May 16, 2010

We have repeatedly emphasized in this Column that at the backdrop of the global crisis lay a fundamental change of role between the U.S. and China, to cut it short. While American citizens consumed more, China produced more, and Europe tended gradually to become an extinct fire of production and accumulation. Obviously, it is not only China but also many an emerging economy produced more in the last ten years; the pattern of global production and trade tended to shift considerably. Whether this was disproportional growth along an unbalanced growth traverse, or whether it was an equilibrium phenomenon in the sense of a *normal business cycle* was again subject to discussion. However, the events that followed July 2007 answered that question in a spectacularly decisive way.

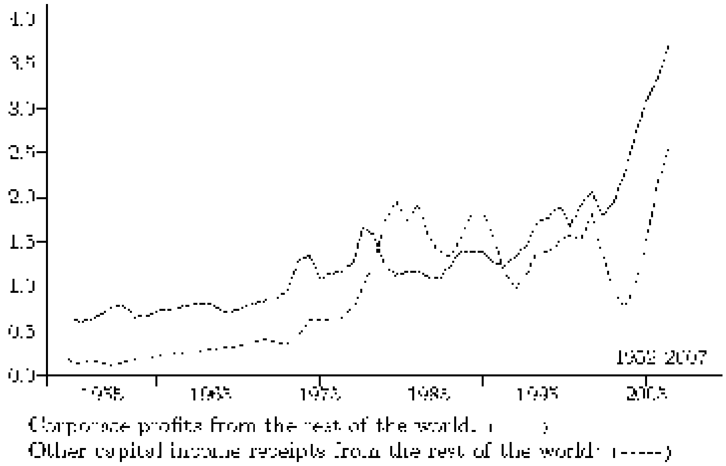
Now at the backdrop lies another fact, which might well be concomitant with the shifting world production patterns. We have clearly witnessed after the advent of the second oil shock of 1979 a reinforced wave of deregulation, privatization and trade openness on the world scale. The same phenomenon can be either labelled globalization, or neo-liberalism, or the Washington Consensus. These terms refer to different aspects of the same set of facts and events. Consider the consequence of neo-liberalism as a proposed new income distribution and look at the American data from a broader perspective. That is, forget the structured finance technicalities, CDO, CDS, housing loans etc. locus and define the focal point as a consequential path over a long span of time.

Figure 1 below tracks the evolution of the share of the total income of U.S. households received by the top 1%, including capital gains. All compiled and adjusted figures are provided by a sequence of articles conceived by Emmanuel Saez (Berkeley), Thomas Piketty (Paris) and Sir Anthony Atkinson (Oxford). Although there have been some debates about important technical issues, the upshot is the percentage share in total income enjoyed by the upper 1% bracket was about 8% during the 1970s, but it soared to about 18% during the neoliberal decades. This is clearly indicative of a considerable shift in income redistribution to the benefit of the top of the income pyramid between 1979 and 2007 where the data ends.

Figure 1: Share of total income in the top 1% tax bracket in the U.S.

Now, there are quite a few comments to be made. First, concentrating on a coarse-grained income grid in measuring the Gini coefficient does not reveal the true impact of neo-liberalism on incomes because the top 4% following the top 1% did not record similar gains. That is, if one concentrates on the top 5% instead of the top 1% the impact looks smoother. The second idea is that a good part of the increase in the top 1% income share is due to wages and benefits etc., which underlines the exaggerated levels top corporate incomes have reached in the last twenty years. Thirdly, the Roosevelt New Deal had in fact extended well over the 1970s, and its distributional consequences could only be reversed after the second oil shock. The main channels of this restoration are well known. To fuel corporate profitability, that is to prevent invested and embodied capital from losing its value swiftly, labour's real income share has been rendered stagnant through the increasingly widespread use of subcontracting to diminish the cost of labour and increased flexibility. Also, globalization is meant to provide ample opportunities for investing in countries where labour costs are low, and opened up channels for the wider use of new production and management technologies. Clearly, there has been a productivity aspect to all that, but in the 2000s we also have come to grasp that the *new economy* and productivity increase interpretations of the 1990s were largely fictitious. We might look at the Volcker Deflation from a different perspective also. In 1979, the Fed sharply increased interest rates (the "1979 coup") in the face of rampant inflation, generating large flows of interest to lenders. The move was a bit heavy-handed though; propelling thus the 1982-84 recession. After Greenspan, the balance was struck, and corporate began distributing rather large flows of dividends; equities had begun their long journey towards unprecedented heights, and new indices –such as NASDAQ- proliferated. What monetary economics call financial innovation soared rapidly as clearly revealed by the more focal and technical analysis of the genesis of the 2008-09 crisis.

Figure 2: U.S. profits and income from abroad as percentage of GDP



What about the globalisation-driven consequences of these decades on the U.S. economy? We cannot say it all in two pages obviously, but consider the Figure 2, provided by Gérard Duménil and Dominique Lévy. Through the 1990s, the percentage share of profit income earned from the U.S. Direct Investments Abroad surged by 50%, from 1.4% to 2.1%. The 2000s witnessed yet another steep ascent from 2.1% to 3.7% in 2007. However, the U.S. was a net importer of capital as well as goods and services. That is, the U.S. foreign trade and domestic saving gaps were financed by the rest of the world. Yet, in the 2000s the U.S. imported capital –including portfolio investments- rather cheaply and American FDIs abroad yielded larger returns. This was "The Debtor's Empire" indeed! Please do take Rogoff seriously, not only for the 1990s and early 2000s, but also for the rest of the decade: "But whatever the reasons, and they are admittedly complex, isn't it still a bit nutty that the world's richest country has become by far the world's biggest borrower, with a net debt to the rest of the world (assets minus liabilities) of more than $ 2 trillion? The Romans would be jealous: They went to a lot of trouble to extract taxes from their empire; the world just gives money to the United States." (Kenneth Rogoff, "The Debtor's Empire", *The Washington Post,* October 20, 2003, Editorial Section, page 23)