2002: 3–4; Winters *et al*. 2004: 72, 78, 106). They point to empirical evidence indicating that global poverty has been reduced since the 1990s, and that trade liberalization reduces poverty by fostering growth (Winters *et al.* 2004: 106–7).[1] And they argue that if developing countries have not done as well as they should, it is because they have themselves failed to implement social and economic policies that are sufficiently market-friendly (Norberg 2004: 2).

Critics of neoliberalism dispute all of these points. They note that rich countries, from the old rich of the West to the new rich of Asia, relied heavily on trade protectionism and state intervention as they themselves developed, and that they continue to do so even now (Agosin and Tussie 1993: 25; Rodrik 2001: 11; Chang 2002; Stiglitz 2002). They claim that free trade theory is irrelevant because it is based on premises that do not hold even in the rich countries, let alone the poor ones. They argue that in the poor countries, trade liberalization has actually led to slower growth, greater inequality, a rise in global poverty, and recurrent financial and economic crises. And they fault the WTO, IMF, and World Bank for their

cruel and inept actions in the face of such miseries (McCartney 2004; Friedman 2002: 3–4; Stiglitz 2002: 1; Weller and Hersh 2002; Weisbrot 2002).

2 Structure of this book

This book examines the preceding themes in greater detail. In addition to this introductory chapter, it is organized in four parts, each dedicated to one of the four major issues that cleave the debate.

- Part I: Globalization and free trade
- Part II: Globalization and economic development
- Part III: Globalization, gender, and inequality
- Part IV: Globalization, capital mobility and competition

2.1 Part I: Globalization and free trade

The first part of the book analyzes the theory and practice of free trade. *Ha-Joon Chang* (*Chapter 2*) examines the notion that the rich countries of the world climbed to the top of the economic ladder through neoliberal policies. This "official history of capitalism" maintains that it was eighteenth century Britain's adherence to free trade and market policies that enabled it to beat interventionist France, its main competitor. A new liberal world order followed, ushering in a period of unprecedented prosperity in the Western countries that lasted until the 1930s, when the Great Depression sparked a round of trade-destroying tariffs. From this point of view, the reign of free trade was not restored until the 1980s, when neoliberalism took the stage.

Chang shows that the real history is very different. He traces in some detail how Britain, the US, Germany, France, Sweden, the Netherlands, Switzerland, Japan, South Korea, and the most recent Asian Tigers used interventionist trade and industrial policies to promote and protect their own industries. He also shows how these very same countries took up the cudgel of free trade only after they were internationally competitive. For instance, Britain had high tariffs even two generations after the industrial revolution, and its repeal of the Corn Laws in 1846 came at a time when its manufacturers became confident that they would dominate world trade. The US, whom Bairoch has called "the mother country and bastion of modern protectionism" (Chang, Chapter 2 of this book, p. 23), openly rejected Britain's ideology of free trade as a threat to its own infant industries, and relied instead on high tariffs and extensive state intervention during its own process of industrialization. As in the case of Britain, the US substantially liberalized its international trade only after it had achieved industrial supremacy. Japan's entry onto the world stage follows a similar pattern of extensive state intervention, beginning with the Meiji Restoration of 1868. Its tariffs were low because punitive treaties prevented it from raising them. State-supported industrialization was therefore its main channel to success until these treaties ended in

1911, after which tariffs and quotas also became a part of its industrialization policy. This long period of steady development set the stage for its explosive growth after the Second World War. South Korea and the other successful East Asian countries (except for Hong Kong) followed this same path, relying heavily on interventionist trade and industrial policies.

For Chang, real history teaches us that successful development requires today's developing countries to fashion similar policies, possibly with even higher tariff barriers given that the playing field is vastly more unequal than it was in the past. The rules of the WTO should be rewritten to facilitate this, and international financial assistance should be redirected away from neoliberal policies toward real social and industrial development.

Some defenders of neoliberalism concede that the rich countries relied heavily on trade intervention and state supported industrialization. Nonetheless, they argue that economic *theory* proves that competitive international markets provide the best option for today's developing countries. They conclude that it is therefore essential to eliminate restrictions on markets, particularly in the developing world, so as to spread competition throughout the globe and allow free trade to work as promised (Bhagwati 2002: 9–12). But if the theory is itself wrong, such a prescription could be disastrous. So it becomes crucial to examine the theory of free trade itself. This is the task taken up by Shaikh and Nayyar in this book.

Anwar Shaikh (*Chapter 3*) focuses on the logic of free trade theory. He maintains that the basic theory is wrong even on its own grounds. It is not the *absence* of competition that produces underdevelopment alongside development but rather its *existence*. He argues that "real competition" between nations operates in much the same manner as competition within a nation: it favors the (competitively) strong over the weak. Thus, the collateral damage arising from globalization is exactly what one would expect to find. From this point of view, the rich countries were correct to recognize, when they were themselves on the way up, that unrestricted international competition was a threat to their own plans for development.

Shaikh argues that the fundamental error in the standard theory of free trade lies in its treatment of international competition. When economists discuss competition *within a nation*, they recognize that firms and regions with lower costs will tend to beat out those with higher costs. Thus, a region with low cost producers will be able to sell many of its products in the high cost region, without buying much from it. It will therefore enjoy a regional trade surplus, whereas the high cost region will suffer a regional trade deficit. Even when it comes to competition *between nations*, economists agree that when international trade is opened up a similar outcome obtains *at first*: The country with the initially lower costs of production will tend to enjoy a national trade surplus, and the other a trade deficit.

It is after this point that a critical divergence arises between standard trade theory and the theory of real competition. Standard trade theory says that in the country with an initial trade deficit, the terms of trade (the relative price of its exports to imports) will automatically fall. This would make its imports more expensive to

domestic purchasers and its exports less expensive to foreign producers, so that if conditions (i.e. elasticities) are right, trade will automatically move toward balance. In this way, trade imbalances will be eliminated through automatic movements of a country's terms of trade. This is the essence of the *theory of comparative costs,* which is the foundation of standard trade theory. It is important to note, as David Ricardo did long ago, that such a movement implies a fundamental change in the determination of relative prices. Within a country, and even when trade first opens up between countries, relative prices are regulated by relative costs. But according to the theory of comparative costs, once trade has been established these same relative prices have to move away from their initial cost-determined values to new levels determined by the requirements of trade balance.

Shaikh argues that the theory of real competition comes to the very opposite conclusion. Competition forces prices, and hence terms of trade, to be regulated by relative real costs at all times. In a country that enjoys an initial trade surplus, the resulting inflow of funds would enhance the availability of credit, which would lower interest rates. Conversely, in the country with the initial trade deficit, the fund outflow would tighten the credit market, and raise interest rates. With interest rates lower in the surplus country and higher in the deficit country, profit-seeking capital would flow from the former to the latter. Thus the surplus country would become a net lender on the world market, and the deficit country a net borrower. Instead of eliminating the trade imbalances, free trade would cover them with capital flows. Trade imbalances would be *persistent*, and deficit countries in particular would be forced to run down their reserves and to depend on foreign borrowing (foreign capital inflows) to cover such deficits. In free trade, it is the profit-motive that regulates trade, and the (competitive) advantage goes to the *firms* with the real lowest costs. Nothing in this process ensures that the resulting outcomes will necessarily serve the needs of the developing world, however much it might serve those of the advanced firms of the rich countries.

Deepak Nayyar (*Chapter 4*) focuses on the history of the doctrine of free trade, with a particular focus on the interplay between economic theory and politics. He argues that Smith and Ricardo's emphasis on free trade was motivated by the desire to challenge mercantilist ideas. Mercantilism emphasized that trade should be managed to enhance national economic power. The classical economists countered with the claim that free trade would provide gains for all parties involved, and would enhance growth, employment, and incomes. This allowed them to associate free trade with a moral stance in favor of the general good and to cast the mercantilist doctrine as an outmoded fixation on domestic national power. The association between free trade and the general good has been a fixture orthodox theory of free trade ever since. As neoclassical economics emerged, it placed particular emphasis on the universal gains that free trade was said to provide. Inserted into the model of perfect competition, free trade also became optimal. And with the advent of the Heckscher–Ohlin model (which assumes away any technological differences among nations), it also led to the claim that wage rates and profit rates (factor prices) would be equalized across nations without any

need for international movements of labor and capital. Hence the holy trinity of modern free trade theory: universal good through universal gains, efficiency through optimality, and equity through international factor price equalization.

Of course, the development of the doctrine of free trade was not without challenge. In the early nineteenth century, late industrializers such as the United States and Germany saw free trade theory as a thinly veiled expression of the self-interest of leading industrial producers such as England (see Chapter 2 of this book). Their opposition was manifested in a critique of the theory itself, with particular emphasis on the failure of market prices to incorporate all relevant social costs, and on the absence of perfect competition in the real world. Both market failure and imperfect competition have been standard elements of the critique of free trade theory ever since.

Nayyar points further that while economic theorizing abstracts from political power, the latter plays a decisive role in the real world. From this point of view, the flexible history of free trade policy signals that this doctrine is as much about the pursuit of political power as was the mercantilism it replaced. The classic case is Britain's varying stance on its textile trade: Britain protected its textile industry when it was inferior to the Indian one, then forcibly imposed "free" trade on India when British textiles became competitive. As Britain rose to industrial dominance, it sought to impose free trade on the rest of the world but the US was strong enough to resist. In the Great Depression all sides shelved free trade in the sake of national interest. And then in the postwar period, when the US was economically hegemonic, it revived the doctrine. Given this history, it is utterly predictable that the developed world and its international institutions would try to force free trade and its associated theoretical claims on the rest of the world. Nayyar argues that in this latest phase, globalization has disproportionately benefited advanced economies, large international firms, and individual asset-owners, profit-earners, rentiers, managers, and professionals. Yet even here, when globalization poses a hazard, these groups typically use their power to try to contain it. For instance, when industries in the rich countries face strong competition from abroad, the focus switches from "free trade" to "fair trade." This same struggle is played out in the "rules of the game" constructed by the WTO, which put almost complete freedom for capital mobility [side by side with] … draconian restrictions on labor mobility" (Nayyar, Chapter 4 of this book, p. 81). For real development to take place, such double standards and rigged rules must be set aside in favor of an ongoing process whose goal is not to level the playing field but rather the contest itself.

2.2 Part II: Globalization and economic development

Lance Taylor (*Chapter 5*) analyzes the experiences of 14 countries that have undertaken external (trade and capital flow) liberalization policies in the last quarter century. He classifies the countries into five groups:

- Steady growth countries: China, India, Singapore, and Vietnam
- Asian crisis countries: Indonesia, Korea, Malaysia, and Thailand

- Countries that experienced cyclical stagnation: Philippines, and Turkey
- Countries in which inflation stabilization was paramount: Brazil, and Russia
- Post-socialist transition countries: Hungary, and Poland

These countries have been implementing external liberalization policies since at least 1980, and even earlier in some cases. Taylor traces the economic effects of these policies, with a particular focus on productivity growth, effective demand, and employment. The first two have opposite effects on employment, because increased productivity growth by itself implies slower job growth whereas increased effective demand growth implies faster job growth.[2]

Trade liberalization typically removes any import quota and export subsidies, and replaces them with fairly low tariffs. Demand tends to shift toward imports because they are now cheaper, and because capital liberalization (see subsequent paragraph) has made credit more available. Fiscal policy becomes more restrictive, as required by the rules. Domestic firms in the traded goods sector tend to suffer declines in their profit margins, leading the survivors to raise productivity growth through workplace reorganization, downsizing, and foreign outsourcing. This tends to raise productivity growth in the traded goods sector but does not generally raise the rate of growth of this sector's effective demand. Thus, after trade liberalization employment growth in the traded goods sector is typically low or even negative. On the other hand, in the nontraded goods sector, productivity growth tends to be low or even negative, whereas employment growth depends on growth in the sector's effective demand. Unskilled workers tend to suffer relatively greater job displacement than do skilled workers, so inequality tends to rise.

Capital liberalization generally produces a surge of foreign capital inflows, with a corresponding rise in a country's foreign debt. Within a country, these capital flows add to the assets of a country's financial institutions, so that unless they are sterilized by the central bank, they tend to set off a domestic credit boom, including booms in housing and asset market. In some cases, this sets off a classic "mania-panic-crash," as in Latin America in the 1980s. Real exchange rates (nominal exchange rates relative to inflation) tend to rise. More than half the economies being considered suffered external crises. The typical (albeit not universal) scenario begins with high interest rates designed to attract foreign capital, followed by a surge in inflows, which causes the exchange rate to appreciate and domestic credit to boom. As the central banks attempt to offset the capital inflows by reducing the domestic money supply, interest rates rise even further. At some point the bubble bursts, short-term capital flees the country, and the real economy undergoes a severe contraction. By contrast, it is particularly interesting that three out of the four "steady growth" countries (China, India, and Vietnam) were relatively *dirigiste* in their policy stances: They retained strong control on capital movements, interventionist policies involving both industrial and export promotion, maintained consistent productivity growth in both traded and nontraded sectors, and managed to avoid the real exchange appreciation experienced by the others.

John Weeks (*Chapter 6*) examines the relation between external liberalization and economic growth in Latin America. It has become "an article of faith" that

reorienting a country toward the world market will increase its growth rate. Because developing countries did indeed experience enhanced export growth and increased capital inflows in neoliberal era which began in the 1980s, the analytical question becomes: how do these enhanced external flows affect overall economic growth? More precisely, does export growth enhance or retard growth in other sectors, and does foreign investment enhance or retard domestic investment? In the latter regard, he reminds us that statistics on foreign direct investment (FDI) must be interpreted with care. Before the liberalization of capital markets in the 1980s, FDI was largely synonymous with fixed capital formation but after that a significant portion of FDI consists of portfolio investment. For instance, among the larger countries from 1985 to 1989, debt-equity swaps alone account for 46 percent of total FDI (Weeks, Chapter 6 of this book, Table 6.1).

Weeks develops an analytical framework to address these questions. He decomposes the overall growth rate of GDP into its export and nonexport components. He assumes that the growth rate of nonexports depends on the growth rate of domestic demand and, through a linkage parameter λ_1 ("the coefficient of export dynamism"), on export growth. As Weeks points out, the standard argument that export growth enhances overall economic growth requires a positive empirical value for λ_1. A similar argument is used to construct a test for the effect of FDI growth on overall economic growth, which results in a parameter ρ_1. The standard argument concerning a positive linkage between foreign investment and domestic investment then requires a positive empirical value for ρ_1.

Seventeen Latin American countries were studied over three intervals: the import-substitution era from 1960 to 1981, the debt-crisis era from 1981 to 1989, and the recovery era from 1990 to 1997. Weeks finds that the positive export linkages assumed by standard theory are not universal. Whereas nine countries generally exhibit positive linkages, another six do not. Of these six, three move from positive export linkages in the first period to lower positive ones in the second, and to negative or nonsignificant linkages in the third; and the other three exhibit neutral or negative linkages in both the second and third periods (Weeks, Chapter 6 of this book, Table 6.1).[3] In the case of foreign capital inflows, 52 countries are studied, beginning from 1970 for reasons of data availability. Thirty-four of these yield nonsignificant estimates of the FDI linkage parameter, ten yield negative parameter estimates (indicating that FDI crowds out domestic investment), and eight yield positive estimates (indicating that FDI stimulates domestic investment). Only the last set conforms to the standard assumption, which is once again shown to be a special case. In the end, the evidence is quite mixed. Neoliberal policies do lead to enhanced export growth and increased capital inflows but can also retard overall growth and displace domestic investment.

Massoud Karshenas (*Chapter 7*) examines the relationship between export performance and the flexibility of real exchange rates and real wages in developing countries. Standard trade theory claims that flexible real exchange rates and flexible real wages would jointly bring about full employment and balanced international trade. From this point of view, the persistence of unemployment and trade

imbalances in developing countries must be due to "rigidities" in real exchange rates and wages (see Chapter 3).

Karshenas shows that this presumption is false. He studies 26 less developed economies in Asia, Latin America, Africa, and the Middle East during the 1970s and the 1980s. Over this interval, the Asian countries of Korea, Malaysia, Singapore, Hong Kong, and Thailand were the most successful, having achieved high growth rates and rising standards of living. Although wage shares were generally stable in these countries (Chapter 7, Figure 7.5), real wages were able to rise because productivity was growing (Chapter 7, Figure 7.6). But he finds that the success of these particular Asian economies cannot be attributed to greater flexibility in real exchange rates and real wages. On the contrary, he finds that both variables fluctuate substantially in most countries in the sample. Real exchange rate variations are not noticeably different between the successful countries and the others (Karshenas, Chapter 7 of this book, p. 146), although wage share fluctuations (often declines) are even greater in the other countries (Karshenas, Chapter 7 of this book, p. 164).

What *does* distinguish the successful economies from the others is their ability to achieve rapid export growth in manufactured goods (Karshenas, Chapter 7 of this book, p. 139). This leads Karshenas to examine the precise linkages between his two key variables and export growth. He begins by considering two different international relative prices; (1) the price of domestic manufactures relative to the price of international manufactures (RER), both expressed in U.S. dollars; and (2) the price of existing domestic exports relative to the price of the exports of competing countries (UVX), both in U.S. dollars. Because each domestic price can be expressed as the sum of its unit labor and material costs and its unit profit, the domestic unit labor cost (i.e. the wage rate over labor productivity) plays an important role in the determination of each price ratio (Karshenas, Chapter 7 of this book, pp. 140–142). Moreover, because all prices are expressed in U.S. dollars, the nominal exchange rate enters into each measure. Indeed, both indexes are types of real exchange rates, although Karshenas reserves the term for the former (RER).

A central finding is that real exchange rates (RER) exhibit strong comovement with corresponding real unit labor costs (Karshenas, Chapter 7 of this book, p. 146, and Figure 7.1). On the other hand, relative export prices are not responsive to variations in RER, except when the latter is associated with short or medium run changes in real wages (Karshenas, Chapter 7 of this book, pp. 156–157). There is an interesting connection between these findings and the argument advanced by Shaikh (Chapter 3 of this book). Shaikh argues that the theory of comparative costs, upon which the whole corpus of standard trade theory rests, is wrong because relative international prices *cannot* simply move around to bring about balanced trade. On the contrary, relative international prices are competitively determined in the same way as relative domestic prices: by relative real unit costs, of which real unit labor costs are a major component (Shaikh, Chapter 3 of this book, pp. 57–58). It follows Karshenas' RER, which are manufacturing relative prices expressed in a common currency, will exhibit strong comovements with

manufacturing real unit labor costs. It also follows that devaluations will not permanently alter the terms of trade (relative export prices) except when they affect relative costs, particularly relative wage costs. This is what Karshenas finds, and it is directly contrary to the expectations of standard trade theory.

A second finding is that export growth is highly sensitive to changes in relative export prices (RERX). This holds across countries, and across time (Karshenas, Chapter 7 of this book, p. 156). On the other hand, export growth is not sensitive to changes in the RER, precisely because the latter does not significantly affect relative export prices except when it affects real wages. In other words, devaluations in the real exchange rate (declines in RER) "seem to be only effective in promoting exports to the extent that they lead to a [medium run] decline in the share of wages in output during the process of adjustment" (Karshenas, Chapter 7 of this book, p. 159). However, over the longer run there does not seem to be any statistically significant association between changes in wage shares and export performance. If we recall that the successful Asian countries had rapid export growth but stable wage shares, this latter result is not surprising. Finally, export growth also responds strongly to the growth of investment. Karshenas interprets this latter variable as an index of technological dynamism and production flexibility. But we could also read this in a more traditional manner, in which investment is viewed as a proxy for aggregate demand.

2.3 Part III: Globalization, gender and inequality

Stephanie Seguino (*Chapter 8*) analyzes the effects of 30 years of globalization on gender inequality in Latin America and the Caribbean. Supporters of globalization tend to believe that it will facilitate economic growth and spur employment. Because women get paid relatively lower wages, it is argued that they will benefit relatively more from a surge in employment in a competitive environment. Thus, globalization should reduce gender inequality. Women in the Latin American and Caribbean (LAC) region would be particularly advantaged, because they rank higher in health and education than women in most other regions of the developing world. Critics of globalization have different expectations. They argue that liberalized trade, investment, and financial flows can put women at a disadvantage. This is because unemployment often increases under such circumstances, and women are generally the first to suffer. Similarly, the social expenditures that can help offset negative effects such as these, as well as preexisting disadvantages, are often reduced under such policy regimes. Finally, job growth need not automatically favor industries with higher female employment. The LAC region provides a good ground for the testing of these competing hypotheses, because it has undergone economic liberalization for quite some time. The consequent shift in economic structure has tended to favor manufacturing industries and which tend to be female-intensive.

Seguino first develops a set of indicators that track the trends in relative female well-being in the LAC from 1970 to 2000. These are grouped along three

dimensions: *capabilities* measured through education, health, and nutrition; *resource access,* measured through income and employment; and *empowerment*, measured through the degree of women's share of parliamentary seats and of professional, technical, and managerial employment. As she notes, there is likely to be feedback among these categories, with improvement in any one spilling over to the others. Most of the changes in these individual measures point to an improvement in women's well-being. Notable among these are a decline in the number of children borne (fertility), and increases in female–male school enrollment rates and female shares of labor force and total employment. On the other hand, women's access to work worsened, as reflected in a rise in their relative unemployment rates.

The next step is to develop an aggregate measure for each of the 21 countries in the sample. This is accomplished by assigning each country points for each indicator according to the country's ranking in that indicator (21 points for the highest rank and 1 point for the lowest), and then summing the points to obtain an aggregate country score (Borda Rule scoring). El Salvador then ranks the highest in terms of improvements in women's relative well-being, and Colombia the second. This is quite striking, because both countries have undergone long period of conflict. On the other hand, the countries with the highest per capita growth in the sample, Chile and the Dominican Republic, ranked among the lowest.

To assess the overall impact of growth on women's well-being, Seguino first regresses each country's aggregate index on growth in per capita income, to control the level of its initial per capita income. By contrast, the World Bank uses single indicators of well-being (e.g. educational gaps), and does not control for initial income. Seguino is thus able to distinguish between income level and growth effects on distribution, and finds that while the former had a positive impact on gains in women's well-being, the latter had a *negative* impact. She concludes that where there were aggregate gains in women's well-being, these were due to factors other than growth. To get a better sense of the factors involved, she proceeds to regress the individual well-being indicators against four main explanatory variables: economic growth, production structure (manufacturing value-added as a share of GDP), the growth rate of government spending, and women's share of the labor force. Of these, the latter three have generally positive effects on gender well-being measures. But economic growth, the primary variable in the proglobalization argument, has mixed results: it has no effect on gender gaps in education; it has a negative effect on female–male population ratios, a stock variable taken as an indicator of female health; but it has a positive effect on relative female–male mortality, which is a flow variable also indicative of relative female health. Once again, the standard neoliberal claims do not stand up to detailed scrutiny.

Massoud Karshenas (*Chapter 9*) returns with a *tour-de-force* on the measurement of poverty in the least developing countries. The depth of world poverty is appalling, and virtually every modern social agenda has made poverty reduction a central theme. Indeed, even neoliberalism proclaims that its very purpose is to

reduce global poverty. Yet it has become increasing evident that official poverty measures, such as those from the World Bank, are unreliable and may even be seriously flawed (Reddy and Pogge 2005). Karshenas tackles the problem head-on, by constructing a new set of poverty estimates that are consistent with country national income accounts. He begins with the survey data from which the World Bank draws its own $1-a-day and $2-a-day estimates of poverty, and adjusts it to make it consistent with data from corresponding national income accounts. He shows that the resulting estimates exhibit powerful structural patterns, and this allows him to extend his estimates to low-income countries excluded from his initial sample. Thus *even* using the World Bank's own data set, and accepting its own (strongly criticized) poverty thresholds of $1-a-day and $2-a-day, he finds that the World Bank measures "systematically underestimate poverty in poorer countries and overestimate it for the richer ones" (Karshenas Chapter 9 of this book, p. 225).

Karshenas starts by noting that the kinds of survey-based measures of income and expenditure used by the World Bank are often highly inconsistent with national income account data for the same country. For instance, in Tanzania, Ethiopia, and Mali, survey-based measures of per capita consumption are two to three times *higher* than those derived from national income accounts. On the other hand, in countries such as Bangladesh, India, Indonesia, Pakistan, and Thailand, they are two to three times *lower*. Similar glaring inconsistencies appear in comparisons of trends. Karshenas argues that while survey measures reflect methodologies and sample designs that vary across time and space, national accounts are built around a given set of methods and concepts. Thus for comparisons across countries and across time, the latter are more reliable. Of course, survey methods also produce information on the *distribution* of income and expenditures, which national accounts do not. Accordingly, he uses the latter to calibrate the scale of the former, by adjusting the average per capita income of survey-based measures of expenditures to match those of national accounts. Thus his country expenditure measures exhibit the same distributions as those of the World Bank, but their levels are consistent with country national accounts. With this, he is able to provide new measures of "headcount poverty," that is, of the numbers of people living below the $1-a-day and $2-a-day poverty thresholds. These new poverty estimates indicate that the World Bank estimates underestimate poverty in the poorer developing countries and overestimate it in the relatively richer ones.

A striking feature of Karshenas' new measures is that his measures of headcount poverty exhibit a strongly nonlinear (logistic) pattern in relation to per capita income. These patterns vary by region but appear stable across time. He performs a number of validation tests on the robustness of these patterns. For instance, he drops individual observations from the sample, fits the curve for the reduced sample, and compares the estimated poverty headcount with the actual one, and finds that the two are quite close. He also finds that his measures are highly correlated with measures of the undernourished population produced by the Food and Agriculture Organization of the United Nations (FAO), and with the Human Development Index provided by the United Nations Development Program

(UNDP). The World Bank poverty measures, on the other hand, are not. The robustness of his fitted curves then allows him to estimate headcount poverty in those developing countries that lack distribution data, by using national income account data on their per capita incomes in conjunction with appropriate regional curves.

In his concluding section, Karshenas considers the implications of his findings for the ongoing debate about the relation between economic growth and poverty reduction. A common perspective, issued from the World Bank, is that there is a stable relation between growth in per capita incomes and poverty reduction, the "growth elasticity of poverty reduction." He notes that most of these estimates are based on regressions of changes in poverty measures on changes in per capita consumption or GDP. The estimated elasticities vary greatly, but Karshenas is more concerned here with their meaning. He argues that in a rich country, economic growth is neither necessary nor sufficient for poverty reduction. It is not necessary because rich countries can afford to directly fund poverty alleviation programs. And it is not sufficient because without such programs, growth by itself will leave those it does not pick up in poverty, and usher some newly displaced into it. Rich countries therefore need the kinds of social programs characteristic of postwar European Welfare States. In poor countries the situation is different, because the resources for redistribution are more limited. This does not preclude redistribution (e.g. land reform) in poor countries. It only implies that growth must play a relatively greater role than in rich countries. But then, can we presume that there exist stable links between growth and poverty reduction? Karshenas shows that there is indeed a stable relation, for both the $1-a-day and $2-a-day poverty measures. But as shown earlier, because the relationship between per capita income and headcount poverty is highly nonlinear, the relationship between their respective growth rates is equally nonlinear: *the "elasticities" are not constant*. Moreover, they are critically dependent on the exact poverty threshold chosen. The fatal difficulty with the World Bank's "growth elasticity" approach is that it confuses the stability of the underlying relation with the constancy of the resulting elasticities.

2.4 Part IV: Globalization, capital mobility, and competition

Ajit Singh (*Chapter 10*) provides a detailed and searching analysis of the debate about capital account liberalization (free flows of portfolio and direct investment). His primary objective is to review the theoretical, historical, and empirical arguments on this issue. While these arguments are of interest as part of the greater debate on the neoliberal agenda, they also have important implications for current discussions on the creation of a New International Financial Architecture (NIFA), and on the post-Doha agenda in the WTO in relation to FDI flows. Singh is concerned with fostering economic development within the context of current and future global rules of the game. In particular, he seeks to identify the kinds of rules about capital flows that would best serve the interests of developing countries.

Singh examines two main topics: (1) capital liberalization in general and (2) the particular impact of FDI. In each case, he begins with the traditional theoretical

arguments, proceeds to the counter-arguments, and then examines the empirical literature on the issue. His overall conclusion is that neither history nor econometric investigation supports the neoliberal claim that free trade and capital flows will automatically lead to economic development. The main message of this chapter is that one needs to fashion particular developmental paths that account for a country's history, resource endowments, and public and private capabilities. One-size-fits-all rules will not work.

The traditional case for capital account liberalization rests directly on the case for free trade. And this in turn derives from the claim that a perfectly competitive equilibrium is optimal. Free trade is then presented as the logical extension of this same argument to the sphere of international competition. Of course, many neoclassical economists recognize that this story is based on highly unrealistic assumptions. They concede that real markets are neither perfect nor efficient. Nonetheless, they generally maintain that free trade is still the best practical policy, on the "sadder but wiser" grounds that free trade is the best "rule of thumb in a world whose politics are as imperfect as its markets" (Krugman 1987 cited in Singh in Chapter 10 of this book, p. 262). Singh points out that this so-called practical approach cannot be grounded in the theory itself, because once the assumptions are contravened, there is no longer any universal rule of thumb. Instead the gains and losses from various market "imperfections" and "externalities" would have to be balanced against the gains and losses of government intervention, on a case-by-case basis (Singh in Chapter 10 of this book, p. 262). Moreover, the putative trade benefits identified by the standard model require that there be full employment in each trading country (see Shaikh, Chapter 3 of this book). In the real world, particularly in the developing world, even this condition would require state intervention. Thus, the central lesson is that trade openness is most beneficial when there is an appropriate set of policies to manage domestic production, foreign trade, and international access to knowledge and technology. He cites Japan and Korea as the modern instances of this path to economic development, although one could also cite every other developed country. In all such cases, exports were promoted and imports were generally controlled, all in the context of comprehensive policies designed to foster rapid technological and industrial development (see Chang, Chapter 2).

The standard case for free trade also leads directly to an argument in favor of free capital flows. Just as the former is said to optimally allocate commodities across nations, the latter is said to optimally allocate capital. Thus at a theoretical level, capital account liberalization should allocate world savings to those who could use them most productively, thereby enhancing global economic efficiency and social welfare. As in the case for free trade, the free capital argument requires many theoretical assumptions that differ markedly from real world conditions. Many neoclassical economists concede this. They even admit that capital liberalization contains special risks, such as the possibility of currency crises. Yet most orthodox economists continue to favor both free trade and free capital flows (Bhagwati being an important exception, because he does not favor the latter). As

Stanley Fischer, the former Deputy Managing Director of the IMF, puts it, "capital movements are mostly appropriate: currency crises do not blow up out of a clear blue sky, but rather start as rational reactions to policy mistakes or external shocks. The problem is that once started, they may sometimes go too far." (Fischer 1997: 4–5, cited by Singh in Chapter 10 of this book, p. 264). For Fischer, the solution lies in establishing economic policies and institutions, particularly financial institutions, which are well adapted to function in a world of free capital flows.

Many counter-arguments exist. The first two are already familiar from the discussion of free trade theory. Even within neoclassical theory, the consideration of real world characteristics, which appear to the theoreticians as "imperfections" and "externalities," tend to vitiate the case for unrestricted international capital flows. Moreover, full employment is a necessary condition for the standard argument on the benefits of free capital flows but is hard to find in the developing world. Third, even within the neoclassical tradition itself, economists such as Stiglitz (2000) argue that free capital flows are fundamentally different from free commodities, because capital flows are intrinsically characterized by asymmetric information, agency problems, adverse selection, and moral hazard. Various heterodox economists (e.g. Davidson 2001) advance even stronger criticism, arguing that financial speculation is inherently unstable because the future is fundamentally unknown. The standard emphasis on greater transparency and better information would not resolve this (Singh in Chapter 10 of this book, pp. 265–266).

In addition to these problems with the standard argument, there is the previously mentioned association between the liberalization of short-term (portfolio) capital flows and deep economic and financial crises in Asia, Latin America, and Russia in the 1990s (Singh in Chapter 10 of this book, pp. 259–260). Such crises have arisen even in the developed world, including the US, the UK, and various Scandinavian countries, but they have invariably been deeper and more destructive in the developing world. Many economists (e.g. Stiglitz 2000 cited by Singh in Chapter 10 of this book, p. 265) recognize that this record provides a serious reason for avoiding precipitous liberalization of short-capital flows, although the official position continues to portray these problems as being induced by "policy mistakes or external shocks" (see the previous quote by Fischer). At an econometric level, the results of studies of costs and benefits are decidedly mixed: some indicate that financial liberalization has a positive impact on domestic investment; others point to a close causal connection between financial liberalization and banking and currency crises in the developing world. Similarly, the econometric link between financial liberalization and growth is quite tenuous (Singh in Chapter 10 of this book, p. 000). On the other hand, studies indicate that the real economic costs of financial crises are substantial, ranging from an estimated 3.2 percent of GDP in the U.S. savings and loans crisis of 1984–91 to 55.3 percent of GDP in the banking crisis in Argentina from 1980 to 82 (Table 10.1). And of course the Asian economic crisis of the late 1990s had devastating effects on employment, poverty, and inequality. Singh attributes these crises to the characteristic instability of financial markets, not to some "inflexibility" of labor markets

because real wages were typically quite flexible (see also Karshenas, Chapter 7, on this issue).

In the final section of this chapter, Singh analyzes the particular impact of FDI. He notes that FDI is generally viewed much more favorably than short-term capital flows, because it is supposedly less volatile and because it supposedly creates access to resources, technology, markets, and knowledge (Stiglitz 2000). It should be noted that *measured* FDI includes retained profits and financial flows associated with derivatives and hedge funds, and these elements can be quite volatile. Even leaving these aside, it is important to recognize that the positive net demand for domestic currency induced by current FDI has to balance against a negative net demand arising from associated future dividend and repatriated profit outflows, which could trigger a liquidity crisis in the future. Finally, the empirical evidence on the technology transfer and spill-over effects (on national productivity and investment) of FDI is quite mixed. The general finding is that technology transfer and productivity are best captured when FDI is integrated into a national plan for industrial development. As for the effect of FDI on domestic investment, it appears to have been strongly positive in Asia, negative in Latin America, and essentially neutral in Africa. This is contrary to standard expectations, because the positive effect appears in the *less* liberalized region (Asia), whereas the negative effect appears in the *more* liberalized one (Agosin and Mayer 2000: 27–8). Lastly, there appears to be no consistent empirical link between FDI and enhanced economic growth (Singh in Chapter 10 of this book, p. 275). Singh's overall conclusion is that, like short-term capital flows, FDI too should be regulated with an eye toward extracting maximum benefits for the country's development.

Andrew Glyn (*Chapter 11*) turns the discussion to the impact of globalization on the advanced world itself: on its internal profitability and on its internal politics. His focus is mainly on four advanced countries (USA, Japan, Germany, and the UK), with an excursion into the profitability patterns of selected developing countries. Glyn considers two main questions. First, has globalization led to a convergence in profitability among the advanced countries? And second, did the increased exchange rate volatility that accompanied globalization also show up in profitability?

Profitability is defined in two ways: as profit shares and as profit rates. Profit shares are in turn measured in two ways, conditioned by the availability of data. At a national level, in the first section of the paper, they are constructed as pretax net profits relative to net national product; and at the level of manufacturing industries, in the second section, they represent the ratio of gross (of depreciation) pretax profits to gross value added. Profit rates, on the other hand, are measured as pretax profits relative to the total capital stock, the latter being the sum of the net fixed capital stock and inventories. Since inventories decline from a range of 18% to 40% of fixed capital in the 1970s, to 12%–15% in the 1990s, their presence in the total capital stock affects both the level and trend of the profit rate. It should be added that because Glyn's data is not adjusted for cyclical fluctuations, the well-known cyclical variations of inventory-sales ratios undoubtedly increases the volatility of his profit rate measures.

Glyn finds that profit rates not only generally decline over the postwar period but also tend to converge. Moreover, the declines themselves are heavily concentrated in manufacturing, and over time this relatively more rapid fall in manufacturing profit rates eliminates the differential between them and profit rates in non-manufacturing. He interprets this as an effect of increased international competition in manufacturing that has been unleashed by globalization. Because the profit rates of nonmanufacturing sectors also fall, albeit at a slower rate, he notes that there must be other causes at work. Indeed, by considering the profit rate as the ratio of the profit share and the capital-output ratio, he shows that both components contribute to the overall decline in profit rates.

In his analysis of the variability of profitability, Glyn analyzes the gross profit share (profit relative to value added, both being gross of depreciation) in manufacturing across 16 OECD countries. Looking profit shares *within* countries, decade by decade, he finds that their volatility increases sharply from the 1960s to the 1970s, declines a bit in the 1980s, and then increases back to the previous level in the 1990s. *Across* countries, manufacturing profit shares are somewhat less dispersed in the 1980s than they are in the 1970s or the 1990s. Glyn ties both of these patterns to globalization, through the volatility in exchange rates induced by sharply increased capital flows. He connects exchange rates to profitability by means of an index of relative unit labor costs in manufacturing, because unit labor costs are important to profits, and because this index is dominated by movements in the nominal exchange rate. His regressions indicate that changes in relative unit labor costs have a major effect on gross profit shares, although the magnitude of this effect varies across countries. In a brief concluding section, he examines the evolution of profit shares for a small selection of developing countries which exhibit some suggestive patterns.

On the whole, Glyn discerns two phases to postwar globalization in the advanced capitalist countries. The first lasts until the 1970s, exhibiting increasing competition, particularly in manufacturing. Because workers are strong enough to maintain and enhance their positions in this era, profits end up been squeezed by the increased competition. But starting in the 1980s, capital mobility becomes more prominent, unemployment increases, and workers increasingly come under political attack. This erodes worker bargaining positions to such an extent that wage shares fall, and hence profit shares generally rise, despite increased international competition. In addition, increased capital flows make exchange rates very volatile, and this volatility is transmitted to profitability.

Notes

1 These authors of a recent major survey called “Trade Liberalization and Poverty: The Evidence So Far” also note that “there is … a surprising number of gaps in our knowledge about trade liberalization and poverty” (Winters *et al*. 2004: 107).

2 Taylor uses the national income accounting identity $Y = C + I + G + \text{Exp} - \text{Imp} = C + S + T$, where the variables used represent GDP, investment, government spending, exports, imports, savings, and taxes, respectively. Following Godley (1999), he uses this to derive the aggregate sectoral balances identity $(I–S) + (G–T) + (\text{Exp}–\text{Imp}) = 0$, where

the terms in parentheses represent the private, government, and external balances, respectively.

3 Weeks (*op. cit.)* finds that Bolivia and Venezuela are anomalous. They both show negative linkages during the first period (1960–81), and either positive (Bolivia) or neutral (Venezuela) thereafter. But these are also the only two countries for which there is no consistent data for the 1960s.

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