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Instability: Confronting the Marx, Keynes
and Polanyi Problems in Advanced
Capitalist Economies**

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**Globalization, Inequality And Financial Instability:
Confronting The Marx, Keynes And Polanyi Problems in the Advanced
Capitalist Economies**

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1. Introduction: Globalization and Ethics

Over the past 20 years, a widespread perception has emerged that a new stage has been reached in the relationship between capitalism and the nation-state. *Globalization* is the umbrella term—indeed the ubiquitous buzzword—conveying a sense the sense that a fundamental transformation is occurring in the contemporary world economy. Governments and opposition political parties around the world rewrite their economic programs to take account of the perceived new realities engendered by globalization. Books, articles (including this one) and editorial pronouncements all pour forth.

A great deal is obviously at stake in these discussions. At the same time, whether or not we have entered a new stage of capitalism, the fundamental ethical standards by which we evaluate the merits of capitalist societies remain the same. These ethical standards are liberty and fairness. Efficiency is the other basic measure by which we judge the performance of capitalist economies. But certainly in ethical terms, the claims for efficiency must carry less weight than those for liberty and fairness.

There is no question that free-market economic capitalism—what Adam Smith termed the “system of perfect liberty”—creates effective material incentives within a competitive environment, and thereby can succeed in encouraging discipline and innovation. But this same free-market “system of perfect liberty” also produces deep and chronic problems of unfairness. This becomes blindingly clear through even observing casually the the degree of income and wealth inequality in societies that more closely approximate the free-market ideal, such as the United States. The most objectionable feature of inequality in these societies is that it is necessarily transmitted through generations, since inequalities of outcomes in one generation produces inequalities of opportunities for the succeeding generation. Inequality also produces inefficiency, by distorting the incentives of both the over- and under-privileged and discouraging cooperative solutions to collective problems. Intelligently applied egalitarian government interventions in market economies can therefore increase both a society’s commitment to fairness

and its ability to produce useful goods and services. These interventions can also be achieved with relatively small losses of liberty.

Has globalization reduced the ability of countries to implement egalitarian policies effectively? Certainly this view is widespread. We know that, concurrent with at least the widely-shared perceptions of increased global integration, various manifestations of rising inequality have arisen in both the United States and the European OECD economies. These are the persistence of high unemployment in Europe and the rise of both earnings and wealth differentials in the United States, even while unemployment has fallen to its lowest levels in a generation. But are these problems really due to globalization? And if so, is it possible, given new constraints on policy created by globalization, that little can be achieved by governments to redress these problems?

These are the issues I examine in the rest of this paper, focusing on the issues as they relate especially to the United States and secondarily to Western Europe. I focus on the advanced OECD economies only in the interests of manageability. The same set of questions need to be thought through differently as they concern developing economies, and therefore deserve separate, careful attention.¹

In section two, I start by raising the most basic question: what is globalization? As we will see, the answer is not obvious. Of course, nobody doubts that major technical innovations have occurred in communications and transportation technologies. These innovations have reduced the transaction costs of maintaining effective economic links on a global scale. Moreover, the collapse of the Soviet system eliminated this challenge to capitalist hegemony, even though the governments professing to Communism had long since abandoned any serious claim to a democratic, egalitarian alternative to free market capitalism. The result, in any case, is

¹ I would suggest many of the essays in the volume I co-edited with Dean Baker and Gerald Epstein, Globalization and Progressive Economic Policy (1998), as one reference that does address these questions from the standpoint of the developing economics.

that huge areas of the world economy were now opened to capitalism to a degree unprecedented in generations.

But even given these changes, a serious literature has emerged challenging the claim that dramatic new departures have occurred in the patterns of global trade, investment, and finance. I in turn question the conclusions of this literature, pointing to three fundamental changes in the patterns of global economic activity: the rise of manufacturing capacity in developing, low-wage economies; the explosion of cross-border trading in all financial markets; and the fact that these two changes are occurring within a “big-government capitalism” institutional framework.

Section three then explores the implications of these three changes. I point to three basic problems that have emerged in the advanced economies in association with these three new economic patterns, which I term “the Marx problem,” “the Keynes problem”, and “the Polanyi problem.”

The Marx problem refers to the expansion of what Marx termed the “reserve army of labor.” The growth of manufacturing capacity in low-wage economies means an expansion in the effective supply of workers capable of producing goods competitive with those produced in advanced economies. As such, workers in the advanced economies lose bargaining power relative to capitalists. All else equal, this should then exert downward pressure on wages in the advanced economies.

The Keynes problem is that highly liquid financial markets, such as those that have emerged on a global scale in our current era, are prone to bouts of speculation and instability. Financial instability, in turn, is frequently transmitted into the real economy, creating severe cyclical volatility in incomes and employment. In addition, as the size and liquidity of financial markets expands, the capacity of governments to counteract such cyclical tendencies also weakens as the size and liquidity of financial markets expands.

The Polanyi problem concerns the ability of non-market forces to engender norms of social solidarity that can serve as effective counterweights to the competitive imperatives of a

free-market economy. In large measure, big-government capitalism was built in the post World War II era to promote such norms of social solidarity. However, as capitalists gain bargaining power in labor markets and rentiers have increasingly free rein in financial markets, a new political dynamic emerges. Workers, and the nonwealthy more generally, favor more Polanyi-esque social protection. But capitalists and rentiers, who favor less social protection, also enjoy increased political power flowing from their enhanced position in labor and financial markets. What makes this dynamic especially complex is that it is played out in an institutional environment in which big-government already exists, but its basic purposes are increasingly open to challenge.

Section 4 tries to consider the relevance of these issues for understanding wage stagnation and the rise of earnings inequality in the contemporary United States. I present some basic facts here, but these are not in dispute. The issue, rather, is whether the pressures associated with globalization are responsible for these widely observed trends. A large literature argues that the main cause of wage stagnation and earnings inequality is actually quite distinct from any pressures resulting from globalization. According to this literature, the driving force is rather that the integration of computer technology into all areas of economic life has created an increased demand for computer-capable workers, and a corresponding decline in demand for those without computer skills. This problem is termed a “skill-biased technological change.” Drawing from the work of David Howell, I review the evidence in support of this perspective and find it unconvincing. At the same time, the evidence remains incomplete establishing a link between earnings inequality and the combined pressures from globalization and the decline in egalitarian social norms. Still, as I will show, the weight of evidence in support of this perspective is substantially more persuasive than that in behalf of the skill-biased technological change hypothesis.

The implication of this last argument is that the problems associated with globalization are indeed real, and that new policy approaches to policy are clearly needed. The concluding

section of the paper sketches an alternative policy approach. I emphasize two main principles. The first is that, even while the problems we observe have fundamental global dimensions, the solutions will still need to be built largely within the framework of domestic policy settings. Following this principle, I then present some thoughts on how best to advance a domestically-oriented egalitarian policy agenda. This approach tries to take the full measure of the difficulties associated with global integration, and then explicitly seeks ways to circumvent or minimize these difficulties. In my view, the viability of such a policy framework will play a major role in confronting the quite formidable ethical concerns resulting from globalization in its current neo-liberal framework.

2. What is Globalization?²

The evolution of capitalist economies has always been intimately bound up with nation-states and national economic policies. Economists have correspondingly placed the nation-state and national economic policy questions at the center of their analyses. Adam Smith, for one, could not have been more clear that his primary concern was to understand the nature and causes of the wealth of *nations*, not merely the wealth of individuals, households, or regions.

The basic perception that pervades contemporary discussions about globalization is that the relationship between economic activity and nation states is dramatically changing. This means, first, that the extent of economic interactions between people in different countries is simply growing, at an ever-accelerating rate: that there is increasingly more trade, more foreign exchange transactions, more foreign direct investment, and more people migrating. But in addition to the increase in international economic interactions, it is also widely held that something more fundamental is occurring: that the quantitative increase in interactions is producing a qualitative change in the way nation-states operate within any given country's economy. In particular, most discussions of globalization hold that the power of nation-states to

² The central argument and data in this section are drawn from Baker, Epstein and Pollin (1998).

influence economic activity is eroding as economies become more integrated, while the power of businesses and market forces is correspondingly rising. This then enables us to provide a working definition to the question, “What is globalization?” For our discussion here, it refers to an accelerating rate and/or higher level of economic interaction between people of different countries, leading to a qualitative shift in the relationship between nation-states and national economies.

Based on this definition, we then need to ask what is unique about the degree of economic integration in the contemporary period that sets it apart from previous historical epochs. Starting with a seminal paper by the late David Gordon (1988), a substantial literature has developed in recent years which argues that the contemporary pattern of globalization does not represent a significant break from patterns that operated through most of the 20th century³.

Some of the key evidence in support of this view is as follows:

1. Relative to GDP, the amount and rate of increase in world trade has not changed significantly relative to the early part of the 20th century, i.e. the period just before World War I.
2. The extent of overall foreign direct investment has also not increased significantly relative to previous historical periods.
3. The overwhelming share of both trade and foreign direct investment is between OECD countries at similar levels of development, not between countries of the wealthier “north” and the poor “south.”
4. Net financial flows between countries, as measured, for example, by the percentage of total current account surpluses or deficits relative to GDP, are also currently at levels roughly equivalent to those during the 1920s, and are lower than those at the turn of the century.

Based on evidence such as this, Gordon and other authors in this stream of thought contend that the contemporary extent of global integration is not historically unique—which is to say, no qualitative break has occurred in our contemporary period in the relationship between

³ See also Zevin (1992), Hirst and Thompson (1996), and Sutcliffe and Glyn (1999).

national economies. From this, they also argue that the difficulties that national governments face in dealing with the forces of globalization are similarly exaggerated.

The general findings advanced in behalf of this perspective are beyond dispute, and the researchers who have developed this evidence have certainly clarified the issues at hand. But it does not follow that such evidence, by itself, provides an adequate empirical understanding of the nature of globalization in our current era, much less about policy constraints governments face in this current period.

In fact, crucial new developments have emerged in the current period. Three, in particular, stand out: the rise in manufacturing capacity in less developed economies; the exponential growth in *gross* financial market trading across borders and in foreign exchange markets; and the fact that these first two developments are occurring while the size of national governments, in proportion to national economies, remains quite large. Let us consider these three developments in turn.

The Growth of Manufacturing Capacity in Developing Economies

Beginning with Table 1A, giving data between 1970-94, we see that for the world as a whole, manufactures rose significantly as a share of total exports, from 60.9 percent in 1970 to 74.7 percent in 1994. Considering this pattern in more detail, we see that manufacturing exports of the developed countries rose over this period, but only modestly, from 72 percent to 79.2 percent. The dramatic change has taken place in the share of manufacturing exports from developing countries, from 18.5 percent to 66.1 percent, and in fact, this rapid increase in manufacturing exports from developing countries really only began after 1980. Not surprisingly, by far the most rapid advances came from Asia, which saw its proportion of manufacturing exports explode, from 23.5 percent to 73.4 percent between only 1980-94. However, Latin America and Africa have also experienced substantial, if somewhat less spectacular, increases in their share of manufacturing exports.

We can also see in Table 1B that the contemporary rise in the proportion of manufacturing exports from less developed region's is historically unprecedented. In Asia, the proportion of manufacturing exports from 1913-53 was roughly comparable to that for the 1970s, i.e. before the dramatic increase in the regions manufacturing exports. For Latin America and Asia, the proportion of manufacturing exports was generally well below that for even 1970. For the industrialized economies, the rise in the proportion of manufacturing exports is substantial since 1913, but only negligible for the UK and Northwest Europe.

[TABLE 1 BELONGS HERE]

In short, the extent of manufacturing exports coming from developing economies has risen to an unprecedented level. The extent of this development becomes even more clear in Table 2, which presents data on manufacturing exports by region and industry between 1980-95. What this table shows strikingly is that the rise of manufacturing capacity in developing economies is not concentrated in low-technology industries, such as textiles. Rather, developing economies are gaining increasing shares of export markets across all manufacturing industries, with the most rapid area of increase being in machinery and transportation equipment, an area requiring substantial technical capacity. The overall point here is that low-wage developing economies are increasingly capable of producing manufactured products that are competitive on world markets.

[TABLE 2 BELONGS HERE]

The Explosion of Financial Market Trading

As noted above, the extent of *net* financial flows—i.e. net resource transfers, such as measured through total current account surpluses and deficits—has not changed significantly in the current period. But, since the demise of Bretton Woods and the emergence of deregulated financial markets, there has been an enormous increase in *gross* flows, i.e. the total amount of international lending as well as secondary market trading in stock, bond, foreign exchange and derivative markets. Representative data on these trends is shown in Table 3.

TABLE 3 BELONGS HERE

To begin with, panel 3A shows the total amount of funds raised on international financial markets relative to world exports from 1950-96. For 1950, this figure was only 0.5 percent. It rises to 1.8 percent by 1970, still prior to the collapse of Bretton Woods. But post-Bretton Woods the ratio rises rapidly in the mid-1970s through the mid-1980s. By 1985, the ratio is 13.5 percent--a six-fold increase over 1970. By 1996, the figure we report is up to 20.0 percent, showing a continuing dramatic rise.⁴

Panel 3B then shows more detailed breakdown of foreign transactions since 1980 in bonds and equities as a percentage of GDP for six OECD countries, including here both secondary trading as well as primary issues. In all six cases, the jump in cross border flows from 1980 has been spectacular--e.g. for the United States, the ratio of cross border transactions/GDP rose from 9 percent to 135 percent. The largest jump was that of Italy, where the ratio rises from 1.1 percent.

In panel 3C we see similar patterns with growth of foreign currency trading. Since the collapse of Bretton Woods in 1973, the rise in currency trading and the gross flows of financial assets across borders is unprecedented. As we see, the ratio of daily foreign exchange turnover relative to the reserves of all central banks has risen spectacularly, from 6.8 percent of central bank reserves 100 percent by 1995.

Big-Government Capitalism

Since the end of World War II, governments have played a central role in the advanced capitalist economies to promote macroeconomic stability, finance social welfare programs, and subsidize favored industries (including, in the United States, the weapons industry). This represents a dramatic change in the role of government relative to the pre World War II era. The

⁴ But even this 20.0 figure for 1996 is a conservative estimate, in that, for purposes of comparability across the full period, we exclude the category "uncommitted facilities", as reported by the OECD for this year. Had we included these "uncommitted" as well as the "committed facilities" in our total for funds raised, the ratio of funds raised/exports for 1996 would be 30.0 percent.

extent of this change can be seen in Table 4, showing total government expenditures as a share of GDP for six representative OECD countries between 1880-1996. This ratio rises from 10.0 percent in 1880 to 11.7 percent in 1913 to 45.7 percent in 1992, before falling slightly as of 1996, to 45.1 percent.⁵

TABLE 4 BELONGS HERE

3. Fundamental Problems due to Globalization

What are the implications of these developments for understanding the current epoch of globalization? This is the issue to which we now turn.

The three unique features of our contemporary epoch of globalization—the rise in manufacturing capacity in the developing economies, the explosive growth of financial market trading, and the fact that these changes have emerged within an institutional framework of big government capitalism—have, in turn, engendered three basic problems, which I have termed the Marx, Keynes and Polanyi problems. In associating these problems with major thinkers whose work all greatly antedates our contemporary epoch of globalization, I am also trying to emphasize that the problems of contemporary globally integrated capitalism are by no means new or unique. What is unique is just how these long-standing problems have become manifested in our current period.

The Marx Problem

The basic issue here is the expansion of what Marx termed the “reserve army of unemployed.” Marx argued that, in general, workers have less bargaining power than capitalists in labor markets because they do not own their own means of production. But Marx also stressed that workers bargaining strength diminishes further when unemployment is high, since that means the employed workers can be readily replaced by the reserve army of unemployed outside the factory gates.

⁵ These differences over time would be greater still if we considered non-military expenditures only. Due to data inadequacies, we have thus far been unable to decompose the figures to that degree.

In terms of the contemporary global setting, the dynamics of the reserve army effect in high-wage economies such as the United States changes when firms operating in low-wage economies can produce export-competitive manufactured products. In this situation, the potential size of the reserve army necessarily expands to also include both the unemployed and, even more to the point, employed but low-paid workers in the developing economies. As such, the capitalists in the advanced economies have gained an additional bargaining advantage in wage-setting negotiations. This is because firms can now *credibly claim* that their own relatively high labor costs will threaten their export markets and increase import competition from low-wage competitors. In addition, the firms in high-wage economies whose operations are not tied to a specific location can credibly threaten to move to low-wage economies if costs in their current locations appear too high. The crucial issue here is not that firms actually leave their existing high-wage location but that they can brandish a *credible threat to exit*.⁶

In terms of the contemporary U.S. economy, this shift in bargaining power has been widely recognized, even if difficult to measure directly. For example, even amid the lowest unemployment rates in a generation, Federal Reserve Chair Alan Greenspan referred in his July 1997 semi-annual Congressional testimony to “a heightened sense of job insecurity,” among U.S. workers and “as a consequence, subdued wages.”⁷ This view is also reflected in the results of a Business Week poll reported in its 12/27/99 issue. Considering what Business Week termed the current “productivity boom,” 63 percent said that the “boom” has not raised their earned income, and 62 percent felt that it had not raised their job security. These negative attitudes by U.S. workers are especially remarkable, given that the media has persistently portrayed the Clinton economy as a period of near-universal prosperity.

The Keynes Problem

⁶ This same point is developed, if from a different analytic framework, in Rodrik (1997) and, through a game-theoretic model, in Rodrik and van Ypersele (1999).

⁷ The Greenspan testimony can be found at <http://www.bog.frb.fed.us/boarddocs/hh/1997/july/testimony.htm>, on the Federal Reserve web site.

Investors in capitalist economies are faced with the unavoidable problem of uncertainty: forecasts and projections aside, “we simply do not know”, as Keynes put it, how profitable a prospective investment project will be. A primary purpose of financial markets is to ameliorate problems due to uncertainty through increasing the liquidity of investments. When financial instruments are freely traded in relatively thick markets, illiquid investments in plant and equipment can be transformed into claims that are convertible into cash or other liquid assets as quickly as the institutional and technological structures permit.

However, enhancing the liquidity of assets also tends to create serious problems for the stability of capitalist economies. One problem is the phenomenon described by Keynes of market participants focusing their energies on outguessing the market rather than understanding the long-term productive capacities of firms. This phenomenon is, in turn, a basic factor generating the persistent problem of instability associated with liquid financial markets. Because markets operate on the basis of ephemeral information, they are liable to function as a herd. The destructive effects of financial market herd behavior are not hard to find: the 1997-98 Asian crisis, the 1995 Mexican crisis, and the U.S. Savings and Loan crisis of the early 1990s are only some recent dramatic examples.⁸

In addition, excessively liquid financial markets weaken the standard tools of macroeconomic stabilization and expansion. As Minsky (1986) argued, standard fiscal and monetary policy tools cannot bring the economy to a full employment equilibrium when financial markets are highly speculative. Depending on the specific circumstances, including those in the nonfinancial economy, full employment will rather promote either euphoric expectations among

⁸ Kindleberger (1978) , discusses the problem of financial instability over a 250-year history of Western capitalism between 1720-1975, developing his analytic framework from Hyman Minsky’s Keynesian theory of endogenous financial fragility. But we need to recognize here that it doesn’t necessarily follow that more liquid financial markets are *necessarily* more volatile. Indeed, all else equal, thicker markets would tend to be more *stable* than thin markets. This is because, if all else were equal, a greater diversity of opinions would prevail in thick markets, thus increasing the likelihood that market optimists and pessimists would counterbalance one another. The reality, however, is that all else is not equal. Rather, by their nature, actual thick financial markets generate uncertainty and herd behavior rather than a diversity of perspectives.

those investors who would benefit from a boom, such as real estate developers; or unfavorable expectations among investors whose fixed-income securities would lose value in an inflationary environment. As a result, policymakers must then respond to the expectations of these investors rather than the underlying conditions of the nonfinancial economy. This is the problem Alan Greenspan has been confronting in recent years in the U.S. in his futile efforts at talking down a stock market driven by what he terms “irrational exuberance.”

Furthermore, once a financial crisis has broken out and governments must try to neutralize a stampeding financial herd, their capacity intervene effectively will be smaller when the size of the stampede is relatively large. The logic of this is clear in the case of contemporary foreign exchange markets. Precisely because daily trading on these markets has risen from 6.8 percent of central banks' foreign currency reserves in 1977 to over 100 percent today, central banks have far less capacity to serve as a market-maker to counteract speculative stampedes.

The Polanyi Problem

The period in which big government capitalism was built was the aftermath of the 1930s Depression, World War II, and the developing worldwide competition with Communist governments. In this context, Karl Polanyi made a forceful case in his classic work The Great Transformation (1944) that for market economies to function with some modicum of fairness, they must be embedded in social institutions that effectively promote broadly accepted notions of the common good.

Various social democratic movements within the advanced economies adapted the Polanyi perspective. They argued in favor of government macroeconomic interventions to achieve three basic ends: stabilizing aggregate demand at some reasonable approximation of full employment; creating a financial market environment that is stable and conducive to the efficient allocation of investment funds; and distributing equitably the rewards from high employment, macroeconomic stability and efficiency in investment allocations. The political ascendancy of

these ideas were the basis for the dramatic increase that we have observed in the government expenditure/GDP ratio.

But the implementation of a social democratic capitalism was never a consensus position. Many sectors of capital opposed efforts to sustain full employment because, as we have seen, full employment engenders greater bargaining power for workers in labor markets, even while it also increases the economy's total output of goods and services.⁹ Greater worker bargaining power can also create inflationary pressures, and inflation will, in turn, depreciate the value of rentiers' portfolio of assets with nominally fixed values. In addition, market-inhibiting financial regulations limit the capacity of rentiers to both diversify risk and speculate.

Hence, it should not be surprising that capitalists and rentiers would utilize their increased bargaining power in labor and financial markets to also change the direction of government policy in behalf of their own ends. The issue here, moreover, is not *deregulation of markets per se*. Rather it is that markets be deregulated to support the interests of capitalists and rentiers, even as these same groups still benefit greatly from many forms of government support, including investment subsidies, tax concessions, and central bank rescue operations during financial crises. At the same time, the deregulation of markets that favors capitalists and rentiers is correspondingly the most powerful regulatory mechanism limiting the demands of workers, in that deregulation has been congruent with the worldwide expansion of the reserve army of labor and the declining capacity of national governments to implement full-employment macroeconomic policies.

This confluence of developments constitutes a unique historical juncture, since the apparatus of big government capitalism is still largely in place even while its purposes have come increasingly under challenge. To illustrate this dynamic, it will be helpful to briefly examine a highly insightful model developed by Elissa Braunstein and Gerald Epstein (1999). Consistent with recent work by Rodrik (1997), Braunstein and Epstein first argue that a positive correlation

⁹ The classic statement of this problem is by Kalecki (1971).

exists between the degree of openness of in the advanced capitalist economies and the demands of the nonwealthy in these economies for various forms of social protection. In Figure 1, we portray this relationship as an upward sloping demand curve for social protection, as a function of the economy's degree of openness.

At the same time, Braunstein and Epstein also argue that the supply of social protection is a negative function of openness. This downward sloping curve in Figure 1 captures the basic political scenario described above. That is, first, capitalists and rentiers have gained increased bargaining power in labor and financial markets in the current era of neoliberal globalization. They have then also transformed this increased market power to increased political power, enabling them to pay lower taxes and operate with fewer regulations.

FIGURE 1 BELONGS HERE

At point O_1 in the diagram, the economy is in equilibrium. However, as openness increases to O_2 , a disequilibrium emerges between the increasing demand and decreasing supply of social protection. The fundamental problem from the standpoint of state policy is how this disequilibrium gets resolved. Figure 2 sketches two alternative possibilities. The “Polanyi solution” would be for social protection to increase—i.e. a movement up the demand curve and a shift out in the supply curve. This generates an increase in social protection from P_1 to P_2 . However, the solution that has dominated politics in the advanced economies is a neoliberal solution, i.e. a movement down the supply curve with a shift out in the demand curve. This means that workers are forced to accept a lower level of social protection as the economy becomes more open, as we see in the movement downward from point P_1 to P_2 in panel B.

FIGURE 2 BELONGS HERE

The most influential expression of this neoliberal solution is the ascendancy of the arguments for “labor market flexibility” as the cure for persistent mass unemployment in Europe. As the term is used, a “flexible labor market” is one in which legal and institutional barriers to hiring and firing workers are minimized, so that workers “reservation wage”—the lowest wage at

which a worker is willing to accept a job—falls. Proponents of this approach say that high unemployment rates in Europe are due to inflexible labor markets and that, correspondingly, the flexibility of U.S. labor markets explains our far lower unemployment rate. Many labor market regulations, no doubt, are outdated and counterproductive. But the basic meaning of labor market flexibility as currently proposed within the neoliberal framework entails that workers in high-wage economies relinquish the gains they have won over the previous two generations, in terms of living standards, safety, and job security. Thus, the call for labor market flexibility as the foundation of an approach to employment policies conforms exactly to the neoliberal solution to disequilibrium portrayed in Figure 1.

4. Globalization and Inequality in the United States

The United States has indeed experienced far lower unemployment rates than the European economies over the past 20 years, and especially during the low unemployment years during the Clinton presidency. But, as claims about the virtues of labor market flexibility itself fully recognize, it does not follow from achieving low unemployment rates alone that conditions for working people and the poor will improve. Rather, as the summary figures presented in Table 5 convey, what has been remarkable especially about the economic boom under the Clinton presidency is really how little the non-wealthy have shared in its benefits. This then provides some objective confirmation for the impressions cited earlier by Alan Greenspan and the Business Week poll about the persistent insecurity of U.S. workers.

We see in Table 5, to begin with, that unemployment has fallen on average relative to both the Carter and Reagan-Bush periods. But the average unemployment rate under Clinton, at 5.8 percent through 1998, is still only equal to the level of the Nixon-Ford era and well below the 4.8 percent average attained under Kennedy and Johnson.¹⁰

¹⁰ The table includes figures only through 1998 since data for 1999 are still not available for all of the indicators in the table. However, figures are now available for the U.S. unemployment rate for 1999, which was 4.2 percent. Adding that year to the Clinton total improves its average performance for 1993-99 to 5.6. The unemployment figures for 2000 will almost definitely produce another year of favorable results,

But even with this relatively favorable employment performance under Clinton, we still see that both average wages for nonsupervisory workers and wages for those in the 10 percent decile of the wage distribution remain well below those during the Nixon/Ford and Carter administrations, and are even lower than those during the Reagan/Bush years. In addition, as measured by the ratio of 90th/10th percent decile wages, we see that wage inequality has increased sharply during Clinton's tenure in office, even relative to the Reagan/Bush years.

Finally, there has been essentially no reduction in poverty under Clinton, relative even to the Reagan/Bush years, during which governmental anti-poverty efforts were sharply curtailed. Even if low unemployment rates are sustained through the end of Clinton's term in 2000, the poverty figures under Clinton may still worsen in his final years in office, as the dismantling of the federal welfare program becomes more fully implemented.

TABLE 5 BELONGS HERE

Alternative Explanations for Observed Trends

Of course, the fact of rising earnings inequality in the United States does not, by itself, provide any explanation about the *causes* of inequality. Indeed, the prevailing explanation does not refer at all to globalization, much less changes in relative bargaining power among workers, capitalists and rentiers. Rather, what has been termed a “skill-biased technological change” is seen by the majority of observers as the primary explanation for the observed trends. According to this view, the rapid integration of computer technology into all areas of economic life has created an increased demand for workers who are capable of operating effectively with computers. Demand has correspondingly fallen for workers without computer skills. This relative shift in demand for the computer-skilled versus the unskilled has, in turn, increased the relative wage differential between those with and without computer skills. Summarizing this

improving still further the overall figure for the Clinton presidency, perhaps to a final average of around 5.4 percent. Nevertheless, even allowing for impressive unemployment figures for 1999 and 2000, we see that the Clinton performance still will not match that during the Kennedy/Johnson era.

perspective in his characteristically confident tone, Paul Krugman (1994) writes that “the growth in earnings inequality...has been the result of technological changes that just happen to work against unskilled workers.”

However, as David Howell shows in a brilliant paper (1999), the evidence which supports this predominant explanation of rising U.S. inequality is remarkably flimsy, if not altogether illusory. Consider the following passage from Howell, just one example of his dissection of this literature:

In one of the most widely cited papers on the growth in skill intensity, Berman Bound, and Griliches (1994) report that the nonproduction to production worker ratio increased from 30.9 percent in 1979 to 35.4 percent in 1987....The authors interpret these trends as evidence that the manufacturing sector experienced substantial skill upgrading over this decade, and conclude that “biased technological change is an important part of the explanation.”

However, the annual data show that the entire increase took place between 1980 and 1982; between 1983 and the early 1990s the ratio remained essentially unchanged. With a similar measure for the entire private, nonfarm economy, a pronounced long-term upward trend is evident from 1948 through 1982, after which the nonproduction share actually begins to decline. The timing of these changes in “skill composition” would seem to pose a major problem for the technology story since computerization does not begin to take off until just about the same time that the stability (or decline) in the skill measure sets in in the mid-1980s. At the same time, much of the decline in the wages of those at the bottom of the wage distribution between the late 1960s and the mid-1990s occurs between 1979 and 1983—again, before computerization could have produced the wholesale restructuring of the workplace that is presumed by the skill-biased technology explanation. (pp. 64-65).

Howell also cites a range of case-study evidence which shows that increased computerization of production has by no means consistently increased the relative demand for skilled workers. In many cases, such as with automated supermarket checkout technologies and numerical controls in machine shops, computerization has engendered a downgrading rather than an upgrading in the skill demands of a given job. Howell shows how such case-study evidence contrary to the skill-biased technology perspective has been either ignored by proponents of this view or even, in some cases, inaccurately interpreted to support, rather than contradict, their perspective.

Contrary to the predominant view, Howell advances a view of rising earnings inequality in the U.S. consistent with the broader perspective advanced here about the effects of globalization. He writes

Increasing trade and capital flows between the United States and low-wage and high-wage nations alike made low-skill workers throughout the world far more easily substitutable with one another, which means that the demand for U.S. labor became more elastic—more responsive to changes in its costs—which in turn would tend to reduce worker bargaining power. (p. 77)

As Howell himself recognizes, the empirical support for this alternative view is itself still far from complete. Part of the problem is that it is inherently difficult to quantify shifts in bargaining power, especially since what one needs to capture is how credible, and therefore powerful, are the threats brandished by business firms in negotiations with workers, rather than just the observable outcome of these negotiations. Nevertheless, a growing body of persuasive evidence in behalf of this perspective is emerging, considering the issue from a variety of angles.

Svejnar (1986) has done the most extensive general study of the impact of threats on bargaining power. His key result is that exogenous changes in the negotiating environment—such as, in our case, an increase in openness—can be shown empirically to affect the relative bargaining power of firms and workers. For example, Svejnar shows that the imposition of wage and price controls negatively affected workers' bargaining power in wage negotiations.

Bronfenbrenner (1996) has conducted the most directly relevant study of how threat effects per se have influenced labor negotiations. She reports the results of a survey between 1993-95, which showed that 50 percent of all firms and 65 percent of manufacturing firms that were targets of union organizing campaigns threatened to close their shops and relocate if the workers voted to unionize. Though only 12 percent of those firms that ended up unionized did then carry through on their threat to relocate, workers nevertheless found the threats credible. In particular, in cases where firms did

make threats to shutdown or relocate, unions lost a significantly larger percentage of elections.¹¹

Addressing the issue from another angle, Fortin and Lemieux (1997) tested the extent to which “quantifiable measures of institutional forces” can explain the rise of U.S. earnings inequality. They conclude that about one-third of the growth of inequality in the 1980s can be attributed to changes in three such forces: the real value of the minimum wage, the unionization rate, and economic deregulation. They also make clear that their model did not attempt to measure the effects of “cultural or social norms that may play an important role in wage determination, but are difficult to quantify.” One should also note that the patterns that prevailed for these three forces in the 1980s—i.e. historically low minimum wages and unionization rates and a deregulated legal environment—did of course persist throughout the 1990s.

Finally, in the analogous situation of negotiations between corporations and governments, it has been widely documented that corporate tax rates have fallen as economies have become more open. For example, using data for 18 OECD countries, Rodrik (1997) finds that capital tax rates fall and labor tax rates rise as trade openness increases.¹²

5. Global and Domestic Policy Approaches

The Marx, Keynes and Polanyi problems associated with the contemporary epoch of globalization help us to understand the political force behind the ascendancy of neoliberal policies.

¹¹ Bronfenbrenner writes, “The union election win rate was lower in units where plant closing threats occurred (33 percent) compared to the overall win rate of 40 percent, and the difference was larger where the threats were put in writing (25 percent win rate for direct written threats, 37 percent for veiled written threats).” In addition, she reports that “30 percent of the organizers in the withdrawal cases (where unionization attempts were withdrawn) and more than half of the organizers in withdrawal cases where threats occurred, reported that threats of plant closings contributed to the union withdrawing the petition before the campaign went to an election,” (p. 14-15).

¹² See also similar findings as concerned capital mobility as opposed to trade openness in Tanzi (1993) and Avi-Yonah (1998).

But does it follow that neoliberal globalization is inevitable—that, as Margeret Thatcher put it, “there is no alternative” to a neoliberal global order?

Recognizing that the Marx, Keynes and Polanyi problems are real and serious does not imply that they impose insuperable obstacles to progressive alternatives to neoliberalism. Quite the contrary: Taking the full measure of the difficulties they impose is actually the first step toward advancing a viable alternative agenda. The intellectual challenge is therefore to think through a new egalitarian policy approach that is able to transcend the real constraints imposed by neoliberal globalization. Of course, such an intellectual effort is by no means either independent of, or alternative to, the political project of building support for such policies. But while it is obvious that a successful political alternative will not emerge in the absence of a political movement to fight for it, it is equally true, if less obvious, that such a political movement will dissipate its well-intentioned energy unless it possesses some clarity and specifics as to what its policy agenda should be.

Given that the problems at hand are global, it is perhaps inevitable that we begin thinking about solutions in global terms as well, for example, of new policy institutions that would promote international policy coordination. Such thinking is at the heart of several proposals, such as the plan of John Eatwell and Lance Taylor (2000) for a new Global Financial Authority whose primary purpose would be to regulate and stabilize financial markets, and thus create space for national governments to coordinate employment-expanding macroeconomic policies. Such proposals certainly have merit on their own terms. However, the reliance on international cooperation as the leading edge of an alternative progressive policy agenda also has serious flaws:

1. The failings of the existing policy framework are by no means due to a lack of institutions and policies supporting global economic cooperation. The IMF, World Bank, and WTO already exist and they do operate on the basis of international cooperation. The problem, of course, is not international cooperation per se, but that these institutions promote cooperation in behalf of neo-liberalism. The need, therefore, is not to simply create another such transnational

institution, but to build a viable international constituency for a progressive alternative to neo-liberalism.

2. The only conditions under which these types of cooperative relationships could form would be through progressive national governments that are attempting to implement egalitarian macroeconomic and labor market policies within their domestic economies. But such governments are not likely to form if they require an environment of global cooperation as a precondition to attempting a domestic progressive agenda. Rather, such governments will need to demonstrate some success with their domestic policy agendas before they acquire the credibility to push for international cooperation. In other words, successful domestic policy initiatives are the prerequisite needed to transform any proposals for an international egalitarian agenda into a realistic possibility. But here we face a Catch 22: if the governments mandated to advance an egalitarian growth agenda are doomed to failure because of global constraints, then it is also certain that the cooperative international policy agenda will remain thwarted.

What is clearly needed therefore is set of domestic policies that can limit the force of existing external constraints and thereby also create the conditions in which desirable forms of international cooperation become possible. But is it constructive to even think about domestic oriented policies that would be broadly applicable given the current degree of global integration? Of course, there are huge structural differences between countries, even those at similar levels of development. As such, there is no reason that the specifics that would be relevant to one country under a given situation can be generalized beyond that time and place. However, some basic propositions as to the most effective ways to sustain a domestic egalitarian policy path should have broad applicability. Indeed, my own thinking on this question began to form in the early 1990s as I was working on two separate macroeconomic policy projects, one for the United States and the other for Bolivia.

With this in mind, I can point to three crucial areas in which an egalitarian domestic policy alternative to neoliberal globalization can make important advances¹³:

1. Full-employment macroeconomic policies that, to the greatest possible degree, minimize the “leakages” and financial pressures that result from globalization, including import leakages, as well as pressures on exchange and interest rates;
2. New financial regulatory policies that both create domestic “circuit breakers” against speculative financial markets and also allocates credit toward investments yielding high social rates of return; and
3. Labor market and welfare state policies that channel a fair share of the benefits of employment growth, relative financial stability and egalitarian credit allocation priorities to working people and the poor. Such policies could also promote wage bargaining systems that minimize the inflationary pressures associated with full employment.

If domestically oriented policies of this sort can be put in place and succeed, two other important outcomes would follow. First, the costs to working people of trade openness would fall sharply, since with full employment and a generous system of social protection, the efficiency gains from trade would not be borne on the backs of workers. Returning to the logic of our diagram in Figure 1, this policy framework would promote the Polanyi solution to the opening of global trade. If one is concerned with social welfare outcomes, it therefore does not follow that trade openness must logically be packaged with a regime of financial deregulation and “labor market flexibility” as the cure for unemployment.

In addition to this, successful domestic policy initiatives will then create the space in which demands for international coordination *in behalf of an egalitarian policy agenda*—not simply international coordination per se—will gather legitimacy and force. There are alternatives to neoliberal globalization. But they will have to be developed fundamentally at the ground level

¹³ I consider each of these policy areas at some length in Pollin (1998).

of domestic politics before they will have solid footing within the citadels of global economic policymaking.

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TABLE 1. Manufacturing Exports as a Percentage of Total Exports***1A: 1970-1994 Period***

| | <i>1970</i> | <i>1980</i> | <i>1990</i> | <i>1994</i> |
|---------------------------------|-------------|-------------|-------------|-------------|
| <i>World</i> | 60.9 | 64.2 | 71.1 | 74.7 |
| <i>Industrialized Countries</i> | 72.0 | 70.2 | 78.0 | 79.2 |
| <i>Eastern Europe</i> | 59.1 | 50.2 | 43.9 | 53.0 |
| <i>Developing Countries</i> | 18.5 | 17.7 | 54.3 | 66.1 |
| <i>Asia</i> | 22.4 | 23.5 | 65.5 | 73.4 |
| <i>Latin America</i> | 10.6 | 14.7 | 30.8 | 48.7 |
| <i>Africa</i> | 7.0 | 4.0 | 15.1 | 17.8 |

1B: 1913-1953 Period

| | <i>1913</i> | <i>1928</i> | <i>1937</i> | <i>1953</i> |
|---|-------------|-------------|-------------|-------------|
| <i>U.S. and Canada</i> | 25.8 | 38.5 | 44.7 | 60.7 |
| <i>United Kingdom</i> | 70.0 | 74.8 | 72.0 | 73.7 |
| <i>Northwest Europe</i> | 52.0 | 65.0 | 63.1 | 57.3 |
| <i>Asia, excluding China and N. Korea</i> | 21.2 | 30.9 | 28.1 | 25.3 |
| <i>Latin America</i> | 3.2 | 2.1 | 1.7 | 2.3 |
| <i>Africa</i> | 3.7 | 2.5 | 3.7 | 8.5 |

Sources: *World Employment Report 1995*, ILO, p. 33 for 1970-90; UN Handbook of International Trade and Development Statistics 1995, Tables A.1 and A.13 for 1994; P. Lamartine Yates, *Forty Years of Foreign Trade*, New York: Macmillan, 1959, p. 55 for 1913-55.

TABLE 2. Shares of World Manufacturing Exports by Region and Industry, 1980-95
(in percentages of world exports)

| <u>Export Area</u> | <u>Industry Group</u> | | | | | | | | | |
|-------------------------------|-----------------------|------|-----------|------|-------------------------|------|--------|------|-------|------|
| | Textiles | | Chemicals | | Machinery and Transport | | Metals | | Other | |
| | 1980 | 1995 | 1980 | 1995 | 1980 | 1995 | 1980 | 1995 | 1980 | 1995 |
| <i>Developed Economies</i> | 61.7 | 42.0 | 87.2 | 79.3 | 86.1 | 76.4 | 78.9 | 63.1 | 68.8 | 70.0 |
| <i>Transitional Economies</i> | 4.3 | 4.2 | 5.0 | 4.2 | 8.2 | 1.6 | 6.2 | 13.5 | 14.0 | 3.2 |
| <i>Developing Economies</i> | 34.0 | 53.8 | 7.8 | 16.4 | 5.8 | 22.0 | 14.9 | 23.4 | 17.2 | 26.8 |
| <u>Developing, by region:</u> | | | | | | | | | | |
| <i>Latin America</i> | 2.3 | 3.0 | 2.0 | 2.6 | 1.0 | 2.9 | 5.0 | 7.6 | 1.5 | 2.9 |
| <i>Africa</i> | 1.5 | 1.9 | 0.9 | 1.1 | 0.1 | 0.2 | 3.8 | 2.7 | 1.5 | 2.9 |
| <i>Asia</i> | 30.1 | 48.9 | 4.8 | 12.6 | 4.6 | 18.9 | 6.0 | 13.1 | 10.0 | 22.3 |

Source: UN World Economic and Social Survey, 1997, p. 248, Table A.17.

TABLE 3. The Growth of Financial Market Transactions**6A) Funds Raised on International Financial Markets as Percentage of World Exports**

| <i>1950</i> | <i>1960</i> | <i>1970</i> | <i>1975</i> | <i>1980</i> | <i>1985</i> | <i>1990</i> | <i>1996</i> |
|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 0.5 | 1.0 | 1.8 | 4.6 | 5.8 | 13.5 | 10.5 | 20.0 |

3B) Cross-Border Transactions in Bonds and Equities as Percentage of GDP

| | <i>1980</i> | <i>1985</i> | <i>1990</i> | <i>1995</i> |
|----------------------|-------------|-------------|-------------|-------------|
| <i>United States</i> | 9.0 | 35.1 | 89.0 | 135.5 |
| <i>Japan</i> | 7.7 | 63.0 | 120.0 | 65.7 |
| <i>Germany</i> | 7.5 | 33.4 | 57.3 | 168.3 |
| <i>France</i> | ----- | 21.4 | 53.6 | 178.2 |
| <i>Italy</i> | 1.1 | 4.0 | 26.6 | 250.9 |
| <i>Canada</i> | 9.6 | 26.7 | 64.4 | 192.0 |

3C) Daily Foreign Exchange Markets Turnover as Percent of Total Central Bank Reserves

| <i>1977</i> | <i>1980</i> | <i>1983</i> | <i>1986</i> | <i>1989</i> | <i>1992</i> | <i>1995</i> |
|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 6.9 | 21.3 | 35.7 | 58.8 | 83.3 | 90.9 | 100.0 |

Sources:

Table 3A: OECD International Capital Market Statistics; A. Maddison, Monitoring the World Economy 1820-1992; IMF World Economic Outlook, October 1996; For 1996, exports from World Trade Organization Annual Report 1997, Table A.3; Funds Raised on Capital Markets, OECD Financial Market Trends, February 1998, Table 1.

Table 3B: BIS, 66th Annual Report, p. 98, and 67th Annual Report, p. 119.

Table 3C: Felix (1998)

Note on Table 3A: The 1996 figure for “funds raised on international financial markets” includes only “committed facilities”, i.e. excludes “uncommitted facilities,” which maintains consistency with the figures for 1950-90.

TABLE 4. Total Government Expenditures as a percentage of GDP

| | <i>1880</i> | <i>1913</i> | <i>1938</i> | <i>1950</i> | <i>1973</i> | <i>1992</i> | <i>1996</i> |
|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <i>France</i> | 11.2 | 8.9 | 23.2 | 27.6 | 38.8 | 51.0 | 54.7 |
| <i>Germany</i> | 10.0 | 17.7 | 42.4 | 30.4 | 42.0 | 46.1 | 49.7 |
| <i>Japan</i> | 9.0 | 14.2 | 30.3 | 19.8 | 22.9 | 33.5 | 36.6 |
| <i>Netherlands</i> | na | 8.2 | 21.7 | 26.8 | 45.5 | 54.1 | 50.9 |
| <i>United Kingdom</i> | 9.9 | 13.3 | 28.8 | 34.2 | 41.5 | 51.2 | 42.3 |
| <i>USA</i> | na | 8.0 | 19.8 | 21.4 | 31.1 | 38.5 | 36.7 |
| <i>AVERAGE</i> | 10.0 | 11.7 | 27.7 | 26.7 | 37.0 | 45.7 | 45.1 |

Source: A. Maddison, Monitoring the World Economy, Table 3-5, pp. 65. For 1996, International Monetary Fund, International Financial Statistics, March 1998.

Table 5. Measures of well-being for workers and the poor
Performance by Presidential Periods

| | <i>1961-68 Kennedy- Johnson</i> | <i>1969-76 Nixon-Ford</i> | <i>1977-80 Carter</i> | <i>1981-92 Reagan- Bush</i> | <i>1993-98 Clinton</i> |
|--|---|---------------------------------------|---------------------------|-------------------------------------|----------------------------|
| <i>Unemployment rate (pct.)</i> | 4.8 | 5.8 | 6.5 | 7.1 | 5.8 |
| <i>Average Wage for Nonsupervisory Workers (in 1998 dollars)</i> | \$11.53 | \$13.17 | \$13.51 | \$12.82 | \$12.37 |
| <i>Average wage for 10th percent decile (in 1998 dollars)</i> | ----- | \$6.14 <i>(data begin in 1973)</i> | \$6.32 | \$5.68 | \$5.52 |
| <i><u>Ratio of 90th/10th percent decile wages</u></i> | ----- | 3.7 <i>(data begin in 1973)</i> | 3.6 | 4.1 | 4.4 |
| <i>Individual poverty rate pct.</i> | 17.5 | 11.9 | 11.9 | 14.0 | 13.8 |

Sources: Bureau of Labor Statistics; Mishel, Bernstein and Schmitt (1999).

Notes: Wage data for decile groupings begins in 1973.

Figure 1. Openness and Social Protection

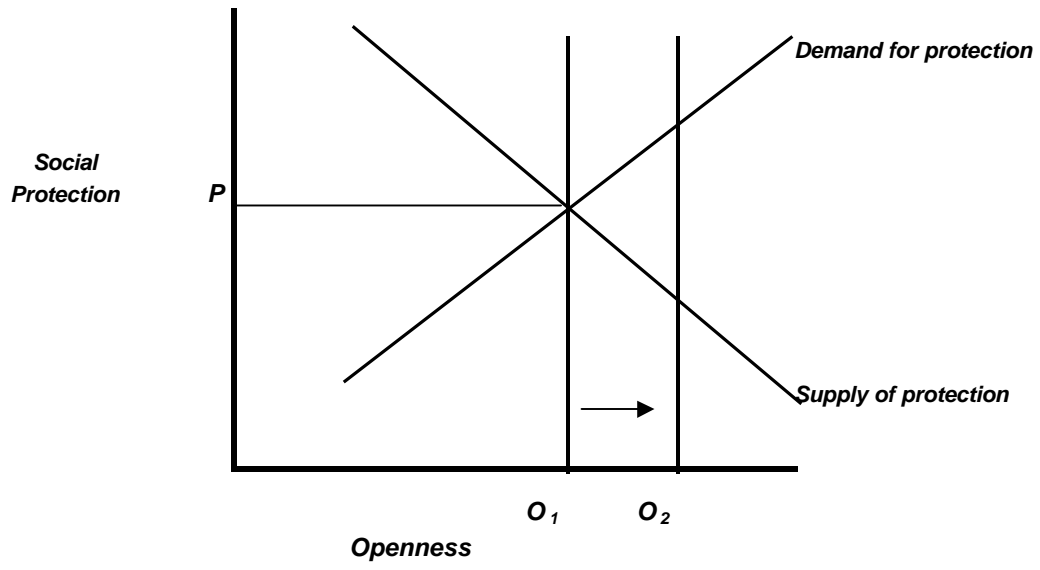
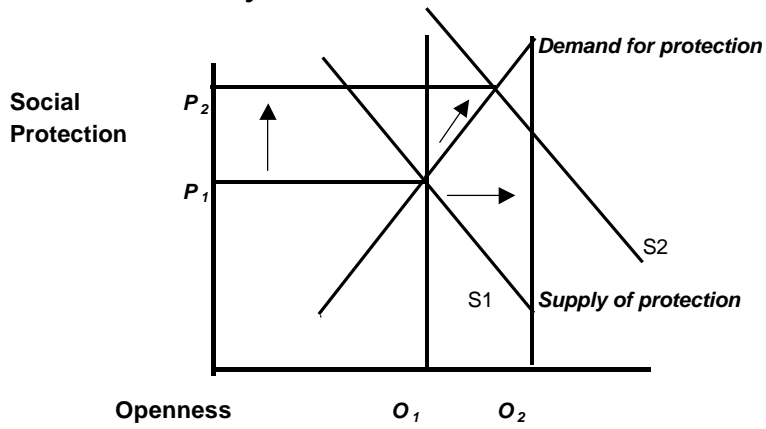


Figure 2. Resolution of Disequilibrium After Openness Increases

A. Polanyi Solution: Protection Increases with Openness



B. Neoliberal Solution: Protection Decreases with Openness

