UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT 2017

BEYOND AUSTERITY: TOWARDS A GLOBAL NEW DEAL

Chapter II

INCLUSIVE GROWTH: ISSUES AT STAKE

UNITED NATIONS
New York and Geneva, 2017

INCLUSIVE GROWTH: ISSUES AT STAKE

II

A. An age of anxiety

Anxiety is fast becoming a new *zeitgeist* of the twenty-first century global economy. While the sources of anxiety among those disillusioned with globalization are well known, if not fully understood, recent events have raised considerable alarm amongst its proponents. Any sign of rising trade protection, or talk of currency wars or stricter controls on migration, have been interpreted as the start of a dangerous race to roll back the open global economic order built over the previous seven decades. Some are even warning of a return to the kind of economic and political chaos witnessed during the interwar years.

There are, undoubtedly, reasons to worry about the current health of the global economy, and about emerging threats to rising living standards, political stability and environmental sustainability. Questions over the strength and effectiveness of multilateral institutions designed to help manage the challenges of an interdependent world order are also of concern. However, much of the current discussion assumes that these institutions were immaculately conceived at the end of the Second World War, and that, subsequently, they have overseen a steady march towards a level global playing field of open and competitive markets and broadly shared prosperity. The reality is more punctuated and nuanced.

The three decades or so after the Second World War ushered in multilateral rules and structures to prevent "beggar-thy-neighbour" policies, restrain volatile capital flows and extend international cooperation. But there was still enough space for national governments to undertake proactive public policies in support of full employment and extended welfare provision in the North, and resource mobilization and industrialization in the South. This balancing act was built around a political consensus (and related compromises) aimed at avoiding a repeat of the international economic disintegration of the 1930s, and the waste, wretchedness and war that followed. That consensus required the leading economies (and their corporations) to accept some constraints on their ability to dominate international markets and to move capital freely from location to location, whilst giving a privileged role to the dollar as a means of stabilizing foreign exchange markets. But it also supported high rates of aggregate capital formation along with wages that rose broadly in line with productivity in the developed countries. These generated strong global aggregate demand, leading to a rapid rise in international trade. Nevertheless, this remained only a *partial globalization*, in that the rules and structures were designed primarily by and for developed rather than developing countries, and was concerned more with openness to trade than to financial flows or transfers of technology.

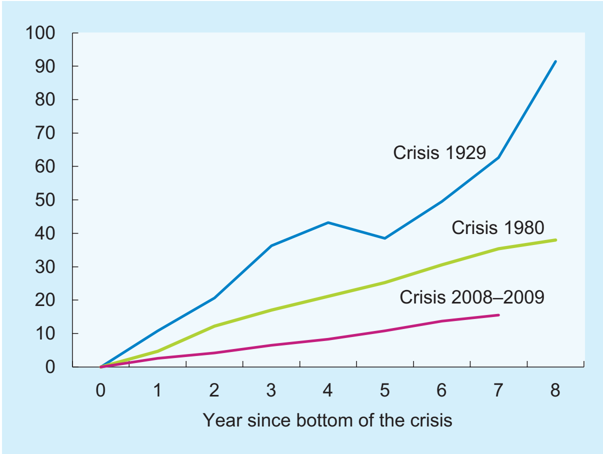
These arrangements buckled under a series of distributional pressures and economic shocks in the 1970s, giving way to *hyperglobalization* from the early 1980s. It was characterized by an extensive deregulation of markets − particularly financial and currency markets − in rich and poor countries alike, the attrition of the public realm, and the extension of profit-making opportunities to ever-widening spheres of not only economic, but also social, cultural and political life. The associated withdrawal of public oversight and management of the economy included the curtailment, and sometimes even the elimination, of policy measures previously used by States to manage their integration into the global economy. This was based on the belief that the unregulated forces of supply and demand were best suited to this task.

New patterns and players in international trade emerged along with a surge in international capital flows and significant shifts in the international division of labour. East Asia's strong growth trajectory established under partial globalization continued, and spread to China. Rapid growth in China from the late 1990s, along with the loosening of monetary and credit policy in the North, which was required to keep hyperglobalization running after the dotcom crisis, triggered a period of robust growth and poverty reduction across the developing world in the first decade of the new millennium. However, progress with respect to structural transformation, employment and distributional outcomes has been uneven, and in some cases it has even experienced a reversal (*TDR 2016*).

Hyperglobalization has also been accompanied by a radical break in the governance of the post-war international framework, whereby "bodies once designed to foster sovereignty are now recast to curtail it" (Mazower, 2012: 421). Meanwhile, there has been a proliferation of more informal cross-border governance arrangements built around corporate networks and public-private partnerships. Developing countries are typically expected to commit to a level of obligations much closer to those of developed countries, and across a range of areas extending well beyond tariffs and related border restrictions. Expansionary monetary policies have become the principal instrument of macroeconomic management, even as tight fiscal policies have constrained expansion. And the goal of financial stability has taken a back seat to the promotion of "financialization", enabling financial markets, financial motives, financial institutions and financial elites to assume the upper hand in the operation of the economy and its governing institutions, at both the national and international levels. Together these pressures have steadily eroded the checks and balances that had previously helped channel market forces into the creative and productive activities needed for long-term growth. Capital formation has stagnated, speculative investments (by banks, businesses and households) have proliferated, and rising levels of private debt have replaced rising wages as the binding agent in increasingly insecure and fragile socio-economic structures.

Even as many economists were anticipating a prolonged period of economic stability and income convergence, hyperglobalization entered its own *dämmerung* with the financial crisis of 2008−2009, causing deep and long-lasting damage in the developed economies and a delayed, but now evident, slowdown in developing economies. As discussed in chapter V of this *Report*, the crisis was linked to rising economic inequalities both as a cause and an effect, and those inequalities were further accentuated by the policies adopted after the crisis. This trend has become a growing concern for policymakers seeking to promote hyperglobalization to an increasingly sceptical public.

FIGURE 2.1 GDP recovery in the United States after three crises: 1929, 1980 and 2008–2009
(Percentage change)



Source: UNCTAD secretariat calculations, based on Federal Reserve Economic Data (https://fred.stlouisfed.org).
Note: Real GDP percentage change relates to changes with respect to the bottom level reached during each of the crises (the benchmark years being 1933, 1982 and 2009 respectively).

Global economic ties have broken down before, most notably at the end of the 1920s and during the 1970s. In both instances, volatile financial flows were the catalyst, but policy choices in the leading economies determined the response. However, unlike these previous episodes, the 2008−2009 financial crisis has not yet elicited a deep-seated reform agenda aimed at establishing a new growth path (figure 2.1). Rather, the global economy has spluttered along a familiar policy route towards "a new normal", wherein "global growth has become too low, for too long benefiting too few" (Lagarde, 2016). In this context, the abiding neoliberal refrain that "there is no alternative" has not only compounded a growing sense of popular frustration; it has also begun to erode the trust between citizens and their political representatives.

To prevent this new normal from becoming seriously disruptive and disorderly, attention has turned to making hyperglobalization "work for all". It is acknowledged that some individuals, communities, and even countries, lack the information, incentives or ingenuity required to grasp the opportunities offered by today's borderless and knowledge-intensive world. Since these are essentially viewed as matters of omission rather than commission, the resulting policy challenge is defined less in terms of changing the rules of the game than ensuring that all the players are properly equipped to participate.

This view misses a crucial point, that most of those who have experienced absolute or relative declines in economic well-being have not been excluded from the processes of hyperglobalization; rather, they have been integrated into such processes, often deeply so, even as they have been excluded from the benefits, and have typically borne the bulk of its costs (Meek, 2017). They have participated in more flexible labour markets that offer precarious and insecure jobs, often at lower wages, while large rootless corporations have enjoyed booming profits; they have had to deal with the consequences of fiscal austerity in the form of reduced public services and social protection, while high-wealth individuals have hidden away their runaway earnings in exotic locations; they have struggled under mounting debts as their underlying assets have been buffeted by distant financial forces; and they have watched as the managers of those same forces have been bailed out, even as their own communities have been left to sink into decay and despair.

This simultaneity of inclusion and exclusion leaves hopeful phrases such as "work for all" and "inclusive growth" open to misrepresentation. Many of its champions simply take it as a given that technological progress and the spread of market forces impart an inevitability to hyperglobalization, such that policymakers are reduced to finding the most market-friendly ways of compensating "the losers" and extending a helping hand to those "left behind".

In reality, the economic and political consequences of the interdependence of nations, the rise and spread of new technologies and the breakdown of existing ways of life have been a recurring source of policy debate and design since at least the French Revolution, if not earlier (Stedman Jones, 2004). Hyperglobalization is not an independent and immutable economic force over which governments have no control. Rather, it has resulted from a set of politically constructed rules, norms, practices and policies that shape the ways in which countries, their firms and their citizens interact with their counterparts elsewhere in the global economy. And as social and economic gaps widen, within and across countries, it is hardly surprising that trust in the rules of the game (and in those administering them) to deliver fair and inclusive outcomes is breaking down, with further damaging consequences.

What is perhaps more surprising is the resilience of those rules, despite the consequences. In particular the institutions, policies and regulatory norms relating to financial markets, corporate governance, wage bargaining and macroeconomic management, have persisted without much change despite repeated shocks and crises. As noted in chapter I of this *Report*, a decade after the global financial crisis began to unfold, many of the economic and social imbalances that preceded it persist, and may even have increased; and austerity has remained the default policy response to a variety of economic troubles.

B. A more measured debate? Estimating trends in inequality and exclusion

There is now a greater willingness to acknowledge that inequality may be an obstacle to growth, that it can pose a serious political threat to more open societies, and that current levels of inequality are morally unacceptable. However, the challenge of forging a more inclusive agenda is compounded by difficulties in measuring the problem. In recent years, poverty has been the metric of choice, particularly in the international community, in part because it seems to be relatively easy to measure, and it speaks to a tangible challenge. However, beyond some basic indicators of extreme deprivation, measuring poverty has never been straightforward; it is subject to changing social attitudes and political sentiments (Reddy and Lahoti, 2016). Moreover, poverty data quickly become embroiled in a whole range of contentious issues that divide supporters and critics of hyperglobalization; for example, is it "the market" or the Chinese State that deserves the most applause for lifting more than a billion people out of extreme poverty?

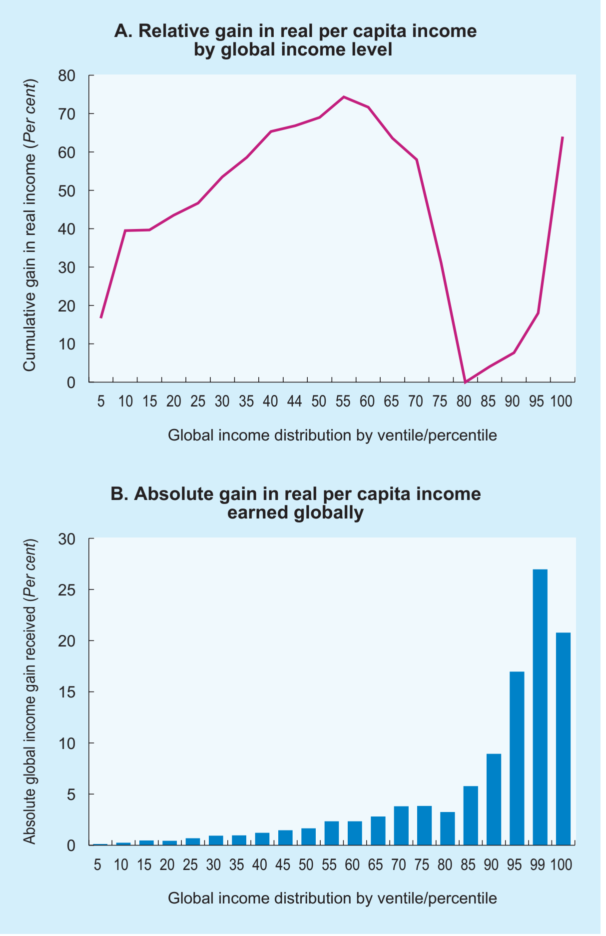
The United Nations Sustainable Development Goals (SDGs), with their related targets and indicators, offer a comprehensive monitoring framework for policymakers concerned with fostering inclusive development.[1] Goal 10 of the SDGs calls for reducing inequalities based not only on income, but also on age, sex, disability, race, ethnicity, origin, religion and economic or other criteria, both within a country and among countries. And because income inequality is strongly linked to other measures of social well-being, it continues to provide an obvious departure point for tackling the wider inclusiveness challenge (Wilkinson and Pickett, 2009).

Measuring inequality, however, has its own long and contested history. Part of the difficulty is that *economic* sources of inequality are many and complex, and they are often connected to forms of *categorical* inequality that arise out of multiple social and cultural identities (Galbraith, 2016). The class and gender aspects of this relationship are examined in chapter IV. The measuring difficulties are compounded by an increasingly interdependent world, where, clearly, there is a need for some internationally comparable income- and/or consumption-related measures of inequality that will allow comparison across countries and over time. Not surprisingly, considerable lacunae in the data persist, and efforts to fill the gaps are perforce largely assumption-driven. The results are sensitive not only to what is being measured and how, but also to various other factors such as country selection and weighting, the time periods covered and the exchange rates used for making local data internationally comparable.[2]

There are also issues relating to measuring incomes or consumption within countries. While household surveys, earnings data and tax records are commonly used in developed economies to generate income inequality data, different series can generate divergent trends. To give some indication of the problems involved, Atkinson (2015) has recorded the variations in individual earnings dispersion and household inequality since the 1950s for the United Kingdom and the United States of America, which demonstrate some clear disparities between two countries that are often portrayed as sharing a common history of inequality trends. But since such data for developing countries tend to be less extensive, replicating these series for many of these countries would be almost impossible.

It is true that in recent years, researchers have been exploiting new data sources and devising new inequality measures (Atkinson, 2015; Picketty, 2014; Milanovic, 2016; Palma, 2011; Cobham et al., 2015; Galbraith, 2016; Lahoti et al., 2016). Piketty and

FIGURE 2.2 Shifts in global inequality, 1998–2008 (2005 dollars)



Source: Milanovic, 2016.

his colleagues, in particular, have made significant strides in tracking the income (and more recently wealth) of the top 1 per cent of income earners, albeit concentrating largely on the developed world. Chapter V of this *Report* uses the relatively new Palma ratio in its discussion of the links between income inequality and economic crises. This is the ratio of the share in gross national income (GNI) of the top 10 per cent of income earners to that of the bottom 40 per cent in any given country, and is well-suited to capturing polarization trends, assuming, as the empirical evidence broadly suggests, that the share of the "homogeneous middle" of income earners (i.e. those receiving between 90 and 50 per cent of GNI) has been relatively stable in most countries. However, while the index draws attention to polarization, it does not capture the material insecurity of the middle classes that has been widely observed in many developed countries. Chapter IV of this *Report* uses the more familiar measure of the labour share of national income to assess the impact of gender inequality in labour markets on the functional distribution of income. This is of significance because, as women's participation in the labour force increases – a nearly universal phenomenon in both developed and developing countries in the era of hyperglobalization – household incomes rise because of additional workers, and not because of rising wages.

Although statistical challenges persist at the national level, bold attempts have been made to construct a comprehensive measure of global inequality, combining inequality both within and across countries, and its evolution over time. This has given rise to Milanovic's elephant chart (figure 2.2A) based on relative gains in real per capita income across income ventiles of the global population between 1988 and 2008, which reveals an emerging middle class in the South, the hollowing out of the traditional middle class in developed economies and an absconding global elite. But as Milanovic (2016) also notes, the absolute gains in real per capita income may be the more telling statistic (figure 2.2B). Inevitably, judging which of these measures – absolute or relative – best reflect the inequality challenge is an issue that continues to divide analysts and policymakers.

C. Explaining inequality and exclusion: Trade, technology and jobs

It may seem incongruous to talk about inclusive growth without first identifying possible causes of exclusion from the benefits of growth. However, much of the recent discussion about making globalization more inclusive does precisely that.[3] As a result, even as inequality has emerged as a primary political concern, the international community has lacked a convincing narrative linking distributional issues to the challenges of growth and development; instead, it has been focusing on the failure of national policymakers to adapt to the borderless forces of economic progress (*Economist*, 2016; Emmott, 2017).

The current discussion continues a debate that began in the early 1990s, on whether it is increased North-South trade or technological change that is the principal source of economic disruption in the developed economies. The details of earlier debates have been discussed in previous Reports (*TDRs 1995; 1997; 2012*). Suffice it to note here that the reluctance on the part of conventional economists to attribute significant economic damage to trade shocks[4] is due to the assumptions common to most theoretical trade models and simulation exercises based on the computable general equilibrium (CGE) model of fully employed resources and competitive markets (Kohler and Storm, 2016). This leaves technological change as the default explanation for labour market disruption, a line of argument that has been readily extended from the problems of unemployment in the early 1990s to rising inequality today.[5] The impact of technological change is usually traced to relative price movements, the factor content of production and elasticities of substitution, with a bias towards new technologies (particularly information and communication technologies, or ICTs) that give skilled labour a wage premium over unskilled labour, thereby skewing income distribution. This argument (examined further in chapter III) seems to offer a more palatable explanation than trade shocks, given the ubiquitous reach of technological change and its reported growth impulses (traditionally measured through the large residual in growth accounting exercises). It also lends itself to an easy policy agenda that targets education as the surest way to achieve more inclusive growth.

The IMF (2017) has recently extended the technological change argument to explain falling wage shares in the North. It argues that technological progress, as reflected in the steep decline in the relative price of investment goods, has disproportionately encouraged firms to replace labour with capital, especially in more routine-based occupations. This argument assumes that changes in capital intensity result only from changing relative prices of capital and labour. It ignores the effects of the pattern of demand and the resulting product mix, which can make capital intensities of individual industries less significant in driving overall capital intensity. Overall, this focus on technology as the chief determinant of profit and wage shares downplays the impact of the power of the financial sector, reflected in that sector's much higher share of profits (driven principally by capital gains) as well as its higher share in gross domestic product (GDP) compared with those of the manufacturing sector – features that have persisted even after the 2008 crisis.

The "trade versus technology" discussion has served to highlight the critical role of employment in fostering inclusive economies, particularly given that a growing number of households are increasingly worried that the kind of stable, well-paid jobs needed to secure a middle-class lifestyle have already been hollowed out in the developed economies, and are also increasingly out of reach for an aspiring middle class in many emerging economies (OECD and World Bank, 2016). However, the evidence linking greater inequality to either trade or technology remains inconclusive, in part because the scale of changes in both these areas over the past two decades does not directly match the pattern of job destruction in the manufacturing sector (Schmitt et al., 2013). This is particularly so given recent evidence of falling productivity growth, and the heavy skewing of rewards in favour of those at the very top of the income ladder. Moreover, rising inequality also reflects growing wage differentials amongst those with the same or similar educational credentials (Mishel, 2011). These discrepancies have led to more hybrid accounts of rising inequality, which incorporate institutional changes in labour markets, changes in macroeconomic policies and changing interactions between trade and finance. The IMF (2007), for example, has argued that it was a mixture of technological progress and financial openness that turbo-charged the income premium for highly skilled and professional workers (including those in finance) as the most potent source of inequality. It also found that foreign direct investment (FDI) was a significant source of both faster growth and rising inequality, as it increasingly intertwined with trade and technology through global value chains.[6] On some assessments, the resulting reconfiguration of the international division of labour around these chains has helped narrow income gaps across countries (Baldwin, 2016), but on others, it is part of a "hollowing out" of the middle class in developed economies (Temin, 2017) and a "middle-income trap" in some developing economies (*TDR 2016*; Felipe et al., 2014), with ambiguous effects on gender inequality (see chapter IV). In any case, as noted in *TDR 2012*, what are seen as purely technology-driven distributional effects may well be related to shifts in macroeconomic policy, as well as to international wage competition that has been at least partly driven by trade and by changes in corporate behaviour resulting from domestic deregulation and financial globalization.

Another approach to making hyperglobalization work for all has seen the inclusiveness challenge as essentially about overcoming marginalization. The prediction that poverty could be alleviated by simply reducing the role of the State in the economy and by opening up to global market forces, which was expected to trigger rapid income gains, some of which would "trickle down" to the poorest segments of society, has not come to pass. Some research reported that the growth dividend from globalization was spread equally across all income cohorts, with little evidence that targeted policies made much of a difference (Dollar and Kray, 2001). But other research found that lower income cohorts were often further marginalized as growth picked up, thus requiring targeted, "pro-poor" growth policies (Kakwani et al., 2000). Subsequently, there has been a convergence of sorts on the view that stimulating growth serves to reduce absolute poverty, while targeted measures can raise the relative standing of the poor (Bourguignon, 2015). As a result, the World Bank introduced its Poverty Reduction Strategy Papers, which added (market-based) provision of primary education and health care to its traditional adjustment packages (UNCTAD, 2002), placing greater emphasis on the importance of human capital and sound economic governance (including the effective provision of public goods) as part of a more inclusive growth agenda (Commission on Growth and Development, 2008).[7] Widespread calls for increasing women's participation in paid activities, especially entrepreneurship, as a path to higher growth echo these perspectives. More recently, the World Economic Forum (WEF, 2017) has adopted a similar approach in response to the challenges of the so-called Fourth Industrial Revolution. It advocates a set of institutional and policy measures that moves beyond economic growth to focus on "people and living standards" through an emphasis on education, training and protection for non-standard work practices.

By contrast, the classical development literature on the interplay between growth, structural change and income distribution, directly addressed exclusionary pressures in the process of development. Kuznets (1955) described a trade-off between growth and inequality over the course of structural transformation: industrialization and urbanization would first generate rising inequality before levelling off and giving way to greater equality in a post-industrial context, as demographic, technological and other exclusionary pressures waned and political power became more evenly distributed. The dual- economy model of Arthur Lewis (1955) addressed the trade-off between growth and inequality by rejecting the assumptions that resources are always fully employed and that markets are perfectly competitive and clear automatically, thereby opening distributional outcomes to bargaining. Others argued that "polarization" is a permanent feature of market forces due to their strong cumulative tendencies (Myrdal, 1970), the first-mover advantages that could accrue from economies of scale and their lock-in through growing market concentration, which play out both within and between countries. Prebisch (1950) showed how structural and technological gaps across countries could, through unequal terms of trade, perpetuate underdevelopment in the South while reinforcing prosperity in the North. Hymer (1971) identified similar stratification tendencies linked to the evolution of the multinational corporation, whereby the international division of labour would come to mirror the hierarchical vertical division of labour within the firm. As a result, global poverty was seen as a consequence of both diverging incomes between rich and poor countries, and the capture of State policy and resources by a small elite within developing countries (Myrdal, 1970), but not as an inevitability. A strong role was assigned to proactive policies, at both the national and international levels, to promote greater equality as a catalyst for development (see, for example, Myrdal, 1970: 64; UNCTAD, 1964).[8]

D. Beyond the trade-versus-technology debate: Power and politics

Clearly, institutional arrangements and policy choices have a determining influence over distributional outcomes, given the conflicting interests and unequal bargaining power in both developed economies (Levy and Temin, 2007; Jaumotte and Osorio Buitron, 2015; Stiglitz, 2015; Atkinson, 2015) and developing economies (Cornia and Martorano, 2012; Milanovic, 2016). This role of relative power means that economic polarization within and across countries and along various axes (wage earners and profit earners, skilled and unskilled workers, creditors and debtors, and financial and industrial interests) cannot be adequately addressed through a singular focus on either trade or technological change (*TDRs 1997*; *2012*). In particular, the impact of such changes cannot be isolated from the macroeconomic and institutional settings in which different groups voice their claims and bargain over the outcomes. This *Report* argues further, that the workings of the global economy and of individual national economies are closely tied to the cumulative sources of market power augmented through specific policy measures, including those that have helped to boost profits at the expense of wages. This has given rise to unstable growth regimes, driven by rising levels of debt, and it reinforces the point that hyperglobalization has become intimately connected to the financialization of economic activity and to concomitant increases in income inequality within and across economies.

Since the financial crisis of 2008−2009, researchers have paid growing attention to these links between polarization and instability, in part because inequality is increasingly considered a factor that contributed to that crisis (Stiglitz, 2012; Stockhammer, 2015). Thomas Piketty's *Capital* has become the leading opus in this emerging canon, and, despite its methodological shortcomings (Galbraith, 2014; Rowthorn, 2014; O'Sullivan, 2015), it has refocused the inequality debate from the bottom of the income ladder (extreme poverty) to the top 1 per cent. This, in turn, has drawn attention to systemic economic causes of rising inequality. Moreover, by bringing wealth back into the discussion, Piketty has revived Adam Smith's political economy aphorism (borrowed from Thomas Hobbes) that wealth is power, and − by implication − that an increasingly unequal distribution of wealth is likely to skew political power, and with it, policy design in favour of those at the top of the income ladder.[9]

The issue of economic power – its distribution, dynamics, uses and implications – is an underlying and occasionally explicit theme of this *Report*. The continued power of finance to influence and benefit from national policies and regulations, as well as international structures and rules, has been discussed extensively in previous *TDR*s under the rubric of finance-led globalization. This has contributed to a climate of wage repression, which in turn affects patterns of consumption and investment. The resulting debt overhangs generate stagnationary or recessionary conditions. However, these cannot be redressed by equivalent public spending because of the continued focus on fiscal austerity. Such a focus itself is a reflection of the continued power of finance in influencing public policy choices. Asymmetric power structures (as expressed in relational inequalities such as those relating to gender discrimination) can segment labour and other markets, and thereby affect macroeconomic processes, as discussed in chapter IV. The nature of technological change (e.g. the advance of more automated production systems) and its impact tend to be seen as an external wave that impacts economies and societies in ways they cannot control, as discussed further in chapter III. However, as that chapter suggests, both the nature of that change and its implications are affected by policies and processes within economies, which in turn are driven by power dynamics within and between countries. Finally, corporate power in general − both sheer market power and the ability to gain from different kinds of rent − plays a significant role in influencing economic policies and in shaping macroeconomic patterns and distributional outcomes, as discussed in chapter VI.

E. Markets and inclusiveness

Since the global financial crisis of 2008−2009, making hyperglobalization more inclusive has become the new mantra in policy circles at both the national and international levels, and it has assumed even greater urgency following a series of unexpected political shocks in 2016. Partly because that crisis exposed the myth of efficient and self-correcting markets, policymakers have become more open to addressing "market failures" and to contemplating more radical measures to mitigate the self-destructive proclivity of some markets (Wolf, 2016). However, much of the inclusiveness agenda, particularly when extended to developing countries, has sought a revival of policies and efforts to boost markets at a local level.

As noted earlier, disappointment with structural adjustment programmes gave rise to a post-Washington Consensus agenda that aimed to include the poor more directly in market-driven wealth-creating processes. Talk of a more "inclusive capitalism" certainly helped to loosen the policy discussion somewhat, but it also reconsidered the poor in developing countries as fledgling entrepreneurs. This resuscitation of the entrepreneur as a catalytic figure in the development process tapped into a strand of the neoliberal project rooted in the Austrian economic tradition (Easterly, 2014).[10]

One of the first to allude to this inclusive entrepreneurial capitalism was Peruvian economist Hernando de Soto (1986), who saw the poor as "entrepreneurs in waiting", frustrated by indifferent bureaucrats and excessive regulations. He suggested that, if these regulations could somehow be dismantled and property rights strengthened, poverty and unemployment would quickly disappear. This claim was backed by Muhammad Yunus, the United States-trained Bangladeshi economist who subsequently received the Nobel Peace Prize along with the iconic Grameen Bank that he founded in 1983. Yunus focused more on the financial constraint on entrepreneurship, claiming that the poor (and particularly poor women) needed only a tiny loan (microcredit) to enable them to establish or expand informal microenterprises − or self-employment ventures – in order to escape poverty.

With the help of international aid agencies and philanthropic organizations, and the appeal of the gender equality arguments that characterized most of these approaches, the idea of poverty alleviation as a micro-motivational challenge quickly gained wider traction. Microcredit was promoted, along with a host of related "bottom-up" ideas designed to more effectively include the poor in creating and managing their own solutions to poverty and social exclusion. "Inclusive capitalism" was espoused through the promotion of concepts such as social entrepreneurship and social enterprises (Borzaga and Defourny, 2001), social capital (Woolcock and Narayan, 2000), the "bottom of the pyramid" notion (Prahalad and Hart, 2002), inclusive value chains (OECD and World Bank, 2015), financial inclusion (World Bank, 2014), and, more recently, new ICT-driven innovations applied to local financial operations, also known as "digital financial inclusion" (Klapper and Singer, 2014).

The simplicity of these innovations has helped expand the scale and scope of the "inclusive capitalism" idea, but with surprisingly little attention to analytical rigour or careful empirical assessment. The resort to a gender narrative in defence of such an approach is examined in greater detail in chapter IV of this *TDR*. But the original idea of individual entrepreneurship via microcredit, in particular, has been found to contain a number of fundamental flaws and it has a sub-standard track record in terms of poverty reduction. This has led to its re-evaluation or abandonment by many institutions and countries (Bateman, 2010; Roodman, 2011; Bateman et al., forthcoming; Bateman and Maclean, 2017).

Specifically, the *types* of businesses established by individual entrepreneurs with the help of microcredit are generally not the sort that boost employment creation − indeed they are more often than not employment displacing − nor do they create a sustainable and equitable local development trajectory based on productive diversification (Reinert, 2007; Sustainable Livelihoods Foundation, 2016). There is a similarly weak record on advancing gender equality or women's economic empowerment (Chant, 2016; Kabeer, 2005). Indeed, there is much evidence to suggest that intermediating scarce financial resources into these activities through microcredit institutions in preference to other types of scaled up activities and enterprises actually *blocks* the development process in the longer run (Bateman, 2010; Bateman and Chang, 2012; Chang, 2010: 157–167). Instead, as argued in *TDR 2016*, productive entrepreneurship in the global South involves the creation of a core of interconnected, formal small and medium-sized enterprises (SMEs) and larger enterprises capable of promoting industrial upgrading and structural transformation. Creating large numbers of new informal microenterprises might look good for the various individuals and programmes that promote individual entrepreneurship as an immediate escape from poverty or as a means to women's empowerment, but the long-term impact on the ground is one of permanently locking in poor communities to only the most unproductive, low-paying, temporary and self-exploitative business practices.[11] However, microcredit's serious failings were largely overlooked thanks to its inclusion into a wider microfinance paradigm, which also included other areas such as micro-savings, micro-insurance and micro-leasing.

This essentially microeconomic perspective on inclusive globalization appears to have found ready supporters in aid agencies, philanthropic organizations and non-governmental organizations (NGOs) (Haering, 2017). However, it fails to address the more systemic causes of exclusion stemming from the unstable and polarizing nature of deregulated markets. In particular, it ignores the new sources of insecurity and inequality that have emerged around market concentration and rent extraction.

F. Rents and rentiers

Two big trends characterize the era of hyperglobalization: a massive explosion in public and private debt, and the rise of super-elites loosely defined as the top 1 per cent of income earners. These trends are associated with the widening gap in ownership of financial assets, particularly short-term financial instruments, and the related growth of financial activities that, as James Tobin (1984) noted long ago, "generate high private rewards disproportionate to their social productivity". This is a world where rent extraction has become a much more pervasive source of income inequality.

The role of rents has a long and contested intellectual history. Some view rents as a hangover from feudal times, reflecting little more than legalized theft that bankrolls a new leisure class; others see them as the catalyst driving technological progress through a process of creative destruction, or as the deserved rewards for unique talents or abilities that enrich our cultures. However, both the classical and neoclassical traditions agree that when rentiers (i.e. those living on largely fixed incomes derived from legal ownership as well as from institutional and political control of physical and financial assets) gain the upper hand over entrepreneurs operating on the basis of expected profit from innovative and risk-taking real investment, the outcome will be "unproductive", "distortionary" and static. Rentiers' competition for a higher share of a given pie will prevail over entrepreneurial initiatives to grow the pie. As Stiglitz (2015: 141) points out, rent-seeking means "getting an income not as a reward for creating wealth but by grabbing a larger share of the wealth that would have been produced anyway", thereby relating the discussion of rising inequality to a range of strategies that in one way or another seek to game the system rather than helping to develop it.

Much of this discussion has focused on the financial sector. Keynes famously anticipated "the euthanasia of the rentier" which he described as "the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital", a power which he viewed as "functionless". Keynes optimistically assumed that a monetary policy of low long-term interest rates, in combination with a gradual socialization of investment, would create a large enough capital stock to make rental (fixed) income from capital non-viable. However, more recent discourse has identified a new generation of rentiers emerging from the financial sector. In a seminal study of the savings and loan crisis in the United States, Akerlof and Roemer (1993) described how "looting" could be used to extract value, and could also become a more generalized strategy of market manipulation, including through the deliberate bankrupting of a company by its senior management to maximize their private gain. Black (2005) and Galbraith (2014) suggest that fraud was at the heart of the 2008 financial crisis, and was enabled by deregulated markets. More generally, firms employing predatory strategies "can quickly come to dominate markets, using their apparent financial success to attract capital, boost market valuation, and expand through mergers and acquisitions" (Galbraith, 2015: 160). At the same time, there is mounting evidence that firms in developed economies, but also in some emerging economies, are diverting profits away from reinvestment into dividend payments, share buy-backs and acquisitions in order to raise share prices and reward senior management (Lazonick, 2016; *TDR 2016*).

Various attempts have been made to gauge the size of rentier incomes in recent years. Defining these as profits realized by firms engaged primarily in financial intermediation plus interest income realized by all non-financial, non-government resident institutional units, Power et al. (2003), for example, found a rising trend in many countries of the Organisation for Economic Co-operation and Development (OECD) beginning in the late 1970s. However, their analysis stops in 2000. Seccareccia and Lavoie (2016) provide a longer trend for the Canada and the United States, albeit using a slightly narrower definition of the rentier class (drawn from Keynes) as owners of low-risk financial assets. They find a particularly sharp rise in rentier incomes from the late 1970s, followed by a sharp drop in the late 1990s, and subsequently fluctuating around a positive trend through to the 2008 financial crisis. From a more microeconomic perspective, Phillipon and Resheff (2009) show that a significant proportion of the dramatic rise of relative wages in the financial sector in the United States from the mid-1980s is attributable to rents, rather than to education, occupational attributes or ability. This may also help explain the failure of regulators to keep tabs on the fraud that became inherent in that sector during this period. Wider distributional consequences of rentier strategies have surfaced since the 2008−2009 financial crisis through the socialization of losses, largely paid for by the bottom 90 per cent of the population, and with a particularly heavy burden carried by the lowest income segments. In so doing, this has compounded the privatization of earlier profits.

However, less attention has been given to the ways in which non-financial corporations have become adept at using rent-seeking strategies to bolster their profits. Indeed, financial incomes constitute only one part of rents in this broad definition. A significant proportion of rents has also accrued through monopolies or quasi-monopolies created by intellectual property rights (IPRs), while still others can be described as "political rents" derived from the ability to influence particular aspects and details of government policies in ways that disproportionately favour certain players. Recent evidence of rising market concentration across several sectors, both at the national and international levels, has revived interest in the links between market power, rent-seeking and income inequality. Market concentration and rent extraction can feed off one another, resulting in a "winner-takes-most competition" that has become a visible part of the corporate environment, at least in some developed economies. This makes intra-firm differences an increasingly important component of the rising inequality story (Bloom, 2017). These issues are explored in greater depth in chapter VI of this *TDR*.

G. From inclusive (hyper) globalization to a global new deal

This year's *TDR* examines three evident sources of exclusion: (i) the automation of production, in particular robotization, and the threat of this causing a "hollowing out" of the human workforce; (ii) the segmentation of labour markets, in particular in terms of the gender dimension, which threatens to engender a "race to the bottom"; and (iii) corporate strategies to concentrate control over markets, particularly by non-financial corporations, combined with growing "rent extraction". Each presents its own distinct challenges to policymakers, in both developed and developing countries, who seek more inclusive outcomes. However, they are all interconnected through the deregulation of markets and a tighter control of assets, along with asymmetries in market power as a potent source of growing inequality.

From all this, it is clear that moving away from hyperglobalization to inclusive economies cannot be a matter of simply boosting human capital, filling information gaps, honing incentives, ensuring better provision of public goods – particularly education – extending credit to the poor and providing stronger protection to consumers. Rather, it demands a more exacting and encompassing agenda, which addresses the global and national asymmetries in resource mobilization, technological know-how, market power and political influence that are associated with hyperglobalization, and which generate and perpetuate exclusionary outcomes.

Such an approach would bolster the SDG agenda of tackling income inequality, both within and across countries, with a strong narrative around which effective policy measures could be designed, combined and implemented. This *Report* suggests that the elements for such a narrative can be gleaned from UNCTAD's founding mandate of 1964 (section I, para. 1) for "a better and more effective system of international economic cooperation, whereby the division of the world into areas of poverty and plenty may be banished and prosperity achieved for all". This was based on the recognition that "economic and social progress should go together. If privilege, extremes of wealth and poverty, and social injustice persist, then the goal of development is lost".

A good deal has changed since 1964, in terms of the human and productive capacities accumulated in developing countries, the insertion of these countries into the global economy, the kinds of economic vulnerabilities they face and the policy space they can use to help climb the development ladder. However, as before, effective internationalism continues to rest on responsible nationalism, and finding the right balance remains at the heart of any meaningful multilateral agenda. Today, no less than 50 years ago, achieving prosperity for all in an interdependent world must still involve paying close attention to the biases, asymmetries and deficits in global governance that can stymie inclusive and sustainable outcomes.

With this in mind, a possible narrative around which an alternative inclusiveness agenda might be fashioned is a "global new deal" (UNCTAD, 2011). The original New Deal, launched in the United States in the 1930s and replicated elsewhere in the industrialized world, particularly after the end of the Second World War, established a new development path with three broad strategic components: recovery, redistribution and regulation. While these components gave rise to specific policy goals tailored to particular economic and political circumstances, they made the taming of finance a common route to success along this new path. Franklin D. Roosevelt, in his 1944 address to the United States Congress, belatedly added another ambitious set of economic rights as a final component to achieving a secure and prosperous post-war United States. These included: the right to a useful and remunerative job, the right to economic security at all stages of life, the right to fair competition, the right to a decent home, adequate medical care, good health and a good education.

Roosevelt's administration also pursued a very different kind of international cooperation agenda, particularly towards Latin America, which eventually informed, albeit in a diluted manner, the negotiations that led to the establishment of the Bretton Woods system (Helleiner, 2014). That system initially promoted New Deal ambitions through a combination of guaranteed policy space for national governments and strengthened international cooperation to correct the kinds of market failures that had generated interwar instability: in particular, destabilizing currency fluctuations, a shortage of international liquidity and volatile capital flows. However, the multilateral rules and regulations were incomplete and lacked a more inclusive dimension, giving way to a partial and technocratic multilateralism largely tailored to the competitive advantage and corporate interests of the developed economies (*TDR 2014*).

The shift from partial globalization to hyperglobalization has failed to bring about a more stable, secure and inclusive international order; and the lead role, ceded to unregulated financial markets, appears to be particularly ill-suited to delivering the SDGs. Just how an agenda built around recovery, regulation, redistribution and rights takes shape will depend, again, on local circumstances, and policymakers will need to ensure that they have the requisite policy space. However, the specific challenges of inequality and insecurity in the twenty-first century will not be tackled by countries trying to insulate themselves from global economic forces, but rather by elevating the elements of the original New Deal to a global level consistent with today's interdependent world. Some possible elements of that agenda are discussed in the final chapter of this *Report*.

Notes

1 A good deal of related statistical work is already under way, including for measuring specific indicators of inclusive growth (Anand et al., 2016) and inclusive development (WEF, 2017).

2 The widespread use of PPP exchange rates as the appropriate deflator for comparison purposes, for example, is not without serious problems (see Pogge and Reddy, 2002; Ghosh, 2008 and 2013; Reddy and Lahoti, 2016).

3 No doubt, this is partly a reflection of the dominance of conventional economic thinking, which has long held that for improving the welfare of people, distributional issues are a distraction from the principal task of increasing the size of the economic pie. The traditional, neoclassical theory of income distribution, as well as its more recent human capital variant, assumes that factors of production earn exactly what they contribute at the margin, and are subject to the laws of supply and demand. For a review and critique, see Folbre, 2016.

4 There is little hesitation, by contrast, in attributing very large gains to trade openness. For a recent example, see Hufbauer and Lu, 2017; and a critique by Baker, 2017.

5 Autor et al. (2015) suggest, at least for the United States, that the impacts of trade and technology differ across sectors and at different times, and that in the 1990s and 2000s, trade at least matched technology as a potential source of disruption (see also Wood, 2017).

6 These links are picked up again in IMF, 2017.

7 The early neoclassicists, including Marshall and Pigou, for example, were concerned that the labour classes were failing to save enough to enable them to survive periods of unemployment and to provide for their old age. This was regarded as "irrational behaviour", with a lack of foresight or self-control (Peart, 2000). Education was seen as the cure, and, once obtained, there would be no further need for government intervention. The lingering influence of such thinking can still be found in much of the literature on human capital.

8 Recent research supports the notion of a two-way causation between equality and growth (see, for example, Ostry et al., 2014; Cingano, 2014), although the results are contested (for a review, see Kolev and Niehues, 2016).

9 Smith (1776) was clear that this was not an automatic connection, stating that "Wealth, as Mr. Hobbes says, is power. But the person who either acquires, or succeeds to a great fortune, does not necessarily acquire or succeed to any political power, either civil or military. His fortune may, perhaps, afford him the means of acquiring both, but the mere possession of that fortune does not necessarily convey to him either." On predatory politics in practice, see Hacker and Pierson, 2010; and Galbraith, 2008.

10 For the evolution and limitations of the entrepreneurship narrative, see Nightingale and Coad, 2013; and Naude, 2013.

11 In fact, these and other flaws in the individual entrepreneurship component of the "inclusive capitalism" narrative have been long known to social anthropologists and labour economists (see, for example, Breman, 2003; Davis, 2006; Standing, 2016; see also UNCTAD, 2015: 97–98).

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