Globalisation, Poverty and Income Distribution: Does the Liberal Argument Hold?

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'Globalisation' is a rag-bag, but the 'anti-globalisation' movement – a combination of trade union protectionists, passionate environmentalists, Third-World sympathisers, and antinomian activists who substitute 'globalisation' for the earlier 'capitalism' and 'multinational corporations' – is proving to be a force not lightly dismissed. Organisations like the World Bank, the UK's Department for International Development, *The Economist*, and the *Financial Times,* have mounted a vigorous defense based on four main propositions:

1. Poverty and inequality have both fallen on a world scale over the past two decades for the first time in more than a century and a half. As Martin Wolf of the *Financial Times* puts it, 'Evidence suggests the 1980s and 1990s were decades of declining global inequality and reductions in the proportion of the world's population in extreme poverty' (Wolf 2002).
2. These falls are due to the rising density of economic integration between countries ('globalisation'), and would have gone further had the poorer countries been more integrated into the world economy.
3. Therefore the empirical grounds of the anti-globalisation movement – the grounds on which it claims to be thinking for the world – collapse. Its policies would cause more poverty and more inequality. The evidence is so clear that Martin Wolf (2001b) concludes, 'The argument about globalisation, as such, must stop'.[2]
4. The governments of poorer countries should take as their top development objective, raising the economy's integration into the world economy.

This argument makes the current wave of globalisation fit well with the great liberal tradition, which presumes that economic liberalisation makes for progress and that resistance to economic liberalisation must be the result of 'special' interests. Many academics, including those not champions of liberalism, have embraced similar arguments. They point especially to the dispersal of manufacturing capacity to developing countries as a force that has eliminated the structural divide between the First and Third Worlds. In the words of two of them, 'Worldwide convergence,

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2. Also see Wolf (2000).

through the global restructuring of capitalism, means that the geographic breakdown of the world into north-south, core-periphery or First and Third Worlds, while still significant, is diminishing in importance' (Burbach and Robinson 1999).

Can such arguments be tested? Are theories linking such a rag-bag concept as globalisation with such multifaceted concepts as poverty and inequality bound to be vacuous? In the end, the question of whether or not by some statistical measure China's getting richer counterbalances Africa's reversion to barbaric misery does not matter much compared with the question of what to do about Africa's misery, or narrower questions like whether protectionism is justified in country *x* at time *y*. But the fact is that a lot of people do make strong claims about the trends in poverty and inequality, and they say that globalisation is the main driving force behind the trends whether for good or ill. It is worth discussing the empirical basis of the claims.

In this paper I raise doubts about the empirical underpinnings of the pro-globalisation argument – the claim that world poverty and world income inequality have both fallen over the past two decades or so, and that countries that have globalised faster have had faster economic growth and bigger falls in poverty. I then discuss a few of the deep structural causes at work in the world economy that may be invoked to explain the failure of the liberal claim. At the end I give some normative conclusions.

1. Poverty

As the economist Richard Cooper says, the record on poverty alleviation in the late 20th century is 'unambiguously positive'.[3] Things may have got worse in Africa, he admits, but the improvements in China and India mean that 'the fraction of the world's population living in poverty has gone way down'.

These and other such statements are based on World Bank figures, for the Bank is effectively the sole producer of the world poverty headcount. It declares in the opening sentence of the *2001 World Development Indicators*, 'Of the world's 6 billion people 1.2 billion live on less than $1 a day' (World Bank 2001b).[4] This number, says the Bank, was the same in 1998 as in 1987. Since world population increased, the proportion of the world's population in absolute poverty fell sharply in only 11 years from around 28 per cent to 24 per cent, an extraordinary historical reversal of trend.

Other Bank sources give different numbers, however. The *World Development Report 2000/2001: Attacking Poverty* says that the number of people living on less than $1 a day *increased* by 20 million from 1.18 billion in 1987 to 1.20 billion in 1998 (World Bank 2001a). Less than two years later, *Globalization, Growth, and Poverty: Building an Inclusive World Economy* showed that the number of people living in poverty *decreased* by 200 million in the 18 years from 1980 to 1998 (World Bank 2002).[5]

3. Richard Cooper, quoted in Jim Hoagland (1999).
4. The $1 a day is measured in purchasing power parity.
5. See Deaton (2002) for further discussion of this issue.

Here are eight reasons not to take the Bank's numbers at face value.[6] First, the Bank's comparison between 1980 and 1998 is not legitimate, because the Bank changed its methodology in the late 1990s and has recalculated backwards only to 1987. We do not know what the 1980 figure would be if calculated by the same methodology as the later figures. Hence the Bank's claim that the number of people living in poverty fell by 200 million from 1980 to 1998 ought not to be accepted.

Second, the Bank's revised purchasing power parity (PPP) numbers caused major changes in poverty counts even for the same country in the same year and using the same survey data. Table 1 shows the impact of the revision in terms of the poverty headcount in different regions *for the same year*, 1993. Notice that the revision to the Bank's PPP numbers makes for a large change in poverty rates in the different regions; and that the rates for Latin America are implausible, both absolutely (almost a quarter of the population of Latin America in the mid 1980s lived on less than US$365 a year in PPP terms?) and relative to other regions (a quarter in Latin America against only 4 per cent in the Middle East/North Africa?). As Angus Deaton concludes, 'Changes of this size risk swamping real changes, and it seems impossible to make statements about changes in world poverty when the ground underneath one's feet is changing in this way' (Deaton 2001).

Table 1: 1993 Poverty Rate using Old and New World Bank PPP Numbers
Per cent

	Old poverty rate	**New poverty rate**
Sub-Saharan Africa	39.1	49.7
Latin America	23.5	15.3
Middle East/North Africa	4.1	1.9

Note: The poverty rate is the proportion of the population living on less than $1 a day. The old rate refers to the 1985 PPP benchmark survey, while the new rate refers to the 1993 survey.

Source: Deaton (2001)

Third, the changes in methodology notwithstanding, the Bank still uses a global poverty line – 'US$1 a day' – that is not connected to any basket of goods that makes sense for measuring poverty, such as food and other essentials (though it does have intuitive appeal to a western audience being asked to support aid). We have no way of knowing what proportion of food-and-shelter needs the Bank's poverty line captures. If the Bank were to use a basic needs-based poverty line rather than its present artificial one, the number of absolute poor would probably rise, because the national poverty lines equivalent to a global basic needs poverty line expressed in US dollars would probably rise by a lot (maybe 25–50 per cent). They would rise a

6. I am indebted to Sanjay Reddy for discussions of the points made here. See Reddy and Pogge (2002) and Karshenas (2002) for a more extensive discussion of these points.

lot because the present PPP price indices include many services that are very cheap in developing countries (e.g., massages) but irrelevant to the poor (and thus the consumption bundle needed to avoid poverty), and therefore give a misleadingly high measure of the purchasing power of the incomes of the poor. Food and shelter are relatively expensive, and if they alone were included in the PPP indices used to adjust the incomes of the poor, national poverty lines would go up.[7]

Fourth, the poverty headcount is very sensitive to the precise level of the global poverty line because income distribution in the vicinity of developing country poverty lines is typically fairly flat. Even a small increase in the line brings a large increase in the number of people below it. Hence we can expect that a shift to a poverty line based on basic needs, excluding services that are very cheap but irrelevant to the poor, would raise the number of people in extreme poverty significantly.

Fifth, the Bank's poverty count comes from household surveys. Household surveys have a number of limitations that add up to a large margin of error in national poverty numbers and so also in the world totals. Some are well-known, such as the exclusion of most of the benefits that people receive from publicly provided goods and services. Others are less well-known, such as the sensitivity of the poverty headcount to the recall period used in the survey. The shorter the recall period the more expenditure is reported. India provides a striking example. A recent study suggests that a switch from the standard 30-day reporting period to a 7-day reporting period itself lifts 175 million people from poverty using the Indian official poverty line, a nearly 50 per cent fall. Using the US$1-a-day international line, which is higher, the fall would be even greater.[8]

Sixth, when new household surveys for a country are not available the Bank assumes that income distribution is the same as it was under the last available household survey and then increases the consumption of the poor in the old survey by the growth in *average* consumption in the national accounts data, no matter that national income distribution may have changed a lot. This procedure can make poverty fall as an artifact of the methodology.

Seventh, the PPP-adjusted income figures for China and India – the two most important countries for the overall trend – contain an even bigger component of guess work than for most other significant countries. The main sources of PPP figures (the Penn World Tables and the ICP) are based on two large-scale international price benchmarking exercises for calculating purchasing power parity, one that occurred in 1985 and was carried out in 60 countries, and a second that occurred in

7. It is remarkable that the International Comparison Program (ICP), which has orchestrated the systematic collection of international price data since its founding in 1967, held its first ever panel meeting to discuss designing a PPP factor specifically relevant to the consumption bundle of the poor in March 2002, yet has been chaired by the World Bank for the past decade. The ICP's central concern has been to design ways of comparing GDPs.

8. See Deaton (2001) for further discussion of this issue.

1993 and was carried out in 110 countries.[9] The government of China refused to participate in both of them. The PPP numbers for Chinese incomes are based on guestimates from small, ad hoc price surveys in a few cities, adjusted by rules of thumb to take account of the huge price differences between urban and rural areas, eastern and western regions. The government of India declined to participate in the 1993 exercise. The numbers for India are extrapolations from 1985 qualified by small, ad hoc price surveys in later years. The lack of good data for China and India comparable with those of other countries compromises any claim about trends in world poverty (Reddy and Pogge 2002).

Finally, we need to bear in mind that the number of absolute poor is a politically sensitive number, because critics use it to attack the Bank. The majority report of the Meltzer Commission (2000), for the US Congress, said the Bank was failing at its central task of poverty reduction – as shown by the fact that the number of people in absolute poverty remained constant at 1.20 billion between 1987 and 1998.[10] (A spurious argument if ever there was one.) People who calculate politically sensitive numbers – in the Bank or anywhere else – may be inclined to make choices that flatter the result even if they remain within the bounds of the professionally defensible, even if they remain far from behaviour that could be construed as 'cooking the books'.

In short, we should be cautious about accepting the World Bank's poverty headcount as approximately correct. We should acknowledge the large margin of error. It would be interesting to know whether the late-1990s revisions to the methodology and to the PPP numbers have the effect of raising or lowering the poverty headcount, and whether they alter the direction of the trend over the 1980s and 1990s.

What can we say about the relationship between poverty and economic growth on a world scale? Some people say that the income of the poor rise 'one-to-one' with average income, implying that economic growth is good for the poor.[11] Others say that the lack of a fall in the number of people in extreme poverty despite historically high rates of economic growth – both in the world as a whole and in specific countries (notably India) – suggests that economic growth does little to reduce poverty. The fact is that our currently available data do not allow confident conclusions (Deaton 2001). The World Bank's poverty numbers come from household surveys, while the economic growth measures come from the national income accounts. In many countries there are large and growing discrepancies between income and consumption estimates from the two sources. In Asia the consumption estimates

9. An ICP benchmark survey was also done in 1996, but the quality of the data was poor because many more countries participated than expected and resources were insufficient for central coordination and data quality control.

10. Meltzer (2001) later described the fall in the proportion of the world's population in poverty from 28 per cent in 1987 to 24 per cent in 1998 as a 'modest' decline, the better to hammer the Bank.

11. '[O]n average there is a one-to-one relationship between the growth rate of income of the poor and the growth rate of average income in society' (World Bank 2002).

from household surveys tend to be well *below* the estimates from the national accounts. The ratio of household survey-based consumption to national accounts-based consumption in India (the biggest single contributor to the world poverty count) fell from around unity in the 1950s to little more than 50 per cent in recent years. A similar drift is found in China, the second-biggest contributor to the world poverty count; and also in Pakistan, Bangladesh, and Indonesia. In some Sub-Saharan African countries, on the other hand, the estimate of consumption from household surveys is two to three times *above* the estimate from the national accounts. As Deaton (2001) concludes, this means that we have no consistent empirical basis for conclusions about the extent to which economic growth reduces poverty.[12]

Some people argue that the whole exercise of constructing a global poverty line and then counting the number of poor below it is futile; not only are our current numbers not meaningful, they *could not* be meaningful. They propose to use national poverty lines to count the number of poor in each of the world's 200+ countries, and then make an interpretation based on 200 data points for one year, or 400 data points for two years. The problem is obvious. My response is that if we are to assess globalisation as a systemic phenomenon and not simply as the aggregate of national phenomena we need aggregate data to measure the overall trends. Our task is to find measures that survive scrutiny. For this we need measures and price indices specifically related to poor people, in contrast to what is presently available.

Having said all this, I think it is quite plausible that the proportion of the world's population living in extreme poverty (facing periods of food consumption too low to maintain health and unable to save enough to finance children's basic education) has indeed fallen over the past 20 years or so, thanks largely to fast growth in China and India. The broad trends in national data for these two countries, including life expectancy and other non-income measures, give grounds for confidence in this conclusion, even allowing for large margins of error.[13] But any more precise statement about the absolute number of the world's people living in extreme poverty and the change in the number over time currently rests on statistical quicksand.

12. Dollar and Kraay (2001) conclude that, in a large sample of countries, the incomes of the poorest fifth rise 'one-to-one' with the average income. (A 4 per cent growth rate of GDP per capita is associated with a 4 per cent rate of increase in the income of the bottom quintile.) This implies a flat statistical relationship between per capita income and inequality, not a Kuznets curve (an inverted U relationship between per capita income and inequality). The conclusion appears to be hard-wired in by their choice of a linear regression equation with no quadratic term. With this assumption the share of the poor in total income cannot increase at one point in the range and decrease at another; it cannot be an inverted U. The share of the poor in total income goes up at the rich-country end because of social security transfer payments. Given the assumption of a linear relationship, this means that at the low-per-capita-income end the share of the poor in total income cannot go down. The authors justify the linear form by saying that the evidence does not allow them to reject the statistical hypothesis that the share of the bottom 20 per cent is uncorrelated with per capita income. This may be true, but does not exclude the possibility that a quadratic specification would have been a better fit. A quadratic specification would have allowed for the plausible possibility that different categories of countries – by average income, by region – show different relationships between average income and distribution. I thank Graham Pyatt and Sanjay Reddy for clarifying this point.

13. See Dollar (this volume).

2. Inequality

Many analysts claim that world income inequality fell sharply in the second half of the 20th century, especially in the final quarter.[14] But in the past several years world income distribution has become a hot topic of debate in international economics and in sociology, and there is now even less agreement about the trend of income distribution than about the poverty numbers. Whereas we *could* get better data on the poor to the extent that the numbers would command general agreement, the issues in the measurement of inequality do not admit of best solutions, even in principle. The answer to the question, 'What is happening to world income inequality?', depends on choices among the following: (a) alternative measurements of income (GNP per capita converted to US dollars using market exchange rates or GNP per capita adjusted for differences in purchasing power across countries); (b) alternative samples of countries and alternative weightings of countries (each country weighted as one unit or by population); (c) alternative measures of distribution (the Gini or other average coefficient of inequality or ratios of the income of the richest decile of world population to that of poorer deciles or of a set of developed countries to a set of developing countries); and (d) national income accounts or household income and expenditure surveys. These choices make a big difference to the results. Here are my abbreviated conclusions.[15]

2.1 Market exchange rates

If we use market exchange rates to convert national incomes into a common numeraire (the US dollar) the evidence is clear: whatever the other choices of measurement, world income distribution has been stable or widening for the past several decades.

For example, if we take the GNP per capita of developing countries as a group and express it as a proportion of the GNP per capita of the developed countries (all countries weighted by population), the share remains steady at around 4.5 per cent from 1960 to 1999 (Table 2). No reduction of the (huge) relative income gap and a big widening of the absolute gap. Indeed, the great majority of developing countries experienced a *growing* relative income gap from *both* 1960 to 1980 and 1980 to 1999 (Arrighi and Silver 2002).[16] At the regional level, Latin America, Sub-Saharan Africa, and the Middle East/North Africa all experienced a growing relative income gap with the core between 1980 and 1999; South Asia remained constant; only

14. For example, Omerod (2000) and Wright (2000) both make the same strong statement about world income distribution: it has become more equal at the same time as globalisation has accelerated. Martin Wolf has also championed the idea that globalisation improves global income distribution (see for example Wolf (2001a)). Ian Castles, a former Australian Statistican, claims that 'most studies suggest that the past 25 years have seen a reversal in the trend towards widening global inequalities which had been proceeding for two centuries' (Castles 2001).

15. In addition to the studies referenced elsewhere I draw on Firebaugh (1999), Jones (1997), Pritchett (1997), Quah (1997) and UNDP (1999).

16. The former Soviet Union countries are not included.

China, and east Asia minus Japan and China, reduced the gap. China's average income rose between 1980 and 1999 from 0.8 per cent to 2.6 per cent of the average of the developed countries. If we had been asked in 1970 to indicate what would constitute development 'success' by 1999 we would surely have set the threshold far above an increase in developing countries' (current exchange rate) income from 4 to 5 per cent of the West's. We would have said that an increase from 4 to 5 per cent in 30 years constituted failure.

Table 2: GNP per Capita of Region as a Per Cent of Developed Countries' GNP per Capita

Region	1960	1970	1980	1990	1999
Sub-Saharan Africa	5.2	4.4	3.6	2.5	2.2
Latin America	19.7	16.4	17.6	12.3	12.3
West Asia and North Africa	8.7	7.8	8.7	7.4	7.0
South Asia	1.6	1.4	1.2	1.3	1.5
East Asia (excl China and Japan)	5.7	5.7	7.5	10.4	12.5
China	0.9	0.7	0.8	1.3	2.6
Developing countries	4.5	3.9	4.3	4.0	4.6
North America	123.5	104.8	100.4	98.0	100.7
Western Europe	110.9	104.4	104.4	100.2	98.4
Southern Europe	51.9	58.2	60.0	58.7	60.1
Australia and New Zealand	94.6	83.3	74.5	66.2	73.4
Japan	78.6	126.1	134.1	149.4	144.8
Developed countries	100.0	100.0	100.0	100.0	100.0

Sources: Arrighi and Silver (2002); World Bank (1984, 2000)

But many economists say that exchange rate-based income measures are irrelevant. GNP incomes should always be adjusted by a purchasing power parity (PPP) factor to take account of differences in purchasing power, they say. One makes the adjustment by using the same relative prices for all goods and services in all countries. Since the market prices of goods and services sold only locally (not internationally traded) are significantly cheaper in poor countries relative to the market prices of goods and services facing international competition, the adjustment generally raises the income of poor countries and lowers the income of rich countries, making the distribution between them less unequal.

It is true that market exchange rate-based income comparisons suffer from distortions in official exchange rates (overvaluation is common in poor countries with trade barriers and non-convertible currency) and from sudden changes in the official exchange rate. Nevertheless, the argument that PPP-adjusted incomes should always be used in preference to incomes converted via market exchange rates should be rejected, for conceptual and practical reasons. The practical reasons concern the intractable problems of knowing what the PPP figures mean, especially for China and India, and before the early 1990s, for countries of the former Soviet Union. The conceptual reasons have to do with the fact that we may be interested in income and its distribution not only to measure relative total purchasing power (for which purpose PPP-adjusted income is a better proxy, *in principle*), but also to measure the relative purchasing power that residents of different countries have over goods and services produced in other countries. If we are interested in any of the questions about the economic and geopolitical impact of one country (or region) on the rest of the world – including the capacity of developing countries to repay their debts, to import capital goods, and to participate, avoid marginalisation in the international political economy – we should use market exchange rates. After all, the reason why many poor countries are hardly represented in negotiations that concern them directly is that they can't afford the cost of hotels, offices and salaries in places like Washington DC and Geneva, which must be paid in hard currency bought at market exchange rates, not in PPP-adjusted dollars.

To repeat, all the plausible measures of inequality using market exchange rates to compare incomes in different countries show that world income distribution has been stable or widening for the past several decades. It is plausible that this matters not only as a cause of the marginalisation of developing countries but also as a cause of trends in relative PPP-based living standards.

2.2 Purchasing power parity

Purchasing power parity (PPP) figures show trends in world income distribution that are more ambiguous than market exchange rate figures, and more conditional on precisely which combination of measures one uses. But the evidence does strongly support the following three propositions.

First, if one uses ratio measurements of inequality (such as richest to poorest decile) rather than the Gini or other measure of inequality over the whole distribution, then PPP-adjusted income distribution has become *much more unequal* over the past two decades, whether countries are weighted equally or by population. World income *polarisation*, in other words, has increased unambiguously.

Second, if one uses a measurement of the entire distribution and weights countries equally (China = Uganda), inequality between countries' average PPP-adjusted income has also *increased* since at least 1980. And if one measures inequality in terms of the dispersion of per capita GDPs across the world's (equally weighted) countries, this too *rose* between 1950 and 1998, and especially fast over the 1990s. The dispersion of per capita GDP growth rates has also risen, suggesting wider variation in performance among countries at each income level. One study using these dispersion measures concludes, there is 'no doubt as to the existence of a definite trend towards distributive inequality worldwide, both across and within countries' (ECLAC 2002, p 85).[17]

17. The dispersion of per capita GDP/PPP is measured as the average logarithmic deviation, the dispersion of growth rates as the standard deviation.

Third, if one uses a measurement of the *entire* distribution, and *weights* countries by population, inequality between the country averages has been *constant* or *falling* since around 1980. This is the result that Martin Wolf, *The Economist*, and many others celebrate. But it comes entirely from fast average growth in China and India. If they are excluded, even this measure of inequality shows inequality widening since 1980.

In any case, this last measure – the average income of each country weighted by population – is interesting only as an approximation to what we are really interested in, which is income distribution among all the world's people or households regardless of which country they live in. We would not be interested in measuring income inequality within the US by calculating the average income for each state and weighting it by their populations if we had data for all people or households.

One recent study makes an approximation to the distribution of income among all the world's people by combining between-country inequality in PPP-adjusted average incomes with within-country inequality. It finds that world inequality *widened* between 1980 and 1993 using all of four common measures of inequality over the entire distribution (and weighting countries by population) (Dowrick and Akmal 2002).[18]

A study of the most comprehensive set of data drawn only from household income and expenditure surveys (it does not mix data from these surveys with data from national income accounts) finds a sharp *rise* in world inequality over as short a time as 1988 to 1993, using both the Gini coefficient and ratio (or polarisation) measures (Table 3).[19]

Table 3: World Income Distribution by Households

	1988	1993	Per cent change
Gini	0.63	0.67	+6
Richest decile/median	7.28	8.98	+23
Poorest decile/median	0.31	0.28	–10

Source: Milanovic (2002)

18. They use between-country comparisons of 'true' PPP-adjusted incomes, complemented by the Deininger-Squire measures of within-country inequality. (They make the PPP adjustment with Sidney Afriat's 'true index' methodology designed to counter the upwards, 'developed-country' bias in the Summers-Heston price relativities.) With this methodology they find a slight increase in world inequality between 1980 and 1993 on four common measures of inequality: Gini, Theil, coefficient of variation, and variance of log income. Their results are, however, sensitive to assumptions made about Chinese PPPs, as are results from other authors.

19. Milanovic is currently working on 1998 data.

We have to be cautious about this finding partly because household surveys have the kind of weaknesses described above (though these weaknesses do not make them worse than the alternative, national income accounts, which have their own problems), and partly because the five-year interval is very short, suggesting that some of the increase may be statistical error.

What about the much-cited article by Dollar and Kraay (2002) of the World Bank that reports a sizable decline in worldwide income inequality since its peak in about 1970? Their underlying method is to calculate the percentage gap between a randomly selected individual and the world average. The bigger the gap, the more unequal the distribution of world income. The article reports that this gap peaked at 88 per cent of world average income in 1970, before falling to 78 per cent in 1995, roughly back where it was in 1950.

This study illustrates again how the conclusion about the trend in world income distribution depends on the choice of measures. Dollar and Kraay's choice flatters the result for the following reasons: (a) The person chosen as the random individual is most likely to be Chinese or Indian; (b) China and India have had much faster growth than the world as a whole over the recent period; (c) The gap between the income of the 'random person' (which is likely to have risen with the average income of China or India) and the world average has been falling; (d) But this does not straightforwardly suggest that world inequality has been falling, because it omits the increasing poverty of less populous countries (Africa), and because it omits rising internal inequality in both China and India (see below). In short, Dollar-Kraay's methodology weights heavily what happens in the *middle* swathe of world population and gives little weight (compared to other accepted measures) to what happens towards the lower and upper ends of the distribution.

By way of summary, a fourth proposition regarding PPP-adjusted incomes: the only set of measurements where the evidence clearly supports the liberal argument of falling inequality is the one using population-weighted countries' *per capita* PPP-adjusted incomes, plus a measure of inequality over the whole distribution. On the other hand, ratio measures show clear evidence of rising inequality (or polarisation), whatever the choices of other measures. And even measures of inequality over the whole distribution, when applied to either household survey data or to the combined inequality between countries and within countries (as distinct from only inequality between countries' average income), show a widening of inequality. We can conclude that world income inequality among households has probably been widening even when measured across the whole distribution, and emphatically so when measured in terms of the richest 10 per cent to the poorest 10 per cent.

2.3 China and India

China and India have grown fast over the past decade (India) or two (China) and together account for nearly 38 per cent of world population. If the figures are to be believed, China has experienced a quite extraordinarily fast rise in its average PPP income from 0.3 of the world average in 1990 to 0.45 in 1998, or 15 percentage points in only eight years. The biggest single issue in world income distribution is how

China and India have moved through the hump of world income distribution. Don't they create a presumption that world income distribution has become more equal over the past 20 years? Not necessarily.

First, recall the point made earlier, that the governments of China and India declined to participate in one (India) or both (China) of the benchmarking price comparison exercises, and therefore the PPP-adjusted figures for China and India contain an even bigger component of guess work than for most other countries.

Second, problems with the PPP adjustments aside, China's income statistics are manipulated in a (sometimes) blatant way. For example, in Table 4, China's level of GNP per capita converted to US dollars at market exchange rates was lower in 1998 than in 1997. However, according to the same World Bank database, China recorded a growth rate of 6.4 per cent between 1997 and 1998! These statistics are, clearly, inconsistent. Behind these numbers is a tale of the Chinese government's arm-twisting of the World Bank (especially after the allegedly accidental US bombing of the Chinese embassy in Belgrade in May 1999) to lower China's average income below the threshold of eligibility for concessional International Development Association (IDA) lending from the Bank. China wanted not so much the cheap IDA loans as the privilege extended to companies from IDA-eligible countries to add 7.5 per cent to bids for World Bank projects.

Table 4: China's GNP Per Capita (GNPPC) and Growth Rate

	1997	1998	1999
GNPPC (US$)	860	750	780
Annual growth rate of GNPPC (per cent)	7.4	6.4	6.1

Source: World Bank (1999, 2000, 2001b)

As further suggestive evidence: Chinese government figures show total real GDP growth of 25 per cent between 1997 and 2000, whereas energy consumption figures show a drop of 13 per cent. (Some of the fall may be due to replacement of inefficient coal-fired furnaces.) Again, government figures show annual real GDP growth of 7–8 per cent in 1998 and 1999. One analyst estimates the real figure at between –2 and +2 per cent (Kynge 2002b).[20]

Over the whole of the 1990s, China's annual growth rate is more likely to have been 5–6 per cent than the 8–10 per cent that the official statistics show. This one change (assuming constant internal distribution) would make a tangible difference to our conclusions about what has been happening to world income distribution. If the official figures are correct, and if we choose one particular combination of measures (rather than other plausible ones), world income inequality has narrowed.

20. Kynge is drawing on the work of Thomas Rawski.

If we use the more plausible lower range, virtually all the plausible measures of world inequality show no change, or a widening, even before China's widening *internal* income distribution is taken into account.

This brings up the other reason for being sceptical of the claim that China and India's fast growth is reducing world income inequality. Whatever reduction in world income inequality comes from relatively fast growth of average income in China and India may be offset by the widening income inequality within the two giants – though careful calculations of the relative strength of the two contrary effects have not yet been made.[21] China's surging inequality is suggested by the ratio of the average income of the richest to poorest province: 7 in the early 1990s, 11 in the late 1990s. The corresponding figure for India in the late 1990s was 4.2, for the US, 1.9.

2.4 Pay inequalities

More doubts are cast on the falling inequality hypothesis by a distinctly different kind of data – trends in industrial pay inequality within countries. Pay inequality within countries was stable or declined from the early 1960s to 1982, then sharply increased from 1982 to the present. 1982 marks a dramatic turning point towards greater inequality in industrial pay worldwide.[22]

Some might claim that these data are irrelevant because few of the world's poor earn wages that get reported. It is true that few of the world's poor are included in figures of pay, but not true that this makes pay dispersions irrelevant to the overall distribution of household incomes. The dispersion of industrial pay measures the difference in pay rates for relatively skilled workers in activities like petroleum refining, chemicals, machinery, and transportation equipment, and the pay rates for the relatively numerous, less-skilled workers in textiles, garments, food processing and similar activities. Workers in, say, garments, are readily recruited from the masses in agriculture or services, whereas workers in oil or machinery are not. For this reason of elastic supply, wages in the low-wage industries are likely to bear a close relationship to the wages of the uncounted masses, whereas wages in the high-wage industries are much less likely to have that relationship. Therefore, when the industrial pay dispersion widens, it is usually because low-wage workers in general are suffering relative to high-wage workers. (We can check this for some countries, including the US and China, and the broader national data sets for these countries bear this out. But they are not available on an internationally comparative basis.) When the pay data show rising inequality in Chile after the coup in 1973, or

21. Evidence for rising inequality in India over the past two decades is set out in Jha (2000). Deaton (2002) agrees that inequality in India has been increasing 'in recent years', and that consumption by the poor did not rise as fast as average consumption.

22. See the work of James Galbraith and collaborators in the University of Texas Inequality Project, available at <http://utip.gov.utexas.edu>. Galbraith has not yet attempted to calculate trends in world pay dispersions. Indeed, it is unclear what the appropriate country weights should be. For example, should the weights be calculated using per capita GDP, the absolute size of each country's manufacturing sector, or the per capita inequality between countries?

falling inequality in Iran in 1979, or rising inequality throughout Central Europe after 1989, it is clear that these measures reflect larger social phenomena beyond formal industry.

Their great advantage is that they are available, accurately and consistently, for many countries on an annual basis over many years, which is not true of the World Bank's inequality data set. (The Bank's data set does not do well on the laugh test – it shows Spain as the most equal country in Europe, France as much more unequal than Germany, and India and Indonesia in the same equality league as Norway.[23]) In short, the pay dispersions should not be disregarded, and they suggest a sharp increase in inequality since the early 1980s.

2.5 The bottom line

Several concluding points about world poverty and income inequality should be made at this juncture: First, all the thunder and lightning about trends can divert attention from what should be our central preoccupation, the sheer magnitude of poverty and inequality. For all the earlier caveats about the statistics, we can be confident in saying that roughly 85 per cent of world income (measured at market exchange rates) goes to 20 per cent of the world's population, 6 per cent to 60 per cent of the world's population. Can this meet any plausible test of distributive justice? It is difficult, for example, to see how it could meet the Rawlsian principle that a given degree of inequality is acceptable if it is somehow necessary for the worst off to be better off.[24]

A second striking feature is the limited mobility up and down the income hierarchy. Very few countries over the past several decades have changed their quintile in a ranking of countries' per capita income, and those few account for an insignificant proportion of world population (Korzeniewicz and Moran 1997, 2000).[25] If economic performance were as sensitive to pro-globalising or anti-globalising policies as the globalisation champions say, one would expect to find more mobility up and down quintiles. The lack of country mobility over several decades is a big fact in need of explanation.

On the trends themselves, the number of people in extreme poverty has a large margin of error and is probably higher than the World Bank says. Whether the trend since 1980 is up or down we really cannot say. But it seems quite plausible that the *proportion* of the world's population living in extreme poverty has indeed fallen.

As for world income distribution, it has certainly become more unequal over the past two decades if measured in terms of market exchange rates. Measured in terms of purchasing power parity (PPP) and in terms of *average* inequality (with the Gini

23 This is the Deininger and Squire data set.

24. Rawls thinks in terms of distribution within states (or 'peoples'), and claims, unconvincingly, that his principles support only meagre income redistribution beyond these units (see Caney (2001)).

25. The data relate to 1965–1990.

coefficient) it has *probably* either remained fairly constant or increased, almost certainly not decreased. Measured in terms of ratios, income polarisation has *increased*, even using PPP-adjusted incomes. A rising proportion of the world's population is living at the extremes of the world income distribution; and a rising share of the world's income is going to those at the top.

One other point is worth mentioning here. Our measures of inequality refer to relative income gaps, not absolute income gaps. We say that income inequality remains constant if the ratio of developing country income to developed country income remains at 5 per cent. But this of course implies a big increase in the absolute size of the income gap. Even if inequality falls by this measure the absolute gap may still increase. In the general case the absolute income gap between a country with average income of US$1 000 growing at 6 per cent and a country with average income US$30 000 growing at 1 per cent continues to widen until after the 40th year! Absolute differences should not be treated as irrelevant, as they generally are, for they too relate to important ethical values and to feelings of disempowerment and deprivation. China and India are reducing the absolute gap with the faltering middle-income states like Mexico, Brazil, Russia and Argentina, but they are not reducing the absolute gap between their average incomes and the averages of the countries of North America, Western Europe and Japan. In the world at large, absolute gaps are increasing fast and will continue to do so for several generations, of this we can be sure.

So what? Many people say that we should not be concerned about rising inequality, relative or absolute, provided the poor are not becoming worse off. This applies within countries and even more so to inequalities between countries. The question of whether we should be concerned about rising inequalities between countries needs a good deal more research than it has received.

On the face of it, the more globalised the world becomes, the more that the reasons why we might be concerned about within-country inequalities also apply to between-country inequalities. Educated people who earlier compared themselves to others in their neighbourhood or nation now compare themselves to others in much richer nations. In this way, the high and rising (relative and absolute) gap in incomes of the richest countries and the poorer ones is bound to affect the national political economy in the poorer states. It may, for example, predispose the elites to be more corrupt as they compare themselves to elites in rich countries and squeeze their own populations in order to sustain a comparable living standard. It may encourage the educated people of poor countries to migrate to the rich countries, and encourage unskilled people to seek illegal entry. It may generate conflict between states, and – because the market-exchange-rate income gap is so big – make it cheap for rich states to intervene to support one side or the other in civil strife. These effects may be presumed to operate even if relative income gaps are declining but absolute income gaps are widening.

3. Globalisation

Now let us examine the second main proposition of the globalists' argument, that globalisation – in the sense of rising integration of poorer countries into the world economy, as seen in rising trade/GDP, foreign direct investment (FDI)/GDP, and the like – is the world's most powerful means of reducing poverty and inequality.

Clearly the proposition is not well-supported at the world level if we agree that globalisation has been rising while income inequality and poverty have not been falling. But it might still be possible to argue that globalisation explains differences between countries: that more globalised countries have a better record of economic growth, poverty reduction and inequality reduction than less globalised ones.

Much of the evidence comes from World Bank studies. One of the best-known, *Globalization, Growth, and Poverty*, distinguishes 'newly globalising' or 'more globalised' countries from 'non-globalising' or 'less globalised' countries (World Bank 2002). It measures globalising by *changes* in the ratio of trade to GDP between 1977 and 1997. Ranking developing countries by the change, it calls the top-third the globalising or more globalised countries, the remaining two-thirds as less globalised countries or weak globalisers. The globalising countries are then found to have had faster economic growth, no increase in inequality, and faster reduction of poverty than the weak globalisers. The conclusion? 'Thus, globalisation clearly can be a force for poverty reduction'.

The first doubt to raise about this conclusion concerns the 'changes in trade/GDP' criterion of globalisation.[26] The list of 'globalisers' includes China and India, as well as countries like Nepal, Côte d' Ivoire, Rwanda, Haiti, and Argentina. As the cases of China and India suggest, it is quite possible that 'more globalised' countries are less open in terms of *levels* of integration than 'less globalised' countries; and also less open in terms of trade policy than 'less globalised' countries. A country with very high trade/GDP and very free trade could still be categorised as a weak globaliser. Indeed, it turns out that the globalising countries are mainly ones that initially had very *low* trade/GDP in 1977. Many of them also had relatively low trade/GDP at the *end* of the period, in 1997. To call them globalisers and countries with much higher ratios of trade/GDP non-globalisers is an audacious use of language.

The criterion shapes the conclusions. Excluding countries with high but not rising levels of trade to GDP from the category of more globalised countries excludes many very poor countries dependent on a few natural resource commodity exports, which have had very poor economic growth. The structure of their economy and the low skill endowment of the population make them very dependent on trade. If they were included as globalisers their poor economic performance would question the proposition that the more globalised countries have the best performance.

On the other hand, the inclusion of China and India as globalisers – whose good economic performance over the past one or two decades is attributed in large part to their globalisation – guarantees that the globalisers will show better performance

26. In this section I draw on the arguments made in Rodrik (1999, 2001).

than the non-globalisers. But two big facts question the Bank's argument. First, China and India experienced a sharp increase in the trend rate of growth about a decade prior to their liberalising trade and investment reforms. Second, they have followed policies far from those advocated by the globalists. They have been heavily protected economies. And even today the World Bank would be the first to denounce their current trade policies and internal market-restricting policies as growth- and efficiency-inhibiting if they had not been growing fast. Their trade barriers remain very high, and they maintain a selective approach to foreign direct investment.

Their experience, and that of Japan, South Korea and Taiwan earlier, shows that countries do not have to adopt liberal trade policies in order to reap benefits from trade and in order to grow fast (Wade 1990).[27] It shows only that as countries become richer they tend to liberalise trade, which is not the same thing. The sensible ones liberalise in line with the growth of domestic capacities – they try to expose domestic producers to enough competition to make them more efficient but not enough to kill them, which is very different from a presumption that trade liberalisation is a good thing and that the costs will be short term as resources shift to more productive uses. China and India today (Vietnam too), and Japan, South Korea and Taiwan earlier, suggest a policy prescription that is not close to what the Bank says, but nor is it 'anti-globalisation'.[28]

Yet for all the Bank study's qualifications (such as 'We label the top third "more globalised" without in any sense implying that they adopted pro-trade policies. The rise in trade may have been due to other policies or even to pure chance'), it nevertheless concludes that trade liberalisation has been the driving force of the increase in developing countries' trade: 'The result of this trade liberalisation in the developing world has been a large increase in both imports and exports' (World Bank 2002).

4. If Poverty and Inequality are Not Falling Despite Globalisation – Why Not?

If the number of people in absolute poverty is probably not falling and is probably higher than the World Bank says, and if income inequality is not falling and by several plausible measures probably rising, why? Not because of the failure of

27. As I document, many neoclassical economists have tried to argue that the economic success of Taiwan and South Korea is a function of their shift towards free markets, coupled with investment in education, law and order, and the like. They argue as though the only positive causal impact of a fall in tariffs from, say, 50 to 40 per cent is the 10 per cent fall, nothing to do with the 40 per cent that remains. They airbrush away the policies for building competitive industries and firms, some of which entailed some sectoral targeting.

28. The folly of presenting integration and openness as anything close to a sufficient condition of development is also suggested by the long experience of southern Italy, which operates in a completely free market with northern Italy but has an output and income gap with the north that has resisted determined state investment to reduce it (Wade 1982). I describe the fight between the World Bank and the Japanese government over appropriate development strategies in South East Asia in Wade (1996).

industrialisation in developing countries. If we take the share of GDP in manufacturing in each country and aggregate up to developing countries as a group and developed countries as a group, we find a remarkable convergence – developing countries as a group now have a *larger* share of GDP in manufacturing than developed countries (Table 5). But each additional increment of what is measured as manufacturing in developing countries is yielding less income, while each additional increment of what is measured as services in developed countries is yielding more income. This is quite contrary to the understandings of the 'modernisation' champions of the 1950s to 1980s, ancestors of today's globalisation champions. They thought that industrialisation was the route to development, and that (market-friendly) industrialisation would be the vehicle to carry developing countries to the living standards of the developed world. The failure of this prediction may help to explain why industrialisation as such is given little attention in today's development debates. It has virtually disappeared from the agenda of the World Bank.

Table 5: Share of Manufacturing in GDP
Per cent

	1960	1980	1998
Developed countries	28.9	24.5	19.8
Developing countries	21.6	24.3	23.3

Source: Arrighi and Silver (2002)

If we cannot say that income inequality has not fallen because industrialisation has not occurred throughout the Third World, what other factors might explain widening or at least non-declining income inequality? Differential population growth is one: population is rising several times faster in the low-income parts of the world than in the rich, raising the share of world population living in countries in the low-income zone. Falls in the terms of trade facing developing countries are another: the prices of industrial goods and services exported from high-income countries are increasing faster than the prices of goods and services exported by low-income countries, and much faster than the prices of goods and services produced in low-income countries that enter little into international trade. By regions, Latin America and Africa concentrate on export products that experience relatively slow-growing demand, while developing Asia has a higher concentration in export products with above world-average export growth, like machinery and equipment.

4.1 Spatial clustering of high-value-added activities

Underlying these patterns of trade and prices is a general property of modern economic growth related to spatial clustering. We know that some kinds of economic activities and production methods are more lucrative than others, have stronger spillover benefits (positive externalities), and more positive effects on growth and productivity; and that countries with higher proportions of such activities enjoy a higher level of real incomes than others. We also know that in free market conditions (and not as a result of market 'imperfections') high-value-added activities cluster spatially; and that these poles are predominantly located in the already high-cost, high-wage zone of the world economy.

This – superficially surprising – clustering of new rounds of high-value-added activities in the high-wage zone, instead of shifting to a low-wage zone, occurs for several reasons. First, costs per unit of output, especially labour costs, may not be lower in the lower-wage – but also lower-productivity – zone.

Second, the 'capability' of a firm relative to that of rivals (the maximum quality level it can achieve, and its cost of production) depends on the knowledge and social organisation of its set of employees, where both knowledge and social organisation are collective properties of the firm rather than of the individuals who make it up; and where much of the knowledge and social organisation is essentially *tacit*, not able to be transferred easily from place to place in the form of (technical and organisational) blueprints or embodied in machinery (Baumol and Gomory 1992; Sutton 2000).[29] If a firm were to move to a lower-wage zone and some of its employees were not mobile, the costs to the firm's capacity, including the loss of tacit knowledge, may outweigh the advantages of relocation.

Third, manufacturing firms in the OECD countries are engaged in dense input-output linkages with other firms. (About two-thirds of manufacturing output in the OECD is sold by one firm to another firm.) The presence of a dense and spatially concentrated network of input-output linkages provides spillover (non-priced) benefits to other firms in the network. So does the presence of well-functioning factor markets and a supply of formally educated people able then to gain technology-specific (and partly tacit) knowledge at low cost. The transfer of tacit knowledge, whose economic value typically increases even as the ratio of tacit to codified knowledge goes down with computerisation, is sensitive to physical distance, social relationships, and cultural similarity. These network effects compound the tendency for any one firm not to move to a low-wage zone, or to move only its *low*-value-added activities by outsourcing or establishing subsidiaries.

All the more so because for many products and services, quality – and value added – goes up not continuously but in steps. Getting to higher steps may require big investments, critical masses, targeted assistance from public entities, long-term supply contracts with multinational corporations seeking local suppliers; and 'normal' market processes may keep producers and countries stuck at low steps. (To take an extreme example, ball bearings below a certain quality threshold are useless; they have to be given away.)

But this is still not the end of the story. At the next round the greater wealth and variety of economic activities in the high-wage zone mean that it can more readily absorb the Schumpeterian shocks from innovation and bankruptcies in the high-wage zone, as activity shifts from products and processes with intense competition to those closer to the innovation end, with less competition and higher returns. There is less

29. I continue to draw on these two papers throughout this section.

resistance to the 'creative destruction' of market processes, even though organising people to pursue common (resistance) objectives tends to be easier than in the low-wage zone. Enron may go bankrupt, but there are plenty more companies to take on its business and employ its employees.

These effects – plus limited labour movement from the low-wage zone to the high-wage zone when international borders intervene – help to explain a stably 'divided world' in which high wages remain high in one zone while low wages elsewhere stay low. The important point is that 'normal' free markets in a highly globalised world economy produce, 'spontaneously', a stable equilibrium division of activities between the high-wage zone and the low-wage zone – a stable equilibrium that is hardly desirable for the low-wage zone.

This mechanism can explain the reproduction of the income gap between developing and developed countries even as developing countries have eliminated the industrialisation gap (in terms of industrial output to GDP or industrial employment to total employment).

Empirically, of course, the picture is more complicated. We do see a rapid growth in the capabilities of firms – domestic and foreign – in China, and the early stages of China-based networks of firms dense enough to bestow sizable spillover benefits on individual firms and hence keep them in China and close to other participant firms even as cheaper wage locations open up. Technological learning (a proxy for capabilities) is proceeding at a furious pace in parts of China and east Asia, a more sedate pace in India, a snail's pace in most of Latin America, and even slower, if at all, in Sub-saharan Africa, the Middle East and central Asia (Amsden, Tschang and Goto 2001; Kynge 2002a; Mathews 2002; Mathews and Cho 2000). China and India are likely to experience a shift towards more internal income equality when they come near to full employment five to ten decades from now. But any such shift in the other developing regions is likely to be even further away.

Yet even about east Asia we should not get too optimistic. Only a miniscule portion of world R&D work is done in (non-Japan) east Asia; virtually all of it continues to be done in the developed countries of North America, Western Europe and Japan. Even Singapore, that looks to be an Asian center of R&D, does not do 'real' R&D; its R&D labs mostly concentrate on adapting products developed in North America and Europe for the regional market and listening in on what competitors are doing (Amsden *et al* 2001). So much for the 'globalisation of R&D'.

4.2 The international monetary system

The post-Bretton Woods (PBW) international monetary system generates financial instability and slow growth in the world economy 'endogenously', and particularly handicaps developing countries. Four features combine to produce this result:

1. The 'original sin' of not allowing economic actors to engage in international payments in their own national currency, requiring them to obtain hard currency, generally US dollars, for paying for imports or for repaying foreign loans.

2. *Private* foreign exchange markets and settlement systems – via private banks, not via central banks.
3. A fiduciary currency, the US dollar, as the main international currency, meaning a currency whose issuance is unconstrained by any supply-side factor (such as a US dollar-gold link).
4. Largely unrestricted capital flows.

This PBW system gives hard-currency (= some rich country) governments, above all the US government, a much freer hand than before to print money and incur fiscal and current account deficits. The amount of US currency in circulation and the size of total international reserves (mostly in US assets) have grown almost exponentially since the early 1970s, associated with rapidly rising trade imbalances and cross-border flows of short-term capital. These trade imbalances and short-term capital flows have become major sources of instability and slow growth in the world economy at large. In particular:

1. The US current account deficit is a 'facilitating condition' of the economic overheating and asset price booms in Japan, the east Asian Crisis countries, China and the US (Duncan 2002). Chronic deficits have caused an explosion of international liquidity (credit). They are financed by the sale of US assets (especially bonds of corporations and government-sponsored agencies like Fannie Mae, as well as stocks and Treasury bills). As they accumulate in surplus countries' banking systems, they have the same impact as high-powered money injected by the central bank into the banking system: they are deposited, lent, re-deposited, and re-lent many times over. They can easily blow out asset price bubbles and industrial over-investment, which end in recessions or depressions. This was the story of the Japanese bubble and crash in the second half of the 1980s and the 1990s, also the story of the east Asian bubble and crash in the 1990s, and China is currently well along this path. The continuing credit expansion being created by record US external deficits ensures that credit bubbles will blow out around the 'emerging market' world with much higher frequency than in the Bretton Woods era; and their bursting will cause bigger economic and social costs. As crisis-affected countries devalue their currencies in order to increase their current account surpluses (a practice sanctioned by the IMF and the World Bank), they make the systemic instability worse.
2. The PBW system makes foreign exchange markets prone to volatility, reflecting essentially speculative movements of funds related to changes in the prices of financial assets rather than to changes in demand for goods and services or costs of production, movements that are *pro-cyclical*, that amplify rather than dampen swings in economic activity.
3. The PBW system makes debtor countries (other than hard-currency ones) vulnerable to exchange rate volatility, because when the domestic currency falls in value the burden of debt service denominated in US dollars rises, which can tip domestic firms into insolvency.

4. The PBW system forces debtor countries (all except the US) to restructure their economies towards exports with which to earn the hard currency needed to pay for imports and to service debt, which can *short-change* domestic demand and national economic articulation (rising density of national, perhaps regional input-output linkages) as sources of growth.

The PBW system liberates the US government from concerns about what other governments do, while constraining other governments more tightly by what the US does. This is the great paradox of globalisation: debtor countries are generally not masters of their fate, but globalisation and the PBW monetary system allow the biggest debtor of all to harness the rest of the world to its rhythms. The system forces all countries to lend to the US at cheap rates, because they hold their reserves mainly in US public and private securities. Other countries' willingness to accumulate US securities (without redeeming them in the form of US-made goods and services) allows the US to continue living far beyond its means. The fact that the world's savings are flowing disproportionately to the US, the richest country, impoverishes everyone else, including the Europeans – European investment levels are held down because European savings flow to the US. On the other hand, the US's platinum credit card, on which it need only pay (low) interest, not principal, allows the US to invest heavily, to accumulate military armaments, and generally to accelerate the density of its hegemony.

In short, I have suggested that the benign effects of free markets as celebrated in the liberal argument may be offset by tendencies for high-value-added activities to cluster in areas of other high-value-added activities, which can create a stable division between a high-value-added, high-wage-zone, and a low-value-added, low-wage zone – even as ratios of manufacturing to GDP, total trade/GDP, and manufacturing exports/total exports rise in the low-value-added, low-wage zone. I have also suggested that this tendency for non-convergence may be compounded by something as apparently remote from matters of poverty and inequality as the international payments system. No doubt there are other basic drivers as well. By highlighting these two drivers I mean to illustrate how 'ordinary' market processes may operate to block the development process, suggesting the need for 'extraordinary' measures of intervention if sizable parts of the world's population are to catch up in living standards over the next half century or so.

5. Conclusions

To go back to the beginning: The globalists set up the debate with a Manichean dichotomy between pro-globalist and anti-globalist positions. My conclusions embrace elements from both. I agree with the globalisers that to raise the living standards of the world's poorer people economic growth is essential (but so are changes in our measures of economic growth to weigh environmental quality and public services properly). I agree that more open markets in the West for labour-intensive and land-intensive exports from developing countries would help, and that more foreign direct investment from the West, more technology transfer, are generally to be welcomed. Attempts at national self-sufficiency are foolish (though few countries apart from North Korea are trying). Protectionist business associations and trade unions in the wealthiest countries, who claim that any threat to jobs must be because of 'unfair competition' from elsewhere, are generally to be resisted; and if industry-specific protection is granted in the wealthiest countries, it should be for a limited period and be accompanied by open access to foreign firms to establish their own production facilities in the country and compete against domestic firms in the same industry.

5.1 The trends?

On the other hand, I part company from the globalists in my reading of the trends in poverty and income distribution. My strong conclusion about the magnitude and trend in world poverty is that we must be agnostic, on the grounds that our current statistics are too deficient to yield a confident answer (though it is quite plausible that the *proportion* of the world's population in extreme poverty has fallen in the past two decades). My weaker conclusion is that the numbers are probably higher than the Bank says – though whether rising or falling over time we cannot say with confidence.

On the trends in income distribution my strong conclusions are that world inequality is increasing when incomes are measured in current exchange rates (and this is more relevant than PPP-incomes for judging relative impacts of one part of the world on others, including the marginalisation of developing countries). Income inequality is increasing too when PPP-adjusted inequality is measured in terms of ratios of richer to poorer, which better captures the idea of polarisation than the Gini or any other average statistic. My weaker conclusion is that the several other measures of income inequality yield more ambiguous trend results, and are more contingent on things like the precise time period and the precise countries included in the sample. But as I have shown, several recent studies, using different combinations of measures, countries and time periods, do find that world income inequality has clearly widened since the early 1980s. This evidence cannot be dismissed with a wave of the hand.

Finally, absolute income gaps between the West and the rest are widening, even in the case of relatively fast-growing countries like China and India, and are likely to go on widening for another half century, at least. No one disputes this, but globalists tend to focus on relative incomes only. I suggested earlier several kinds of negative effects likely to follow from widening absolute income gaps even when relative income gaps are falling.

5.2 The value on inequality?

I also part company with the globalists by giving higher priority to reductions not only in world poverty but also in world income inequality. This cannot be a direct objective of public policy, which has to focus on inequalities within nation states or (via trade rules, aid, etc) inequalities among states. But it can be taken as a higher-level objective and built into our measures of world development. We should not accept the commonly heard assertion that widening world income inequality is not to be seen as a negative provided that 'real' indicators like life expectancy are improving and the proportion living in extreme poverty is going down.

5.3 Globalisation as the driver?

I again part company with the globalists over the proposition that globalisation is the driver of the allegedly positive poverty and inequality results. The point is not that 'globalisation' cannot be precisely defined for these purposes; it is that the definitions used in the 'globalists' studies do not survive scrutiny. In particular, the main World Bank studies, by defining globalisation in terms of *increases* in trade/GDP or FDI/GDP and ignoring the level, manage to include China and India as 'globalisers' and many highly trade-dependent but badly performing African countries as 'non-globalisers'. As I said earlier, this is an audacious use of language.

Having placed well-performing China and India into the category of globalisers, the Bank does not go on to emphasise that the economic policies of the main 'globalisers' – China in particular – are far from the core economic policy package that it has recommended over the past two decades. The disingenuousness brings to mind the *World Development Report 1987* (World Bank 1987) which defined 'strongly outward oriented' countries as those where 'Trade controls are either nonexistent or very low...There is little or no use of direct controls and licensing arrangements', then found that in a set of 41 developing countries for 1963–73 and 1973–85 the strongly outward-oriented countries had much better economic performance than the others (moderately outward, moderately inward, strongly inward). The strongly outward-oriented countries included only South Korea, Singapore and Hong Kong, or in effect, only South Korea, since the results were weighted by GDP. Only the most determinedly one-eyed advocate could say that South Korea in 1963–85 met the Bank's criteria for strongly outward-oriented trade policy.

5.4 The policies for catch-up

Evidence from the countries and regions that have succeeded in significantly reducing the relative and absolute income gaps with the West – to the point of rising above 50 per cent of the West's average income – suggests that the current development emphasis on openness, deregulation, privatisation and good governance is not likely to go with sufficient technological learning for a large demographic mass – think of 1 billion people – to move over the next two to four decades from material living standards less than a quarter of the West's to more than a half. Most of the now developed countries used more active measures to promote the growth of new industries at the time of their catch-up, and there is no reason to suppose that markets have changed to the point of making this unnecessary today (Amsden *et al* 2001; Chang 2002; Kozul-Wright 1995).

We must make a distinction between two senses of the word 'integration'. One sense is 'external integration', which is the meaning of 'integration' in today's discussion. The other sense is 'internal integration', creating a national (or regional) economy with denser input-output linkages, a matter of much interest to development economists of the 1950s to the 1970s and since the 1980s largely dropped off the agenda of the international development community. The experience of the successful developers shows that 'export orientation' (external integration) and 'import substitution' (part of internal integration) need not be opposed, they can complement each other. The question of public policy is how to nurture competitive industries and upgrade technologies in existing industries – for example, how to use the power of the state to encourage supply linkages between subsidiaries of multinational corporations and domestic firms, and to encourage firms to invest in higher-technology processes sooner than they would in free market conditions without inter-firm coordination. If we are to slow down and even reverse the present tendency to widening absolute (and perhaps relative, depending on how measured) income gaps these questions must be returned to centre stage.

So too must the questions implied in my discussion of the PBW monetary arrangements. We should consider establishing – as an extreme option, the better to concentrate minds on more realistic improvements – a system that allows countries to make cross-border payments in their own currency, and that gives the central management role in international payments to public institutions – central banks and a new international clearing agency (D'Arista 1999). In this new architecture the key point is that banks receiving payments in foreign currency would be required to exchange them for domestic currency deposits at their national central banks; and the national central banks would in turn be required to present the foreign currency payments to an international agency for clearing. Net payments through the international agency would be debited or credited against a member country's reserve account (held in the country's own currency). Exchange rate changes would be made in-house in accordance with changes in reserves, at regular intervals. The exchange rates would reflect costs of production and demand for goods and services, not speculation against future movements. They would become an order of magnitude more stable than under the PBW system. This system, I suggest, could speed up the catch-up of developing countries, or hold them back less.

5.5 Exogenous statistics and exogenous research

The discussion about the potential bias in the World Bank's statistics on poverty should remind us of the dangers of having the Bank as the near-monopoly provider of key development statistics; and the discussion of the Bank's recent study of globalisation, growth and poverty should remind us of the dangers of having the Bank as the world's main centre of development economics research. The Bank is too committed to an 'official view' of how countries should seek development, too exposed to arm-twisting by its leading member states, too compelled to defend itself against criticism. It faces constant pressures from within and without for its statistics and its research to be made 'endogenous' to the debate.

The problem stems from the Bank's strategy for maintaining legitimacy. Lacking coercive power, it depends on 'voluntary' compliance. It seeks to bolster its legitimacy – its chances of obtaining voluntary compliance – by appealing to 'technical' economics findings that show that the policies behind the Bank's market-opening conditionalities will generate higher growth and faster poverty reduction in developing countries, while also bringing benefits to the rich non-borrowing members in terms of better market access in developing countries. Mutual benefit must reign. Indeed, the more politically intrusive the Bank's conditionalities have become – the more its rich non-borrowing countries have required it to adopt policies that require borrowing governments to agree to politically sensitive things they may not wish to do ('participation' and 'indigenous peoples' protection plans' in China, for example, or rapid trade liberalisation everywhere) – the more the Bank must justify the conditionalities and policies on 'technical' grounds, as being thoroughly in the interests of the borrowing countries, as demonstrated by the best research using the best statistics.

In this light we can understand the apparent discrepancy between the *World Development Report 2000/2001* (World Bank 2001a), which said that the number of people in extreme poverty *increased* between 1987 and 1998, and *Globalization, Growth, and Poverty* (World Bank 2002), which said that the number of people in extreme poverty *decreased* between 1980 and 1998. When the first was being written in the late 1990s the key ideas-controlling positions in the Bank were held by Joe Stiglitz and Ravi Kanbur (respectively, Chief Economist and Director of the *World Development Report 2000/2001*), not noted champions of the Washington Consensus;[30] and at that time the Bank was trying to mobilise support for making the Comprehensive Development Framework the template for all its work, and hence emphasised the lack of progress in development in order to justify a new approach. By 2000/01 the Bank needed to defend itself against attacks from the US Congress and the Meltzer Commission; hence it wished to show progress in development. Also, both Stiglitz and Kanbur were gone by this time, and David Dollar, a prominent Bank economist, was in the ascendancy. He was chief author of *Globalization, Growth, and Poverty*. The data and the choice of methodologies seem to change with the people and the organisation's needs.

Data provided by a monopoly that are then used to judge the performance of the monopoly are doubly unreliable. We would not want Philip Morris' research labs to be the only source of data on the effects of smoking, even if the research could be shown to lie within the bounds of professional standards. At the least, the Bank should have an independent auditor to verify its main development statistics; or else the Bank should give up producing statistics and cede the work to an independent agency, perhaps under UN auspices, with a carefully specified contract. Much the same applies to the whole of the Bank's development research function.

30. See Wade (2002) for further discussion. This paper uses Stiglitz's firing and Kanbur's resignation to illuminate the US role in the Bank's generation of knowledge.

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