

In our lifetime: long-run growth and polarisation since financial liberalisation

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Abstract

This paper assesses the present state of the world economy.

Using publicly-available data from the IMF and from the World Bank it assesses two claims that the world economy is growing faster, and becoming less unequal, under globalisation.

A comprehensive dataset back to 1960 is now available from world institutions. Defining 'globalisation' as the period of intensive financial deregulation and privatisation which began in 1980, this data allows us to compare 'before' and 'after' globalisation, and to compare the present stage of the world economy with the past twenty years.

We find that the economy has, since globalisation, been growing at approximately half the rate it was before, and that this trend shows no sign of reversing. To the contrary, the 2000 recession turns out to have been one of the most serious since 1974, and the recovery from it is as faltering, geographically uneven, and dominated by imbalances between the USA and the rest of the world.

We also find that inequality under globalisation, measured as the ratio of GDP per capita in the 'advanced' countries to those in the rest of the world, increased by a factor between two and three times under globalisation, and this ratio too, shows no sign of reversing.

Introduction

Data on the world economy has improved with the release of two databases in September 2006: the IMF's September 2006 World Economic Outlook (WEO) and the World Bank's World Development Indicators (WDI). World Bank data now covers 75 per cent of the world's population for as far back as 1960. The two datasets together offer a long-run overview of the world economy for nearly half a century. Despite Keynes's dictum, we should note that most people alive in 1960 are still alive today.

This report studies two decisive indicators of world economic health over that period: growth, and the inequality between nations. It updates a previous study¹ in two ways: the data is now goes back to 1960; and it is now limited strictly to those measures of GDP that the IMF and the World Bank themselves make available to the public. The conclusions in it require no special analysis or statistical technique: they emerge directly from the data provided by the international financial institutions themselves.

¹ Freeman, A (2004) 'The Inequality of Nations', in Freeman, A and Boris Kagarlitsky (2004) (eds) *The politics of Empire and the Crisis of Globalisation*. London: Pluto

I have made only three changes to official data. I have omitted the countries in transition from all world and regional totals. This is because authorities differ about how to measure the GDP of these countries before transition and do not supply much data before 1970. I have obtained data for the German economy, for 1960-1974, directly from German official sources, who supply comparable data for the whole territory of the present Federal Republic, which the World Bank and IMF do not. Finally I have adapted the regional classifications of the IMF, which change over time, to provide consistent comparisons over the whole period of this report.

Better than what?

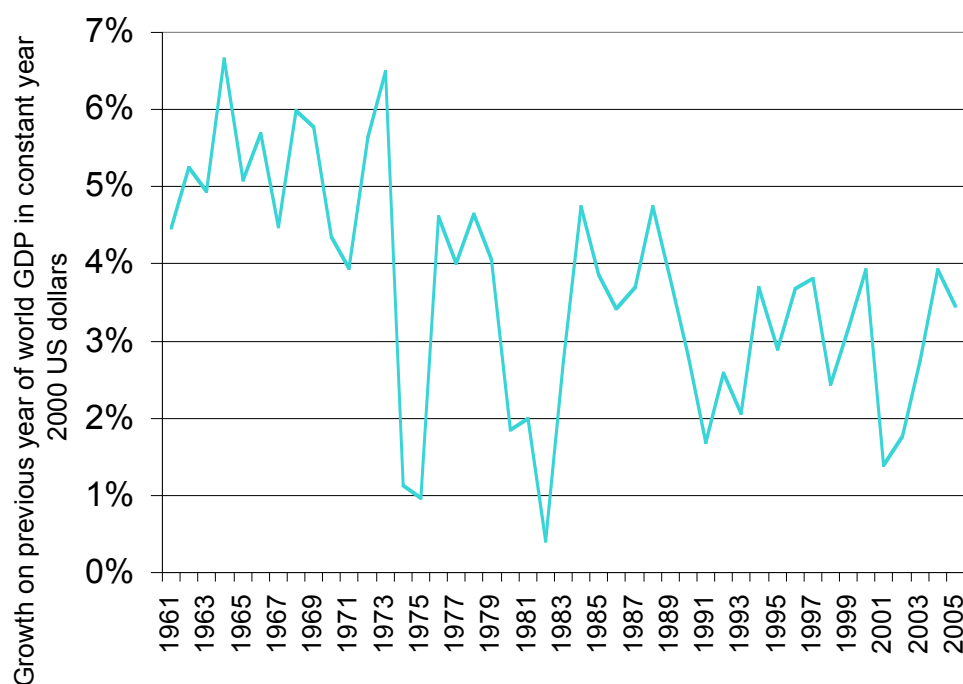
One of the biggest problems, when analysing the success or failure of a policy, is to find a proper comparator. Is the world in 2005 a better place? The answer is a question: better than what? It depends what you compare it with.

Compared with four years ago, the world is growing faster: its annual growth, measured in constant dollars of the year 2000, was 1.4 per cent in 2001, 1.8 per cent in 2002, and 3.9 per cent in 2004. In 2005, according to our calculations based on the IMF's estimates, it will grow by 3.5 %. Compared with four years ago, the world outlook has improved.

However, it would have been hard to get worse. Year 2001 world economic growth, as chart 1 shows, was the worst since 1982.² We should go back farther than the recent past to find a good benchmark. Using long-term data we can compare today's performance, not as the IMF and World Bank tend to do with the previous twenty-five years of financial liberalisation, but with the period that preceded such policies: the sixties and seventies.

² This section of the report is confined to those countries (about 80 per cent of world population) for which data on both GDP and population is available for the whole of 1965-2005. For the second section, dealing with inequality, we use the countries for which data on both GDP and population are available in each particular year.

Chart 1: Annual growth of world GDP



Notes: Throughout this report, transition countries are omitted from world totals

Calculations: Alan Freeman

Data after 1980: World Economic Outlook

Data before 1980: World Bank World Development Indicators

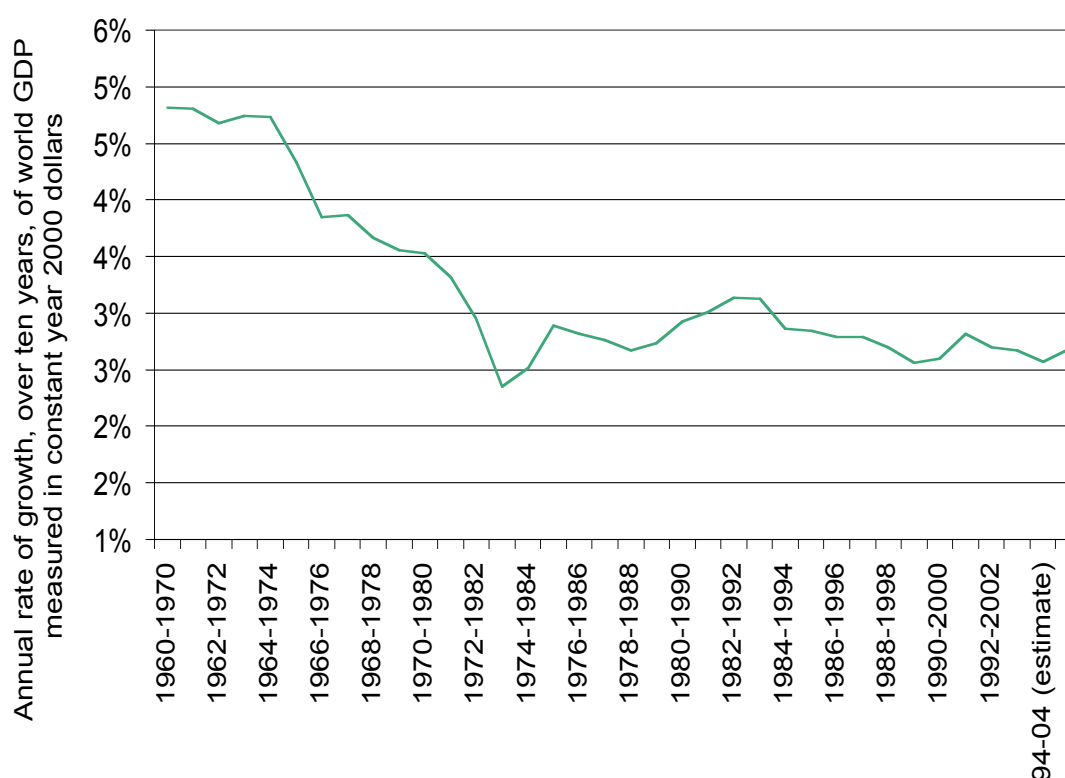
Figures for 2004 and 2005 include IMF estimates based on best available information

The comparison is instructive. Between 1960 and 1970, in no year did world GDP grow more slowly than 4%: since 1991, in no year has it grown more than 4%.

Even in the rocky seventies, world growth fell below 4% in only two years: 1974 when it dropped to 1.1%, and 1975 when it reached 1.0%. At the time, such growth rates were regarded as catastrophic, and the 1974 downturn is generally held not only to be the world's worst since the 1930s but a major reason for the economic policies of the 1980s, with their intense concentration on financial and trade liberalisation. Yet, twenty years later, world growth in 2001 was only 0.4 percentage points above the worst of these two years.

Moreover annual growth is only a part of the full picture. During the 1970s, as noted, growth overall was generally above 4%. In consequence, average growth over this decade was a relatively healthy 3.5%. What about average growth in the period of financial liberalisation? This is shown, and compared with previous years, in the trend line in chart 2, which shows annualised growth over the previous ten years, for each of the years since 1970.

Chart 2: 10-year average growth of world real GDP



Notes: as for chart 1

Better, or worse? Throughout the 1980s, annualised world growth has never risen above 3.1 per cent in any ten-year period. Before 1981, it never sank below this level.

Nor, indeed, is there any real sign that things are improving. We are now three years into the economic upturn, with US growth already becoming shaky as the housing bubble starts to sag. Annual world growth for 2005 according to the IMF itself is down to 3.5 per cent. For 2006 it is forecast to rise to 3.8 per cent, healthy by modern standards – but as we have noted, until 1974, it never sank *below* this level.

A conclusion, rarely offered, is begging to be drawn. For whatever reason, whether a general change in world conditions, or because of the policies applied under the stewardship of the International Financial Institutions since the 1980s, the world economy has in the last two decades performed little better than half as well as in the bad old days. Whether we lay the blame at the feet of globalisation, or poor economic management, things are worse now, in terms of the speed at which the general condition of economic life is improving,³ than they were then.

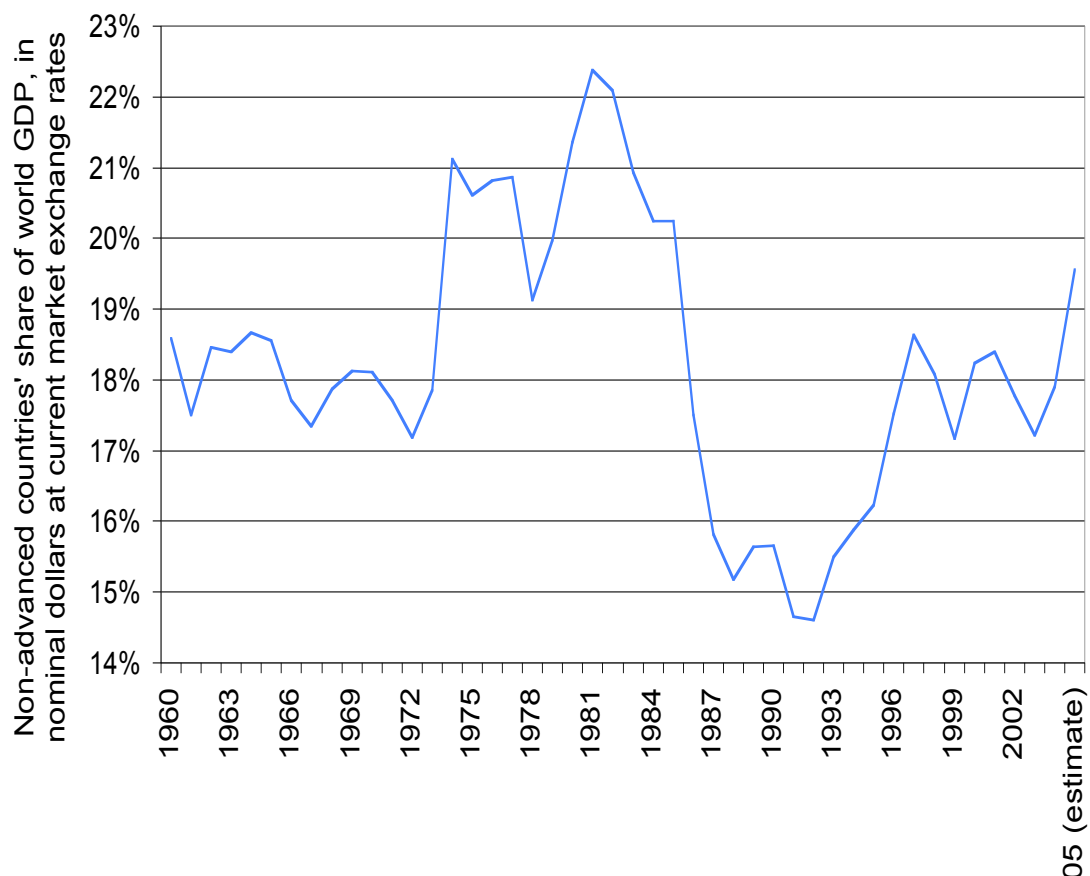
The geography of wealth and poverty

The second major indicator of the economic welfare of the world studied in this report is inequality. It is of little use to a person that the world is growing faster, or that

³ Of course, many criticisms can be made of this as a sole criterion of human welfare. But it is after all the criterion which the financial institutions themselves regard as primary, and so it is surely reasonable that their performance should be judged by it.

wealth is increasing, if the benefits of this growth accrue only to her neighbour. This is particularly germane since one of the reasons urged on the world for accepting the inconvenient growth of poverty and inequality, was the world growth that would result. As we have seen, world growth has not happened. So what about world equality?⁴

Chart 3: Share of the non-advanced countries in world GDP



Since the early twentieth century, and probably since the middle of the nineteenth century, the economy of the world has kept its countries divided into two great groups. The first group, which in this report we call the advanced countries,⁵ comprises what is now termed the Euro Area, North America, and Japan. It has been joined, since the second World War, by about 80 million people living in South Korea, Singapore, Malaysia, and Taiwan. (Together with Japan, Australia and New Zealand, this latter comprise a group which this report calls ‘Advanced South-East Asia’). The combined population of the advanced countries, so defined, was 930 million in 2005 and 660 million in 1960.

The second group comprises everyone else. Its population was 2,330 million in 1960 and 5,338 million in 2005. Thus relatively less people are now living in the advanced

⁴ Throughout the second section, GDP is measured in nominal dollars at current market exchange rates, using the ‘Atlas’ method of the World Bank which smooths out short-run exchange rate variations.

⁵ and which comprises all countries which the IMF has at one time or another called ‘advanced’. Our comparisons thus use the IMF’s own classifications, stripped of any but this basic distinction.

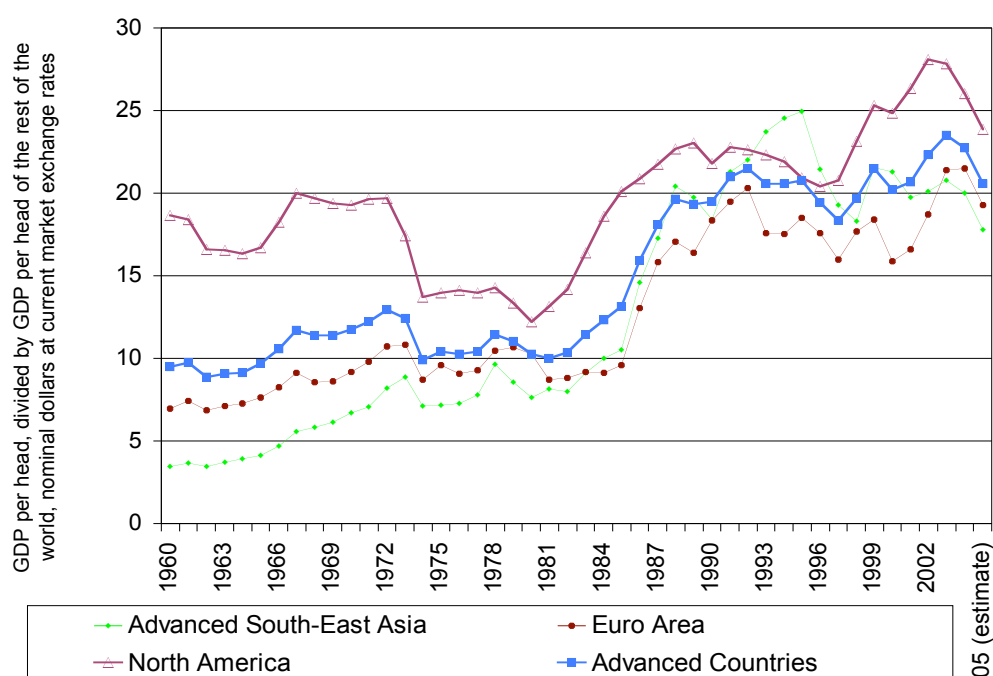
countries. In 1960 they contained 22% of the world's population, nearly a quarter; in 2005, 14%, almost exactly one in seven.⁶

The GDP of each group has, of course, changed. In dollars at current market exchange rates, the total GDP of the advanced countries⁷ in 1960 was \$943 billion and in 2005, \$33,221 billion. The total GDP of the rest of the world was \$215 billion and in 2005, \$8,087 billion.

By any objective measure, this is a staggering level of inequality: one seventh of the world's population receive, today, three quarters of its wealth. But from it would appear to be improving. In 1990 the rest of the world's share of world GDP was 14.8 per cent, and in 2005, 19.8 per cent. Better, or worse?

Unfortunately, worse. As chart 3 shows, 1990 was the lowest point in world history. During the sixties and seventies, the share of the poor countries in world income rose until high point, never again attained, in 1980 – just when financial liberalisation began. This share then sank – ‘collapsed’ would not be an inappropriate word – and has only now got back to where it was in 1960. Indeed, from this chart it is hard not to conclude that the function of financial liberalisation was to finish off a subversive trend towards equality and put the third world back where it belonged.

Chart 4: GDP per head of the advanced countries relative to rest of the world



But even this is not the whole picture. Third world income is distributed among a population which has more than doubled in half a century, whilst that of the advanced countries has gone up by only 50 per cent. Over this period, the average income of the

⁶ At some points in this report we call this group the ‘rest of the world’, the ‘third world’, the ‘poor countries’ or the ‘non-advanced countries’. These terms all mean the same thing: those countries that the IMF does not call ‘advanced’.

⁷ In this section as noted earlier, we use those countries for which data on both population and GDP are available in the given years. Growth is therefore slightly less than these figures suggest and for this reason, the most reliable indicator of world performance is GDP per head.

advanced countries has therefore risen by significantly more than that of the rest, even though the share of each in total world income is about the same as in 1960.

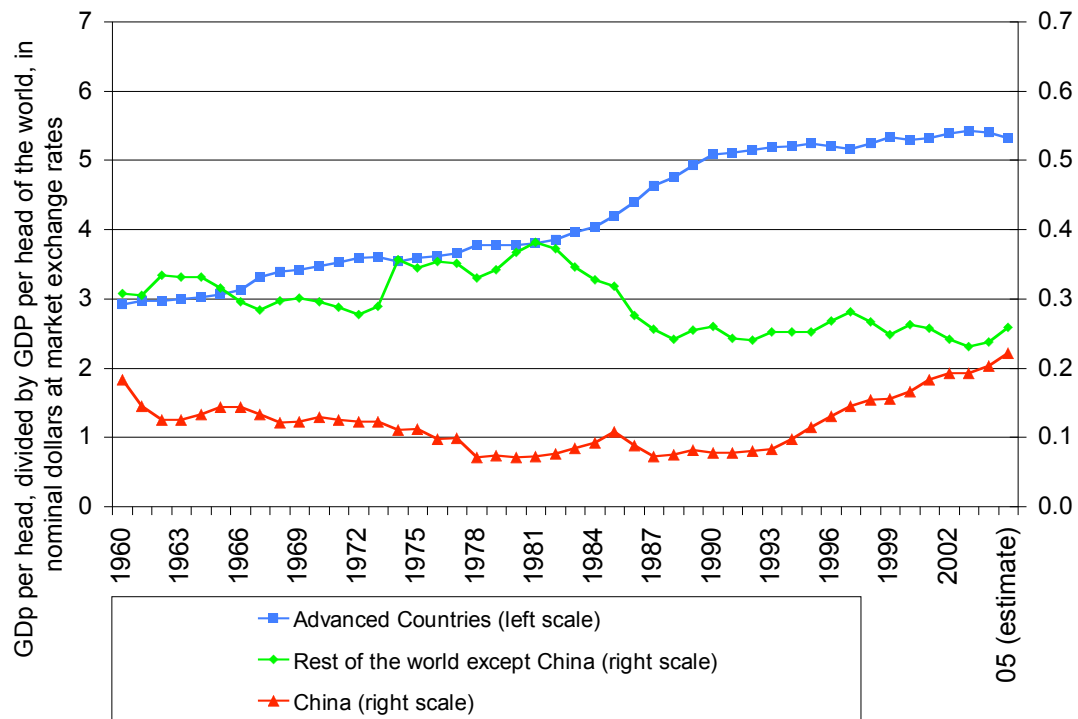
A better measure of geographical equality is therefore to compare GDP per head, rather than GDP. This gives chart 4, a basic indicator of world inequality. It shows the ratio between the average income in the advanced countries, and that of the whole of the rest of the world.

Throughout the sixties and seventies, the average income in the advanced countries was, as this chart shows, about ten times that of the poor countries. Within seven years of financial liberalisation, this ratio doubled.

The GDP per head of the advanced countries is thus now, as it has been for the last eighteen years, 20 times higher than that of the poor countries, with the exception of a brief dip during the Asian crisis of 1996-97. Even this dip was not a sudden betterment of the poor countries but was brought on by the fall in South-East Asian advanced economy GDP in the financial crisis of 1996-97, as chart 4 also shows.

The same crisis pushed the average income in North America (where the USA was running, it should be noted, the highest debt of any country anywhere, ever) for the first time higher than 25 times that of the average income in the poor countries.

Chart 5 GDP per head relative to world GDP per head



Better, or worse? The ultimate standard of comparison, for any region or nation, is the GDP of the whole world. Chart 5 compares the income per head of our main groups with that of the world as a whole. It makes a further distinction, which is the subject of our final section: it separates the rest of the world into two parts: China, and everyone else.

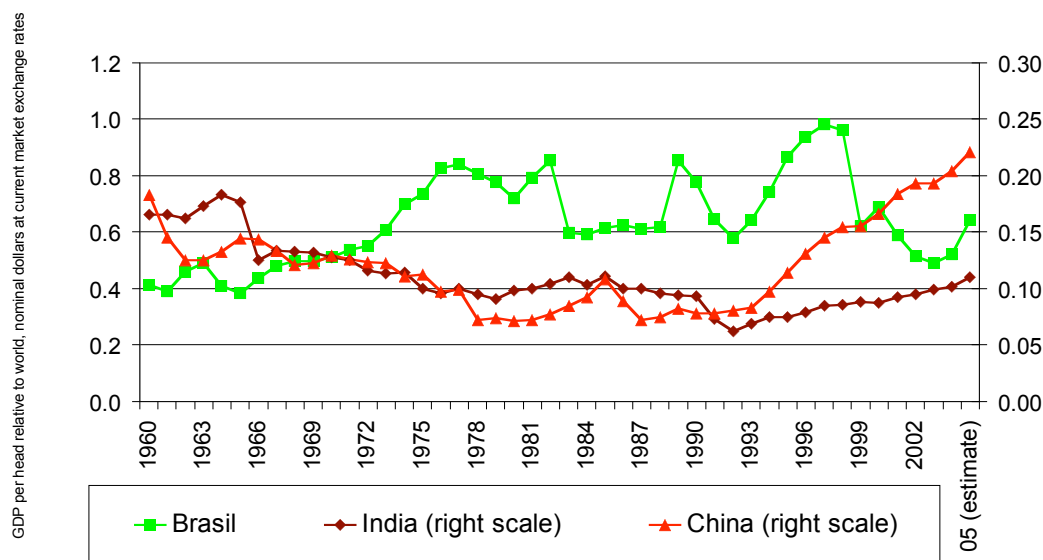
The GDP per head of the poor countries, excepting China, is when compared with the world, now lower than it was in 1960. The high point was reached in 1982 when average income in the poor countries was 40% of the world average. During ten years of financial liberalisation, this fell to around 25%, where it has remained ever since. In contrast, the average income of the one-seventh of the world living in the advanced countries has risen from three times the world average in 1960, to five and a half times in 2005.

BRIC or China?

There is an exception to this pattern, as everyone now knows: China, the third world country which, with sustained annual growth of 9-11%, has broken from the pack. Less widely known – or at least, less triumphantly acknowledged – is the fact that China paid less attention to IMF prescriptions than any other third world country, steadfastly maintaining capital controls, a strong state and co-operative sector, and stringent arrangements to capture the technology of foreign investors.⁸

Perhaps, nevertheless, China’s performance arises primarily from other factors such as size, or from as yet unknown new processes at work in history. Has a new trend set in: are we entering a new age of Third World prosperity, headed by the now-celebrated ‘BRIC’ (Brasil, India and China) group?

Chart 6: GDP per head of Brasil, India, and China, relative to world GDP per head



The longrun evidence does not bear this out. Chart 6 compares the GDP per head, relative to that of the world, of the three BRIC countries. China, for sure, is going through an unprecedented transformation. India is also going through a transformation of some kind, but not on the Chinese scale. For Brasil, sadly, nothing remotely parallel is happening.

⁸ And holding most of the US’s foreign debt, an unusual, historically new and, for the USA, somewhat inconvenient circumstance.

Once again, this chart establishes the importance of the long run. By 1997, Brasil had expanded, in nominal terms, at the same rate or indeed, even better than China, for no less than five consecutive years.

Better, or worse? In 1998 Brazilian GDP fell so far that it wiped out the entire gains of the previous five years. The country has never really recovered. By 2003 its GDP per head was, relative to the world, back to the level of 1970.⁹ This is substantially different from the performance of China or India. China's relative income has risen in every single year since 1991, including the world recession years of 2001-02, and since 1993 at constant rate. India's has grown at a constant rate since 1992.

Better, or worse? The magnitude of change matters as well as its constancy. India's income has indeed risen steadily, relative to that of the world, since its low point of 1992. But this should be compared with 1960. During the bad old days before liberalisation, India's per capita income reached nearly 20% of the world average. By the 1990s it had fallen to well under half this level. It has since climbed back by around four percentage points, a significant rise which, however, leaves India worse off, relatively, than at any time since independence.

China now occupies a different position in the hierarchy of world powers. This should be placed in perspective, since extrapolating China's GDP has become a favourite game. Concentrating firmly on the long run, the qualitative change is that China has broken economically from the status of Asia and Africa. It has moved off the bottom rung.

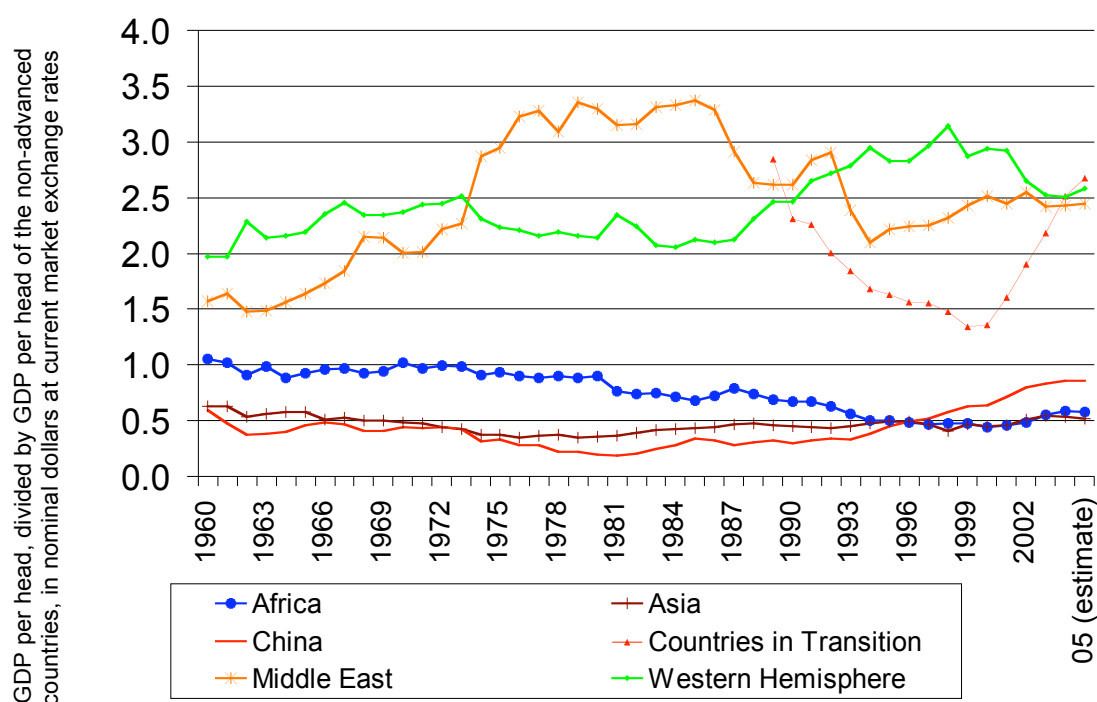
So is this only a minor change? At this point sheer size also becomes decisive. During the fifties and sixties, a small – in fact tiny – part of the developing world, through prodigious sacrifice, joined the advanced countries in the shape of Korea, Taiwan, Singapore and Malaysia. But the combined population of these countries, at 80 million, added a mere 10 per cent to the size of this group. In contrast, China contains a fifth of the people of the world. In consequence, even a relatively small rise in its GDP per capita propels it from one world power bracket to another, and also transforms world power relations.

This picture is re-enforced by our final chart, chart 7, which looks at the geographical distribution of wealth, measured by GDP per head, among the various main components of the rest of the world. Since it is the hierarchy of the bottom that is now under study, we now measure relative to the average income of all poor countries, that is, the rest of the world including China.

China is in a league of its own. It began from an exceptionally low level at only 55% of the rest of the world average, in 1960, and actually fell from this level until 1981. At this point – when all others were assiduously following IMF prescriptions – China went its own way. It has now risen above Asia (the South Asian continent comprising India, Pakistan, Bangladesh, together with poor South-East Asia) and Africa.

⁹ It should be remembered that a second major reason for IMF policies was, it was argued, that it would provide increased stability.

Chart 7 Comparative performance of regions: GDP per head relative to total non-advanced



The chart also shows that the poor countries of the world divide into two groups. At the bottom are Asia, Africa and China with an income about half the average of the poor countries as a whole. A second group has an income between two and three times that of the poor countries as a whole and consists of the Middle East, the Western Hemisphere (Latin America and Caribbean) and the countries in transition.

The second group are more volatile than the first. The Middle East, the main beneficiary of the 1974 crisis whose relative income collapsed with liberalisation, oil wealth notwithstanding, to just over half its 1985 peak. It is also hard to discern an improvement for Latin America, which in the late 1990s went through its own crises, many like the Argentina because of over-zealous financial liberalisation. It is surely no coincidence that the Middle East and Latin America are today the most politically turbulent regions of the world.

Conclusion

Whether or not the world was healthy in 1980, it is sick now. By any objective standard, it is worse off under IMF and World Bank stewardship than it was before. Moreover a simple empirical observation can be made: the less attention a country pays to the IMF's advice, the better it appears to have done.

If you are sick and your doctor fails to cure you, you should question the treatment. If you are healthy and the treatment makes you sick, you should question the doctor. But if you can only cure yourself by renouncing the treatment, then it is the doctor, not you, who needs to start asking questions.