



2005 WIDER Annual Lecture

Why Inequality Matters in a Globalizing World


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“Holy mackerel, the world is becoming flat. Several technological and political forces have converged, and that has produced a global, Web-enabled playing field that allows for multiple forms of collaboration without regard to geography or distance - or soon, even language.”

-Thomas Friedman



“But the world is not flat. Those of us on the top, with the right education and in the right countries, can easily overlook the countries and the people stuck in deep craters across the global landscape.”

-Nancy Birdsall, this lecture

. . . which is about why they are in craters, why that matters, and what we need to do about it.

The message

- Inequality matters to people. It is often a sign of injustice.
- Global markets by their nature generate inequality.
- We need to manage the downside of globalization if we are to sustain its upside. We need a global polity to complement our global economy.
- Constructing that global polity is a key challenge of this 21st century.

The message in three parts:

- 1. Inequality Within Developing Countries: Why It Matters**
- 2. “Globalization” is Desequalizing**
- 3. Constructing a Global Polity for Our Global Economy**

1. Inequality Within Developing Countries: Why It Matters

Definitions and facts

- 1.A. Inequality inhibits growth**
- 1.B. Inequality undermines good public policy**
- 1.C. Inequality undermines collective decision making and social institutions critical to health societies**

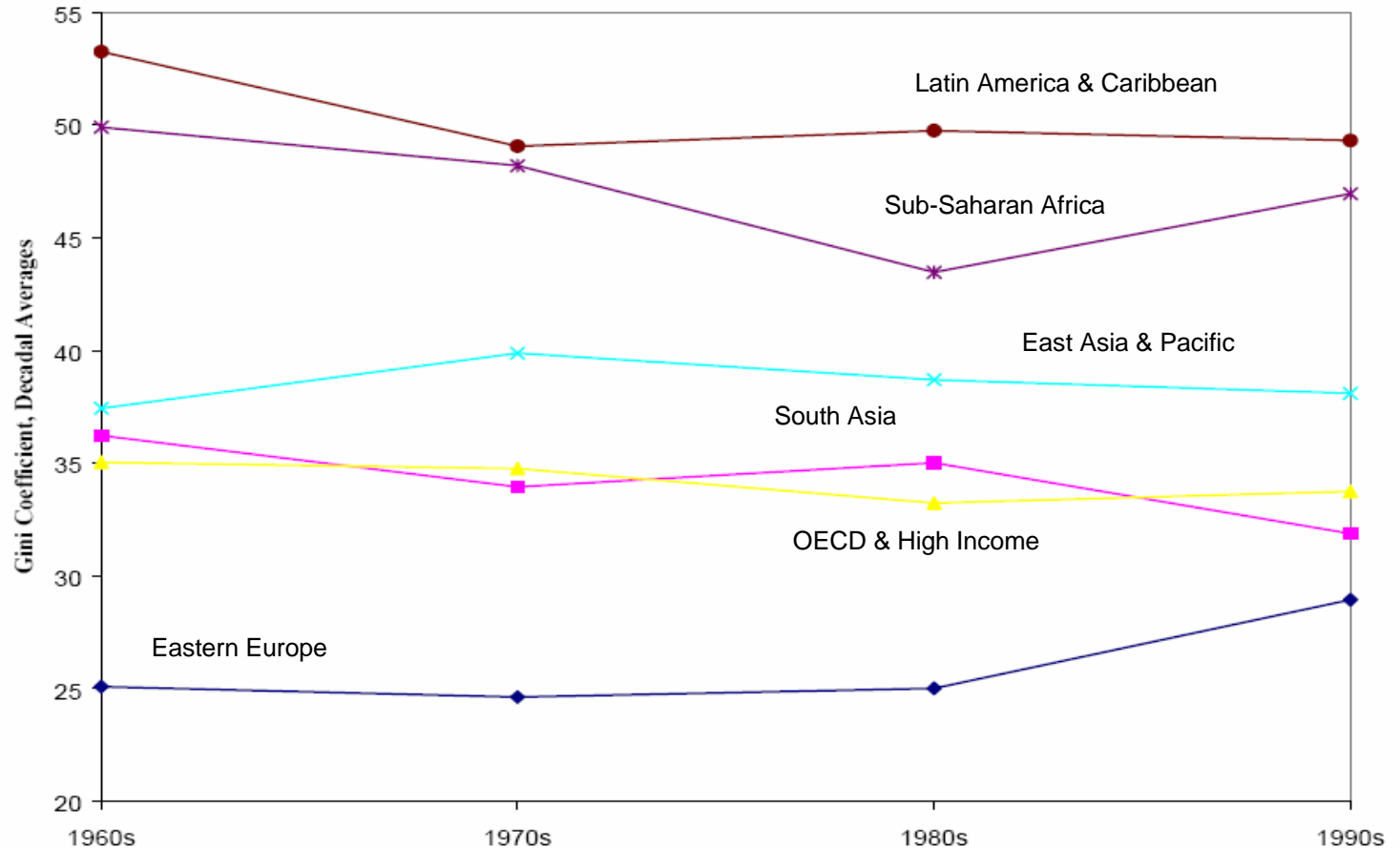
1. Inequality Within Developing Countries: Why It Matters

Definitions and facts

- **Poverty**
- **Inequality (money inequality)**
- **Inequity (process not outcome)**

...inequality varies across regions and changes little within regions/countries over time

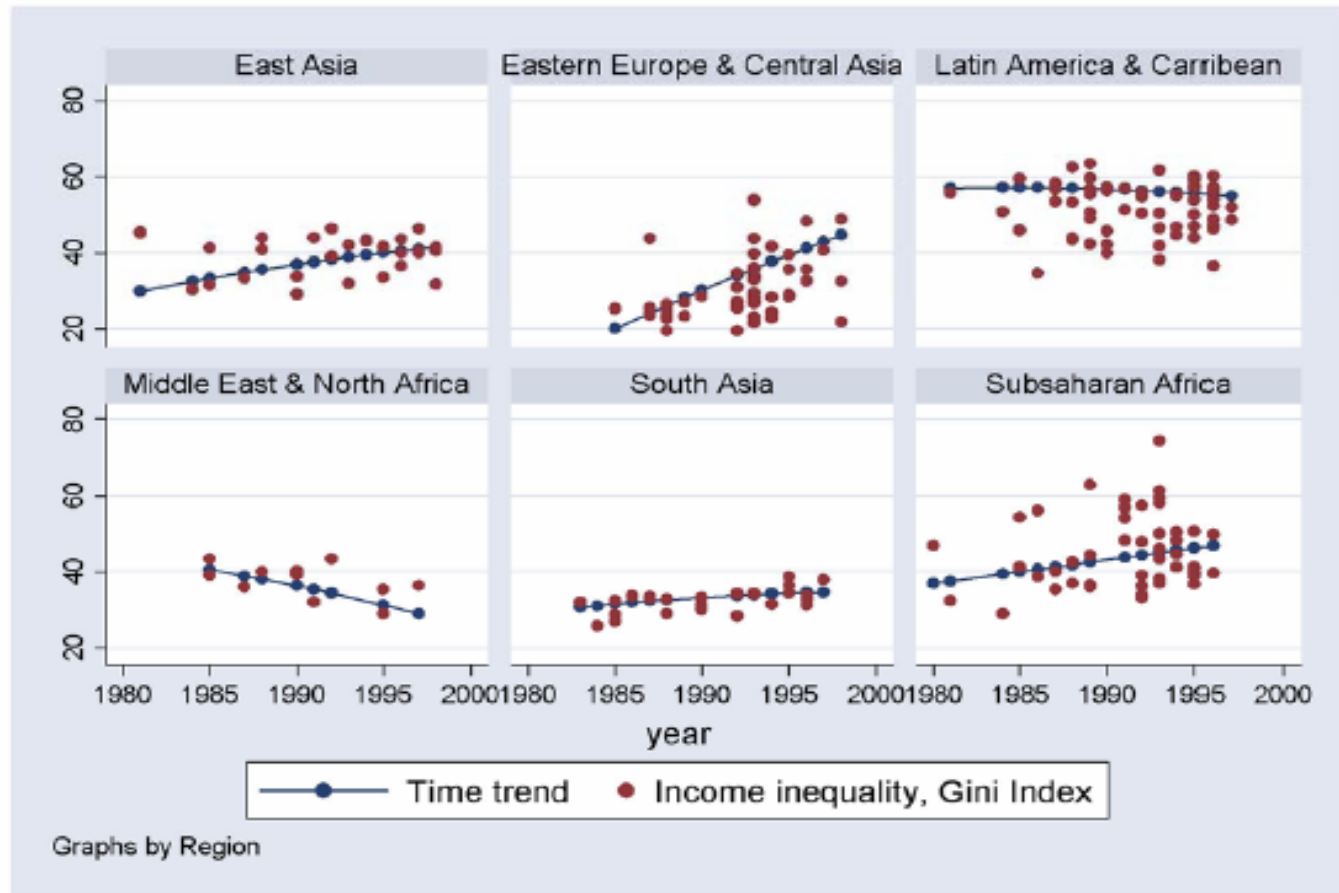
Inequality by region and decade



Source: Birdsall (2001) "Why Inequality Matters."

...high in Latin America and rising in Eastern Europe...

Inequality across regions



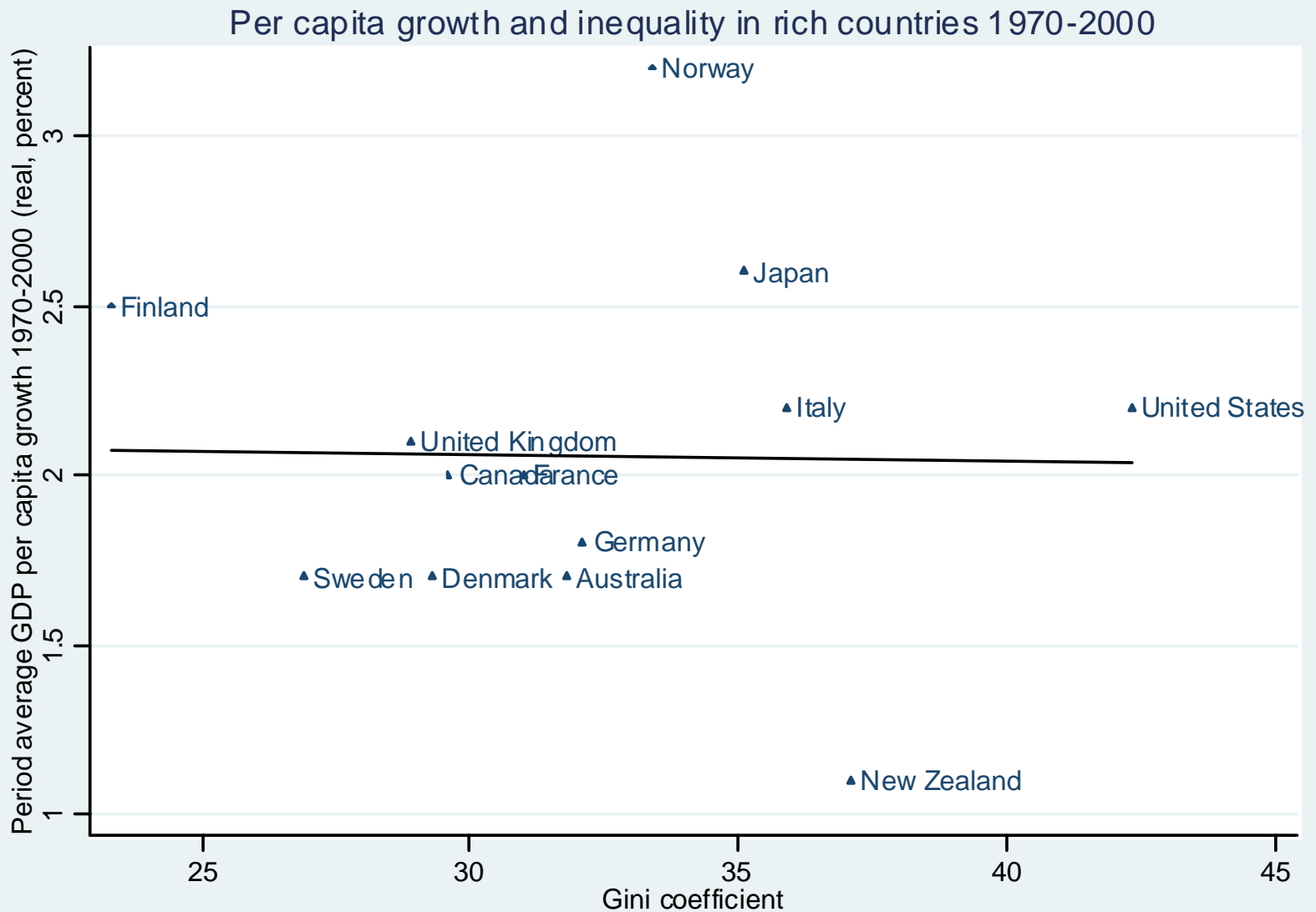
Graphs by Region

1. Inequality Within Developing Countries: Why It Matters

Definitions and Facts

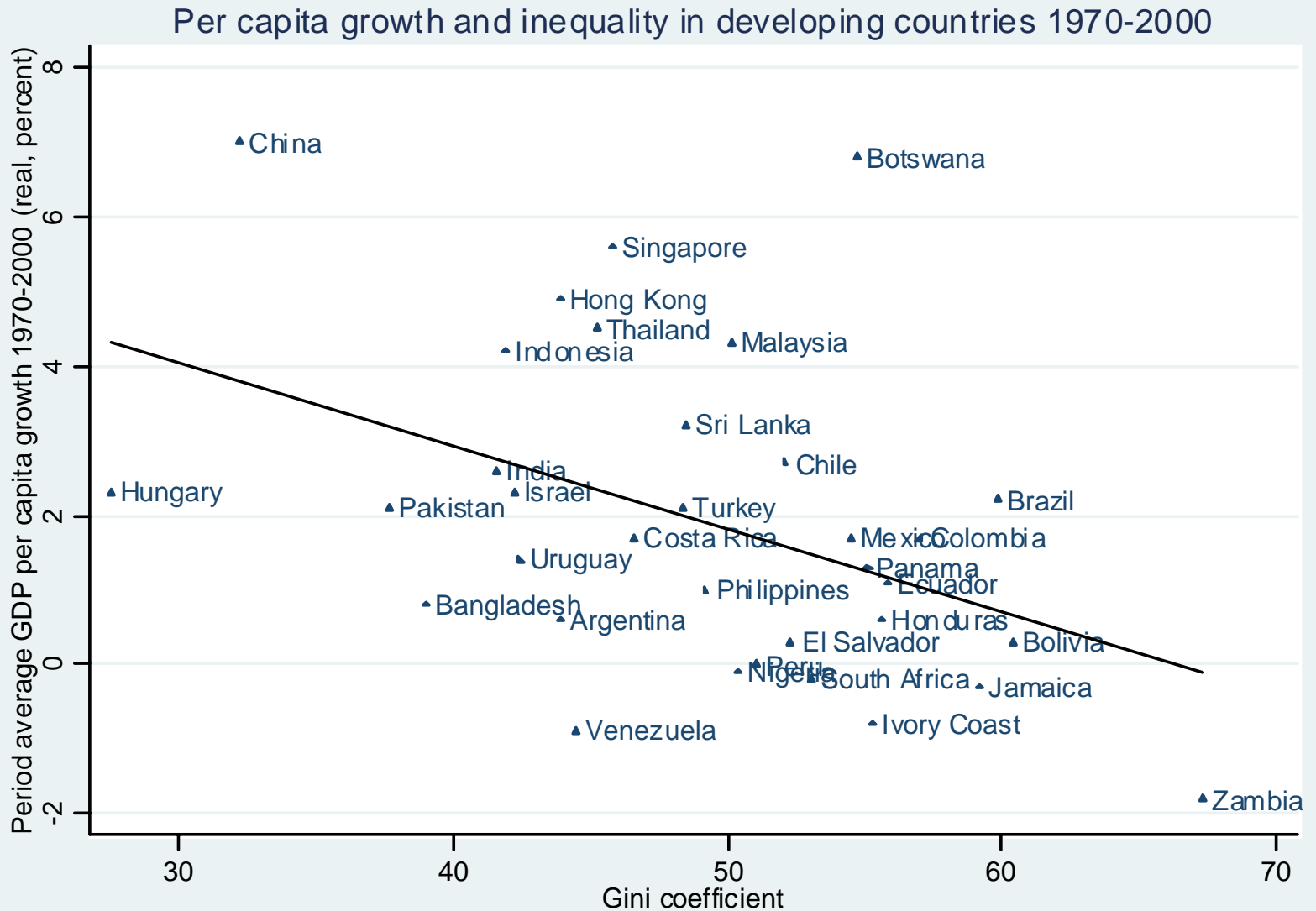
- 1.A. Inequality inhibits growth
- 1.B. Inequality undermines good public policy
- 1.C. Inequality undermines collective decision making and social institutions critical to health societies

There is no strong relationship between inequality and growth in rich countries...



Source: WIID2a, WDI (2005) and author's calculations.

...but developing countries with high inequality tend to grow more slowly

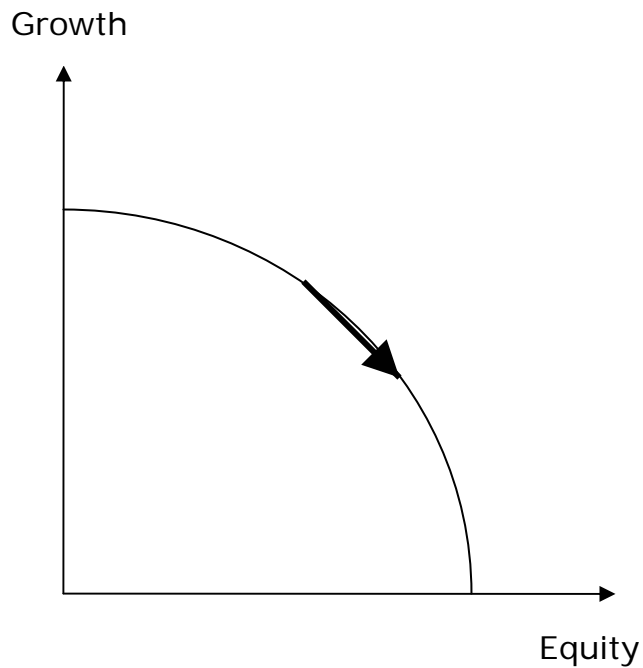


Source: WIID2a, WDI (2005) and author's calculations.

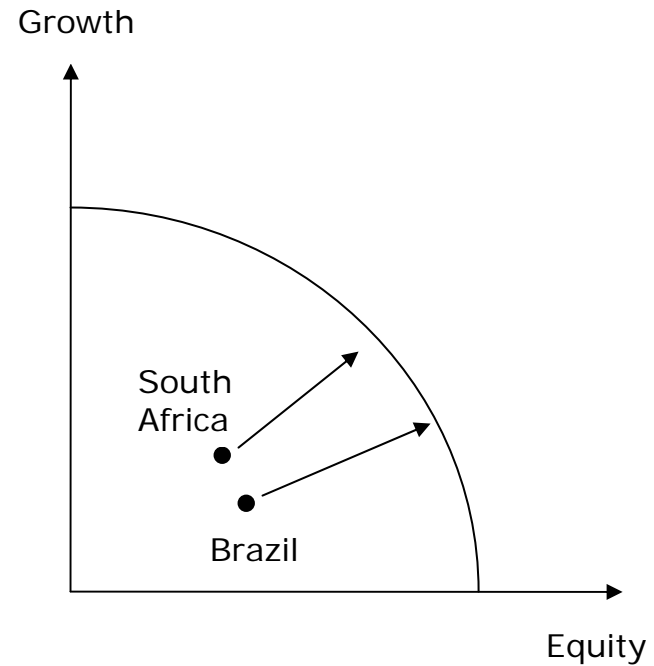
1.A. Inequality inhibits growth

– in developing countries, where markets and governments are weak

Constructive inequality
(perfectly competitive markets)

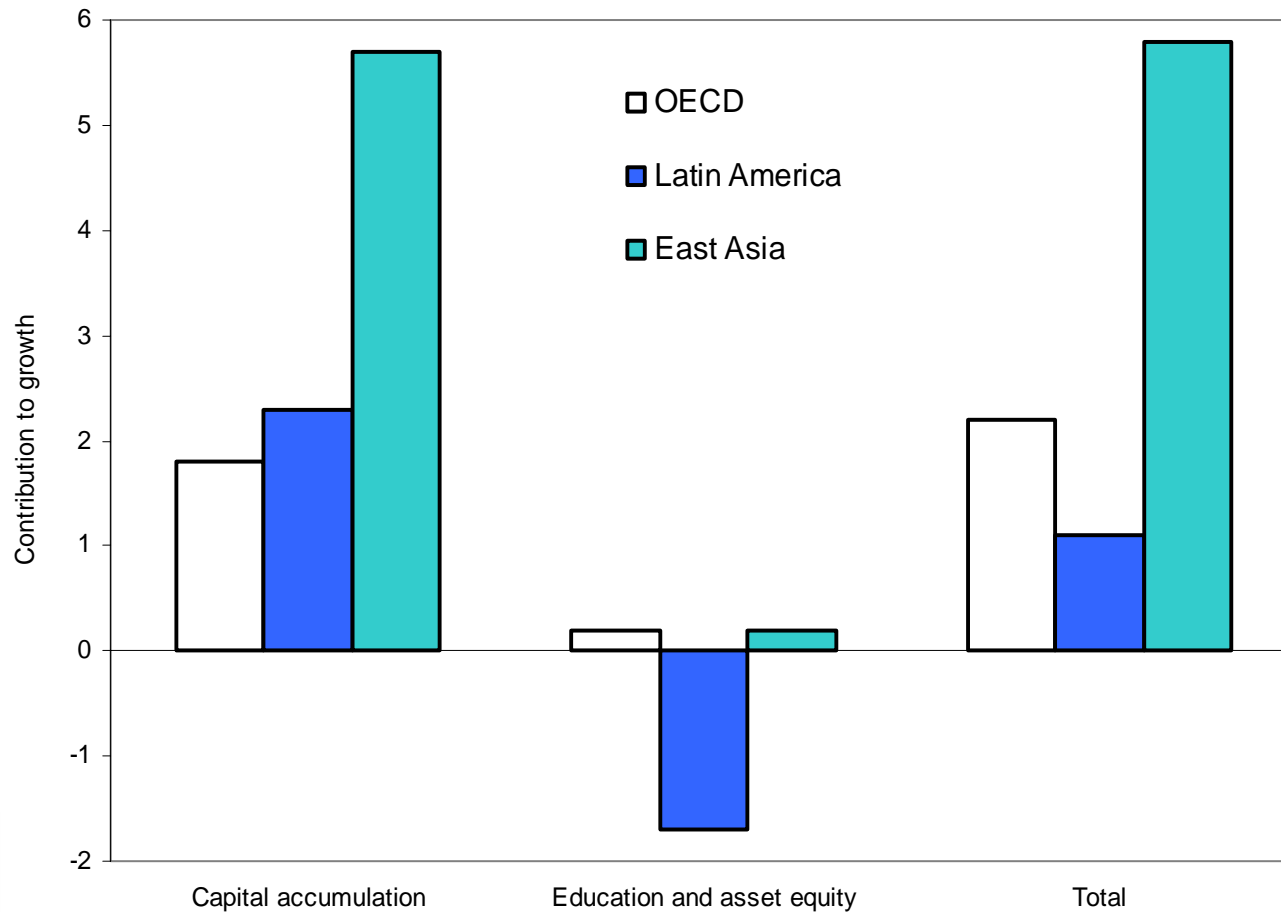


Destructive inequality
(market and government weakness)



Latin America is an example

Factors of aggregate growth 1960s-1990s
(contributions to variations in GDP, percentage)



Source: Birdsall and Londono (1998) "No Tradeoff: Efficient Growth Via More Equal Human Capital Accumulation."

1. Inequality Within Developing Countries: Why It Matters

Definitions and Facts

1.A. Inequality inhibits growth

1.B. Inequality undermines good public policy

1.C. Inequality undermines collective decision making and social institutions critical to health societies

1.B. Inequality undermines good public policy – for example educational opportunities are probably not equal in many developing countries

	Average years of schooling (15-24), 2000-2003 ^{1,2}	
	poorest 20% of households	richest 20% of households
Colombia	2.4	9.8
Guatemala	2.0	8.9
Peru	5.0	9.8
Cambodia	2.4	7.4
Philippines	6.2	10.2
Vietnam	5.2	10.3
Ethiopia	0.9	5.2
Kenya	4.9	9.0
Nigeria	3.5	9.9

Notes:

1. Average years of schooling are the years of formal schooling received on average, by adults aged 15-24.
2. Data is for the latest year available during the period 2000-2003, except for Colombia (1995), Guatemala (1995), Peru (1996) and the Philippines (1998).

Source: World Bank EdStats (2005).

1B. Inequality undermines good public policy

Inequality encourages self-defeating economic policies to “protect” poor and near-poor households, e.g.

- trade protectionism, overvalued exchange rates and price controls that hurt poor rural producers and poor urban consumers
- job “protection” (high cost of layoffs) that discourages job creation
- underpricing of water and electricity that leads to rationing that hurts the poor

1. Inequality Within Developing Countries: Why It Matters

Definitions and Facts

- 1.A. Inequality inhibits growth
- 1.B. Inequality undermines good public policy
- 1.C. Inequality undermines collective decision making and the social institutions critical to healthy societies

1.C. Inequality undermines collective decision making

- The middle class seems to matter for social capital, for democracy, and for the blessings of a common shared “civic” life in communal domains
- But high concentration of income in unequal societies implies a missing middle class
- The middle class is mostly missing at the global level and within many developing countries

The well-off middle class

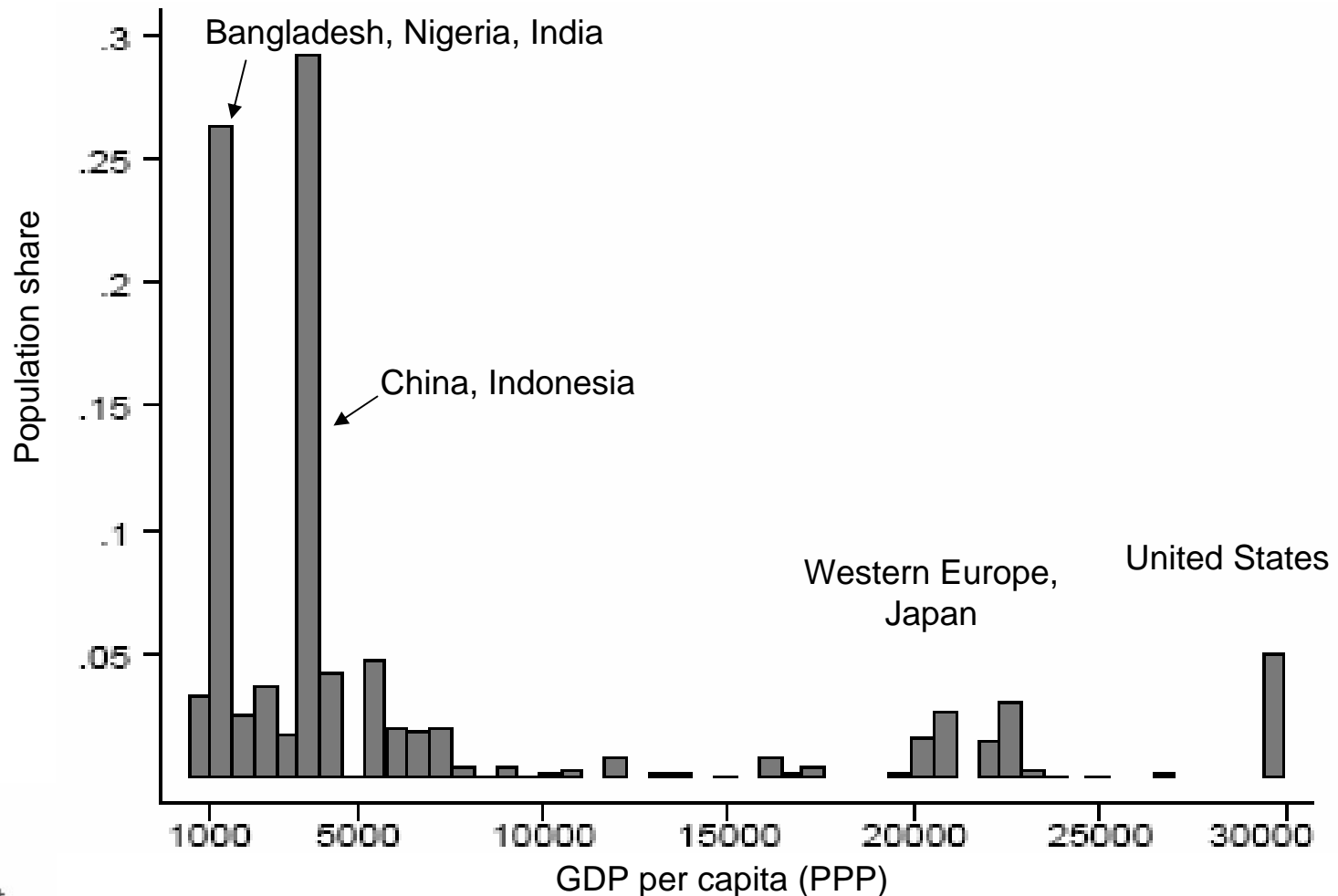


Joachim Beuckelaer, *The Four Elements: Earth*, National Gallery London

1.B. Inequality undermines collective decision making

– few countries today are “middle class”

Distribution of world population by 1998 GDP per capita

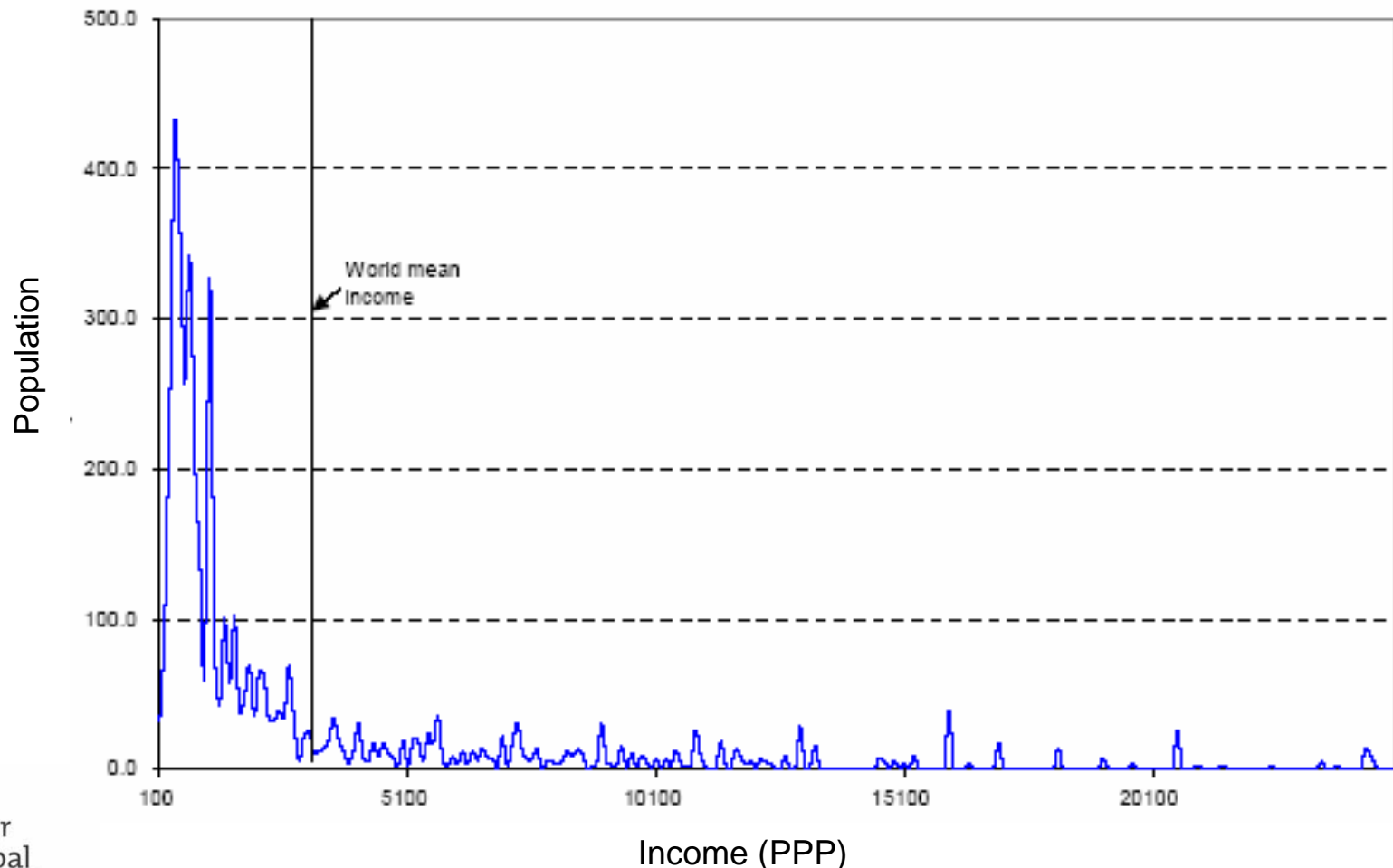


Source: Milanovic (2005) *Worlds Apart: Measuring International and Global Inequality*.

1.B. Inequality undermines good public policy

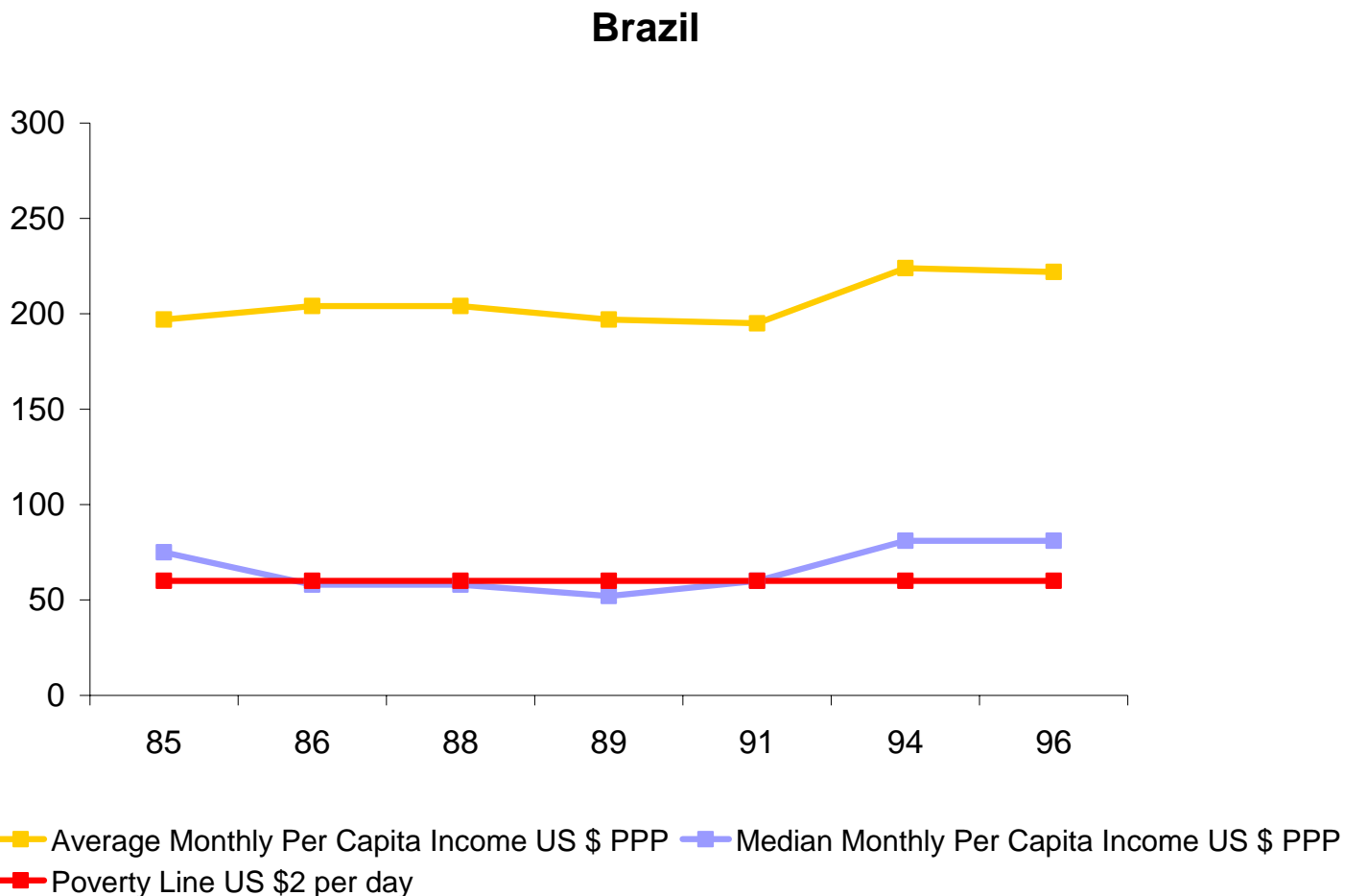
– few people are “middle class”

World income distribution (based on household survey data; year 1993)



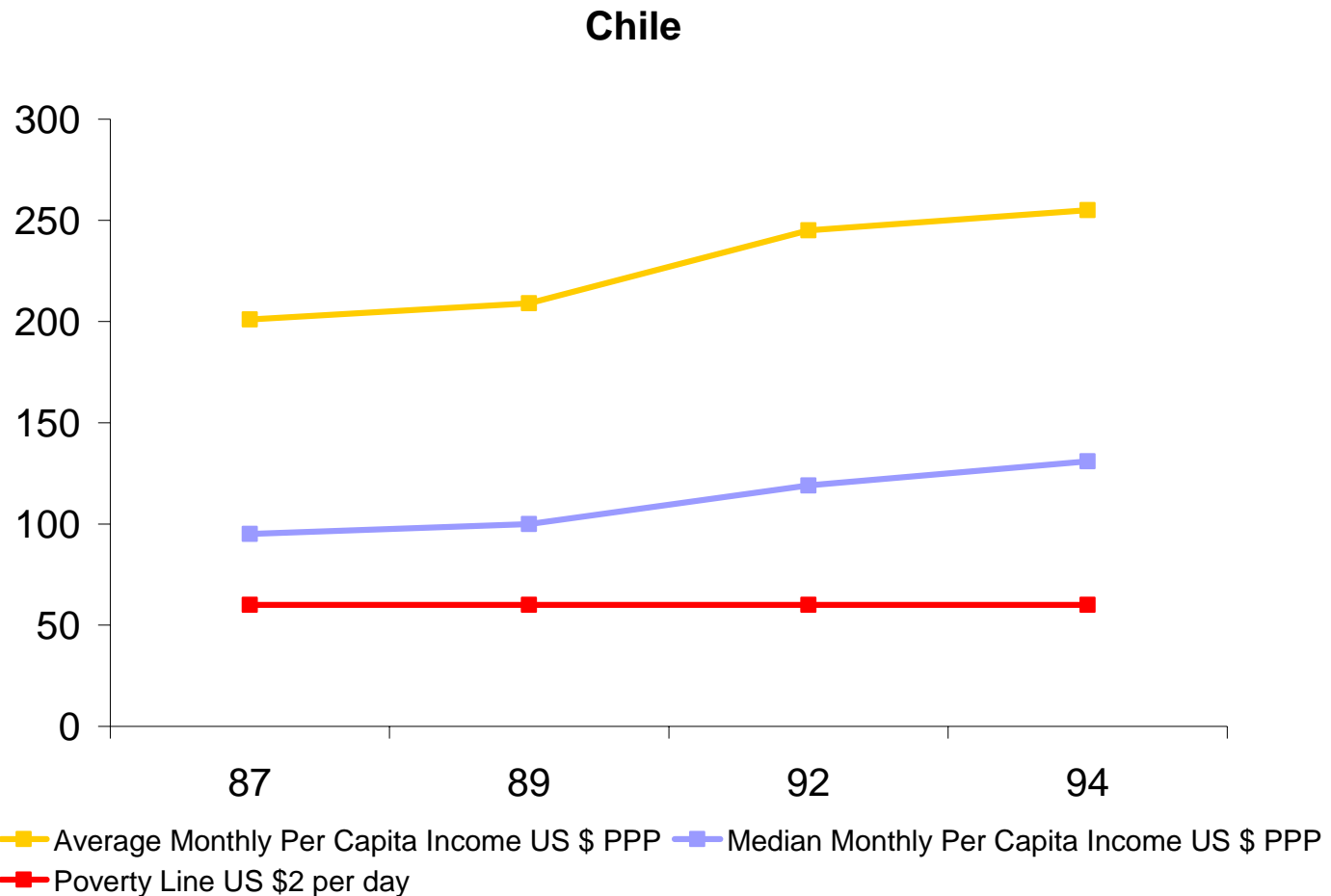
Source: Milanovic (2005) *Worlds Apart: Measuring International and Global Inequality*.

In Brazil, median household income per capita was about a third of average national income in the 1990s



Source: Birdsall (2002).

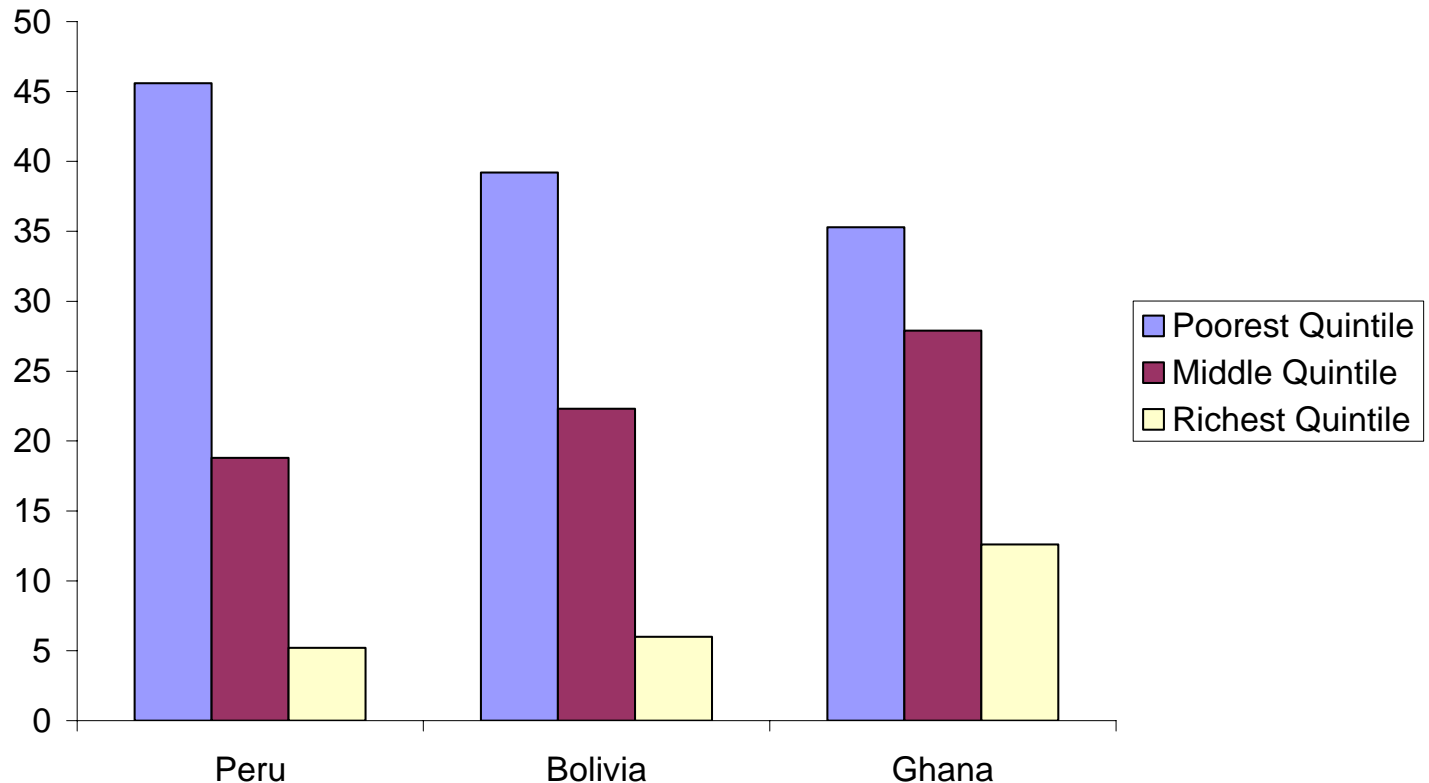
In Chile, median income has been about half of average income



Source: Birdsall (2002).

In Peru in the 90s, almost 20 % of children under 5 in middle-income households were stunted

Rates of stunting for children < 3 (Bolivia and Ghana); < 5 (Peru)
(in %)



Source: DHS.

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The message in three parts:

- 1. Inequality Within Developing Countries: Why It Matters**
- 2. “Globalization” is Desequalizing**
- 3. Constructing a Global Polity for Our Global Economy**

2. “Globalization” is Disequalizing

Definitions, debates, facts

- 2.A. Global markets work—and reward those with productive assets**
- 2.B. Global markets are imperfect—and hurt most the poor**
- 2.C. Global rules naturally reflect market power and interests of the rich**

Definitions, debate, facts

Globalization is the increasing integration of economies and societies – through flow of goods, services, capital and of ideas, norms, and peoples.

In popular use, globalization often refers to the increasing influence of global market capitalism and of global corporate and financial interests.

The debate about globalization

“No country has developed successfully by turning its back on international trade and long term capital flows.”

-Stanley Fischer, former Sr. Deputy Managing Director, IMF

“If you're totally illiterate and living on one dollar a day, the benefits of globalization never come to you.”

-Jimmy Carter, former President, USA

The debate about globalization and inequality

Globophobes: Global inequality is high and rising

Globophiles: Global inequality is declining

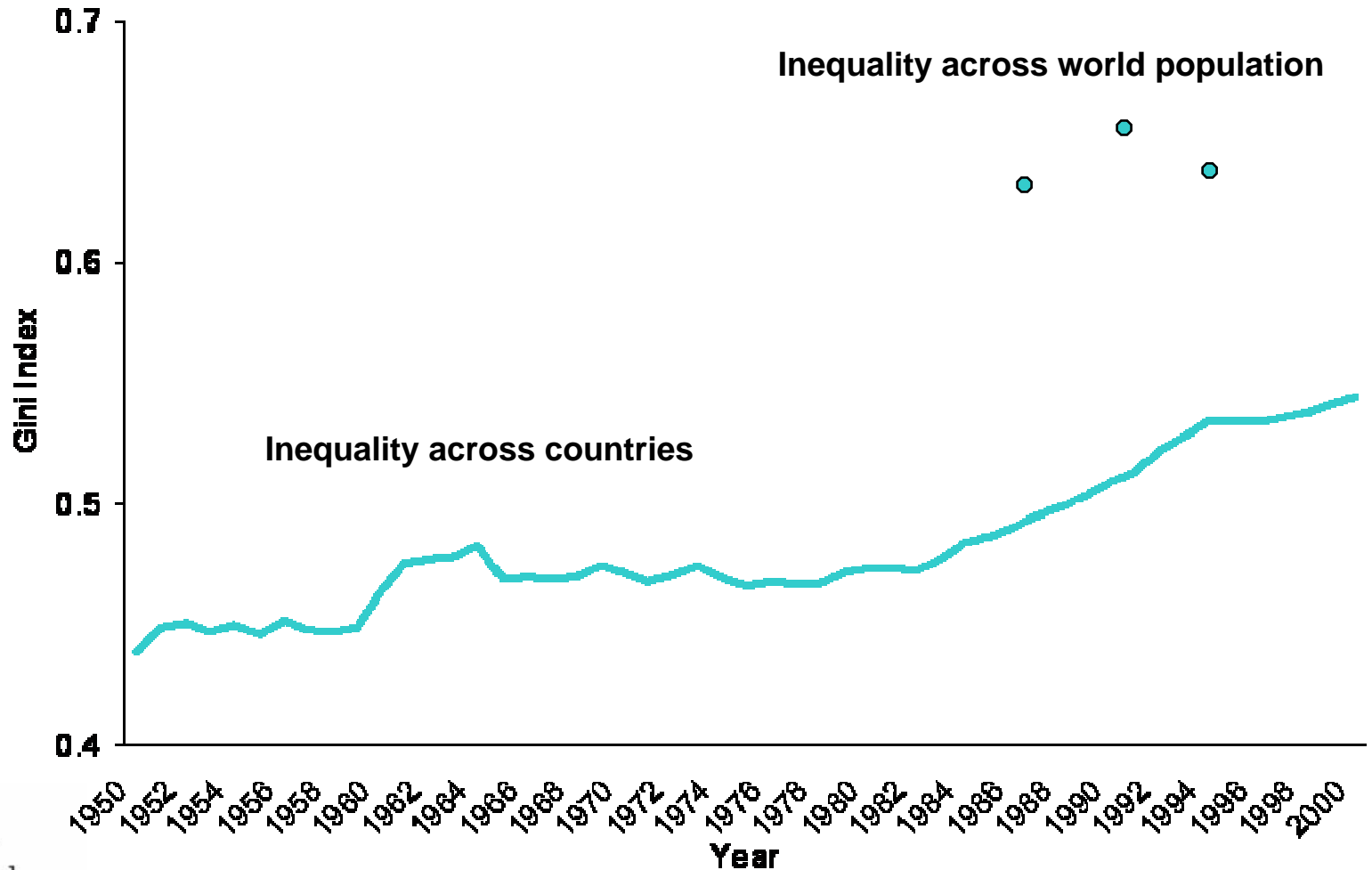
Inequality between rich and poor countries is increasing, because the rich are growing faster – “divergence big time”

Annual per capita growth rates 1980-2002

	Mean	Median	Percentage negative
"Old OECD"	1.9	2.0	17
Middle income countries	1.0	1.8	33
LLDCs	0.1	0.8	43

Source: Milanovic (2005).

At the same time, high growth in China and India is reducing inequality across all people in the world



Source: Milanovic (2005).

Globophobes and globaphiles are both right

- Inequality between the richest and poorest countries is high and continues to grow.
- But thanks to rapid growth in China and India, global poverty is declining and so is global inequality across all people.
- (Globalization is not the cause of deep poverty and destructive inequality but neither is it the solution. Indeed, where globalization is reducing poverty, e.g. China, it is also associated with rising inequality – planting seeds of future problems.)

2. “Globalization” is Disequalizing

Definitions, debates, facts

2.A. Global markets work—and reward countries and people with productive assets

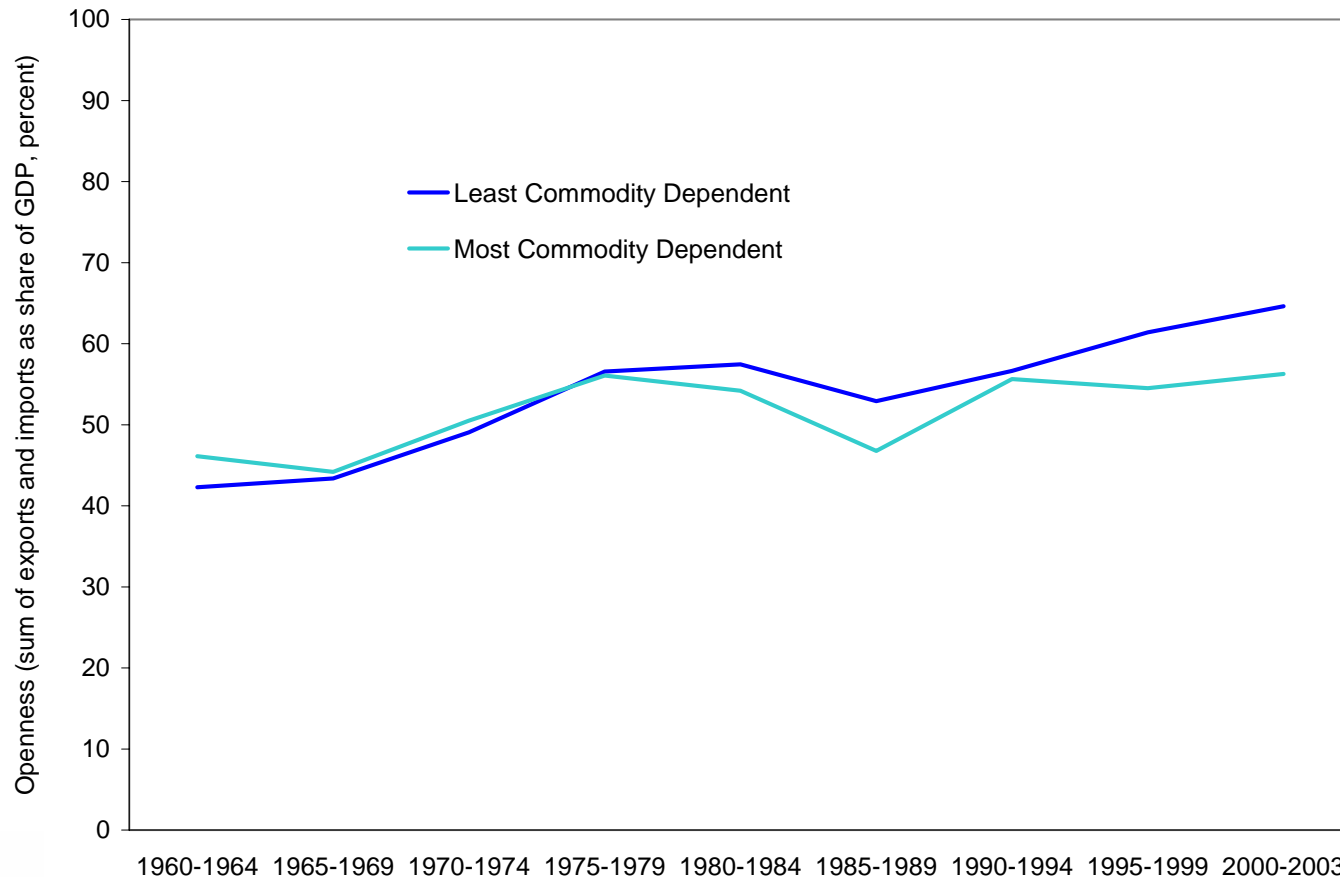
2.B. Global markets are imperfect—and hurt most the poor

2.C. Global rules naturally reflect market power and the interests of the rich

2.A. Global markets work

The most commodity dependent countries have participated in global trade for decades

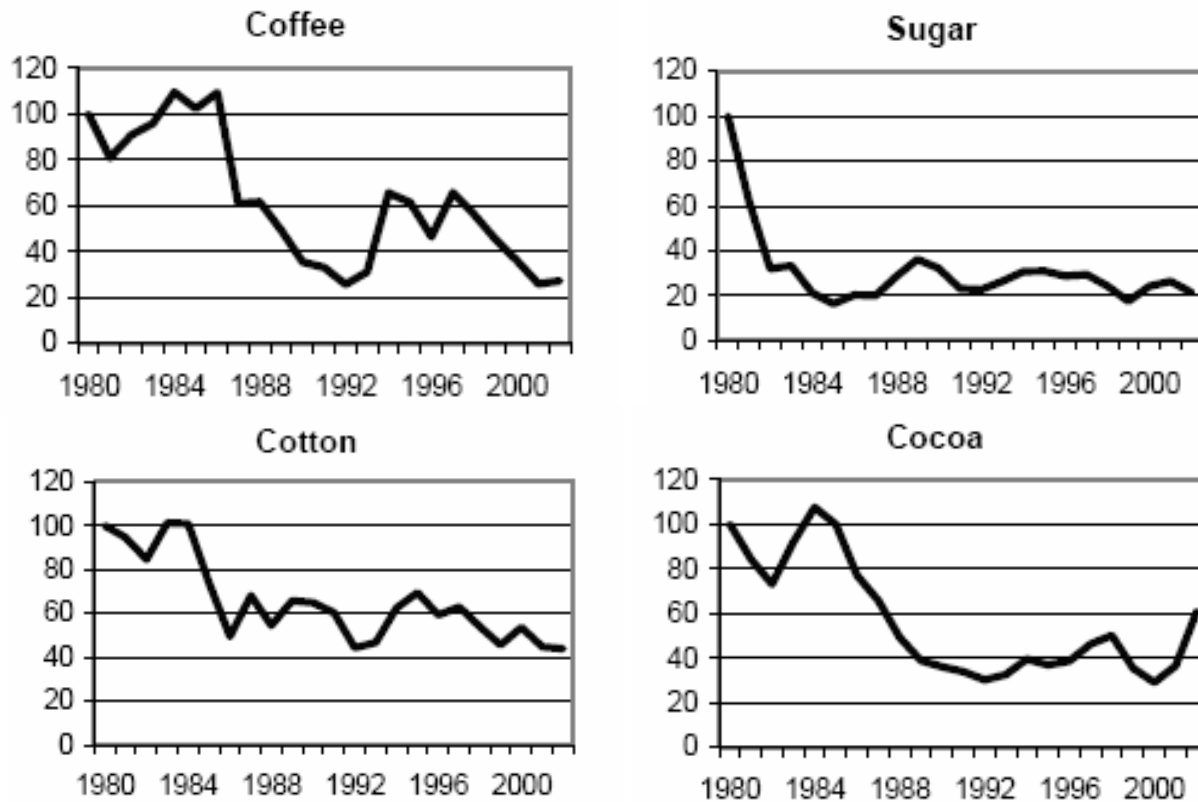
Trade to GDP Ratios for the Most and the Least Commodity Dependent Countries



Note: There are 72 "least commodity dependent" countries and 34 "most commodity dependent" countries. Trade to GDP ratios are unweighted averages.

Source: World Development Indicators, 2005 and author's calculations.

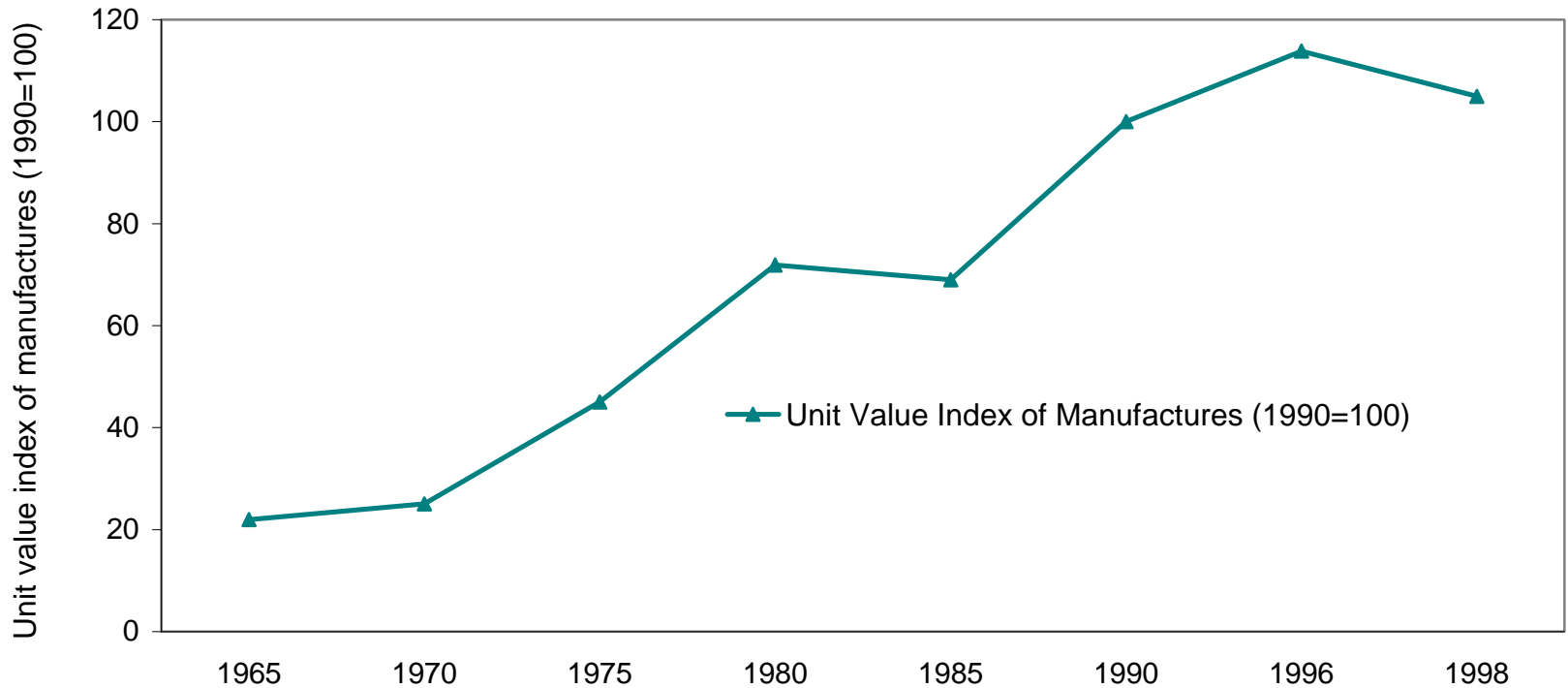
But commodity prices have been falling



Source: UNCTAD. 2005. *Commodity Price Bulletin*.

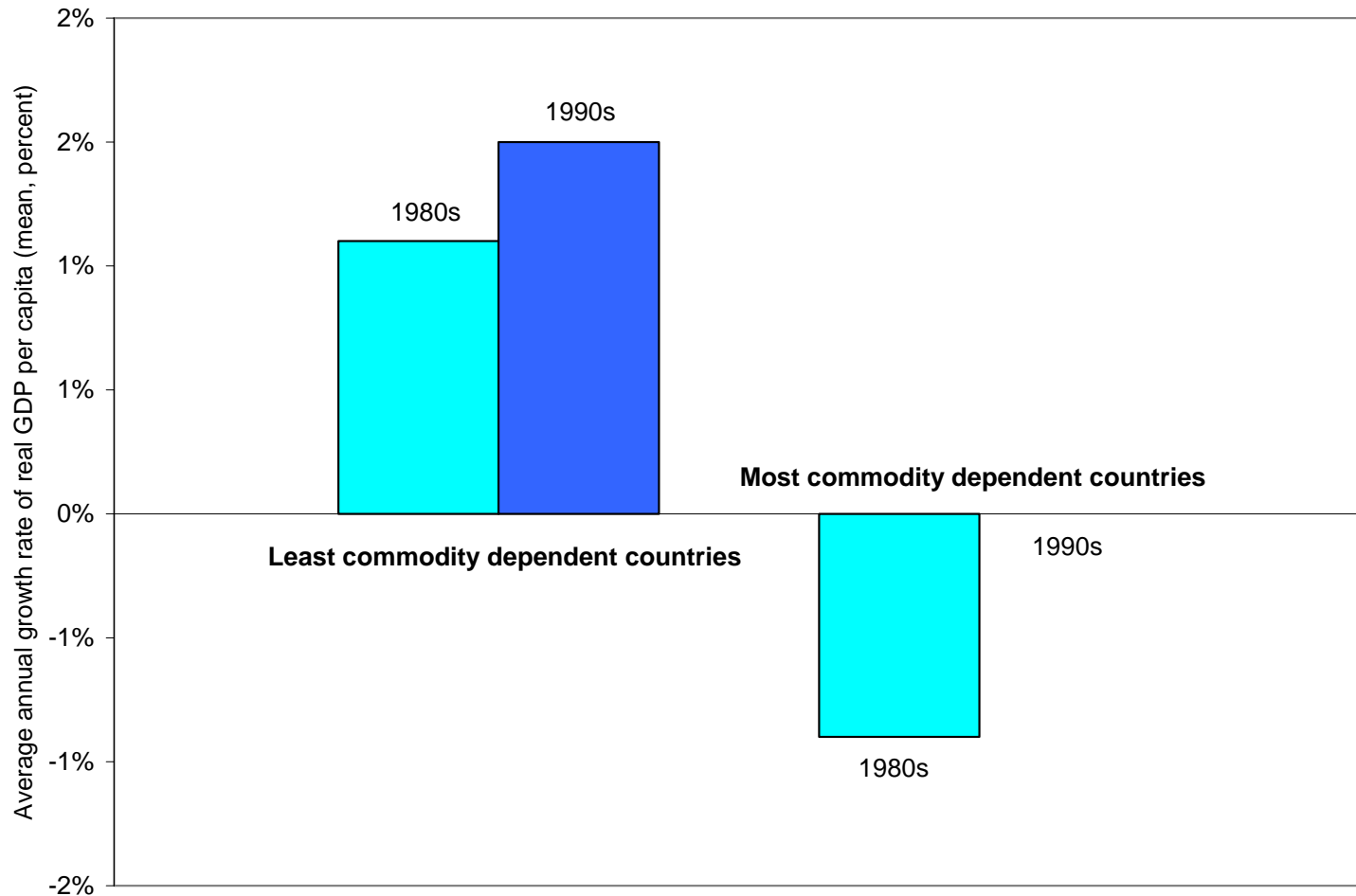
And manufacturing prices have been rising

Unit Value Index of Manufactures 1965-1998



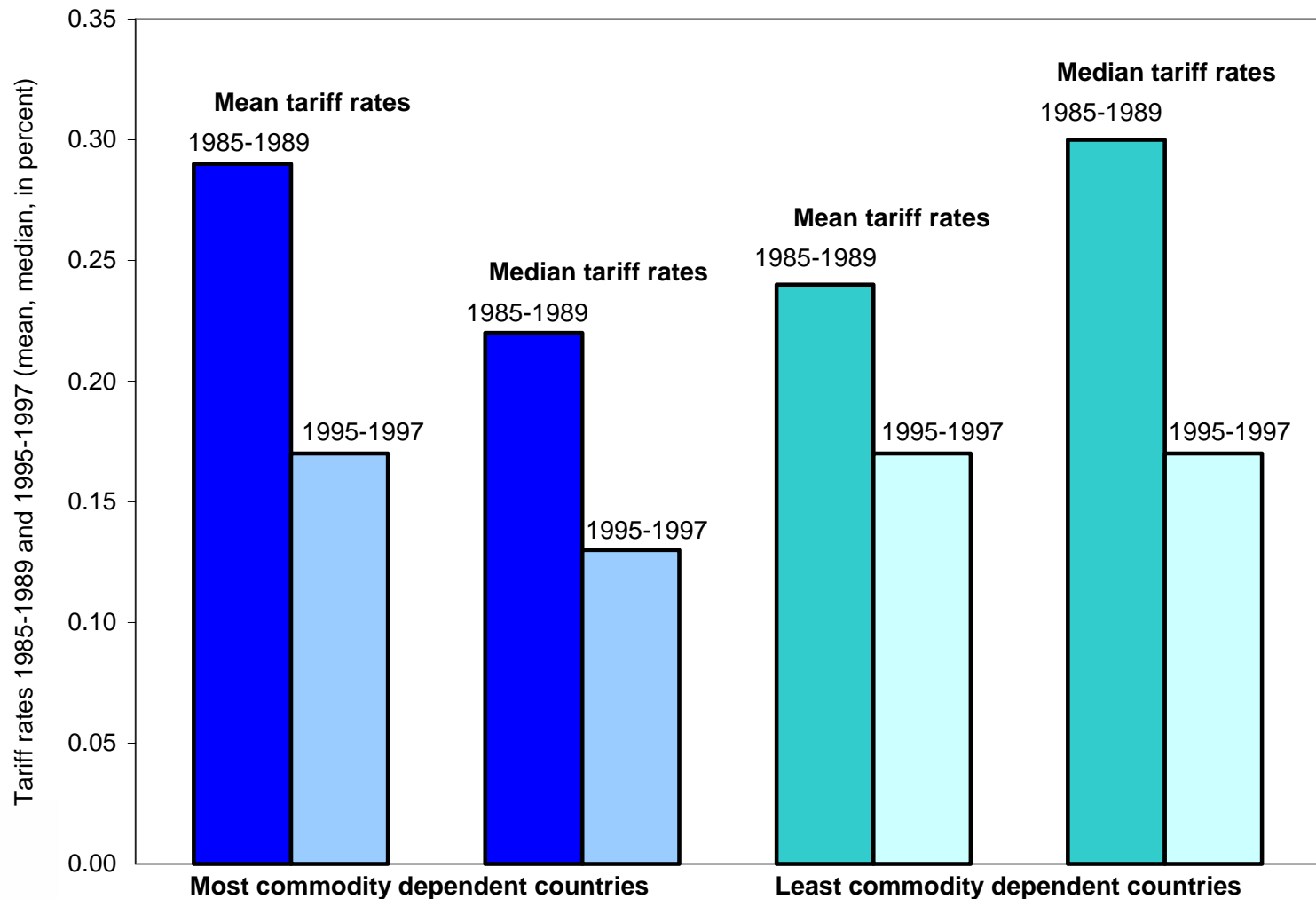
Note: Unit value index of manufactures exports from G-5 to developing countries.
Source: World Bank. 2001. *Global Economic Prospects*.

The wrong asset: Open, globalizing countries dependent on commodity prices have not grown



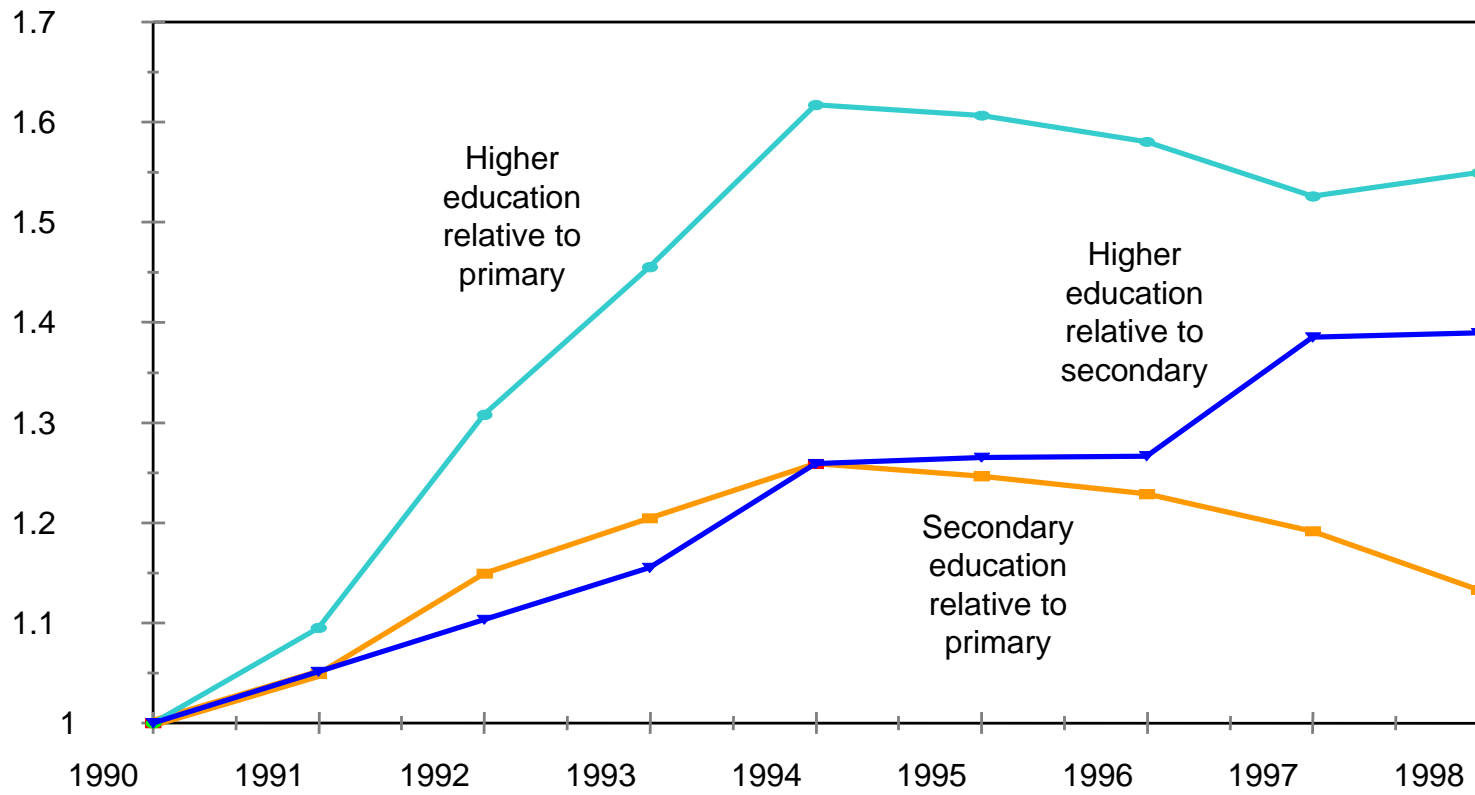
Source: Birdsall and Hamoudi (2002) "Commodity Dependence, Trade, and Growth: When "Openness" is Not Enough."

Despite having comparable tariff rates to other countries



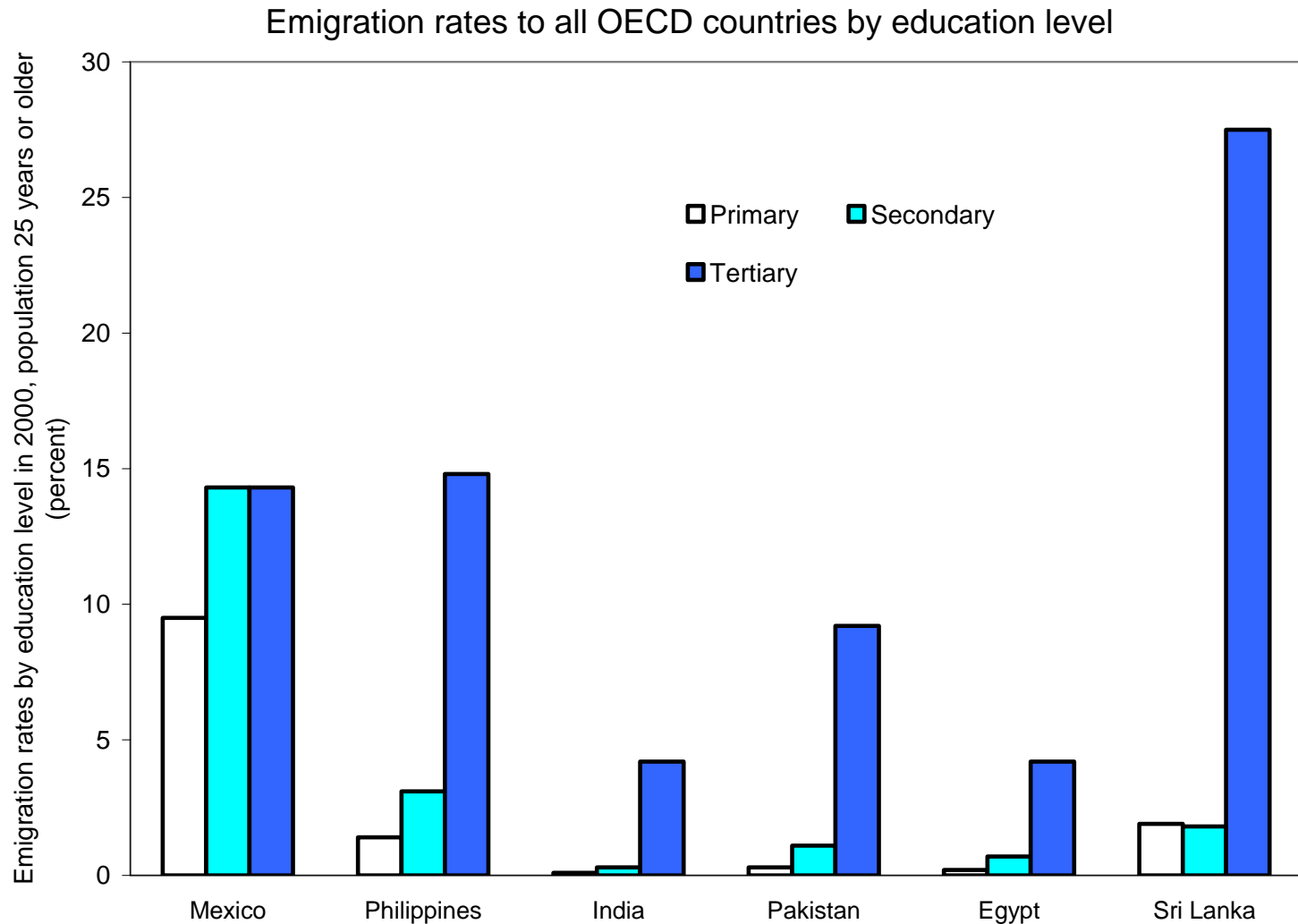
2.A. Global markets work – and reward those with productive assets

Relative log wage

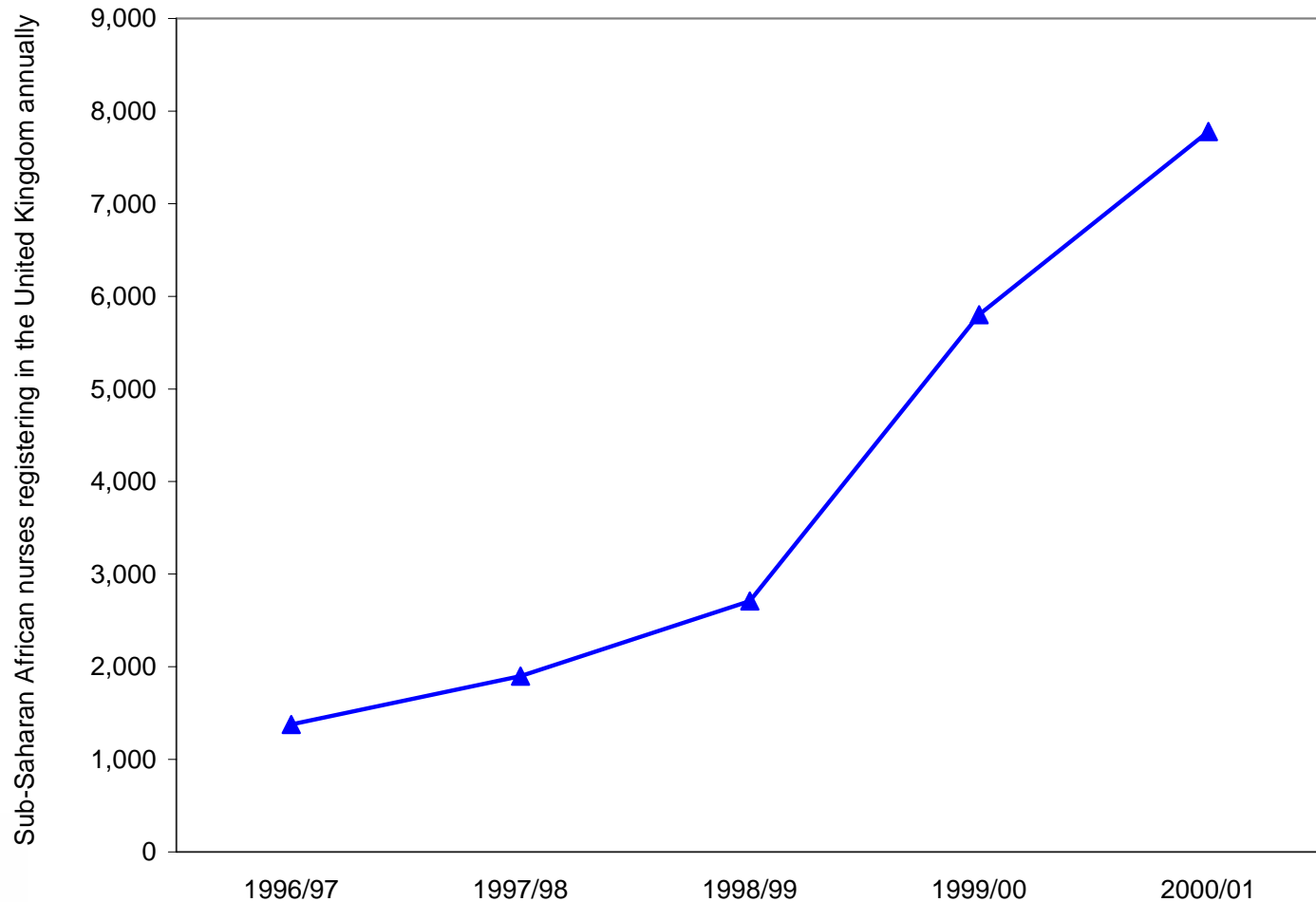


2.A. Global markets work

– encouraging emigration of those with more skills



Nurse flows from Sub-Saharan Africa to the United Kingdom



Source: UK NMC (2005).

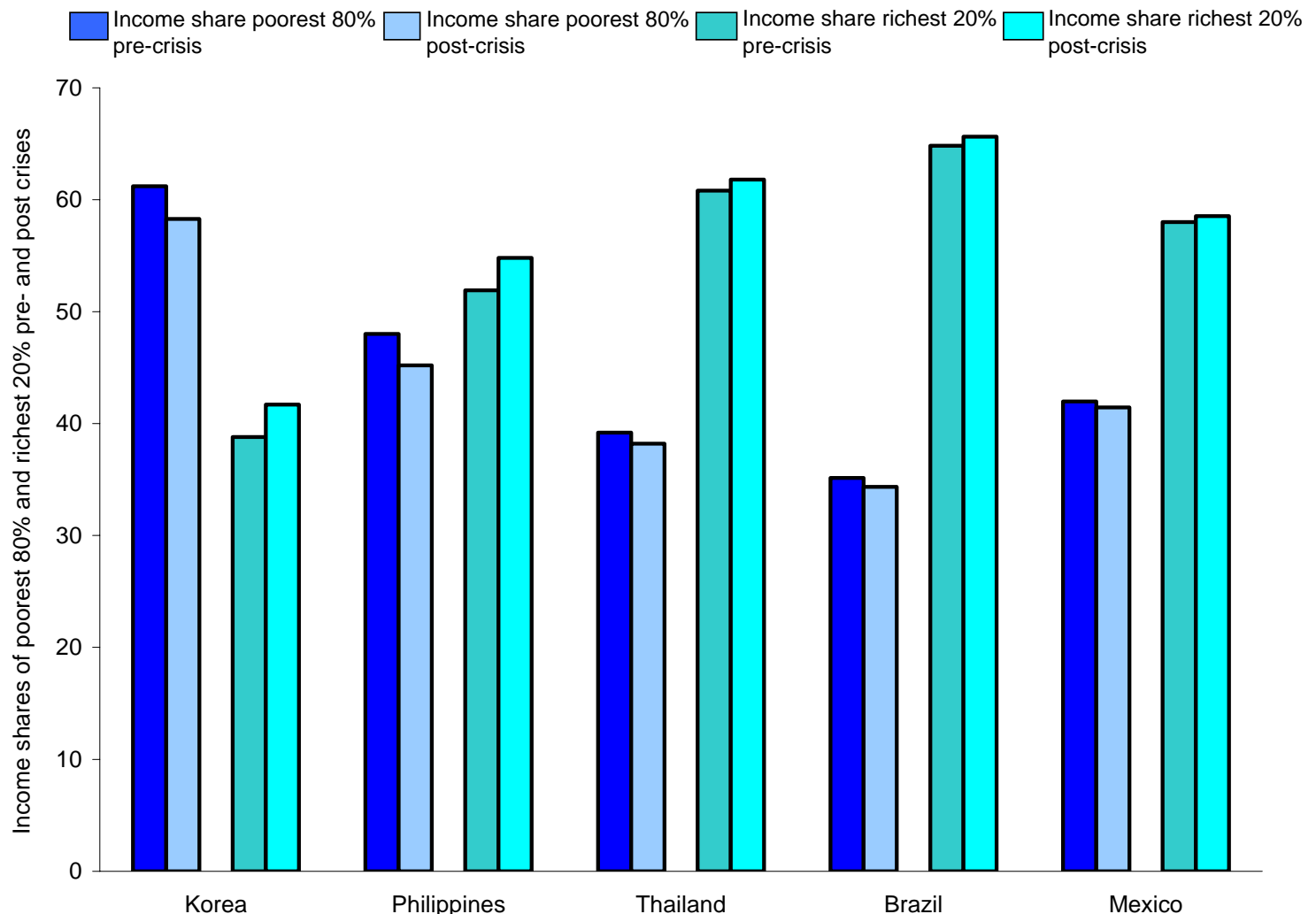
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Definitions, debates, facts

- 2.A. Global markets work—and reward those with productive assets**
- 2.B. Global markets are imperfect—and hurt most the poor**
- 2.C. Global markets naturally reflect market power and the interests of the rich**

2.B. Global markets are imperfect – and hurt most the poor.

Financial crises and changes in income concentration



Note: East Asian financial crisis 1997/1998, Brazil crisis 1999, and Mexico crisis 1994/1995.

Source: Reproduced from Birdsall (2005) "Stormy Days on an Open Field: Asymmetries in the Global Economy."

2.B. Global markets are imperfect – and hurt most the poor

Financial crises and Inequality

	Pre-crisis	Post-crisis
	Gini	Gini
Korea	32.6	37.2
Philippines	46.2	49.5
Thailand	57.5	58.5
Brazil	60.2	61.2
Mexico	52.9	53.7

East Asian financial crisis 1997/1998, Brazil crisis 1999, and Mexico crisis 1994/1995.

Pre-crisis data for Thailand, Korea and Brazil are from 1996, for the Philippines from 1994 and Mexico 1992. Post-crisis data are from 1996 for Mexico, 1998 for Korea, 1999 for Thailand, 2000 for the Philippines, and 2001 for Brazil.

Source: WIDER WIID 2.0a.

Source: Reproduced from Birdsall (2005) "Stormy Days on an Open Field: Asymmetries in the Global Economy."

Message in three parts.

The connection between 1 and 2?

- 1. Inequality Within Developing Countries: Why It Matters**
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2.C. Global rules naturally reflect market power and the interests of the rich

Design of rules favors rich country interests:

- Current trade regime
- International migration
- International property rights (TRIPS)

And *implementation* of reasonable global rules often reflects interests of more powerful rich

I.e. just global rules and fair implementation

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3. Constructing a Global Polity

- Because markets work:
A global social contract to address unequal endowments across countries – foreign aid, aid for trade, World Bank, aviation taxes and so on.
- Because global markets are imperfect:
New and improved global rules and regulatory arrangements to provide for public goods (Green Revolution), protect the global environment against global bads (Kyoto and beyond), manage global financial risks (IMF, Sovereign Debt Financing Facility), discourage anti-competitive processes (a global anti-trust agency), and so on.
- And. . . .

3. Constructing a Global Polity

Because global rules tend to reflect the interests of the rich (With costs for all who seek a more secure, prosperous and just world):

- More voice and more votes for poor countries and poor people in global fora ... in the IMF, the World Bank, the UN Security Council, the Basle Committee for Banking Regulation and Supervision, the G-8, and so on;
- and more emphasis on surveillance of rich countries' commitments and adherence to fair rules; new efforts to complete the Doha as a development round; an International Migration Authority ...

A Global Polity for Our Global Economy

Most global inequality is destructive – reflecting unequal endowments and opportunities across countries and peoples. In the face of that inequality, global justice will remain a constant theme in the 21st century.

Our global market system has tremendous potential benefits – but only if we construct a more robust and representative global “polity.”

. . .with a mission to secure a less divided, more just and more development-friendly world.