Abstract

Major changes have characterized the international economy since the ’70s. Asian growth, in China in particular, is changing the economic relations and development cooperation, with many emerging countries now becoming ‘new donors’. International finance has boomed to a level almost 10 times larger than world GDP; however, financial crises are a recurrent phenomenon. Income distribution has been worsening in many countries: income and wealth are highly concentrated in the top 10% and top 1% of the population. Since the 2007 crisis, economic growth has slowed. Is this a secular stagnation? Large trade ‘imbalances’ and protectionist policies have emerged. Developing countries are experiencing huge migration outflows, and these economic forces can affect the long-run progress towards sustainable development. Putting development process into a historical perspective might help.

Chapter 3. The economy strikes back; convergence, divergence and imbalances

The debates of the last four decades have provided a very rich view of what development is and of how it should be achieved. Development is not just about economic growth but a multi-faceted phenomenon. International cooperation should foster a global partnership, with coherent policies among the various stakeholders, and lead to country and people ownership. The economic component of development has become less and less relevant.

However, since the eighties, some major economic changes have taken place in the world economy, two of which have a long run structural nature and are here to stay:

1. the economic growth in Asia;
2. the rising role of international finance.

There are two more changes for which it is difficult to say if they will become long run features of the capitalist economy, but they will certainly exert a major influence on development processes:

3. the worsening of income and wealth distribution;

4. the slowing down in the world growth rate, the so-called 'secular stagnation'.

Powerful economic forces cannot be ignored. But are distances among countries increased or reduced in terms of development? Is there a convergence within and among countries, the topic of SDG number 10? Or are there growing imbalances?

The next four sections briefly deal with the four changes, while the final one addresses two major imbalances related to trade and to migrations.[1]

3.1. Rising Asia

The 21st century will be the century of Asia. Since the 1980s, many countries in Asia have experienced sustained economic growth. This phenomenon has involved countries which thirty years ago were regarded as being 'developing' and even 'low income'. Economic growth is still spreading across East Asia, though at different speeds and in different ways. This fact can be regarded as an example of convergence in income per capita among rich and poor countries, which provides some support to mainstream growth theory, according to which low income economies should grow faster than high income ones (see section 1.2 above).

There are several explanations for Asian economic successes. Different interpretations refer to different economic models and to different theories. This is not irrelevant since the Asian experience can be used to assess how far the economic growth models we have examined in the first chapter contribute to the understanding of such a far-reaching phenomenon. With a drastic simplification: is Asian growth the outcome of market forces and of Washington Consensus policies or is it instead the outcome of the pervasive intervention by the state?

The 1993 *The East Asian Miracle* (World Bank 1993) by the World Bank highlights the fundamental role of trade openness, high savings and incentives to private investment; market competition appears to be a decisive push factor. The picture is more nuanced in the UNCTAD

Trade and Development Report of 1996, which also ascribes a decisive role to capital accumulation, emphasizing that it results from policies meant to favour export industries (UNCTAD 1996). According to UNCTAD, there are two fundamental links which have favoured the high growth rate in many Asian countries. First the export-profit nexus in which the state supports export industries and sectors; second, the profit-investment nexus, in which policies favour profit re-investment by the exporting firms. Firms receive these bonuses in so far as they are successful in selling abroad. This model requires a strong coordination between the state and the leading capitalists; the Japanese Ministry of International Trade and Industry (MITI), now Ministry of Economy, Trade and Industry (METI) was an early case of strict collaboration with the big transnational groups, the *keiretsu*. Something similar has taken place in South Korea with her large corporations, the *chaebol*.

This pattern seems to have been applied in the most successful economies of East Asia, including Japan, and the first tier of NIES, Newly Industrializing Economies: South Korea, Taiwan, Hong Kong and Singapore, the four tigers. The last two tigers are probably special cases, but what is definitely remarkable about East Asia is that strong economic growth has not been limited to one or two economies only. The 1996 UNCTAD Report adopted a beautiful metaphor to describe this fact: the "flying geese" model, borrowed from the Japanese economist Akamatsu.[2] One country takes the role of the leading goose while the other geese follow in an inverted V formation, all flying in the same direction.

Governing the Market (Wade 1990) helps to better understand the Asian economic success stories. The title illustrates what has come to be known as the developmental role of the state; a set of policies by which the government bolsters the export-oriented firms. Domestic markets are managed and governed with fiscal, credit, exchange rate and labour regulations which are designed to support the two nexuses above. But the key issue is that of 'going up the ladder': to prop up a process which modifies the composition of both GDP and exports in such a way as to move towards products with a higher technological content and a higher value added. This structural change is the only guarantee to avoid being stuck in exporting either low wage/low technology products or primary commodities.

Thirty years ago, most Asian countries were still in the low-income group, but by now many East Asian economies are either middle or high-income. The notion of emerging markets did not exist twenty years ago, nor did we have the BRICS.[3] East Asia was the only region to have experienced strong economic growth since 1980, notwithstanding the 1997-98 financial crisis.

China is part of this story, but because of her size it is also a case in itself. It is important to recall some of China's performances. First, China is a very strong competitor: since the year 2000 it has a current account surplus, mainly due to the export of goods. Second, the ratio of investments to GDP has been in the range of 35% since the late eighties, and from 2009 it has exceeded 45% . Third, since 2000 there has been an exponential growth in both the Gross Expenditures in Research and Development and in the number of patent applications. China is 'going up the ladder'.

The Asian success model is a combination of export-led growth based on capital accumulation and of structural change. There is no space to discuss these aspects here, but two major questions arise: can the Asian story be replicated in other developing countries? What is the impact of Asian and Chinese growth on developing countries, and on Sub-Saharan Africa in particular (Kaplinsky 2013)?[4]

Asian growth and the emergence of some middle-income economies have some implications.

At the world level, Millennium Development Goal number 1, halving the number of those living in extreme poverty, has been achieved largely thanks to economic growth in Asia, China in particular. The very good economic performances of China and India mean that, at present, most poor people live in middle income countries (Sumner 2013: 1).

There are more players on the ground and, even with all the difficulties and complications, there are more possibilities for South-South cooperation.[5] The world economy is now much more interconnected than it was forty years ago, but it is also going through a period of profound changes in the international division of labour. The so called 'South' now includes some global powers, China and perhaps India, and some regional powers, Brazil, South Africa and Russia. The five BRICS have quite different economic characteristics, but the old divisions into rich and poor countries and the tri-partition into first, second and third world need to be replaced by a more articulated geography; there are more players in the economic arena.

This situation presents opportunities but also challenges for Low Income Countries. Between 2000 and 2010, Sub-Saharan Africa (SSA) grew on average around 5% a year, with peaks close to 7%, which is regarded as the necessary increase to guarantee a decent improvement in income per capita; population in SSA is growing around 2.7%. Since 2010, the GDP growth rate has been slowing down to less than 4%. The issue is whether African economies will be able to sustain economic growth over a long period, say a generation. During the coming years, these countries will also have to try to achieve the SDGs.

3.2. International Financial Markets

3.2.1 The bright and the dark sides of international finance

In 1985, the overall notional value of financial derivatives was slightly more than $1 trillion; in 2007, at the beginning of the sub-prime crisis in the US, it exceeded 600 trillion. Since then it has kept on growing, stabilizing around a proportion of 9 to 10 times the world GDP.[6]

The massive increase of international finance dates to the end of the Bretton Woods system based on the dollar-exchange standard and to the financial liberalization process, which has taken place since the early eighties (see section 1.5 above). On August 15, 1971, Nixon “closed the gold window” and the dollar floated and from the mid-seventies to the late nineties the foreign exchange market, where currencies are traded, boomed. In the Bretton Woods system, bonds were largely issued in domestic markets, but since 1971 they began to be increasingly traded in international markets. Between 1970 and the mid-nineties, overseas sales of US and UK bonds rose exponentially.

There is a bright side to finance. Since the nineties we have been going through a period of abundant financial means and a variety of financial instruments. This seems to be good news for developing countries, in particular Low Income Countries which need funds both for economic growth and for the SDGs and have limited domestic sources of financing(Chang and Grabel 2004, chapter 9).

The last two decades have seen major changes in North-South financial flows. Since 1998, private flows to developing countries have become increasingly important. Foreign Direct Investment and remittances represent the largest financial flows to developing countries, accounting in 2015 for around \$600 and \$450 billion, respectively.[7] In 2016 international aid Hs been around \$140 billion (OECD, 2017: 141). Private philanthropy and Sovereign Wealth funds have also increased enormously in the new millennium. A lot of money is now available and at very cheap rates.

International financial markets also have a dark side: repeated crises, both in developing and in developed countries.[8] Since the eighties, developing countries have experienced repeated major financial crises; to recall just the major ones: the debt crisis of 1982 with Mexico's default, Mexico (again) in December 1994, and the Asian Crisis of June 1997(Vaggi 1993, chapter 3). Between July 1998 and December 2000, Russia, Brasil, Turkey and South Africa were hit by various types of crisis, and Argentina had to devalue in December 2001.

More than 30 countries were involved in the 1982 debt crisis[9] and in most of the economies in Sub-Saharan Africa, in the Middle East and North Africa, and in Latin America and the Caribbean, income per capita stagnated for almost twenty years. It was the period of the so-called 'lost decade', though, in fact, the impact on the real economies continued until the late nineties.[10]

A reasonable solution to the crisis emerged only with the Heavily Indebted Poor Countries Initiative (HIPC) of 1996. Fourteen years after the outbreak of the crisis this initiative at last was taking into account the fact that most of these countries, in particular that of the weakest African ones, were not able to pay back debts. The growing foreign debt was due to arrears on previous payments. Thanks to an advocacy activity, the HIPC initiative was enhanced at the Cologne G7 of 1999. Unfortunately, the procedures to obtain the partial cancellation of foreign debts were very cumbersome and could take as long as six years. In 2005, the World Bank and the IMF introduced the Multilateral Debt Relief Initiative (MDRI), which implied debt cancellation.

Debt cancellation has been very effective, but the improvements in the debt ratios were concentrated in the early 2000s. Following the initial reductions, both the debt to GNI ratios and the debt service ratios have stabilized without any further improvements. After some quiet years, in 2015 Puerto Rico encountered major sustainability problems on its external debt, subsequently defaulting. Since 2016, Mozambique has gotten into serious repayment troubles. Another debt crisis cannot be ruled out, especially in the Least Developed Countries (Eurodad 2014: 16).[11]

Another major crisis took place in September 1992. The British pound, the Italian lira and the Spanish peseta were forced to abandon the peg to the German mark, which led to the tearing apart of the European Monetary System (EMS). This currency crisis was certainly due to some misalignments inside the EMS countries, particularly during a time of diverging inflation rates; thus, the EMS was not an Optimal Currency Area.

This time the crisis did not hit some poor African country or some Latin American country prone to economic crises but three High Income Countries of Western Europe. Financial markets proved to be more powerful than three important central banks in Europe, including the Bank of England, established in 1694, the second oldest central bank in the world.

The three central banks found themselves short of ‘ammunition’, reserves, to defend their currencies, and the markets were now able to demand many more German marks than the reserves available in the coffers of each of the three banks. In the preceding years, between 1977 and 1992, the financial derivative markets had increased from a negligible value to around $10 trillion and by 2007 it had increased more than 40 times to $520 billion. The 1992 EMS crisis showed the growing dimension and power of the international financial markets; the ratio of global official reserves to the daily turnover in the foreign exchange markets had decreased from almost 15 to less than 2.[13].

3.2.2 Financial markets and developing countries

Either no lessons have been learned from the 1982 and 1992 crises or the growing power of financial markets is difficult to keep in check. Finance is characterized by systemic risk; the best description of this situation is in the work by Hyman Minsky, the author who foresaw the potential damage of an uncontrolled financial system. His contributions date back to the mid-seventies, when the overall market for derivatives was still negligible and the consequences of abandoning the Bretton Woods system were not yet clear (Minsky 1974 and 1975).

The massive increase in the markets for financial derivatives occurred between 1985 and 1995 and eighty per cent of the transactions are OTC, Over-the Counter, since they do not take place in regulated markets; therefore, there is a lack of transparency and most contracts are not known to any financial authorities. This is also due to technological innovations, which have resulted in new types of contracts and favoured the increase in the number of transactions in which each financial operator is involved.

In most of the crises, currency depreciation led to an improvement in the external account and restarted economic growth. The most successful case has been South Korea. The Asian countries were accused of keeping their currencies pegged to the dollar instead of letting the exchange rate fluctuate. A 45% depreciation of the South Korean won between November 1997 and April 1998 and a fall of 8% in GDP in 1998 were followed by a growth rate in the range of 5% in 1999, only slightly lower than before the crisis. By the end of 1999, Korea was already paying back the funds received by the IMF.[14] It was a typical V crisis, deep but short-lived.[15]

Most of these crises were related either to defaults on commercial loans and on sovereign bonds or to financial bubbles. All the crises were preceded by large capital inflows mainly because of the high interest rates for local bonds and the high expected returns on equity investments. However, these flows reversed direction because of changes in external conditions, such as an increase in real interest rates, a fall in commodity prices in international markets, or the bursting of a financial bubble, as in East Asia in 1997. Following the crises of the eighties, many authors advised developing countries to beware of easy borrowing and to focus on means and policies to try to lock-in capital inflows. A high share of short-term loans, the main component of ‘hot money’, in the overall foreign inflows and a current account deficit represent a very dangerous situation which could easily lead to liquidity problems. In any event, even with flexible exchange rates it is not possible to insulate emerging economies from financial crises originating in the global financial cycle (Rey 2013).

3.2.3 The temptation of cheap money

There are a lot of funds in international financial markets and borrowing looks cheap. Between 2012 and 2017, interest rates have been decreasing in High Income Countries, reaching very low levels because of an expansive monetary policy in the United States and in Europe, the so-called Quantitative Easing, QE. The search for higher yields has led capital flows towards emerging markets and developing countries. In this type of ‘carry trade’[16] financial operators can borrow at low rates in High Income Countries and lend at higher rates to developing countries.[17] Hence, in many cases these portfolio flows have bought bonds of emerging countries, but bond prices are very sensitive to changes in interest rates. In 2014 we have already seen financial outflows from emerging markets due to the gradual abandonment of QE by the US Federal Reserve, the so-called “tapering”, which has led to expectations about interest rates rises.[18]

There are two main components of nominal interest rates on the debt of developing countries:

- the nominal rates on the benchmark type of assets, for example, US Treasury bonds
- the spread element, which largely reflects the country risk

Nominal rates on developing country debts are strongly influenced by the spread element. Low rates favour foreign borrowing, but any unexpected event might cause a run on domestic deposits, and capital flights might trigger a 'flight to quality' type of phenomenon with higher interest rates, even in a situation of abundant savings at the world level. The financial integration of economies with very asymmetric and unbalanced financial systems could lead to more financial crises in emerging markets (Martin and Rey 2006).

Since 2000, the world overall debt, both private and public, has grown, and after the 2007 crisis the debt to GDP ratios of many High Income Countries have increased beyond the 100% of GDP threshold. In the coming years a lot of countries will need to refinance their debts, and tensions could easily generate higher interest rates.

Notice that low interest rates do not necessarily imply low returns on financial investments; on the contrary, there seems to be a decoupling between the level of interest rates in the bond markets and the ability of financial institutions to generate high returns. Low rates and abundant money favour investments in the stock exchange and the returns on equities, but they may also lead to a bubble. Moreover, in a period of low rates large scale financial operators intensify their buying and selling of financial products, and volatility tends to rise(see section 5.5 below).

3.3 Increasing Inequality

One of the most famous relationships in economics is the 'Kuznets' curve', according to which, in the process of long run economic growth the relationship between income per capita and inequality has an inverted U shape; inequality increases during the initial phases of economic growth but then decreases (Kuznets 1955 and 1963). In Kuznets' paper there is no graph or curve; inequality is described by quintiles of income distribution and by average income levels over a long period of time, which he calls 'secular incomes' (Kuznets 1963: 2, 6). Kuznets observes that inequality is higher in underdeveloped countries than it is in the developed ones (ibid: 20-4), but he does not draw any specific trend as if it were a universal law. Moreover, he was well aware that the data set was quite small and very cautious not to generalise his conclusions (Kuznets 1955: 3-6), to the point of writing in the concluding remarks that perhaps the paper is “95 per cent speculation” (ibid: 26). Nevertheless, Kuznets’ view has been adopted as a general law that accompanies the processes of economic growth. The idea is that in the initial phases of economic growth the concentration of income in the hands of the rich supports capital accumulation and economic growth. At a higher level of income per capita the entire society begins to benefit from the larger ‘cake’. First growth, then sharing!

This view has a reassuring implication that goes hand in hand with the idea of the ‘trickle down’ mechanism of economic growth (see section 1.2 above). In the end, economic growth benefits all sections of the population, and high-income economies should be characterized by an equitable distribution of income, which is part of that decent and inclusive society which is the aim of Agenda 2030 (see SDG 10, in particular).

However, since the seventies, income distribution has worsened in all high-income economies, thereby reversing a pattern of increasing equality which had taken place in the first seventy years of the twentieth century, above all during the ‘golden period’ between 1945 and 1975. Piketty shows that between 1970 and 2010 in high income countries the distribution of income has worsened(Piketty 2014: 24), contrary the popular interpretation of Kuznets’ work. Other studies have confirmed that during the last decades there has been a very fast concentration of income and wealth (Deaton 2013, Bourguignon 2015, Milanovic 2016 and Atkinson 2015).

The re-discovery of the issue of income distribution has contributed to the inclusion of the problem of inequality in the SDGs, in particular in SDG 10, which concerns inequality among countries but also within countries.[21]

According to Piketty, the worsening of income distribution depends on the concentration of wealth/capital in the hands of a few people and to the fact that in many countries the average annual rate of return on capital, *r*, has been higher than the growth rate of the economy, *g* (Piketty 2014: 25).[22]

Piketty has a very broad definition of capital, a term he uses also as synonymous of wealth, including all types of assets which can be accumulated and passed on to heirs (ibid.: 46-48).[23] Capital includes real estate as well as financial assets, and international finance provides a lot of opportunities to amass a fortune. People with large amounts of capital can earn higher returns because they have more choices in their portfolio allocation (Atkinson 2015: 165-167).

The top 10 % of the wealthiest individuals largely coincides with the owners of capital, and thus both the functional and the personal distribution tend to worsen. Piketty calls $r > g$ the fundamental force for divergence (Piketty 2014: 25); this is a long run tendency of modern capitalism, which he calls ‘patrimonial capitalism’ (ibid.: 173). When the growth rate is lower than the average rate of return on large fortunes, the ratio of capital to income, β, increases since the shares of those who live on their incomes is squeezed. Patrimonial capitalism is characterized by the decisive role of accumulated wealth, which takes us back to a ‘society of rentiers’ (ibid.: 276, 418).

This is a worrying trend because in many High Income Countries the social achievements of the golden period are in danger and the welfare system is under threat. This system still guarantees decent minimal conditions and a certain equality of opportunities in education and health to a large section of the population. It would be very difficult to move towards the inclusive society, which is the aim of SDG 16, with a very polarized distribution of income and wealth. According to Duménil and Lévy the concentration of wealth into the ends of few is a strategic feature of capitalism (Duménil and Lévy 2011).

Preventing the concentration of income distribution requires the intervention of the state and, in particular, an active fiscal policy. A progressive income tax would help, but Piketty and Atkinson focus on the taxation of capital and wealth, since this is the way to counteract the increasing wealth and power of the new rentiers in the system of patrimonial capitalism. Piketty asks for a global taxation of capital (ibid.: 515-ff.), while Atkinson insists on progressive taxation, specifically a tax on inheritance and wealth (Atkinson 2015:179, 192,199).

The active role of the state is not limited to the taxation side of fiscal policy; the state must play an active role in guaranteeing an effective social security system as a means of improving equality but also as a fundamental component of a decent society. Both Atkinson and Piketty highlight the importance of a social state and of social security for all (Piketty 2014 Chapter 13 and Atkinson 2015 Chapter 8). Atkinson presents fifteen proposals to reduce the extent of inequality within and among countries, including the idea of High Income Countries increasing their share of Official Development Assistance to 1% of GNI (Atkinson 2015: 237-38).

Piketty criticises the Kuznets curve predictions (Piketty's 2014: 13-4) because rich countries do not seem to be in the downward sloping part of the curve; but what about developing countries and the increasing section of the curve? In general, when working on large data-sets, both in terms of time and number of countries, there is no clear relationship between increasing income per-capita and worsening income distribution.

Asian economic growth, especially regarding the four first tier NIEs, has been accompanied by a decrease in the share of people in absolute poverty and by improvements in human development indicators: namely, life expectancy.

The relationship between inequality and liberalization depends on the structure of the GDP and on the composition of the labour force. Low skilled workers tend to suffer from trade openness because of competition from the cheap labour of other countries, while skilled workers may exploit better opportunities by moving across borders.

Financial liberalisation, which usually goes hand in hand with the opening up of the financial account to capital movements, easily leads to an increase in inequality (Furceri and Loungani 2015). But the most important element to counteract the concentration of income and wealth has to do with the quality of institutions and the existence of active policies in favour of the redistribution of income, which can be quite effective.[24] Globalization and liberalization *per se* do not necessarily produce higher growth rates, and economic growth does not automatically 'trickle down' and benefit all (Stiglitz 2006).

In former socialist countries economic growth tends to worsen income distribution; and quite the distribution of income among different parts of the country becomes much more unequal. This same phenomenon can also be detected in many developing countries.[25]

In 2011, Gabriel Palma also stated that there was no empirical ground for ‘Kuznets curve’, since many countries have a similar distribution of income even at very different levels of income per capita.[26] Palma goes on to offer an alternative way to measure income distribution: the Palma ratio, which focus on the distributive trade-off between the top 10% and the bottom 40% of income distribution. [27] Needless to say, the top decile has the power and the tools to bend distributional policies to its interests (ibid.: 45-7). The population in the intermediate income groups seems capable of defending its income share, but there is also a debate going on about the vanishing middle class (Temin 2017).

3.4. Secular stagnation. And three paradoxes about savings

Since the outbreak of the 2007 financial crisis, economic growth has been quite weak in many high-income economies despite very low interest rates. This has led to a debate on the secular stagnation hypothesis, following Larry Summers’ reappraisal of this term.[29] Many explanations of this phenomenon focus on the relationship between savings and investment and on the fact that, due to an excess of savings, the ‘savings glut’, the real interest rate needed to equate investments and savings at the full employment level, might be negative. In this situation monetary policy becomes ineffective because, due to low inflation, there is a floor for nominal rates, the Zero Bound Level, ZBL(Baldwin and Teulings 2014: 2.), which makes it impossible to reach negative rates.[30] To put it in Keynesian terms, it is as if the liquidity trap had become a permanent feature of the economy (Krugman 2014: 15).

Major explanations for the increase in savings are related to demographic trends and to “the required stock of savings to smooth lifetime consumption” (Baldwin and Teulings 2014: 11, 12, 14). The ageing of the baby-boomer generation and the increase in life expectancy, combined with the lower population growth rate, have led to the “ageing society”. There has been an increase in the dependency ratio because of the raising share of pensioners. An older population requires more savings and investments in financial markets as a way of trying to ensure future incomes (ibid.: 14). Hence, there is an increasing competition among pension funds to achieve high returns and attract more clients.[31]

The decline in the growth rate of High Income Economies is not a recent phenomenon; the growth rate has been continuously decreasing since the sixties. Between 1961 and 1970, the average growth rate was higher than 5%, went down to less 4% in the seventies and eighties, and during the nineties stayed around 3%, decreasing again to less than 2% between 2001 and 2015.[32]

The ‘savings glut’ and demography are not the only explanations of the slowing down of growth rates in high-income economies, as it is also important to look at the demand side. With the exception of East Asia, in many countries savings exceed investments because of the lack of the latter magnitude. Nonetheless, both high and low-income economies need huge investments, above all in infrastructures (Caballero and Farhi 2014: 118-119) in developing countries (Wolff 2014: 146).[33]

There are three paradoxes related to abundant savings.

> ***Paradox 1***: in Harrod’s model a higher saving ratio, s= S/Y, leads to a higher warranted growth rate. In Solow’s version, with savings fully invested, a higher s implies a higher income per capita in the steady state (see sections 1.1. and 1.2 above). *High savings should be good for growth, but now it seems this leads to a growth slowdown.*

Paradox 2: China, Japan and continental Europe are the three countries/areas which save the most, while the US is the country which saves the least (Blanchard et al. 2014: 104). *However, the US is now growing faster than Europe and Japan.*

> ***Paradox 3***: In East-Asia, economic growth has been explained by a combination of export promotion, industrial policies and the accumulation of physical capital. *Capital*

accumulation and high investments have been based on self-financing and on domestic savings through reinvested profits, a process which has bypassed international financial markets.

These paradoxes lead to two questions. Are savings good or bad for growth? What is the role of international financial markets?[35]

Let us first consider savings. In a very interesting section entitled *Beyond Bubbles: Low Growth, High Saving*, Piketty concluded that during the period 1970-2000 a higher saving ratio s did not lead to a higher growth rate g (Piketty 2014: 173-75).[36] Piketty's explanation is not related to a theory of economic growth but is a long-run tendency of the capitalist economy, which he calls 'the second fundamental law of capitalism': $\beta = s/g$ (ibid.: 166-69).[37] If a country saves too much in relation to its growth rate, then inevitably its capital/income ratio β will increase.[38]

Sluggish growth generates more inequality because it gives more power to accumulated incomes than to the income which is annually produced. The possessors of wealth/capital have more power than the people who live only on their yearly income.

It is less well known that Kuznets was also worried by "the concentration of savings in the upper-income brackets"(Kuznets 1955: 7). This fact leads to "an *increasing* proportion of income-yielding assets in the hands of the upper groups - a basis for larger income shares of these groups and their descendants" (ibid.: 7, italics in the original). This is a natural tendency that seems at odd with a reduction of income inequality; in fact, Kuznets dedicates a section to the "Factors Counteracting the Concentration of Saving"(ibid.), where he says that "legislative interference and "political" decisions" (ibid.: 8) play a major role in limiting the accumulation of property and assets, mainly through inheritance taxes, capital levies and also by keeping artificially low interest rates on government bonds (ibid.: 8).[39]

Contrary to Piketty, Kuznets does not make explicit the link between high savings and low growth rates, and in general he thinks that the counteracting factors are typical of a dynamic economy (ibid.: 11).

Now the second question: what is the role of international financial markets? In principle they should favour a better allocation of resources at the world level. Free movements of capital and a large set of financial instruments should help to allocate capital in the most efficient way. Financial markets should bring savings where they are lacking and hence most needed and where they can also generate higher returns. All this derives from the 'efficient market hypothesis' (see section 1.5 above).

International financial markets should increase the average world growth rate and speed up the convergence of low income economies towards those with high levels of income per capita; however, there are serious doubts that more finance implies more growth (see Arcand et al. 2012). It is difficult not to agree with Hélène Rey who writes: "it is hard to ascertain or measure the real gains from financial openness and freely moving capital….trillions of dollars have crossed borders, and yet despite our best efforts and hundreds of studies, it has been extraordinarily difficult for economists to identify any benefits from these flows" (Rey 2015: 6).

High savings and the enormous dimension of international finance go hand in hand, but they do not seem to enhance investments and growth.

3.5 Imbalances

The four changes above do not seem to lead the world economy towards an equilibrium situation. There are two more aspects which denote major imbalances: trade and migrations, which are movements of commodities and of people.

There are large deficits/surpluses in the trade and current accounts of most regions and countries. There is a surplus in East Asia, in the Gulf countries and in the Euro zone, and a deficit in the US and the UK.[40] For several years the Euro zone had a very large surplus in the current account, more than 3 of the GDP, mostly due to the German surplus.[41] Current account imbalances also increase household indebtedness in deficit countries (Kumhof et al. 2012: 9-10).

Low and Lower Middle-Income Countries have structural deficits, with exceptions for the producers of commodities when their international prices are high.

According to the ‘efficient market hypothesis’, competitive markets should eliminate these imbalances, at least in the long-run, all the more so with free capital movements and flexible exchange rates. Capital should flow from deficit countries to surplus countries, thus lowering the value of the currency in deficit counties and increasing it in the surplus countries; a mechanism pointed out by David Hume in the eighteenth century(see section 4.3 below).

Exchange rate movements should reduce the imbalances in the trade and current accounts, yet this adjustment does not seem to take place. The exchange rate level does affect the current account but not in a decisive way. The trade surpluses of the Euro area, Japan and China have been there for many years, even when their currencies were strong and the dollar weak, and Germany’s current account surplus has been growing since 2002.

High Income and Emerging countries implement policies to be successful in international trade. A reduction of the trade deficit is regarded as a positive occurrence and a surplus is even better.

This goal can be pursued with a mixture of deflationary policies:

-a balanced fiscal budget, to be achieved by increasing taxes and reducing expenditures

-the deregulation of labour markets

-the fostering of exports

These are the typical measures of fiscal austerity which lead to the restriction of domestic demand. Since 2010, most High Income countries have reduced their overall budget deficits, and the primary budgets, net of interest payments, are in surplus. These policies, however, endanger the social conditions achieved in these countries since 1945. The welfare system is under threat, even though this system still guarantees decent minimal conditions and a certain equality of opportunities in education and health to a large section of the population. Health and education are the two pillars of the notion of human development.

The above policies constraint domestic demand, which means that all countries rely on exports to sustain growth. The increasing competition in the export markets can lead to protectionist strategies which could generate trade conflicts; these policies have a neo-mercantilist flavour (more in sections 4.1 and 5.4. below). The constraint of domestic demand in High Income Countries can reduce the export possibilities of Low Income countries, in particular the Least Developed ones. It is difficult to see how these countries could be pursue the very demanding SDGs agenda.

A second imbalance to which we must briefly refer relates to people, an area of critical importance in the SDGs, especially concerning migrations. The economic growth rates in many developing countries are higher than in the nineties, but young people cannot find appropriate employment. The situation is particularly severe in the Middle East and North Africa (MENA) region, from Morocco to Lebanon, which should generate almost 3 million new jobs every year to absorb all the people entering the labour market. The uprisings which exploded in the region in 2011 are a clear sign of this problem, which of course is related to the concentration of wealth in the hands of local elites. Economic growth does not necessarily lead to more employment or to the number of jobs required by a population composed of many young people(ILO 2014). Recall the emphasis on employment by Dudley Seers and ILO back in seventies(section 1.3.3 above).

One of the most worrisome imbalances is the 'mismatch' between the number of qualified people holding secondary and tertiary degrees and looking for a job and the capacity of the economies to absorb them; quite often the result is outmigration. The problem is not just that of having better educational systems in vocational training or of bending the system to the needs of production. Education is a fundamental component of human development, a specific value in itself. Anticipating chapter 5 below we can say that education is a fundamental use value, the core of SDG 4, and the enhancement of human capacities is at the forefront of Agenda 2030 (see sections 2.1 and 2.4 above). It is a goal which should be pursued in any case, but the exchange value the reward for the years spent in education is not necessarily there. Thus, if developing countries invest in education, they have a high probability of suffering from a 'brain drain' and of losing many skilled workers. A weak demand for labour can force skilled workers to migrate, and it inhibits the opportunities for innovation and growth. It is a vicious circle in which the brightest people have a strong incentive to leave. The development process is hindered by the existing economic conditions, which do not encourage the improvement of people and institutional capacities.

3.6 Discouragement

This chapter has examined four changes: the rise of Asia, the growth of international financial markets, increasing inequality, and secular stagnation, and two imbalances in trade and migration. All six facts are related to each other (Palley 2016). For example, the increasing role of the financial sector has contributed to increasing the income share of the top 1% of the population (Palma 2009: 850-52). These 4+2 ‘facts’ demonstrate the enormous power of economic structures and of capitalist market forces. If societies are dominated by economic structures, are there policies and means which can realistically be implemented to pursue the SDGs? The changes and imbalances described in this chapter represent the background for the economic environment in which sustainable development is supposed to be pursued and in which international cooperation will necessarily have to navigate. Both the weakest individuals and the weakest countries are constrained by economic structures and by powerful market forces.

These considerations are quite depressing; the holistic view of development and international cooperation described in Chapter 2 looks like a dream. Before moving to the final chapters of the book we need to pause; we need to take a longer perspective, a breathing space in the history of ideas, to help us better understand the interplay between human progress and economic structures in the history of mankind. Chapter 4 takes us back to the long-run visions of the founding fathers of economic thought.

[1] On five imbalances UNCTAD 2017: 152.

[2] For a history of the 'Flying Geese' model, see Kasahara 2013.

[3] Emerging markets are important players in the world economy and in international cooperation, where they also constitute the main block of the so-called 'new donors'.

[4] The emergence of new economic powers, or 'new donors', not members of the OECD-DAC, implies that many countries in Sub-Saharan Africa have the possibility to move beyond the economic relations of the post-colonial period, during which they maintained major economic links with the former colonial powers and with a limited number of other High Income Countries.

[5] Between 1995 and 2012, South-South exchanges doubled their share in world trade.

[6] The incredible amounts achieved by financial markets has been called "The dance of the trillions" (Palma 2009: 833).

[7] Remittances include only the officially registered ones, while hundreds of billions are assumed to enter developing countries in an unofficial way.

[8] More on this topic can be found in Vaggi 2018.

[9] The countries hit by the debt crisis of the eighties were: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, Venezuela, Costa Rica, Jamaica, Cote d'Ivoire, Nigeria, Sudan, Yugoslavia, Poland, Hungary, Turkey, Algeria, Egypt, Morocco, Bangladesh, India, Pakistan, The Philippines, South Korea, Indonesia, Malaysia, Thailand, and Portugal (Vaggi 1993).

[10] In Sub Saharan Africa the average GNI per capita declined from 1,278 US$ (constant 2010 prices) in 1984 to 1,123 US$ in 1998(World Bank, *World Development Report 1986* and 1999/*2000*).

[11] Griffith Jones and Tyson 2012 find many similarities between some African countries today and some Latin American and Asian countries in the eighties and nineties, respectively.

[13] The story of the 1992 EMS collapse is more complicated than this; only the essential elements are highlighted here. On the financial crises, see also Moro and Beker 2015.

[14] However, the share of investments in GDP decreased from 35% to 25%.

[15] Thanks to large devaluations, most countries recovered rather fast; Malaysia, Thailand and the Philippines followed patterns similar to the Korean one, although the crisis was much deeper and longer in Indonesia (Vaggi 2002).

[16] The expression *carrying trade* can be found in the Mercantilist literature, where it refers to the physical transportation of commodities (Rubin 1929: 50-51).

[17] In the second part of the nineties this mechanism already played an important role in bringing large capital inflows into emerging markets, namely, into Latin America.

[18] Blanchard et al. expect no major changes in nominal rates in the coming years, but they also stress the fact that forecasts of future global rates are very tricky (Blanchard et al. 2014:106).

[21] The combination of the two 'inequalities', among and within, determines the so-called global inequality(Milanovic 2012 and Milanovic 2016).

[22] A criticism of the weak theoretical grounds of Piketty's analysis is in Garbellini (2018).

[23] For a comment of Piketty's book, see Milanovic 2014.

[24] Active fiscal policies can reduce 'net inequality', after taxes and transfers, with respect to 'market inequality'; net inequality is positively correlated to economic growth (Ostry and Berg (2014). In Latin America some successful policies have contributed to a decrease in inequality (Cornia 2014).

[25] In China some regions along the coast have incomes per capita which are almost three times higher than those of internal regions.

[26] As Palma writes "about 80 per cent of the world's population now live in regions whose median country has a Gini not far from 40" (Palma 2011: 2, 10-12).

[27] This is the ratio of the first decile to the bottom 40% of the population, which derives from the observation that the share of income accruing to the five deciles from 5 to 9 is rather uniform across different countries (Palma 2011: 19).

[29] On the various explanations for secular stagnation, see Baldwin and Teulings (2014). Backhouse and Boianovsky(2016) describe the origin of the term.

[30] Galbratith (2017) presents alternative views on the determination of the interest rate.

[31] Many contributors to the secular stagnation book by Baldwin and Teulings have remarked that low interest rates in the financial centers and for highly rated types of assets can easily lead to financial bubbles because of the search for high yields.

[32] Some emerging economies are now experiencing a decrease in their growth rates; Brazil, Russia and South Africa have had very low rates since 2012. Growth is slowing down in Indonesia, Turkey and in other emerging countries in East Asia.

[33] Gordon explains 'secular stagnation' in terms of the slowing down of the growth rate of labour productivity, which in turn is determined by a declining pace of technical progress, thereby generating a reduction in potential output (Gordon 2015).

[35] According to Solow, it is "time to rethink the way the credit mechanism mediates between savers and investors and puts credit to productive use" IMF *Finance and Development* of June 2011: 51.

[36] Piketty compares the US and UK, countries with low saving ratios (just above 7%), with Japan, whose saving ratio was close to 15%.

[37] Piketty seems to support the view that increased savings are due to demographic trends and to the so-called 'ageing society'(Piketty2014: 175).

[38] Remember that Piketty's notion of capital is not physical capital as in Harrod (see section 1.1 above) but includes all types of assets and is similar to wealth.

[39] Other counteracting factors are demography and technological change (Kuznets 1955: 8-9).

[40] Both in the US and in the UK the goods balance is much more negative than the trade balance and the current account, because both countries are very strong exporters of services, namely financial services.

[41] There are large differences within the Euro area: in Germany and the Netherlands the current account surplus is close to 8% and 10 % of GDP respectively; other countries have either much smaller surpluses or small deficits. Between 2010 and 2018 Greece has been going through a financial crises which bears many similarities to that of developing countries during the eighties.