

# Globalization and Inequality

The Ralph Miliband Lectures on Inequality

LSE February 15, 2005

1. Historical perspective
2. Global inequality today
3. Why global inequality matters
4. What to do about it?

A few words on Miliband's *The State in Capitalist Society*,  
1969

# On governments of the left

- One reason why new governments of the left seek to provide such reassurance to these [conservative] forces is that they have normally come to office in conditions of great economic, financial and social difficulty and crisis, which they have feared to see greatly aggravated by the suspicion and hostility of the “business community.”

# On the civilians and the military in a democracy

- The exaggeration of the role of the military in the counsels of the capitalist governments has its dangers, for it tends to deflect attention from the responsibility of the civilian power-holders for the state's policies and actions. That these power-holders, particularly in the United States, have accepted what Mills called 'military definition of reality' may well be true.

# Disputes about international and global inequality

- Terminological confusion
- No dispute about extraordinarily high levels of global inequality
- Dispute about trends: is it increasing or declining?
- Why is it important: because of causal link between globalization and inequality

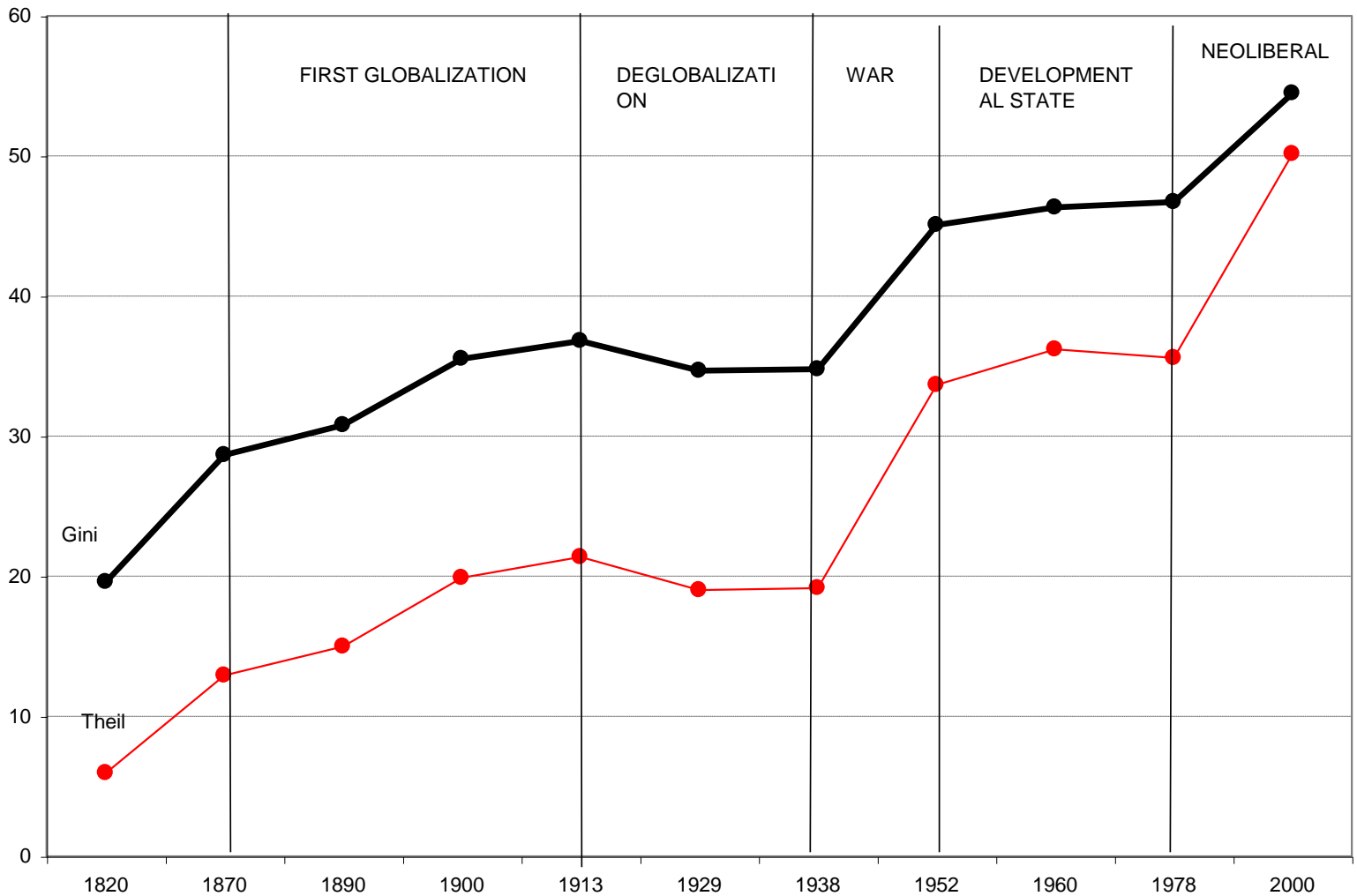
# What world inequality are we talking about?

Comparison between the three concepts of inequality

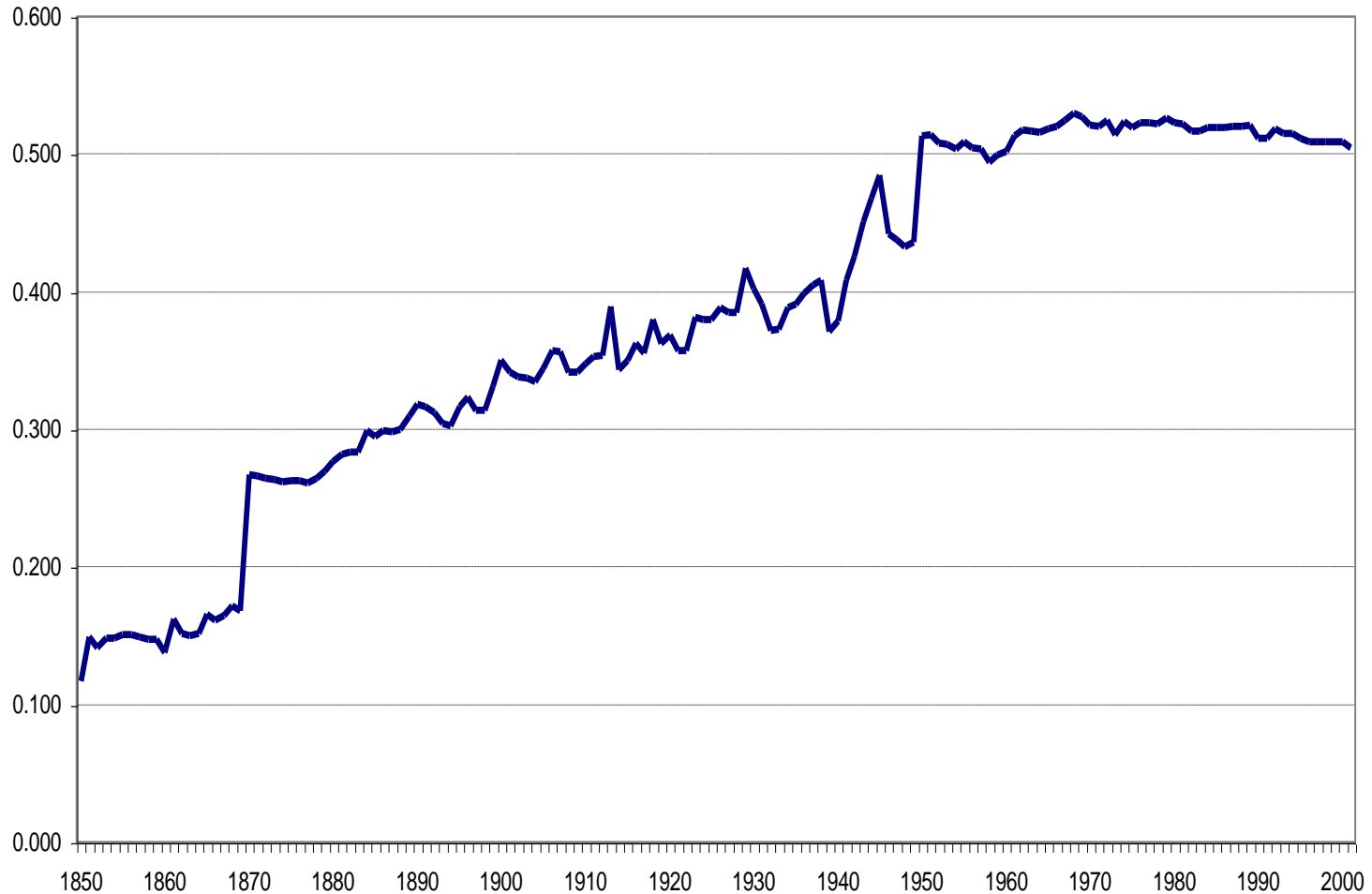
	<b><u>Concept 1:</u> unweighted inter-national inequality</b>	<b><u>Concept 2:</u> weighted inter- national inequality</b>	<b><u>Concept 3:</u> “true” world inequality</b>
<b>Main source of data</b>	National accounts	National accounts	Household surveys
<b>Unit of observation</b>	Country	Country (weighted by its population)	Individual
<b>Welfare concept</b>	GDP or GNP per capita	GDP or GNP per capita	Mean per capita disposable income or expenditures
<b>National currency conversion</b>	Market exchange rate or PPP exchange rate (but different PPP concepts used)		
<b>Within-country distribution (inequality)</b>	Ignored	Ignored	Included

# 1. Historical perspective

# Concept 1 inequality in historical perspective: Convergence/divergence during different economic regimes

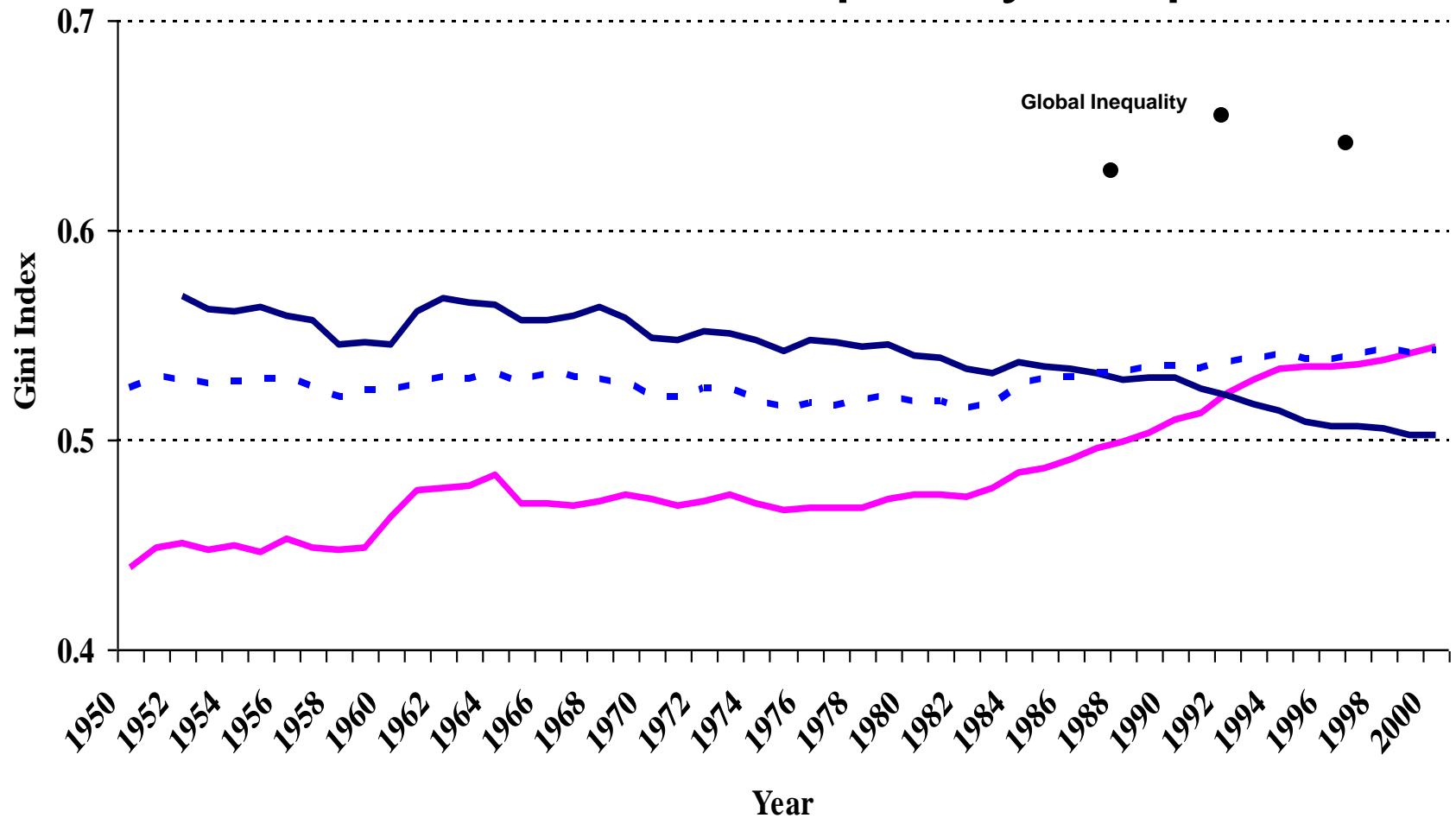


# Concept 2 inequality, 1820-2000 (Maddison data)



## 2. Inequality today

# Inequality, 1950-2000: The mother of all inequality disputes



— World unweighted — World population-weighted - - - World weighted except China

# Discontinuity in development trends around 1978-80

- ***The watershed years*** (Bairoch)
- Tripling of oil prices
- Increase in real interest rates (from -1 to +5 in the USA)
- Debt crisis
- China's responsibility system introduced
- Latin American begins its "lost decade", E. Europe "stagnates"

# But also discontinuity in inequality trends

**Within-country** inequalities have been rising during the last two decades (US, UK, China, India)

Inequalities **between countries** are rising since 1978

**Population weighted** inequality **between countries** decreasing since 1978 thanks to growth in China and India (Caveat: acc. to Maddison Concept 2 inequality is almost stable)

Inequality among **people in the world** is very high (Gini between 62 and 66) but its direction of change is not clear

# The outcome:

- Middle income countries declined (Latin America, EEurope)
- China and India pulled ahead
- Africa's position deteriorated further
- World growth rate decreased by about 1 % (compared to the 1960-78 period)
- But no change if that rate is population-weighted

- Africanization of poverty: 80% of African countries are very poor (The Fourth World); half of them have incomes lower than 20 or even 30 years ago; What to do?

# The difficulty stems from contradictory movements

- Greater inequality within nations
- Greater differences between countries' mean incomes (think of UK vs. Africa)
- But catching up of large and poor countries
- All of these forces determine what happens to GLOBAL INEQUALITY

# Why inequality between countries matters

- Are poor countries catching up as we would expect from theory?
- Are similar policies producing the same effects or not? (Rodrik: convergence of policies, divergence of outcomes). Why?
- Migration issues
- Countries are not only interchangeable individuals (random assortments of individuals); they are cultures. Divergence in outcomes is elimination of some cultures. Perhaps it's good, perhaps not.

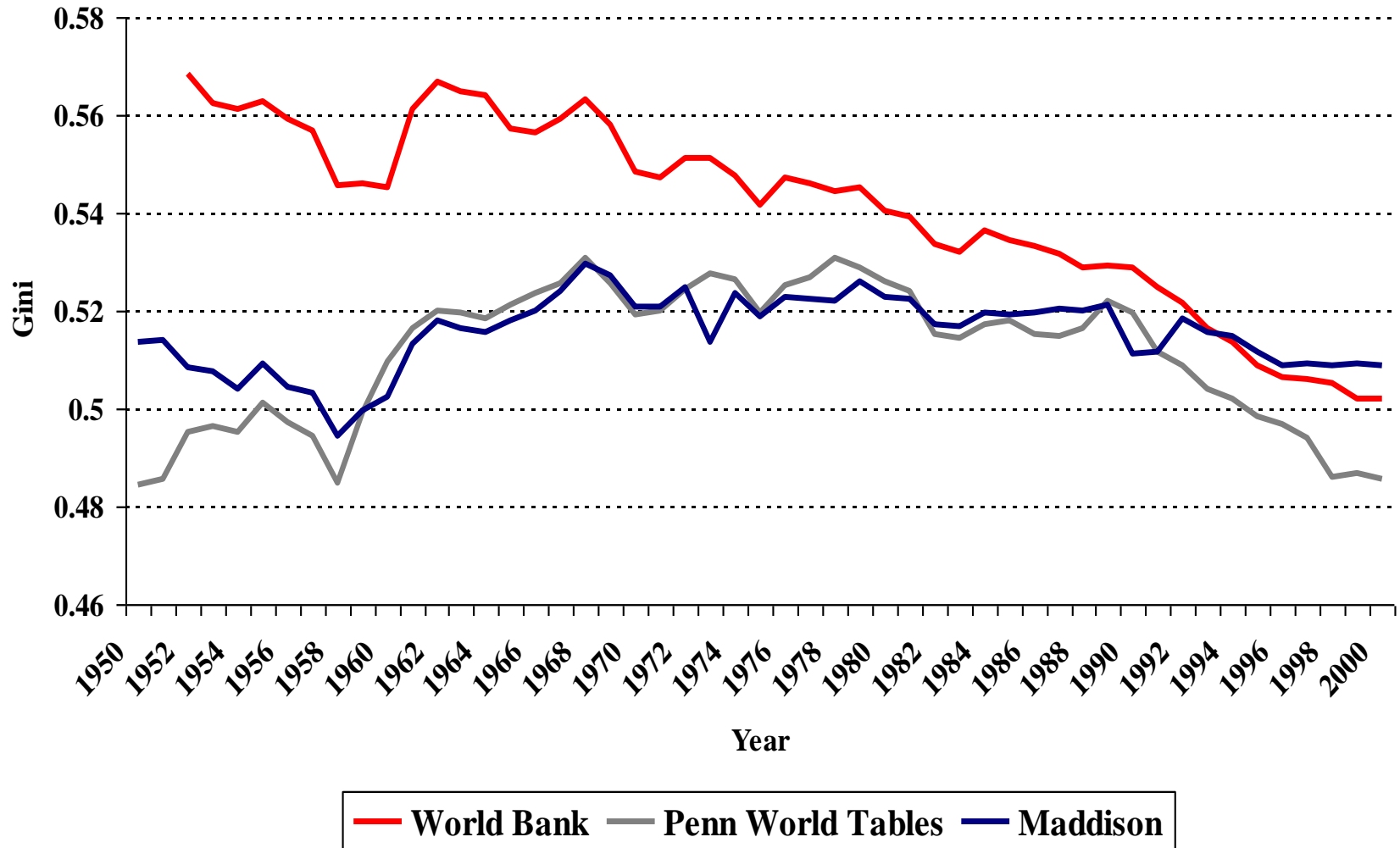
# Why Concept 2 inequality matters

- Because it gives us an approximation (lower bound) to Concept 3 or global inequality between individuals
- Try to get to global inequality from below, that is by breaking large countries into their provinces/states or rural/urban areas
- Why it matters: if Concept 2 inequality is more or less stable over the last two decades, then Concept 3 inequality must have gone up.

# Recalculation of Concept 2 inequality

- Breaking large countries into their states or rural/urban
- Using alternative GDI per capita data for China
- Expanding sample size to “failed” countries (i.e. using Maddison’s data)

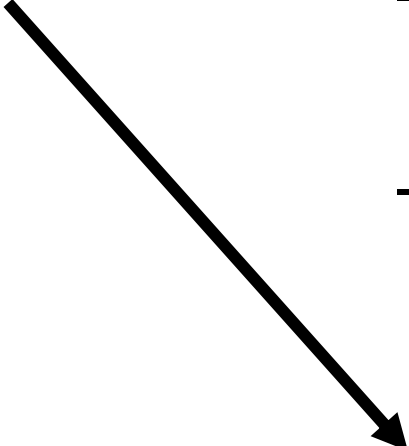
# As seen before, the extent of decline in Concept 2 depends on what GDI numbers for China one uses



Further, breaking down most populous countries into their provinces/states makes a difference too.

Concept 2 inequality change (Gini points; 1985-00)

	World Bank data	Maddison data
Whole countries	-3.3	-1.9
China by states + whole countries	-3.9	-2.2
R/U for China	-3.3	-1.5



- Finally, if we use Maddison's data which include 160+ countries, there is only 1.5 Gini point Concept 2 decline btw 1980 & 2000.
- Bottom line: An unambiguous Concept 2 decline which seemed to have been more than 3 Gini points turns out to be half of that.

### 3. Inequality between world citizens today

## How are Concepts 2 and 3 related?

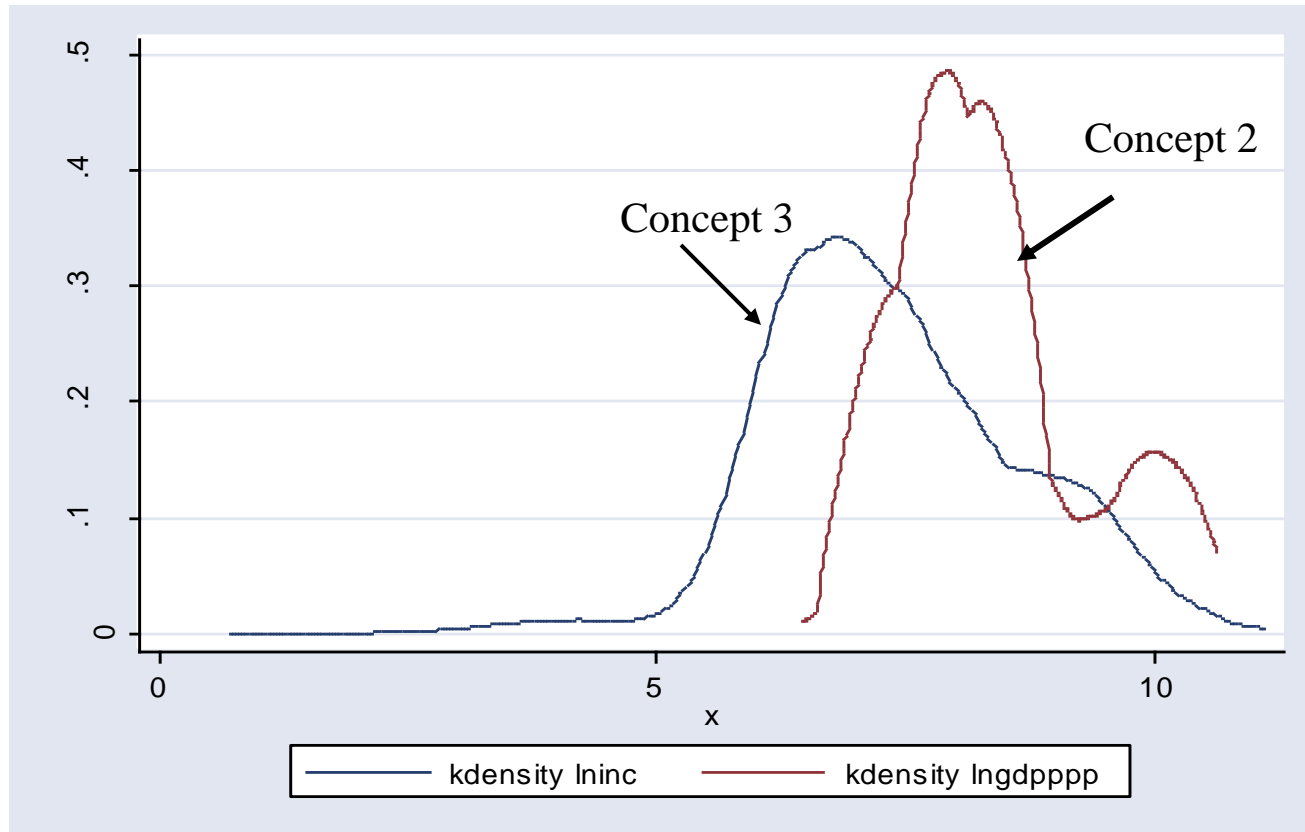
- In Gini terms: Concept 3 =

$$\sum_{i=1}^n G_i p_i \pi_i + \underbrace{\frac{1}{\mu} \sum_i^n \sum_{j>i}^n (y_j - y_i) p_i p_j}_{\text{Concept 2}} + L$$

Concept 2

- Where  $G_i$ =individual country Gini,  
 $p$ =population share,  $\pi$ =income share,  
 $y$ =mean income of country  $i$ ,  $\mu$  = world mean

# Difference between world in 1998 as seen by Concept 2 and Concept 3 (global inequality)



Number of  
observations  
1828 or 113

```
twoway (kdensity lninc [w=pop] if year==1998 & mysample==1 & lninc>0) (kdensity lngdpp  
> pp [w=totpop] if year==1998 & mysample==1 & group==1)
```

# What does Concept 3 say?

**World international dollar inequality in 1988 and 1993**  
(distribution of persons by \$PPP and \$ income per capita)

	1988	1993	1998
<b><i>International dollars</i></b>			
Gini index	<b>61.9</b> (1.8)	<b>65.2</b> (1.8)	<b>64.2</b> (1.9)
<b><i>US Dollars</i></b>			
Gini index	<b>77.3</b> (1.3)	<b>80.1</b> (1.2)	<b>79.5</b> (1.4)

Note: Gini standard errors given between brackets.

Intuitively, what is a Gini of 64-66; how big is it?

	Top	Bottom	Ratio
In \$PPP: 5%	33%	0.2%	165-1
10%	50%	0.7%	70-1
In US\$: 5%	45%	0.15%	300-1
10%	67.5%	0.45%	150-1
5 top countries	31,850 \$PPP	580	55-1
10 top countries	28,066	660	42-1

# Top decile has one-half of income; top 5%, one-third

Cumulative % of population	Cumulative % of PPP income/consumption
5	0.2
10	0.7
25	2.9
50	9.6
75	24.7
90	50.4
Top 10	49.6
Top 5	32.7

How do we get an increase in inequality and then a decline if NA-based Concept 2 inequality seems to be going down?

1) Global inequality includes also within inequality. And it went up.

1988

1993

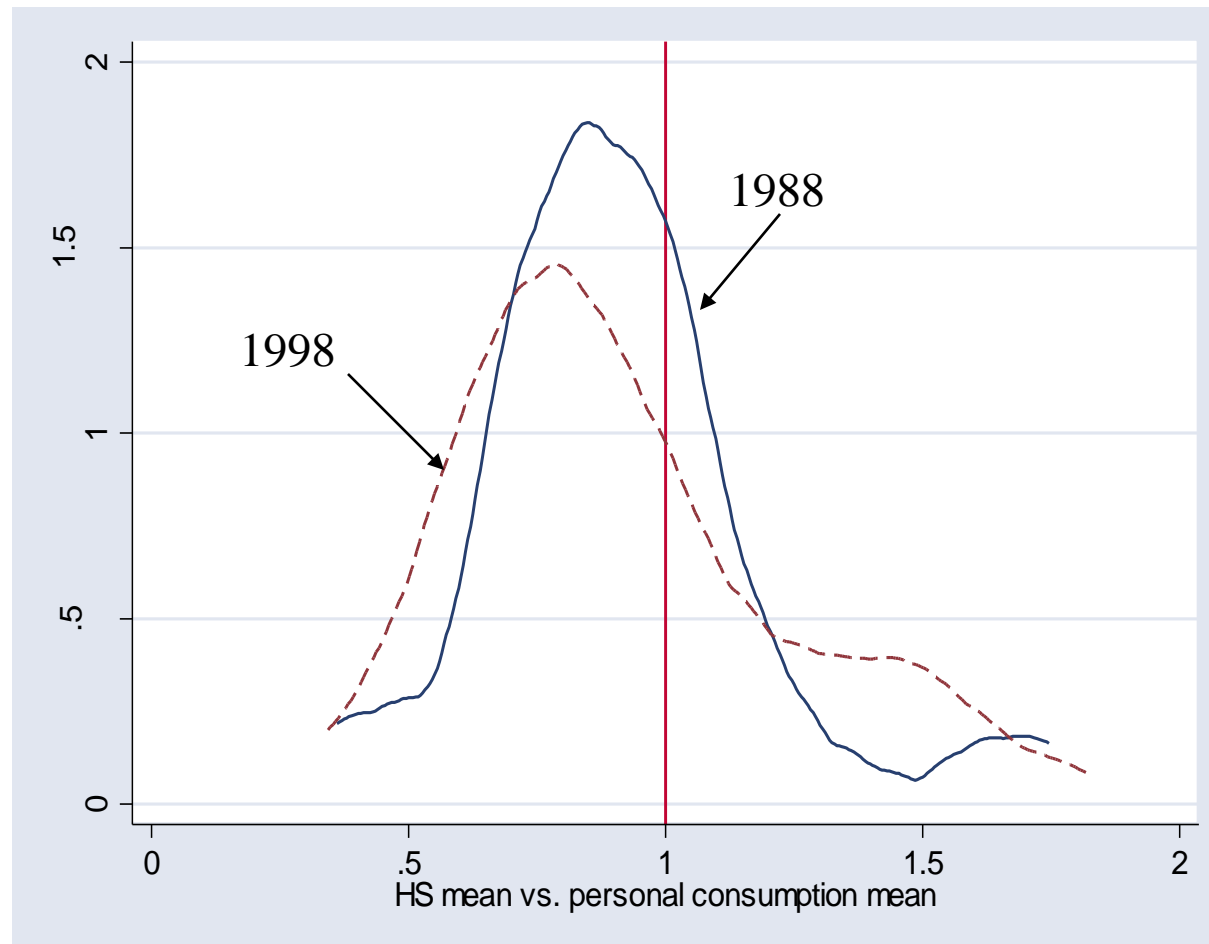
1998

13.7

14.5

14.5

## 2) Difference in the movement of household survey mean and GDI per capita from NA



twoway (kdensity ratio1 if year==1988 & ratio1<2) (kdensity ratio1 if year==1998 & rat

- HS/NA "capture" ratio decreased in poor countries (*cause celebre*: India)
- Picketty and Banerji: 20% to 40% of the growth discrepancy due to under-reporting of high incomes
- => Ginis under-estimated in fast growing and transforming countries (India and China)
- => an equi-proportional adjustment favored by some authors is wrong for two reasons:
  - Static: property incomes are under-reported and hence GDI/HS difference cannot be allocated across the board
  - Dynamic: But now that this difference seems even more skewed toward the rich than usually

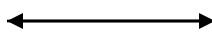
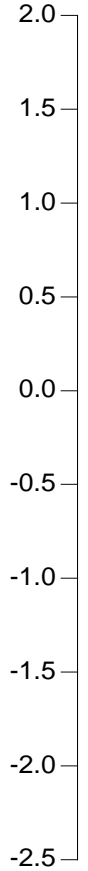
# Why global inequality using HS means moves differently from global inequality which would use GDI per capita

HS/NA "adverse" movement

Rural/urban  
breakdown

Within inequality

Gini points

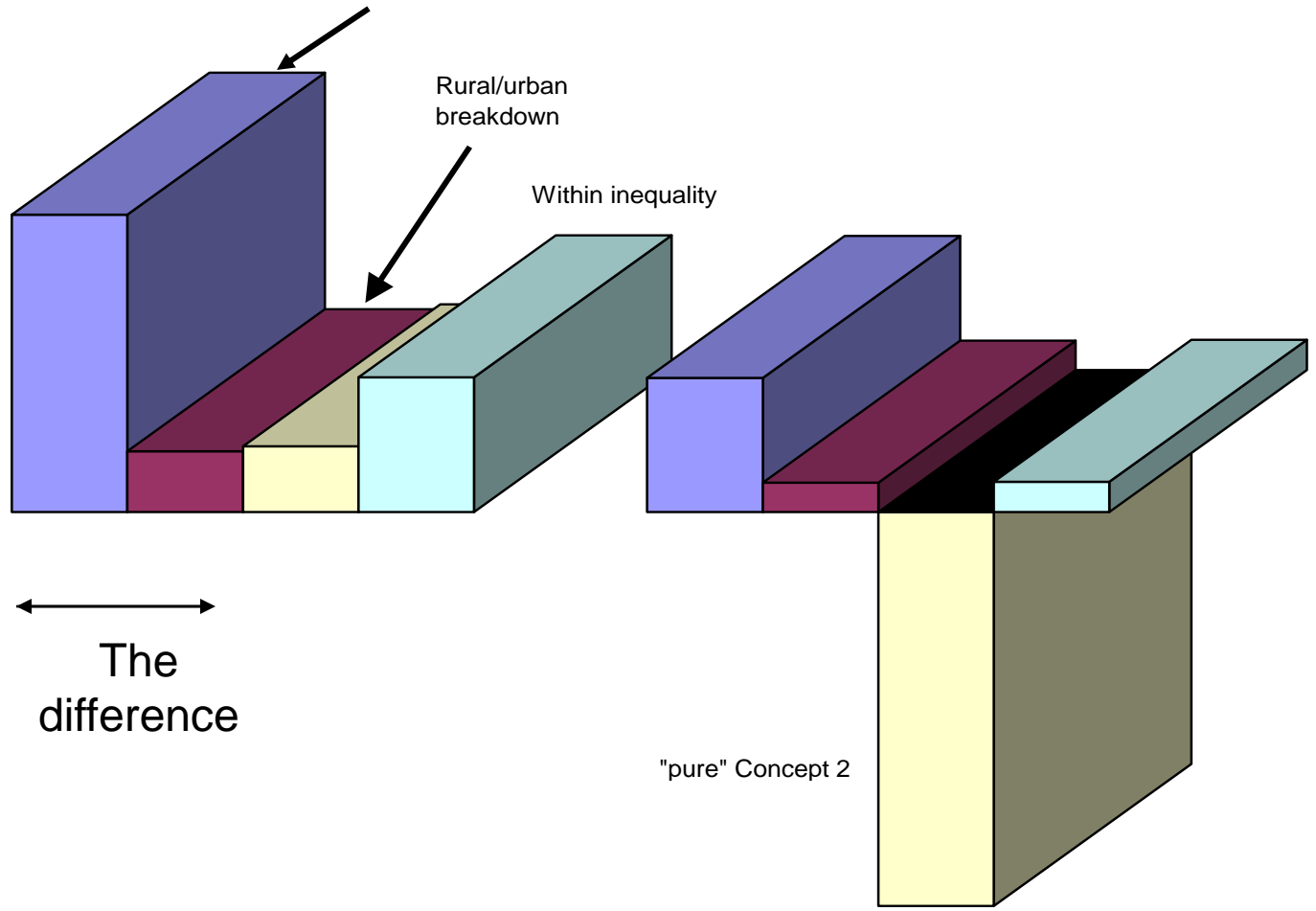


The  
difference

1993-88

1998-93

"pure" Concept 2



## *The key determinants of global inequality: **substantively***

### Interaction between

1. the rich countries of the West,
2. urban incomes in China and India
3. rural incomes in these two countries

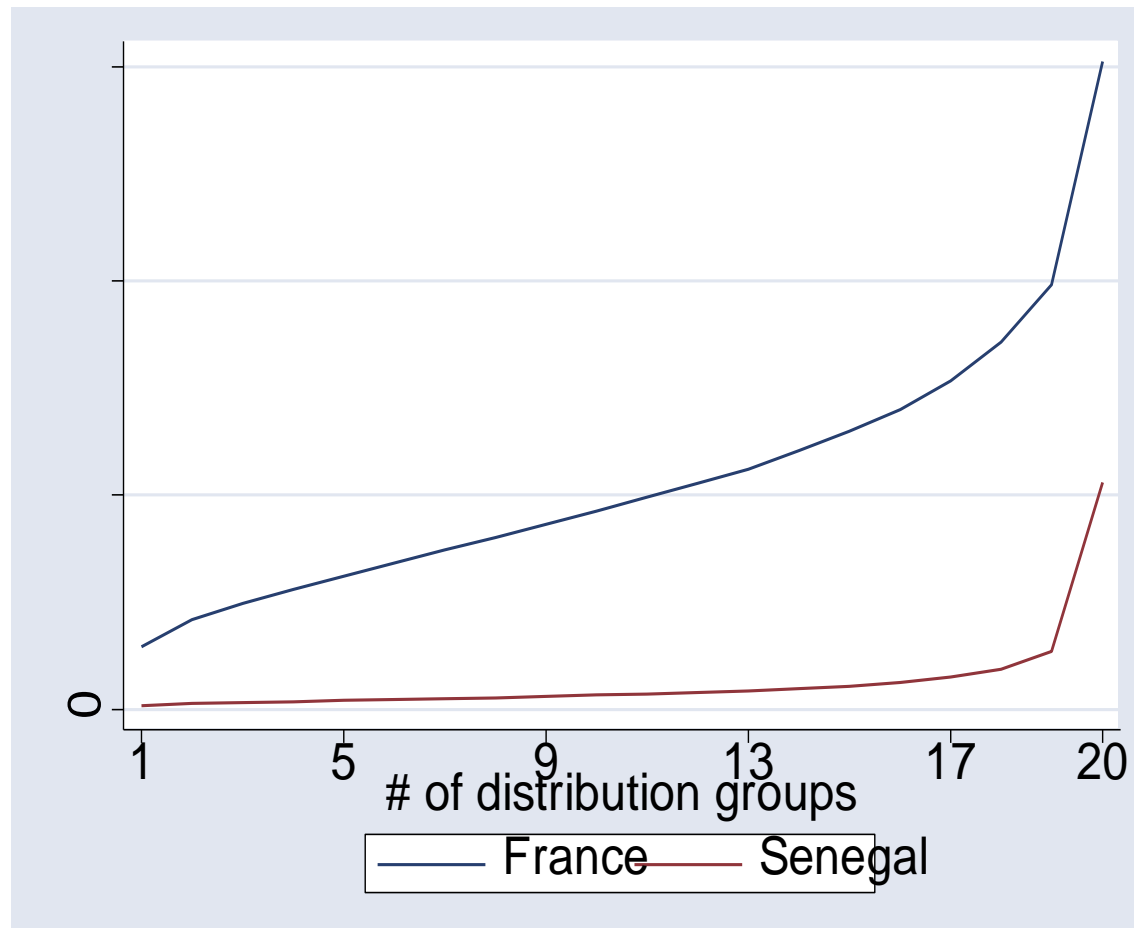
The ratio between (2) and (3) has been rising, and is unlikely to moderate. Moreover, while China and India are the most important examples of the trend, the urban-rural gap is rising in several other Asian countries (Bangladesh, Indonesia, Thailand).

But as (2) catches on (1), world inequality is reduced.

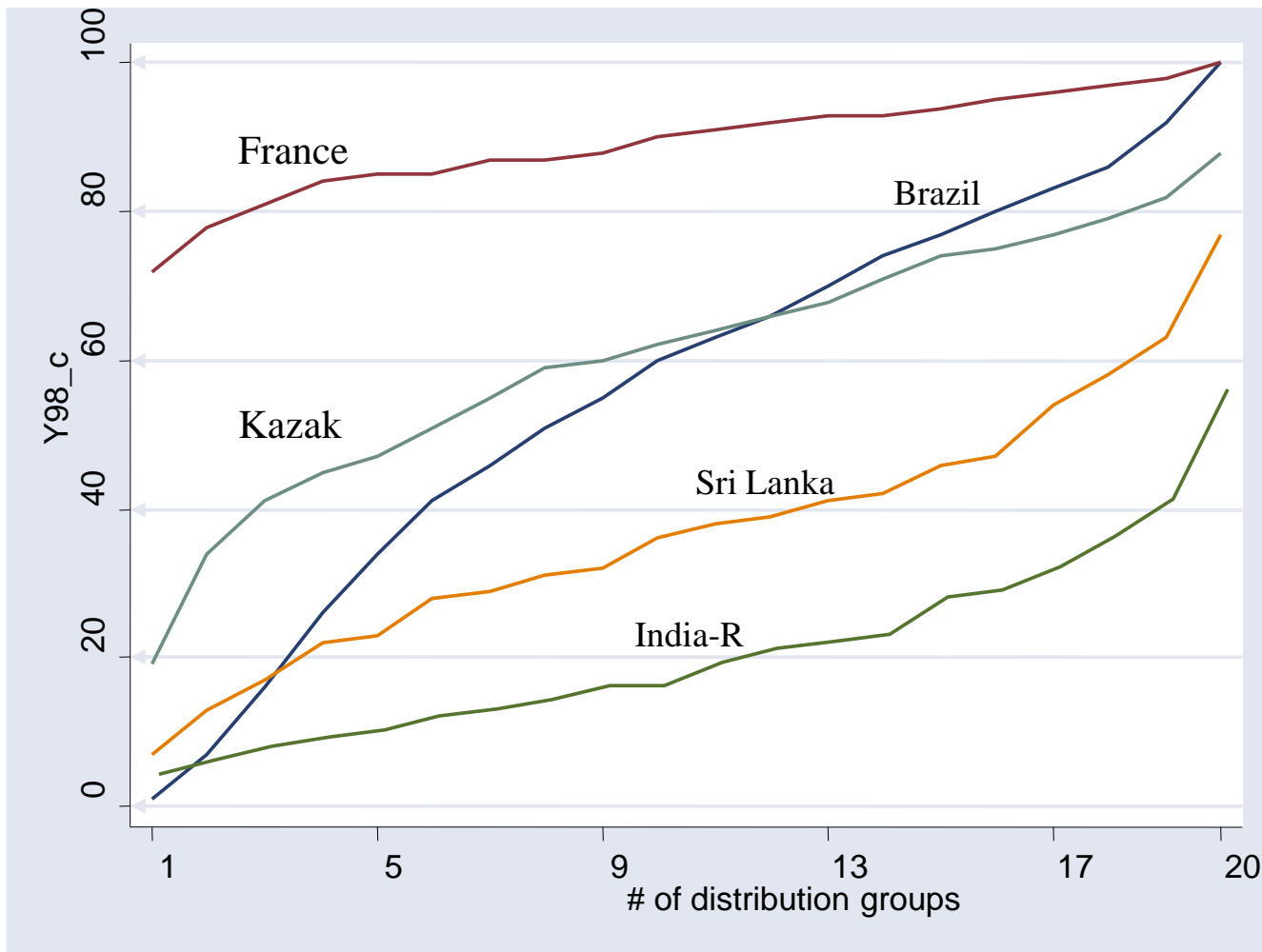
The crucial “swing” factor then becomes the ratio between (3) and (1): what happens to rural incomes in China and India vs. incomes of the rich world.

Compare distributions of different countries

France vs. Senegal in 1998 (in \$PPP)



# First order dominance (year 1998) expressed in terms of percentile of world income distribution

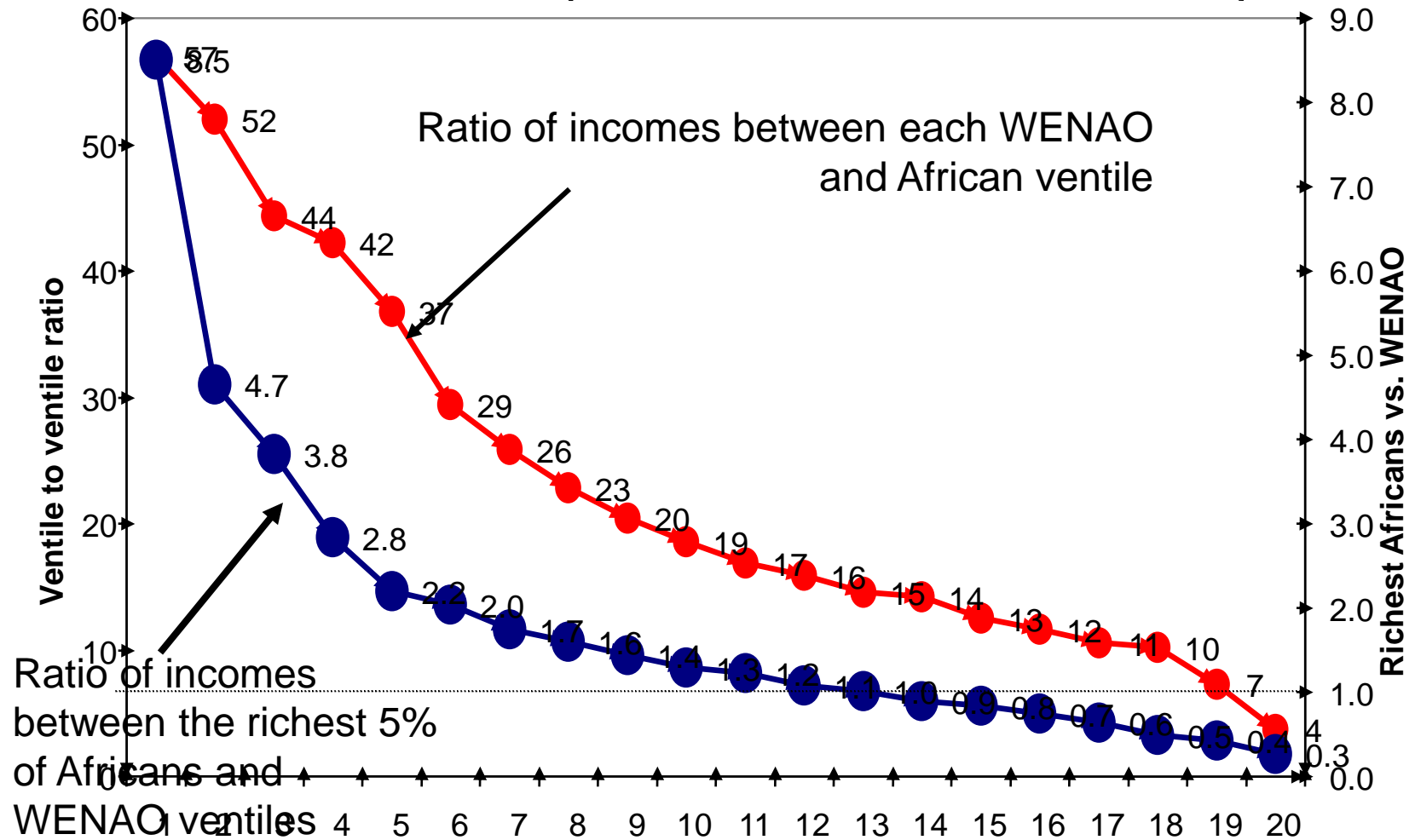


twoway (line Y98\_v group if year==1998 & contcod=="BRA") (line Y98\_v group if year

# Note...

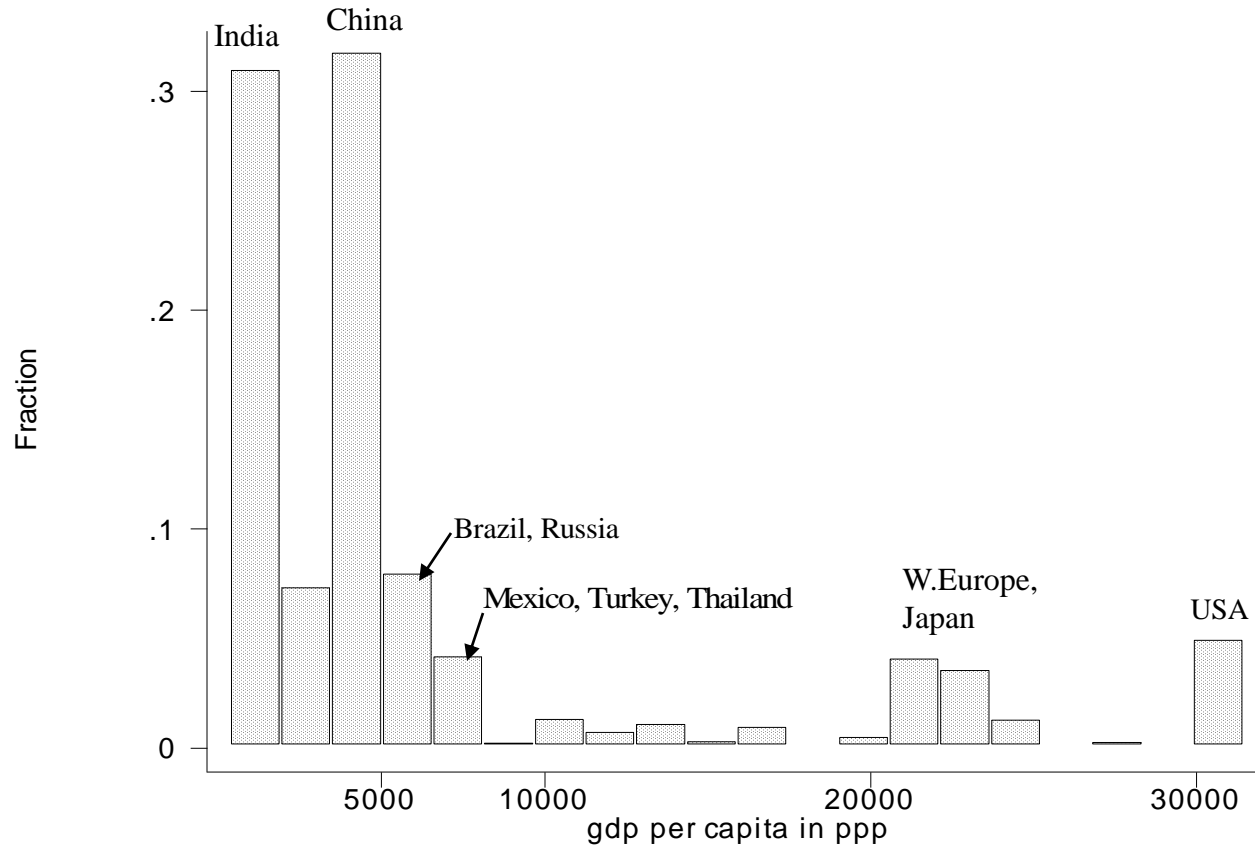
- Not even richest people in rural India intersect with poorest people in France
- Almost no intersection between people in Sri Lanka and France
- But this is not true for Brazil: about a third of the population is better off than the poorest decile in France
- Important later for rules re. global transfers

# Comparison between Africans and the rich world (1998 data; in PPP)



# A World Without a Middle Class

Distribution of people in the world according to GDP per capita in international dollars of country where they live (year 2000)



- Define **poor** as in the West: a per capita income less than \$10 per day ( = mean income of Brazil)
- Define **rich** as people with income higher than mean income of Portugal...(the poorest rich country)
- Then...

*Poor people in poor countries?* **Almost 4 billion.**

*Rich people in rich countries?* **About 700 million.**

*Poor people in rich countries; rich people in poor countries?*  
**About a hundred million each.**

Brings us to almost 5 billion people? So, where is the middle?

Persons	Poor people	Middle-income people	Rich people	Total population
Countries				
Poor countries	3879	210	<b>96</b>	4185
Middle-income countries	189	35	52	277
Rich	<b>92</b>	115	707	913
Total population	4160	360	855	5375

Note: Full sample countries (122 countries). Poor below mean income of Brazil, or social assistance eligibility in the West (about \$PPP 10 per capita per day).

# 4. The Future of Global Inequality

# "Inequality transition"?

- Lucas and Firebaugh view: global inequality has peaked; Why?
- Permanent effects of industrial revolution
- Policy convergence => Income convergence
- Historically, Concept 2 inequality drove global inequality since IR; for the last 30+ years has been on the decline; then Concept 3 must follow.

# But...

- Technological revolution continues (not only one discrete big bang...), differences may be accentuated (speed of tech. inventions = > speed of dissemination)
- Policy convergence did not result in income convergence
- And all hangs on the break in Concept 2 trend which depends on one country and one particular set of growth numbers for it.

So, even if globalization leaves overall inequality unchanged...

- Within-countries, it means that rich Americans will gain 18 times more than poor Americans, Brazilians 40-1, Indians 12-1, Nigerians 30-1...(based on deciles)
- Differentiate between absolute (Atkinson & Brandolini) and relative gains
- Issue of perception and “fairness”

# 5. Does Global Inequality Matter?

- No one in “charge” of it; there is no global government
- No one can do much about it
- No global taxation authority

# Why it might matter?

- Globalization increases awareness of differences in living standards
- Leads to migration
- At country level, inequality linked with conflict
- At world level, likely to lead to conflict too (Jennifer Government)

- **What is the correct utility function?**
- Is it simply:  $U_i = fct(X_i)$  where  $X$  is a vector of consumption?
- Or is it  $U = fct(X_i, X_i/X_{mean})$  where relative consumption matters too?
- If the latter, then with globalization the relevant (mean or median) consumption increases as people get to know more about each other
- Then even when  $X_i$  increases, if  $X_i/X_{mean}$  goes down, people may be unhappy.

# Simply: $U_i = fct(X_i)$ ?

- **YES**, according to Ann Krueger (2002):

“Poor people are desperate enough to improve their material conditions in absolute terms rather than to march up the income distribution. Hence it seems far better to focus on impoverishment than on inequality.”

Or is it  $U = fct(X_i, X_i/X_{mean})$  where relative consumption matters too?

- **YES**, according to Kuznets (1954).

“...one could argue that the reduction of physical misery associated with low income and consumption levels...permit[s] an increase rather than a diminution of political tensions.”

## **BECAUSE**

“the ***political misery*** of the poor, the tension created by the observation of the much greater wealth of other communities...may have only increased.”

# Feedback effect of globalization on perception of inequality

- Then, with globalization the relevant (mean or median) consumption increases as people get to know more about each other
- *Hypothesis:* The process itself influences the perception (differentiate btw. the objective reality and its perception)

## 6. What can be Done?

# Possible changes in global rules of the game

- Stanley Fischer: “The international trading system is biased against the poor countries”
- Removal of agro subsidies; free trade in textiles, steel (sensitive products) etc
- Change in WTO rules: less emphasis on intellectual property rights, financial liberalization

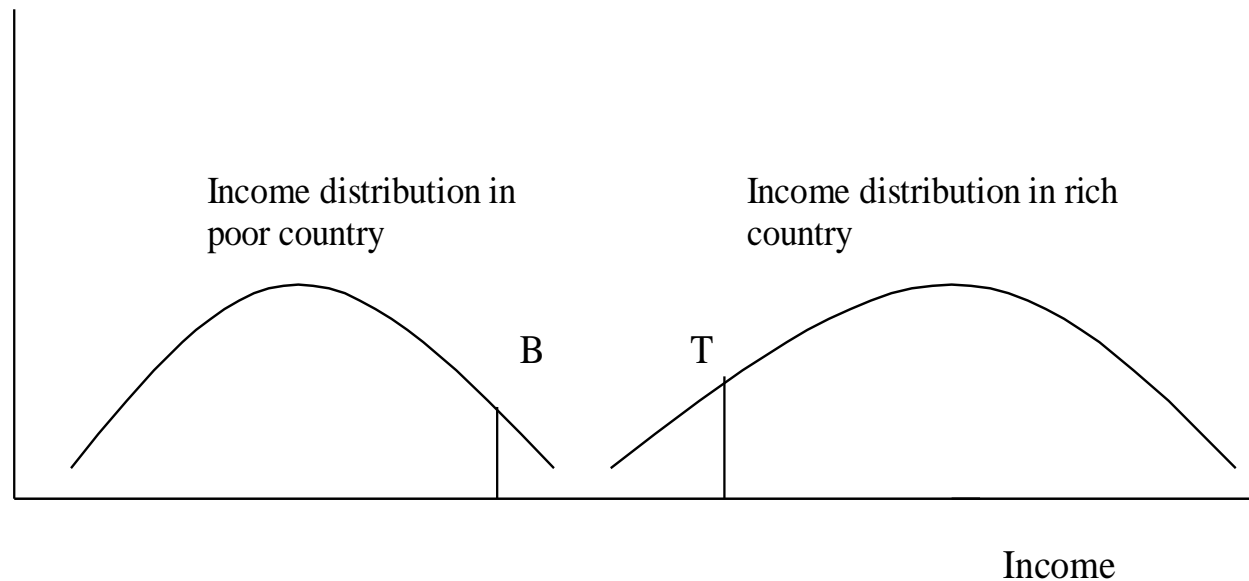
- Democratization of decision-making at the global level (vs. plutocratization)
- Possible movement toward grants rather than loans
- Special programs for Africa (AIDS, stability, export help)
- Africa particularly affected by aid fatigue and end of the Cold War
- But how about **global transfers** (something akin to **global safety net**)?

# We need some rules for global transfers

- They will satisfy Progressivity 1 condition  
=> They flow from a rich to a poor country (Concept 1 inequality is less). That is easy.
- But they have to satisfy the same rules as at the national level =>
- Transfers should be globally progressive, that is flow from a richer **person** to a poorer **person**

In addition transfers have national income inequality implications too

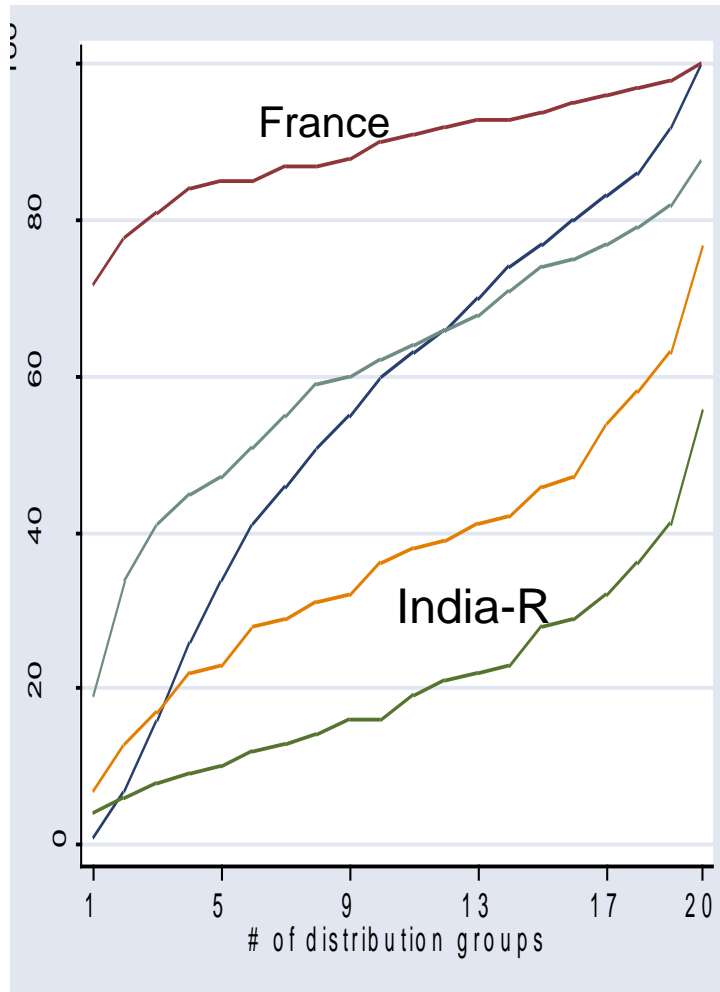
Progressive transfer at the global level and worsening national distributions (may not be sustainable)



# Thus transfers have to satisfy

- **Progressivity 1**: reduce mean income differences between the countries
- **Global progressivity**: tax payers should be richer than beneficiaries
- **National progressivities**: in rich country, tax payers should be rich (reduce rich country inequality) and in poor country, beneficiaries should be poor (reduce poor country inequality)

# Go back to the example of non-overlapping distributions



The probability that a transfer from France to rural India will be globally regressive is extremely slight. Even if beneficiary is randomly selected, global progressivity is assured (but not national progressivities).

Or differently, one needs to “penalize” poor countries with highly unequal distribution

**=> Probability of a globally regressive transfer cannot be discounted**

# Global transfers:

- A supra-national taxation authority with grants focused on Africa
- Limited country sovereignty relating to the use of the funds
- Transfers are no longer from **state to state**, but from **global authority to citizens** (change in paradigm)
- A natural complement to global tax authority is relationship with (poor) citizens, not states

# “Global thinking”

- Change in the approach I: global issues, global institutions, circumventing of nation states
- Change in the approach II: neither projects, nor structural adjustment—rather direct transfer of purchasing power (example of Russian pensioners)