

Discussion

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Introduction

The second half of the 20th century has been marked by an unprecedented move towards worldwide financial and commercial integration. This integration has led to an overall rise of welfare. Economic theory has proved that trade generates considerable gains. These gains arise from the specialisation of each country according to their comparative advantages, and from their access to larger markets, which enable countries to benefit from economies of scale and to diversify their production. During the second half of the 20th century, world GDP experienced a six-fold increase while world population increased by only around 2.5 times. But the effect of globalisation on income distribution remains a debated issue.

Skeptical opinions are heard, in both developing and industrialised countries, be it in civil society or among economists, which denounce an increasing dispersion of income both within countries and between countries, ascribed to financial and/or commercial globalisation.

This debate matters for three main reasons. From the standpoint of ethics, the community ought to keep a watchful eye on both overall income disparities and the income levels of the poorest people in the community. From the standpoint of economic efficiency, income disparities on too large a scale can threaten the stability of growth and the integration of the most unprivileged populations. Finally, from a political point of view, the globalisation process can be accepted and legitimate only on the condition that everyone benefits from it.

This analysis presents methodological difficulties. First, globalisation covers a range of phenomena that have different consequences and act over different time scales. Second, measuring income inequalities is difficult: the different methods available lead to diverging perceptions of the phenomenon. On the whole, it appears that the evolution of inequalities in the course of the globalisation process exhibits some concerning features. To sum up the main facts:

- Income inequalities have apparently stabilised during the last two decades; but it should not hide the fact that inequalities have increased dramatically throughout the century. This discrepancy is mainly the result of growth differentials between countries. Africa is clearly the first hit in that respect.
- Beyond short or medium-term changes, the main ground for concern is the very high *level* of income disparities.

1. This text sums up the main conclusions of a report written by Luc Eyraud for the French Treasury. We are grateful to François Bourguignon, Pierre Jacquet, Jean-Pierre Landau and Daniel Cohen for their comments.

- The number of people in extreme poverty remained stable during the 1990s.

The report aims at assessing whether the high level of inequalities is linked to globalisation and, in addition, at drawing possible ways to make the distribution of gains from globalisation more equitable.

Is globalisation creating inequalities?

Recent academic research demonstrates that globalisation undoubtedly generates wealth but that the distribution of this wealth among and within countries is at issue and seems unequal. More precisely, it seems that:

- Market opening is necessary, but is probably not sufficient to reduce inequalities between countries.
- Other things being equal, the opening also has redistributive effects within both developing and industrialised nations.

Globalisation and inequalities between countries

A direct link between trade opening and income inequality is hard to establish, both in theory and in facts. But the question is not to weigh up the pros and cons of trade opening. Undoubtedly, trade opening is an essential condition for convergence. However, its benefits do not show automatically:

- Opening generates opportunities for development, but seizing them is another issue. For example, history shows us that ‘under-development traps’ that prevent countries from benefiting from trade, can exist.
- Opening has its own costs and risks, which are unequally distributed among economic players (as demonstrated by the new ‘economic geography’ theories).

As a consequence, reducing inequalities requires trade opening, but not just of any sort. This raises the question of how the opening process can be conducive to a reduction of inequalities.

Inequalities within developing countries

Trade opening is essential for developing countries to catch up, and therefore for reducing ‘within-country’ inequalities, but it also can be seen as a shock that has consequences for domestic income distribution. In the end, does trade opening improve or reduce the living standard of the poor? According to classical international trade theories, opening reduces inequalities in developing countries, endowed with low-paid labour, because it prompts specialisation in areas that require comparatively more of these workers.

Empirical studies suggest that the increase in wealth brought about by globalisation delivers benefits to the overall income distribution, and thus improves the income of the poorest. This evidence leads to an optimistic assessment of globalisation. However, it takes more to assess globalisation’s impact on internal inequalities

because it also induces indirect effects stemming from global shocks (such as AIDS, financial crises, collapses of commodity prices), which affect poor populations more seriously.

Inequalities within industrialised countries

There is a widespread consensus that unskilled workers are those who ‘lose’ from globalisation in the industrialised countries, because it makes the demand for their labour both lower and, according to some authors, more volatile.

The question is whether the decline in the demand for unskilled labour should be attributed to globalisation (through the competition exerted by developing countries, relatively more endowed with this factor), or to the emergence of technical progress that is biased in favour of more skilled workers.

Academic research attaches more importance to technical progress. However, the two explanations are not exclusive. If globalisation reinforces a new division of labour that gives a central role to technical advances in the North, then it will aggravate inequalities. For example, this will happen if globalisation prompts the North to reallocate activities towards research and development and towards the production of high-value-added goods, which, because they require the mastering of technical skills, reduce the demand for unskilled workers.

However, new trends call for confidence in the future. The demand for low-skilled workers could rise under two forces:

- Technical advances (especially, information and communication technologies) can deliver benefits directly to unskilled workers. Indeed this underlies efforts by the international community to reduce the so-called ‘digital divide’.
- Reactivity to the market, which becomes a key issue in corporate strategy, leads to a concentration rather than a relocation of activities.

Towards a more even distribution of the gains of globalisation

There are different ways to make the distribution of wealth more even by implementing appropriate economic policies.

Fighting inequalities between countries

How to minimise risks and costs, while benefiting from the opportunities provided by globalisation? The report identifies several conditions to be met by the opening process in order to enable developing countries to catch up on a stable basis:

- *A sound opening*: good governance and appropriate institutions to ensure the efficient functioning of markets (implementation of the standards and codes agreed by the international community, a sound financial system, creation of supervisory and competition authorities, participation in multilateral regulation bodies, etc) are essential to mitigate the shocks that open economies are exposed to.

- *A diversified opening*, with an aim to find growth-conducive market specialisations and to promote new information and communication technologies.
- *A cautious opening*: as far as capital flows are concerned, there is now a widespread consensus that the opening has to be progressive and conditional on the implementation of sound macroeconomic policies and an appropriate supervisory and institutional framework. Regarding the flow of goods, the opening process must ensure effective progress towards complete openness and eliminate rents, entrenched advantages, and economic inefficiencies, while preventing the shocks that weaken the poorest populations.
- *A reciprocal opening*: rich countries should open and provide developing countries with new markets (as illustrated by initiatives like ‘Everything But Arms’) and help these countries strengthen their trade capacities.
- *An opening accompanied* by international development aid. Aid must be better allocated and better used. It should support, in priority, countries where it will best be used, i.e., those with the best governance and where its allocation can be monitored. It must finance projects ‘owned’ by the recipient countries and which are embedded in a global development strategy; it must be managed more efficiently and in a more coordinated manner by donors; finally, its volume must grow to meet the infrastructure, education and health needs of developing countries.

Fighting inequalities within developing countries

Should we aim at fighting absolute poverty (a ‘Rawlsian’ criterion) or income inequality? Although it is difficult to settle the question, this report considers the reduction of poverty as the main objective: priority must be given to the improvement of the situation of the most vulnerable, who bear the cost of the opening process without taking advantage of its opportunities. Analysing the consequences of globalisation on the distribution of income on the whole is necessary, though only as a second step.

Therefore, the report advocates the implementation of policies targeted at the poor. These policies should aim at:

- giving the poor access to markets, as suggested by Sen, who stresses the importance of the inequality in opportunities. Policies against inequalities should favour economic, political and social integration of the poor; and
- reducing the exposure and vulnerability to risks of the poorest populations.

Aid must play a key role in the fight against ‘within’ inequalities, because these are not only related to internal causes. The poor are directly affected by factors that are beyond their control, and sometimes also beyond the control of their governments: fluctuations of the global economy, financial crises, the consequences of technical progress, pandemics, and regional conflicts.

Fighting inequalities within industrialised countries

Effective means of preventing the exclusion of unskilled workers are available to the governments of industrialised countries:

- In the short run, traditional income redistribution, support of the demand for unskilled work (for example, by lowering social security contributions for the lowest paid) and, particularly, encouraging return to work (for instance, by introducing earned income tax credits and by restructuring unemployment benefits to provide more incentives to work) can balance the effects of globalisation on unskilled workers, without challenging the functioning of the labour market.
- In the long run, the problem should be tackled at its root by raising professional qualification levels through initial and lifelong training, encouraging redeployment towards the most dynamic sectors of activity, and enabling the South to enjoy progressively the social standards of the North.

Yet, the issue of financing policies that counteract income inequality remains, especially when countries' tax bases are increasingly mobile. There is a risk that, ultimately, the less mobile segment of tax bases might be relatively more taxed, which would penalise the poorest. First, governments must aim at a sound management of public finances and at re-allocating their resources in accordance with their priorities, among which is the fight against inequalities. A certain degree of coordination is also necessary in the field of tax policies in order to fight the most harmful forms of tax competition.

In the very long term, in the prospect of an increasing integration of economies, analysis has to be carried out concerning various proposals of international levies meant to reduce global inequalities. Proposals already discussed publicly are, *inter alia*: levies on carbon dioxide emission, on arms trade, on international financial transactions, or the allocation of a fraction of corporate taxes on a global scale. However, the implementation of redistribution tools on a global scale should not be detrimental to economic and fiscal efficiency and to the continuation of opening.

2. Edward M Gramlich

I appreciate the hospitality in Sydney, and congratulate the Australians on having such a nice conference on such an important topic. I am a relative novice to the field of globalisation and inequality, but I found the three papers this morning very interesting and plan to bring in material from all three. Since this is a research conference and since I have not had a chance to show my remarks to others at the Fed or the US Treasury, my remarks represent only personal opinions, not official positions.

The papers ask two central questions:

1. Does openness lead to economic growth?
2. Does growth reduce poverty?

There seems to be little dispute about the second question but much about the first, so I begin there.

Does openness lead to growth?

The earlier view was that import substitution, numbers of factories and workplaces was the key to economic development. Sometime around 1980 most people became disabused of this opinion and changed their minds. But there has been a split on what they changed to.

The Dollar-Romer view, in Dollar's paper, focuses on innovations and their connections to globalisation. The internet, and technology brought in by foreign firms and learned by students studying abroad, are key transmission factors. The spread of technologies around the world eliminates the idea gap and permits emerging market economies to grow. Openness is important to emerging market economies, as are reductions in barriers to openness. But logically this view does not mean that openness without the technology spread will work and Birdsall shows why. She has pretty convincing evidence that commodity-dependent countries were open, but did not grow well. Moreover, capital account liberalisation can actually increase growth volatility, which can be especially damaging to the poor.

The theoretical opposite to the Dollar-Romer view can be found in Wade's paper. He stresses internal integration, input-output networks, supply chains and technology spillovers. He cites the industrial policies of Japan, South Korea and Taiwan as focusing on these networks and being highly successful.

Can we reconcile these views? Partly. It is not impossible to have both together – openness to ideas with some attention to internal integration. For example, US graduate schools had many students from Japan, South Korea and Taiwan in these countries' growth spurt periods.

Beyond that, I can see how openness would raise imports of capital, technology and ideas, constrict sheltered industries and promote growth – a basic lesson of European economic history. But I can also see, *à la* Birdsall, how measured openness could leave a country with just its earnings from a cash crop, leave it subject to the vagaries of world commodity prices, and never promote internal integration.

Similarly, I can see how industrial policies could work. But I can also see how industrial policies could get captured by politicians and turn into a gigantic rent-seeking machine.

The basic point here is that openness as such seems like a statistical instrumental variable, somewhat but not perfectly correlated with policies that are truly designed to stimulate growth. These policies are sensible monetary and fiscal policies, efficient tax systems, enforceable contracts, support of human capital investment and stamping out corruption. Openness is valuable to the extent that it enhances

these. But if it does not enhance these, openness as such may not be all that valuable. As Birdsall says, it all depends.

Poverty reduction

As said before, there is not much doubt that economic growth leads to poverty reduction. But there is an empirical debate on how much poverty reduction there has been. I'll let Dollar and Wade fight it out on that issue but I would like to make some methodological comments regarding the measurement of poverty reduction.

One involves poverty and inequality. Take a population mired in poverty, as much of the world was around 1980. How can it improve its status? By the economic equivalent of a magic wand moving the whole income distribution up? Probably not. By some countries getting lucky or following sensible policies? Probably more likely. But inequality statistics will show increased inequality when this happens by stretching out the right side of the income distribution. There are some times when inequality statistics might be very meaningful, but here is a case where they are not. For these cases analysts are better advised to focus directly on poverty reductions, which will give appropriate signals.

My second methodological comment refers to geography – the difference between a country and the world. Many papers use worldwide distributional statistics – line up everybody in the world according to their per capita income and compute Gini coefficients or some other distributional statistics. There may be some use for statistics like this but it reminds me of computing worldwide GDP. I've never seen anybody compute that and wouldn't know what to make of it if they did.

I would instead argue for measures that permit individual country data to be analysed separately. First, the data are of different qualities for different countries. Second, living styles may differ, family sizes may differ and the interpretation of per capita statistics could be clouded by family economies of scale. Third, and most basic, policies are made by individual countries, poverty line norms differ from country to country, public good provision differs from country to country and it makes sense to analyse different countries separately.

Civilising hand

Nancy ends her paper with a reference to a civilising hand designed to make openness work. Except that she doesn't say what she means by that. Let me try to fill in the blanks, separately for emerging market countries, developed countries and the rules of the game.

Emerging market countries

Emerging market countries are of course affected by external factors, but recent experience has shown that they can do a lot to put their own houses in order. They need proper fiscal policies to promote national saving and capital formation. They need efficient tax systems and a system of enforceable contracts. They need to limit

rent-seeking and corruption. They need monetary policies to promote low inflation. The real reason they cannot settle international accounts in their currencies, or borrow long-term in their currencies, is that the international community does not trust their currencies. There are plenty of things that emerging market countries can do to put their own houses in order, and many countries around the table are doing just that.

Developed countries

One can perhaps debate openness for emerging market countries, but not for developed countries. Developed countries should be open, period. They should eliminate trade barriers and subsidy programs. They should eliminate capital barriers and have generous aid policies. They should control their own rent-seeking politicians. I would even say that they should be open to immigration and when a developed country has an ageing population, this openness can be a win-win situation for emerging and developed economies alike. No developed country in the world is a perfect model, my own included, but we should all strive harder to achieve this goal.

Rules of the game

Beyond the requirements for individual countries, we should also strive for rules of the game that are fair to both parties. There are valid disputes on matters such as intellectual property rights but countries should be able to sit down and negotiate differences, perhaps ceding some sovereignty in the process.

None of this will be easy for any country. But it is important to make openness work for growth and poverty reduction in all countries.

3. Masahiro Kawai

Introduction

Globalisation is a hot issue that has attracted considerable attention among policy-makers, international organisations, academics and researchers, mass media, and civil society from both developed and developing countries. While globalisation appears successful in raising the living standards of a large number of people in many parts of the globe, there is a concern that its benefits are distributed unevenly in favour of the rich and not the poor, that it has been widening the income disparity between rich and poor nations as well as between the rich and the poor within nations, and that it makes many developing countries vulnerable to the vagaries of global capitalism. Opponents of globalisation often argue that it has harmed developing countries by increasing poverty and exacerbating income inequality across nations and within nations.

Hence it is quite appropriate to: (a) explain how certain developing countries have successfully integrated themselves with the world economy; (b) establish statistical facts regarding economic growth, poverty conditions, and income distribution for both globalising and non-globalising developing countries; and (c) identify factors and policies that have led a certain group of developing countries to benefit from globalisation in the form of higher growth and poverty reduction, and those that have prevented another group from doing so. I would like to commend the organisers of this workshop for undertaking to tackle these complex issues.

David Dollar, a World Bank economist, and Robert Hunter Wade, an academic from the London School of Economics and Political Science, present and analyse data on poverty and inequality, discuss implications of globalisation for developing countries' economic growth, poverty and income distribution, and provide some policy lessons. They reach quite different assessments on the progress on poverty reduction and income distribution, with equally different policy implications.

David Dollar argues that globalisation has been accompanied by higher economic growth of poor countries, a considerable reduction in global poverty, and a modest improvement in global income distribution over the last 20 years. He cautions, however, that globalisation can be disruptive and has not always been accompanied by improvements in national income distribution. Progress made in a group of globalising developing countries – such as China, India, Vietnam, Bangladesh and Uganda – in terms of faster economic growth and significant poverty reduction has contributed to global inequality reduction, while Sub-Saharan African countries have not been successful in globalisation, growth or poverty reduction. He asserts that globalisation, if accompanied by complementary reforms of policies and institutions, is a driving force of economic growth and poverty reduction.

Robert Wade, on the other hand, throws serious doubt about the positive role of globalisation for reducing poverty and income inequality. He argues that poverty data are subject to such a large margin of error that the number of poor could be higher than estimated by the World Bank, and that world income distribution may have become more unequal over the past 20 years. He asserts that earlier successful globalisers, particularly those in east Asia including Japan and the Asian tigers, have not simply liberalised external regimes, deregulated domestic markets or privatised public enterprises in a way the 'Washington Consensus' might prescribe, but they instead opened their economies gradually and selectively and began to liberalise in line with the natural development of domestic industries. According to Wade, the key to success lies not in globalisation or external liberalisation, but in internal economic integration that focuses on spatial clusters and input-output networks among producers.

Though some aspects of the analyses by Dollar and Wade are mutually consistent with each other, the largest difference between the two lies in their assessment of data. I divide my discussion into four parts: issues on data and statistical facts; relationships among globalisation, economic growth, poverty and income distribution; the development experience in east Asia; and policy implications.

Data and facts

Five trends on poverty and income distribution

David Dollar presents five statistical trends on poverty and income distribution. Let me summarise them first and then introduce criticisms by Robert Wade:

1. *Poor country growth rates have accelerated.* During the period 1980–1997, the population-weighted average growth rate of the poorest one-fifth of countries in 1980 (4 per cent per capita per annum) has been higher than that of the richest one-fifth of countries (1.7 per cent per capita per annum). This is in contrast with the experiences for the prior two decades (1960–1980), where the growth rate for the poor group (1.8 per cent) was lower than that for the rich group (3.3 per cent).
2. *The number of poor people in the world has declined significantly, the first such decline in history.* Over the period 1977/78 to 1997/98, there has been a large net decline in the number of poor due to massive poverty reduction achieved in China and India, which more than offsets an increase in poverty in Sub-Saharan Africa. The only exception over the past 20 years is found for the period 1987 to 1993, when poverty in China and India rose due to temporary setbacks.
3. *Global inequality (among citizens of the world) has declined modestly over the last 20 years.* Global inequality, measured by indicators such as the global Gini coefficient, has declined modestly since 1980, reversing a 200-year-old historical trend toward higher inequality. Rapid growth in Asia (China, India, Bangladesh and Vietnam) has been a force for greater global equality because that is where the majority of the world's extreme poor lived in 1980 and they benefited from the growth.
4. *There is no general trend toward higher or lower inequality within nations; in particular, among developing nations inequality has decreased in about as many cases as it has increased.*
5. *Wage inequality is rising worldwide.* There is a general pattern of rising wage inequality, i.e., larger wage increases for skilled and/or educated workers relative to those for unskilled and/or less educated workers. This does not contradict Trend (4) because wages are a small part of threshold income in developing countries, which make up the bulk of the world in terms of countries and population.

Criticisms by Robert Wade

Robert Wade provides important criticisms against the statistical procedures employed by the World Bank, thus implicitly those by David Dollar. One of his criticisms is that it is virtually impossible to make accurate statements about progress on poverty reduction and global income distribution. The reason is that internationally comparable headcount estimates of the poor, i.e., the number of people whose consumption is below some pre-defined threshold level like \$1 a day at purchasing power parity (PPP), are subject to the quality problem of national household

expenditure surveys, PPP estimates, and other assumptions and hence are very sensitive to changes in the underlying assumptions.

For example, international poverty data for a developing country are often constructed by using national data that are based on household expenditure surveys. For international comparison, a country's nationally defined poverty line, expressed in local currency, has to be converted into an internationally common unit of account like the dollar at the PPP rate. If this PPP-based poverty line is below or above the World Bank's threshold level, say \$1 a day per person, then the number of people with consumption under \$1 a day needs to be estimated using information on the distribution of individual consumption (or income) for the country. If the national poverty line is originally defined in terms of income, then a consumption-based poverty line needs to be redefined by using survey information on the difference between income and consumption of the poor. When new household surveys are not available for a country, poverty data need to be constructed by assuming that consumption (or income) distribution remains the same as in the last available survey and that the consumption of the poor has grown at the same rate as average consumption in the national income accounts data, which are available every year.

Wade forcefully argues that the poverty headcount in developing countries is thus very sensitive to: the precise level of the national or international poverty line because consumption distribution in the vicinity of developing country poverty lines is typically flat; the PPP conversion rate used because the implied consumption basket may be inappropriate for the poor due to the inclusion of many non-essentials that are cheap in developing countries but are irrelevant to the poor; and the assumed rate of change in the consumption of the poor – which tends to be overestimated, particularly in Asia – because there are large discrepancies between consumption estimates from household expenditure surveys and estimates from the national income accounts. Based on these observations, Wade claims that the margin of error is so large that one does not have definitive knowledge as to whether there has been real progress on poverty reduction, and that the number of people in extreme poverty is probably much higher than the World Bank's estimate, thus rejecting the view that there has been a significant decline in the absolute number of poor in the last 20 years.

Wade also rejects the well-accepted (at least among economists) notion that for making international comparisons of standards of living and assessing global income distribution, PPP rates should always be used, but instead insists on using market exchange rates. He reasons that there are intractable problems associated with the PPP figures and that the data need to capture the economic and geopolitical impact of one country on the rest of the world. Based on market exchange rates, he claims that world income distribution has become more unequal over the past 20 years. Even when measured in terms of PPP, he claims that world income inequality has worsened as long as countries are weighted equally, because this procedure minimises the bias posed by the fact that China and India dominate statistical results.

What do we get?

Despite data deficiencies, as noted by Wade, the preponderance of statistical evidence appears to support the proposition that a group of ‘globalising’ developing countries that have successfully integrated their economies with the rest of the world has achieved faster economic growth and significant poverty reduction. Assessment of global poverty conditions and the global income distribution is more complex because it involves various types of aggregation problems. Nonetheless, if countries are population-weighted and incomes and consumptions are expressed at the internationally comparable PPP dollar – which is a well-accepted procedure for many economists – there has been a reduction in both poverty and income inequality at the global level.

For a better international comparison and aggregation, however, comparable data on incomes, consumption, income distribution, and poverty must be collected and analysed. The quality of national household expenditure surveys must be improved, the surveys’ national coverage expanded, and their frequencies raised. More accurate data on income/consumption distribution need to be obtained or constructed within each developing country. Better estimates of PPP conversion rates need to be constructed to better reflect the typical consumption basket of the poor.

It must be noted that any chosen threshold for poverty lines, for example \$1 a day at PPP, is not fully satisfactory because there is no significant difference between consumption of \$0.99 and \$1.01, and the distribution of the poor around the threshold level is flat. Given that the measure does not capture the shape of the income distribution around the \$1-a-day threshold, it would be desirable to provide additional information such as the number of poor for the threshold of \$2 a day at PPP.

Relationship among globalisation, growth, poverty and inequality

Dollar and Wade agree that there is no definitive relationship among globalisation, economic growth, poverty, and income inequality. Nancy Birdsall (this volume) also states that globalisation is not necessarily good for growth, for the poor, or for fair income distribution.

All we know is that there must be sustained economic growth for systematic poverty reduction, that is, sustained growth is a necessary – though not a sufficient – condition for countrywide poverty reduction. Without economic growth, there will be no poverty reduction. On the other hand, even in the presence of economic growth, poverty may not be reduced if the growth is not accompanied by higher demand for unskilled labour. Economic growth accompanied by the development of labour-intensive sectors, particularly in manufacturing, is likely to result in poverty reduction. Poverty reduction is only possible through raising the rate of return on assets the poor have or have access to, such as unskilled labour and small plots of land. The challenge is how developing countries can exploit the opportunities provided by globalisation to generate economic growth and employment for the poor.

Growth, poverty and global inequality

On the relationship between globalisation and growth, Dollar claims that openness to foreign trade and investment is likely to lead to faster growth in developing countries if accompanied by complementary reforms. For example, cross-country statistical analyses generally find that countries with greater trade openness have higher growth after controlling for reverse causality from growth to trade. Firm-level studies also reveal that open economies are more innovative and dynamic – if accompanied by privatisation, deregulation and greater competition – due to higher entries, exits, and turnover of firms. In contrast, Wade argues that there is no serious evidence that opening to trade – lowering tariffs and other barriers – generally results in subsequent faster growth, holding other factors constant.

As noted by Dollar, five successful globalising countries (China, India, Vietnam, Bangladesh and Uganda) have all benefited from increased integration in terms of faster economic growth and significant poverty reduction. Faster growth and significant poverty reduction in these countries contributed to a reduction of global income inequality, while slow growth in most of Sub-Saharan Africa contributed to a rise in global inequality. The net result is a modest global decline in inequality with the former outweighing the latter.

The net results from the average are important, but it would be more informative to uncover what is happening behind the average. The relevant questions are: why have certain countries such as China, India, Vietnam and Bangladesh been successful in generating growth and poverty reduction under globalisation and why have others, such as most of the Sub-Saharan African countries, not done so? The issue here is not only whether and how countries have implemented external liberalisation policies and other complementary policy reforms – such as domestic deregulation and institution building – but also how they have overcome unfavourable initial conditions (such as low levels of industrial infrastructure, poor geography, poor health, and poor human resources) and nurtured private sector development.¹ The challenge is how developing countries can create a favourable investment climate that can generate growth and employment.

National income inequality

One of the common claims about globalisation is that it leads to greater inequality within nations and hence fosters social and political polarisation. Dollar finds that changes in national income inequality are not related to any of the measures of globalisation. For example, greater trade integration is associated with rises in national inequality in some countries and declines in others. Among the five successful globalisers, only two (Vietnam and Uganda) have achieved an improvement in income distribution in favour of the poor.

1. Private sector development is often led by private investment in labour-intensive manufacturing and services industries.

One may argue that national income inequality induced by globalisation may be a natural phenomenon that takes place in the course of economic development and structural changes. For example, in a labour surplus economy, the real income of unskilled labour hardly rises, and thus, at early stages of economic development there can be rising inequality under globalisation. Labour, capital and other productive resources naturally migrate away from less productive sectors/areas of the economy to more productive ones. Income inequality facilitates such resource re-allocation and would eventually be eliminated in the long run. So, one may argue that there is nothing to worry about it. Nonetheless, to the extent that rising income inequality becomes a potential source of social and political instability, there is room for public policy to mitigate the negative effects of development under globalisation through social protection and investment in education and health.

The east Asian development experience

The early successful globalisers in east Asia – including the high-income industrialising economies (Singapore, Hong Kong, Korea, and Taiwan) as well as the middle-income ASEAN countries (Malaysia, Thailand, Indonesia and the Philippines) – achieved rapid economic development and remarkable poverty reduction over the last 30 years. China and Vietnam have been following similar patterns of development. East Asia's historical experience reveals that three essential elements contributed to their successes:²

- political stability, sound policies, the right institutions, and national ownership;
- outward orientation with a focus on private sector development and the investment-trade nexus; and
- effective development assistance.

Political stability, sound policies, the right institutions and national ownership

First, political stability, sound policies, and the right institutions played an essential role in the economic development process in east Asia during the two to three decades leading up to the financial crisis in 1997–98. Needless to say, the crisis has revealed inadequacies and weaknesses of economic institutions – particularly in the financial and corporate sectors – across crisis-affected east Asia, which should have been strengthened through appropriate regulatory and supervisory frameworks in a way commensurate with the pace of globalisation. Nonetheless, the east Asian economies had, until the age of financial globalisation, institutional and governance capabilities that facilitated sustained growth, rapid development and poverty reduction. The presence of sound policies, the right institutions and stable and predictable policy regimes were particularly important.

2. Some of these elements, but not all, and others have been analysed in the World Bank's study, *The East Asian Miracle: Economic Growth and Public Policy*, Oxford University Press, New York, 1993.

In addition, the east Asian economies had clear national ownership over long-term economic development programs and structural reforms. The rigorous implementation of policy and institutional reforms backed by national ownership was an important driver of successful economic development. Strengthening institutional capacities and human resources was indispensable in their efforts to enhance national ownership.

Outward orientation, private sector development and investment-trade interactions

Second, the east Asian economies embraced the notion of globalisation by adopting outward-oriented policies with emphasis on private sector development and investment-trade linkages. Many of them initially focused on import substitution and then shifted to export promotion. A major mechanism for export sector growth was through the expansion from sales in domestic markets to sales in international markets. Successful domestic market development was made possible by product and factor market integration and the creation of spatially concentrated clusters of firms, supplier networks and distribution systems. This provided the basis for successful export expansion. Export expansion in turn helped each economy overcome the limits of the domestic markets and foreign exchange constraints, promoted learning and technology upgrading, economies of scale, and production networks. It was also accompanied by the liberalisation of imports, foreign direct investment (FDI), and the use of foreign technologies and ideas. Formation of regional FDI-trade linkages has been a natural consequence of their market-based, outward-orientated policies.

These east Asian economies emphasised the role of investment – in capital equipment, human resources, and market knowledge – and its nexus with trade as a basis for sustained economic development. Their governments focused on the creation of a favourable investment climate, reduction of the risks and uncertainty of investment activity, and ensured the availability of finance for productive investment opportunities. Their pro-growth development strategy was supported by the mutually reinforcing interactions between investment and trade. Investment – by both domestic firms and foreign multinationals – and trade stimulated each other, thereby contributing to output growth. Output growth in turn stimulated further investment and trade.

Effective Official Development Assistance (ODA)

Third, external development assistance was used very effectively in east Asia. The number of people living in extreme poverty (i.e., below \$1 per day at PPP) in east Asia declined substantially from 450 million in 1990 to 260 million in 1999. The amount of ODA that east Asia received during this period totalled US\$78 billion, or less than US\$8 billion per year on the average. This ODA performance in east Asia is outstanding. It helped to achieve more rapid economic growth and poverty reduction than in any other part of the developing world. For example, a total of US\$166 billion was disbursed as ODA in Sub-Saharan Africa during 1990–99 but the number of poor rose (from 240 million to 300 million) rather than declined.

The reason behind the successful ODA performance in east Asia was that it was used as a catalyst to support the broad, nationally-owned development programs. These programs focused on overcoming unfavourable initial conditions – particularly low levels of industrial and social infrastructure such as power, telecommunications, transport, water, health and education – of the recipient countries, providing them with a basis for pursuing private sector-driven, outward-oriented, pro-growth strategies. ODA in east Asia essentially helped create a favourable investment climate and interacted positively with the recipient countries' political stability, stable macroeconomic policies, predictable business environments, and right institutions.

Policy implications

On balance, globalisation can be a driving force for economic development and poverty reduction if accompanied by complementary policy and institutional improvements, and a good investment climate. Nonetheless, globalisation can aggravate national income inequality, and be disruptive, thereby producing winners and losers.

Need to improve the quality of data

There is clearly a case for obtaining, or developing, better statistical data on incomes, consumption, poverty, and income distribution in developing countries. In order to make objective, internationally comparable assessments about national and global trends in poverty conditions and the distribution of income, there is an urgent need to improve the quality, coverage and frequency of national household expenditure surveys, to obtain more accurate data on income distribution within each developing country, and to construct accurate estimates of PPP to better represent a reasonable consumption basket of the poor.

Maximising the benefits and minimising the costs of globalisation

There is no way to stop the globalisation process. Doing so would be highly counterproductive. If globalisation provides significant benefits as well as costs, policy-makers should focus on how to manage the process of globalisation, by maximising its benefits and minimising its costs. Table 1 summarises the benefits and costs of globalisation for developing and developed countries.

The discussion so far has focused on 'real' globalisation, that is, integration through trade and FDI with the world economy. In practice, it is quite important to make a clear distinction between 'real' and 'financial' globalisation, the latter referring to integration through financial sector opening and capital account liberalisation. Financial globalisation calls for greater care on the part of policy-makers, because it can amplify shocks and increase turbulence affecting the country, as was witnessed in east Asia in 1997–98. Sequencing of liberalisation, provision of financial safeguards, and the choice of exchange rate regime are some of the other policy issues that the authorities must pay attention to.

Table 1. Benefits and Costs of Globalisation

	Benefits	Costs
Developed countries	<ul style="list-style-type: none"> • Greater efficiency of resource allocation • Greater consumer benefits 	<ul style="list-style-type: none"> • Pressure for domestic industrial adjustment and dislocation • Potential for greater domestic income inequality • Potential for loss of policy autonomy
Developing countries	<ul style="list-style-type: none"> • Access to developed countries' product markets, capital, technology, and knowledge • Greater efficiency of resource allocation if accompanied by structural reforms 	<ul style="list-style-type: none"> • Potential for greater domestic income inequality • Greater vulnerability to external shocks

Implications for developing countries

If a country wishes to benefit from globalisation by liberalising trade and FDI regimes, it must not only establish a nationally-owned development strategy and pursue a variety of complementary structural reforms – including privatisation, deregulation, and greater competition – but also strengthen the capacity of policy and institutions to manage economic and social risks due to globalisation, including social protection and financial safeguards. Simply maintaining sound macroeconomic policy and pursuing external liberalisation and domestic deregulation is not enough for this purpose. A country must go beyond the Washington Consensus and focus on wide-ranging reforms of institutions and policy frameworks and strengthen market infrastructure so as to be able to benefit from globalisation at smaller costs.

In addition, the country must set market-friendly environments for private sector activity, particularly private investment, by ensuring political and social stability, increasing business predictability, establishing the rule of law and property rights, and providing necessary industrial infrastructure. Globalisation can be beneficial if accompanied by internal economic integration, leading to the creation of a dense and spatially-concentrated network of input-output linkages among firms and entrepreneurs, which can provide spillover benefits to the rest of the economy. Though Robert Wade puts greater emphasis on the importance of internal market integration, both external and internal integration should deepen simultaneously and interact with each other.

At times, globalisation can be disruptive, by forcing certain industries to shrink and others to prosper, which may call for public policies (social protection, investment in education and health) to mitigate these negative effects. The provision of social safety nets should be an important component of structural reform policy under globalisation because it cushions the damage done to the most severely affected, it helps the momentum of these reforms, and it avoids a backlash against the distributional and social consequences of globalisation. Where informal social safety nets based on families and communities play an important role, the public sector must find a complementary mechanism to support the existing informal arrangement.

Implications for developed countries

The developed countries can help developing countries benefit from trade and investment openness by maintaining a liberal trading system and providing market access to their exports of agricultural and labour-intensive manufacturing products. For this purpose, the developed countries must be ready to accept industrial adjustment on their part by making their labour markets more flexible. Transfers of production technology and organisational skills through FDI are also crucial to enabling developing countries to accumulate knowledge and participate in the innovation process.

Given that many developing countries had disadvantageous initial conditions, developed countries should extend ODA to assist them to overcome these unfavourable initial conditions and pursue private sector-led development under globalisation. As the east Asian experience demonstrates, ODA can have a greater positive impact, in terms of economic development and poverty reduction, on the recipient economies if it stimulates private investment and trade and leads to economic growth.

4. General Discussion

The papers by David Dollar, Robert Wade and Nancy Birdsall generated wide-ranging discussion. Among the most important issues discussed were: the nature of the appropriate policy recommendations for developing countries to raise their living standards; the extent to which uncertainties about trends in poverty and inequality cast doubt on these policy recommendations; the effects of globalisation on the observed trends in poverty and inequality; whether openness was a necessary or sufficient condition for developing countries to improve their living standards; whether trade liberalisation should occur before capital account liberalisation; what institutional features were required in developing countries to realise the potential gains from liberalisation; and whether concerns about income inequality across (and within) countries should be secondary to the goal of reducing global poverty.

Some concern was expressed that the imperfect data used to estimate poverty and inequality for developing countries make it difficult to draw confident conclusions about longer-run trends. The point was also made that time spent debating trends was time lost addressing the question of how to reduce absolute poverty and/or global inequality. In response, one participant agreed that considerable uncertainty would always remain about the total number of people in the world living in absolute poverty, but argued that the total number had almost certainly fallen over the past couple of decades, and that this reversal of a long-standing trend was encouraging, newsworthy, and yet not widely recognised.

The question of what role globalisation had played in generating the observed trends in the global distribution of income then generated a discussion about the nature of policies that developing countries should pursue to raise their average living standards, and particularly the living standards of the poor. One participant pointed to the re-unification of East and West Germany as a good example of how the integration of two economies with different levels of productivity could raise living standards in the low productivity economy. Another participant argued that developed countries had in the past used a range of policy interventions in industry, education, and trade that had assisted their development, and suggested that ruling out these policy options for currently developing countries would have unfavourable implications for their future growth. That position was challenged, however, with a warning against policies that encouraged developing countries to 'pick winners', on the grounds that industry policy was not necessary for convergence, that it could encourage countries to favour industries in which they did not have a comparative advantage, and that industry policy had a poor track record in developing nations. Finally, one participant suggested that despite disagreement about precisely what role government should play in developing-country economies, the complete absence from the historical record of any autarkic success stories was striking, and strongly suggested that linkage with the global economy was a crucial ingredient for economic success.

It was widely agreed that openness alone was not a sufficient development policy. Some participants expressed scepticism about the proposition in Nancy Birdsall's paper that openness to trade and foreign direct investment flows could be bad for growth in countries heavily dependent on commodity exports. One participant questioned the classification of a number of commodity-dependent countries as 'open', arguing that factors such as inefficient ports and corruption in customs services served to raise barriers to trade, and lock developing countries into commodity dependence. Another suggested that it was not commodity dependence *per se* that was bad for growth, but a lack of commodity diversification, which left many developing countries particularly vulnerable to shocks.

Another feature of this discussion was participants' keenness to differentiate between different types of openness. Some participants argued that capital account liberalisation should be considered separately from trade liberalisation, and that developing countries should proceed cautiously with the former, especially when institutions were weak, or the macroeconomic environment was unstable. One participant also argued that policy-makers should broaden their definition of

openness. First, it was argued that openness as an outcome (summarised, for example, by the ratio of trade to GDP) should be distinguished from openness as a policy, because it was possible to have an open trading regime and yet still have a relatively low ratio of trade to GDP. Second, countries could in principle pursue policies such as targeted industry assistance (which was argued to have occurred in the ‘Asian Tigers’) and still be described as ‘open’, provided the transfer of technology and ideas to the domestic economy was encouraged.

In emphasising the point that openness might not, by itself, generate higher growth rates in developing countries, it was argued that good governance was important in providing an economic environment conducive to investment both by domestic firms and by foreign firms that facilitated technology transfer to the domestic economy. Good governance was interpreted quite broadly by most contributors to this discussion, and included institutional features such as democracy, the maintenance of law and order, contract enforcement, and measures designed to reduce corruption. It was also suggested that raising the skill and training levels of the domestic workforce was vital to building and maintaining institutions, as well as framing policy, and that aid should be targeted at assisting developing countries to build this capacity.

Another issue that sparked debate was whether high levels of inequality across (and within) countries should be of as much concern as absolute poverty. Putting this debate in stark terms, one participant remarked that reduced inequality within developing countries was presumably not desirable if it was accompanied by lower absolute living standards for the poor. Another raised the experience of Ireland as an example of a country where income inequality had risen significantly in the recent times, but because economic growth had been so strong, almost everyone was much better off, and hence there was little debate about inequality at all. Another participant drew a distinction between two different types of inequality: constructive and destructive inequality. Inequality was constructive, it was argued, when income differentials acted as an incentive for people to work, invest, and educate themselves. Destructive inequality, by contrast, arose if wide income differentials were a consequence of unequal access to services such as education and health, which limited the opportunity for some groups to raise their living standards. Because only destructive inequality had deleterious implications for growth, it was important to determine which type of inequality (if any) globalisation was connected with, before policies to reduce inequality were recommended.

Some also observed that the starting point of inequality in particular countries was relevant to judging the acceptability of subsequent trends. Some rich countries had relatively low inequality but incentive-damaging tax and transfer systems which needed reform, and some relatively poor former command economies also had low levels of inequality that were not readily compatible with the structural changes and economic modernisation they wanted to achieve.

Another topic of discussion concerned the role of multilateral institutions (including the IMF and the World Bank), as well as individual developed countries, in creating an international environment in which developing countries could thrive – including

assisting financially constrained countries with help to develop effective domestic institutions. One participant remarked that as developing countries became more open to flows of goods and money, they would also become more vulnerable to international crises (such as the Asian crisis). To maintain support for liberalisation within the developing world, it was therefore important for institutions such as the IMF to work on crisis prevention, and to properly manage crises if they arose.

Finally, it was pointed out that inadequate attention was often paid within developed countries to the issue of reciprocity in trade liberalisation. Many developed countries have highly subsidised agricultural sectors, and effectively close their domestic markets to many agricultural imports from developing nations. Reducing such subsidies could, it was argued, generate large welfare gains for developing nations and help consolidate the benefits of domestic liberalisation.