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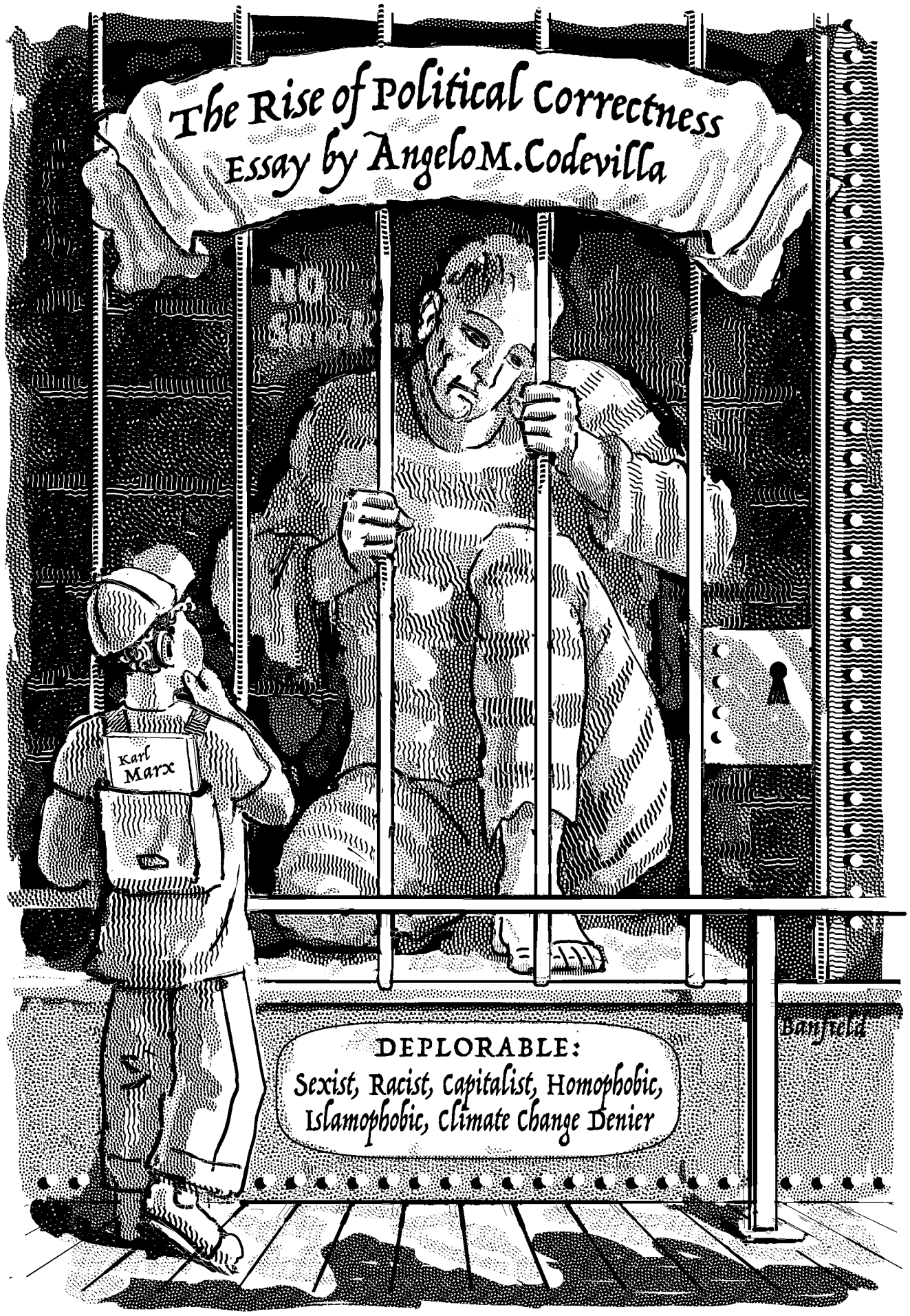

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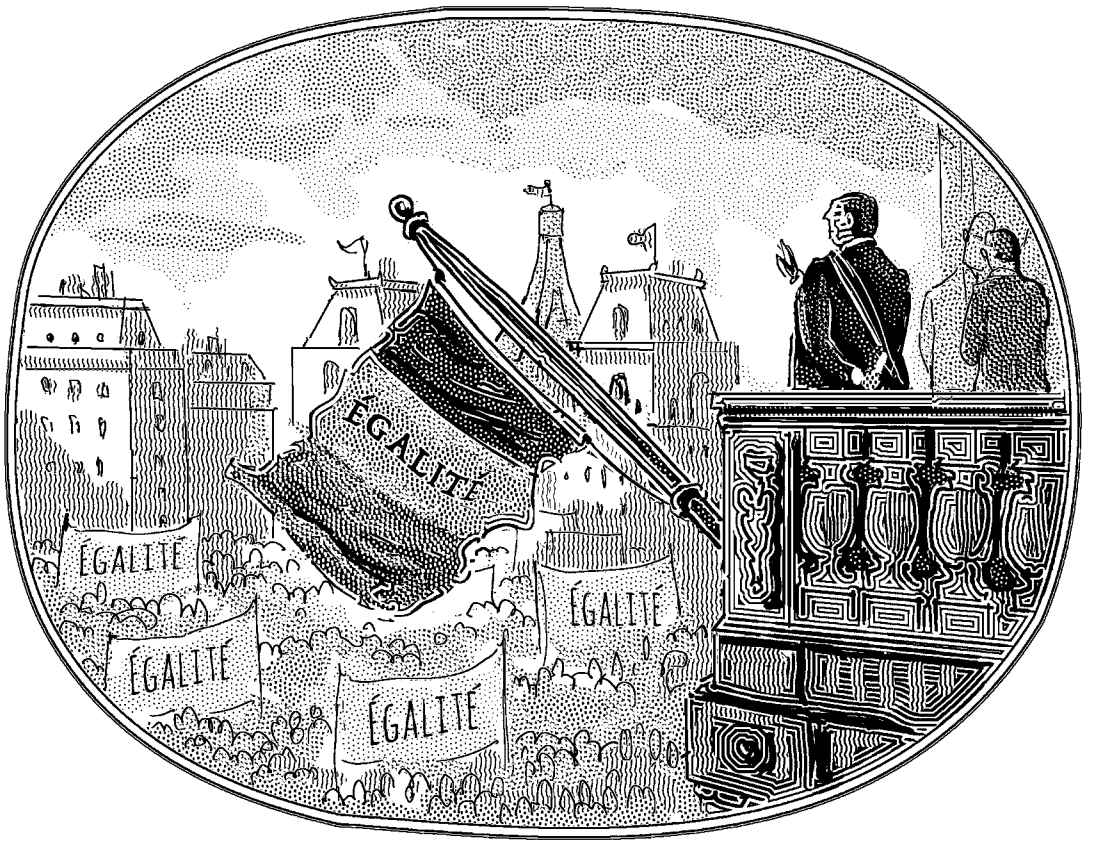
Book Review by Deepak Lal

Rising Tides and Mega-Yachts

The Globalization of Inequality, by Francois Bourguignon.
Princeton University Press, 210 pages, $27.95



This is a translation of a french book (published in 2012) by a former chief economist at the World Bank, and a Chevalier of the National Order of the Legion of Honor of France. His book is a curate's egg.

It begins with a workmanlike account of the various concepts of inequality within and between countries, and of poverty measured in terms of a $1.25 per capita line (in purchasing power parity dollars). He summarizes well-known trends in global inequality: measured by the Gini coefficient of the standards of living of individuals in the global population as a whole, after rising steadily from the beginning of the 19th century, global inequality started falling from 1990, and this reversal accelerated at the start of the new millennium.

A parallel reversal in absolute poverty occurred. Globalization induced "catch up" growth particularly in the Asian giants of China and India, so that the percentage of the global population in absolute poverty fell from more than 70% at the beginning of the 20th century to below 20% today. But, because of the growth of population in developing countries in the 20th century, the absolute numbers of those in extreme poverty kept going up till 1990. There were two billion living in extreme poverty in the early 1980s, Bourguignon notes.

> Since 1990, the number of people in poverty has dropped by around 500 million individuals. For the first time since the Industrial Revolution two centuries ago, economic progress is moving more quickly than population growth, in part because the latter has slowed down but overwhelmingly because of the accelerated growth in average income per capita in the developing world. This is a stunning turn of events.

So far, so good. but then why the title of the book? The answer is provided in the two chapters "Are Countries Becoming More Unequal?" and "Globalization and the Forces Behind the Rise in Inequality." These chapters are concerned with income inequality within countries. They chart the well-known trends in rising income inequality caused by wage stagnation in developed countries since 1980, as well as the lack of general trends in comparable indices for developing countries.

But as the author notes, these statistical trends are not mirrored in the perceptions of inequality in different countries. Thus he cites a 2010 survey of a dozen developed and emerging countries in which respondents were asked about the evolution of inequality in their own countries over the past ten years. Despite a large increase in statistical measures of income inequality in the U.S., less than 50% of Americans thought it had increased. By contrast, 80% of French and Dutch believed that inequality had increased in their countries, though statistically it had increased only slightly. Brazilians thought their country was becoming more unequal, though while the country's inequality index is historically very high, there had recently been a historic downward shift.

These perceptions mirrored the conceptions these countries had "about their own levels of social justice." A majority of Dutch and Americans saw their societies as "'just' or 'fair,'" even though income inequality is much higher in the U.S. than in the Netherlands. In France three quarters of respondents saw their country as "especially unjust" even though it had an inequality index similar to the Netherlands. Of those countries with high inequality

index, only in Brazil did respondents see their society as "especially unjust."

The reason for the popular occupy movements in developed countries after the 2008 financial crisis was not so much, as Bourguignon contends, concern about inequalities of income per se but the rage of ordinary people at the obscene personal gains the bankers and financiers—who were seen to have perpetrated the crisis—received from the official bailouts to stem the crisis. As the *Financial Times* noted, quoting Neel Kashkari, the head of the Minneapolis Fed who oversaw the bailouts, they "had 'violated a core American belief' that risk takers had to bear the consequences of things going wrong." It was the lack of retribution for the perpetrators of the financial crash—seen as the "underserving rich"—which fueled popular anger at the political "establishment."

Moreover, the reason for these financial excesses was not market failure, as Bourguignon seems to imply, but government failure. When Marriner Eccles created the Federal Deposit Insurance Corporation (FDIC) in Franklin Roosevelt's New Deal to stem ubiquitous bank runs, he also established the Glass-Steagall Act, which separated the (public utility) commercial banking system from the (gambling) investment banking part. With the abolition of Glass-Steagall during the Clinton Administration, and the creation of universal banks, the risk-taking investment bankers, who had in the past operated in unlimited liability partnerships with their own "skin in the game," were now free to form limited liability companies that were covered by deposit insurance. This meant that they could off-load part of the losses of any failed bets onto the general public. This—not the accompanying rise in an inequality index—was the source of public rage.

These public responses underline the reasons why Hla Myint and I, in our comparative study of 21 developing countries in the late 1980s for the World Bank, chose the title *The Political Economy of Poverty, Equity and Growth* (1996)—making a clear distinction between "equity" and "equality." For as we argued, to judge economic performance by the standard inequality measures is to accept egalitarianism as either a self-evident or universally accepted moral imperative. But it is neither: the world consists of diverse countries, few of which have embraced egalitarianism. What we found was that income equality as measured by statistical indices has not been a major concern of governments (or citizens) but rather notions of equity as between nationals and foreigners, and among the various ethnic, tribal, and regional groups within the domestic population, which cut across statistical indices of income inequality.

This brings us to the central flaw in Bourguignon's book. There are two rival ethical and political traditions: classical liberalism and distributive egalitarianism. For the classical liberal, it is a contingent fact that there is no universal consensus on what a "fair" or "just" income distribution is, despite the gallons of ink spilt by moral philosophers trying to justify their particular views. Egalitarianism ought therefore to be rejected as the norm for deriving principles of public policy. But from Adam Smith to Milton Freidman and Friedrich Hayek, classical liberals have also recognized that society or the state should seek to alleviate absolute poverty, with the disabled and indigent being helped through targeted benefits, and most importantly through an efficient growth process.

By contrast, the distributive egalitarianism that animates this book is based on the technocratic approach often called "public economics." This approach arbitrarily gives a normative weighting to the incomes of different persons or households, which leads to some form of redistribution from the rich who have too much to the poor who have too little. This smuggling in of an ethical norm that is by no means universally accepted, leads to a misleading and reductionist form of "mathematical politics."

In my *Reviving the Invisible Hand* (2006), I argued that over the last 200 years there have been three industrial revolutions. The first was the one that replaced circulating by fixed capital. This is best epitomized by the textile industry, where the "putting out" (circulating capital) system of handicraft production was replaced by the mechanized or factory system (fixed capital). The latter, as it used less capital and labor per unit of output, was more efficient than the handicraft system. Over time as production shifted to the less labor-intensive mills, the demand for labor did not rise as fast as its supply. There was a long debate about the resulting effects on the standard of living of workers. The most recent evidence by Nicholas Crafts shows that, over the long haul, this first industrial revolution in Britain, and the accompanying globalization, did raise workers' standard of living.

The second industrial revolution relied on long production lines to manufacture mass consumption goods. It is called Fordism, after Henry Ford. The third industrial revolution is based on the new I.T. revolution. Today much of the consumer goods industry is going bespoke. Variety rather than standardization is the name of the game, in which differentiated versions of the same good, more closely tailored to differing individual tastes, are produced at the cheapest location in the world, through "outsourcing" and "just in time production." The "design" and "sales" capacities are located in "rich" countries as they are human capital intensive. They then have "virtual factories" with their production bases spread across the world, which use modern telecommunications to convert these "designs" into the differentiated "bespoke" consumer goods demanded.

The resulting outsourcing reduces the demand for unskilled and semi-skilled labor within an industry in developed countries, just as skill-based technological change does. Both trade and technology thus put a premium on skills. The widening skill differentials and the stagnant unskilled wages in the U.S. are in effect signals to workers to enhance their set of skills. Over time the resulting accumulation of skills will lead to a rise in the levels of living of even those on the lowest rung of the current distribution of income. This will take time as in the first Industrial Revolution—but not as long. For the handicraft workers displaced by machines in the 19th century had to wait for the adjustments in the capital stock, which came slowly, to raise their wages. Today's unskilled workers need only go to school. So we would expect that there will eventually be a rise in real wages in developed countries, and a fall in those inequality indices that so bewitch Bourguignon.

Finally, what of the policies the author suggests for a fairer globalization? These are the same tired old technocratic recipes of public economics, like foreign aid for reducing between-country inequality, despite the growing evidence that this aid has done little to redress the problem. By contrast, private remittances from migrants in developed countries, which are greater than foreign aid flows, have greatly helped in reducing poverty.

For reducing within-country inequality, the author offers the usual remedies: income taxation and transfers, and taxation of wealth. The author himself notes many of these policies could damage the efficiency and thence growth of the economy. But, from a classical liberal viewpoint, there is a more basic reason why these redistributive policies are undesirable. They are ultimately based not on some accepted or reasoned morality about equality, but on envy. As Hayek noted in *The Constitution of Liberty* (1960), this human failing is not one a free society can eliminate, but "it is probably one of the essential conditions for the preservation of such a society that we do not countenance envy, not sanction its demands by camouflaging it as social justice, but treat it, in the words of John Stuart Mill, as 'the most anti-social and evil of all passions.'"

Deepak Lal is the James S. Coleman Professor Emeritus of International Development Studies at the University of California, Los Angeles.