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(Conference Draft)

"Some Problems of Law and Development in High Income Countries"

Hans-Bernd Schäfer*

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* Bucerius Law School, Hamburg

Hans-Bernd Schäfer, Bucerius Law School, Hamburg

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First Draft, September 2021, please do not quote

A. Introduction

For high income counties the research agenda "Law and Development" is not less important than for middle and low income countries but usually not addressed under this heading. This overview highlights some of the questions of law and development for these countries.

Since the 12th century western European countries in Latin Europe had higher economic growth rates than other world regions. Around 1500 per capita incomes in Western Europe had become significantly higher than in India or China. This historical trend continued together with the western offshoots in North America and Australia. Over the last decades developing countries became more dynamic in terms of economic growth than high income countries. Not only countries of eminent population size like China and India but many others achieved real per capita growth rates of their economies much higher than the average of high income countries, whose economic growth is now not only lower per capita but decreased substantially over the last four decades.

This paper informs about these trends of divergence and later convergence. This affects the international economic order and the power distribution in international organizations. China and India emerge as new global powers.

The paper continues with highlighting some institutional and legal aspects, which might have contributed to the slowing down of growth rates. Among them are technological and economic changes, which put pressure on wages. Politics does not always respond to such changes swiftly enough. Also, the legal systems, which structure international finance, international trade and the European Union, notably the Euro are becoming less functional, caused several huge crises like the Lehman crisis, the European debt crises and the Euro crisis with heavy impact on the real economies. Internal legal weaknesses including lengthy decision making procedures -for instance for public infrastructure projects- are among them.

Some new rich countries have either reached the same level of economic development as western countries or even surpassed them. What western countries can learn learn from those is another question, which concludes the paper.

B. Social and economic conditions in low middle and high income countries

1. Growth differentials between rich and poor countries.

For more than 500 hundred years western countries left all other regions behind in terms of economic growth as long time series data of Maddison show. In a heroic and lifelong project Maddison constructed per capita GNP estimates for periods, for which statistical economic data as we know them today did not exist. According to him 1000 years ago the per capita income in Western Europe was lower than in India and some thirty percent lower than in China. This had reversed in the year 15000 -before the period of colonialism- Western European per capita income had become 25 percent higher than in China and more than that compared with other world regions. In the year 1600 western per capita incomes had become about 50 percent higher than those of China and much higher than in other world regions. This tendency continued and accelerated until the year 1800. [1] More reliable data than those exist from the 19th century onwards. One of the most comprehensive statistics on economic per capita growth around the world is by Jutta Bolt et al. and spans the period from 1820 to 2010.[2] During the following 160 years, from 1820 to the 1970ies this trend persisted. Average per capita growth rates in western Europe and in "western offshoots" (USA, Canada, Australia and New Zealand) was twice to three times as high compared with other world regions. Only since the 1980ies this century old growth pattern reversed. And it reversed sharply. The data show that per capita incomes increased from 1980 to 2010 by 59 percent in both Western Europe and in western offshoots (USA, Canada, Australia and New-Zealand) but by 196 percent in South and South East Asia and by 295 per cent in East Asia, whereas South America and the Caribbean as well as Africa South of the Sahara had still lower per capita growth rates than western countries. The last 40 years mark a turning point in comparison with a trend, which persisted for centuries. In the 1980ies many developing countries gave up a policy of import substitution, started to produce for the world market, introduced market oriented reforms and developed either the rule of law or protected investors by strong growth oriented policies and substitute institutions for the rule of law. It is now clearly visible that a century old divide between rich western countries and all others is disappearing. Some Asian Countries, notably Japan and the four Asian tigers have achieved this already and Singapore left even the richest of the rich countries behind in terms of per capita income. Others, like China and later India achieved extraordinarily high growth rates over decades never before seen in economic history for any large country.

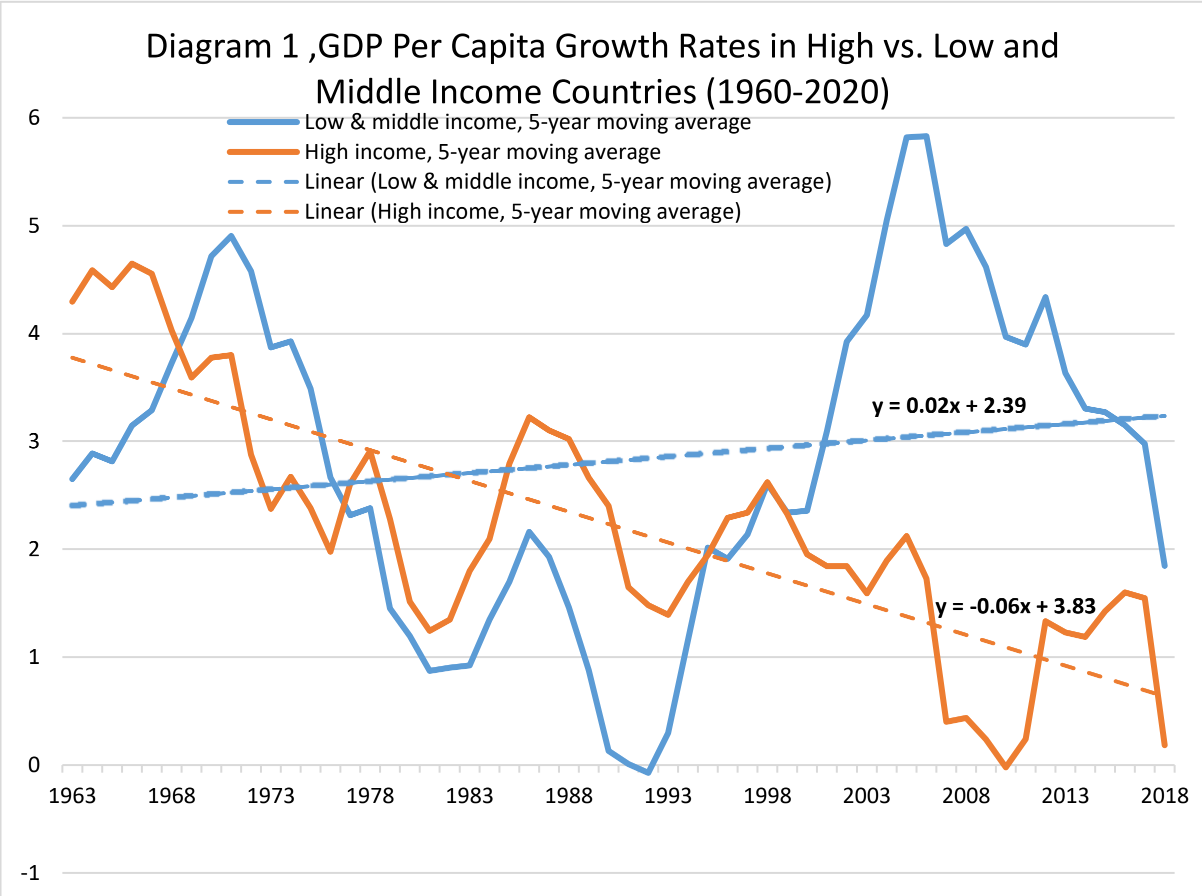
A related but different fact about economic growth over the last five decades is a decreasing growth rate of rich countries as a group in comparison with low and middle income countries as a group, where average growth rates increased. This result is to a large degree driven by China and India but also reflects a more general feature. More and more developing countries in Asia and Africa and to a lesser extent in Latin America achieved per capita growth well above 4 percent over an extended period.

This contemporary economic trend reversal was sudden and sharp. Contemporaries could not overlook them and met them with surprise, joy and even envy. This is in contrast to the period, when the economic divide between Western (Latin) Europe and other world regions

[1] Maddison, A. Historical Statistics. Paris: OECD, 2003

[2] by Jutta Bolt and Marcel Timmer, University of Groningen and Jan Luiten van Zanden (), GDP per capita since 1820 (2014) in: How Was Life? – Global Well-Being Since 1820, edited by Jan Luiten van Zanden/ Joerg Baten/Marco Mira d'Ercole /Auke Rijpma /Conal Smith/Marcel Timmer (2014), Pim de Zwart /Bas van Leeuwen / Jieli van Leeuwen-Li, p. 63.

began with the Italian commercial revolution during the 12th and 13th century. Then it took many decades and even centuries to realize that a divide had at all happened.[3]



Source: Own calculations based on World Bank, World Development Indicators (9 Sept. 2021)

2. Current Patterns of Human Wellbeing

Per capita incomes are strongly correlated with human development indicators but still can not show a reliable and comprehensive picture of wellbeing or in more general terms of "development". This was a matter of critique for a long time, which led to more comprehensive development indicators. Particularly relevant in this context is Amartya

[3] Timur Kuran (2012), The Long Divergence. How Islamic Law Held Back the Middle East. Princeton: Princeton University Press. Kuran compares the institutional innovations in western Europe with the institutional status quo thinking in the Middle East, which led to an economic divide, which was however not felt within a human's lifespan.

Sen's capability approach, Ccapabilities define an individual's possibility space or an individual's factual freedom to make choices. Collective decisions should expand this space. On this basis, Sen calls for better education and training for socially disadvantaged groups as well as for women and better public health. Sen's views fell on fertile ground and in cooperation with Martha Nussbaum led to a new orientation towards the goal of "human development" at the UNDP. This includes a statistical measure of "human development" as an expression of the capabilities, which is statistically manageable and meaningful.[4] Since 1990, the Human Development Index has been compiled annually for more than 180 countries. The ranking of the countries according to this index does not deviate vastly but considerably from the per-capita-income ranking. European welfare state with high per capita incomes rank higher than Anglo Saxon states with high incomes -with the exception of Hong Kong.

Table 1. Human Development Indicators, Ranking of Countries with very high Human Development , Changes from 2014-2019

UNDP, World Development Report 2020

HDI rank 2019	Rank Change since 2014	Country	HDI rank 2019	Rank Change since 2014	Country	HDI rank 2019	Rank Change since 2014	Country
1	0	Norway	23	-1	Korea (Republic of)	46	-2	Argentina
2	7	Ireland	23	0	Luxembourg	47	-6	Brunei Darussalam
2	0	Switzerland	25	1	Spain	48	2	Montenegro
4	7	Hong Kong, China (SAR)	26	-1	France	49	2	Romania
4	4	Iceland	27	-1	Czechia	50	-3	Palau
6	-3	Germany	28	2	Malta	51	7	Kazakhstan

[4] Human development Report 2020.

7	-3	Sweden	29	2	Estonia	52	1	Russian Federation
8	-2	Australia	29	-1	Italy	53	-4	Belarus
8	-1	Netherlands	31	6	United Arab Emirates	54	5	Turkey
10	-6	Denmark	32	-3	Greece	55	1	Uruguay
11	-2	Finland	33	0	Cyprus	56	-2	Bulgaria
11	0	Singapore	34	0	Lithuania	57	5	Panama
13	0	United Kingdom	35	-4	Poland	58	-3	Bahamas
14	1	Belgium	36	1	Andorra	58	-6	Barbados
14	1	New Zealand	37	1	Latvia	60	-1	Oman
16	-1	Canada	38	-1	Portugal	61	7	Georgia
17	-3	United States	39	-2	Slovakia	62	-1	Costa Rica
18	0	Austria	40	1	Hungary	62	1	Malaysia
19	1	Israel	40	-4	Saudi Arabia	64	-5	Kuwait
19	2	Japan	43	0	Chile	64	4	Serbia
19	0	Liechtenstein	43	2	Croatia	66	-2	Mauritius
22	2	Slovenia	45	0	Qatar			

This table reveals some noteworthy information. The ranking of per capita incomes differs considerably from the ranking of human development indicators. Some very high income countries like the USA, Singapore, Liechtenstein and Luxemburg have lower ranks for the human development index. Western European Countries and Western offsprings occupy 31 of the first 40 ranked countries. And with the exception of Japan and the four Asian tiger states no other state in the rapidly growing zones of South Asia and South East Asia could so far make it into the group of 66 states with high human development, according to UNDP. The Human development ranking is more stable over time than the ranking according to economic growth and the pattern shown in table 1 has not changed much over the last 30 years since the index was first published. Not a single African country and only two developing countries of some size, Chile and Argentina are part of this group. The profound changes in the development patterns between high, middle and low incomes over the last 40 years seem to be most profound for economic growth less so for per capita income rankings and even less so for human development rankings.

3. Growth and Law

How does law influence the economy and economic growth? Law and economics were closely intertwined at the beginning of economics as a science. The French Physiocrats Francois Quesnay and Jaques Turgot developed illuminating ideas on the backwardness of the 18th century French agriculture as a consequence of sharecropping between the nobility and serfs and the un-pledgeability of manors, which made noble agricultural land dead capital which could not generate agricultural credit and led to undercapitalization of agriculture wherever a landed aristocracy dominated this. Adam Smith propagated the institutions of a market economy and had a subtle knowledge of law. He even lectured Roman law at the University of Glasgow. The theories of these founding fathers of economics imply a clear causational effect from legal institutions to economic performance. Modern institutional economics as founded by Douglas North had a similar causational link between law and the economy in mind. North and Thomas related the economic rise of England and Northern Europe to the rapid abolishment of inefficient common land and a resulting expansion and modernisation of farming. North ascribes the extraordinary rise of the British and Dutch economies since the 17th century to the development of accountable governments and constitutionally constrained state power. From such findings it is not a far step to postulate the rule of law as a necessary condition for growth. Constrained and accountable government, independent courts, the avoidance of court delays, freedom of establishment, non-interference with private investment decisions, market oriented financial institutions, protection of private property, enforcement of contracts and corporations, which can become big and exist for a long period as wel as an insolvency law, which protects firms with a good business idea and swiftly closes down all other firms are in this view a necessary and sufficient condition for economic growth.

However, the available data on present day economic growth cannot easily be aligned with such a generalisation. [5] Investors must be protected from a kleptocratic government and private robber gangs. Contracts must be enforced. But the available data give no easy clue for understanding the relation between formal legal institutions and economic growth. In figure 2 we plotted the Rule of Law Index (Kaufmann Index) of a World Bank working group against growth rates of 136 countries. A data point represents the average value of the rule of law index, a number between -2.5 (lawlessness) and 2.5 for the years 2010-2016 and the real per average capita growth rates from 2014-2017. One can easily see that in this period there exists no correlation at all between the index for the rule of law and per capita growth rates for a six year period. The author did the same exercise about 10 years ago with the equivalent data for an earlier period. The result was the same. Several authors highlight that without enforcement of contracts and protection of property and investments economic development is not possible. Hall / Jones (this footnote) summarize the result of their comprehensive empirical study.[6] Rodrik (this footnote) stresses that to achieve this a rule of law state in the western sense is not a necessary condition but can also be realized by substitute institutions, as merchant guilds or powerful intermediaries of the state or a political party.

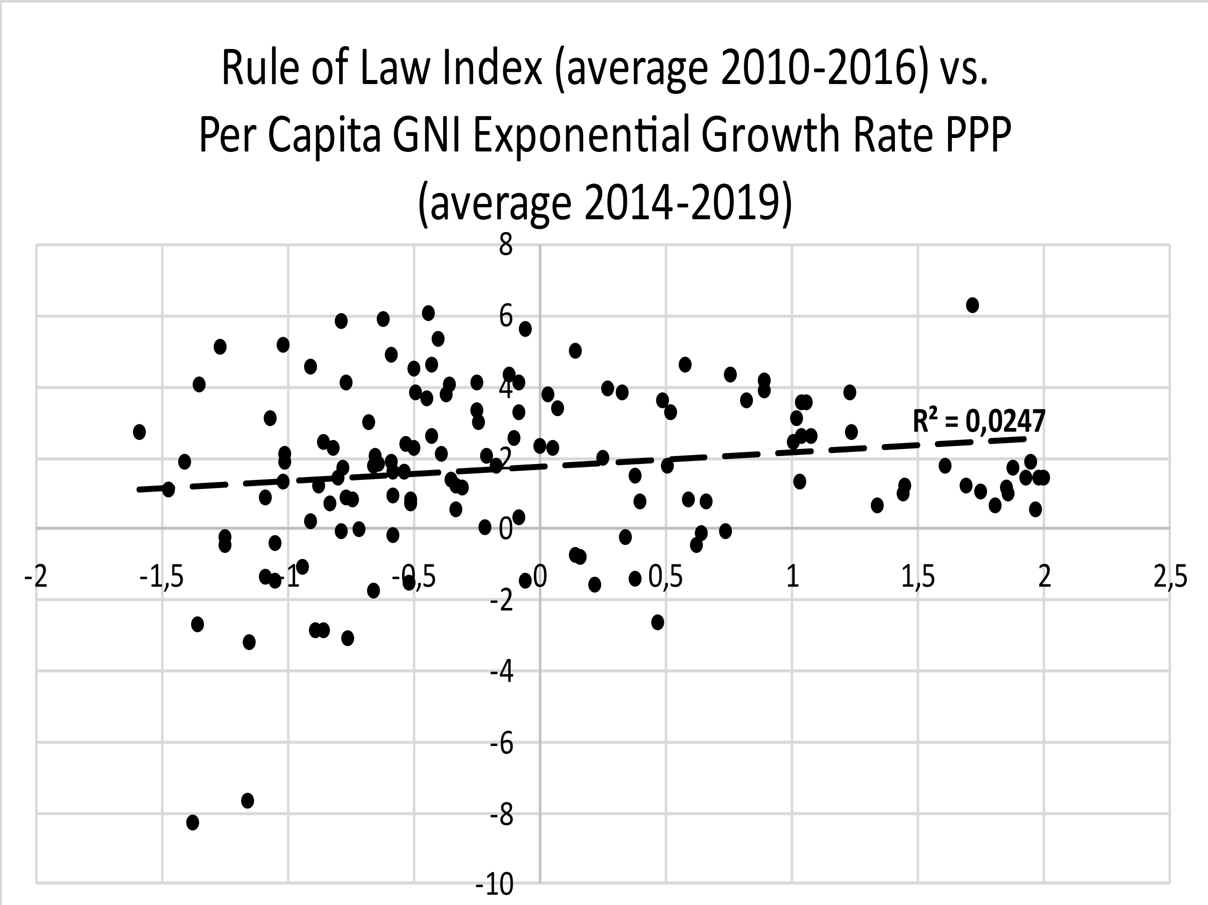
> „The cross-national literature has been unable to establish a strong causal link between any particular design feature of institutions and economic growth. We know that growth happens when investors feel secure, but we have no idea what specific institutional blueprints will make them feel more secure in a given context. The literature gives us no hint as to what the right levers are. Institutional function does not uniquely determine institutional form ".[7]

Diagram 2 shows that with low values for the rule of law -China is an outstanding example- a country can achieve high growth rates for an extended period. But such countries might also have no growth or a shrinking economy. Countries with high values for the rule of law -in the sample above 0.8 for the rule of law index- have however neither zero growth nor a shrinking economy. This indicates that an effective formal legal system might be a sufficient but not a necessary condition for economic growth.

Diagram 2

[6] Robert E. Hall /Charles I. Jones, Why Do Some Countries Produce So Much More Output per Worker than Others, 114 Quarterly Journal of Economics 83–116 (1999), they write: „Countries with corrupt government officials, severe impediments to trade, poor contract enforcement, and government interference in production will be unable to achieve levels of output per worker anywhere near the norms of Western Europe, Northern America, and Eastern Asia ". (86).; See also Dani Rodrik /Arvind Subramanian /Francesco Trebbi, Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development, 9 Journal of Economic Growth 131–165 (2004).

[7] Dani Rodrik, Goodbye Washington Consensus, Hello Washington Confusion? – A Review of The World Bank's „Economic Growth in the 1990s: Learning from a Decade of Reform", 44 JEL 973–987 (2006), esp. p. 979.

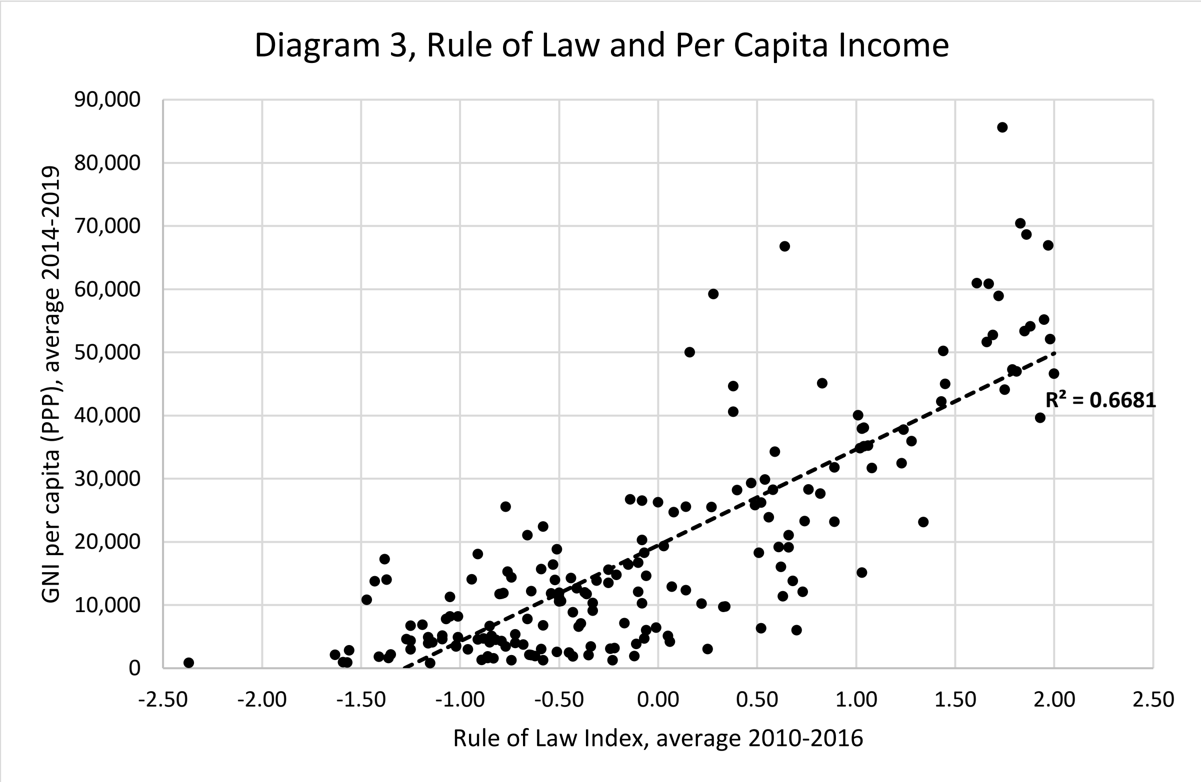


Sources: World Bank, World Development Indicators (9 September 2021) and World Bank Data bank, Rule of Law (9 September 2021)

The following diagram 3 plots the same rule of law values against the average per capita Gross National Product from 2014 to 2019 and shows a strong positive correlation between the two. It is noteworthy that almost all rich countries with per capita incomes of more than 39.000 US Dollars have high values for the rule of law much above 1, an average value of 1,44 and the highest value of 2 for Finland. This implies 11 Western European countries with the only exception of Italy, which has a high income but only 0,38 for the rule of law. It also implies the USA, Canada, Australia, and New Zealand and in Asia South-Korea, Singapore, Hong Kong (as well as Taiwan, which UN statistics do not include). Apart from those only some small oil producing countries or tiny states, for which special conditions like offshore financial hubs exist, belong in this category. The correlation in Diagram 3 reveals nothing about causation. One should however keep in mind that in high income countries norms are more complex than in low and middle income countries. This applies for contracts on research and development, in the finance and insurance sector as much as for corporate charters, and financial instruments. Above all in high income countries many investments often span comparatively long periods. Without the rule of law such long run investments cannot be credibly protected. Zhang Wei showed for China, that such investments depend on good political investor relations, are not open to anyone and get politicized.[8] This indicates

[8] Zhang, W., & Li, J. (2017). Weak law v. strong ties: An empirical study of business investment, law and political connections in China. Review of Law and Economics, 13(1), 1-45.

that for moving from low to middle income is possible without the rule of law but this might become more difficult when moving from middle to high income. The empirical data show at least that so far almost all rich countries of some size have a professional, effective and stable rule of law with independent judges.



Sources: World Bank, World Development Indicators (9 September 2021) and World Bank Data bank, Rule of Law (9 September 2021)

C. Institutional challenges in high income countries

High income countries in Western Europe and Western offshoots have -as a group- over the last decades preserved their top positions as having the highest per capita incomes and even more so with regard to the human development index, which includes data denoting capabilities of their citizens arising from education, life expectancy, public health, and more capabilities for women. They fill the top 30 on this list with the notable exceptions of Hong Kong, Singapore Japan, and South Korea. (Taiwan never shows up in UN statistics as if it did not exist). However, these countries lost the lead in having the highest growth rates too to the low and middle income countries. This trend in low and middle income countries should be welcomed without reservation as it ended an ages old divisive trend and is narrowing a rift between western countries and all other regions of the world. In the 1980ies developing countries gave up import substitution and integrated into the world market. Three factors contributed to this fundamental policy change. First it had become clear that the only really economically successful countries outside the western sphere were Japan and the 4 Asian tiger states, which had all integrated into the world market, whereas not a single import substituting state had achieved anything comparable. Second a huge amount of scholarly literature had accumulated showing that import substitution led to inefficient use of resources, often with extremely low or even negative value added of industrial production valued at world market prices.[9] Third, the rewards from globalizing for low and middle income economies had increased dramatically with new technologies, which reduced costs of international communication making it possible offshoring factories, production lines, ideas, intellectual property, and knowledge from high to low income countries at much lower cost than any time before.[10] That as a consequence growth differentials between western high income countries and low and middle income countries reversed and led from an age of economic diversion to the "great conversion" (Baldwin 2016) is not per se "a problem for high income countries" at all, even though it certainly causes a redistribution of political power and influence from Northern America and Western Europe to other regions, so far especially to South Asia and South-East Asia.

However, what concerns observers writing on law and development is not the reversal of growth rates between high and low income countries but the heavy decline of per capita growth in Western high income countries, which Table 2. Illustrates.

Table 2. The Changing Growth Pattern in High Income Countries v Low and Middle Income Countries 1960-1980 and 200-2019

	Per Capita GDP Growth Rates in Percent, Averages 1960-1980	Per Capita GDP Growth Rates in Percent, Averages 2000-19
Low and Middle Income Countries	3.16	3,68
High Income Countries	3,40	0,98
European Union	2,81	0,98

[9] For an overview see Jayanthakumaran, Kankesu (2000), Industrialisation: Import Substitution to Export Promotion, Department of Economics, University of Wollongong, 2000. https://ro.uow.edu.au/commwkpapers/30

[10] Baldwin R (2016) The Great Convergence: Information Technology and the New Globalization.

USA	2,49	1,04
China	3,52	8,11
India	1,31	4,36
Source: Own calculations from World Economic Indicators (Visited Sept. 2021). The growth rates are averages of the available numbers for single years, not average exponential growth rates, as sufficient per capita income data are not available for the period from 1960-1980. These data might therefore differ somewhat from other growth rate calculations in this article.		

It is self-evident that these figures need careful interpretation with the help of metric methods and do not speak for themselves. We mention only two factors. First, in the period of 1960-1980 in most high income countries women, who traditionally had stayed at home after marriage, entered the workforce in large numbers, which did not increase the income per person employed but the per capita income. This is however a once and for all effect on economic growth, which later disappears. Second, in the period after 2000 environmental investments for less noise, clean air, cleaner river water and for CO_2 emissions increased in high income countries more than in low income countries, partly because a better environment is an income elastic good. The demand increases more than proportionately with national incomes. National account statistics do however not capture the benefit of a better environment sufficiently. The same applies for the reduction of greenhouse gas. Middle and low income countries are so far exempted (until 2030) from binding obligations to reduce carbon emissions. The investments of high income countries produce something valuable, which does not show up in GNP statistics. But even with this caution it is reasonable to argue that many rich countries achieved growth rates which fall below what is achievable.

Several authors, including Steve Lee[11] argue that the shrinking economic growth in high income countries reflect a weakening of institutional factors in western countries. They regard growth rates of one per cent or less below what would be achievable even for rich countries, which produce at the production possibility frontier, cannot catch up by using known but so far unused technologies, organisations, and institutions. Per capita growth can then only result from resource mobilisation and rising total factor productivity. Resource mobilization implies more women in the workforce, working more hours and -with an increased life span- working more years, which causes only once and for all effects. Resource mobilization also implies capital accumulation that is more capital per person employed. The growth effect of more capital intensive production runs however fast into decreasing returns to scale. Continuous per capita growth for high income countries, which already exploit all known legal, organisational, and institutional techniques is dependent on the discovery of new products, product methods, technologies, organisations, and institutions including new legal norms.

[11] Lee S (2021) Law and Economic Development in the United States, manuscript.

The authors of this conference volume make valuable contributions on this problems. Steve Lee [12]shows that the USA do not only consist of Silicon Valley. The declining and presently low US per capita growth results from insufficient education and training, particularly for those in the lower end of the economic ladder. The formerly high wages for semiskilled workers disappeared with the industrial jobs now outsourced. A lack of infrastructure isolates many areas in the USA from the economic centres; rising income inequality, the downward trend for investment growth, excessive public debts and labour substituting new technologies are elements of this development. Cooperation and coordination between the municipal, state, and federal levels in the USA is often difficult to achieve, which often increases regional disparities rather than to remove them.

In this edition Christian Rasquin [13] points to the long approval procedures for public infrastructure projects like highways, airports, electricity and railway networks, train stations harbours and their expansion. Citizens' participation, class actions of those affected, and public interest litigation can all have benevolent effects for the affected, the environment and the shape of landscapes and cities. But they also support a selfish "not in my backyard" attitude, which delays or prevents necessary projects at high costs for the economy. In Germany the duration of the approval procedure for railway network projects is 10 years.[14] The same applies for the planning of electricity distribution systems. [15] The first plans for the new airport in Berlin are from 1990. The airport opened in 2021. The city of Hamburg hosts Germany's largest seaport. The draft of big container ships increased from 9 meters in 1969 to 16 meters in 2007. To unload such ships' cargo huge construction works along 120 km in the river leading to the harbour were necessary. They implied huge effects on the environment. Lengthy procedures to hear the interests of the affected and to defend the public investment in administrative courts were necessary. The planning procedure until the final approval of the project lasted more than 17 years.[16] Reforms are under way and aim at reducing planning procedures in Germany from about 10 to 5 years. It is discussed, whether legal disputes in courts from the first to the third instance are necessary and should be replaced by 2 court proceedings in 2 instances. This alone would reduce planning periods for many public projects by two years. Hearing and participation rights of the affected, citizens and environmental activists remain however important. They "produce" a healthier and more liveable environment, whose value is real, but does neither increase company profits nor enter the national income statistics, except indirectly through the productive effects of better public health. Germany will close all atomic energy plants in 2022 and all coal based energy plants in the 1930ies. There exists an urgent need for more electricity networks, which transport the new wind energy to industrial centres. So far

[12] See S (2021) ibid.

[13] Rasquin C (2021) "Unlocking Legal Gridlock in High-Income Countries: How Excessive Litigation Hampers Growth and Harms Democracy", manuscript.

[14] Nanz P (2014), Bürgerbeteiligung und Energiewende: Dialogorientierte Bürgerbeteiligung im Netzbau Viertes Jahrbuch Nachhaltige Ökonomie (edited by Holger Rogall et al), pp. 195-216

[15] Federal Government of Germany (2011), Gesetzentwurf der Bundesregierung, Gesetz über Maßnahmen zur Beschleunigung des Netzausbaus Elektrizitätsnetze (Draft Bill for the acceleration of electricity network planning), p.66 and p.4.

[16] FAZ, 24 July 2019.

however a reform which accommodates swiftness of planning and approval decisions with participation rights of the affected and of citizens does not exist.

In the following overview I shall concentrate on aspects not already covered extensively in other papers of this conference.

1. Financial order in distress

Rich countries with liberalized financial sectors faced 4 financial crises over the last 20 years, which all had severe consequences for the real economy, the dot.com bubble of 2001, the Lehman crisis of 2008, which placed heavy strain on government budgets and led to fiscal crises in several European Countries especially to a state insolvency in Greece in 2010. This again led to the Euro crisis of 2012.

The Lehman crisis resulted from a worldwide sale of subprime US mortgage loans. Creditors recoded them as commercial paper and mixed them with other higher rated credits. They sold them to banks worldwide with a seemingly attractive interest rate. Many banks, especially in Europe, got soaked into these financial products until they finally had to be rescued by the state. One can rule out that the banks were uninformed, or unaware that at the end of the financial chain there were only subprime loans, even though their legal construction was intransparent. It is also impossible that they blindly trusted the triple-A ratings of rating agencies. This crisis can neither be explained with asymmetrical information between securitisation firms and banks similar to market failure in the business to consumer relation. Nor did it begin with exploitative goals, but rather with the social policy efforts of the Clinton administration to enable every American to buy their own home with mortgage loans. The Housing and Community Development Act of 1992, passed under the Clinton administration, was designed to help disadvantaged groups and minorities to achieve home ownership.[17] President Bush continued this policy. The loans were to cover the full purchase price of the property, require no equity on the part of the buyer, and also limit the recovery of the debt to the value of the property in the event of non-servicing. The US government encouraged mortgage banks to market these subprime loans aggressively (reverse redlining). This is social policy strategy in a country whose parliament is permanently opposed to establish a welfare state financed by progressive income taxes and levies. Every bank that spent billions was aware of this. Why then were so many such claims bought in securitised and money-like form from banks outside the US, including the proverbial "stupid German money"? The US Federal Reserve supported the expansion of mortgage lending

[17] See Board of Governors of the Federal Reserve System (US): Effective Federal Funds Rate, <https://fred.stlouisfed.org/series/FEDFUNDS>, Bank Prime Loan Rate, <https://fred.stlouisfed.org/series/DPRIME>, Delinquency Rate on Consumer Loans, All Commercial Banks, <https://fred.stlouisfed.org/series/DRCLACBS> (alle 25.6.2021).

with an “easy money policy” that created property price inflation such that mortgage lenders who had financed 100 per cent of the purchase price of the property were able to sell the property at an inflated price if borrowers defected or failed to service their loans. The plan was to let this asset inflation run out with a soft landing via the central bank's monetary policy. These securitisations would ultimately have generated a win-win constellation in which (almost) all Americans would have emerged as homeowners and many banks along with their depositors of time deposits around the globe would have profited. Many believed in this bet; the very low equity ratio of countless financial institutions fuelled the risk appetite beyond healthy levels and systemically important financial institutions, which were too big to fail probably also hoped to be bailed out in a worst case scenario. Otherwise, the toxic papers would not have found buyers at hundreds of banks around the globe. Things turned out differently, and when real estate prices in the USA fell sharply, the crisis unfolded. The Greek and Euro crises that emerged in the wake of the Lehman crisis had a similar cause. Banks with low levels of risk capital were incentivised to assume risk by buying Greek government bonds. The Nobel Prize winner Kenneth Arrow arrived at this assessment of the financial crises in the last decade.[18]

> „[…] given the incentives, the agents were behaving rationally. The root of the matter is that liabilities are limited from below. A firm can go bankrupt, but that is the worst that can happen to it. Similarly, an executive of a company can at worst be dismissed. The extra bonuses compensating him or her for performance in the event that things went well are not paid back in bad times. As a result, a risky investment that is socially unprofitable (a negative expected value or a positive expected value insufficient to compensate for the market-determined risk level) may be privately rational for the decision-maker, because the latter will not bear all the negative consequences“.

It was the belief in prolonged asset inflation coupled with the undercapitalisation of financial institutions in Western countries. Martin Hellwig and Anat Admati arrive at a similar assessment and consequently demand increased equity capital ratios for banks. These authors conducted a historical study of banks in western societies and show that in the 19th century equity capital counted for up to half of the total capital of banks. Under this condition a severe conflict of interest between bank managers and owners of equity capital did not arise. In the wake of the Lehman crisis equity quotas are much lower and often below 5 percent ore less. The authors propose that banks should be financed with 20 percent equity capital.[19]

[18] Kenneth Joseph Arrow, Economic Theory and the Financial Crisis, Information System Frontiers 14 (2012) 967–970.

[19] Martin Hellwig /Anat Admati, The Bankers' New Clothes: What's Wrong with Banking and What to Do About it (2013)

Both authors' interpretation of the financial crises in the second decade of the 21st century point to a weakness of corporation law. Low equity ratios for financial institutions destroyed the alignment of interests between bank owners and bank managers. And banks had incentives as a whole to take overly risky decisions, when they could expect a bail out. The fallout of these crises in terms of lost economic growth was considerable and concentrated in high income OECD countries with globalized financial sectors and free financial capital flows. On the contrary most developing countries had liberalized international trade and their current accounts but not the capital accounts of their international balance of payment. This explains, why the Lehman crises led to severe impacts on the real economy in the EU or in South Korea, but not in India and many other low and middle income countries. The heart of the matter is a legal problem. The stock listed limited company is undoubtedly an engine of economic growth, but insufficient equity in financial institutions distorts incentives of bank owners and bank managers so much that that they engage in overly risky transactions, which can severely affect the real economy.

2. The Incomplete legal architecture of the Euro

In the European Union the Lehman crisis and its impact on the real economy led to high government deficit spending in member states. This led several countries, namely Ireland, Portugal, Spain, Cyprus and Italy to a fiscal crisis and one, Greece to state insolvency, associated with shrinking economies. For this crisis the European Union was not only unprepared, but it lacked any legal structure to cope with the crisis. Even more, the legal architecture of the Euro even excluded or made it extremely difficult for the European commission and the national governments of member states to respond swiftly and reasonably to the crisis, which contributed to its huge fallout.

The Lehman crisis forced the Eurozone states to increase their public debt by roughly 20 percentage points.[20] In most nation states this is usually not a matter which can immediately trigger an even more severe economic crisis because the central bank can either provide or ease credits for the state. But the legal constitution of the European central bank, which makes it exclusively a lender of last resort for banks but not for states excluded this (Art. 123 TFEU).

Without the Lehman crisis public debt in the Eurozone would not have been 80 percent as it was in 2010[21] but only 60 percent of GDP. It would be higher than that in the South, in Portugal and Italy, and much higher in Greece, but much lower in Spain, a country with low budget deficits and even budget surpluses until the Lehman crisis. In Germany the Lehman

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[20] From 2008 to 2010, public debt in the euro area rose from 66 percent to almost 85 percent of gross domestic product. In the UK, the increase was significantly steeper, from 54 to 84 percent. See Eurostat, gross debts.

[21] Eurostat (2011)

crisis added 15 percentage points and the costs of the German unification added 20 percentage points to its public debt ratio, which would have been less than 50 percent of its GNP without these two events.[22] The widespread view that the crisis reflects above all the crisis of the Continental European welfare state is clearly wrong. This becomes obvious when one looks at public debts in other rich countries. For 2011 the public debt estimates for the USA in the USA were 102 percent of GNP, considerably higher than in the Eurozone, 84 percent in the United Kingdom, slightly higher than in the Eurozone and 204 percent in Japan, higher than in any country in the Eurozone including Greece.[23] And none of these countries faced a similar crisis of its public debt as Spain or Italy. Also, in historical perspective present public debts are not excessive as the British example tells. The ratio of British public debts to GDP after the Napoleonic wars and after World War II was about 250 per cent.[24] And this burden did not lead to state bankruptcy nor did it cripple the British economy but disappeared with time and economic growth.

Why were some countries in the Eurozone in trouble and faced high interest rates for their government bonds, whilst at the same time other countries like the USA, Britain and Japan have no problems at all to roll over their debts with interest rates around 2 percent, which in the UK and the USA were even slightly lower than for German government bonds? This was a consequence of the legal construction of the European central bank. The legal status of the European central bank does not allow it to signal to creditors that it will buy government bonds with full firepower in case of a liquidity crisis. In the USA, the UK and Japan as well as in almost all countries worldwide the central bank can act as a lender of last resort to the banks and – directly or indirectly – to the state and can credibly signal this to creditors, as quantitative easing is in principle unlimited.The European central bank cannot give the same signal. It cannot buy government bonds on the primary market and its purchases of bonds on secondary markets are limited by the categorical priority of price stability (Art. 127 TFEU). Unlimited quantitative easing would annihilate the

expenditures. Therefore the possibility/ability to finance the states in the Eurozone with public debt is inherently lower than in other countries. This should have been clear from the outset. The Maastricht criterion of an upper threshold of public debt of 60 percent of the GNP reflects this.[25] But neither the European Commission nor the states of the Eurozone nor even the creditors have taken this criterion seriously because of its weak enforcement mechanism[26]. Debtors as well as creditors learned it the hard way through market forces.

[22] Gert G. Wagner (2012)

[23]USA, The World Factbook, Central Intelligence Agency, www.cia.gov/library/publications/the-worldfactbook/rankorder/2186rank.html

[24] UK Public Spending www.ukpublicspending.co.uk/uk_national_debt, EJCE, vol.9, n.2 (2012) Available online at http://eaces.liuc.it

[26] In February 2012 The Federal Reserve held 1.7 bn. Dollars of US securities, about six times as much as the European Central Bank. See Federal Reserve Statistical Release, February 2012. The central banks in the UK and Japan follow a similar policy to keep interest rates down.

When during the Euro crisis interest rates started to rise above sustainable levels in several European states including Spain, Italy and Greece the European Central bank simply neglected the legal framework and bought government bonds of distressed countries to lower the interest rates, without much effect. Later the European Council that is the representatives of member state governments agreed on a permanent crisis mechanism, the European Stability mechanism (ESM). To avoid the complicated procedures of changing the European treaty (TFEU) this organisation was created by an international treaty among member states of the Euro area outside the legal architecture of the EU, endowed with a financial lending capacity of 700 billion Euro, as sum which was high enough to save Greece and other smaller country but not Italy. After the establishment of the ESM interest rates of Italian government bonds continued to rise in Italy as financial markets saw that the firepower of the ESM credits were not sufficient. The crisis thus evolved further with a focus on Italy. In this situation the president of the central bank Draghi announced that if any member country in distress would take up an ESM credit given under strict conditionality and if even then interest rate for government bonds in distressed countries would continue to rise to unsustainable levels the central bank would buy bonds of this country "whatever it takes". After no government contradicted this announcement interest rates in Italy began to fall, which ended the Euro crisis. It remained unclear, whether such Outright Monetary Transactions (OMT) to save a member state from financial collapse violated European law, especially the prohibition of state financing (Art. 123 TFEU). However, the Pringle decision of the European Court of Justice (ECJ) endorsed this. It is noteworthy that the European Central bank made no use of this possibility and spent not a single Euro on OMT transactions. The pure announcement was -due to its credibility- enough to bring interest rates down in Italy. Still, Italy suffered much from this crisis with having no per capita growth in a period of 20 years from the introduction of the Euro till 2020.[27]

The Euro resembles a medieval building, whose architects did not know anything about static and erect a huge edifice, which can collapse anytime. When the architects see the cracks in the wall, they rush to add shores to the construction. This method worked for the Euro but included strains to the economies of distressed countries for too long. This contributed to growth rates much lower in the Eurozone from its start in the Year 2000 up to 2019 than in the 20 years before in the same countries.[28] According to World Bank data the average exponential growth rate of the GNI at constant prices for the countries of the Eurozone was 2,33 percent in the twenty years from 1980-200 before the introduction of the Euro and 1,24 percent in the 19 years after its introduction. The difference to medieval architects is however that the fragility of the Euro's legal architecture was well known ex ante but politics was unable to remove them ex ante.

3. The global trade order in distress

[27] Own calculation from World Development Indicators 2021, real GDP per capita (PPP) in US Dollar prices of 2017.

[28] Calculated from World World Development indicators for GNI data at constant dollar prices of 2010.

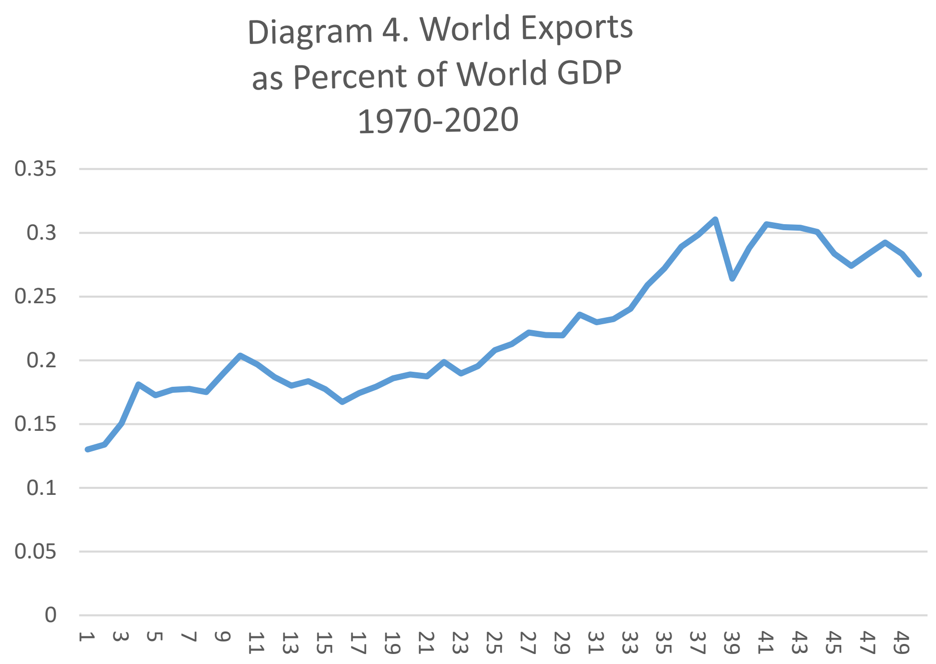
Few international developments reflect the speed of globalization better than the growth of international trade of goods and services. The integration of the world economy can be illustrated by the development of total world exports as a quota of the world GNP. This quota was around 1 percent at the beginning of the 19th century.[29] It rose enormously until the first world war to 13 percent in 1913.[30] That is in an era of permanent economic growth in western countries world exports increased by a factor 13 times higher than the world economic product. The legal order making this possible was public international law, which accepted the most favoured nation clause, which kept impediments to international trade low and also accepted the -with some exceptions- the gold standard for national currencies, which provided an automatism keeping the balance of international trade between nations in equilibrium. The guarantor of this system was the United Kingdom, the first country with an industrial revolution and at the time the "L'économie dominante" of the world. Another reason was the rapid decrease of transportation costs, when steamships replaced sailing ships.[31] This system collapsed in the first world war, later on in the big slump of the 1930ies and World War II. Thereafter the western states led by the USA aimed at restoring an international free trade order. The Truman administration achieved the General Agreement of Trade and Tariffs (GATT), which restored the most favoured nation clause, limited trade barriers to customs only and established a dispute resolution mechanism. Later the World Trade Organisation gave GATT a solid organisational structure. In a long series of negotiations, which spanned decades customs duties for industrial goods were drastically reduced to presently an average of around 5 percent in western Europe and North America. [32]The resulting growth in trade has been a powerful engine for overall economic expansion. On average since the establishment of GATT in 1948 trade has grown by 1.5 times more than the global economy each year. Total exports in 2019 were 250 times the level of 1948.[33] Still from diagram 4 we can see that only in the year 1970 the intensity of globalization reached again the level of 1913 to further increase afterwards. A big push can bee seen between the middle of the 1980ies and 2008, the year of the Lehman Crisis. This reflects the change of economic policy by many developing countries, which unilaterally liberalized their international trade, notably China and India. Since then, the intensity of globalisation as expressed by the quota of world exports to the World Gross Product did not further increase and is decreasing since the Corona Pandemic. Since many years however the GATT framework has become more and more backward and dysfunctional, thus contributing to lower growth in countries most exposed to the world economy.

[29] Maddison (2001)

[31] O'Rourke and Williamson G (1999), Globalization and History of the Evolution of a nineteenth Century Atlantic Economy, Cambridge MIT, p.36.

[32] https://www.wto.org/english/res_e/booksp_e/chap2_e.pdf, Chapter 2, p.9.

[33] WTO, https://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr_e.htm (Sept.2021)



Source: World development indicators 2021.

The rules of GATT are part of classical public international law which, in which only states and not private persons have rights and duties. It falls more and more behind legal developments in economic regions like the EU or in bilateral agreements like bilateral investment treaties. EU law is directly applicable and gives rights to private persons. International bilateral investment treaties with an arbitration clause at the ICSID panel allow investors to take direct action against the host state. Despite the currently low level of customs duties on industrial products no "level playing field" for the international trade of goods is required. WTO law and panel and Appellate Body decisions do not interfere with sovereignty as much as EU law with its direct effect. In a nutshell, the GATT obliges WTO members to remove non-justifiable trade barriers except for tariffs, which it seeks to reduce ("tariffs only"). Foreign "like products" (in general, substitutable ones) enjoy national treatment, i.e. they must not be discriminated against. In principle, no importing State may impose restriction on grounds of production methods or legal standards governing the production. Exceptions to this default rule of national treatment are enshrined, inter alia, in GATT Art. XX, which permits import restrictions "necessary to protect public morals" or "necessary to protect human, animal or plant life or health". The wording of these rules strikingly coincides with Art. 30 and 36 TFEU, which obviously emulates Art. XX GATT. However, absent a powerful executive body (the Commission) and an ECJ that has shaped those EEC/TFEU rules into directly applicable individual rights, the GATT provisions entirely lack the strength of the European rules.

Decisions by panels and even by the Appellate Body do not in and of themselves carry a legal obligation for the losing party but only highlight in a declaratory manner obligations pursuant to the very GATT Treaty. The winning party may then impose sanctions (but only the ones permitted by that Treaty) on the losing party. While the European Court of Justice ECJ has at least some instruments at hand to enforce its judgments (e.g. pecuniary sanctions), no such levers exist in WTO law, where countermeasures remain a matter for the States.

It should be added that the WTO regime also encompasses a legal framework for the provision of services – the General Agreement on Trade in Services (GATS). However, it does not provide for the general liberalisation of trade irrespective of its sector; liberalisation depends on the parties' voluntary commitments, which are confined to specific service markets. In other words, the States concerned must determine whether, how and to what extent a service can be traded internationally. This requires a lengthy process of submitting and certifying trade "schedules".

The WTO system is becoming increasingly dysfunctional. The USA vetoes the appointment of judges to the Appellate Body, where of six of seven posts are now vacant. Thus, the Appellate Body is currently paralyzed and unable to take the decisions that would be required to give panel decisions legal authority.[34]

The other problem is disrespect of the substantial WTO law. In China, state-owned or state controlled, and heavily subsidized firms sell their products worldwide without observing the WTO rules on state aid contained in the Agreement on Subsidies and Countervailing Measures (SCN). Thus, in international trade relations, law is losing ground to lawlessness.[35] The WTO system is also unable to modernize its rules, for instance, to accommodate digital trade. A growing share of international trade is subject to preferential trade agreements with specific dispute resolution tribunals outside of the WTO framework, making it increasingly superfluous. This contributes to lower economic growth especially for those high income countries, which are most exposed to the world market and cannot fully substitute their international economic relations with either bilateral treaties or regional forms of cooperation like within the EU or with establishing regional or bilateral free trade zones and customs unions.

4. Increasing inequality in western high income countries since the 1980ies

Western market capitalism which became the prevailing western economic system in the late 18th and early 19th century has led to an unprecedented increase in mass prosperity and general welfare, including better health, schooling and higher life expectancy. There exists also no general evidence that inequality systematically increases in market capitalist systems. No competing economic system has ever come close to achieving this.

[34] Terhechte JP (2021) Dead end or pathway to new relations? pp.94-112.

[35] Schäfer HB and Kämmerer A (2021) At Brexit Crossroads, Autonomy and Gains from Trade as Alternatives? in Kämmerer JA and Schäfer HB (Ed.) Structure and Problems of the EU-Uk withdrawal agreement, in: Brexit, Legal and Economic Aspects of a Political Divorce, in: Kämmerer JA and Schäfer HB (Ed.) Structure and Problems of the EU-Uk withdrawal agreement, in: Brexit, Legal and Economic Aspects of a Political Divorce, pp. 1-33

A comprehensive economic history study by Jan Luiten van Zanden and others in 2014 proves this.[36] Between the year 1820 and 2000, average real wages of construction workers in Western Europe increased 13-fold and real per capita income increased 16-fold. The USA, Canada, Australia and New Zealand are often grouped together in economic history time series as "western offshoots".[37] In this group of countries, real per capita income increased 21-fold from 1820 to 2000. Estimates of the real wages of construction workers are only available for the period from 1860. By 2000, they had increased 3.8-fold since 1860. In the US, real per capita income increased 21-fold from 1820-2000. For real wages in the USA, the above-mentioned study only contains time series from 1920 to 2000. During this period, real wages of construction workers increased by a factor of 2.9.[38] In every strata of the population, life expectancy and educational attainment have increased dramatically since then. Similar figures apply to the USA, Canada or Australia, but by no means to those countries that were less capitalist than the ones mentioned.

Long time series also do not support the view that capitalism has an inherent tendency to more unequal income distribution. Diagram 5 contains a time series of the Gini coefficient for Western Europe and the USA. The Gini coefficient, a number between zero and 1 (or expressed as a percentage between zero and 100), is the most common statistical measure of inequality of income and wealth. A Gini coefficient of zero implies that all income earners have the same income; a Gini coefficient of 1 implies that all national income is accounted for by one individual. The empirically determined Gini coefficient thus indicates the deviation (in terms of percentage points) of the factual income distribution from an equal distribution.

Diagram 5: Income inequality in Western Europe and the USA, 1820-2000, development of the Gini coefficient (in per cent)

[36] How Was Life? – Global Well-Being Since 1820, hrsg. von Jan Luiten van Zanden/ Joerg Baten/Marco Mira d'Ercole /Auke Rijpma /Conal Smith/Marcel Timmer (2014), Pim de Zwart /Bas van Leeuwen / Jieli van Leeuwen-Li, Real Wages Since 1820, in: van Zanden et al. (Fn. 20) 73–86

[37] Maddison introduced this term in his seminal empirical studies of time economic history time series data. Angus Maddison, The World Economy, Vol. I: A Millennial Perspective, und Vol. II: Historical Statistics (both in the 2006 edition).See Jutta Bolt /Marcel Timmer / Jan Luiten van Zanden, GDP Per Capita Since 1820, in: van Zanden et al. (Fn. 20) 57–72.

Source: World Inequality Database, <https://wid.world/> (22.1.2021).

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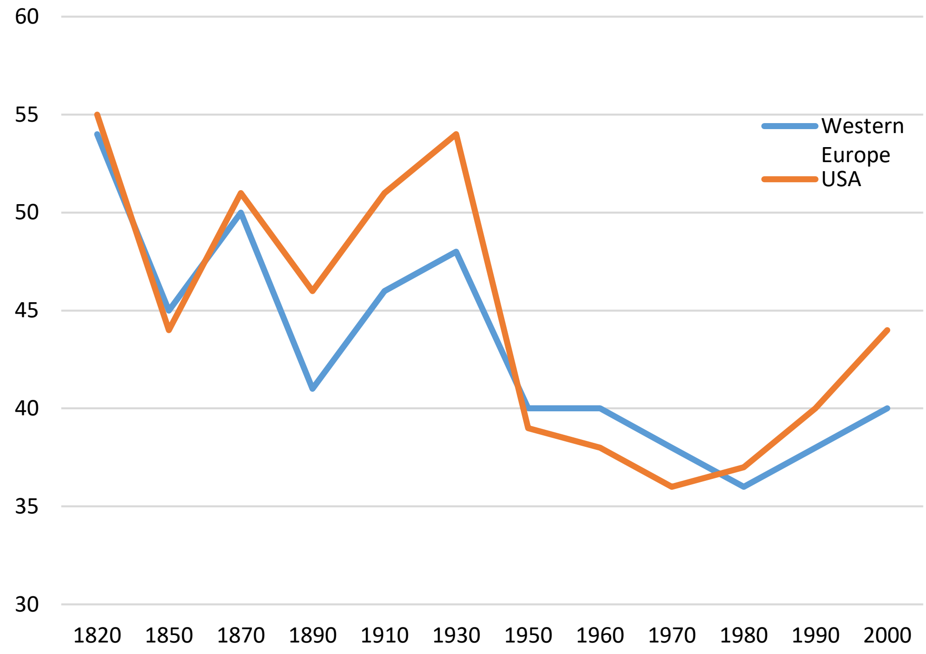
[38] Figures are based on own calculations on the basis of data in the study of Jan Luiten van Zanden et al. (see Fn. 20) Compare especially Table 3.2. on p. 65, Table 3.4. on p. 67, Table 4.4. on p. 80 and Table 4.6 on p. 81.

Figures are from Michail Moatsos / Joerg Baten /Peter Foldvari /Bas van Leeuwen / Jan Luiten van Zanden, Income Inequality Since 1820, in: van Zanden et al. (Fn. 20) 199–215, 206, 210



The study by Moatsos and others[39] shows that income inequality in Western market economies, expressed by the Gini coefficient, has increased since 1980 and that in the USA the inequality estimated in this way was greater than in Western Europe in 9 of the 12 investigated time series. [40]However, it does not provide evidence for the claim that market economies have a tendency to increase inequality.

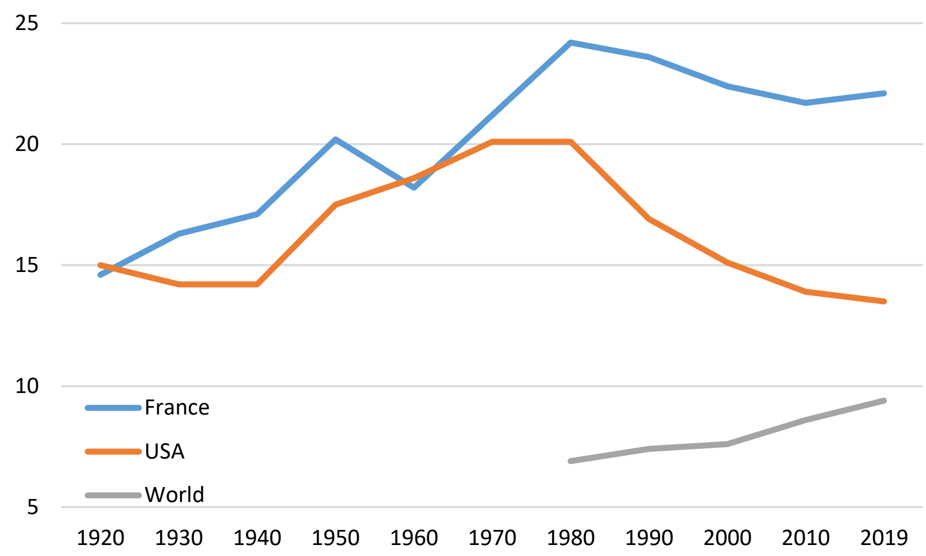
A time series of the World Inequality Database reinforces these findings. It expresses the sum of the incomes of the lower half of income earners as a percentage of all incomes and, unlike van Zanden's study, contains data up to 2019. Long time series going back to the 1920s exist in this study only for the USA and France and are included in Diagram 6.[41]

[39] Figures are from Michail Moatsos / Joerg Baten /Peter Foldvari /Bas van Leeuwen / Jan Luiten van Zanden, Income Inequality Since 1820, in: van Zanden et al. (Fn. 20) 199–215, 206, 210.

[40] Michail Moatsos / Joerg Baten /Peter Foldvari /Bas van Leeuwen /Jan Luiten van Zanden, Income Inequality Since 1820, op.cit., 206, 210.

[41] Source: World Inequality Database, <https://wid.world/> (22.1.2021).

Diagram 6: Share of the 50 per cent of lowest income earners in France and the USA 1920-2019



The long-term series of this inequality indicator available for France and the USA also show no long-term increase in inequality. For France, the overall trend line is rather indicative of a long-term decrease in inequality. Until 1980, inequality in the USA trended downwards, after which it increased - as in France - but more sharply than in France and most western industrialised countries. The same study shows that income inequality, as defined in Diagram 6, decreased slightly for the most part in Western industrialised countries between 2010 and 2019, and that the trend of increasing inequality since 1980 did not continue in the second decade of the 21st century. There is no evidence of a trend-like permanent increase in inequality in the Western capitalist system. This is not contradicted by the fact that more than three decades of rising income inequality after 1980 and even stagnating real wages in the USA have destroyed the confidence that the market economy always brings rising prosperity for all.

Income inequality (and even more so wealth inequality) has always been much higher in capitalist systems than in socialist systems, all of which had Gini coefficients of just over 20. They rose consistently from just over 20 to over 30 in the former CMEA states after the end of the Soviet Union[42], whilst China's coefficient rose to 45.[43]

[42] Milanovic B, Explaining the Increase in Inequality During the Transition, The Economics of Transition 7 (1999) 299–341.

[43] Statista (2021) Gini Coefficient in China, <https://www.statista.com/statistics/250400/inequality-of-income-distribution-in-china-based-on-the-gini-index/> (11.1.2021)

It is clear and indisputable that income inequality in Western free-market economies has increased sharply since 1980 and into the second decade of the 21st century. In the USA, this was even associated with a stagnation of real wages. The causal factors for the increase in inequality since 1980 [44] include inadequate schooling and more difficult access to institutions of higher learning. They also include the disappearance or shrinking of industrial production in many Western countries after most developing countries ended their nationalist (import-substituting) economic policies in the 1980s and began production for the world market, which reduced the income opportunities of low and semiskilled workers in rich countries. And it includes the rise of the IT industry, which pays well educated workers very well and does not need others. But also in this sector jobs get "bangalorized" by the booming IT sector in India. Finally, too little state investment in public goods also plays a role. As an important factor, the internationalisation of law can also be part of this. Private international law, which contains the adjusting screws for the degree of internationalisation of law, was still a matter for specialists in divorce law a few decades ago. In the meantime, it has become a central legal matter that strongly shapes our lives.[45]

Table 3 below shows that the trends to more inequality which began in the 1970ies and 80ies continued over 40 years. Using more recent data from the world development database it shows, how much of the total national income was earned by the 20 percent income earners with the lowest incomes. These data are not available for every year. For Asian high income countries, they cover so few years that these countries are not included in Table 3. The first column indicates the country and the years to which the data are related. The second column shows the income of the 20 percent income owners with the lowest income as percentage of the total income in the 1980ies and the third column shows the equivalent figure in the second decade of the 21rst century. The 4rth column shows how much this share changed in percentages. With the notable exception of France and the Netherlands income inequality in all other countries expressed this way increased. In the USA this trend had already started in the 1970ies.

Table 3 Income share of the 20 percent with lowest incomes in per cent of national income				
Country (years)	Share of lowest quintile closest	Share of lowest quintile closest	Change of income share of the lowest quintile in percent	Yearly exponential Change of real Income of the

[44] World Inequality Report 2018, Editors: von Facundo Alvaredo/Lucas Chancel /Thomas Piketty /Emmanuel Saez /Gabriel Zucman (2018); see also Kaushik Basu, Globalization, Poverty and Inequality: What Is the Relationship? What Can Be Done?, in: The Impact of Globalization on the World's Poor, edited by Machiko Nissanke /Erik Thorbecke (2007) 300–318.

[45] Pistor K (2019) The Code of Capital.

	to 1980	to 2020		lowest quintile in percent
Australia (1981,2014)	7,7	7,4	-3,9	3,1
Canada (1981.2017)	7,3	7,1	-2,7	n.a.
France (1984, 2018)	6,5	8,0	+23,1	2,4
Germany (1991, 2016)	8,8	7,6	-13,6	1,6
Italy (1986, 2017)	7,5	6,0	-20,0	0,3
Netherlands (1983, 2018)	8,8	8,9	+1,1	2,3
Sweden ((1984, 2019)	10,0	7,7	-23,0	1,4
UK (1986, 2018)	7,5	6,8	-9,3	1,9
USA (1984, 2018)	5,6	5,2	-7,1	2,3
Source: World Economic Indicators 2021, GDP in constant $ prices of 2010				

The relative deterioration of the distributional position of the lowest quintile of income recipients is compatible with rising real incomes. In all the above countries the total real income of the lowest quintile of income recipients increased in the relevant period. The author verified this by multiplying the share value for an available year in the 1980ies with the GDP in constant prices for the same year, which is for all countries in Table 3 smaller than the equivalent value for the multiplication in a year shortly before 2020.[46] Only in Italy the two values are closely together. That is the total real income of the lowest quintile of Italians was only 10 percent higher in 2017 than it was 31 years before in 1986. This amounts to an annual exponential growth of 0,3 percent.

Basu summarized the causes of this trend to more inequality.[47] These include inadequate schooling and more difficult access to institutions of higher learning. They also include the disappearance or shrinking of industrial production in many Western countries after most developing countries ended their nationalist (import-substituting) economic policies in the 1980s and began production for the world market. This together with rising immigration, capital and know how transfers reduced the income opportunities of poorly educated or semi-

[46] Calculations were based on GDP data in constant US Dollar prices of 2010, see World economic indicators (Sept. 2021)

[47] Basu K (2007), Globalization, Poverty and Inequality: What Is the Relationship? What Can Be Done?, in: The Impact of Globalization on the World's Poor, edited by Machiko Nissanke /Erik Thorbecke (2007) 300–318.

skilled workers in rich countries and led to pressure on wages.[48] It also includes the rise of the IT industry, which pays well educated workers very well and does not need others. Finally, too little state investment in public goods also plays a role. Most of these causes call for better education and training for a job market, which pays increasing premiums on high skills.

The legal policy instruments for alleviating such consequences of globalization are education and training [49], social safety nets and labour laws and standards. [50]

D. Lessons of new high income countries for other high income countries

I continue with some remarks on Steve Lee's highly recommendable book on law and development, which is now in its second edition and in which he compares economic policy in different countries, namely the USA and South Korea, both countries about which he has an intimate and privileged knowledge. South Korea, which only 60 years ago was a poor country and 100 years ago one of the poorest in the world is now a high income country. In 2019 its per capita income was higher than in Israel, almost the same as in Japan and Italy and a bit smaller than in the UK and France. [51] This is one of the most admirable achievements in modern economic history. Lee describes the process from very low to high income. It included a state led development of the private sector. The state did not only care for good governance, infrastructure and education. It also defined, which industries it regarded as strategic, to be financed, subsidized, and internationally supported. The investments in the new industries were not market driven but state selected. The process was led by an authoritarian but firmly growth oriented government providing protection to private investors. Only later at a high stage of economic development government control over industries were relaxed, the political system democratized and the rule of law established. Lee writes: "The legal and institutional approaches adopted by these countries present a useful reference model not only for the other developing countries seeking success in economic development but developed ones today, such as the United States, experiencing stagnant growth and economic polarization." [52]Lee presents

[48] Gunter BG and Rolph van der Hoeven R (2004), p.20; The social dimension of globalization: a review of the literature, Working Paper No. 24, Policy Integration Department International Labour Office, Geneva, June 2004 p.11.

[49] The growth effects of more education is debated in the literature. But that more education leads to high premiums on wages is established beyond reasonable doubt. For a survey see Blöndal S, Field S and Girouard N (2002) Investment in Human Capital Through Post-Compulsory Education and Training, Selected Efficiency and Equity Aspects, 60 pages, OECD Economic Department Working paper No. 333.

[50] Gunter BG and Rolph van der Hoeven R (2004) The social dimension of globalization, op.cit. ; Berger N and Fisher P (2013), A Well Educated Workforce is the Key to State Prosperity, Economic Analysis and Research Network, Report, August 2013, PP. 1-14; Haveman, R and Wolfe B, (1995), The Determinants of Children's Attainments: A Review of Methods and Findings, Journal of Economic Literature, vol. 33, no. 4, 1829–1878.

[51] Data from World Development Indicators, Per Capita Gross National Income 2019, (PPP) in 2017 Int $ was (in thousands): 43,1 for Korea, Dem. Rep. 39.9 for Israel, 43,0 for Italy, 45,6 for the UK, and 46,7 for France. For a comparison with Japan the equivalent most recent data existed only for 2018, 42,1 for Korea, Dem. Rep. and 42,7 for Japan.

[52] Lee YS (2021) Law and Development (Second Edition), Manuscript p.180

many examples about how high income countries can learn from South Korea, with which I agree and may refer the reader to Lee's book and want to comment only about one aspect, that is state driven development in which the state not only provides infrastructure and other public goods, education, a medical system, and a social welfare system but also steers the private economic sector with strategic decisions on key industries.

Every state, which does not provide the efficient amount of public goods, networks, education and public health is to be criticized. Lee shows, which factors contribute to an undersupply of such goods in the USA. The economic miracle in South Korea was however also associated with strategic planning for the private sector. And this strategy was successful beyond imagination. This is not in line with the argument that the state lacks the information to successfully promote the private economy by giving priority to specific sectors, production lines and goods. The optimal level of investment for infrastructure, schools and public health can be achieved with public or publicly available information. Such public information is usually not available for investments in the private sector. This information is private, spread around in the economy and can only be mobilized and made productive if private entrepreneurs make investment decisions based on their private knowledge and are successful.[53] The private information gradually becomes public indirectly by high prices and extra profits in successful firms, which motivates others to invest in the same products, production processes and organizations. It seems from the experience of South Korea and other Asian countries that for a backward country this argument is not as relevant as for a high income country, which produces at the production possibility frontier. When South Korea started its catch up run 60 year ago state planners took the decision that the country's economy should integrate into the world market. This implied that it should produce and export goods, for which it had a comparative advantage. There are many industrial goods, whose production requires much semiskilled labor. For economic planners it is possible to identify such goods. Planners might not know, whether it is better for the country to produce electrical equipment, optical instruments, leather or textile products, radios, TV sets or ships. All of those qualify for an export led growth. State planners might then possess or acquire a similar information level for strategic industrial planning as they have for the production of public goods. However, this informational advantage for the state disappears the more the country moves to the production possibility frontier. Then the probability of mistakes by central planners increases and -due to the central level at which the mistake is made- multiplies with the consequence of huge negative effects on the economy. It seems therefore that economic planners can identify future key industries better in a backward economy, whereas an advanced economy this depends more on mobilizing the private knowledge of entrepreneurs.[54] Those have more, better and more productive but private and dispersed information to which the government has little access. This information remains unproductive if instead of entrepreneurs the state takes decisions on future key sectors and channels the investment funds into them. Also, if private investors make mistakes the fallout to the economy is limited to their investments. If however private investors

[53] This argument is based on the seminal paper of von Hayek FA (1945) The Use of Knowledge in Society, The American Economic Review, Vol. 35, No. 4 (Sep., 1945), pp. 519-530.

[54] Cooter R and Schäfer H-B (2012) Solomons' Knot, How Law Can End the Poverty of Nations.

are successful with new ideas their huge profits signal indirectly to other investors how successful their idea was, which attracts more investors and generates more wealth.

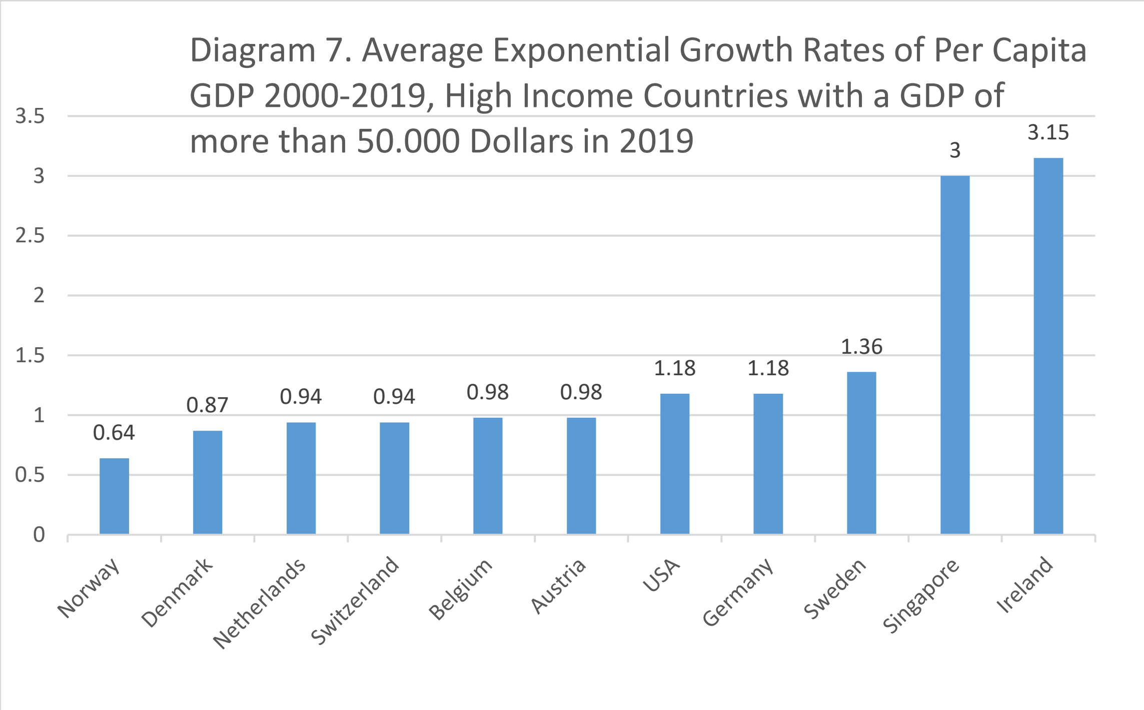
Not a single very high income country with a per capita GDP of 50.000 Dollars or more in 2019 had strategic planning for the production of private goods along the lines of Japan or South Korea. [55] It is also noteworthy that Japan, where strategic industrial planning has a tradition like in South Korea the GDP per capita was 42.7 thousand Euro in 2019 not higher than in Italy and its annual growth rate from 2000 to 2019 of 0,79 per cent was smaller than that of all richer countries of some size with the exception of Norway, which had much higher per capita incomes in 2019 than Japan that is more than 50.000 US Dollars. The high importance of strategic investment planning for private goods has seemingly not contributed to Japanese growth in this period. All high income countries with per capita incomes significantly higher than in Japan, that is more than 50.000 Dollars in 2019 with the exception of Norway had more economic per capita growth than Japan from 2000 to 2019. Singapore and Ireland had a much higher growth than all other countries in this collection but had no strategic investment planning for private goods comparable with Japan or Korea.

It should however be noted that even in developing countries, which open up to the world market, strategic state planning of key industries has not always been successful. In India, where strategic industrial planning had a tradition since independence the large new IT service industries, which delivers via the internet to the rest of the world developed without planning and to the surprise of the planning commission to an Indian key industry and a world leader for such services, without privileged access to credit or other government support. Government and state planning changed its attitude only after private entrepreneurs had led this industry to an unimaginable success.[56]

Ireland has now a per capita income twice as high than that of the UK or Italy and continues to have much higher growth than these countries. Low tax rates for corporate incomes and regulatory arbitrage contributes to this success but strategic investment planning comparable with the high income countries in Asia does not exist. Singapore has left behind all other countries except for some tiny states or autonomous entities. Singapore provides good governance, does much better on the rule of law index than most Western European Countries and the USA. It is a country with almost no corruption, facilitates the establishment of new firms and can swiftly expand and restructure infrastructure projects. This places it ahead of most other rich countries. That it was able to gradually remove the intensity of state planning of the private sector with a larger and more professional business community, better private financial institutions and makes better use of the dispersed private information on the productivity of investments in Singapore probably adds to its success.

[55] The following list of high income counties with a per capita GNI of 50.000 USDollars (PPP) in dollar prices of 2017 does not include tiny countries with a population of less than one million inhabitants. It contains Austria, Belgium, Denmark, Germany, Netherlands, Norway, Singapore, Switzerland and USA. In none of these countries the state is engaged in strategic planning for the private sector to an extent comparable with South Korea or Japan.

[56] Kapur D (2002), The Causes and Consequences of India's IT boom, India Review, Vol.1 No. 29, 91-110.



Source: Own calculation based on World Development Indicators, based on per capita GDP (PPP) in constant prices (Sept. 2021).

Diagram 7 presents growth rates of the 11 richest countries in the world with the exception of some very small states or autonomous regions (like for instance the Channel Islands, Macao, or the Bermudas). 8 of those belong to a group, which was already relatively rich 100 or even 200 years ago. These countries achieved per capita growth rates of around one percent per year from 2000-2019. In this group of the richest countries Singapore is a remarkable exceptions on 3 counts.

1. Like all East Asian states -with the exception of Japan- it was a low income country only 60 years ago.
2. Like China, India or South Korea and earlier Japan it achieved high and at times even double digit growth rates over the last decades.
3. Singapore made it to the top. In 2021 India is still a lower middle-income country according to World Bank classification. China is still a higher middle income country. South Korea and Japan are high income countries, comparable with the UK and Italy in this respect. But Singapore has become -before Ireland- the richest among the richest countries of some size in the world, which are listed in Diagram 4. In 2019 its per capita GDP was higher than that of all others in this group, for example 75 percent higher than in the Netherlands and 12 percent higher than in Ireland, the second richest country in this group. And Singapore ranks very high on the rule of law index, the corruption perception index and was on rank 11 worldwide on the human development index of 2020. Here it ranks below most other countries on this list of the 10 richest states, but before the UK, the USA, France or Italy.

It is a remarkable fact that a country, which ranks at the top of the list of a small group of most developed countries achieved growth rates of 3 per cent per capita over an extended period of 19 years. China, India, South Korea and Japan so far support the neoclassical convergence theory, according to which the law of diminishing returns to capital must lead to lower per capita growth rates in high as compared to low income countries. Singapore is a counterexample as it has not only reached the same level as other rich countries but is racing off at high speed. This paper cannot comprehensively explain this difference. But it is certainly not investment planning for private goods. On the contrary, Singapore is an example on how the role of the state changes, when the country makes it to the top and beyond.

In the 1960ies and 70ie the public sector played an active and interventionist role of to substitute for the weak private sector and ensure rapid industrialization. This changed with Singapore's economic success. Menon (2007) described the changing economic role of government concisely with the following words:

> "… during the past two decades, this leading role of the public sector became less pronounced as the government began to allow local and foreign private firms to compete in sectors that had been traditionally reserved for state monopolies. Banking, insurance, power, health and other sectors are more open to foreign players. Irrespective of the precise scale of this change toward greater competition, it does represent a significant shift in the role of the traditionally dominant public sector. This is also evident in the government's statements that it is inclined to change public agencies from "first class regulators" to efficient "facilitators" of business activity. Although the public sector still remains quite dominant in Singapore, its role is now to support the private sector by creating an atmosphere conducive to business, in terms of favorable corporate tax rates, infrastructure facilities, trade rules, and business licenses. …Thrust towards nationalization and strengthening of state apparatus has gave way to deregulation, privatization, corporatization, outsourcing, withdrawal of Subsidy and reduction in public spending."[57]

Singapore is another example that the role of the state to steer successfully the economy changes after a transition from a low to high income country. The provision of public goods, rule of law, regulation in cases of market failure and providing safety and security for all and leave other investment decisions to private persons and firms becomes more central in comparison to strategic planning of the business sector.

The success of countries like Ireland and Singapore to be the richest of the richest countries in the world (except for some tiny entities) is the result of international tax competition and good governance, including the rule of law, not of good central planning. However, in both countries some of the wealth is accumulated at the cost of other countries and is redistributive rather than productive. Both countries have extremely low corporate income taxes, currently 17 percent in Singapore and 12,5 percent in Ireland. This attracts firm seats of multinational countries, who pay taxes there, often on value added and profits produced somewhere else. It is questionable

[57] Menon V (2007) Governance, leadership and economic growth in Singapore, ICFAI Business School, Ahmedabad, Online at https://mpra.ub.uni-muenchen.de/4741/MPRA Paper No. 4741, posted 06 Sep 2007 UTC, p.9.

whether both countries can continue their race if either corporate income taxes become internationally harmonized or if affected countries counteract.