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IS GLOBALISATION DOOMED?

The Economic and
Political Threats
to the Future of
Globalisation

Antimo Verde



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To Anna, Daniele and Stefano

Preface

Why This Book?

In 2013, a book of mine about globalization came out.¹ In it I argued that globalization was doomed to slow down. When speaking specifically of “slowing down,” but not a “reversal,” I referred to a cleavage of certain qualified elements of globalization, having to do, for instance, with limits to the freedom of people to move from one country to another, or trade restrictions or controls on financial movements.

In 2013, the slowdown thesis was not shared by economists or politicians—it was then absolutely new.² Today, things have changed dramatically: Economists and experts often speak of “broken globalization” or use similar phrases.

Anyway, in my 2013 book I examined *why* the slowing down of globalization would have to take place. But absolutely nothing was said about *how* it would have to happen: no *mechanism* was envisaged to explain globalization’s braking.

The objective of this book is to expound this mechanism, which was lacking in the 2013 volume. The pillars of the mechanism are identified through answering the following questions:

1. *Who* among the actors in globalization is more penalized by globalization, and so would have an interest in stopping or eliminating part of it?
2. *Which* factors justify their interests and potential reaction against globalization?
3. *How* could these actors organize this reaction in an effective way?

Related to these questions is that concerning alternative policy approaches.

In answer to question (1) it should be assumed that globalization produces winners and losers. The main losers are the *middle and lower middle classes*, particularly in the advanced countries as well as in *some* emerging countries.³

The evolution over time of the income distribution in Europe and the USA tells a long story of the weakening of these classes.⁴ In the USA the middle class has been “decimated” and things are not too different in Europe. This withering of the middle to lower classes has a number of causes, among them the following structural ones:

- Skill-biased technological changes.
- Demographic aging processes.
- Predominance of financial activities in the economy.
- Globalization.
- Exasperating and unfair competition from the emerging countries allowed by globalization.
- Delocalization of national systems of production abroad, as favored by globalization.
- Distributional impacts of monetary and fiscal policies, or at least those carried out because of globalization constraints.

The answer to question (2) is crucial, as it lead us to identify the reasons or problems pushing the middle class to oppose globalization. These are as follows:

1. Immigration.
2. Terrorism.
3. (Immoral) inequality or globalization.

We assume that these are not temporary, but destined to last at least a couple of decades. This is a realistic hypothesis for immigration and inequality. As regards terrorism, it is equally realistic if we deem the Islamic State (IS; Daesh) to be more than a state: it is an ideology too. All this suggests that the middle and lower classes will take a long time to react to the impact of the three problems (Fig. 1).

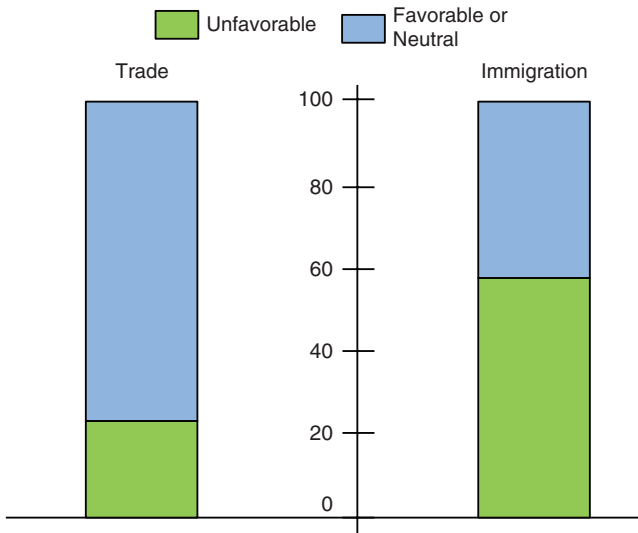
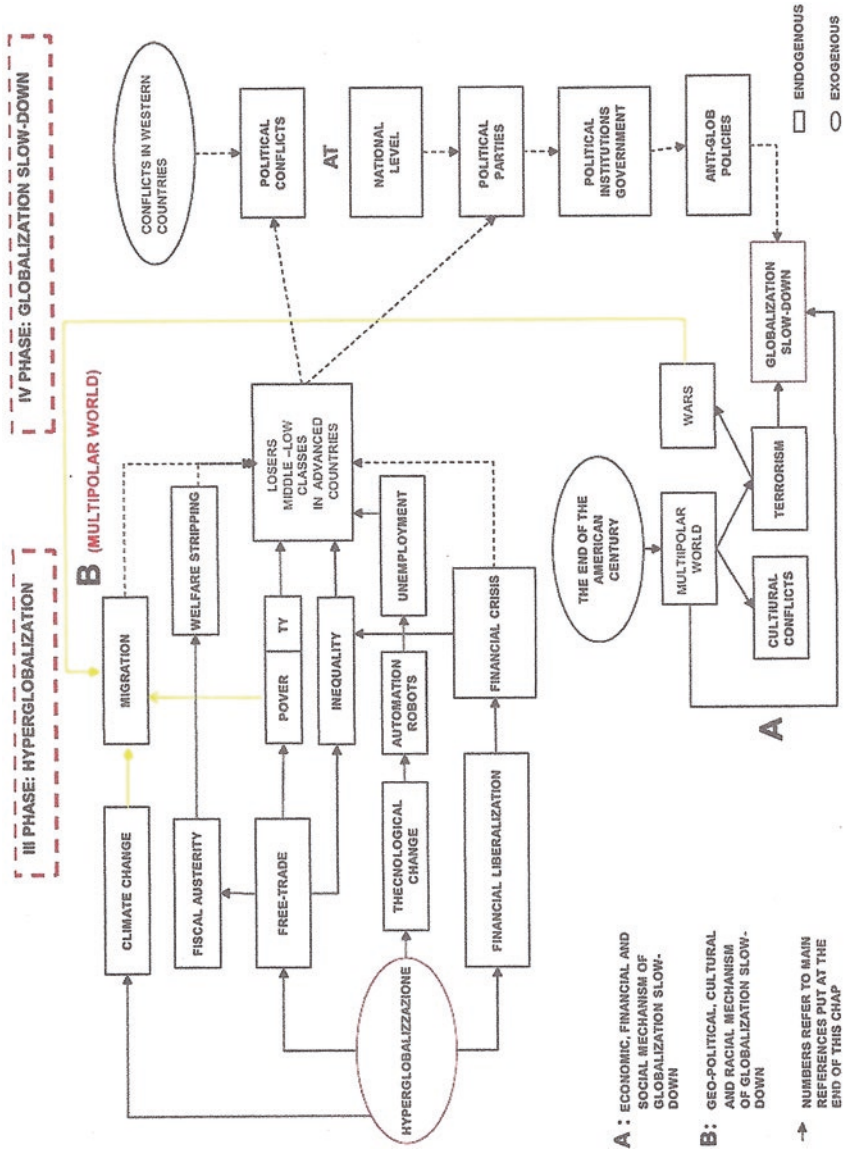


Fig. 1 Attitude toward trade and immigration: Selected Advanced Economies, 2014 1/(%, average). Sources Pew Research and Gallup data for United States. 1/ Selected economies include France, Germany, Greece, Italy, Spain, United Kingdom, and United States

Points (1) and (2) are particularly relevant not only for Europe, but for the USA too.



In particular, unskilled labor forces are worried about immigration, perceiving it as bringing with it high risks to jobs and wage levels.

The link between Islamic terrorism and the middle class's anti-globalization sentiment is not obvious. But terrorism thrives amid racial and cultural clashes between advanced and Islamic worlds. So, while terrorism can be deemed to be certainly a problem for *security* reasons, it can also be included among the main problems of the middle class because it is top of the public opinion surveys of people's fears (along with immigration). Moreover, this problem is to some extent also linked to immigration, as people see the risk that migrant routes could be a channel to introduce terrorists into the Europe.

To immigration and terrorism we add (immoral) inequality as a further reason for the anti-globalization sentiment of the middle and middle-lower classes, because it has reached an immoral level and people in Europe and in the USA understand it to be produced by globalization. In fact, many aspects of globalization—technological changes, unfair free trade, delocalization, the reduced role of trade-unions—are responsible for rising inequality. It is always true that rising inequality is intrinsic proof of the lowering of the income share of the middle class.

Finally, I here refer to *immoral* levels of inequality both because they are the current ones and because a lower level of inequality would be publicly acceptable (Keynes 1936, ch. 24).

Let's pass to the third question of how the middle and lower classes can organize their opposition to the process we call globalization, once they consider immigration, terrorism and inequality to have reached intolerable levels. In this case the starting point is that the losers from globalization do vote, and that they may use their votes to protect their interests.

In this vein, we focus on the political representation of middle-class interests. It is assumed that people belonging to middle and lower classes will make contact with *national* parties in order to get the elected bodies to share their interests, thus inducing them to change national policies in an anti-globalization way.

The middle class usually form the majority in national electorates. It is easy to imagine that the protection of their interests could lead to a change of the political picture as a whole, towards stances that are *in their favor*.⁵ This is particularly true when the political class is weak.

The thesis of this book rests on the hypothesis that the middle and lower classes are in a condition to affect the future of globalization. In particular, they will be able to force globalization to slow down.

As we will see in Chap. 2, a slowing down is already evident. By developing a new globalization index, which is a very important by-product of this book, it is shown that this slowdown took place in 2012–13 and 2015.

Finally at this point one question could be: are there alternatives to the anti-globalization policies to protect the middle classes? The answer is theoretically, yes, and the main policy instrument would be fiscal policy. This policy could be used to compensate the losers from globalization with adequate tax cuts in favor of people belonging to the middle class. But it is only a theoretical hypothesis, posed for intuitive reasons.

On the other hand, we can assume the *secular stagnation hypothesis*, which characterizes the current economic stance of the advanced world. This hypothesis favors immoral inequality as it reduces the possibility of using fiscal policy. Moreover the use of fiscal policy to this end brings with it a tendency of politicians to enlarge the definition of middle class,⁶ making such a policy unfeasible in practice.

The conclusion is that if there is a lack of serious alternatives to putting brakes on globalization, then the thesis of this book gains ground: The slowdown of globalization will be an inevitable scenario if the middle class are be able to achieve the political protection of their interests. This protection will be able to throw “sand in the wheels” of globalization.

What remains now for this book is how to introduce this mechanism, and that is the focus of what follows in this chapter.

The Plan of the Book

This book is divided into three parts. The next part, comprising the two chapters after this one, concerns the definition of globalization and its phases. The objective here is twofold: first, to stress the interaction between political-institutional and economic aspects in the evolution of globalization—this is the task of Chap. 1; second, to identify the three

phases of globalization to be confirmed by a new globalization index—this I will expound upon in Chap. 2. This definitional work is valuable because it enables a new globalization index to be obtained using principal component analysis (PCA) in an original way.

The most important index—the *globalization index*—shows the evolution of the integration process and confirms that the slowing down of globalization was already evident in 2015, as well as in 2012–13. For sure, this was not due to the middle-class reaction, as envisaged in this book, but it allows us to conclude that the analysis is on the right track.

The second part, Chaps. 3 and 4, investigate two of the three problems which will push the middle and lower classes in the search for the political protection of their interests, in terms of jobs, wages and security. In this part we deal with migrations (Chap. 3), and inequality (Chap. 4)

The third and final part of the book, Chap. 5 and 6, address primarily international and political problems. Chapter 5 deals with the Islamist problem, Chap. 6 dwells in detail on the process of political representation—that is, the political protection of middle-class interests. The last section in Chap. 6 focuses on some concluding remarks.

The starting points of our analysis can be allocated in the aftermath of the two crises : the global financial crisis (2007–10) and sovereign debt crisis (2010–13). We can add to these another pair of crises stemming from the dramatic problem of migrants and refugees since 2014, which are considered in Chap. 3. In light of this problem, we cannot be completely sure that we have not yet slipped into a new, and somewhat less fortunate, fourth phase of globalization. If this is the case, the doubts about the future of globalization expressed in these pages are well founded.

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Notes

1. A.Verde- La globalizzazione ripensata- Luiss University Press Roma 2013 It is here called the “2013 book” or (my) previous book.
2. See for all D. Rodrick (2011) who maintains that markets, sovereign states and democracy can't coexist. One option is to contrast democracy

to earn “market confidence” and attract trade and capital inflows. The second option is to limit globalization in the hope of building democracy at home. While on the opposite bank of the river, we find Martin Wolf (2004) who explains “why globalization, the great event of our time, works.”

3. With the exclusion of MLC of China, India and other emerging rich countries, like Brazil, South Africa and so on.
4. In this book, middle class (or bourgeoisie) usually include the lower middle class (small bourgeoisie) even if the latter is not cited.
5. Indeed parties that differ politically from those that globalization’s losers vote for could be sympathetic with them for fear of losing voters.
6. For instance Hillary Clinton uses a definition of middle class completely out of touch with reality: any household that makes \$250,000 or less a year! (cfr. Covert B. New York Times, 29 December 2015).

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Part I

Globalization: Definitions and Measure

1

Globalization: Definition and Phases

Abstract This is a book about globalization. There are different definitions of it. Any-way globalization is a dynamic process driven by technological changes and carried out through well-identified International channels: free trade, liberalized capital flows and movements of people. Globalization is divided into three phases: the first going from 1870 to 1913, the second from 1945 to 1991 and the third from 1992 up to today. The identification and analysis of the phases are carried out in an original way with the help of the phases of the International Monetary System: Gold Standard, Bretton Woods, After Bretton Woods. This kind of coupling leads us to wonder if we are entering the fourth phase of globalization.

Keywords Globalization · International Monetary System
Bretton Woods · Gold Standard · Washington Consensus
Macroeconomic Theories

1.1 Introduction

If we take a look back over the history of globalization from 1870 on, we can detect different phases. Each phase has been based on a mixture of economic, technological, political, geographic and institutional characteristics. When this mixture is significantly modified it is usually said that a new phase of globalization is coming into being. The current phase of globalization, the third in its history, is characterized by a new robotic revolution, the internet and mobile telephony, low-cost global trade and international migration flows, as well as very complex and sophisticated linkages in all human fields. These characteristics allow us to talk about “hyper-globalization” or “new globalization” as Jeffrey Sachs (2011) does. So it is not fully correct to talk about “globalization” without specifying its phase.

Moreover, this book adopts a particular way of defining globalization: coupling its phases with those of international monetary system (IMS). In this way the evolution of globalization is “seen” through the characteristics of the IMS.

Usually, the political and cultural aspects of globalization are neglected by economists, since it is difficult to consider them. But this does not mean they are unimportant. This book puts together the evolution of globalization with that of the IMS in order to insert international and institutional aspects into our analysis.

When political consensus on the economic integration process, or certain aspects of it, come to an end and/or its negative consequences increase to a socially unsustainable level, risks begin to emerge that challenge the future of globalization. It goes without saying that this book is not the sole text in the literature about that future.¹ But in our particular case the new departure lies in trying to define the mechanism whereby globalization may be doomed to slow down. This slowing down means, essentially, two things: Either one or more of globalization’s constituent elements, such as free trade or the movement of people and capital across borders, are subject to a pronounced slowing down; or important states will undergo a significant closure of their exchange with the rest of world, choosing to revert to autarky, closing their borders to migrants, goods and capital. A similar case of widespread autarky, after a period of lasting globalization, is not a theoretical

hypothesis, since it has already occurred, in the 1930s in Europe. Today, if certain political ideologies prevail in the advanced world (AW) this scenario could be a realistic prospect for the near future.

1.2 Globalization: Definition

Globalization is a complex and dynamic phenomenon. The first problem we meet is that of its definition. According to Martin Wolf (2005, p. 19), globalization is the “integration of economic activities, via markets. The driving forces are technological, and policy changes—falling costs of transport and communications and greater reliance on market forces.”

We can also conceive globalization as a social and political phenomenon. In fact globalization affects wages, income distribution, unemployment and poverty, with significant political implications.

Dani Rodrick (2011) argues rightly that globalization is potentially able to limit democracy. More exactly, global markets, sovereign states and democracy cannot coexist. Thus globalization is a genuine political phenomenon.

As mentioned above, our task here is to define globalization along with its division into different phases and then to couple these phases with the evolution of the international monetary system.

This approach allows us to define globalization in terms of different degrees of real and financial integration, different rules concerning currency convertibility, the kind of exchange rate regime, the definition of reserve currency and so on.

Thus, by choosing this approach the two concepts of “globalization” and “international monetary system” are strictly connected. This connection gives rise to a very promising way to study globalization. In fact, it is:

1. possible to identify different phases of globalization (which is the main objective of this chapter);
2. easier in each phase to summarize the main problems and the more salient issues;
3. possible to go back to different theoretical schemes, such as neo-classical, Keynesian and new-classical, and see how they lie behind different phases.

Indeed these three points enable us to synthesize the evolution of the phenomenon we call globalization as a shifting phenomenon in a changing world, which is at the same time embedded in evolving theory.

1.3 Globalization and the International Monetary System

The Gold Standard System

Our story starts at the end of the nineteenth century, when the gold standard (GS), which at that time was the international monetary system, was adopted by the most important countries. Exchange rates were fixed, not because the member states² had their commitment embedded in a treaty, but as a consequence of the acceptance by member states of three specific rules imposed by central banks and banking systems. These rules were: (1) each exchange rate between two currencies was fixed on the basis of the respective gold contents of those currencies; (2) all member states' central banks committed themselves to purchase or sell currencies against gold at the fixed exchange rates; (3) central banks only generated or destroyed monetary bases according to the outcomes of national balances of payments.

The gold standard was an *automatic adjustment mechanism* to external imbalances among member states, thanks to the full flexibility of prices and wages. The main policy objective pursued by member states was the equilibrium of the balance of payments (BOP). The world had to wait for more than a half century before states took a different policy objective.

Within the gold standard, currencies were fully convertible. This aspect allowed the explosion in the international exchange of goods and financial assets. The process of integration made great progress. Globalization advanced under one hegemonic power: Britain. The theoretical scheme was neo-classical. Debates on integration were concentrated above all on the *benefits* stemming from the integration of financial markets.

Things dramatically changed from 1914 onwards. The outbreak of World War 1 meant that the international monetary system clashed with globalization. A *de-globalization* phase began. The period between the end of World War 1 and the start of World War 2 was characterized by a marked reversal of globalization. The gold standard ended, and after

some unsuccessful attempts by sterling, currencies become unconvertible; free trade was substituted by barter-kind exchanges; the clearings of the German finance minister Dr. Hjalmar Schacht prevailed;³ nations ended up closing in on themselves; the world dominated by Britain's hegemonic power was substituted by a multipolar world; fascism and Soviet communism gradually pushed the world toward a devastating conflict. Thus an opinion gained momentum: the war was to some extent rooted in the economic closure of nations—that is, in the de-globalization phase.

The de-globalization phase lasted twenty-five years. In this period, the Great Depression (1929–1932) hit the advanced world. In 1936, John Maynard Keynes's *General Theory* came out, according to which high employment and monetary stability, rather than the BOP equilibrium, became, at least theoretically, the main economic priorities of modern states (Yeager 1976).

The Bretton Woods System

The second phase of globalization started in 1944, when the new international monetary system was introduced, named after Bretton Woods, the US city where the founding conference was held. Lord Keynes, as he now was, the head of the British delegation, surfaced as the main instigator of a new monetary order. The other protagonist was Harry Dexter White, head of the US delegation. The Keynesian ideas were largely shared among the delegates. Thus, in this second phase of globalization, the state's economic policy and its main goal of the economic growth of output and employment officially entered the international system.

According to the Keynesian scheme, the equilibrium of the balance of payments should be overlooked if it is inconsistent with full-employment policy. To put member states in a situation of being easily able to fund balance-of-payments imbalances without hampering growth, Keynes suggested a new mechanism based on the automatic recycling of resources from the surplus member states (meaning, at that time, only the USA) to deficit ones (the others). This mechanism acted through a sort of world central bank (called the international currency unit, or ICU) which was able to print a reserve supranational currency (the so-called “bancor,” composed of the French words for “bank” and “gold”). The second pillar of the Keynesian recipe for the new international monetary system consisted of capital controls.

In the agreements reached at Bretton Woods, capital controls were accepted,⁴ while the idea of recycling financial resources was rejected.⁵

The Bretton Woods agreement instead provided the system with new international financial institutions: the International Monetary Fund (IMF), which was a “cooperative” among the member states charged with coping with BOP problems, and the World Bank, which was charged with addressing structural and development problems.

However, to witness a real globalization recovery, the world had to wait until 1950 when the European Payments Union, among the European countries and funded by Marshall Plan resources, allowed the advanced world to open its borders to trade. It also heralded, from 1958, generalized currency convertibility. Thus, the second phase of globalization started de facto from 1950, while the Bretton Woods system was fully workable from 1958 on.

The Bretton Woods system allowed the world to live in “without crises,” because under speculative attacks each member state had different ways to resist: it could adopt capital controls; ask for loans from the IMF; or change to currency parity in cases of *fundamental* BOP disequilibrium. The Bretton Woods system fell in 1971, but the second phase of globalization continued. However, in the “post-Bretton-Woods system” many important changes took place. Let’s start with the new theoretical schemes. From the first half of the 1970s onwards, Keynesian thought was shattered by the surfacing of Lucas’s new classical macroeconomics (NCM) approach. The new theory’s implications, in particular neo-liberalism, burst upon the world. The two components of globalization, namely the liberalization of free trade and capital movements, were regarded *as beneficial or policy objectives*, “*ex se*” or in themselves. This policy approach reached its height in the 1980s when the Washington Consensus (WC)⁶ long ruled the international monetary system.

In particular, because of the Washington Consensus, the IMF’s loans, which in the original Keynesian spirit were unconditional, became conditional on the debtor country’s adoption of trade and financial liberalization, both crucial components of neo-liberalist philosophy. This represented the triumph of the “market.” At the same time, international liquidity would be poured into the system through the markets, not only through central banks.⁷

The phase of hyper-globalization

In this context dominated by the markets, a historical event hit the already globalized world, enlarging it out of all proportion: the fall of the Berlin Wall (1989) and the fall of Soviet Union (1991). In 1991 the third and current phase of globalization now started. Once the former Soviet bloc broke up, by 1991, and ex-Soviet communist countries joined the “market economic system,” the whole world became globalized. This third phase of globalization is, for this reason, called “hyper-globalization.”

1.4 Are We Entering a New and Slower Globalization Phase?

Each phase of globalization was opened and interrupted by a dramatic break. For example, the technological revolution of the nineteenth century and the outbreak of the World War 1 heralded the opening and closing of the first phase. The new international monetary order in the 1950s and the 1989 fall of the Berlin Wall similarly heralded the beginning and end of the second phase. Between the two World Wars there was the period of de-globalization.

The current, third phase of hyper-globalization started in 1989. In this phase we have known at least two dramatic financial and sovereign crises, and also the spread of global terrorism to the advanced countries with the attack on the twin towers of the Trade Center in New York on 11 September 2001.

Furthermore, since 2014, the drama facing migrants and refugees has appeared endless. It constitutes a structural and epochal phenomenon, with Europe, Africa and the Middle East tied together by mass movements. This is the real European scenario, though the USA too could be involved in huge migrations, in particular because of climate change.⁸

In the same years when these epochal phenomena prevail, the fourth industrial revolution proceeds at a quick pace. Driven by the applications of the AI and robotics this revolution appears in condition to have, in the short run, devastating effects on jobs, the labor quality,

and more important, on its requirements doomed to reduce dramatically. The impact on the labor market will be magnified out of all proportion by globalization and in turn, globalization plus technology will emphasize inequalities within the countries and among them. Finally, since 2014, the International exchanges of goods and capital are showing a sluggish evolution. As we will see, these closures can have dramatic consequences not only for the survival of the EU but for globalization too. They are caused by the widespread fears of the *losers* of globalization, here identifiable as the middle and lower classes, of losing jobs and wages because of the arrival of migrants.⁹ Because these “losers” vote, almost all countries and political parties (and not only those on the right wing) of all EU member states have ensured their political representation. This has so far led to the closure of borders, to be followed soon with the closure of countries within themselves.

But this is not all: Another thing is going to cause tensions and fears to rise among the European peoples and their middle classes, namely terrorism. According to a report of national intelligence services, jihadist terrorists can infiltrate into the routes taken by migrants and refugees. In 2015, the number of ISIS foreign fighters who had so far entered Europe by this means, it has been estimated, was about 900. Immigration and terrorism could therefore seem well to be entirely pernicious expression for the free movement of people.

All of this comes in the context of a world with multipolar powers, where the cold war is over and both traditional and new military powers block each other. In the fight against ISIS, even at the fall of Mosul (10 June 2014), President Obama told his West Point audience, “We need partners to fight terrorists alongside us” (Cockburn 2015, p. 7). So, in light of the above, it should not be unreasonable to wonder if we are entering a new and fourth globalization phase.

In Table 1.1 the differences between the three phases clearly confirm that it is impossible to talk about globalization without saying which period we are referring to.

Table 1.1 The globalization phases

1°Phase of Globalization	2°Phase of Globalization	3°Phase of Globalization
Gold Standard (1870–1913)	Bretton Woods (1944–1971) and After Bretton Woods (1972–1991)	From the 1992 the fall of the Soviet Union or hyper-globalization
<i>System goals:</i> Adjustment of BOP	<i>System goals:</i> Pursuit of the goal of full employment and balance of the BOP, thanks to the capital controls, IMF loans and exchange rates parities changes	<i>International policy goals:</i> Maximum development of trade and liberalization of capital movements
Relevance maximum of the mechanism of international adjustment	Prevalence of the goals of domestic policy compared to those of the real and financial integration	Maximum relevance of the process of globalization
Irrelevance of the other objectives of policy of the states	The states prevail on the system and on international institutions	At State level, relevance of the objectives of the neoliberal Washington Consensus (fiscal discipline, monetary stability, privatization, deregulation)
Total Convertibility of coins	Convertibility on current account and Liquidity provided by the US BOP	Total convertibility; liquidity ensured by markets
Theoretical framework: Neoclassical	Theoretical framework: Keynesian	Theoretical framework: New Classical Macroeconomics
Frequency of crises: High	No crises	High frequency of currency and financial crises
Debate: On the benefits	Debates on Globalization's benefits	Debates on Globalization's costs

Notes

1. We can consider, for example, Dani Rodrick's *The Globalization Paradox* (2011).
2. Member states of the Gold Standard numbered about 100. This system was dominated by the hegemonic power of Britain.

3. Clearings were *bilateral* trade agreements. They worked as follows. Let's suppose two countries A and B. Both of them import and export from and towards the other country; both of them have an Agency of Clearing (AoC). In A, the importer makes a deposit, equal to the value of import, in his *own* currency to the AoC; this deposit is used to pay the credit that the A's exporter has towards B. In B, the importer makes a deposit in his own currency to B's AoC; this deposit is used to pay the B's exporter. Thus all payments are made in local currency through a clearing office in each country, without the transfer of (unconvertible) currency. It goes without saying that things are more complicate. In particular if the two countries do not have a balanced trade between each other. Then the exporter of the surplus country must wait for the import of his country to be paid. Clearings are tied to Schacht's name and were largely used in the thirties above all by Germany with South East European Countries. But clearings and bilateral trade agreements having the same goal to avoid the transfer of currency prevailed in Europe in the aftermath of World War II.
4. Thus under Bretton Woods the convertibility of the currencies belonging to the system was a current account one, and not total.
5. Because of the opposition of the US financial circles.
6. The term Washington Consensus was coined by John Williamson and was formed by institutions based in Washington: the International Monetary Fund, the World Bank and the US Treasury.
7. In the Bretton Woods system, the international liquidity was poured into the system by the FED, according to its monetary policy and the USA's BOP balances.
8. The climate problems are particular serious in Bolivia, Mexico, and some Central American countries.
9. As we will see in the next chapter, this is not the case.

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2

A New Globalization Index

Abstract “Measuring” globalization is a very intriguing task in International economics. Certainly, I am neither the first economist to attempt to build a globalization index, nor the last. What I can say is that, I am trying to do it in an original way. The new index shows a clear slow-down in 2007–2010 and a smaller one in 2015. According to the thesis of this book in the medium term, globalization is falling back permanently. The reasons are explained in the next four chapters.

Keywords Principal Components Analysis (PCA) · Econometric models
Globalization’s components · Globalization’s impact
Shocks to Globalization

2.1 Introduction

It is true that a complex phenomenon like globalization involves different concepts and variables linked to each other. We have three kinds of concepts:

1. The definition of globalization.
2. The impact of globalization.
3. The shocks to globalization.

Each concept involves a certain number of variables. Normally in building a globalization index the component variables are used together without distinguishing which concepts they refer to.

In this chapter, I present three composite globalization indexes according to concepts (1), (2) and (3) above.

The most important concept for us is the first: the definition of globalization. As we will see, estimates of globalization involve very few variables:

1. Technology;
2. World demand for goods and services;
3. Capital movements;
4. People movements.

Because of the lack of data, the variable “people movements” is substituted by a proxy given by the yearly data of “migrants and refugees.”

The approach followed aims to reduce the essential number of variables needed to construct the index; I will explain why in a while. This could be a limit of the approach, as we are dealing with a very complex phenomenon. Yet this limit is not necessarily a bad thing. Indeed, a globalization index should be *simple, visible and understandable* by people, whether they are economists or not. Moreover, international data sources should be easily found. In this way, we can reduce complexity and the number of variables as well. This is a key objective in building our globalization index. I hope to have been successful in meeting it.

2.2 Globalization Indexes in General

The number of variables included in a globalization index is usually very high—take a look at the globalization database of the European University in Florence, for example. In any case, building a globalization index is not an easy task, and not only because of the amount of data involved. Let us try to list some problems:

1. As just stated, the number of the variables involved is very high.
2. Variables are of a different nature as they are drawn from economic, social, political, institutional or environmental fields.
3. Variables are differently linked to the concept of globalization: some have simply to do with its definition; others are indeed consequences of globalization and not components; eventually, some are *shocks*, impacting on the evolution of globalization, and they have nothing to do with definition or its own impacts on other phenomena.

Point (3) is the starting point of the New globalization index, made up of:

- (a) A composite new globalization index measuring and defining it through its components;
- (b) A composite index measuring the impact of globalization;
- (c) A composite index of the shocks to globalization.

The methodology used is explained in the Appendix to the book.

2.3 The New Globalization Index¹

Point (a) is the most important to us and refers to the definition level. In this case we define globalization through four variables, namely: technology and three freedoms of movement—of goods, of capital and of people. This is the first and the most intuitive definition of globalization, as discussed in the previous chapter.

In particular, we defined globalization as a dynamic process producing free trade and free capital movements as well as the chance for people to move from one country to another. The impacts of these variables on the index are not constant, but vary according to the evolution of technology. Thus we could write:

$$GI = A(TEC^\beta)(TRADE^\gamma CAP^\mu MIGR^\rho) \quad (2.1)$$

where: GI = global index (*unknown*); TEC = technology; $TRADE$ = world demand for goods and services; CAP = financial assets and liabilities; $MIGR$ = migrants.

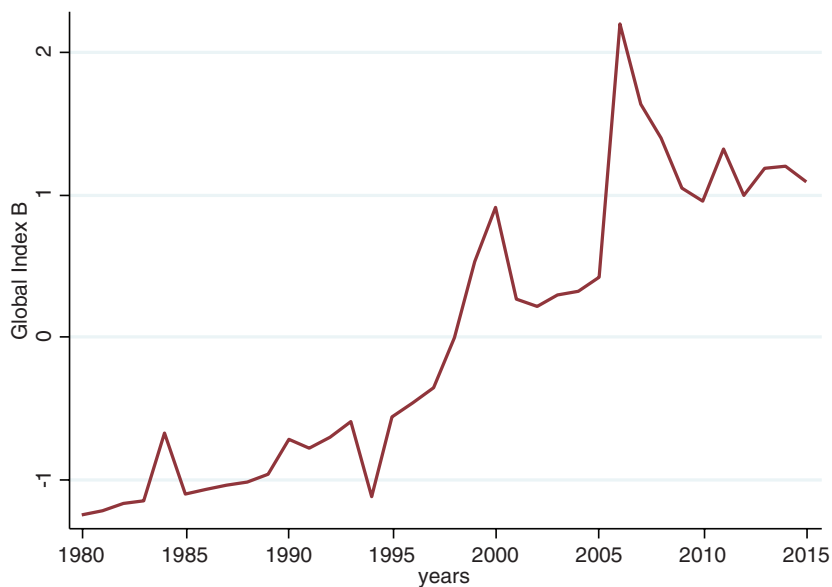


Fig. 2.1 Globalization index

In logarithms, we have:

$$gi = a + \beta tec + \gamma trade + \mu cap + \rho migr \quad (2.2)$$

where the lower-case letters stand for log.

Thus from the statistical point of view, this new globalization index gi is obtained by estimating Eq. (2.2).

Equation (2.2) has been estimated using yearly data referring to industrial countries, from the OECD classification, from 1980 to 2015. The methodology used is principal component analysis (PCA) and Fig. 2.1 shows the new index. In the Appendix the correlation matrix is reported.

The variable tec has been dropped because of a significant lack of data.

Figure 2.1, showing the new globalization index (NGI), is of particular interest. First, g_i appears able to catch the start of the third (and current) phase of hyper-globalization in 1991—that is, when the Soviet Union was broken up.

Second, the fall shown in 1993–1994 is consistent with a period of speculative attacks against French, Italian and British currencies which led to a shrinking of capital movements.

Third, the new index shows the global financial crisis of 2007–2009, which spread from the USA to the rest of the world, along with the sovereign debt crisis of 2012–2013, which had its source in Greece.

Fourth, and most importantly, the new globalization index does not show linear development, but rather temporary retreats and rebounds in globalization. It shows a clear slowing down by 2015, which is consistent with the hypothesis of this book. The fall in gi in 2015 is due to world demand for trade and finance flows; the opposite happened to movements of people or migrants.

2.4 The Shock-to-Globalization Index

The second index refers to the shocks to globalization (or SGI). Other important considerations can be taken from it.

Also in this case we carried out a composite index using the following variables:

1. financial crises, FC ;
2. the “excessive” flow of migrants and refugees, MIG_{sd} ;
3. the evolution of China’s exports, CX .

Here a financial crisis variable is given by an updated indicator built by Reinhart and Rogoff (2009); the “excessive” flow of data regarding migrants and refugees is given by their positive standard deviation, s.d.

$$SGI = B * FC^\varphi MIG_{sd}^\theta CX^\delta \quad (2.3)$$

where SGI = shock index (unknown); B = constant term; FC = financial crises, MIG_{sd} = migrants s.d.; CX = Chinese exports.

This last variable has been included in an attempt to catch the negative impact of Chinese exports on the ability of other advanced countries to grow and to export themselves (see Chap. 6).

That is, in logs:

$$sgi = b + \varphi fc + \theta mig_{sd} + \delta cx \quad (2.4)$$

where quantities represented by lower-case letters are logarithms.

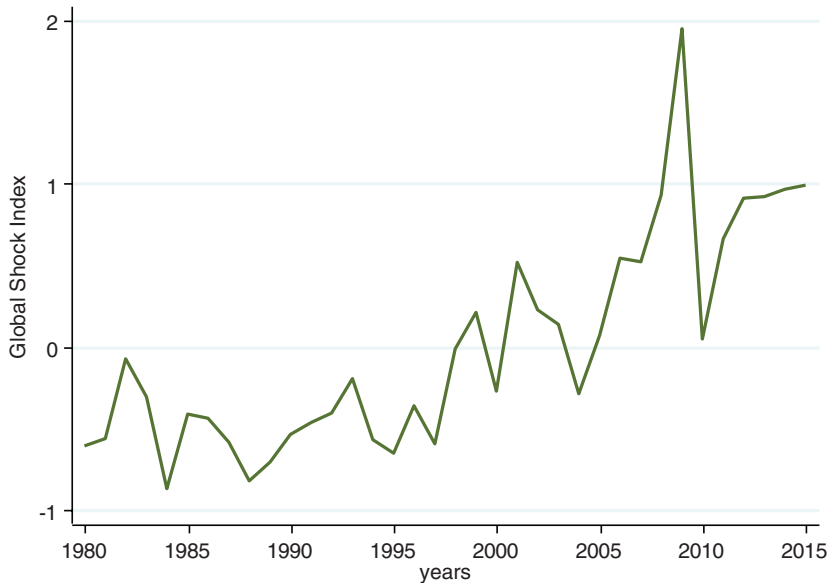


Fig. 2.2 Shock-to-globalization index

All variables contribute to shocks to globalization and have a positive sign (that is, φ , θ , $\delta > 0$). That is: the increase (or decrease) of *sgi* is due to higher (or lower) values of explanatory variables.

Figure 2.2, depicting the SGI, allows us to detect the effects of the main shocks to the globalization process. For instance:

- 1993: the European Monetary System (EMS) crisis;
- 2007–2009: the global crisis or US subprime crisis;
- 2012–2013: the European sovereign debt crisis.

2.5 The Impact-of-Globalization Index (IGI)

The third and final index refers to the estimated impact of globalization. These effects are limited to:

- GDP per capita rate of OECD countries;
- exports of OECD countries or XOECD;
- unemployment rate of OECD countries or UOECD;

- the labour income share (wages/GDP) in the OECD countries;
- absolute poverty, or POVERTY (number of poor in the world);
- inequality index, or INEQUALITY (Gini coefficient for OECD, weighted average);
- social spending OECD, SOCIALSPENDING.

The outcome is:

$$GEI = D * PCGDP^x * XOECD^k * UOECD^f * (W/GDP)^g * POVERTY^y * INEQUALITY^z * SOCIALSPENDING^w \tag{2.5}$$

where GEI = globalization effects index.

Or, in logs:

$$gei = d + x pcgdp + k xoecd + f uoecd + g [w - gdp] + y poverty + z inequality + w socialspending \tag{2.6}$$

where, as usual, lower-case letters are logarithms.

The expected signs of variables are as follows:

$x > 0, k > 0, f < 0, g > 0, y < 0, z < 0, w > 0$ (Fig. 2.3).

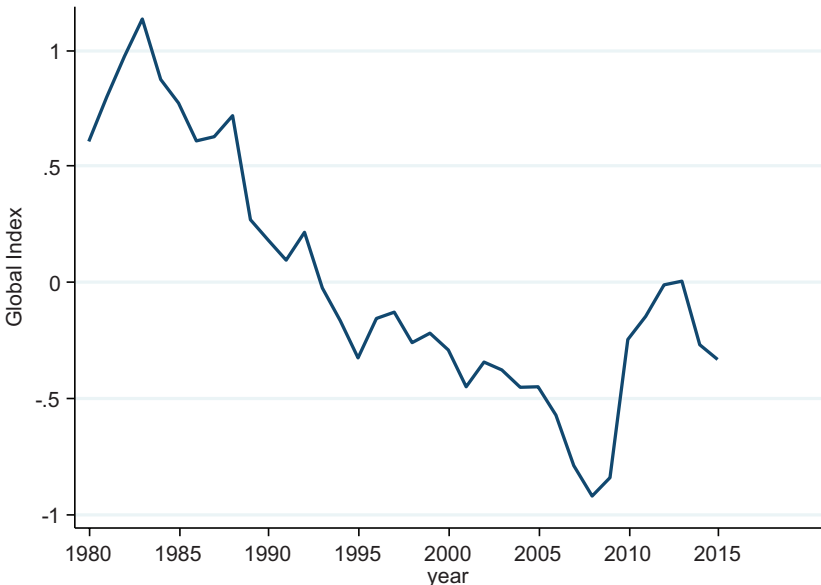


Fig. 2.3 The impact-of- globalization index

Note

1. Warning: in Appendix to the book where the methodology used is expounded, the labels of variables are, for sake of simplicity, different from those used in the text.

Reference

Reinhart, C. M., & Rogoff, K. S. (2009). *This time is different*. Princeton and Oxford: Princeton University Press.

Part II

The Globalization Slow Down: Economic Aspects

3

Migration

Abstract The immigration in the EU is the main problem for the middle and lower classes—the very protagonists of this book—of the Member States. They are afraid to lose jobs and to see reduction in their wages, because of the immigrants’ invasion. But things are not so, as we will see. After the year 2015, *annus horribilis* of immigration, with more than 1,800,000 people crossing the European borders, of which more than 1 million arrived by sea, we have witnessed a marked reduction of arrivals thanks to the €6 billion deal with Turkey and the plan with the UN-recognised Libyan government to intercept migrant ships. But because the future foreseen demographic pressure of Africa the migration problem is not solved. It will need a structural coordinated plan by the EU: a new Marshall Plan for Africa. A small step in this direction has been the Paris Summit of August 28, 2017.

Keywords Immigration · The impact on the host and origin countries · The Merkel’s migration policy · Proposals to address migration problem · A new Marshall Plan for Africa · The Paris Pact (2017)

3.1 Introduction

In 2016 and 2017, there has been a dramatic reduction of migrants' arrivals in the EU. Thanks to the €6bn. deal with Turkey and with the UN-recognised Libyan government. All that when in 2015 in Europe about 1,850,000 migrants arrived. In 2015—the year of the migration crisis blow up—the migrants in the world were about 244 million, of which 55 million lived in the EU, about 23 per cent of the global number of migrants. With a population of about 510 million migrants were equivalent to 10 per cent of it. Thus, we have to do with manageable numbers. Moreover if we consider the European countries' demographic drop, the national populations' increases—i.e. the sum of migrants' inflow and natural balance (births–deaths)—are very low if not negative. They show the positive contribution of immigration. For instance, Germany needs a yearly inflow of 700 thousand people to keep its population stable. Indeed, between 2015 and 2017, two million migrants arrived in Germany. In Italy in 2015–16, the natural balance (births–deaths) was negative: -296 thousand. In the same years, the net inflow was equivalent to 334 thousand; thus, the increase in the Italian population was about 38,000, that is to say 0.005 per cent out a total population of about 61 million people.

Yet, immigration is considered today the main problem of the Union—more serious than terrorism. This problem gives rise to an anti-immigration sentiment that so far is not justified neither by numbers, concerning the stocks and flows of arrivals, nor by the economic consequences of migration, as we will see.

It is true, things will change in perspective. In this case, without corrective intervention, according to a widespread opinion, immigration in the EU will be an unmanageable problem. This is for at least two reasons: the very strong demographic pressure from Africa and the arrivals of the climatic migrants, that is those who flee their countries because of the climate change effects.¹ The anti-immigration sentiment will assume a crucial importance.

The consequences of this widespread sentiment against immigrants in the EU are very serious and manifold:

- a) There is a general worsening of national political pictures, with the success of populism, and its rapid slipping from the right-wing parties to the left wing ones; left parties, which are expected to oppose populism renounce to do so since they are afraid to lose votes;
- b) It sows a growing discord among the Union's 27 Member States putting it at risk;
- c) In a perspective, a globalization slowdown. This is the thesis of this book.

This conclusion, which is the central thesis of the book, has its basis in the reaction of middle class and its anti-immigration sentiment in the political parties an adequate representation of its interests.

It is true that in the next years, immigration from Africa and Middle East could become again (after the 2016–17 drop of arrivals) a dramatic problem. It would require a commitment by the European Union towards agreements about the regulation of flows of migrants. They should envisage institutions and adequate financial resources. One thesis is gaining ground: a new Marshall Plan for Africa. It could be the sole instrument able to manage the immigration problem, as we will see at the end of the book.

This chapter is organized as follows.

In the second section, I present data on economic migrants and refugees along with an introductory note about refugees—definitions, origin countries and so on. The third and fourth sections are devoted respectively to the old and new causes and consequences of immigration.

The fourth section is particularly significant as it dwells on the costs as well as the undeniable benefits of immigration, above all for the recipient countries. Some of these benefits are well known, both theoretically and empirically, but are often underestimated or neglected in the current debate about migration.

Crucial is the fifth section which focuses on the essential features concerning the problem of immigration in the advanced countries, in particular in Europe. The continent has had, from 2014 onwards, the worst experience in this regard. The chapter will try to elicit the theories and opinion able to allow us to grasp the reasons of the deep changes in the political picture all over Europe, mainly in the 28 nations of the EU.

The sixth section covers the cultural, military and political themes touched upon in the endless debate on this topic, in particular in Europe. Finally, the seventh section refers to the policies carried out in this field. We will hint at the policy responses to the dramatic problem of refugees and economic migrants. We will venture onto bumpy ground which has sadly been characterized by the poorness of proposals. The idea expressed here will be that in detecting a new way to address old and/or serious problems, the better way could be “merely to look at things from a new angle where they show hitherto unexposed facets” (Selye 1984, p. 44). The chapter ends with a summary of the more important conclusions reached.

3.2 Migrants and Refugees: Essential Data

The number of migrants around the world reached 243.7 million in 2015, that is about 4.0% of the world’s population. In 2013 they were 231.5 million; in 2000 174.5 million; 45 years before that, in 1970, migrants were little more than 80 million, or 2.2% of the world’s population (Table 3.1).

These stock data, based on figures from host countries, include both regular and irregular migrants. Some estimates suggest irregular migrants are somewhere between 20 and 30 million (i.e. between 10 and 15% of all migrants). These numbers are very probably underestimated since irregulars are almost by definition not clearly identified.

In Table 3.2 the inflows of permanent immigrants into selected OECD countries are reported. Data are limited to 2014 but the OECD estimates an increase of 10 per cent for 2015.

Table 3.1 Immigrants in the world (millions)

Destination area	1970	1990	2000	2005	2010	2015
All countries	81.5	154.8	174.9	190.6	213.9	243.7
Africa	9.9	16.4	16.3	17.1	19.3	20.4
Asia	28.1	49.8	43.8	53.3	61.3	71.9
Latin America	5.8	7,0	5.9	6.6	7.5	8.5
North America	13	27.6	40.8	44.5	50,0	54.9
Europe	21.8	49.4	62.3	64.1	69.8	80.1
Oceania	3,0	4.8	5.8	5,0	6,0	7.9

Source UN IMO

Table 3.2 Inflows of permanent immigrants into selected countries

	2007	2008	2009	2010	2011	2012	2013	2014
All countries	4,451,300	4,160,300	3,902,300	3,823,500	3,802,000	3,799,600	3,913,100	4,042,700
USA	1,052,400	1,107,100	1,130,200	1,041,900	1,061,400	1,031,000	989,900	1,016,500
Germany	232,900	228,300	201,500	222,500	290,800	339,900	408,800	574,500
United Kingdom	343,300	317,300	359,200	394,800	320,100	283,600	290,600	311,500
France	206,200	214,100	213,200	224,300	231,200	251,200	259,400	258,900
Italy	571,900	490,400	390,300	355,700	317,300	258,400	251,400	204,100
Sweden	74,400	71,000	71,500	65,600	71,800	81,700	86,700	84,500

Source OECD (2016)

Another distinction, which has become crucial in the last couple of years, is that between “economic migrant”, or simply migrant, and “refugee”. According to the Geneva Convention of 1951, refugees are people who flee from their nations because of military conflicts or political or religious persecution, as well as racial discrimination. They move from not-safe countries, because of war, persecution and so on. Instead, economic migrants refer to people leaving their countries for economic reasons.

This distinction requires refining however as it is becoming less important, as we will see in the next paragraph.

So far large numbers of people have not been forced to leave their countries because of the consequences of climate change (famine, drought and so on). But it is sure that in the future there will be much more interest also in talking about *climate* migrants.

According to the United Nations High Commissariat for Refugees (UNHCR) in 2015 there were roughly 16.121 million refugees in the world. To this amount we must add about 5 million Palestinians included in the United Nations Relief and Works Agency for Palestine Refugees in the Middle East (UNRWA) created by the United Nations in 1949. 3220 million were the asylum-seekers. Table 3.3 show the numbers of refugees in the world.

Important is also Table 3.3 regarding the the so-called *forced flows*. This definition includes all people forced to leave the house and their country: refugees, asylum seekers, evacuated and stateless people. According to the most recent estimates, in 2015, 34,000 persons have been forced to leave their houses in the world. In 2015, the forced flows were about 64 million. To this number, we must add about 6 million of Palestinians included within the UNRWA created by the United Nations in 1949.

3.2.1 Migration’s Annus Horribilis: 2015

In 2015, 1,800,000 people crossing the European borders, of which more than 1 million migrants (1,011,700) arrived by sea. More than 3,770 migrants died trying to cross the Mediterranean. The most

Table 3.3 Refugees and forced flows (2006–2015)

Country of origin	Refugees	Country of asylum	Total refugees	Forced flows		*
				Years	Refugees	Forced flows
Syria	4,872,585	Turkey	2,541,362	2006	9.877,70	32.865,30
Afghanistan	2,666,254	Pakistan	1,561,162	2007	11.391,00	31.678,00
Somalia	1,123,052	Lebanon	1,070,854	2008	10.489,80	34.462,10
South Sudan	778,697	Iran	979,437	2009	10.396,50	36.460,80
Sudan	628,770	Ethiopia	736,086	2010	10.549,70	33.924,70
Congo	541,499	Jordan	664,118	2011	10.404,80	35.440,10
Central Africa Rep.	471,104	Kenya	553,912	2012	10.498,00	35.848,00
Myanmar	451,807	Uganda	383,095	2013	11.699	42.865,30
Eritrea	411,342	Congo	369,540	2014	14.380,10	54.945,40
Colombia	340,240	EU	2.355,40	2015	16.121,40	63.912,70
		<i>Total</i>	16,121,400		* refugees+asylum seekers+sfollati	

Source UNCR, IDOS

evident channels for migrants were those from Syria to Germany, from Morocco to the Netherlands and from Pakistan to the United Kingdom. Mrs. Merkel's open door to immigrants and refugees took European public opinion and her political party by surprise. In particular, some leaders of Germany's regional states denounced her sudden promise of welcome, saying that they were not informed and were left unprepared.

Across Europe, anti-migrant sentiments have prevailed. After a first and short period of solidarity by vocal minorities, the worsening of conditions of migrants and refugees reached its peak in the last days of 2015 when the attacks to German women in Cologne took place.

All around Europe, from Finland to Austria, native attitudes are hardening towards migrants and refugees, producing the closure of national borders and associated actions, such as in Denmark where immigrants must pay US\$1450 before receiving their first social security benefits. Until 2014 we could not say there was a country in the

world which was not a point of departure, arrival or transit of people. People could live in a country different from one where they had been born. This was implicit in the definition of migration. Some months later, things had dramatically worsened. Indeed, the Schengen Agreement risks being cancelled and migrants thus being trapped in their country of arrival—de facto, Greece or Italy.

3.2.2 What Next?

Looking to the future, we might imagine at least three scenarios.

First, as there is a persistent lack of a clear migration and relocation policy among EU member states, the risk of exasperated migrants' revolts is very high. There are many dramatic situations in Europe, from France (the Calais Jungle) to, Greece, Italy and Macedonia: it is unthinkable that these situations can persist without being further aggravated.

Second, starting from the second half of 2015, mass migration into Europe has suddenly appeared unstoppable. In particular, looking at the demographic trends it can be seen that today the EU's roughly 500 million people account for 7% of the world's population but by contrast there are more than 1 billion people in Africa now and according to the UN there will be almost 2.5 billion by 2050. The population of Egypt has doubled since 1975 to more than 80 million today. Nigeria's population in 1960 was 50 million. It is now more than 180 million and likely to be more than 400 million by 2050.

These trends cause many to fear for the Old Continent, which is not an island like Australia or Japan, but on the contrary is part of the Eurasian landmass and is separated from Africa only by narrow stretches of the Mediterranean. In face of this, in the coming decades Europe could take measures to withstand mass immigration that meant suspending its adhesion to universal liberal values.

The third and final possible scenario involves Europe reacting to immigration from the rest of the world by accepting it as inevitable. In

this case we should need to consider some coordinated efforts, such as a sort of new Marshall Plan, or perhaps Merkel Plan, among the involved countries to manage, if not to solve, the huge problems that immigration brings with it and their many implications.

3.3 New and Old Causes of Migration

Why do people move from one country to another? If you look again at the scheme of the book (Fig. 0.1) on page x you will see at least four important causes:

- Demographic evolution;
- Poverty;
- Wars;
- Climate change

And indeed, as was also suggested in the first pages of this book, poverty, climate change, wars and migrations are strictly linked to each other, in the sense that the first three phenomena appear to be the immediate causes of the latter. Even if no important signs are known, at least so far, of forced migration caused by climate change, we can be sure that there will be hundreds of thousands of people migrating for this reason in the near future.

3.3.1 Demographic Factors

These are the first cause of migrations. Some data concerning the evolution of populations around the world are impressive. The question of how Europe will cope with continued mass immigration is of central importance, involving as it does costs and benefits for host and origin countries. We will deal with this aspect in the next section, under the economic effects of migration.

3.3.2 Poverty

Another crucial and intuitively obvious cause of migration from Africa, the Middle East and Latin America is poverty. The interregional spread between the richest and the poorest areas—the USA and Africa—has reached a level never before seen in the history of humanity. In 1870 this spread was 4.9:1, 8.3:1 in 1913, 13.3:1 in 1950 and 18.1:1 in 2003.

Still more important is that the differences in wages show great inequality between incomes of people in industrialized countries and those in emerging ones. According to the International Organization for Migration (IOM), wages are ten times higher in host countries than in countries of origin. Over the last century, in the years of the second phase of globalization, the maximum difference reached was only 4:1 (Maddison 2007).

Immigrants are usually concentrated in low-skill job sectors in host countries. Indeed, in industrial countries, the strongest demand for housing, social and health assistance comes, to a large extent, from people arriving from emerging countries.

At this end of the labor market many of those seeking employment are holders of *temporary work permits*, in which there has been a marked growth in numbers in the advanced countries. According to the estimates of the OECD, from 2000 onwards these countries saw a combined annual arrival of about 1.8 million of people with temporary work permits. The USA and Canada have been the main destination countries of this flow.

3.3.3 Wars, Terrorism and Political Instability

A growing mass of people moving from one country to another has characterized international migration patterns over recent years. They fled abroad not because of poverty or inequality, but for political and military reasons: wars, terrorism, dictatorial regimes, government instability. Wars from Syria to Iraq and the Horn of Africa have been dramatic and

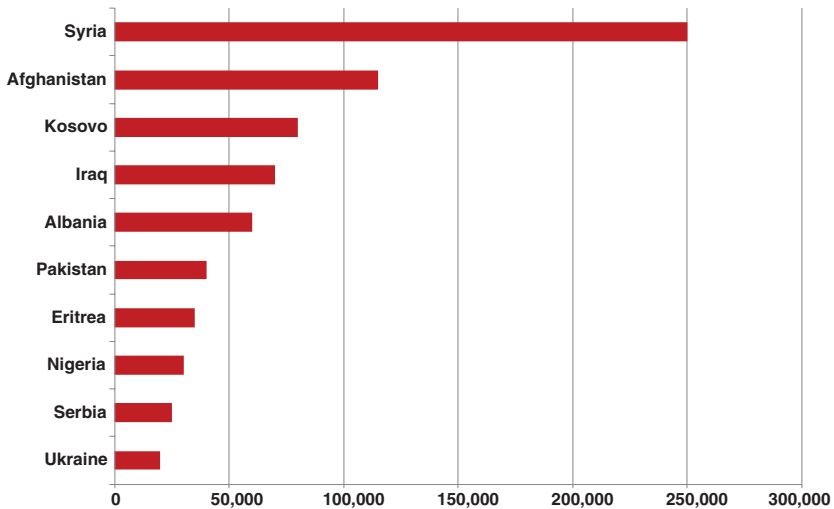


Fig. 3.1 Top ten origins of people applying for asylum in the EU; October 2014–October 2015, first-time applications. *Source* Eurostat

ongoing, and seem doomed to remain so for the next years. In 2015, according to Eurostat (2016), together, people of these three nationalities accounted for more than half of all first-time applicants (Fig. 3.1).

3.3.4 Economic Migrants and Refugees: Is It a Groundless Distinction?

A crucial division is that between economic migrants and refugees. Economic migrants are those fleeing from their origin countries in the attempt to escape from poverty and the worst conditions of life, among them lack of drinkable water and accessible health services. Refugees are migrants fleeing abroad for the reasons already mentioned: wars, terrorism and so on. Refugees flee from unsafe countries, from countries such as Syria and Iraq where with civil peace restored there could be a dignified way of life.

However we could include in this group of countries others where, despite the lack of war, there is no democracy or freedom of expression. These countries too should be defined as unsafe. Just as refugees flee from unsafe countries, so too those coming from these countries should be defined as refugees. In other words, many countries that are deemed “safe” simply are not. Moreover, economic migrants often leave or pass through unsure countries: Desert tracks in the sub-Saharan countries are strewn with the remains of migrants who died on them when trying to reach European shores. In such cases the difference between refugees and economic migrants inevitably becomes blurred.

Yet the distinction between economic migrants and refugees is of basic importance, as different policies stem from it. For the EU, refugees can apply for asylum in Europe, whereas *illegal economic migrants* should go back home. But despite people saying “they should go back home,” this is not necessarily safe, for at least three reasons. First, the number of countries afflicted by war or state failure is increasing: Egypt, Algeria, Libya and so on. Consequently, the distinction between economic migrants and refugees is failing. Second, those who are deemed economic migrants might never leave Europe. Finally, once large immigrant populations are established, the right of “family reunion” will ensure a continued flow.

3.3.5 Climate Change

In other cases, people migrate because of negative natural phenomena: famine, drought, epidemics. Or in more modern words: climate change. So far, people migrating for this reason have not been counted, but things are changing.

3.4 The Economic Effects of Migration

The economic effects of migration are the most important topic of debate in this chapter. These effects refer to both the host countries and the countries of origin, even if the latter are almost always neglected. As regards the former, they are instead frequently discussed but very often without an adequate empirical and theoretical grounding.

The widespread thesis in Europe, which this book stems from, is that the economic consequences of immigrants' arrivals are negative or even lethal for unskilled workers and for the middle and lower classes. Why? Is it true? To find an answer to these questions is a tremendous task, as things alter continuously. The ever-changing economic scenario of immigration and its characteristics must be completely reconsidered in this chapter. Day by day, new and often contradictory information becomes available, which experts would need one or more whole books to deal with. Here I am necessarily and unfortunately forced to limit myself to a few pages.

The goal here is to detect ties between *immigration and voting decisions* in the advanced countries, specifically in the EU. These ties are the key to the book's conclusion: that globalization slow-down exists.

We will now concentrate on the economic impact of migrants, in particular on destination economies. Later we will examine the political consequences for European countries.

This section, meanwhile, is in two parts: first we deal with the migrants in the host countries' economies, where an uncertain future looms, and then we go on to dwell rather more briefly on the migrants' problems in their countries of origin. Neither of these consequences are negligible, as often the most dynamic and enterprising people may tend to migrate.

3.4.1 The Impacts of Immigration on Host Countries: Theoretical Aspects

This section examines the theoretical and empirical perspectives from the following points of view:

- The impact on labor markets;
- The impact on health care and welfare systems;
- The impact on state budgets;
- The impact on economic growth, potential growth and trade.

We will discuss these aspects with specific reference to the European economies.

3.4.1.1 Migrants and the Labor Market

It is from the perspective of the labor market that the most hard-to-fight anti-immigration sentiments in Europe arise. But first, let us pause on the topic of the migrants and the host countries' labor markets. This is a very salient topic within the debate on immigration in advanced countries. It is nothing new but it has yet to reach broadly accepted and shared conclusions—which is something all parties need to remember.

We are interested here in migration from emerging countries to developed ones.² So we will concentrate on the rather traditional scheme of the phenomenon of migration from poor nations towards rich ones. That said, we must pay attention to a couple of aspects. First, the *skill* of migrants; they include both unskilled and skilled workers. Second, the structure of the host country's economy is also important. Together, the skill levels of migrants and those of existing workers as well as the characteristics of the host country's economy shape the impact of migration on labor markets. Economic theories suggest that immigrants damage the status of native individuals who work in production with skills that are close *substitutes* for those supplied by immigrants. In particular, if migrants have skills that are substitutes for those of existing workers, migration is expected to push competition in the labor market and to drive down wages, at least in the short run. We can also expect some loss of jobs by unskilled native workers.

By contrast, if the skills of migrants are *complementary* to those of existing workers, then all experience increased productivity which, in turn, can be expected to lead to a wage increase. In this second case, then, native workers who supply complementary factors will gain from immigration.

All of this is valid on a theoretical level, but what about reality? Let us have a look at the following points:

1. Usually, unskilled migrants accept jobs which natives don't like to do.
2. Some studies of the UK show that immigration has a more significant impact not on average wages but on the wage distribution—that is, low-wage workers lose and high-wage workers gain.

3. More important, the skill level of immigrants and their division into skilled and unskilled has proven decisive *for political elections*, at least in some empirical studies of Austria. We will come back to this later.

Results stemming from empirical analyses are not conclusive. We can say that in some traditional sectors, the complementarity effect between migrants and natives seems to prevail over substitution. Indeed, much evidence suggests that in the majority of cases, migrants do the jobs that natives are not keen to do. This is the case with jobs such as assisting children and the elderly or in agriculture and other less-skilled sectors.

The majority of migrants are still low-skilled, but the share of medium—to highly qualified skilled migrants has been increasing (IOM 2008). Moreover in the aftermath of the war in Syria, more than in other countries, the component of medium-to-high-skilled refugees has grown enormously.

According to a prior study of skilled migration, at least 12% of Indian physicians work in the United Kingdom. From 1984 to 1996, Ethiopia lost about half its physicians specializing in pathology; each year, Pakistan loses half its medicine graduates; Ghana is able to keep within its borders only a third of its physicians. According to the 2005 *World Migration Report*, at the end of the 1990s a million people from India, equal to 0.1% of the population, lived the USA. This was worth a net gain of about 10% of the Indian GNP.

For these reasons, the impact of migration on natives' wages tends in general to be very small. In fact, after the waves of refugees arriving in the EU in recent years, Lidia Farrè (2015) tried to update the existing literature on the labor market effects of migration. Most studies confirm what has been long known: Immigration's impact on the wages and employment of native workers is either small or nonexistent. Foged and Peri (2015) show that immigrants, usually unskilled workers, displace native workers towards occupations with less manual work and a higher amount of specialization, and possibly also higher remuneration. Farrè also quotes a couple of studies that indicate complementarity between immigrant workers and qualified native women: many immigrants find jobs in caring for children and the elderly. This increase in the labor supply for the domestic service sector allows qualified native women to

substitute unpaid domestic work hours for paid work hours, and thus progress in their professional career.

3.4.1.2 Migrants and Healthcare and Welfare Systems

Europe's aging economy may be about to receive a new lease of life from refugees and economic migrants. Some estimates claim that immigration into Europe in 2015 was as high as about 1.8 million people. Few predicted an upturn without surging immigration or higher retirement ages. Immigration has been the biggest engine of demographic growth in the EU as a whole since the mid 1990s. It is about to become the only one. Germany needs net immigration of around 700,000 people per year over the next 10 years. Economic growth should continue to benefit over coming years as young migrants start to become integrated into the labor market.

These data allow us to talk positively about effect on welfare systems of increased net migration. This is an important question which economists have struggled to answer. The impact of migrants on pension schemes will naturally depend on their characteristics—that is, their age, the family's economic conditions and their skills. Also, time is crucial here because although the impact of first-generation workers may be negative for the public budget of the host country, with the second generation the state will receive a net gain as the numerous daughters and sons of the first-generation migrants pay for services granted to the resident adult population.

As we will see, young and high-skilled migrants are usually net contributors to the state budget, while the opposite is true when foreign workers are adult and low-skilled. For instance in Italy, the Treasury Department estimates that 600,000 Italian people receive their pensions yearly thanks to the contributions paid in by immigrants. The balance between paid contribution and received pensions is about 5 billion euros. In this way, migrant labor ensures that the welfare state is sustainable.

3.4.1.3 Migrants and the State Budget

Another concern regarding immigration is the possible negative impact on public finances. Official profligacy towards migrants is often

emphasized in public, with the newcomers receiving greater benefits than the taxes that they pay. But things seem to be different, as we have just seen with the pensions scheme in Italy.

According to the OECD's *International Migration Outlook* (2016), which estimates the net contribution to public finances in the 27 member states of EU without UK, the net direct contribution of migrants tends to be smaller than that of natives, but this is because they pay less in taxes, not because they claim more in benefits. They pay less in taxes because of their lower levels of employment, especially among women.

To have a higher fiscal contribution would require a higher level of labor force participation. Therefore, a possible and reasonable conclusion is that migration is “neither a significant gain nor a drain for the public purse.”

3.4.1.4 Migrants, Growth and Trade

According to Credit Suisse (2014), over the next five years net immigration will lift the *euro area*'s population by an estimated five million. This is equivalent to 1.5% of the current population of 340 million. Assuming that public spending to provide asylum has a one-to-one multiplier effect on GDP, then this increase will add between 0.2 and 0.3% points to eurozone growth. Potential GDP by 2025 could be 300 billion euros higher than it would otherwise have been. Based on an average expenditure on each migrant of about 12,000 euros per year, this tells us that extra spending alone could be as much as 10 billion euros, which is between 0.3 and 0.4 of German GDP.

As regards the relationship between migration and trade, what do the data say? Empirical works suggest that immigration increases trade.³ In particular, according to a paper by Genç et al. (2014) covering 48 studies from 1994 to 2011, a 10% increase in the stock of immigrants can stimulate trade by, on average, 1.5% (Fig. 3.2).⁴ For instance, from 1980 to 1992, each immigrant in Canada generated \$8000 in Canadian imports and \$3000 in exports. This is an important impact, even if the authors of the study urge caution as results change according to several factors, from the type of commodities to the characteristics of the immigrants and the size of the existing migrant population.⁵ Given this positive link,

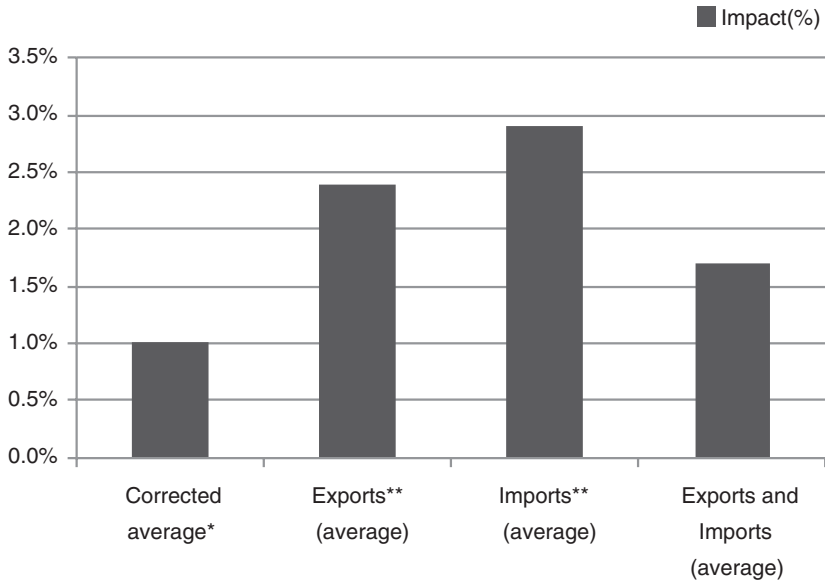


Fig. 3.2 How a 10% increase in immigration boosts bilateral trade *Notes* *Correct for overestimates in cross-sectional studies **Pre-2000 data. *Source* From 48 studies between 1994 and 2010 in Genç et.al. (2014)

one conclusion is that *by opening their doors to migrants, governments can further increase trade*. This result is crucial and to some extent surprising, considered the often-mentioned contradiction of advanced countries' migration governance: *they are ready to open their borders to trade while refusing more liberal migration policies* (Genç et al. 2014).

A Bruegel's paper (Merler 2017) allows us to sum up the economic effects of migration as follows:

1. In the long run, both high—and low-skilled migrants bring benefits to their new home countries by increasing per-capita income and living standards.
2. An increase in immigration lowers unemployment, even for native workers, and has no negative effects on public finance.
3. An integration policy has the potential to play an important role in improving social inclusion, addressing Europe's demographic challenges and boosting jobs and growth in the EU.

3.4.2 The Impact of Migration on Countries of Origin

Let us now concentrate on the two most important effects of migration for countries of origin: migrants and brain drain, and migrants' remittances.

3.4.2.1 Migrants and Brain Drain

Where do the benefits of emigration for countries of origin come from? In the first place, they come from the reduction of unemployment and poverty. A fall in poverty levels is obtained thanks to migrants' remittances, as we will see shortly. At what cost? The most important cost is linked to brain drain, which deprives the countries of origin of the most dynamic and skilled workers.

In many cases, this means engineers, health staffers and physicians, who are forced to leave their countries because of wars or political dictatorships. Other costs are linked to the integration of migrants from a cultural, religious and social point of view. In host countries the migrants' expectations about work are not always met, as they are often forced to accept underpaid jobs and/or lower salaries than their skill levels qualify them for.

Venturini and Villosio (2008) show, for example, that in Italy in the years 1990–2003, migrants experienced many problems trying to obtain the same conditions as were assured to natives. Here, risks for migrants are higher when they are unskilled and irregular workers who may face exploitation or the denial of human rights.

So, in general, the main benefits for the countries of origin are expressed by a reduction in unemployment and poverty. As early as 1882 Knut Wicksell suggested that migration from Sweden favored the economic growth of the country. Pressure on the labor market decreased when more land was at natives' disposal.

3.4.2.2 The Remittances from Migrants

In 2013, according to the World Bank, remittances to emerging countries totaled the equivalent of more than 400 billion US dollars. The main destination countries were those of Latin America and East Asia.

Faini (2006) found, however, that skilled migrants have a lower propensity to send money to their country of origin as they find it easier to stay indefinitely in the host country with their families.

Several studies confirm the positive impact of migrants' remittances on poverty. For instance Adams and Page (2005) found, in their analysis across 71 emerging countries, that in the origin country an increase per capita of 10% of remittances leads to a fall of around 3.5% of people living in poverty (that is, with an income of less than 1 dollar a day). Moreover, remittances would have caused a decrease of 11 percentage points in Uganda, of 6 in Bangladesh and of 5 in Ghana.

However, despite the widespread consensus about the positive link between remittances and poverty, it is not possible to say the same concerning the link between remittances and inequality.

The 2005 *World Bank Report on Migration* suggests that the empirical studies on this topic are contradictory and depend on several factors. In general the remittances might increase inequalities in the short term, but this effect is lower in the longer time.

From a macroeconomic point of view, migrants' remittances have two positive effects: their stability in time, and their counter-cycle evolution. Some studies show that remittances increase in situations of natural turmoil, and in political and economic crises. In this way, they allow countries to compensate, to some extent, for falls in consumption and to overcome a potential monetary squeeze.

Moreover, remittances can improve the international standing of a country by favoring its access to international capital markets. Once foreign remittances are taken into account, the ratio between current account and foreign debt falls significantly for many emerging countries. For instance, this ratio goes down from 732% without considering remittances to 355% for Lebanon, and from 190 to 126% for Jordan.

However, some uncertainty persists as to the final impact of remittances. For instance, Faini (2006) maintains that they favor economic growth since they allow origin countries to overcome the imperfections of financial markets and to incentivize capital accumulation for investment. By contrast, Chami et al. (2005) deem migrants' remittances to have a negative impact on economic growth because of the reduction of the propensity to labor and entrepreneurial activity.

3.5 Disciplining Migration in the EU: From Dublin to Schengen

The European middle and lower classes are against globalization. Why? Because of their fears about migration, terrorism, (unfair) free trade and skills-biased technological changes. This finds clear confirmation in what can be defined as a “race to the bottom among European countries to see who can be the least welcoming to asylum seekers.” (New York Times, February 2016)

Negative national attitudes towards immigrants and refugees, restrictions on their free flow and the continuous threat to the bloc’s system of passport-free travel were defining features of Europe in 2014–2017.

Indeed, the EU member states’ behavior with respect to thousands of increasingly desperate people vary greatly, as seen in the Union’s inability so far to settle on a common policy to address the migration crisis. The largest part of migrants and refugees don’t seek to remain in the arrival countries—specifically Greece and Italy, as well as some of the Balkan countries—but they have been stymied in their efforts to reach Germany.

Indeed Mrs Merkel, the German chancellor, has welcomed refugees and continues to send signals that Germany will accept legitimate refugees, in particular from Syria, with Italy and Greece giving voice to the same positive sentiments. But as we will see, Mrs Merkel’s policy has increasingly been attacked by populist parties, their anger clearly surfacing in Europe and in the USA at the beginning of 2016. At least nine EU states are stubbornly hostile to the policy of accepting migrants and refugees—specifically Austria, Denmark, France, Hungary, Netherlands, Slovakia, Slovenia, Sweden and the United Kingdom.

Denmark is, so far (as of February 2017), the nation employing the cruelest strategy: stealing from people fleeing war. This was established in a law approved by the Danish government, which is led by a social-democrat party, with the votes of right-wing parties. As already mentioned, the law allows Danish authorities to seize valuable items from migrants, including jewelry and cash worth \$1450 or more, in order to offset the cost of resettling them. Yet in 2015, Denmark absorbed a significant number of refugees. It admitted roughly 20,000 asylum-seekers, making

the nation of 5.6 million one of the top recipients of refugees per capita in Europe. Moreover, Denmark was the first nation to ratify the 1951 United Nations Refugee Convention, a pillar of international law.

This testifies to deep changes in 2015 in the European Union. Denmark is, among other things, one of the ten member states which have refused to accept a borderless Europe and have closed their borders.⁶ That has negatively altered the European political landscape and will lead to the infringement of the Schengen Agreement, which set up the bloc's system of passport-free travel. In the EU today we can speak of two kinds of migrations: intra—and extra-European ones. The first type refers to the European citizens who can transfer themselves among the member states in search of new jobs, or for tourism, study or other reasons. Extra-European migrations can take place for several more reasons, such as to escape from poverty, wars, famine, dictatorships and so on.

The Schengen Agreement is relevant for the latter kind of migration. Giving it up means that because of new border restrictions migrants who land on, say, Italian or Greek shores will be able to move on to another country at will.

Thus by voting against Schengen, EU member states implicitly place the primary cost of immigration management onto Italian and Greek shoulders.

In general, however, the loss of the system of passport-free travel within the Union would mean its end, because it would also restrict all kinds of cross-border movements; the EU member states would sustain higher costs in transferring goods and also the loss of time because of border controls on all people.

The aim of Table 3.1 is to synthesize the main European rules regarding migration.

Box 3.1 The Evolution of EC and EU Competences for Asylum

The Dublin Convention*

The Dublin Convention was signed on 15 June 1990 by all the then twelve member states of the European Community. It concerns the identification of the member state competent to examine an application for international protection by a citizen of a third country. Its aim was to harmonize the asylum policies, to ensure to refugees an adequate protection

in obedience of the Geneva Convention of 1951 and the New York Protocol of 1967. Basically, the Dublin Treaty establishes that extra-European Community citizens who flee from their countries of origin because of war or persecution for political or religious reasons can request asylum in the first country of the European Union where they arrive, but may not make subsequent applications elsewhere.

The Dublin II Regulation*

In 2003, the Dublin Convention was replaced by the Dublin II Regulation.

In short, the regulation is based on the principle that only one member state is competent to examine each asylum case. The aim is to avoid the asylum-seekers being sent from one country to another and at the same time to prevent the presentation of more applications by one person alone. This regulation defines the criteria for identifying, for each application, the competent member states: illegal entry or stay in one member state, issue of visa or residence permit, and so on.

The Dublin III Regulation*

The Dublin III Regulation was issued in 2013, replacing the previous Dublin Regulation II. This new regulation establishes "criteria and mechanisms of determination of the Member State competent for the exam of the international protection in one of the Member States by a citizen of a third country or a stateless person." The basic principle is that the international application for asylum must be examined by only one member state, that state assuming the higher role with reference to the arrival and stay in the territory of the member states.

The Schengen Area and the Schengen Convention*

The Schengen Area is an area of freedom of people movements.

Controls at the frontiers have been abolished, except in exceptional circumstances, for all travelers. In 2016 the Schengen Agreement was signed by 26 countries, only 22 of them belonging to the EU. Bulgaria, Croatia, Cyprus and Romania did not sign it. Ireland and the United Kingdom did not sign the convention, exercising the opt-out clause. This area of free circulation started from the Schengen Agreements signed on 14 June 1985.

Instead, on 19 June 1990, the Agreements were replaced by the Schengen Convention which includes and completes them. When we talk about the "Acquis of Schengen," we refer to both the 1985 Agreements and the following Convention. Within the Schengen Area the EU citizens and those of third countries can move freely without being subject to border checks. By contrast a flight from a Schengen state towards a non-Schengen one has to be checked at the frontiers. Other topics considered within this area are cooperation among national police forces in order to fight crime and terrorism. As well as conducting trans-borders pursuits, Schengen states can establish exceptional and temporary controls. But these controls must be justified by a "grave threat to public order and internal safety or serious deficiencies in the control of external borders which could endanger the general functioning of the Schengen area".

The Rabat Process

The Rabat Process was launched at the Euro-African Ministerial Conference on Migration and Development held in Rabat in 2006. It is composed of 55 European and African countries along with the European Commission and ECOWAS (the Economic Community of West African States). Its main objective is to strengthen cooperation among countries involved in migration flows from West Africa. It is up to a committee formed by the following EU and African states to manage the Process: Belgium, Burkina Faso, France, Guinea, Italy, Mali, Morocco, Portugal, Senegal and Spain. Among the main results of the Rabat Process we can mention the Seahorse Atlantic Network, which allows the exchange of information among the involved authorities in order to fight illegal migration and trans-border crime.

The Khartoum Process

The main objective of the Khartoum Process is to further talks about migrant trade and criminality. Countries of the Horn of Africa, specifically Egypt, Ethiopia, Kenya, Libya and Tunisia, as well as the EU Commission, ECOWAS and the European Service for External Action, are part of the Process. It was launched in 2014 by a European Conference held in Rome.

The 2015 Malta Conference

This was held at the Mediterranean Conference Centre in Malta, and attended by the heads of states and governments of the EU and of the African countries belonging to the Rabat and Khartoum Processes, on 11 and 12 November 2015. The Conference attendees made a commitment to deeper cooperation against migrant smuggling and criminal networks and established an emergency fund for Africa.

*These points are analyzed in detail by F. Cherubini (2015).

Having come so far in this section on disciplining migration into the EU and Table 3.1 in particular, we can better understand the challenges posed by migrants and refugees reaching European coasts. In sum, we can say that there is a great difference between the principles of the Dublin and the Schengen accords.

According to current Dublin regulation, applications for international asylum must be examined by only one member state. And the competent state is the one that is assumed to have played the main role in relation to the entry and the first stay of the applicant—that is, the state where the applicant arrived, which recently will very likely have been Italy and Greece.

Instead, if the present Schengen rules apply, all migrants and refugees can enjoy the freedom to cross the internal borders of all the 26

Schengen European member states. Almost all of the migrants arriving in Italy over recent years have wished to continue their “journey of hope” to North European Countries. This is possible within the Schengen Area. Migrants and refugees can go everywhere in Europe, which is what almost all EU states do not want. That’s what the nine mentioned EU states don’t want.

The immigration crises in Europe started from this point. They have been dramatic,⁷ and involve both “systems”—pitting Dublin against Schengen. At the highest point of the migrant crisis, in September 2015, ten EU Member States openly violated the Schengen agreements by imposing controls at their borders, which were to last until May 2016. According to some rumors at the time, these controls at the national borders would also be renewed for another 24 months.

What are the consequences of this farewell to Schengen? They are essentially two:

First: All of the migration process falls under the Dublin system. Thus it will be up to the arrival member states (Italy and Greece) to ensure asylum for thousands of men, women, children fleeing from North Africa, Syria and other countries. This is an artificial change to their intended routes in order to “save” Central and Northern European countries with their anti-immigrant voters’ demands. It comes at the expense of the weaker southern member states.

Second: The ending of the Schengen Area would put the very existence of the EU at serious risk.

A very crucial question can be asked at the end of this section: Who is behind this widespread closure of borders (which could in fact even be justified), fuelling an enormous anti-migrant sentiment?

This aspect is discussed in the next section and to a larger extent in the final chapter of the book.

3.6 Political Attitudes Towards Immigration in Europe

In this book it is assumed that political attitudes towards migration flows to the advanced world are overwhelmingly important. From this point of view, two principal aspects emerge from among the panoply

of events characterizing refugee and migrant arrivals in Europe over the last couple of years. They are: (1) the widespread and growing anti-migrant sentiments in many EU member states; and (2) the move, which was to some extent unexpected, to an open-door-policy by Angela Merkel, the German chancellor.

Let us discuss them in turn.

3.6.1 Anti-immigrant Sentiments Among the European Middle Classes

The anti-immigrant sentiments in Europe are the real factor we are interested in here. This book takes the view that it is the political implications of these sentiments that have triggered the slowdown of globalization. But the sentiments are not new. They surfaced in 2004, when the EU countries decided to throw their doors open to new members from Eastern and Central Europe. At that time, the influx of migrants that would follow was underestimated. The numbers of arrivals were noticeably higher, creating the perception that migration was spiraling out of control. Initially immigration had been welcomed by European policy makers as a means to offset Europe's aging population. But a few years later, when economic and financial crises emerged in Europe too, consternation spread fears all around that immigrants were taking away scarce jobs. Migrants became easy culprits.

From 2014 on, a new anti-immigrant sentiment has been gaining ground in almost all EU member states. To a growing number of them, immigrants appear an unstoppable mass. Starting from Orban's Hungary, five other member states, namely Austria, France, Slovakia, Slovenia and Sweden, have infringed the Schengen obligations.

More importantly, the immigration debate has played a large role in increasing the fortunes of rightist parties in almost all European countries. In France the National Front, in Britain, the United Kingdom Independence Party, in Italy the Lega Nord, in Netherlands the Party for Freedom and in Germany the *Alternativ für Deutschland*, have seen increases in their votes, stemming from the fears of the middle and lower classes, as well as xenophobes and "old white" men.

Even the European leaders who are more conscious that the farewell to Schengen would mean giving up one of the Union's founding principles, are wary of what has been happening and seem ready to call for the bloc to overhaul its current visa-free area. Indeed the arrivals of migrants put member states against each other: Each of them is driven towards narrowing the rights of asylum-seekers in order to avoid to being more attractive than their neighbors.

As we know, many fears that are stoked by right-wing parties seem exaggerated. In numerous cases considerable costs are largely perceived as linked to immigration, but this perception is wrong. Yet many members of the middle and lower classes perceive themselves as the losers in globalization largely because of immigration.

And, logically, losers vote. This has major consequences for globalization and its future. We will come back to this point in the final chapter of the book.

3.6.2 Merkel's Migration Policy

In 2015 the German chancellor officially declared her country was in condition to take about 800,000 Syrian refugees. The open door took European public opinion by surprise. However, everything we have discussed so far in this chapter would allow us to agree with what we might define as Merkel's migration policy. But let's first try to understand its economic and political rationale.

In the first place, the chancellor has doubtlessly shown remarkable leadership in the refugee crisis. And it goes without saying that the lack of strong leadership in Europe has been an enormous limit to the political framework. It also helps to explain the inactivity of the Union and the European Commission on this issue.

In her New Year's address Merkel affirmed: "Handled properly, today's great task, presented by the influx of the integration of so many people, is an opportunity for tomorrow." That is a New Year's message all of Europe should heed.

If we look at the impact of migration, we find three pillars supporting this point of view.

In first place, as we know, Germany needs about 700,000 in net immigration over the next 10 years to keep its population stable.

Second, if immigrants' skills are complementary to those of natives, then the host economy will gain in terms of productivity, potential and actual output, employment and fiscal stability.

Finally, as regards the welfare system and public finances, the impact of immigration seems positive or at least very minor, albeit perhaps not in the short run.

However, time is crucial. Indeed the first-generation workers' impact could be negative for the public budget of a host country, but the state will receive a net gain from the second generation onwards. The high number of children of the first-generation migrants will pay for services granted to the resident adult population. Thus foreign workers' contribution to the state budget will be positive over time. And so on.

Yet it does not seem to be the right moment in history to take strong and controversial political decisions such as that of Angela Merkel. Indeed, international law asserts that Europe must offer asylum at least to every genuine refugee who reaches the EU. The Union has not cancelled national obligations to meet this obligation or to fulfill humanitarian needs.

We should be aware of the legal implications of behavior which de facto denies these obligations while pretending, at the same time, that no change need be introduced in the EU legislation. But many European states act exactly in this way: They reject refugees, simply observing that the number involved would be too large to sustain domestic support and to comply with the existing migration rules. When Europe's politicians move down that path they can be rightly accused of failing to live up to "European values." Indeed they face a clash of values.

Now, Mrs. Merkel has maintained that Europe has the moral and legal obligation to accept genuine refugees. But, as we have just noticed, politicians operating in a democracy also have a moral and legal obligation to respect the wishes of their voters who have opposite ideas.

This is a dramatic dilemma. Point (1) under the heading just above, "Political Attitudes Towards Immigration in Europe," about

anti-migrant sentiments has shown that a slowing down of globalization on one hand and European disintegration on the other are both possibilities, while point (2) about Merkel's migration policy also indicates the new lines for addressing or coping with migration problems.

3.7 Proposals for Addressing the Economic Problems of Immigration

It goes without saying that the current challenge of migration is a testing one to meet. It is a widely held opinion that the EU cannot solve all the problems, but should try to find ways to manage them.

Indeed, to address the immigration crisis, the EU should assume a long-term perspective of the ongoing phenomena. In other words it should assume an immigration policy for the Union as a whole. It will be difficult for it to push back the inevitably continuing inflow of migrants. It would probably be impossible. But also, the future integration of refugees and migrants will not be completely negative for Europe. The EU has a population of around 500 million. In 2015 migrants and refugee arrivals amounted to a little more than 1 million; Turkey absorbed about 3 million and Lebanon 1.5 million. Anyway, we have some points to start from. The arrival of migrants and refugees is becoming a structural phenomenon. It will last for decades. The solution lies at the source.

We can imagine new forms of partnership with North Africa, and some already even exist. Yet it is easy to see that, alone, they are insufficient to solve the problem.

Summing up, we are in the presence of two types of strategy:

- (A') We should imagine a *plan for overcoming migration problems structurally*. This plan will require financial resources for decades and new institutions as part of a new migration policy.
- (A'') At a lower level, we could think of a program for gathering financial resources to help countries which migrants leave from.

- (B) It could be realistic to focus on a local approach—that is, a zonal development program, limited to firms and institutions within two or more countries, both recipient ones and those of origin. The program would be aimed at funding projects involving service providers and producers and entrepreneurs in those countries.

Further to this list, there is the situation that would be created by suspension or cancellation of the Schengen Convention—that is, the ending of possible movements of migrants and refugees from one EU member state to another. It is off the list as a possible strategy, but we will look at it in more detail now.

3.7.1 The Schengen Cleavage

The first move, which is easy to imagine, could be a plan aiming to suspend the Schengen Convention in response to public fears of mass migration. Intuitively, we can say there could be two possible consequences of this move.

The first, *political*, impact of the removal of the freedom of persons to move within the Union—that is, to cross frontiers of member states—is obviously more important than the second, *economic*, impact.

In the latter case, according to some preliminary estimates, the farewell to Schengen would cost about 100 billion of euros, in the form of a cut to EU GDP of about 0.8%. Intra-UE trade would fall to about 10–20% below that in the previous situation.

3.7.2 Drawing Financial Resources to Fund Migration Spending from the Taxation of Oil and Its Derivatives

In January 2016, the German finance minister Wolfgang Schäuble suggested increasing taxes by EU countries on oil products to fund public spending arising from the unexpected arrival of refugees and migrants on the shores of the Old Continent. The purpose of this was to avoid the suspension of efforts to help migrants. The timing of the Schäuble

proposal seems to have been suggested by the dramatic fall in oil prices and the complete lack of any risk of inflation.

3.7.3 The Zonal Development Model: The Case of Jordan (Betts and Collier 2015)

Within point (B) we meet two proposals: that of a zonal development model advanced by Betts and Collier (2015), and that emanating from the Istituto per la Documentazione Statistica (IDOS) which makes reference to micro agreements between Italy and one or more nations of North Africa. These agreements concern the funding of projects of small firms and individual entrepreneurs willing to go back to their countries of origin (IDOS 2015).

Betts and Collier expound their proposal regarding refugees from Syria. They suggest a “zonal development model”, or rather an agreement between Syria and Jordan. Their starting points are: (1) the current wars in Syria sooner or later will come to an end; (2) Jordan hosts more than 1 million Syrian people; (3) many of these displaced skills already have skills, many are well educated and almost all share a common language with their Jordanian hosts; (4) Jordan has landed in a difficult economic situation and the refugees can represent an opportunity to overcome this transition.

But how would it work? This is the core of the Betts and Collier proposal. Refugee camps and some urban areas could be conceived as industrial zones for the displaced and for trade concessions. Syrians could gain access to education, training and the right to work. The international community could encourage this model through financial incentives.

3.7.4 Micro Agreements Between Italy and North Africa’s Small Firms

This proposal has to do with the migrants from North Africa who have lived for a long time in Italy, worked with Italian machinery and produced Italian products and services. As years went by, these people with African roots became smarter entrepreneurs.

The IDOS proposal goes as follows. First, IDOS stresses that under the United Nations Millennium Development Goals, advanced countries have formally committed themselves to provide poor nations with a yearly contribution of 0.7% of their nominal GDP. Italy is usually among the last countries on the list regarding contributions actually made. In 2015 its contribution amounted at 0.16% of nominal GDP, that is about €1.7 billion, against the due amount of about €7.7 billion. On the other hand the Italian budget receives taxes from migrants of €23 billion. The difference of 16 euros per person could have been spent on new enterprises in Morocco, Algeria, Tunisia or Egypt within a form of “local development zone” scheme. In particular, financial resources could have been used to fund small firms for the production of goods that were previously made in Italy, with Italian machinery. Both the country of origin and that of destination would have been better off under this scheme.

Finally let look at point (A') and the suggestion of something more complex which forces us to regard matters from a new angle, with the imagination needed to face dramatic problems that are difficult but not impossible to solve. While the proposal is certainly new, it nevertheless recalls to some extent the experiences of the past, in particular that of the June 1947 Marshall Plan. However, the proposal I am about to advance has in fact little to do with the Marshall Plan and is more similar to a plan drawn up by Keynes in 1943.

Before expounding my proposal let me shortly dwell on Keynes's plan, which had its roots in its author's paper of 1930. In this, the great twentieth-century economist proposed what was an advanced idea for the time: a World Central Bank.

3.7.5 A New Marshall Plan for Africa

The closure of borders is not needed. Europe must adopt a different immigration and aid policy. This is could be found in a new Marshall Plan, which to date has been the only successful example of structural adjustment in history. However, such a plan is frequently and inappropriately characterized as just a measure by which funds are transferred

from one country (in 1947, the USA) to others (Europe). But the Marshall Plan or ERP (European Recovery Program), announced on 7 June 1947 at Harvard University by Secretary of State George Marshall, was much more than that. The financial resources were not at all its strong point: from 1948 to 1951 less than \$13 billion was transferred, of which 30% went to England, just over 10% to Germany and very little to Italy; in the first year only \$5 billion was spent.

According to experts, the \$13 billion alone would not have been sufficient to stimulate economic growth and to fund the postwar reconstruction; others have not found any correlation between aid from the USA and the growth rates of the beneficiary countries. However, the ERP's greater resources avoided the conflict between capital and labor in the income distribution that occurred immediately after the end of World War II.

Indeed the 1947 Marshall Plan is considered a remarkable success in terms of institutions. It implied a new liberal international policy as opposed to the hitherto pursued bilateral agreements. The most important institution was the European Payments Union (EPU), a "multilateral clearing house" for credit and debit trade among the 17 member countries of the Organisation for European Economic Co-operation (OEEC). This allowed European countries to develop greater trade multilateralism, to save hard currency and to overcome the problems caused by dollar shortages. The EPU, whose first president was Guido Carli, was a success: set up in 1950 and initially designed to last for only two years, it did not cease its activities until 1958. A non-repayable fund was initially needed for its constitution: the Marshall Plan contributed to this end with \$350 million (although it was eventually cut to \$272). The estimated economic impact of the plan was around 2% of GDP of the 17 countries. This impact was due to: (1) a new balance of payments adjustment policy; (2) new institutions; (3) additional financial resources.

But the ERP also had a political purpose: to pull the rug out from under the feet of the Soviet Union, whose army was near the northeastern borders of Italy.

In short, the most useful insight to draw from the "old" 1947 Marshall Plan for a new European Plan is that we need: (a) a new immigration policy; (b) new institutions; (c) new financial resources.

First, the new immigration policy should aim at managing migration flows towards the European Union and promoting economic growth in countries of origin. Managing the migration flows does not mean stopping them and certainly not closing national borders, as that would dismantle the Schengen system.

At least in the medium term, the Old Continent has much to gain from immigration: the lower and middle classes, those that most fear immigration, have a perception of employment and wage costs that, according to data, is almost always wrong. Several empirical studies confirm that, with the arrival of the immigrants, unskilled native workers are pushed to higher and better-paid skills levels. The net contribution (taxes paid minus transfers received) of immigrants to national budgets usually becomes positive after one or two years. Immigrants will ultimately prevent national welfare states from collapsing. And the whole of Europe from dying of consumption.

Yet a spectre is haunting Europe: populism. Its growing political representation can be found not only in right-wing parties but also in a number of centrist and leftist ones that are afraid of losing votes. A new Marshall Plan, slowing and regulating migration flows, would weaken the appeal of such populism. This should be the focal point of a new immigration policy.

Second, regarding new institutions, as already mentioned, the old Marshall Plan pattern also suggests the setting up of new institutions. Particularly, in order to promote growth in the home countries, we could consider the creation of a new entity along the lines of the EPU. We could in fact consider the establishment of a new “European Union for Economic and Social Development in North Africa and the Middle East,” to be included within the European Commission. It should be aimed at: (1) strengthening the Euro-Mediterranean association agreements between the EU, Morocco, Algeria and Tunisia, and encouraging the application of the strategy to other local agreements (such as the one suggested by some economists, between Jordan and Syria); (2) building new basic infrastructure and enabling training courses; (3) identifying forms of support for the exportation of local products.

Third, new financial resources require that particular attention is given to the destination of the funds of the Plan. To this end, the

European Union should demand accurate checks on the proper use of the funds allocated to the various countries that migrants move from. In fact, there is a high risk that such funds, or part of them, could fall into the wrong hands, thus thwarting every effort. Corruption, ravenous politicians and bureaucracy could have undermined the achievement of the Marshall Plan's purpose, and this remains a real risk.

There is a final issue connected to the resources to be allocated: where to find them? There are two possibilities. The first is a pro-rata contribution by member states, to be excluded from the Stability Pact. The Stability and Growth Pact provides the fiscal rules for the Eurozone countries.

3.7.6 The Paris Pact

On August 28, 2017 in Paris, a first step towards a coordinated policy was accomplished between some EU Member States and some African States. The meeting was attended by the heads of States and government of Germany, France, Italy and Spain along with the heads of States and government of Chad, Niger, Mali and (the UN-recognized government of) Libya. The participants' goal was to control the illegal migrants flow. This flow is going to destabilize Europe which is unable to stop it, as we have seen. The 2016–17 collapse is only temporary, given the demographic perspective from Africa. The heads of States and governments attending the Summit agreed on the necessity of short-term intervention against traffickers of human being in the desert and the Central Mediterranean, along with long-term stabilization policies in the origin countries. The Paris meeting was very important because for the first time the more important African countries on the routes from south-east and south-west towards Libya were involved. Even though no new measures were adopted. To stabilize Libya politically and to establish hot-spots where escaping migrants towards Central Mediterranean are identified as refugees or economic migrants were two theses of general consensus by the Summit. Resident permits would be guaranteed only to the refugees, while economic migrants would be sent back. The Europeans attending will dislocates a contingent of troops to

control—as police forces—migrants and to fight the risk of terrorists’ intrusion. The French President Emmanuel Macron and the German PM Angela Merkel have suggested an alteration of the Dublin Treaty, as it put the burden of immigration on the arrival countries, in *primis* Italy. After the August 28 Summit, another is to be held in Madrid in October, which will introduce the final Summit EU—Union Africaine in November. In this final stage the implementation of a permanent Institution for the intervention and running of problems linked to the immigration. An institution like that here suggested talking about a new Marshall Plan for Africa.

3.8 Review and Concluding Remarks

In this chapter we have discussed one of the most important causes of the anti-globalization sentiment of the middle and middle-lower classes in the advanced countries. In particular, we have seen how immigration is a perceived problem often more important than the real one. Indeed, the impact on employment and wages is in many countries less important than it is believed to be. In this vein, the divide between “substitutive” and “complementary” works provided by immigrants is crucial: Only in the first case will there be a negative impact on jobs and wages. Yet, immigration represents a strong incentive for the middle class to aim at hampering the integration process through an adequate political representation.

A proposal of a new Marshall Plan for North Africa and the Middle East closes the chapter.

Notes

1. Un primo caso di migranti climatici potrebbe essere quello legato alla drammatica situazione di siccità della Somalia.
2. According to Docquier et al. (2014) a large portion of migration flows is from OECD countries to other OECD countries. Moreover retirement

migration from rich countries to lower-cost countries with better climates is a new and growing type of international migration.

3. It is interesting to detect the channels whereby migration stimulates trade. The channels or mechanisms are (1) the transaction cost effect and (2) the immigrant preference effect. As regards point 1, it is intuitive that immigrants can lower the transaction costs for trade because they have a superior knowledge of a country's markets, customs and laws. This channel is more important the greater is the difference between the host and the home countries in any particular area. The transaction cost effect will affect both imports and exports. The immigrant preference effect (point 2) is expected to boost only imports because these occur in response to the immigrants' demand for products from their home countries. Over time, there can be a countervailing immigrant substitution effect if the number of immigrants is high enough for domestic firms to start producing those products.
4. The average elasticity of 0.15% may be an overestimate, the true average being about 0.10 as a large number of estimates are based on cross-sectional studies. The paper I refer to reviews 48 studies and extracts 284 elasticities for exports and 229 for imports. The vast majority of elasticities are positive and only 13 negative.
5. In general, the trade-inducing effect of immigrants is particularly strong when the first migrants from a particular country arrive, while the impact becomes smaller once a sizable migrant community has been established. One limit of these studies is that elasticities do not depend on the level of migrants stocks. (For more information about export and import elasticities see Genç M. IZA, World of Labour).
6. Austria, Denmark, France, Germany, Netherlands and Sweden adopted border controls in September 2015. As we will see, temporary and exceptional controls can be adopted within the Schengen Agreement.
7. Infinitely more dramatic is the child refugee crisis. Indeed according to the European police agency Europol, more than 10,000 children who entered Europe during the last two years have disappeared, vanishing through the gaping cracks in Europe's chaotic system for dealing with refugees and migrants.

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4

Inequality in the Advanced Countries

Abstract In the advanced countries, inequality has reached immoral levels. By 2015, according to the 2017 OXFAM Report, 8 individuals held the same wealth as 3.6 billion people around the world, i.e. poorest half of humanity. The middle class is directly damaged by the very bad income and wealth distribution. Indeed, inequality is defined as the ratio between the increasing income (or wealth) of the rich and the middle class' stagnating average income (or wealth). Inequality increases because of domestic factors (i.e. cuts of welfare state and unfavourable evolution of wages) or because of external factors such as skill-biased technological changes, outsourcing, and unfair trade. In one word: because of globalization. Thus after migration, inequality (or globalization) is another problem damaging middle class. This is important in our story. Policy maker should target the reduction of inequality: not for ethical reasons but for economic ones. In fact, the economic growth is sustained by inequality reduction. At the end of this chapter, the author suggests a proposal of a redistribution policy coordinated and funded at EMU's level. It should be able to assure an inclusive growth (i.e. with equality and efficiency, to avoid the tradeoffs that preoccupied Okun [1975]) for all its Member States.

Keywords Inequality · Inequality causes and consequences
Inequality and growth · Inequality and banking crises · Equality and efficiency

4.1 Introduction

Thus, the increasing concentration of incomes—that is, increasing inequality—implies, by definition, the relative economic worsening of the middle class.

Inequality increases because of domestic factors, for instance cuts in state welfare and decreasing wages, or because of external factors such as skill-biased technological changes, outsourcing and unfair trade. In a word: because of globalization. Thus, after migration, immoral inequality (or globalization) is another problem hurting the middle and lower middle classes.

By 2015, according to an Oxfam report published in 2017, the 8 richest individuals in the world held the same wealth as the 3.6 billion poorest people in the world. The top 1% of the global population held more than the remaining 99%.

Barack Obama has called inequality “the defining challenge of our time.”

As the causal international factors of inequality are skill-biased technological changes, delocalization and unfair free trade, which are all typical aspects of globalization, we could say that the middle class is negatively affected by inequality or globalization.

Within any particular country, stagnating or decreasing incomes could derive from domestic factors such as unemployment and poverty, which to some extent partly contribute to the immoral level reached by inequality, which is a crucial factor, along with migration and terrorism, pushing the middle class to organize themselves politically in an attempt to throw sand in the machinery of globalization.

“In the USA the concentration of income is higher than in Russia and lower than China. Italy too shows an income concentration that is relatively high (0.32), above those of Germany and the Northern European economies, such as Sweden and Norway” (Fig. 4.1).

It is worth now proceeding with some introductory and perhaps obvious concepts. Inequality is a very complex phenomenon. We

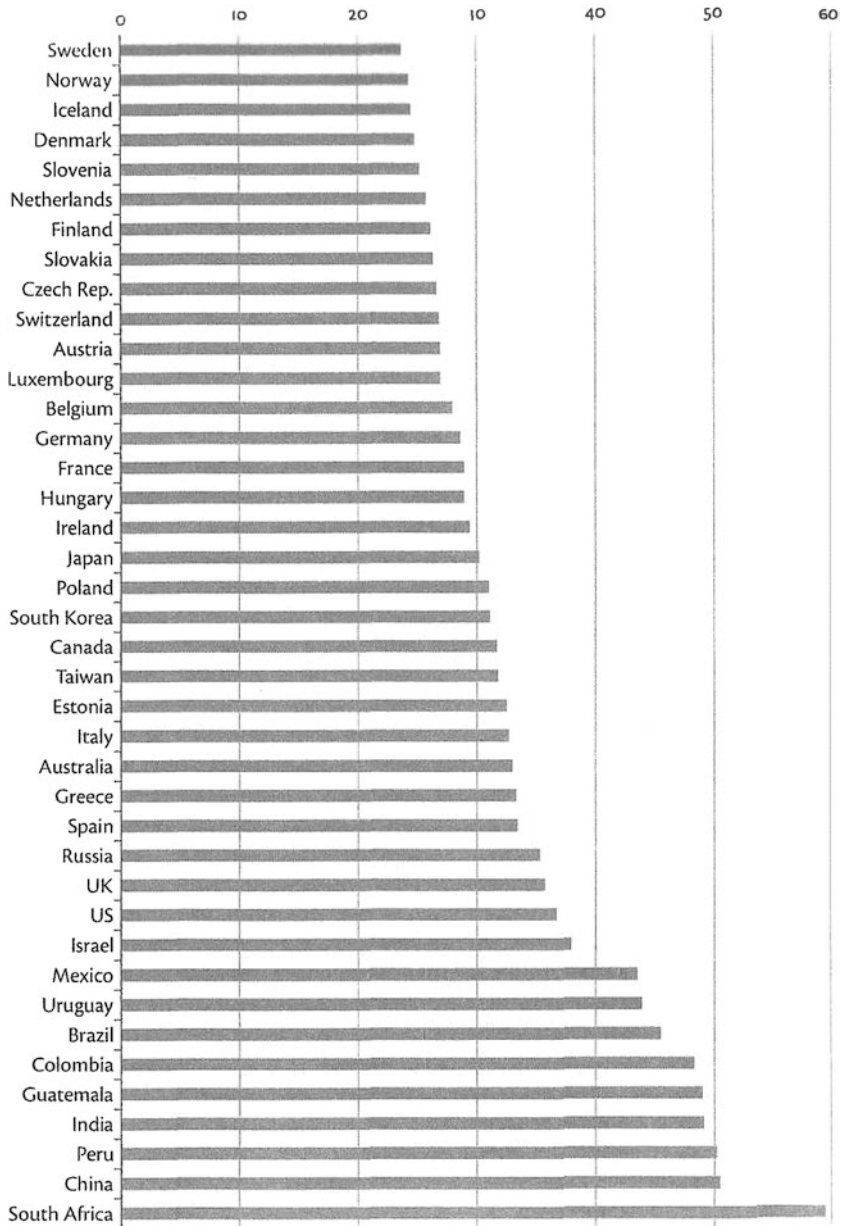


Fig. 4.1 Gini Index 2010. Source Atkinson (2015)

have different definitions which refer to income or wealth: inequality within a country, or among countries¹; global inequality; inequality of opportunities. Clearly these definitions have evolved down different trajectories and each has a different focus. Global inequality means a combination of inequality *within* and *among*. Indeed, at the moment, both inequality *between* two or more countries and global inequality are decreasing, while inequality *within* countries is increasing.

Another question is how inequality is measured. To this end, we have different indexes.² The most popular synthetic measure is the Gini coefficient or index, which ranges in value from 0 to 1, zero means a state of perfect equality in which each person has the same income; 1 means “perfect” inequality, where all income is owned by a sole person.

An important aspect is the evolution of inequality *within* countries. According to the first economist who studied this, the Nobel laureate Simon Kuznets (1955), inequality is low at very low income levels, then rises as the economy develops and eventually falls again at high income

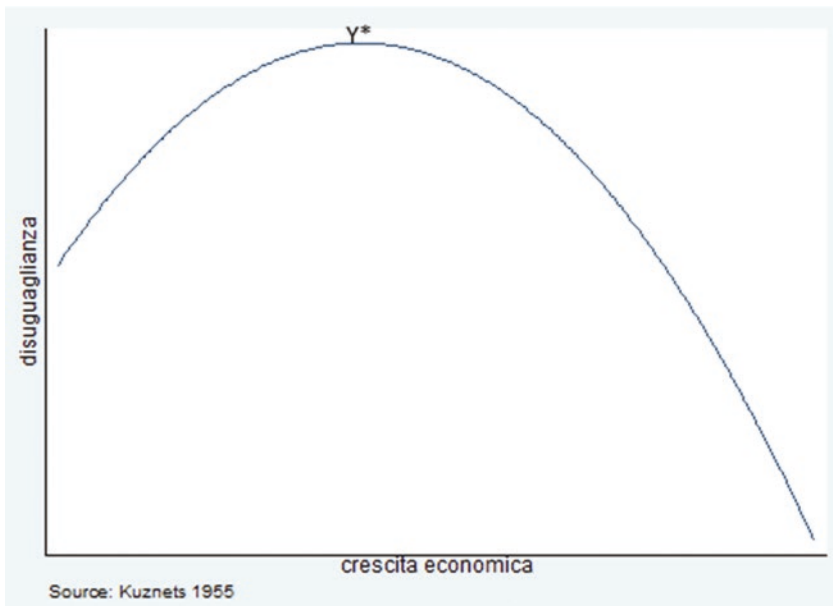


Fig. 4.2 The Kuznets curve. *Source* Kuznets (1955); Y-axis: Inequality (Gini index), X-axis: economic growth

levels. Therefore, if we plot inequality levels measured by the Gini index (on the y -axis) against national GDP levels we obtain an inverted-U-shaped curve (Fig. 4.2).³

Is inequality a bad thing? At first sight it might be, but not everybody agrees. For instance, Martin Feldstein (1999, p. 41), a professor at Harvard University, maintains: “I believe that inequality as such is not a problem and I deem that it would be wrong to establish policies able to reduce it. Policies should be concentrated not on inequality but on poverty” (Fig. 4.3).

Also for John Maynard Keynes (1936, Chap. 24), some degree of inequality may not be a problem in so far as it provides the incentives for people to compete, save and invest, to move ahead in life. The problem will arise when inequality exceeds certain levels. Then it becomes a source of concern.

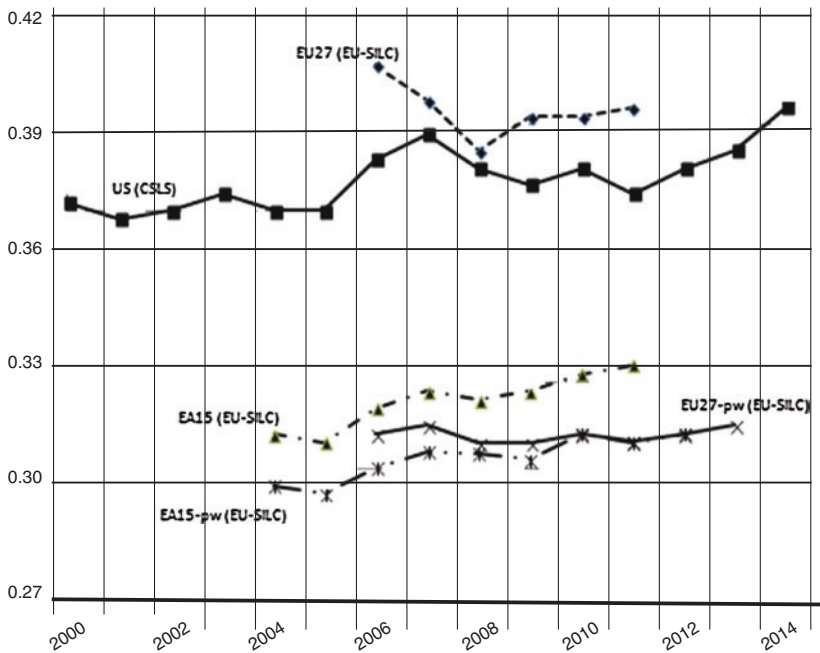


Fig. 4.3 Inequality in EU, EA and United States (Gini index); series denoted “pw” are population-weighted averages of national values. *Source* Brandolini et al. (2007); Eurostat

4.1.1 Inequality, Distribution and Growth

These three concepts are strictly linked each other. We will see that inequality is harmful to growth. When this happens, it is generally opportune to redistribute incomes through national fiscal policy. However, redistribution is not always good for growth, even if in general the impact of redistribution is positive. We will come back to this point later in this chapter, in the section on coordinating wage policies.

A concept contiguous to inequality is *poverty*. However, inequality and poverty are very different. It is not rare for decreasing poverty to be found where there is increasing inequality. Yet for a long time poverty has been increasing in advanced countries. In 2012, when I was writing another book on globalization, poverty was an important factor in many industrialized economies. But, at that time, the thesis according to which poverty was only a concern for underdeveloped economies was still widely shared.

On the other hand, at that time, the increasing inequality in the First World (principally the USA, Europe, Japan, Australia and South Africa) was clearly evident. This growing inequality in a context of increasing GDP seemed to disavow the Kuznetz hypothesis.

This chapter is organized as follows. The next section discusses the consequences of inequality, and the third addresses the drivers or causes of inequality. In the fourth section we talk about tackling inequality. The fifth is more policy-oriented, discussing redistribution, inequality and growth; in that section I will present a proposal for coordination of income (wage) policies in the European Monetary Union within the existing Procedure against Macroeconomic Imbalances.

4.2 Inequality and Its Consequences

We have just said that the distance between rich and poor has been increasing in many industrialized economies during recent history. For example, data from the USA can allow us to have an idea about inequality. From 1984 to 2010, the income share received by the richest 20% of population has increased by 75%, while the income share received by

the poorest 20% has decreased by 90%. In terms of wealth the impact is still higher: 1% of US households hold 225 times the wealth of the middle American ones. This is about twice the value that they would have held in 1962 or 1983 (Stiglitz-Gallegati 2013).

In the past, the US middle class was the richest in the world. Its subsequent decline can be explained by: (1) the fall in the level to which US young people are educated; (2) the fact that US firms distribute less profits to their employees than those in the rest of the world (ROW); (3) the lower taxes that the rich people pay in the USA compared with elsewhere in the world.

Let us also have a look to the main consequences of inequality.

4.2.1 Inequality and Social Conflicts

Inequality can be source of social conflicts within a country, directly and indirectly, as it hampers poverty reduction. This is a crucial point to make, because social conflict and discontent are decisive factors triggering political “rebellions” against globalization (as we will discuss in Chap. 6).

4.2.2 Inequality and the Middle–Lower Middle Classes

The unexpected success of Donald Trump in the race to the White House in November 2016 has been the occasion to talk about inequality in the United States. According to a widespread thesis, the economic and social discomfort of lower-middle “white” classes made that success possible.

We can find these reasons among the middle classes in the advanced countries, using the world’s distribution of per-capita real income from 1988 to 2008. In Fig. 4.4, on the y -axis we have the per-capita income in per cent with respect to the starting year (1988) and on the x -axis we have the income classes or percentiles from 0 to 100. These classes are in turn linked to countries or group of countries, as we will see.

The distribution of income can be called an “elephant head” because of its shape. It shows which classes are the winners and losers from globalization. In the figure points A and C are winners as they have gained

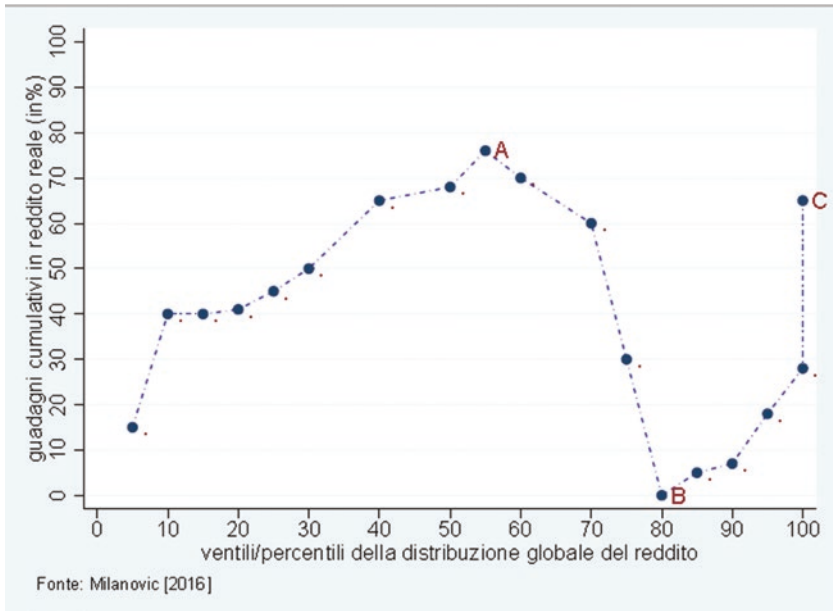


Fig. 4.4 “Elephant head” distribution of income showing which classes are the winners and losers from globalization. *Source* Milanovic (2016); Y-axis: cumulate per-capita real income 1988–2008 with reference to 1998, X-axis: income class in percentiles from 0 to 100

higher values of income; B represents the losers as their gains are near zero. At point C we find the so-called “global top 1 per cent” as it is around percentile 100. This point represents the very rich people of countries in the OECD and in rich emerging countries. The average gain in increased percentage (2008/1988) of per capita real income of this class is about 65%.

Point B is to the left of the rich classes. It refers to the middle and lower middle classes of the advanced world, *principally* the USA and Europe. The average gain is near 0: these classes are the losers from globalization. Their “white” (non-black, non-“Hispanic”) components are the ones who decided the victory of Donald Trump.

At point A, reference should be made to the percentile or class of income which is smaller than in advanced countries. A therefore refers to the

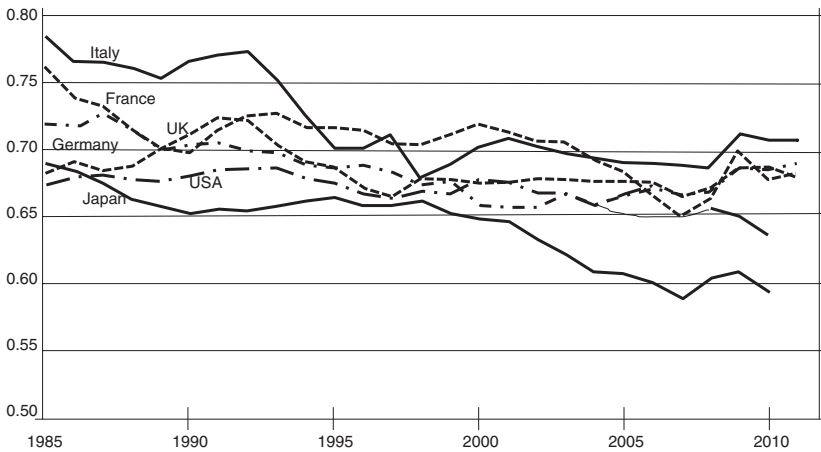


Fig. 4.5 Labor income share (selected countries, OECD). *Source* OECD

middle and lower middle classes of emerging countries. They are the winners from globalization and have the highest income gain, of about 80%.

In the industrialized countries, real wages have been stagnant; wage differentials between skilled and unskilled workers have widened; unemployment rates have risen everywhere and instability and job insecurity have come to characterize labor markets in almost all of the advanced countries.

As a result of these processes the share of labor income in GDP has decreased in industrialized countries in a very evident way, as Fig. 4.5 clearly shows.

Inequality has touched unacceptable levels in the OECD countries.

4.2.3 Inequality and Economic Growth

In his *The General Theory of Employment, Interest and Money*, John Maynard Keynes wrote (Chap. 24) against the inequality of incomes beyond certain limits. He argued this not on ethical reasons, but on economic ones. When inequality is significantly beyond certain limits it penalizes growth, because middle and lower middle classes have a higher propensity to consume. Post-Keynesians go further, taking income distribution as a Keynesian concept in the sense that consumption depends on income distribution. Kaldor (1961)

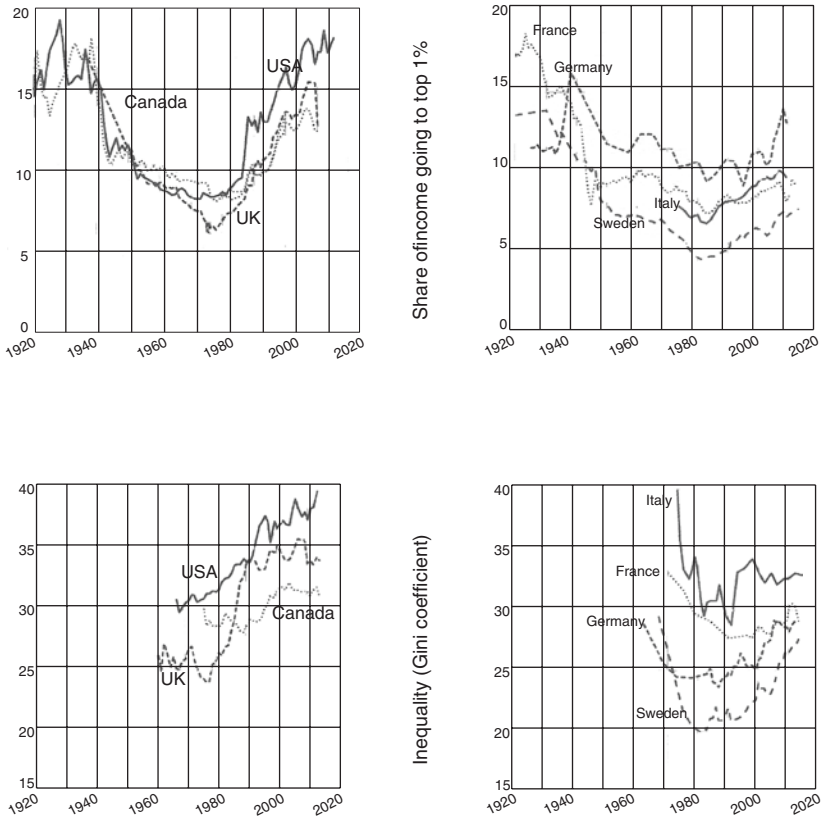


Fig. 4.6 Income inequality in seven advanced countries. *Source* Brandolini (2016)

showed a realistic consumption function, by dividing incomes deriving from wages and incomes deriving from profits. Two marginal propensities to consume were noted: one for drawers of profits and another for drawers of wages and salaries. The latter is higher than the former. Thus an important and negative consequence of inequality is lower economic growth (Fig. 4.6).

Perhaps in this perspective we can consider Ostry et al. (2014), who find an inverse relationship between the income share accruing to the rich (top 20%) and economic growth: if the income share of the of the top 20% increases by 1 percentage point, GDP growth is actually 0.08 of a percentage point lower in the following years. Instead, a similar

increase in the income share of the bottom 20% (the poor) is associated with a 0.38 percentage point higher growth.

This link between inequality and growth will be revisited in subsequent chapters, when policies on redistribution and incomes will be introduced.

4.2.4 Inequality and Financial Crisis: The Rajan [2010] hypothesis

High levels of inequality could be associated with the occurrence of banking crisis. Indeed, the economist who supports this connection is Raghuram Rajan (2010). According to the former chief economist of the IMF, inequality has led to a bank crisis since it leads to political pressure for the redistribution that eventually assumes the form of subsidised housing financing, then a credit and mortgage boom, and rising household debt. His thesis makes reference to the subprime crisis in 2007 which led to the 2008 global finance crisis and to the 1920s crisis. Overextension of credit, high leverage, and the action of lobbyists pushing for financial deregulation are linked to inequality and cause banking crisis. The problem is if inequality leads to a credit boom. According to some economists, the Rajan approach is not convincing because it is not sure that inequality leads to a credit boom: data would not confirm this nexus. Bordo and Meissener (2012) argue that the causes of banking crisis are many and very different from inequality. Atkinson and Morelli (2015) find other ties between inequality and financial crisis:

1. Inequality reduces aggregate demand as rich consume a substantial portion of their income;
2. Inequality increases the demand for credit by the lower middle class, as rising inequality has pushed households to work more, consume more and take on more debt in response to the shift of their income in comparison with richer households;
3. Inequality increases the supply of funds available in the economy as richer individuals search for new investments.

Those who admit this correlation, maintain that the inequality in the advanced countries is linked to the crises because it leads to an increase

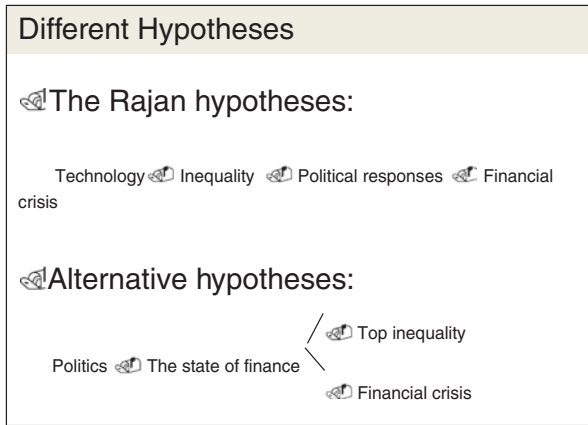


Fig. 4.7 Inequality and crisis. Source Acemoglu (2011)

of leverage. Of credit along with a loosening of conditions for granting mortgages as well as a deregulation required by lobbies (Fig. 4.7, Acemoglu 2011).

4.2.5 Inequality and Global Imbalances

A persistent external imbalance, that is of the balance of payments, often has its roots in the inequality in the distribution of income. An increase in the share of income which goes to the “rich” produce—*rebus sic stantibus*—a slowing down of consumption and an increase in internal savings. The excess of savings, over investment, will translate itself into a surplus of the current account of balance of payments. The opposite happens in a country where inequality is decreasing because of the soaring of the share of labor income. Thus, given the investment consumption goes up, savings decreases. The current account shows a deficit. Countries with persistent surplus and deficit give rise to scenarios characterized by global imbalances. If we introduce the liberalization of capital movements, the excess of savings in the surplus countries will flee to the deficit ones (e.g. Chinese’ Savings flee to the USA, a deficit country). This new liquidity coming from abroad may give origin to a banking

crisis, which, in turn, will hurt economic growth, as we have seen in the previous section, talking about the US subprime crisis (Bernanke 2005).

4.3 Inequality: Its Causes

The causes of inequality are complex, sometimes triggered by market forces and in some cases produced by economic policies. We will hint at globalization (unfair free trade, delocalization of firms, financial liberalization, skills-biased technological changes). Also relevant are the growth of financial services; the reduced role of trade unions; monetary and fiscal policies; unemployment. But let us start with globalization.

4.3.1 Free Trade: China’s Exports and Outsourcing

We begin by looking at China’s exports. By 2014, more than 10 million people in the USA had lost their jobs because of the transfer abroad of national firms and competition from Asian countries, especially China (Fig. 4.8).

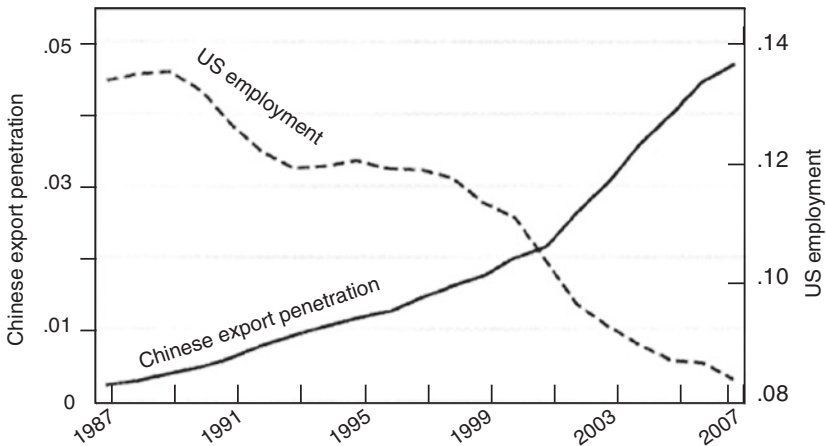


Fig. 4.8 Chinese export penetration and US employment; Y-axis right: unemployment rate, Y-axis left: chinese export penetration (import from China/US GDP)

According to Samuelson (2004) the economic growth of emerging countries had a negative impact on the income distribution and the standard of life in the USA, because the increasing competition of China's goods produced a reduction in their prices.

Krugman (2008) maintains that the thesis according to which free trade had only a very modest impact on poverty and inequality in the advanced world is completely wrong. Both Samuelson (2004) and Krugman (2008) have stressed that rising inequality due to imports from China has involved unskilled workers above all. Finally Autor et al. (2013) show that those imports are able to explain the rise of unemployment along with the reduction of wages in national labor markets. In particular, in the USA the increase of imports of goods from China explains 16% of the reduction of employment in the industrial sector from 1991 to 2000 and 27% of it between 2000 and 2007. As a consequence, unemployment benefits have increased dramatically in the countries hit hardest by Chinese competition.

The growing role of emerging countries in international markets has forced firms from advanced economies to adopt measures which have made unskilled workers poorer. Among them, there have been deep processes of industrial restructuring, fragmentation of production processes and the delocalization abroad of many production lines to countries with lower labor costs.

These measures have produced, and continue to produce, very high social costs. They have enlarged the distance between middle-lower classes and the rich. Delocalization is a very serious problem. It not only makes the specific sectors involved poorer, but harms the country as a whole. It could be seen as a step towards countries' de-industrialization.

Firms tend to move towards countries where not only wages are lower, but where taxes and protection of workers by unions are lower also. For these reasons, in the EU, Poland and Hungary attract foreign capital more than other member states. The same happens in the USA, where Tennessee is favored thanks to its very low wages as well as the lack of union guarantees. All of these aspects are *consequences* of globalization. Inequality around the world also rises because of *financial liberalization*, a "pillar" of globalization.

4.3.2 Skills-Biased Technological Changes

According to many economists, technological changes are the main source of inequality. Because of these changes, in the labor market the demand for highly skilled workers increases. At the same time, demand for unskilled workers decreases. Skilled workers can exploit a wage premium for their training, and this lies at the heart of inequality. Technological changes distribute themselves worldwide in an uneven way and this explains differences in inequality all round the world.

Much depends on how the gains from globalization and technology are divided. One firm point emerging here is that in the developed countries, the middle classes are the sole losers in the evolution of the distribution of incomes.

4.3.3 Growth of the Services Sector

The last thirty years have seen deep changes in the West's economic structure. The contribution of heavy industry to national GDP has significantly reduced while the weight of the service sector has increased noticeably. The passage from industry to services has brought with it the destruction of millions of jobs that were never completely replaced. On the other hand, the employment structure of the service sector is characterized by a large dispersal of wages and salaries because, among other things, of the reduced role of unions. Inequality is driven also by the fact that managers or CEOs of big private and public firms, along with bankers, receive excessive remunerations even in bad economic times. This accelerates increasing inequality.

4.3.4 The Reduced Role of Unions and Institutional Changes to the Structure of Labor Markets

As noted by Atkinson, “there is general agreement that the widening of the pay distribution has coincided with a decline in the role of trade unions and of collective bargaining” (Atkinson 2015, p. 93). Wages and

salaries are fixed according to the institutional structure of labor markets. Here there are deep differences between the USA and the EU.

4.3.5 Increasing Unemployment

The link between inequality and unemployment is very complex. Yet its existence is without doubt. An econometric model can allow us to see how the increase of unemployment will in turn bring about changes in disposable income and its dispersion to the people involved. Then, using a Gini coefficient, it will be possible to estimate the impact of higher unemployment on income inequality

4.3.6 Economic Policies, de-Industrialization, Capital Liberalization

Inequality can worsen as a result of the impact of fiscal and monetary policies carried out for other policy purposes. Examples are fiscal policy aiming at reducing public deficit and debt, and cuts in state welfare funding aimed at making sustainable systems welfare.

From this point of view, a study by Furceri and Longani (2014) is particularly interesting. According to their estimates, the inequality of incomes in advanced countries is linked to policies of reduction of public deficits and debts. These policies are strictly tied to globalization, as they force governments to reduce taxes to face fiscal competition and then to cut public spending. Decreased spending comes, of course, at the expense of the weaker and poorer classes and in this way contributes to a worsening of inequality. Fiscal austerity is damaging in the first place for poor people. Thus the relationship between fiscal entrenchment and inequality is clearly confirmed. Furceri and Longani confirm a negative impact of fiscal consolidation and long-term unemployment.

In the European Monetary Union (EMU), the single monetary policy carried out by the European Central Bank (ECB) of quantitative easing (QE) programs has had a particularly negative impact on inequality. QE is represented by purchases of public and private bonds

with the purpose of reducing long-term interest rates and providing liquidity to European banks in trouble. Decreasing interest rates implies increasing bond quotations and, therefore, wealth. In this way inequality rises. Other causes of the deindustrialization of the economic system and financial liberalization culprit of financial crises.

4.4 Policy Response to Inequality: The State's Distributive Action

The state can take on the fight against inequality as a primary policy objective, if it is persuaded that inequality is harmful to economic growth. But when called upon to redistribute income or wealth, how should it do so? By acting through taxes and transfers.

The two following equations allow us to understand the mechanism of a redistributive action.

$$YD_M = W + TR_W - T_W \quad (4.1)$$

$$YD_R = Q + iB + TR_R - T_R \quad (4.2)$$

where subscript M stands for middle-lower classes and R for top or rich class; YD = disposal income, W = wages and salaries; Q = profits, i = nominal interest rate, B = wealth; TR = transfers or deductions, T = taxes.

Let's suppose, now, that the state aims at reducing inequality. Its finance minister could increase TR_W and/or reduce T_W if he or she assumes that the policy objective is to increase the disposable income of the middle class. But there is another way to reduce inequality: through more progressive taxation (T_R increases) and/or reducing TR_R transfers to the firms, if the latter coincide with the richest classes.

To sum up: By acting on T and/or TR , a state can carry out a more or less deliberate redistributive fiscal policy. The search for equality in the fiscal burden can spur economic growth. But there is a problem which we will look at in the next section. Second, in Eq. (4.2) there is

B = the stock of financial assets whose value is sensitive to the ECB's QE transactions, as we have shown in the previous Section.⁴

Economic policy has a significant capability of affecting inequality. It can essentially act in two directions. The first is to proceed to income redistribution through fiscal policy. In the US case, governments could increase taxation on the 1% (but not only them) who accumulated huge wealth over past years. This solution is valid for all advanced countries. We have to find a sliding scale of progressive rates. At the same time, this fiscal policy should aim at reviving internal demand through lower tax rates on the gains of the middle classes.

4.4.1 Redistributive Policy and Growth: The Okun's trade-off [1975]

Before we reach the end of this crucial section, it is worth noting that even if equality seems to produce higher and more sustainable growth, this does not imply that the efforts at redistribution are always positive for growth. In other words, a fiscal policy intervention through taxes and transfer changes could instead undermine growth, a result that is the opposite of the expected one. There is a negative effect of redistributive policies which cannot be neglected. Indeed, interventions looking at improving equality may induce a loss of efficiency (or growth) which outweighs the improvement in equity. In general it could be a trade-off between efficiency and equity (Okun 1975), but this is usually neglected. This does not mean that it is always so but rather that we should pay attention to what kind of taxes and transfers we have to do—for instance, taxes with negative externalities for the poor, public spending on education that benefits the poor. But we have many cases of government spending (for example, public investments in infrastructure, spending on health and education and social insurance provision) which may be both pro-growth and pro-equality, while other categories may imply the trade-off which Okun (1975) talks about.

In sum, whether a package of redistributive fiscal policy is pro- or anti-growth is an empirical question. The various channels that

redistributive interventions work through should first be disentangled to understand which case we have before us. In general, however, redistribution has a positive impact on growth: but in some cases there is evidence that it may have a negative impact (Ostry et al. 2014). Anyway, this caveat also emphasizes the importance of the second instrument to reduce inequality: income policies.

4.4.2 Income Policies and Growth

The second way to fight inequality has to do with reinforcing the unions' powers and the bargaining power of unskilled workers. In this case in Eq. (4.1) the variable destined to increase is W . One way to make this happen is that of a *minimum income* ensured to all or almost all citizens. This idea is not new. Thomas Paine suggested a similar measure in 1795 to cope with the increase of poverty in France.

When W is the variable that is subject to the respective bargaining powers of workers' unions, on one hand, and of employers on the other, we are speaking about an "income policy". Unlike redistributive action by the state, carried out through fiscal policy, incomes policies do not have the state as the incumbent. Rather, it is up to the workers' and employer's unions to take part in the bargaining process. Despite this, the state usually summons both protagonists and intervenes in the process since its outcome is relevant from the macroeconomic point of view.

The wage share (that is, total wages out of GDP, W/GDP) is, therefore, a measure of inequality: inequality increases as, for given GDP, W/GDP decreases.

In Europe, finance ministers know that an increasing level of W is good for the country as it will spur the economy; this also so according to Keynes (1936, Chap. 24) and Kaldor (1961). Indeed the crucial equation of private consumption is

$$C = a_0 + a_1 YD_M + a_2 * YD_R \quad (4.3)$$

where $a_1 > a_2$, so that the marginal propensity to consume of the middle and lower classes is higher than that of the rich. The difference in

propensity to consume between the middle and rich classes gives rise to the Kaldorian consumption function (Eq. 4.3).

Thus, the increase of the disposable income of the middle classes could be an intermediate policy objective which would give shape to wage-led economic growth or recovery.

In the USA a different approach has sometimes prevailed: the *trickle-down* approach. According to this, the optimum redistributive policy is to reduce taxes on the rich class, since benefits, sooner or later, trickle down to benefit the middle and lower classes. This thesis has failed every practical test, without a doubt. But, incredibly, it has had many supporters. Trickle-down policies are definitely factors of inequality in the countries where they are applied (Stiglitz 2012).

Box 4. 1 Anthony Atkinson: Fifteen Proposals Against Inequality

Sir Anthony Barnes Atkinson (1944–2017) was a much-renowned economist concerned particularly with issues of inequality, poverty and the distribution of income and wealth. He would have deserved the Nobel prize for the soundness of his analysis and his commitment to advancing constructive solutions to the problems of our economic and social system. His recent book, published in 2015 with the title *Inequality: What Can Be Done?*⁵ is the crowning achievement of his many studies and his intellectual legacy.

In this book, Atkinson situates the problem of inequality within a coherent system of principles of justice: a matter almost always neglected by economists—with the notable exception of Amartya Sen—who have usually dealt with income inequality without considering the system of values behind it. It is very different indeed to address inequality starting from an idea of justice, whether that is based on utilitarianism or on liberal principles à la John Rawls, on the capability approach à la Sen or even on communitarianism by associating justice with the common good. Atkinson's views are close to those of Sen, in particular in considering as key both the range of opportunities available to individuals in the starting position and the outcomes achieved in terms of equality.

Atkinson's thesis states that the problem of inequality cannot be tackled simply by correcting the distortions of the current system—that is, by intervening downstream with some measure of redistribution. What is needed is action upstream, to build a system that does not produce inequality or at least produces as little as possible: "Today's high level of

inequality can be effectively reduced only by tackling inequality in the marketplace." Then we must start from economic forces that determine labor and capital incomes, and understand how inequalities are formed in different markets; then, after that, we must drive economic forces to build a fairer society. In this kind of analysis it is wrong to start with an ideal, a priori setting, thinking that phenomena like globalization or new robotic technologies are inevitable and that you cannot do anything to avoid them.

Atkinson sets out fifteen proposals to reduce the growing inequality in the world.

The first proposal is concerned with innovation from the point of view of both technological developments and social progress, as he states that "the direction of technological change should be an explicit concern of policy-makers, encouraging innovation in a form that increases the employability of workers and emphasizes the human dimension of service provision."

The second proposal is a wide-ranging policy program, designed to balance the power of the market and to ensure that government policies in economic sectors cannot neglect the aim of achieving equality. As Atkinson notes,

Public policy should aim at a proper balance of power among stakeholders, and to this end should

- (a) introduce an explicitly distributional dimension into competition policy;
- (b) ensure a legal framework that allows trade unions to represent workers on level terms; and
- (c) establish, where it does not already exist, a Social and Economic Council involving the social partners and other nongovernmental bodies.

The third and fourth proposals are concerned with the role of employment and earnings in reducing inequality:

Proposal 3: "The government should adopt an explicit target for preventing and reducing unemployment and underpin this ambition by offering guaranteed public employment at the minimum wage to those who seek it."

Proposal 4: "There should be a national pay policy, consisting of two elements: a statutory minimum wage set at a living wage, and a code of practice for pay above the minimum, agreed as part of a 'national conversation' involving the Social and Economic Council."

The fifth, sixth and seventh proposals aim at favoring capital sharing via the participation of all citizens in financial markets and the role of a public investment authority:

Proposal 5: "The government should offer via national savings bonds a guaranteed positive real rate of interest on savings, with a maximum holding per person."

Proposal 6: "There should be a capital endowment (minimum inheritance) paid to all at adulthood."

Proposal 7: "A public Investment Authority should be created, operating a sovereign wealth fund with the aim of building up the net worth of the state by holding investments in companies and in property."

From the eighth to the twelfth proposal we find five redistributive measures of fiscal policy in favor of the most disadvantaged social classes:

Proposal 8: "We should return to a more progressive rate structure for the personal income tax, with marginal rates of tax increasing by ranges of taxable income, up to a top rate of 65%, accompanied by a broadening of the tax base."

Proposal 9: "The government should introduce into the personal income tax an Earned Income Discount, limited to the first band of earnings."

Proposal 10: "Receipts of inheritance and gifts inter vivos should be taxed under a progressive lifetime capital receipts tax."

Proposal 11: "There should be a proportional, or progressive, property tax based on up-to-date property assessments."

Proposal 12: "Child Benefit should be paid for all children at a substantial rate and should be taxed as income."

The thirteenth and fourteenth measures are aimed at social inclusion via the adoption of a so-called participation income or the renewal of the welfare state:

Proposal 13: "A participation income should be introduced at a national level, complementing existing social protection, with the prospect of an EU-wide child basic income."

Proposal 14 (alternative to 13): "There should be a renewal of social insurance, raising the level of benefits and extending their coverage."

The last proposal concerns aid to developing countries:

Proposal 15: "Rich countries should raise their target for Official Development Assistance to 1% of Gross National Income."

In the conclusions to his book, Atkinson emphasizes the complementarity and the boldness of his proposals, which deserve to be discussed in a broad public debate. Some of these, such as those related to technological progress, a participation income, capital sharing and competition policy are truly innovative. Put together with measures on income distribution and employment, they form a unitary and balanced program, able to face the challenges of contemporary capitalism with confidence. Despite inequality increasing since 1980, the view

of Atkinson remains optimistic. "I have written this book in a positive spirit. I have stressed the importance of looking back in time, but I do not believe that we have returned to a world like that when Queen Victoria was alive. The citizens of OECD countries today enjoy a standard of living that is much higher than that of their grand-parents. The achievement of less unequal society has not been fully overthrown... It is true that since 1980 we have seen an 'Inequality Turn' and that the twenty-first century brings challenges in terms of the ageing of the population, climate change and global imbalances. But the solutions to these problems lie in our own hands. If we are willing to use today's greater wealth to address these challenges, and accept that resources should be shared less unequally, there are indeed grounds for optimism."

Attilio Pasetto

4.5 Coordinated Wage Policies Within the European Monetary Union (EMU): A Proposal for Inclusive Growth

Income policies seem to have been long forgotten. Yet they are able to ensure sustainable and inclusive growth, where *inclusive* stands for growth with decreasing inequality.

At the time of writing, in 2016, the Advanced World is in deep trouble. The EMU is in a never-before-seen political and economic crisis.

Economists and policy makers have sought out errors and causes directly linked to the crisis, and one particular problem is the inability to grow. In Europe, more than in the USA, the economic scenario calls forth the idea of secular stagnation, an expression used by Larry Summers (2014) to describe the current economic situation in the advanced World. In the EMU it is deemed to be the result of austerity and blind fiscal rules, such as the Stability and Growth Pact and the Fiscal Compact. Yet the Union has a number of instruments available for the coordination of economic policies which have never used. This has left a gap in the current governance system. One such instrument for coordinated national policies in EMU is the Macroeconomic Imbalances Procedure or MIP.

4.5.1 A Caveat: The EMU Macroeconomic Imbalances Procedure or MIP

Periodically, the European Commission does evaluate, for each member state, risks deriving from macroeconomic imbalances. This evaluation is made on the basis of a scoreboard (Table 4.1) where ten indicators are reported with for each of them a couple of thresholds which cannot be crossed. For instance one indicator is that balance of payments current account thresholds are +6 and -4% of GDP. Let's suppose now that Germany has a surplus on the current account out of GDP equal to 9% and Spain has a deficit/GDP equal to -6% . In this case, both of them are obliged to correct their current account by reducing the surplus by 3% of GDP and reducing the deficit by 2% of GDP, respectively.⁶

When thresholds are crossed a specific procedure against excessive imbalances is (or should be) opened: the macroeconomic imbalances procedure or MIP. The first step is accomplished by the European Commission, which undertakes a deep examination of the causes of the imbalances. If it concludes that there is a risky situation, it sends out an *early warning* towards the countries which have exceeded their thresholds. The early warning is an invitation to the countries with risky imbalances to correct them.

In our example, Germany would have to carry out expansionary policies in order to reduce its current account surplus from 9% of GDP to less than 6% . At the same time, Spain would have to carry out a restrictive policy in order to reduce its current account deficit from -6% of GDP to less than -4% . It is up to the countries to choose the policies aimed at reaching each objective.

Regarding the remaining steps of the procedure, we can say that it is closed if a country under early warning meets it. If it doesn't respect the early warning, the procedure is closed again but with a fee inflicted to the defaulting country equal to 0.1% of its national GDP.

Table 4.1 Scoreboard of the macroeconomic imbalances procedure (MIP)

Indicator	Threshold(s) (%)
Current account in % of GDP	-4 and +6
International investment position/GDP	-35
Export share percentage change	-6
Unit labor cost percentage change	+9
Real exchange rate percentage change	+5 and -5
Private sector debt in % of GDP	+160
Credit flow to private sector in % of GDP	+15
Housing prices percentage changes	+6
Public debt in % of GDP	+60
Unemployment rate	+10

4.5.2 A Proposal for Coordinated Income Policies

From 2011 onwards, when the MIP has been in force, Germany's current account surplus has often been higher than the threshold of 6% of national GDP. In 2015 the ratio between current account and GDP was equal about 9%. Yet the Union has never opened the MIP against Germany, despite its persistent current account surplus being a big problem for the Union as a whole. Why? To answer this it is useful to show that a surplus of the balance of payments current account is offset by an excessive volume of domestic savings.

We can write:

$$Y = C + I + X - M \quad (4.4)$$

where $Y = GDP$, $C =$ consumption, $I =$ investment, $X =$ exports, $M =$ imports

And it is always true:

$$Y = C + S \quad (4.5)$$

where $S =$ domestic savings

Substituting (4.5) in (4.4) we have:

$$X - M = S - I \quad (4.6)$$

If $X > M$, that is, if the country has a surplus on current account of $(X - M)$, it is about to export domestic savings abroad. This is precisely

what happens in a country like Germany. And this provides a big problem for the sustainability of the Union. The excess of S with respect to I means that S has not translated into a higher internal demand and higher imports from other member states. Instead S has been translated into a current account surplus and in an equivalent increase of official reserves.

On the contrary, Germany's optimal behavior for the stability of the single currency and of the Union would have been to "spend" its current account surplus. How should Germany and other surplus countries spend their surplus in an optimal way for the Union as a whole?

Here is my proposal. By 2016, the EMU was in trouble, not only from a political point of view, but also from an economic one. We can say that the European countries were facing widespread stagnation. The term secular stagnation has been applied.

In this context we can imagine that member states could carry out a wage-led recovery. It would be the basis of a traditional or Keynesian income policy. In this case, governments should put aside their redistributive fiscal policy and intervene directly in the remuneration of labor, W .

We assume that private employers and workers' unions agree de facto about the higher level of wages, as suggested by governments. We also assume that in the short term entrepreneurs will accept a reduction of their profits, but in the medium term they will recover thanks to higher sales. To show this wage-led mechanism, we used the model formed by Eqs. (4.1–4.4) above integrated with Eq. (4.5) concerning expected profits:

$$YD_M = (W + \Delta W) + TR_W - T_W \quad (4.7)$$

$$YD_R = (Q - W - \Delta W) + iB + TR_R - T_R \quad (4.8)$$

$$C = a_0 + a_1 YD_M + a_2 YD_R \quad (4.9)$$

$$Y = C + I + X - M \quad (4.4)$$

$$EQ_{t+1} = b_0 + b_1 EY_{t+1} \quad (4.10)$$

Let's suppose that in year t , the representative EMU state convinces firms to increase wages and at the same time to give up an equivalent amount of their profits. In this case we will have a reduction of inequalities, and an increase of consumption and GDP as well as an increase of expected profits, EQ_{t+1} where E is the expectation operator.

In this way inequality is reduced and income is augmented. Economic growth is inclusive, as inequalities go down. This scheme is, however, more complicated when governments try to apply it. Not all member states are in a condition to spur domestic demand at expense of national firms.

The choice of member states to carry out the income policy, or wage-led recovery, should be made within the Macroeconomic Imbalances Procedure or MIP. Here it is up to the countries with a current account surplus higher than 6% (Austria, Finland, Germany, Netherlands and so on) to adopt the incomes policy. The increases of national wages would translate into higher levels of internal demand and greater imports from other member states. The mechanism could be conceived as the best way to spend the current account surplus.

To sum up: This proposal suggests a European coordinated income policy. The policy would be considered part of the MIP. This latter procedure should be integrated with an *automatic* wage increase in the member states that have a surplus on balance of payments current account. In these countries governments should adopt a *wage-led expansionary policy* in order to spend their surpluses. Thus member states with current account deficits could exploit the increase of internal demand in surplus countries. Further, they also would experience rising wages.

The benefits of the proposals are essentially two. They allow: (1) the reduction of inequality within the union, and (2) the widespread and *inclusive* growth of all member states. This would in turn make the Union more stable and sustainable.

4.6 Some Concluding Remarks

Inequality is a very complex phenomenon which can be divided into inequality of *opportunity* of access to education and jobs, and inequality of *outcomes*, such as income and wealth. Inequality is the result of internal causes or external ones. Among the internal causes we find “flexibilization” of labor markets, “wage devaluation” engaged in by firms in order to win foreign competition, reduced trade union power along with “predatory behavior” by managers whose gains are not correlated with the economic cycle. Public policies —fiscal and monetary—are other internal causes. In particular, we have hinted at some policies adopted to fight inequality that result in its increase (trickle down approach and Okun 1975). In this book we have neglected the internal causes to talk about the external ones. That is: free trade, financial liberalization, skill-biased technological changes—in one word, globalization. The internal causes are, to a large extent, imposed by globalization. All the consequences discussed in this book make inequality (or globalization) a compelling incentive for the middle class to seek adequate political representation through which to hamper the integration process.

Notes

1. Or, respectively, inequality within and inequality among.
2. For instance: the income quintile share ratio (also called the S80/S20) S80/S20 is calculated as the ratio of total income received by the 20% of the population with the highest income (the top quintile) to that received by the 80 % of the population with the lowest income (the bottom quintile).
3. Instead according to Tomas Piketty’s idea about inequality within, it has a U-shaped curve.
4. The QE’s impact is evident from Eq. (4.2) as the stocks B increase, but the consequence for disposal income will depend on the interest rate change.
5. Anthony B. Atkinson, *Inequality: What Can Be Done?* Harvard University Press, Cambridge, MA.
6. Cfr. Verde, A. (2012).

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Part III

The Globalization Slow-Down: The Political Aspects

5

Islamist Terrorism

Abstract As we have seen, the middle and lower-middle classes fear immigration. According to the most recent inquiries of the Eurobarometer about the half of the interviewees puts immigration as their mater worry and next we find terrorism. When we talk about terrorism, we mean Islamic Terrorism and then the Islamic State (IS). For a long time, under the US Obama Administration, the US refused to be directly engaged with troops on the ground, leaving the task of fighting the IS to the reconstituted Iraqi Army and the kurds troops, favouring the IS constitution. The US attitude was linked to the prevailing at geopolitical level of a multipolar world in which it is difficult for a super power to intervene militarily without triggering a world conflict. Differently from what happened under the period of the Cold War [1946–1990] and of the so called Pax Americana [1991–2005] that is respectively a “bipolar World” and an “unipolar World”. Even if defeated, the IS has been successful in transferring terrorism and threats from its region to the whole of Europe. Terrorism does not finish with fall of the IS but, like immigration and inequality, it is doomed to last years.

Keywords Terrorism · Geopolitical Phases · Islamic Terrorism and Multipolar World

5.1 Introduction

Let me start with a definition of terrorism. It seems that studies have found more than 200 definitions. According to the FBI, there is no universally agreed definition of terrorism. A “most universally accepted” definition is “the use of violence to create fear (that is, terror, psychic fear) for (1) political, (2) religious, or (3) ideological reasons.”¹ Moreover, we have old and new terrorism, and classical, modern and postmodern terrorism.

Very interesting is Samuel Huntington’s (1993) notion of a “clash of civilizations” according to which cultural and religious differences between civilizations worldwide have become the primary source of terrorism today. The clash of civilizations is akin to the “war of ideas,” in which ideals and ideologies of the West come into conflict with others of the Muslim world, large sections of which continue to oppose Western political forms such as democracy.

From the early years of the twenty-first century, Islamist terrorism has been favored by a multipolar world which, as such, does not hamper its rise. Indeed, it would not have surfaced during the previous Cold War (1945–1991) and Pax Americana (1992–2005) periods.

*Geopolitics*² is crucial to understanding how and why Islamist terrorism started and how it evolved. In the advanced world, it is very important to know what leads nations and international institutions towards a globalized multipolar world. This requires a discussion about the world’s geopolitical equilibria from 1944 up to the present day.

Geopolitical phases since 1944 have been strictly linked, interdependently and to a significant degree, to the phases of globalization discussed in Chap. 1. This linkage means we can in fact talk about the geopolitics both of and during globalization.

It goes without saying that in this chapter on terrorism, the geopolitical context assumes an obvious introductory role, in which the political equilibria change between and among the superpowers, on one hand, and the rest of the states on the other, about the importance of these

will emerge a growing emphasis as we approach the years when terrorism erupted.

The chapter is organized as follows. As just stated, the geopolitical aspects occupy the next section, which is then followed by discussion of the link between Islam and violence, and the rise and the fall of the Islamic State (IS). The final section is devoted to the tie between terrorism and anti-globalization sentiment in the advanced world. Two boxes respectively concerning differences between Sunnis and Shi'ites as well as al-Qaeda and IS complete this chapter.

5.2 The Geopolitical Context

This section discusses the geopolitical phases since 1944, a long period covering all the three phases of globalization.

Geopolitics defines all the relations that are more or less formalized in agreements or conflicts among states, and between states and international institutions.

As regards geopolitics from 1944 onwards, we can identify three periods or phases:

1. 1944–1991: The Cold War period or bipolar world.
2. 1992–2004: The so-called Pax Americana or unipolar world.
3. 2005–2017: A multipolar world.

Like every classifying scheme, this one contains a certain arbitrariness. The problem lies with the last two phases. Clearly, classification depends strictly on cognitive purpose. Thus, given that the main topic of this chapter is terrorism, the relative period goes from 2004–2005, the years of the jihadist suicide attacks, up to 2017 when the Islamic State has known a deep crisis on the ground, in Iraq and in Syria.³

There are at least two reasons for introducing geopolitics in this chapter:

1. Because the evolution and the rise of IS can successfully be addressed in geopolitical terms: IS surfaces in a multipolar context, the last phase of those just listed, in which, as we will see, the USA is unwilling to engage

directly in military conflict in Iraq and Syria. This is quite a different attitude from the previous two phases (Cold War and Pax Americana); the multipolar world is thus a decisive factor for the rise of IS.

2. Because, when globalization is considered, geopolitics allows us to understand better that the different phases and their characteristics—concerning the freedom of trade and of capital movements, exchange rate systems, the creation process of international liquidity and so on—*also change depending on the geopolitical phase*. Usually this strict correlation between globalization and geopolitics is unduly neglected by economists.

5.2.1 The Cold War or the Bipolar World Period (1944–1991)

The first crucial and well-known period starts with the Yalta Conference held in Crimea from 4 to 11 February 1945.⁴ Franklin Delano Roosevelt, Winston Churchill and Josef Stalin, the victors in the World War 2, met to discuss the future of the world.

This conference ruled that Europe would be divided into two zones of influence. The first, or Western Zone, would be under the influence of the United States. It included Western Europe and the larger part of Germany. The second, or Eastern Zone, included Eastern Europe up to the Italian border in Trieste,⁵ and it would be under the influence of the Soviet Union.

The Yalta Conference marked the starting point of the Cold War. It lasted until 1991. Both the USA and the USSR were armed with atomic weapons. This necessarily imposed peace between the two zones or blocs through an equilibrium based on nuclear terror. Wars were limited, involving few nations and never taking place directly between the two superpowers. These wars were proxy wars.⁶ The world experienced political crises that were able to break the political and military equilibrium, but also went through a lasting period of prosperity.

The Western bloc fully exploited the Bretton Woods agreements signed by 42 countries in July 1944, but which only came into force in 1958. The Bretton Woods world [1958–1971] was a world of fixed exchange rates without important financial and balance of payments crises.⁷ When Bretton Woods collapsed, a “No International Monetary System” mechanism of creating international liquidity surfaced in which

there was no explicit agreement among states concerning the exchange rate system. Exchange rates began to float, and financial private markets charged themselves with providing the world with its required liquidity.⁸ Thus the Cold War, characterized by a bipolar world, ensured a period of peace along with an important rise in globalization.⁹

5.2.2 The Pax Americana or the Unipolar World Period (1992–2004)

The fall of the Berlin Wall in 1989 and even more importantly the disintegration of the Soviet empire in 1991 opened the second geopolitical phase. At this time, the USA became the world's *dominus*, a sort of planetary gendarme from a geopolitical point of view.

Peace was preserved by the USA, with military interventions to bring an end to conflicts among countries. The Pax Americana was imposed all over the world.

Immediately after the fall of the Berlin Wall, “the Americans liquidated the cold war, imposing their world reconstruction plan” (Onfray 2016, p. 112).

After the al-Qaeda attack on the New York twin towers on 9 September 2001 the USA-led coalition invaded Iraq in 2003. Before the world, they declared the invasion's objectives and, more generally, their foreign policy objectives. These were essentially two: to neutralize potential further military attack by “evil” states, and to export democracy to those countries where it was lacking.

As concerns the evolution of globalization, we have seen in Chap. 1 that following the disintegration of the Soviet bloc, the third and current phase, of *hyper-globalization*, began. At this point the field of action became truly global.

5.2.3 Islamist Terrorism and the Multipolar World (2005–2017)

Suicide attacks by Islamic jihadists in 2004–2005 opened the third and most recent phase of our geopolitical context. The world is now *multipolar*: Even if the USA preserves its superiority in the military and

strategic fields with respect to all the other countries, it has given up its previous role of planetary gendarme. On a political and military level, the USA is side by side in first place with Russia and China.

As concerns the economic field, new important groups have emerged, such as the BRIC countries (Brazil, Russia, India, China) and the MINT countries (Mexico, Indonesia, Nigeria, Turkey).

The Pax Americana scheme of the previous period was changed after the jihadist¹⁰ attacks and the creation of IS. Against the Caliphate the USA decided to pull back, limiting itself to guide a military coalition with UK, France and Italy and *to not intervene directly* (that is, with soldiers on the ground), as it might have done in the past.

Russia, on the contrary, was anxious to recovery an international role for itself. It intervened with raids against IS and, for geopolitical reasons, in favor of Syrian President Bashar al-Assad, the son of Hafez Assad who died in 2000.

According to Barak Obama's words, the solution to the danger posed by IS was "to ramp up support for those in the Syrian opposition who offer the best alternative to terrorists."¹¹ The US pullout from Syria was a confirmation of one of the consequences of a multipolar world: the creation of the Islamic State.

The US unwillingness to use ground forces in Iraq and Syria was due to wishing to avoid making the same mistake as in the Iraq War that was embarked upon by the Bush administration in 2003. Or, to put it simply, the USA would likely lose another war in the Middle East for all the same reasons that it had lost in Iraq and in Libya¹² (Simon and Stevenson 2015). Moreover, they aimed at putting greater weight behind the opposition to IS from the more directly involved *local* countries.

Political and economic reasons lay behind the decision of the USA to pull back from the conflict:

- Political reason: the projector ground war would [have] require[d] political will backed by the support of the (and so on) American public; a large cadre of deployable civilian experts in reconstruction and stabilization; deep knowledge of the society for whose fate a victorious United States would take responsibility; and, most problematic, a

sustained military force to provide security for populations and infrastructure. (Simon and Stevenson 2015, p. 5)

- Economic reason: Still more, the pulling back could be a necessity, simply because an expensive US policy in Middle East could be too costly—just in a time of cuts to the US military budget.

All in all, these were the same problems faced by the USA on the occasion of the invasion of Iraq in 2003.

An alternative explanation of the US disengagement in the Middle East and the end of Pax Americana could be that the Americans did not seem to have adequate strength to impose their will, even if they remained the most powerful country all over the world.¹³ In a way they were powerful but powerless.

5.3 Islam and Violence

The link between Islam and violence seems undeniable to some, but it is not very simple to explain the reason for it. On these two points let me discuss briefly the opinions of Dominique Moisi and Michel Onfray. A couple of my brief objections to both contributions close this important section.

5.3.1 Islam and Violence: The Identity Problem

The starting point of Moisi's work *The Geopolitics of Emotion* (2010) is that emotions are important, because they are linked to the identity problem of nations or ethnic groups. Key emotions considered by Moisi are fear, hope and humiliation. Moisi's reasoning is as follows.

First, the current multipolar world is out of balance as concerns power and influence, as well as political and social outlook. In particular, Europe and America are similar in their approaches to affairs and in their belief in universal values, specifically democracy. But recently the West has lost its faith in models of democracy.¹⁴ At the same time, its economic supremacy has been fading. It has reacted to global changes with bitterness and a desire to protect its open world against hostile

forces, especially Islamist ones. On the other hand, Moisi suggests that the Arab world comes not only from a very different cultural and religious domain but seemingly from another era, one with premodern historical and political references (Moisi 2010, pp. 10, 14) (see Table 5.1).

Second, in such a situation, *emotions* return to the forefront of the international scene. But at the roots of the emotions surfacing we find, above all, *globalization*, which is the cause of *insecurity*—and, in turn, *insecurity raises the problem of identity*. In the twentieth century *ideology* was the pillar of conflicting models: socialism, fascism, capitalism. In today's world¹⁵ what's crucial is the struggle for *identity*. “I am unique, I am different, and if necessary I am willing to fight until you recognize my existence. But *identity* is strictly linked to *confidence*, and in turn *confidence* or the lack thereof is expressed primarily in emotions: *fear, hope and humiliation*.”¹⁶

Third, *at the basis of Islamist violence there is the search for a particular identity for Arab-Muslim states*. More exactly, the link between Islamist movements and violence stems from a sensation of deep humiliation.¹⁷ Moisi argues that “The Islamic world seems painfully aware of the growing contrast between the success of the Western and Asian world at surfing the waves of globalization and its own failure to do so” (Moisi 2010, p. 76).

Fourth, one cannot speak of Islam as a single entity. It has exploded into multiple incarnations with different religious, political and cultural variations: Sunnis and Shi'ites, Arabs versus non-Arabs and so on.

Table 5.1 Muslim presence in selected countries of EU and % of total population

	Muslim	%
Germany	4.760.000	5.8
France	4.710.000	7.5
UK	2.960.000	4.8
Italy	2.220.000	3.7
Spain	980.000	2.1
Netherlands	1.000.000	6.0
Denmark	230.000	4.1
Bulgaria	1.020.000	13.7
Cyprus	280.000	25.9
EU	20.610.000	6.0

Very important is the difference between moderates as opposed to radicals. Among radicals we find the jihadist groups who hate all humankind that does not adhere to their brand of Islam—Jews in particular, but also Christians and even other minority groups within Islam. The division between moderates and radicals is particularly relevant as it is absolutely necessary to establish constructive relations with “moderate Islam” as well as to fight against military aggression and frustrate suicide attacks. The West, first and foremost, needs such relations to reduce the risk of a new global war.

Finally, Moisi observes that the Islamist terrorists who attack the West are not recruited among the poorest. On the contrary, their level of economic wellbeing and education is higher than the average.¹⁸ This means that the humiliation culture may have affected multiple levels of Islamic societies, from the poorest to the most affluent and Westernized. We will come back to this point later.

5.3.2 Islam and Violence: The Debate About the Responsibility for Violence

The link between political Islam and Islamist movements and violence is clearly undeniable. But who is responsible for it? According to Michel Onfray (2016), identifying the prime movers is a more complex task.

It can be interesting to list in brief the essential points of Onfray’s analysis, because discussion about them could help us to better understand the topic we are dealing with.

1. We can begin with the last point of the previous section concerning the recruitment of terrorists. We have just observed that they are not the poorest and least educated. On the contrary, they are above average in income and education. In his book, Michel Onfray disputes a widespread and largely accepted opinion according to which IS fighters are people with psychic or judicial problems (that is, that they are either “mad” or “bad”). The reasoning from this view leads to the specific conclusion that Islam has nothing to do with suicide attacks: they are actions of the mentally deranged or criminals. Therefore, it is

not correct to lump things together without judgment. This conclusion is rejected by Onfray. The IS jihadists are neither mad nor bad, but regular soldiers, part of an army of a true state: the Islamic State. In fact, the IS is capable of levying taxes, of making investments, and using public resources. The suicide attacks are indeed war actions.

2. Like Moisi, Onfray states that Islam is not a single entity: we have to deal with at least two Muslim worlds, the radical and the moderate. In the former, Islamist leaders hate all and everything. In order to kill enemies a jihadist is keen to immolate himself. Suicide and all kinds of attacks come from this *radical* Islam. At this point, the question is, who attacked first? According to Onfray, Islamists have not attacked first; their attacks are simply answers to the attacks by Western countries. If this is true, another question is:
3. Why do Western Countries stress that Islamist attacks are the fruit of mad minds or cruel people, denying they are war actions? According to Onfray, Western countries talk about targeted killings launched by mad or bad terrorists in order to deny that they opened fire first and have killed about 4 million people.

5.3.3 Islam and Violence: Brief Comments on Moisi and Onfray

The contributions by Moisi and Onfray are challenging. Both however encounter intuitive objections, as follows. Moisi maintains that the undeniable link between political Islam and violence lies in the search for identity. It is a convincing thesis. Indeed there is an absolute lack of historic works about the past history of the Arab-Muslim world. The usual works of reference are still those of very ancient scholars such as Tabari (839–923 AD) and Ibn Kathir (born c.1301 AD) (Adonis 2014). The problem of Arab-Muslim identity remains dramatically unexamined and unresolved.

However, if the base problem is the lack of research on identity, what about the religious causes of Islamist violence? Moisi seems forget them.

We know that in the Koran—the holy book of Muslims—we find clear incitements to kill infidels. And these incitements remain always in

force, since nobody can modify—by deleting or inserting—anything in the holy book.

Also for this reason, there exists no Arabic culture. We can say that Muslims look at the world with an Islamic vision that is closed and outdated. And the persistence of this perception, in a changing world, could give rise to violence (Adonis 2014). These aspects are lacking in Moisi's analysis.

The analysis by Onfray is weaker, for a couple of reasons. Onfray is anxious to establish who, between Muslims and infidels—Western countries—attacked first, arguing that Muslims' martial activities are the unavoidable answer to the West's. But this is neither always correct nor the biggest problem.

Onfray's argument is not always correct simply because often the targets of al-Qaeda, or IS or Al-Nusra are non-Western countries: Egypt, Bangladesh, Libya etc.

His argument is not however the biggest problem, because, even if the idea of the attack as a *response* to the USA and other Western countries were valid, he cannot ignore the fact that Islam has deliberately and stubbornly initiated annihilation policies against the West, *independently of any prior attack*. Indeed the targets preferred by the Muslims have been democracy and everyday life. And if this is the case then Western military policy has a valid justification.

However, it goes without saying that the Bush administration's invasion of Iraq in 2003 for economic and geopolitical reasons has been a great mistake (see Table 5.1).

5.4 The Rise and Fall of Islamic State (IS)

5.4.1 From Suicide Attacks to the Terrorist IS State to the Inspired Fighters

A big problem we meet in talking about the evolution of the Islamic State from birth of ISIS—13 April 2013—the change of the name in IS and the capture of Mosul—10 June 2014—up to the Autumn of 2017 after the fall of Raqqa and of the IS.

IS a new structure, assembled in a few weeks and quickly taking on the features and functions of a real state. In a short time, this structure was able to control sizable areas of Iraq and Syria, to levy taxes, to sell oil on international markets, to build schools and so on. Through its life, Islamic State, assuming different names, surprised the whole world with its seizure of power and the conquest of cities like Mosul, Falluja and Raqqa, its capital.

The life of IS is characterized by a singular paradox. At the start—in 2013—its program, to be realized with about 5000 irregular fighters, appeared absolutely fanciful. (A report by CNN stating this view has now become famous.) This widespread impression rapidly changed because of the conquest in June 2014 of Mosul, Raqqa and other cities as well as the beheading of captives that was well publicized all over the world. The IS army increased in numbers thanks to the arrival of many foreign fighters who in a short time supposedly swelled its ranks to 30,000 or even 50,000; this time, the numbers were exaggerated but were made plausible by the defenders of the cities giving up the fight even before the attacks by IS thanks to the latter's formidable reputation.

In the second half of 2017, however, IS appears to be in trouble. In Iraq and Syria, Mosul and Raqqa have been reconquered. In Libya, troops of the US-backed Government of National Accord drove out the IS soldiers from Sirte. Having lost the control of Iraq and Syria, what remains of the IS now has fewer battle-training fields and the number of volunteers has accordingly decreased.

While having been undervalued at the beginning the strength of IS was exaggerated in the period of maximum notoriety and savagery, we now run the risk of again undervaluing its kind of terrorism. Indeed the end of IS does not mean the end of the Islamist terrorism. To cope with several military defeats, IS is trying to offset them by opening another military front: multiplying suicide attacks in the West. We thus have to deal with criminal attacks launched in countries outside the Caliphate on soft or easy targets, not by foreign jihadists but by young people inspired by IS (so-called "lone wolves") who do not leave the country where they live and have a nationality. They are not trained but they know how to kill.

We can synthesize the history of IS through the events concerning its protagonists: Abu Musab al-Zarqawi and Abu Bakr al-Baghdadi.

5.4.2 Musab al-Zarqawi

The starting year of our story is 2003 when the USA of George Bush invaded Iraq. In that year, Baghdadi—the future head of the Caliphate and self-proclaimed Caliph—met al Zarqawi, true name Ahmad Fadil al-Khalayleh, who had just created a small terrorist group, Tawhid al-Jihad.

Al-Zarqawi was born in 1967 in Jordan. He spent five years in jail. In this period he converted himself to Salamis.¹⁹ Al-Zarqawi met Osama bin Laden for the first time in 2000 in Kandahar and rejected his invitation to take part in al-Qaeda. He believed that Islamist terrorism was incapable of seriously opposing the USA, but that a real Islamic state would be. The starting core of a real Islamic state should be the Kingdom of Jordan, once it was conquered for the Islamic cause.

Al Zarqawi was a strong supporter of suicide attacks as a crucial instrument of the military tactics of armed Islamic groups. This instrument was to be used against external enemies, such as the Anglo-American coalition, as well as internal ones, such as Shi'a members.

In August 2003 a car bomb exploded at the headquarters of the United Nations in Baghdad, killing the head of the delegation and some of his aides. Some days later a car with explosives killed Bagar al-Hakim, the head of the Iraqi Shi'ites. The driver was Yassim Jarad, the father of al-Zarqawi's second wife.

From August 2003 to the second half of 2004, al-Zarqawi was the head of Tawhid al-Jihad. However during this period Osama bin Laden appointed him leader of al-Qaeda in Iraq (AQI).

Al-Qaeda in Iraq engaged the USA, while the suicide attacks against Shi'ites continued to push the country toward a sectarian civil war. In 2006 al-Zarqawi was killed by a US raid. This event had negative consequences for AQI and a fierce struggle began for its control.

In this period the so-called *Sunni Awakening* developed, thanks to elder Sunni Muslims leaving the jihadist groups. This decision along with the USA military recovery pushed those groups into a serious crisis.

Box 5.1 Sunni and Shi'a

Islam is not a single entity. Sunni and Shi'a are two Muslim groups which represent the largest and the oldest schism in the history of Islam.

This divide has assumed great relevance in the contrast between the al-Qaeda leaders Osama bin Laden, first, and al-Zawahiri, after, and the IS leaders al-Zarqawi, first, and al-Baghdadi, after. According to the al-Qaeda leaders, Shi'ites should have not been the targets of killings, while in total contrast the IS main objective was a sectarian war between the two groups.

Religion

The division between Shi'a and Sunni Muslims dates back to 632 AD when the Prophet Muhammad died. On that occasion, the problem was who could take over the leadership of the Muslim nation.

The majority of the Prophet's followers believed that the new leader should be elected from those capable of the job. Thus Abu Bakr, Muhammad's friend and adviser and father of his wife Aisha, was chosen, becoming the first Caliph of the Islamic Nation. Sunni Muslims believed that there should be no possibility of Islamic spiritual leaders enjoying any hereditary privilege and no basis for the veneration or intercession of saints.

The word "sunni" stands for "the man who follows the traditions of the Prophet."

On the other hand, Shi'a Muslims believe that leadership should be chosen from people belonging to the Prophet's own family, from among those appointed imams to this end by him, or from among imams appointed by God himself. In other words they believe that following the Prophet's death leadership should have passed directly to Ali, his cousin and son-in-law. These Muslims became known as "Shia't Ali" or the "Party of Ali." Shi'a is simply a contraction of Shia't Ali.

Religious Leadership

In Sunni Islam, the Caliph is the leader of all the Muslim community or *ummah* and is the *political* leader, while the Imam is simply a *religious* figure who guides prayers in the mosque.

In Shi'a Islam instead, the Imam is the *political and religious* head of the *ummah*.

Distribution

Sunni Muslims represent the majority—about 85–90%—of Muslims all over the world.

Shi'a Muslims are the majority in Iran and Iraq and large minority communities of Shi'ites are in Yemen, Bahrain, Syria and Lebanon. Sunni Muslims are the majority in Saudi Arabia and in the Gulf States.

Holy Book and Religious Pillars

Despite the crucial differences between Sunni and Shi'a Muslims, both of them share the five pillars of Islamic belief, as follows:

1. *Shahadatein*: God is one and Muhammad is his Prophet.
2. *Salah*: Each Muslim must say five prayers every day.
3. *Zakah*: Each Muslim must give the poor 2.5% of his annual gains.
4. *Siam*: Each Muslim must fast during the Ramadan month.
5. *Hajj*: Each Muslim must perform pilgrimages to Mecca at least once in his life.

Both Sunni and Shi'a Muslims share the same holy book, the Qur'an. But Sunni Muslims deem that the holy book is contemporary to God and directly dictated by him to the Prophet. For Shi'ites, instead, the Qur'an has been created.

5.4.3 Abu Bakr al-Baghdadi

Abu Bakr al-Baghdadi, true name Ibrahim Awad al-Badri, is the head of Islamic State, or the "Caliph." In 2003, al-Baghdadi belonged to the al-Zarqawi group—Tawhind al Jiahd—with the task of recruiting foreign fighters. In 2004 he became the emir of Rawa, an Iraqi city close to the Syrian border. There, he became notorious for brutality and savagery. In 2010, four years after al-Zarqawi's death, al-Baghdadi became the leader of what remained of AQI. Under his leadership things began to change radically. For instance, AQI assumed the name of Islamic State in Iraq, or ISI. Even if the ISI continued to attack the US targets in Iraq, the new group moved away from the original al-Qaeda in Iraq, AQI, led by Ayman al Zawahiri.

Indeed, the group created by Osama bin Laden, AQI, was becoming popular with the Iraqi Sunnis who followed the Awakening, and for this reason al-Baghdadi deliberately changed his strategy. He knew that the Sunni population was hostile to the Shi'ite government led by al-Malinki, who was more against Sunni people than al-Qaeda.

Thus, al-Baghdadi aimed at a sectarian conflict between Sunnis and Shi'ites, a conflict which bin Laden opposed. In 2013 al-Baghdadi definitively disassociated himself from Al-Qaeda.

However the ISI was too small for its targets, so al-Baghdadi turned his attention to the Syrian civil war, as an opportunity to strengthen his leadership and to increase the number of fighters in his organization.

In 2011, Baghdadi sent into Syria a small group of jihadists as the ISI vanguard; ISI changed its name to ISIS—Islamic State in Iraq and Levant (or al-Sham).

In June 2014, ISIS took Mosul, the capital of northern Iraq, and also Fallujah, just 20 km from Baghdad.

In 2014, an Islamic caliphate was declared, with Raqqa in Syria its capital. The name changed again, from ISIS to IS. The new state took profit from the indistinct political nature of the region—formed with part of both Iraq and Syria—which had its roots in the 1916 dissolution of the Ottoman Empire and the subsequent imposition, in 1924, of absurd and crumbling borders by the Turkish president Atatürk.

The ISIS could count on 30,000–50,000 fighters.

On the ground, the IS was fought by:

- Peshmerga in Iraq.
- Kurds of PYD, the Syrian-armed wing of the Turkish-Kurd PKK.
- Iranian troops (which fought IS but not openly).

Table 5.2 From al-Zarqawi to al-Baghdadi and beyond

2003	Invasion of IRAQ by USA-led coalition
2003–2004	Al-Zarqawi founds Tawhid al-Jihad, a terrorist group
2004	Tawhid al-Jihad merges with al-Qaeda to become AQI (al-Qaeda in Iraq)
2006	Al-Zarqawi is killed by a US air raid
2010	Al-Baghdadi is the head of what remains of AQI
2011	Al-Baghdadi gives his organization the name of Islamic State in Iraq or ISI and sends a group of jihadists to Syria
2013	Al-Baghdadi dissociates himself from the AQI of Ayman al-Zawahiri
2014	ISI changes its name to ISIS (Islamic State of Iraq and al-Sham)
9/6 2014	ISIS becomes IS (Islamic State)
10/6 2014	ISIS conquers Mosul (the capital of northern Iraq) and Falluja (at a distance of 20 km from Baghdad). Raqqa in Syria is the ISIS capital
June and July 2016	IS is in trouble. It has lost Falluja but not Syrte (Libya). “Inspired” (by IS) attacks launched by terrorists in the countries where they live (e.g. Orlando, Paris, Dacca, Nice, Berlin)
Summer-Autumn 2017	Falluja, Mosul, Raqqa are conquered by Iraqi Army and by Peshmerga in Syria (Raqqa). The IS is defeated

In June 2016, trouble increasingly hit the IS army and its cities in Iraq and Syria. It lost a sizable part of its Iraqi territory. It lost territories in the Tigris and the Euphrates valleys and in Syria as well. October 2017: fall of Raqqa and the IS defeat.

Table 5.2 summarizes.

Box 5.2 IS and Al-Qaeda

Al-Qaeda was born on the occasion of the invasion of Afghanistan by Russia in 1979.

As we have seen, at its start, ISIS was founded by al-Baghdadi in 2013 with a group of jihadist heirs who disassociated themselves from al-Qaeda in Iraq (AQI) led by Ayman al-Zawahiri.

It would be a long time until IS had displaced al-Qaeda as the main threat for the West. Al-Qaeda remains active, with its affiliates, in North Africa and Yemen.

Structure

Al-Qaeda is an organization of terrorist groups, each of a dozen to a hundred people. In its attack al-Qaeda is worried about saving Muslim population. Even if the Sunni people is sacred. Bin Laden does not want a sectarian war (Warrick J. 2016).

Instead, IS counts on an army of about 30,000–50,000 affiliates; it controls territories in Iraq and in Syria; it has a sizable military capability; it controls communication lines and infrastructures. It finances itself and engages in sophisticated military actions. According to Kurth Cronin (2016) IS is not a terrorist group, but something quite different. It is a state with its own institutions and a conventional army (Audrey Kurth Cronin—*ISIS is not a terrorist group—Foreign Affairs*, March/April 2).

Unlike the leaders of al-Qaeda, who eschewed territorial conquest, al-Baghdadi thought that without a large and strong territorial base its fight was doomed to fail.

The Choice of Target

Even if both al-Qaeda and ISIS have common principles, they behave differently in the choice of their targets. In its attacks al-Qaeda is worried about saving the Sunni Muslim population. The blood of Sunni people is sacred.

ISIS fighters attack all people and do not care about the side effects. Shi'a people and their sanctuaries are both killing targets.

Communication

Al-Qaeda has a centralized strategy of communication. It uses video announcements and even filmed spots.

The IS communication strategy is based on video productions, glossy magazines, video registrations made by terrorist cells; the use of social networks is very important too.

Notes

1. Ideologies are systems of belief derived from worldviews that frame human social and political conditions. FBicit p. 4.
2. Thomas Friedman (2005) maintains that globalization has made the world “flat.” In his book *The Lexus and the Olive Tree*, Friedman defines globalization as the international system that replaced the cold war, in this way completely conflating globalization with geopolitics, globalization phases with geopolitical ones.
3. Madrid, 2004, and London, 7 July 2005.
4. To be more precise the Conference was in Lavadija, 3 km from Yalta.
5. Trieste was divided into a Zone A and Zone B. Zone A was under the Western military allied government. Zone B was under the Yugoslavian government. Trieste became Italian in 1954.
6. The war between the USA and North Korea was an exception.
7. As we have seen in Chap. 1, the Bretton Woods agreements envisaged that currencies under speculative attacks would have three lines of defence: conditional loans from the International Monetary Fund (IMF), the adoption of controls on capital movements, and the revision of official parity. Instead, in the 1980s the IMF suggested the abolition of controls on capital movements. This position was shared by the World Bank and the US Treasury Department. This policy prescription was incorporated in the so-called Washington Consensus. The Washington Consensus represented the point of maximum success of new-liberalism revision after the period of Bretton Woods System (1944–1971), i.e. a period in which policy was substantially Keynesian. Controls on the International financial flows were a typical Keynesian device. During the Washington Consensus globalization was strengthened by the freedom of capital movements.
8. See Verde (1999, 2008).
9. It is the second phase of globalization (Cfr. Chap. 1)
10. *Jihad* in an Arabic word meaning “struggle,” while *sharia* means Islamic law.
11. Cfr. Cockburn, P. (2015, p. 3)
12. We refer, of course, to the invasion of Iraq in 2003 and the NATO air campaign against Libya in 2011.
13. See Jean, C. (2013) in Verde A. La globalizzazione ripensata cap.6 pag.

14. As democracy has been dangerously devalued through the inflationary use of the word by the Bush administration in its attempt to justify the USA's geopolitical ambition.
15. The identity question was not important during the cold war, because in order to answer to "Who are we?" it was sufficient take a look to a map.
16. Fear is the absence of confidence. If your life is dominated by fear, you are apprehensive about the present and expect the future to become ever more dangerous. Hope, by contrast, is an expression of confidence; it is based on the conviction that today is better than yesterday and the tomorrow will be better than today. And humiliation is the injured confidence of those who have lost hope in the future; your lack of hope is the fault of others who have treated you badly in the past. When the contrast between your idealized and glorious past and your present is too great, humiliation prevails (Moisi 2010, p. 5).
17. The dominance of humiliation in the Arab-Islamic world has many causes, but the first and most important is a sense of historical decline.
18. It is not easy to trace out the identikit of the foreign fighter or Islamic terrorist. The attacks launched by IS's jihadists on 6 July 2016 in Bangladesh showed they belonged to the middle and high classes.
19. Salafism is a branch of Islam.

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6

The Middle Class and Political Representation: The Risk of Globalization Slowing Down

Abstract Here we are at the epilogue of our story. In this final chapter, the middle class and the lower-middle class—the very losers of globalization—organize themselves politically. They are successful since they are the vocal majority of the society. As such, they are able to attract the protection of the right and extreme right parties but also the protection of the left parties. At this point another protagonist is placed side by side social classes and parties, crossing them: populism. The alliance between social classes and political parties gives rise to risks of globalization slowdown: this is the thesis of the book.

Keywords Political representation · Political conflict in Western Europe · Rise and fall of middle class · Populism

In this chapter we use “middle class” (or bourgeoisie) and “middle class and lower middle (or small bourgeoisie) classes” with the same meaning. At the end of this chapter we will consider “middle class” and “lower middle class” separately because they have different goals and voting.

6.1 Introduction

In this final chapter the middle class and the lower middle class—the very losers of globalization—organize themselves politically. These classes are tied strongly to the core idea behind this book, namely that they are the main losers in the process we call globalization. At the same time, they are *players* capable of interrupting the *globalization game* because within the advanced countries they are the majority and, naturally, they can be successful at organizing themselves politically.

Political parties and governments will become willing to ensure political representation of the interests of those classes. By political representation, I mean ways of looking after the interests of, in this case, the middle class and protecting them by means available within the political system.

It goes without saying that opposition parties will tap into the above-mentioned classes' anti-globalization sentiments, in order to gain their votes. Governments will respond by doing the same in order to be re-elected.

As the title of this final chapter clearly suggests, of particular interest is the link between the middle and lower classes on one hand, and the setup of political parties on the other.¹

The middle and lower middle classes represent the majority of the population and are a “precious target, for a mixture of rent-seeking and truly ideological motives, for political parties which seek office, either alone or as part of broader coalition” (Beramendi 2008).

Thus this chapter will discuss, first, the evolution of the middle and lower middle classes—starting from Marx's two classes (bourgeoisie and proletariat) and up to the present. After this, it will concentrate on the relationship between classes and the political system as well as political representation within (Western) European countries.

At this point three qualifications are needed. First, the analysis is limited to the countries of the European Union. The USA is omitted. This is necessary because of the differences between the USA and the EU in major economic, social, political and legal respects. In the USA, there are only two significant parties, while in most EU member states there

are many. The USA is a federal state, the EU is an economic union without a political one. One aspect of specific interest is that in the USA the individuals at the very top of the income distribution setup continue to enjoy the fruits of income growth (Piketty and Saez 2006), while European political economies produce a somewhat more egalitarian distribution of income (Kenworthy and Pontusson 2005). This is a crucial point when dealing with political representation in the two cases.

However, even if we are limited to the EU, we cannot ignore the great wave of political change which European parties have encountered ever since the 1980s. These changes have produced:

1. A new kind of radical populist ideas mobilized against immigration, integration and the euro. At first sight we can consider this new wave of politics as being a response to the globalization process (Grande 2012).
2. The surfacing of populist parties in almost all European countries; these parties share anti-globalization, anti-immigration and anti-euro sentiment both among themselves and to a large extent with extreme-right European parties.

Second, we are interested in the *movements* between classes and parties. This is not a book about political science and the history of parties, so discussion is limited to mentioning them rather than examining them in any detail, even if we agree with Kuznets (1955) that politics and institutions² are essential for understanding inequality, which is the other face of the evolution of social classes in terms of income. For the same reason, this chapter does not discuss the theoretical results of elections in given conditions, such as the median voter model³ and the approaches linked to it. Such complexity is unnecessary for this particular analysis, which is limited to the consistent movements of classes and parties.

This chapter is organized as follows. In the next section we examine the debate on economic and social classes as well as their link to economic systems. The analysis will be limited to focusing on how this link has made some systems more important and others less. Of particular interest is the recent experience of the middle class during globalization and what their role and relative importance today. This is a very

critical point in our story. The following section focuses on relationships between political parties and government on one hand, and economic classes on the other—in other words, why and how parties represent the economic, social and political interests of each class. The section before the final conclusion shows in particular the political representation of the middle and lower classes' interests, which parties represent them and in what way. It also examines the way that is consistent with a slowdown of globalization. On this basis, policy responses will be suggested which assume specific anti-globalization contents. Finally in this section a preliminary look is taken at the division between *middle* and *lower middle* classes which should explain better the policy mechanism leading to the slowdown of globalization; for while so far we have bracketed within a single category both the middle and the lower classes, with right and far-right parties representing their interests, this assumption turns out to be wrong, as we will see in the section that now follows.

6.2 The Debate on Social Classes

In this section, three phases of the evolution of social classes will be considered, starting from the ideas gaining detailed and succinct formulation with the publication of the first volume of Marx's *Capital* (1867).⁴ The emphasis is put on the middle class, since it is the one at the center of the analysis.

6.2.1 Karl Marx and the Two Classes

Karl Marx (1818–1883) occupies a crucial role in the study of new industrialized societies. He assumed two classes: the bourgeoisie and proletariat. This division is consistent with the conflict between capital and labor, and with a radicalization of the political character of social relations. The bourgeoisie are the owners of the means of production while the proletariat are the owners of nothing but their hands. According to Marx, capitalism was destined to crash because of an “overproduction” crisis. Indeed the system would have led to a great

concentration of wealth in a few hands, those of the capitalists, while the proletariat were destined to become poorer and poorer. So, the latter were unable to buy the goods produced by the system, which would provide the roots of a crisis of over-production. Thus, an increasing level of inequality would have been responsible for a shortfall in demand and the system would have crushed itself.

6.2.2 The Rise of the Middle Class (Nineteenth and Early Twentieth Centuries)

Marx was wrong about the revolution of the proletariat that he predicted as following logically from their impoverishment: his utopian idea did not materialize in advanced countries. In the last part of the nineteenth century and the first years of the twentieth, the systems of production and the labor markets struck out on a different course. Capitalism expanded rapidly. The proletariat found new kinds of employment, which arose from the changing needs of markets and from the greater use of capital and human resources required in production. Labor income began to increase, contradicting Marx's theory. The industrial sector of the economy assumed a crucial role and the need for more educated workers rose. Moreover, the main industrialized countries adopted universal public education programs and new investments were made in education. The industrial sector required highly educated people, such as scientists, engineers and lawyers. Furthermore, in particular in the industrial companies, workers were successful at organizing themselves: trade unions were legalized and in some countries were supported by socialist parties such as the Labour Party in Britain. The political power of the working class rose, and thanks to this power social legislation regulating working conditions became more common, along with welfare state policies including pensions and publicly provided healthcare. On the other hand, the conservative parties changed as well: instead of representing wealthy landowners they shifted their base of support to the new middle-class elite.

As we have seen in Chap. 1, when the phases of globalization were discussed, technological changes assumed a crucial role in it as a facilitator. This opened up a new era for the rising middle classes.

At this time, the constant replacement of human labor with new technology brought huge benefits not just to the elite but also to the broad mass of people in industrialized countries. The major technological innovations of this period created large numbers of jobs for low-skilled workers in many industrial sectors and in construction. In this period, Henry Ford's adoption of the assembly line for producing automobiles in his Michigan factory actually lowered the average skill required to make an automobile. Technology and the new demand for labor contributed to the rise of a broad middle class in the industrialized world (Fukuyama 2015).

In general, social classes may be defined in two ways. The first, or the economic one, defines by income level; the second, or sociological one, by to how that income has been earned. We need to measure in some way the income of each class. As we know from Chap. 4, in this case we can refer to income *distribution*. Thus, for example, we could consider the middle class as comprising people whose incomes fall for instance within the range of 25% below and 25% above the national median income (Table 6.1). And as composing the upper class, we may consider, for instance, those whose incomes fall within the top 20% of the total income. At this point we thus had:

The *upper class*, as the list shows, included important entrepreneurs, landowners and bankers. They differed from Marx's capitalists (that is, the owners of the physical means of production), because in the modern world this kind of property has become largely democratized through stock ownership. The sources of income in this new upper class are profits, rents, interest, salaries and various mixtures of all four of these.

The *middle class* is of crucial interest to us. It includes skilled workers (on salaries), professionals (receiving mixed incomes, including monopoly rents—that is, payments for their relatively scarce knowledge and skills) and

Table 6.1 Social classes

Upper class : big entrepreneur, landowner bankers CEO
Middle class: skilled workers professionals entrepreneurs
Lower middle class: unskilled workers, civil servant, artisans, retailers
Working class: unskilled workers, agricultural workers, service workers
Lower class: marginalized people, temporary unemployed, poor

entrepreneurs (whose remuneration is in the form of profits). As we have just said, we could consider as belonging to the middle class all those individuals whose incomes fall within $\pm 25\%$ of the value of median income.

The *lower middle class* includes all underprivileged and marginalized people, or those with very low wages who remain temporarily unemployed and could also be dependent on state subsidies. Poor people are included in this class.

So far, in the previous chapters we have considered the middle and lower middle classes together as if they were a single class. This approach now needs refining.

The human beings who compose the two classes differ greatly as concerns their objectives and the kind of economic policy they each require. The differences between them concern domestic objectives and economic policies.

Middle-class political and economic values differ from those of lower middle class people. The middle class want individual freedom and democracy. They prefer economic and monetary stability, and support governments that promise less public spending and lower taxation. They espouse the bourgeois values of hard work and long-term planning, which encourages savings; the theoretical scheme of their economic preferences is essentially neo-classical (Lipset 1959).

The goals and the theoretical scheme of the lower middle class are quite different. They are essentially Keynesian, as they consider public spending to be best directed at benefits for unemployed and poor people. Pursuing these goals means increasing taxes.

However, both middle-class *and* lower middle-class people of the advanced countries are the main losers from globalization. On international relations and policies, the differences between these classes virtually disappear. Both classes are characterized by growing sentiments against globalization: they fear immigration, terrorism, globalization (in terms of technological advancement and unfair free trade). They are afraid of losing their jobs, particularly—but not only—if they belong to the lower middle class. Waves of immigrants and technological changes are their main perceived threat. They fear they will be hit by ever-rising inequality and will lose their safety because of terrorism. Both issues they consider to be linked to globalization. The reasons for these fears have been discussed in great detail in Chap. 3.

6.2.3 The Decline of the Middle Class in the Twentieth and Twenty-First Centuries

The evolution of inequality and the loss of the economic weight of the middle and lower middle class are obviously two faces of the same coin. Inequality goes up when, for given GDP, the income (or wealth) of the middle and middle-lower classes decreases, and vice versa. In this most recent historical period we have seen, in particular, the decline of the middle class. This decline began in the second half of the twentieth century, when inequality soared. It can be linked to the current phase of hyper-globalization (or the “new globalization” as Jeffrey Sachs [2011] calls it). This decline accompanies the evolution of inequality.

As discussed in Chap. 4, the decline of the middle class is defined either in terms of the number of people included in the range (for example, $\pm 25\%$) around the median value or in terms of the total income with respect to the income of the rich (for instance, the top 20%).

Thus, if we want to understand the decline of the middle class in this phase of hyper-globalization we can restate the main causes of growing inequality: skill-biased technological changes, unfair free trade and the reduced role of trade unions.

These three factors, among others, have pushed down workers who were previously above the minus-25-per-cent line to a position below it, as new production techniques become established, the importation of goods and services increases, and the protection of workers by trade unions is reduced. In particular, new technology has driven millions of people from their places of work; Chinese imports brought with them the destruction of millions of skilled and unskilled jobs; and trade unions in their reduced role were unable to protect workers and prevent the loss of millions of jobs.

According to Milanovic (2016), the loss of economic weight by the middle class has been high in every Western country. In these countries, the middle classes are now less numerous and economically weaker with respect to those in the top income distribution than they were some thirty years ago.

In the USA where the change has been the most dramatic, the share of the middle class (defined as people with disposal incomes around the

median) decreased from about one-third of the population in 1979 to 27% in 2010. In other words one-fifth of the middle class in 1979 have been downgraded.

At the same time the average income of the middle class was 80% of the US overall mean income in 1979, but had dropped to being 77 in 2010. The outcome of this decline in relative numbers and relative income is a sharp drop in the economic power of the middle class. In 1979, they accounted for 26% of total income, in 2010 for only 21%.

6.2.3.1 A Winner-Takes-All Society and the Return to Two Classes

The current phase of hyper-globalization favors particular characteristics of the process. It is the top class or “elite” especially who are able to receive the greatest benefits from globalization. This is due to the way people are recruited for the elite and the kind of service they provide. For many reasons, this factor is the most problematic for the middle and lower middle class, who are most in conflict with the elite.

After the first wave of technological changes which brought with them the rise of the middle class in the twentieth and early twenty-first centuries, we can see a new wave of changes in information collection, transmission and use, transportation and communication, and a new wave of technology, which bring about the *decline* of the middle class. This obviously has negative social consequences.

In fact, new technological changes have eliminated a large number of low-skill production lines and the skill ladder has taken away many jobs formerly done by middle-class workers. These workers have then been pushed toward the lower part of the distribution of incomes.

Today this modern technology creates what Frank and Cook (1995) call a *winner-takes all society*, in which a disproportionate share of income goes to the *top members of each sector*: entrepreneurs, bankers, CEOs, doctors, journalists, novelists, academics, musicians, actors and athletes, with a negative impact on the middle and middle-lower classes.

Indeed, in the winner-takes-all society the decline of the middle class reaches its maximum extension, or in other words, inequality reaches its highest value.

In such a situation, societies risk being highly politically unstable. According to Fukuyama (2015, p. 450) “the future of democracy in developed countries will depend on their ability to deal with the problem of a *disappearing* middle class” (emphasis added). This is all taking place in the political context of a surge of populist groups across many European countries, from France to Italy, Germany, Austria and Poland to the United Kingdom and

what unites all of them is the belief that elites in their countries have betrayed them. And in many ways they are correct: the elites who set the intellectual and cultural climate in the developed world have been largely buffered from the effects of middle-class decline.

The issue now is the reaction of the middle class to the “winner-takes-all” scenario. The answer depends on the ability of the middle and middle-lower classes, who are the losers in the winner-takes-all society, to organize themselves politically.

The decline of the middle and middle-lower classes in this phase of globalization poses at least a couple of questions: How will the definition and order of the social classes be modified in a winner-takes-all context? And what will be the fate of the middle class?

The reply to the first question is as follows:

Elites: Entrepreneurs, CEOs, bankers, musicians, doctors, academics, athletes.

Middle and lower classes: workers, civil servants, professionals, craftsmen, retailers, marginalised people.

According to Milanovic (2016), the main routes of recruitment to the elite are by “family background,” by “connections” and by chance.

Thus in the current phase of globalization we have a *new capitalism* which resembles a big casino, characterized by the highest level of inequality we have ever known, in which individual success will depend on of having been born in socially favoured circumstances and having luck in life.

6.3 Economic Classes and Political Systems

Although this is not a book on political science,⁵ this final section will touch on voting systems as well as the behavior of European voters. Two very particular and critical aspects will be the focus on the following:

1. A synthesis of the evolution of social classes, in order to understand how and why the anti-globalization sentiment of the middle and lower middle classes has arisen.
2. A synthesis of the evolution of the main political parties in Europe.

In this section, the aim is to understand why particular social classes are associated with particular political parties. This will be the last stage of the book, before conclusions are drawn in the final section of the chapter.

Point (1) depends on how globalization has affected economic national systems and with them the evolution of economic and social classes in the advanced countries. We know from the previous pages that over recent decades there has been a complex shuffling of economic and social classes. In this chapter we started with Marx's division between two social classes: capitalists and workers. Capitalists were the owners of technology, using it to extract surplus from labor provided by the workers, the proletariat. This form of capitalism should have led to a great concentration of wealth and the progressive impoverishment of workers.

Instead, in the following period, the late nineteenth and early twentieth centuries, capitalism expanded and workers found new opportunities for employment; technological progress allowed the *rise* of the middle class. In this period at least four classes surfaced in the advanced economies: upper class, middle class, working class and lower class.

When we talk about starting in the twentieth century, further technological changes were again the protagonist, but in this case in the opposite direction: they eliminated, in the industrially advanced countries, millions of jobs which could be carried out by robots or automated devices. At the same time a *decline* of the middle class began.

Millions of workers were pushed into the lower classes. Things worsened in the third and current phase of globalization with the advent of modern technology and the “winner-takes-all” society. The impact on social classes has been powerful: basically, the population is divided again into two classes: the upper class or elite and the “middle and lower class,” including all the unemployed.

When we talk about anti-globalization sentiment, we refer to the unrest that has emerged in this last phase of the evolution of the social classes. In the “winner-takes-all society” middle and lower middle classes” is against globalization:

- (i) Because it is against immigration, as it is afraid of losing jobs and wages.
- (ii) Because globalization spurs technological changes and exports from emerging countries, unfair free-trade and outsourcing, all of which eliminate jobs.
- (iii) Because the middle class is afraid of Islamist terrorism, which it believes is linked to globalization.

As concerns point (2), we have to remember what happened in the main European countries, the societies characterized by Marx’s analysis: in the nineteenth century trade unions emerged, and were supported in the political sphere by socialist parties. This occurred first in the United Kingdom, Germany and in Italy. After the end of World War 1, socialist and communist parties were founded in other European countries. After World War 2, many more parties emerged in Western Europe, giving rise to a political spectrum with centrist, center-right and center-left, plus regrouped and re-formed organizations with more extreme alignments—the communist parties on the extreme left wing and the fascist parties on the extreme right. The right wing in particular is important in our story, as we will see below.

Moreover, as concerns the political conflict in Western Europe hinted at in the introduction to this chapter, the following observations are useful:

1. The political changes in almost all European countries are clearly “inspired” first by political parties but later by social classes. That is, initially the middle and lower middle classes have moved towards center and right, following the surface of populism towards the extreme right parties. Then, the other parties (center, center-right, center-left) have followed the middle and lower classes, moving towards the right, for fear of otherwise losing votes. Thus in almost all the European Union and the UK the barycentre of the political scenario has gradually shifted towards the right. This has important implications in terms of political representation, as we will see in the next section.⁶
2. The opposition of classes and parties to globalization is organized on a *national* rather than at the European Union level (Grande 2012, p. 300). This makes what is said in point (1) of crucial importance.

6.4 The Political Representation of Social Classes

We can now address the issue of political representation⁷ through the coupling of its two key components:

1. The *representing parties*—for instance, political parties in a given historical period.
2. The *represented parties or clients*—in our case, the socioeconomic classes.

The respective alignments of the representing and the represented parties have been indicated in the previous paragraph, namely:

1. *Representing*: Socialist party, communist party, conservative party which in a following period become normally: left-wing, center-left, center, center-right, right-wing.
2. *Represented*: The classes are, in the phases mentioned, first, the bourgeoisie and the proletariat (the Marxian scheme); these then change

into other classes, notably the upper class, the middle class, the middle and the lower middle classes, the working class and the lower class; eventually (in the winner-takes-all society), there are just the “elite” and the “middle and lower classes.”

It is worth stressing now that this link (1–2) could not always be the same, since the behavior and/or objectives of the representing political parties can change, not least when they try to attract new “clients” in order to gain votes. For this reason, political representation should be seen as a process, or a *dynamic* phenomenon.

Thus, matching each of the above-mentioned economic classes (or clients) to a political party is more difficult than may appear at first glance.

As the analysis of the previous section suggests, three periods have shaped the association of parties with social classes. Let’s begin with the first period, characterized by the Marxian scheme with two classes and limited political representation.

1. This is the first period, roughly the end of the nineteenth century and the early half of the twentieth. In this period, according to Karl Marx, the economic classes were two: the capitalists or bourgeoisie (in this case, people who were owners of the means of production—that is, equipment and land), and the proletariat or working class (people who did not possess the means of production but only their hands). By the end of the nineteenth century and the early twentieth century, the proletariat or working class was represented by socialist or communist parties. This was true across industrialized Europe (France, Germany, Italy, the UK). By the mid twentieth century there was a widespread improvement of living conditions thanks to the expansion of the political power of the working classes, or proletariat. This took place through struggles to legalize and expand trade unions and the rise of political parties associated with them, particularly socialist and communist parties. The working class’s new-found political power was then used to implement social legislation regulating working conditions (Fukuyama 2015).

The conservative parties, meanwhile, represented landowners in the European countries.

2. The second period (the second half of the twentieth century) starts from the end of World War 2, when many things changed. The numbers of both political parties and social classes increased. This is the period of the middle class in Europe and all over the world. That is, the period of the rising middle class who prospered thanks to the technological progress forcefully entering European factories. Skilled workers significantly advanced up the ladder of productive qualifications.

Yet, at the same time, workers without the required education were pushed down below the industrial working class. A new class of poor people then emerged in the industrialized world, often consisting of immigrants, ethnic minorities and other marginalized people. They had lower-waged jobs or were unemployed and dependent on government benefits. The vast majority of these workers had no representation by trade unions as they were employed in sectors where the fragmented, often unmechanized processes of production, frequently of services rather than manufactured goods, involved less skill and/or less group cohesion and discipline.

During this time, when the middle class in the advanced economies was expanding, there were four social classes, and after World War 2 many political formations surfaced in Western Europe, their roots and their popularity lying in part in the partisan warfare against the nazi-fascist forces. As a result we have the following association of parties with social classes:

Upper class: Center, center-right

Middle class: Center, center-right, left, center-left

Lower middle class: Right, center-right, center-left

Working class: Left-wing, right-wing

Lower class: Left-wing

3. The third period is the most important in our story. The reason is very simple: both social classes and political parties have changed dramatically.

Let's start with the social classes. In this case, there has been the decline of the middle class, caused by technology which has eliminated millions of unskilled and semiskilled jobs. Previously, the old oligarchies in many developed countries had evolved into a more entrepreneurial capitalist elite, while the working class became middle-class thanks to unionization and the political struggle which won greater privileges for them.

In the most recent period, we have seen the middle class decline while the working class seeks to climb the class ladder. We live in the winner-takes-all society and in this case the consequences have been a reduction of relevant social classes from four to the following two:

Elite: Entrepreneurs, bankers, CEOs, journalists, academics, actors, musicians, athletes.

Middle and lower classes: Skilled and unskilled workers, civil servants, craftsmen, retailers, poor.

This list is extremely important: the elite is the class which benefits from globalization, while anti-globalization sentiment is expressed by the middle and lower classes. The middle and lower class (which includes the lower middle class and working class), newly defined during the twenty-first century, is the majority of the population and voters. This majority has become the subject of political parties' efforts at mobilization.

As regards political parties, the recent changes are highly significant. A new and confusing political scenario has surfaced in Europe since the first years of the twenty-first century. In the first place, voters in many European countries—Austria, Belgium, Denmark, France, Netherlands, Norway, Italy, Switzerland—have in recent years given strong support to populist and extreme right-wing parties. From the 1970s until the mid 1980s hardly any of these parties had gained more than 5% in a general election. Fifteen years later some of them in the above-mentioned countries received between 10 and 25% of votes (Halla et al. 2015). These extreme-right parties were strengthened by receiving votes from the middle class and lower middle class.

More important, new populist parties have also been founded in almost all the EU countries plus the UK (Austria—Freedom Party for Austria; Finland—True Finns; Germany—Alternative für Deutschland; Greece—Golden Dawn; Italy—Five Stars; Netherlands—Party for

Freedom; UK—United Kingdom Independence Party), fuelling the anti-immigration, anti-globalization sentiment of the middle and lower middle classes (Fig. 6.1).

Populism has reached its peak, touching the main European countries and taking votes from other political formations, from the center-right to the center and the center-left. Moreover, as we have hinted, the

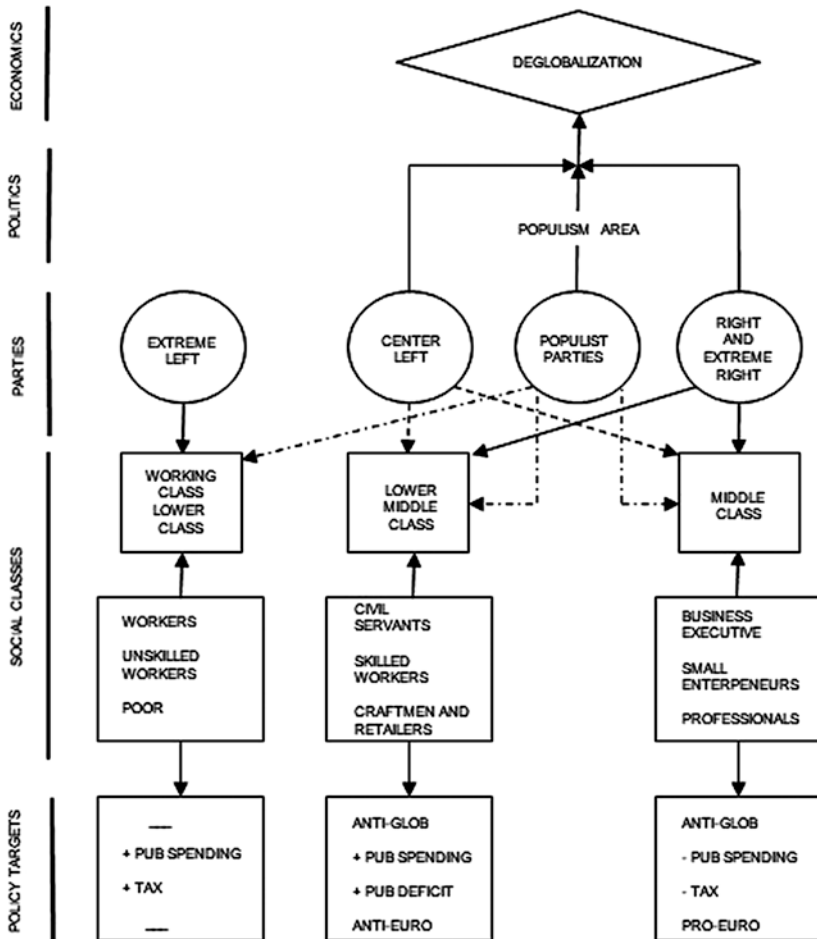


Fig. 6.1 Middle classes, Populism and Globalization

political barycentre has been moved towards the right, as the traditional parties have run after the middle class in order to avoid losing votes.

On the other hand, the political left, extreme left, new populist parties has also changed its identity, as it seems to have lost its interest in economic and class issues. Rather, to some degree it has concentrated on a new form of identity based on environmentalism and human rights (Milanovic 2016).

In this context, the majority of the population (that is, the middle, lower middle classes, working class and lower class) seem to find a large part of the political representation of its interests in most of the political parties:

Elites: Center-right

Middle and lower classes: Extreme right, center-right, center-left, extreme left, new populist parties

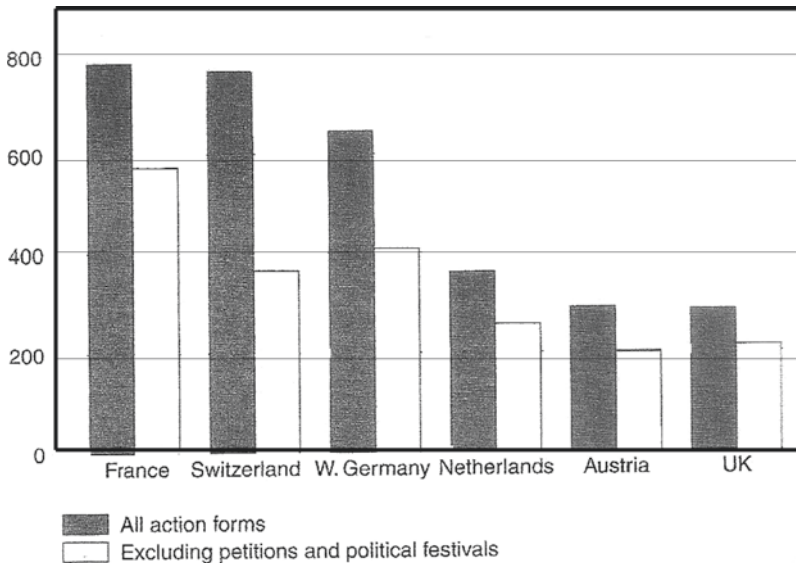


Fig. 6.2 Participants in protest politics per million inhabitants, 1975–2005 (in thousands). *Note* The absolute number of participants is divided by the number of inhabitants in the year 1990. *Source* Hutter S. (2012)

The economic expression of the dramatic impact of migration, terrorism and globalization on the middle and lower classes, and the adoption of economic protectionism by policy makers (governments and political parties) could eventually lead to the adoption of policy measures to limit globalization, or even to remove some of its features. In particular, this may mean limiting or cancelling the freedom of movement of people, capital and goods. In this way, people belonging to the middle and lower classes hope to protect their jobs against competition from foreign goods (above all from China), their employment incomes against a reduction in wages resulting from immigration and globalization, and the loss of savings due to the international crisis. Naturally, the future of globalization will depend on the ability the middle and the lower classes to force parties and then governments to adopt measures against the freedom of movement of goods, capital and people, either directly or indirectly.

From this aspect, we have just seen that the majority of today's political parties are sensitive to the interests and concerns of the middle-lower class, since traditional parties have pursued them as they look and move toward populist and right-wing ones, in an attempt to retain or recover their votes. The popularity of populist and extreme-right parties is very high and growing in almost all European countries. They have adopted the anti-globalization, anti-immigration, anti-euro stances of the middle class as their own. In addition, the political scenarios of EU countries are being shifted towards the right. Even if it is unlikely that a populist party will come to power anywhere, either alone or in alliance with other parties, the prevalent political climate in Europe against globalization is very important.

And if the future of globalization depends on political parties, whether in the shape of new populists that have arisen in the aftermath of middle- and lower middle-classes protests against immigration, free trade and technology, or in that of the traditional groups now themselves moving rightwards, then we should conclude that globalization is indeed at risk (Figure 6.2).

Box 6.1

Populism

We are discussing “populism”, but what does *populism* mean?

Is it right or left wing? Populism *is* both right and left wing. It is not a political party, but an opinion movement showing three characteristics (see Moffit [2016](#), [2017](#)):

- **An appeal to the people against the élite.** This appeal is the result of the attitude of the élite, perceived by populists as betraying them (i.e. “people” or lower classes). Globalization knows how to create wealth, but does not know how to distribute it. Better: internal distribution is the result of a non-cooperative play between the élite—who become richer and richer- and middle and middle-lower classes—destined to be poorer and poorer.
- **Bad manners.** In the clash between the élite and lower classes, populists use bad manners, in sorts of ways; they employ politically incorrect language that is often very coarse. The objective is to make people believe that populists are different from ordinary elite politicians.
- **Favouring crises or making threats.** Populists try to evoke crises, in some cases provoking them or hampering their solutions. In this case, the objective is to demonstrate that, without them, it is impossible to find adequate solutions. That is, populist parties are absolutely crucial to solve current political problems, while the mainstream parties are an obstacle to solving problems.

Populists can be right, centre or left wing. However, there are differences between them. What *are* the differences between right- and left-wing populism? According to Benjamin Moffit ([2016](#)), the main difference between the two is in the different characterization of “élite” and “people”. Left populism is inclined to consider people *inclusively*, that is it includes “people” in all subjects not considered élite. On the opposite side, right populism is *exclusive*: that is, it is inclined to restrict the definition of populism leaving outside not only the élite but also “others” considered dangerous supported by the élite.

Moreover, while leftist populism focuses on social questions (talking about poor people against a rich élite) right populism focuses on cultural questions (talking about nationalist people against a multicultural élite favouring globalization and—to some extent—to immigration).

The concept of populism is based on the divide between the élite and the lower classes. Populism has increased because of the suspicion that the world’s élite is seen able to appropriate the wealth produced by others and perpetuating its dominance.

How long will the current populism last? According to Moffit (2017), it will last a very long time, but it is *not* necessarily a fascist movement. Populists are able to stimulate and to excite very many people politically and it will last until mainstream politicians in the established are able to do the same.

Whether this danger becomes a reality will depend on the capability of the middle and lower class to force governments to limit immigration, outsourcing, free trade and international capital flows.

In other words, the final question remains: Is globalization doomed?

6.5 Conclusions

This book has developed the idea that globalization is going to slow down.

Although that conclusion was already reached in my earlier book about globalization (Verde 2013), there I only expressed *why* globalization would slow, but did not identify the mechanism whereby it would happen. In this book I have taken the argument further.

In Chap. 1, I questioned whether we were entering the fourth phase of the development of modern globalization. Judgment on this point was, however, suspended. Then, in Chap. 2, a new globalization index was constructed and that showed that a rollback of globalization has in fact already happened, during 2015.

In Chaps. 3, 4, 5, 6, I examined the economic and political causes of this rollback. It was assumed: (1) that the middle and lower middle classes continue to be the majority population of the European countries; and (2) that these classes are particularly hostile to immigration and are afraid of inequality and terrorism.

The middle class in Europe and in the USA risks disappearing, a view shared by various experts (such as Fukuyama). In order to understand how to avoid that, we must look at the political representation of their anti-globalization sentiments. As the middle and lower middle classes are the majority of national electorates, the protection of their interests

will come not only from the extreme right and the new populist parties that have surfaced in all the European countries but also from centre-right and centre-left parties. These parties are afraid to lose votes, but the middle and lower middle classes seek greater political support. Thus the chance of globalization being doomed is strong: it is a real risk for the future.

Dani Rodrick argues in his book: *The Globalization Paradox* [2011], global markets, sovereign states and democracy cannot coexist. It is an inconsistent trilemma. If a country wants to have a sovereign state and democracy, it must block global markets, i.e. to make globalization move back. This can happen because of free choices of policy aiming at the control of capital and goods flows. These choices are adopted by sovereign governments.

In this book, we arrive at the conclusion that globalization is at risk. In other words, we deem controls on capital and/or goods flows or people movements would be adopted. Democracy is not at risk, and the policy choices substantially analogous to Rodrick's are adopted by governments conditioned by parties' victims of nationalistic and populist pushes. Politics and parties play a crucial role, that is not in Rodrick's.

A variable we do not consider is time. This also plays a fundamental role in the theories concerning the future of globalization. At the moment populism in the EU seems to be losing ground and the migrant arrivals on the Italian and Greek shores are also decreasing. But this situation is destined to change in a few years. Populist movements—i.e., the anti-globalization sentiment—is a positive function of three variables: immigration, inequality and terrorism. Demographic forecasts on Africa tell us that migration flows will be unstoppable, if we do not adopt extraordinary measures such as a new Marshall Plan for Africa. Inequality is destined to increase and, as we know, this means, by definition, a drop of income share of middle and lower middle classes. Terrorism has become really global after its attacks in Europe and for the future we cannot be optimistic, above all if we will witness to the IS's defeat on the ground.

On the other hand, when we consider the anti-globalization sentiment and political parties, other delays will arise and time about the analysis results will be unpredictable. All we can ask is one question: "Is

globalization doomed?” since we know the risks which it is exposed to and which, *rebus sic stantibus*, will force it to move back.

Notes

1. Incidentally, it is worth noting that the income ratios between different classes is a measure of inequality. For the relationship between democracy, inequality and political representation see P. Beramendi and C. Anderson (2008).
2. We have two types of institutions: economic and electoral. The economic ones are corporatist arrangements for the representation of economic interest, while the electorate institutions constitute the system of representation that translate citizens' preferences into political outcomes. We are here interested in the electoral institutions.
3. According to the median voter theorem, if decisions are taken by majority vote and the voters vote for the policy nearest to the one they prefer then the outcome will be the choice of the median voter (see Meltzer and Richard 1981). In our case however it is up to citizens to fix policy objectives: to limit globalization.
4. The first volume of *Capital* was published in 1867. This work remained unfinished. Marx died in 1883 without having completed the two subsequent volumes. His friend Engels published them.
5. In this field a very interesting book is Kriesi et al. (2012).
6. On the other hand, see Grande (2012, p. 300); political parties, populist and not, follow social movements and not vice versa.
7. Political representation is defined in the introduction to this chapter.

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Appendix: The New Globalization Index: The Methodology

An integrated methodology is presented for the development of composite globalization indicators based on principal component analysis (PCA). Three indices are then generated to measure the overall globalisation performance.

The central idea of PCA is to reduce the dimensionality of a data set consisting of a large number of interrelated variables, while retaining the variation present in the data set as much as possible. This is achieved by transforming the PCs, which are uncorrelated and which are ordered so that the first *few* retain most of the variation present in *all* of the original variables, to a new set of variables (Jolliffe 2003). PCA can be done by eigenvalue decomposition or singular value decomposition of a data covariance matrix, usually after standardizing the attribute data. The results of a PCA are usually discussed in terms of component scores (the transformed variable values corresponding to a particular case in the data) and loadings (the weight by which each standardized original variable should be multiplied to get the component score) (Shaw 2003).

This appendix is due to Ilaria Benedetti PhD.

Composite globalisation indicators were constructed using PCA with a matrix of p indicators \times n years. In the application of the PCA method, all the values need to be signed as positive or negative in order to make them unidirectional.

The data are then normalized to zero mean and unit variance, to calculate eigenvalues and the amount of variance explained by each PC. Normalization is required prior to any data aggregation as the indicators in a data set often have different measurement units. We used standardisation z -scores. This method converts indicators to a common scale with a mean of zero and standard deviation of one. Indicators with extreme values thus have a greater effect on the composite indicator

$$I_{qc}^t = \frac{x_{qc}^t - x_{qc}^t - \bar{c}}{\sigma_{qc}^t - \bar{c}}$$

Before applying PCA, we investigated the correlation among dimensions of the data. A lack of correlation in the principal components is a useful property. It indicates that the principal components are measuring different “statistical dimensions” in the data.

After extraction the researcher must decide how many factors to retain for rotation. Both overextraction and underextraction of factors retained for rotation can have deleterious effects on the results. The default in most statistical software packages is to retain all factors with eigenvalues greater than 1.0. There is broad consensus in the literature that this is among the least accurate methods for selecting the number of factors to retain (Velicer 1990).

Another method of deciding the numbers of factor to retain is determined by the accumulative amount of variance that can reach up to 70%. The value of the eigenvectors and loadings of variables with PCs can then be computed. The loading of the PCs can be calculated through

$$l_{kj} = \sqrt{\lambda_k} e_{kj}$$

where l_{kj} is the loading of the PCs, λ_k is the eigenvalue of the component k , and e_{ij} is the eigenvector.

The next decision is which rotation method to adopt. The goal of rotation is to simplify and clarify the data structure. In this case, we used orthogonal rotation because it produces uncorrelated factors and more easily interpretable results. Rotation cannot improve the basic aspects of the analysis, such as the amount of variance extracted from the items.

The purpose of the next sections is to demonstrate the construction of various index mentioned above. PCA is used to analyze the globalization indicators using Stata software. Tables A.1 to A.2 show the analyzed results including correlation matrix, eigenvalues, eigenvectors, accumulation of variance, and the loadings of correlated indicators.

Global Index

In order to construct the globalization index we took into account the aspects related only to the definition of globalization: world demand (*wds_1*), trend values for migrants and refugees² (*imm_ref*) and foreign investment flows (*fdiinfl*), due to the high correlation with other index.

Table A.1 Correlation matrix

```
. corr afpfgdp nfay s_mig_ref fdiinfl ca migref
(obs=36)
```

	afpfgdp	nfay	s_mig_ref	fdiinfl	ca	migref
afpfgdp	1.0000					
nfay	-0.9410	1.0000				
s_mig_ref	0.9749	-0.9437	1.0000			
fdiinfl	0.6654	-0.6303	0.6725	1.0000		
ca	-0.6180	0.6484	-0.5965	-0.6929	1.0000	
migref	0.9752	-0.9438	1.0000	0.6719	-0.5957	1.0000

The results are presented in Table A.2.

$$GI = g[Wds, (\sigma Migr + Ref); fdiinfl]$$

Table A.2 Scores of correlation matrix and global index B

Factor analysis/correlation Number of obs = 36
 Method: principal-component factors Retained factors = 2
 Rotation: orthogonal varimax (Kaiser off) Number of params = 3

Factor	Variance	Difference	Proportion	Cumulative
Factor1	1.67212	0.63569	0.5574	0.5574
Factor2	1.03643	.	0.3455	0.9029

LR test: independent vs. saturated: chi2(3) = 23.37 Prob>chi2 = 0.0000

Rotated factor loadings (pattern matrix) and unique variances

Variable	Factor1	Factor2	Uniqueness
s_mig_ref	0.9181	-0.1420	0.1370
wds_1	0.0115	0.9928	0.0141
fdiinfl	0.9106	0.1747	0.1404

The extraction method produced two factor extraction with total variance explained for 0.90%.

As shown in the lower part of the previous table, trend values for migrants and refugees (*imm_ref*) and foreign investment flows are correlated positively with the first factor retained, whereas world demand is instead correlated with the second factor retained.

Combining the two factors with their specific weight we obtain the composite indicator of globalization, so called global index B. On the whole, all the variables have a positive impact on globalization.

Global Shock Index

In order to construct the third global index we took into account aspects related to the definition of globalization and shock variables: migrant and refugees (*mig_ref*), the global index A that was calculated earlier (*GIA*), world demand (*wds*), and foreign flows (*fdiinfl*). The results of the analysis are presented in Table A.6.

$$GSI = g[WDS, (Migr + Ref), giA, fdiinfl]$$

Table A.3 Correlation matrix

```
. corr afpfgdp nfay s_mig_ref fdiinfl ca migref
(obs=36)
```

	afpfgdp	nfay	s_mig_ref	fdiinfl	ca	migref
afpfgdp	1.0000					
nfay	-0.9410	1.0000				
s_mig_ref	0.9749	-0.9437	1.0000			
fdiinfl	0.6654	-0.6303	0.6725	1.0000		
ca	-0.6180	0.6484	-0.5965	-0.6929	1.0000	
migref	0.9752	-0.9438	1.0000	0.6719	-0.5957	1.0000

Table A.4 Scores of correlation matrix and global shock index

Factor analysis/correlation	Number of obs =	36
Method: principal-component factors	Retained factors =	2
Rotation: orthogonal varimax (Kaiser off)	Number of params =	6

Factor	Variance	Difference	Proportion	Cumulative
Factor1	1.91337	0.13696	0.4783	0.4783
Factor2	1.77640	.	0.4441	0.9224

LR test: independent vs. saturated: $\chi^2(6) = 157.67$ Prob> $\chi^2 = 0.0000$

Rotated factor loadings (pattern matrix) and unique variances

Variable	Factor1	Factor2	Uniqueness
wds_1	0.1329	-0.9718	0.0379
migref	0.9012	0.2745	0.1125
pcA_	0.4927	0.8648	0.0093
fdiinfl	0.9169	-0.0931	0.1506

The extraction method produced two factors extraction with total variance explained for 0.9225%.

As shown in the lowest part of the table, world demand and the first composite indicator previously created (global index A, so-called pcA_), correlate with the first factor retained, but their influence has a different direction: world demand correlates negatively with the first factor retained, and instead global index A correlates positively with the first factor retained.

Furthermore, migrant and refugees (mig_ref) and foreign investment flows (fdiinfl) are positively correlated with the second factor retained.

Combining the two factors with their specific weight we obtain the composite indicator of globalization, a so-called global shock index. On the whole, migrants and refugees, global index A and foreign investment flows all have a positive impact on globalization, whereas world demand has a negative effect on the global shock index. Figure 3 shows the index created.

Global Impact Index

In order to construct the last global index we took into account aspects related to globalization's definition and shock variables: inequality index (gini), social expenditure (socialspendy), OECD per capita GDP at constant prices (gdpoecd), output (outputw), unemployment rates (uoecd), labour income share (wagey). The results of the analysis are presented in Table A.2.

$$GSI = g[\text{gini}, \text{socialspendy}; \text{gdpoecd}; \text{outputw}; \text{uoecd}; \text{wagey}]$$

Note

1. Trends value for immigrants and refugees are calculated with a regression $\text{imm} + \text{ref} = a_0 + a_1 t_{t=1}$ for 1980.

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