

New facts on globalization, poverty and income distribution

Prepared by the Corporate Economists Advisory Group

In the debate over globalization, it is often claimed that the gap between rich and poor has kept widening over recent decades and that the living conditions of the poor have deteriorated as a result of globalization. But new research now disproves such claims, shedding a much more favourable light on the contribution of global economic integration to incomes and income distribution. This new research shows that, contrary to popular belief, it is precisely during the recent period of increased globalization of the world economy that poverty rates and global income inequality have most diminished.

Widely cited as an authoritative source by critics of globalization, the Human Development Report 1999 of the United Nations Development Programme (UNDP) has largely contributed to feeding a pessimistic view of the recent wave of globalization and its consequences. It claimed: "The new rules of globalization - and the players writing them - focus on integrating global markets, neglecting the needs of people that markets cannot meet. The process is concentrating power and marginalizing the poor, both countries and people".

The report's conclusions rely on alarming figures about world income distribution: "Gaps between the poorest and richest people have continued to widen.

In 1960 the 20% of the world's people in the richest countries had 30 times the income of the poorest 20% - in 1997, 74 times as much".

Recent research sheds new light on the pessimistic picture painted by the UNDP 1999 report. In The Disturbing "Rise" of Global Income Inequality, Xavier Sala-i-Martin, Professor at Columbia University, points out that the Human Development Report computed its poverty ratios using current exchange rates, therefore ignoring the fact that the cost of living is lower in developing countries.

Once adjusted for purchasing power parity, Sala-i-Martin finds that the poverty ratio of the richest 20% to the poorest 20% has actually started to diminish over the last two decades: "Rather than rising from 20 to 74, the ratio increases from 11.3 in 1960 to 15.9 in 1980, but then declines slowly to 15.09 in 1998".

Sala-i-Martin identifies another important shortcoming in the methodology used in the Human Development Report. The Report considers each country as a data point regardless of its population size. It thereby gives an equal weight to China and any much smaller African country, while in reality China's population is twice that of all 35 African countries together. Analyzing inequality between

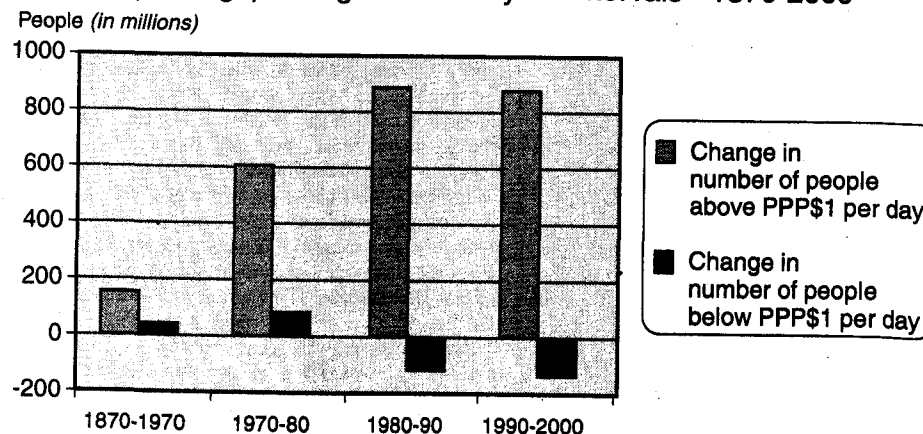
individuals - rather than between countries - would be a much more reliable indicator of the actual trends in income distribution across the world.

Hence, the UNDP's claims that income inequality has increased both between countries and within countries may not be wrong per se, but they simply fail trends to give a complete picture.

In a paper entitled 'Global Income Inequality: Beliefs, facts and unresolved issues', Arne Melchior, from the Norwegian Institute of International Affairs, warns against reaching hasty conclusions about inequality between countries. Many poor countries, especially in Africa, have experienced falling income during recent years. But, as Melchior says, "it is also true that a significant number of poor or formerly poor countries, including the world's two most populous countries, China and India, as well as other large developing countries, particularly but not only in Asia, have grown faster than the richest group of nations". China and India account for 38% of the world's population. Once weighted by population, the measure of income inequality shows that many developing countries are actually converging toward the richest countries' living standards.

Inequalities have increased within several countries with high levels of growth over recent years. Yet, this should not overshadow the significant progress made in terms of raising incomes and living standards for the large majority of the population of these countries. A World Bank publication, 'Globalization, Growth and Poverty: Building an Inclusive World Economy', notes that, while inequality in most of the globalizing developing countries - such as Malaysia or the Philippines - has declined since 1980, rapid economic growth in China has widened the gap between rural and urban areas. But as the report points out, "if this increase in inequality in China has been the price of growth, it

Trends in absolute poverty in recent decades
(Average) changes over 10-year intervals - 1870-2000



has paid off in terms of massive reduction in poverty."

The very fact that countries with comparable levels of growth have experienced different trends in income distribution also shows that there is no direct relation between globalization and inequality within countries. Income distribution in a given country primarily depends on domestic factors such as economic policy choices and redistribution mechanisms.

While it is true that inequality has increased, in some countries and fallen in others, there is a clear trend towards convergence in world income distribution between individuals, i.e., regardless of their country.

In 'The World Distribution of Income' (estimated from individual country distributions), Sala-i-Martin uses nine different indexes to measure global income inequality (or world inter-personal inequality). All of them show that there has been a substantial narrowing of the gap between rich and poor during the last two decades:

A report published by the Australian Department of Foreign Affairs and Trade, 'Globalization and Poverty: Turning the Corner,' reaches similar conclusions by comparing the frequency distribution of global income (Lorenz curve) in 1965 and 1997. The authors found greater income equality in 1997 than in the mid-1960s.

Poverty

Year after year, the UNDP reports an alleged failure to reduce world poverty. It backs up its assertion by stating World Bank figures on the growing number of poor people in Sub-Saharan Africa. But again, without denying the critical situation of many African countries, a closer look at developments in other regions of the world reveals a far more optimistic picture.

Contrary to what is often repeated, globalization has contributed to

unprecedented advances in increasing the living conditions of many of the world's poorest people. New research by Xavier Sala-i-Martin shows that absolute poverty and poverty rates have both substantially declined over the last 30 years. On a global scale, the proportion of people living on less than a dollar a day has fallen from 20% to 5% over the last 25 years. The two-dollar-a-day poverty rate dropped from 44% to 18% of world population. In Asia, the proportion of people living on less than two dollars a day has dropped from 60% in 1970 to 17% in 2000, lifting more than 650 million people out of deep poverty.

Countries like Indonesia, Bangladesh, Uganda and Vietnam have all succeeded in sharply reducing poverty over the last decade. Dramatic decreases in poverty rates took place in Indonesia, with just 3% of the population living on less than two dollars a day in 1998 compared with 69% in 1970. This was also the case in Bangladesh, where the proportion of people living on less than two dollars a day has dropped by a quarter since 1970. In Vietnam, 98% of the poorest 5% of households in 1992 were better off six years later, according to a paper entitled Spreading the Wealth by David Dollar and Aart Kraay. Poverty in Uganda fell by 40% during the 1990s. In India, in spite of controversy over different poverty measurement methods, poverty rates have also been shown to be declining.

Living standards

When measuring poverty it also important to take into account living standards and not just incomes. Here again, evidence tells us that, overall, quality of life has improved in the developing world. According to the Australian Department of Foreign Affairs and Trade, the number of undernourished people in the world has been reduced from 920 million in 1970 to 810 million today.

The World Bank study says school enrolments in Uganda have doubled

during the 1990s. In a study for the Brookings Institution Global Inequality Group, Gary Burtless shows that life expectancy has been rising almost everywhere in the world and that as a result "world inequality in the distribution of expected lifespans has declined."

The purpose here is not to give a rosier picture than the real situation. Global income inequality and poverty rates have declined, but many countries have also suffered from increased marginalization and have been unable to reduce poverty and inequality over the last two decades. More than 40% of Africans live on less than a dollar a day, a rate that has been steadily increasing in the continent as a whole since the 1970s. Conflict and inappropriate policy choices persist in holding many African countries back from economic progress.

Nevertheless, several African economies show hopeful signs of progress.

According to the latest UN report on Africa, Economic Report on Africa 2002: tracking performance and progress, the majority of African countries achieved economic growth of more than 3% in 2001 - although from a very low base - hence outperforming other developing regions. Since 1970, the proportion of people living on less than a dollar a day decreased in 13 African countries. Global integration is crucial for the recovery of African countries. Globalisation must therefore, be seen not as a threat to welfare but rather as an opportunity to achieve higher economic growth and rising incomes.

The rapid economic progress of countries, and particularly developing countries, that have integrated into the global economy has shown the positive contribution that globalisation can make by raising incomes and living standards throughout the world. Wealth creation through entrepreneurship, opening of export markets, flows of foreign direct investment and technology, and the resulting spiral of prosperity and job creation are the benefits that global economic integration can bring to developing nations.

The results so far are encouraging: poverty rates have decreased and global income inequality has diminished in recent decades. The challenges is now to enable the poorest countries to benefit from the opportunities of the global economy.

The success of the WTO Doha Development Agenda will be a key factor in meeting this challenge. World business has a leading role to play in showing how globalisation can be an opportunity for all and ensuring that necessary public actions are undertaken to create the conditions for growth and prosperity in these countries.