

# ***Globalization, Poverty, and Inequality since 1980***

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## ***Abstract***

One of the most contentious issues of globalization is the effect of global economic integration on inequality and poverty. This paper documents five trends in the modern era of globalization, starting around 1980. Trend #1: Poor country growth rates have accelerated and are higher than rich country growth rates – for the first time in modern history. The developing world economy grew at more than 3.5 percent per capita in the 1990s. Trend #2: The number of poor people in the world has declined significantly – by 375 million people since 1981 -- the first such decline in history. The share of the developing world population living on less than \$1 per day was cut in half since 1981. Trend #3: Global inequality (among citizens of the world) has declined – modestly -- reversing a 200-year-old trend toward higher inequality. Trend #4: There is no general trend toward higher inequality within countries. Trend #5: Wage inequality is rising worldwide (which may seem to contradict trend #4, but it does not because wages are a small part of household income in developing countries, which make up the bulk of the world in terms of countries and population). Furthermore, the trends toward faster growth and poverty reduction are strongest in the developing countries in which there has been the most rapid integration with the global economy, supporting the view that integration has been a positive force for improving peoples lives in the developing world.

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*...globalization has dramatically increased inequality between and within nations.*  
-- Jay Mazur, *Foreign Affairs*

*...inequality is soaring through the globalization period, within countries and across countries.*  
*And that's expected to continue.*  
--Noam Chomsky

*...all the main parties support nonstop expansion in world trade and services although we all know it ... makes rich people richer and poor people poorer...*  
– Walter Schwarz, *The Guardian*

*We are convinced that globalization is good and it's good when you do your homework... keep your fundamentals in line on the economy, build up high levels of education, respect rule of law... when you do your part, we are convinced that you get the benefit.*  
--President Vicente Fox of Mexico

*There is no way you can sustain economic growth without accessing a big and sustained market.*  
--President Yoweri Museveni of Uganda

*We take the challenge of international competition in a level playing field as an incentive to deepen the reform process for the overall sustained development of the economy. WTO membership works like a wrecking ball, smashing whatever is left in the old edifice of the former planned economy.*  
– Jin Liqun, *Vice Minister of Finance of China*

There is an odd disconnect between debates about globalization in the north and the south. Among intellectuals in the north one often hears the claim that global economic integration is leading to rising global inequality – that is, that it benefits the rich proportionally more than the poor. In the extreme claims, the poor are actually made out to be worse off absolutely (as in the quote from Walter Schwarz). In the south, on the other hand, intellectuals and policy-makers often view globalization as providing good opportunities for their countries and their people. To be sure, they are not happy with the current state of globalization. President Museveni's quote above, for example, comes in the midst of a speech in the United States where he blasts the rich countries for their protectionism against poor countries and lobbies for better market access. But the point of such critiques is that integration – through foreign trade, foreign investment, and immigration -- is basically a good thing for poor countries and that the rich countries could do a lot more to facilitate

this integration – that is, make it freer. The claims from anti-globalization intellectuals of the north, on the other hand, lead inescapably to the conclusion that integration is bad for poor countries and that therefore trade and other flows should be more restricted.

The main goal of this essay is to document what we know about trends in global inequality and poverty, over the long term and during the recent wave of globalization that began around 1980. The phrase “global inequality” is used to mean different things in different discussions – distribution among all the citizens of the world, distribution within countries, distribution among countries, distribution among wage earners – and I take up all the different meanings. A second objective is to relate these trends to globalization.

The essay starts in the next section with a brief discussion of the growing integration of developing countries with the rich countries and with each other, starting around 1980. The opening up of big developing countries such as China and India is arguably the most distinctive feature of this wave of globalization. The heart of the essay is section 2, which presents evidence in support of five trends in inequality and poverty since 1980:

*Trend #1. Poor country growth rates have accelerated and are higher than rich country growth rates – for the first time in modern history.*

*Trend #2. The number of poor people in the world has declined significantly – by 375 million people -- the first such decline in history.*

*Trend #3. Global inequality (among citizens of the world) has declined – modestly -- reversing a 200-year-old trend toward higher inequality.*

*Trend #4. There is no general trend toward higher inequality within countries.*

*Trend #5. Wage inequality is rising worldwide (which may seem to contradict trend #4, but it does not because wages are a small part of household income in developing countries, which make up the bulk of the world in terms of countries and population).*

Section 3 then tries to draw a link between the heightened integration and the accelerated growth and poverty reduction. Individual cases, cross-country statistical analysis, micro evidence from firms, and opinion surveys in developing countries all suggest that opening up to trade and direct investment has been a good strategy for such countries as China, India, Mexico, Uganda and Vietnam. My conclusions for policy are very much in the spirit of the comments from Presidents Fox and Museveni. Developing countries have a lot of “homework” to do in order to develop in general and to make effective use of integration as part of their development strategy. Rich countries could do a lot more with foreign aid to help with that homework. And, as Museveni indicates, access to rich country markets is important. There remains a lot of protection in OECD markets against the goods and people of the developing world, and globalization would work much better for the poor if developing countries and their people had freer access to those rich country markets.

### ***1. Growing integration between north and south***

Global economic integration has been going on for a long time. In that sense globalization is nothing new. What is new in this most recent wave of globalization is the way in which developing countries are integrating with rich countries. As in previous waves of integration, this change is driven partly by technological advances in transport and communications, and partly by deliberate policy changes.

**Table 1.**  
**Measures of global integration**

	<b>Capital flows</b>	<b>Trade flows</b>	<b>Transport and communications costs (constant US \$)</b>		
	<b>Foreign assets/world GDP (in percent)</b>	<b>Trade/GDP (in percent)</b>	<b>Sea freight (average ocean freight and port charges per ton)</b>	<b>Air transport (average revenue per passenger mile)</b>	<b>Telephone call (3min NY/London)</b>
<b>1820</b>	-	2a	-	-	-
<b>1870</b>	6.9	10a	-	-	-
<b>1890</b>	-	12b	-	-	-
<b>1900</b>	18.6	-	-	-	-
<b>1914</b>	17.5	18ab	-	-	-
<b>1920</b>	-	-	95	-	-
<b>1930</b>	8.4	18a	60	0.68	245
<b>1940</b>	-	-	63	0.46	189
<b>1945</b>	4.9	-	-	-	-
<b>1950</b>	-	14a	34	0.3	53
<b>1960</b>	6.4	16b	27	0.24	46
<b>1970</b>	-	22.4a-20b	27	0.16	32
<b>1980</b>	17.7	-	24	0.1	5
<b>1990</b>	-	26ab	29	0.11	3
<b>1995</b>	56.8	-	-	-	-
<b>Source</b>	Crafts (2000)	a.Maddison (1995) b.Crafts (2000)	UNDP (1999)	UNDP (1999)	UNDP (1999)

The first great wave of modern globalization ran from about 1870 to 1914. It was spurred by the development of steam shipping and by an Anglo-French trade agreement. In this period the world reached levels of economic integration comparable in many ways to those of today. The volume of trade, relative to world income, nearly doubled from 10% in 1870 to 18% on the eve of World War I (Table 1). There were also large capital flows to rapidly developing parts of the Americas, and the ownership of foreign assets (mostly Europeans owning assets in other countries) more than doubled in this period from 7% of world income to 18%. Probably the most distinctive feature of this era of globalization was mass migration. Nearly 10% of the world's population relocated permanently in this era. Much of this was migration from poor parts of Europe to the Americas. But there was also considerable migration out of China and India (much of it forced migration in the latter case). It is important to keep in mind that while global indicators showed considerable integration in the 1870-1914 period, this was also the

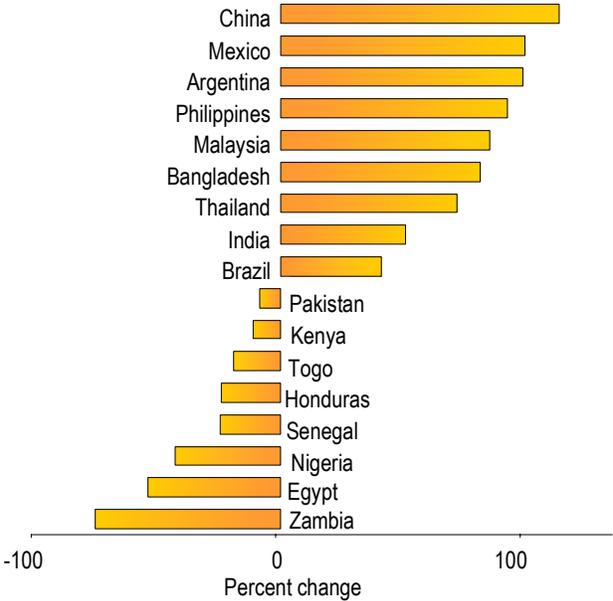
heyday of colonialism, and most of the world's people were highly restricted in their opportunities to benefit from the expanding commerce. Colonies supplied raw materials to the metropolitan powers and had no freedom to develop modern economies.

Global integration took a big step backward during the period of the two world wars and the Great Depression. Some discussions of globalization today assume it is inevitable, but this dark period is a powerful reminder that policies can halt and reverse integration. By the end of this dark era, both trade and foreign asset ownership were back close to their levels of 1870 – the protectionist period undid 50 years of integration. And the era of free migration was also at an end, as virtually all nations imposed restrictions on immigration.

In the period from the end of World War Two to about 1980, the industrial countries restored much of the integration that had existed among them. They negotiated a series of mutual trade liberalizations under the auspice of the General Agreement on Tariffs and Trade (GATT). Liberalization of capital flows proceeded more slowly, and it was not until 1980 that the level of ownership of foreign assets returned to its 1914 level. Over this period there was also modest liberalization of immigration in many of the industrial countries, especially the United States. In this second wave of modern globalization, many developing countries chose to sit on the sidelines. Most developing countries in Asia, Africa, and Latin America followed import-substituting industrialization strategies – that is, they kept their levels of import protection far higher than in the industrial countries in order to encourage domestic production of manufactures and usually restricted foreign investment by multinational firms as well in order to encourage the growth of domestic firms. While limiting direct investment, quite a few developing countries turned to the expanding international bank borrowing in the 1970s and took on significant amounts of foreign debt.

The most recent wave of globalization starts, by my reckoning, in 1978 with the initiation of China’s economic reform and opening to the outside world. China’s opening coincides roughly with the second oil shock, which contributed to external debt crises throughout Latin America and elsewhere in the developing world. In a growing number of countries from Mexico to Brazil to India to Sub-Saharan Africa, political and intellectual leaders began to fundamentally rethink their development strategies. What is distinctive then about this latest wave of globalization is that the majority of the developing world (measured in terms of population) has shifted from an inward-focused strategy to a more outward-oriented one.

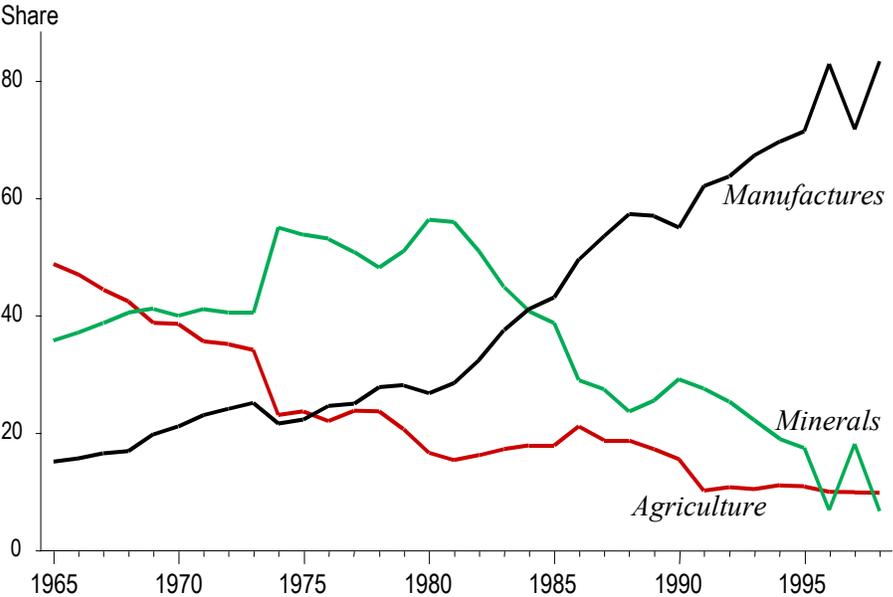
Figure 1.  
Change in trade/GDP, 1977-97 (selected countries)



This altered strategy can be seen in the huge increases in trade integration of developing countries over the past two decades. China’s ratio of trade to national income has more than doubled, and countries such as Mexico, Bangladesh, Thailand, and India have seen large increases as well (Figure 1). It is also the case, however, that quite a few developing countries trade less of their income than two decades ago, a point to which I will return. The change has

not just been in the *amount*, but also in the *nature of what is traded*. Twenty years ago, nearly 80% of developing country merchandise exports were primary products: the stereotype of poor countries exporting tin or bananas had a large element of truth. The big increase in merchandise exports in the past two decades, however, has been of manufactured products, so that 80% of merchandise exports from the South today are manufactures (Figure 2). Garments from Bangladesh, refrigerators from Mexico, computer peripherals from Thailand, CD players from China – this is the modern face of developing country exports. Service exports from the developing world have also increased enormously, both traditional services such as tourism and modern ones, such as software from Bangalore, India.

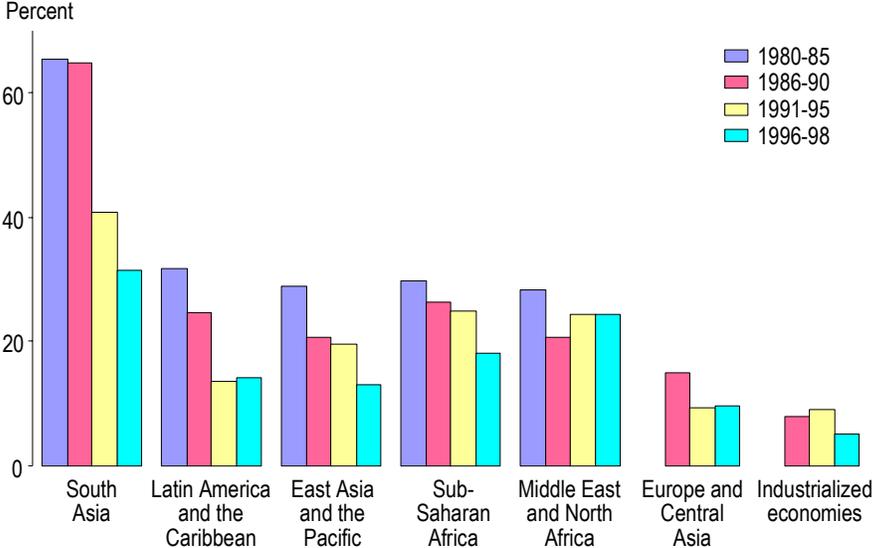
**Figure 2. Developing country exports have shifted toward manufactures**



The manufactured exports from the developing world are often part of multinational production networks. Nike contracts with firms in Vietnam to make shoes; the “world car” is a reality with parts produced in different locations. So, if we ask why this integration has taken off, part of the answer must lie with technological advances that make integrated production

feasible (refer back to Table 1 to see the dramatic declines in the cost of air transport and international communications). But part of the answer clearly lies in policy choices of developing countries as well. China and India had almost totally closed economies, so their increased integration would not have been possible without policy steps in these countries to gradually liberalize trade and direct foreign investment.

Figure 3. Average unweighted tariff rates by region



Source: Martin (2001)

Some measure of this policy trend can be seen in average import tariff rates for the developing world. Average tariffs have declined sharply in South Asia, Latin America, and East Asia, while in Africa and the Middle East there has been much less tariff-cutting (Figure 3). These reported average tariffs, however, only capture a small amount of what is happening with trade policy. Often the most pernicious impediments are non-tariff barriers: quotas, licensing schemes, restrictions on purchasing foreign exchange for imports. In China’s case, reducing these non-tariff impediments starting in 1979 led to a dramatic surge in trade (Figure 4). In 1978 external trade was monopolized by a single government ministry. (The phrase “free trade,”

incidentally, refers to a situation in which trade is not monopolized by the government, but rather is permitted to private firms and citizens as well – so China began to shift to a policy of free trade in 1979.) The specific measures in China included allowing a growing number of firms, including private ones, to trade directly and opening a foreign exchange market to facilitate this trade.

**Figure 4. Trade Reforms and Trade Volumes**  
**China 1978 - 2000**

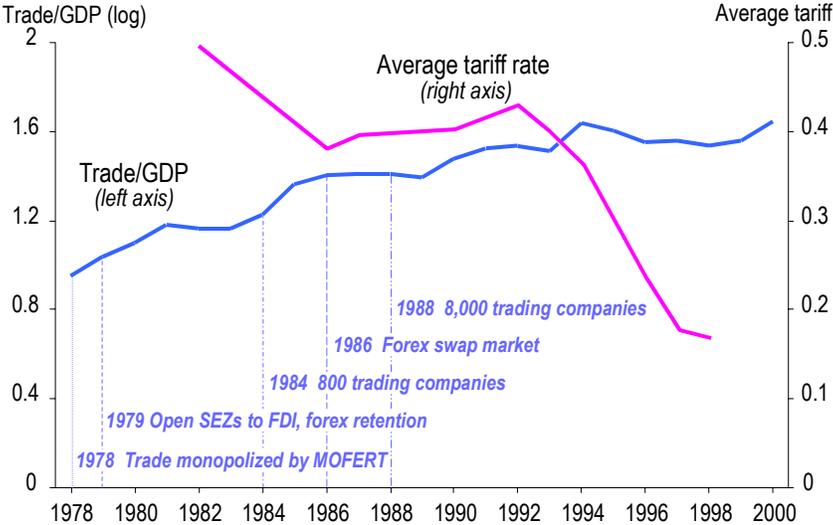
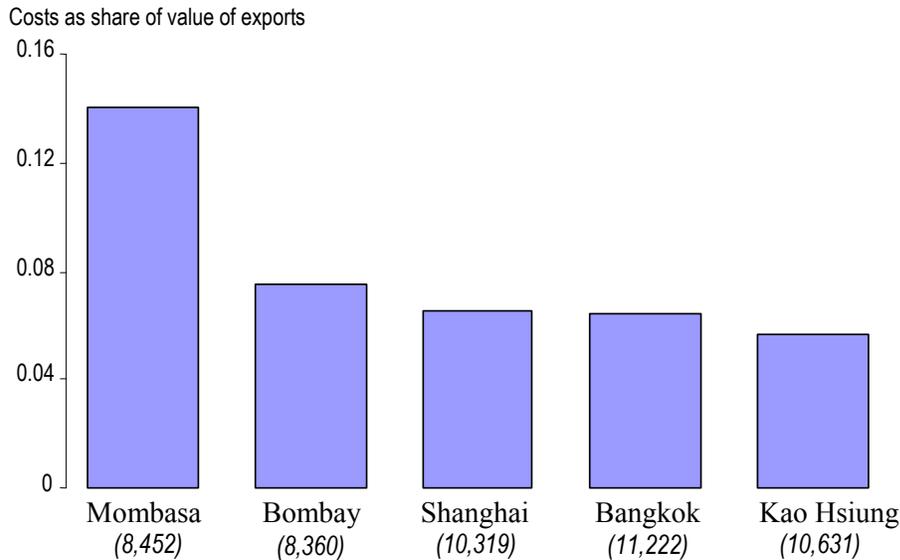


Figure 5. Maritime transport to the U.S.  
(East Coast): textiles



Another major impediment to trade in many developing countries is inefficient ports and/or customs administration. For example, it is much more expensive to ship a container of textiles from Mombasa port in Kenya to the East Coast of the U.S., than it is from Asian ports such as Bombay, Shanghai, Bangkok, or Kaohsiung, even though Mombasa is closer (Figure 5). The extra cost, which is equivalent to an 8% export tax, traces back to inefficiencies and corruption in the port. Long customs delays often act as import and export taxes. The developing countries that have become more integrated with the world economy have reasonably well-functioning ports and customs, and the improvement of those has often been the deliberate target of policy. I noted above that quite a few countries, including Kenya, trade less of their income today than 20 years ago, and surely this is partly the result of restrictive trade policies, defined broadly to include inefficient ports and customs.

Thus, one of the key developments in this current wave of globalization is that the way in which many developing countries relate to the global economy has changed dramatically. The

developing world as a whole is a major exporter of manufactures and services, many of which compete directly with products made in the industrial countries. The nature of trade and competition between rich and poor countries has fundamentally changed.

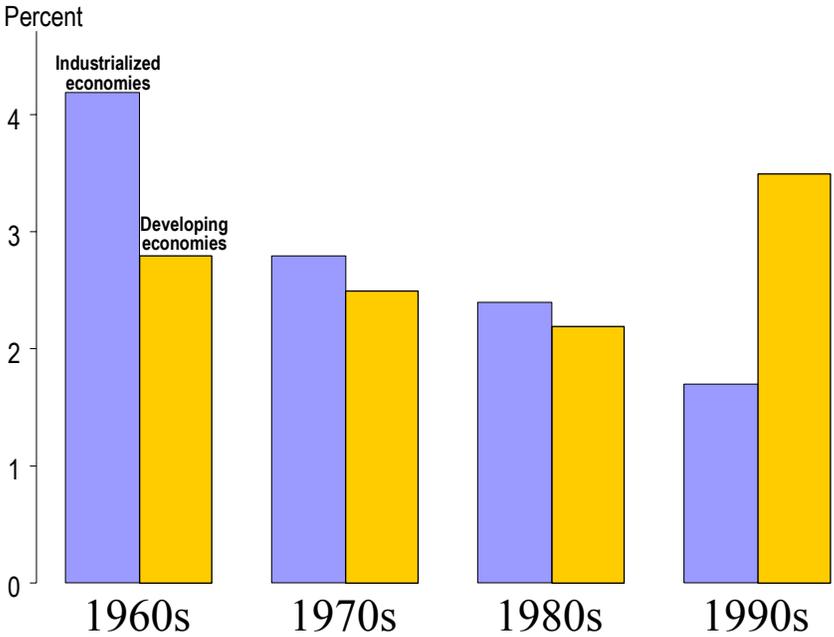
## ***2. Accelerated growth and poverty reduction in the new globalizers***

Some of the debate about globalization concerns its effects on poor countries and poor people. In the introduction I quoted a number of sweeping statements asserting that global economic integration is leading to growing poverty and inequality in the world. The reality of what is happening with poverty and inequality is far more complex, and to some extent runs exactly counter to what is being claimed by anti-globalists. Hence in this section I am going to focus on the trends in global poverty and inequality. Let's get the facts straight, and then in the next section I will try to link global integration to these facts. The trends that I want to highlight in this section are that (1) growth rates of developing countries have accelerated in the past 20 years and are higher than rich country growth rates; (2) there was a large decline in the number of poor in the world between 1981 and 2001, the first such decline in history; (3) measures of global inequality (such as the global Gini coefficient) have declined modestly since 1980, reversing a long historical trend toward greater inequality; (4) there is no pattern of rising inequality within countries, though there are some notable cases in which inequality has risen; and (5) there is a general pattern of rising wage inequality (larger wage increases for skilled workers relative to those of unskilled workers). It may seem that trend #5 runs counter to trend #4, but I will explain why it does not. Nevertheless, trend #5 is important and helps explain some of the anxiety about globalization in the industrial countries.

*Trend #1. Developing country growth rates have accelerated.* We have reasonably good data on economic growth going back to 1960 for about 100 countries, which make up the vast

majority of world population, summarized in the Penn World Tables. If you aggregate all of the industrial countries and all of the developing countries for which there are data back to 1960, you find that in general rich country growth rates have declined while growth of the developing world has accelerated (figure 6). In particular, in the 1960s growth of OECD countries was about twice as fast as that of developing countries. The rich country growth has since gradually decelerated from about 4 percent per capita in the 1960s to 1.7 percent in the 1990s. The latter figure is close to the long-term historical growth rate of the OECD countries; the rapid growth in the 1960s was still to some extent a rebound from the destruction of World War Two as well as a payoff to economic integration among the rich countries. Subsequently, growth has returned to the long-term historical trend level.

Figure 6. Growth rate of per capita GDP

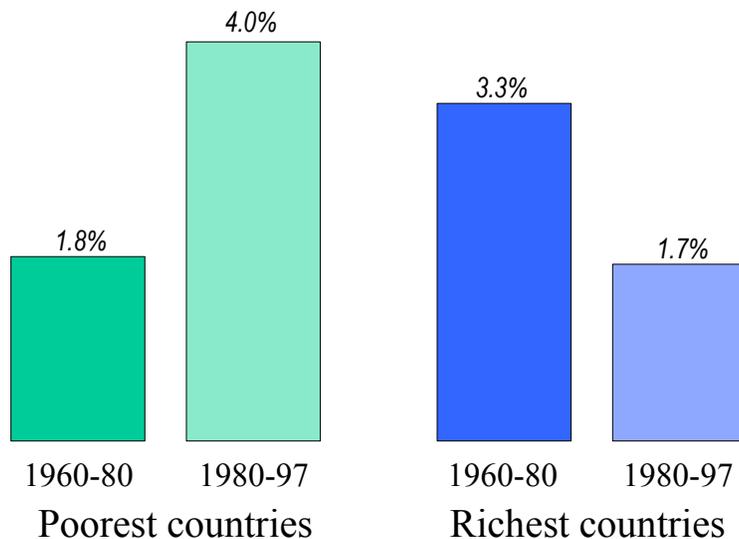


In the 1960s and continuing into the 1970s the growth rate of developing countries in the aggregate was well below that of rich countries, a paradox whose origin has been long debated in the economics profession. The slower growth of backward economies is a paradox because the

dominant neoclassical growth theory suggested that, other things equal, poor countries should grow faster. This expected pattern finally emerged in the 1990s, with per capita growth in developing countries of about 3 and a half percent, more than twice the rate of rich countries.

Aggregating the GDPs of developing countries treats each dollar of GDP in the developing world the same. Additional insight into the shift in growth patterns is gained by looking at population-weighted averages of growth rates, which alternatively treats each person equally. If you take the poorest one-fifth of countries in 1980 (that is, more than 20 countries), the *population-weighted* growth rate of this group was 4% per capita from 1980 to 1997, while the richest fifth of countries grew at 1.7% (Figure 7). This phenomenon of the fastest growth occurring in the poorest countries is new historically; the growth rates of these same countries for the prior two decades (1960-1980) were 1.8% for the poor group and 3.3% for the rich group. Data going back further in time are not as good, but there is evidence that richer locations have been growing faster than poorer locations for a long time. So, not only has the developing country growth rate accelerated, but the growth has been concentrated in countries that were among the poorest in 1980.

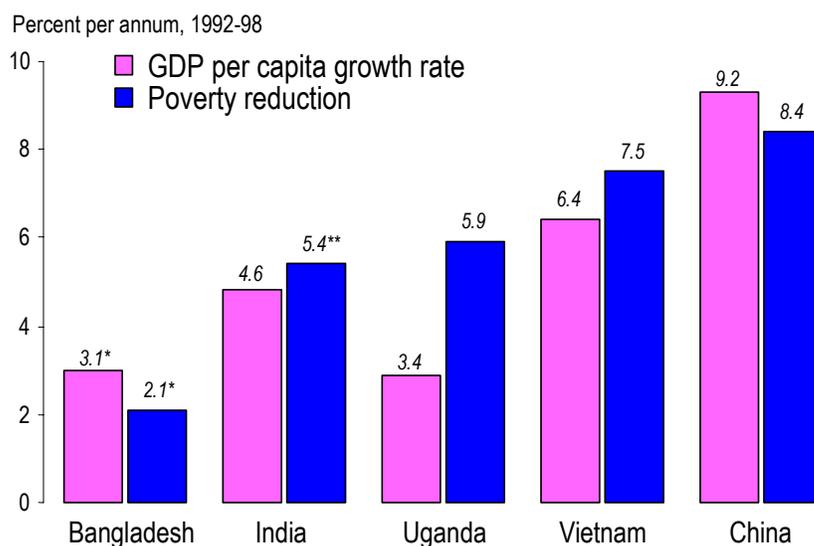
Figure 7. Growth rates of the poorest and richest quintiles of countries (population-weighted)



Now, the adjective “population-weighted” is very important. If you ignore differences in population and just take an average of poor-country growth rates, you will find average growth of about zero for poor countries in the 1980-2000 period. Among the poorest quintile of countries in 1980 you have both China and India, and you also have quite a few small countries, particularly in Africa. Ignoring population, the average growth of Chad and China is about zero, and the average growth of Togo and India is about zero. Taking account of differences in population, on the other hand, one would say that the average growth of poor countries has been very good in the past 20 years. China obviously carries a large weight in any such calculation about the growth of countries that were poor in 1980. But it is not the only poor country that did well. India, Bangladesh, and Vietnam have also had accelerated growth and grown faster than rich countries in the recent period. A number of African economies, notably Uganda, have also had accelerated growth.

*Trend #2. The number of poor people in the world has declined by 375 million, the first such decline in history.* The most important point that I want to get across in this section is that poverty reduction in low-income countries is very closely related to the GDP growth rate in these countries. Hence, the accelerated growth of low-income countries has led to unprecedented poverty reduction. By poverty, we mean subsisting below some absolute threshold. Most poverty analysis is carried out with countries' own poverty lines, which are set in country context and naturally differ. In the 1990s we have more and more countries with reasonably good household surveys and their own poverty analysis. Figure 8 shows five poor countries that have benefited from faster growth, and in each case significant poverty reduction has gone hand-in-hand with faster growth. Poverty reduction here is the rate of decline of the poverty rate, based on the country's own poverty line and analysis.

**Figure 8. Poverty reduction in Bangladesh, India, Uganda, Vietnam, and China closely related to growth**



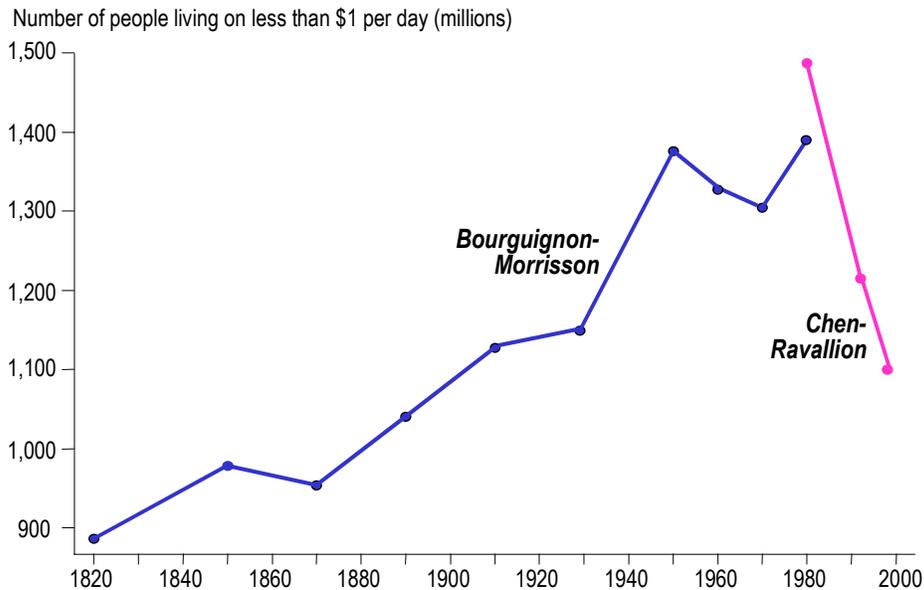
\* Bangladesh figures are for 1992-2000 \*\* India figures are for 1993-99

China, for example, uses a poverty line defined in constant Chinese *yuan*. The poverty line is deemed the minimum amount necessary to subsist. In practice, estimates of the number of

poor in a country such as China come from household surveys carried out by the statistical bureau, surveys that aim to measure what households actually consume. Most of the extreme poor in the world are peasants, and they subsist to a large extent on their own agricultural output. To look only at what money income they have would not be very relevant, since the extreme poor have only limited involvement in the money economy. Thus, what Chinese poverty measures try to do is ask households what they actually consume, and attach a value to this based on prices of different commodities. So, a poverty line is meant to capture a certain real level of consumption. Estimating the extent of poverty is obviously subject to error, but in many countries the measures are good enough to pick up large trends. In discussing poverty it is important to be clear what poverty line one is talking about. In global discussions one often sees reference to international poverty lines of either \$1 per day or \$2 per day, calculated at purchasing power parity. For discussions of global poverty we need to choose a common line to apply to all countries.

Chen and Ravallion (2004) have used household survey data to estimate the number of poor worldwide based on the \$1 and \$2 poverty lines, back to 1981. They find that the incidence of extreme poverty (consuming less than \$1 per day) has basically been cut in half in 20 years, from 40.3 percent of developing world population in 1981 to 21.3 percent in 2001. It is interesting that the decline in \$2 per day poverty incidence was not as great, from 66.4 percent to 52.9 over this period. In 1981 extreme poverty was concentrated in East and South Asia, and these are the regions that have grown especially well, dramatically reducing extreme poverty.

## Figure 9. World poverty, 1820-2001



Poverty incidence has been gradually declining throughout modern history, but in general population growth outstripped the decline in incidence so that the total number of poor people was actually rising. Even in the 1960-1980 period, which was reasonably good for developing countries, the number of poor continued to rise (Figure 9).<sup>1</sup> What is really striking about the past 20 years is that the number of extreme poor declined by 375 million, while at the same time world population rose by 1.6 billion. This decline in the number of poor is unprecedented in human history.

While the overall decline in global poverty is positive news, it should be noted that there has been very different performance across regions. While East and South Asia grew well and reduced poverty, Sub-Saharan Africa had negative growth between 1981 and 2001 and a rise in poverty: the number of extreme poor in Africa increased from 164 million (41.6 percent of the

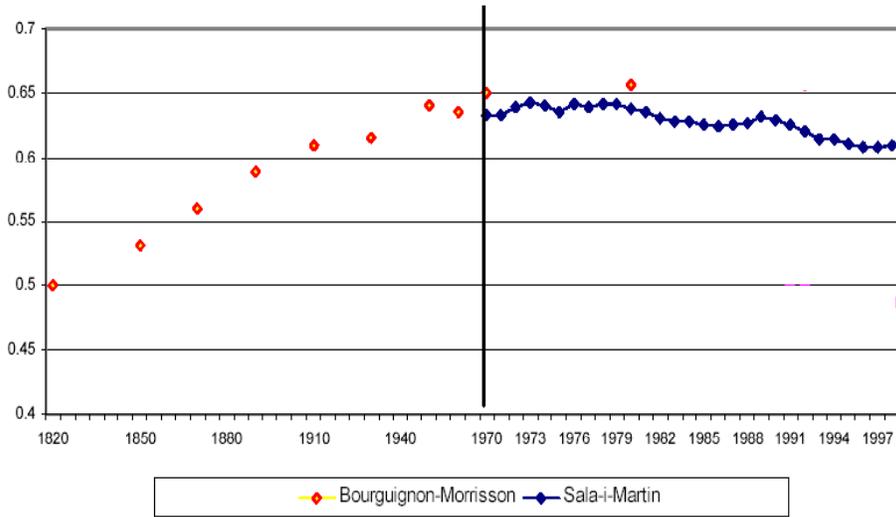
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<sup>1</sup> It is difficult to take the survey-based estimates of poverty back before 1980. Bourguignon and Morrison (2002) combine what survey data are available with national accounts data to provide rough estimates of poverty back to 1820. The broad trend is clear: the number of poor in the world kept rising up to about 1980.

population) to 316 million (46.9 percent of the population). It is still the case that two-thirds of the extreme poor live in Asia, but if strong growth there continues, then global poverty will increasingly be concentrated in Africa.

*Trend #3. Global inequality has declined (modestly).* People use the phrase “global inequality” casually to mean a number of different things. But the most sensible definition would be the same one we use for a country: line up all the people in the world from the poorest to the richest and calculate a measure of inequality among their incomes. There are a number of possible measures, of which the Gini coefficient is the best known. Surjit Bhalla (2002) estimates that the world Gini coefficient declined from .67 in 1980 to .64 in 2000, after rising from .64 in 1960. Xavier Sala-I-Martin (2002) likewise finds that any of the standard measures of inequality shows a decline in global inequality since 1980. Subjectively, I would describe this as a modest decline, and one about which we do not have a lot of statistical confidence. But, again, it represents an important reverse of a long historical pattern of rising global inequality.

Figure 10. Bourguignon-Morrisson and Sala-I-Martin: Global Gini Coefficient



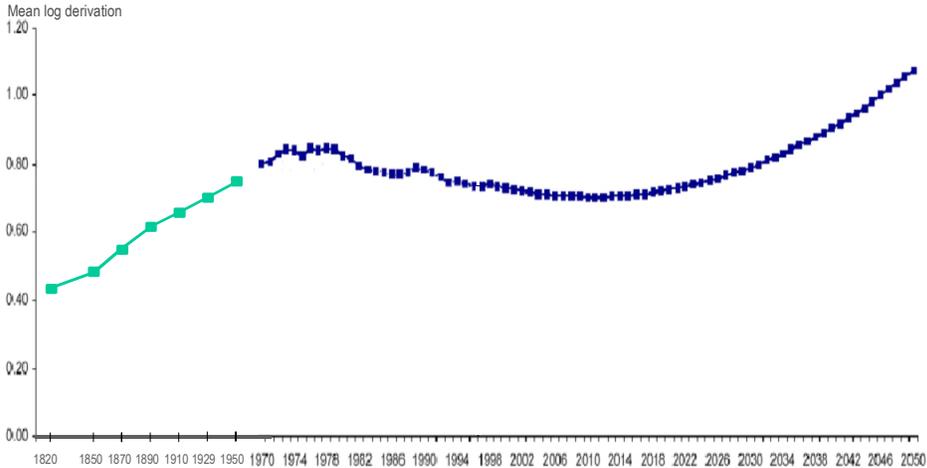
Bourguignon and Morrisson (2002) calculate the global Gini measure of inequality going back to 1820. Obviously we do not have a lot of confidence in these early estimates, but they illustrate a point that is not seriously questioned: global inequality has been on the rise throughout modern economic history. The B-M estimates of the global Gini have it rising from .50 in 1820 to about .65 around 1980 (Figure 10). Xala-I-Martin estimates that the global Gini has since declined to .61. Other measures of inequality such as the mean log deviation show a similar trend, rising up to about 1980 and then declining modestly since then (Figure 11). Roughly speaking, the mean log deviation is the percent difference between average income in the world and the income of a “typical person” – a randomly chosen individual. Average income in the world today is around \$5,000, but the typical person is living on \$1,000, that is, 80% less. The mean log deviation has the advantage that it can be decomposed into inequality among countries (differences in per capita income across countries) and inequality within countries. What this decomposition shows is that most of the inequality in the world can be attributed to inequality among countries. Global inequality rose from 1820 to 1980 primarily because countries already relatively rich in 1820 (Europe, North America) subsequently grew faster than poor locations. As noted above (trend #1), that pattern of growth was reversed starting around 1980, and the faster growth in poor locations such as China, India, Bangladesh, and Vietnam accounts for the modest decline in global inequality since then. (Slow growth in Africa tended to increase inequality, faster growth in low-income Asia tended to reduce it, and the latter outweighed the former, modestly.)<sup>2</sup>

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<sup>2</sup> Milanovich (2001) estimates an increase in the global Gini coefficient for the short period between 1988 and 1993. How can this be reconciled with the Bhalla and Xala-I-Martin findings? Global inequality has declined over the past two decades primarily because poor people in China and India have seen increases in their incomes relative to incomes of rich people (that is, OECD populations). The period from 1988 to 1993 was the one period in the past 20 years that was not good for poor people in China and India. India had a serious crisis/recession in this period, and rural income growth in China was temporarily slowed in this period.

Thinking about the different experiences of Asia and Africa, as in the last section, helps give a clearer picture of what is likely to happen in the future. Rapid growth in Asia has been a force for greater global equality because that is where the majority of the world’s extreme poor lived in 1980 and they benefited from the growth. However, if the same growth trends persist, they will not continue to be a force for equality. Xala-I-Martin projects future global inequality if the growth rates of 1980-98 persist: global inequality will continue to decline until about 2015, after which global inequality will rise sharply (Figure 11). A large share of the world’s poor still lives in India and other Asian countries, so that continued rapid growth there will be equalizing for another decade or so. But, increasingly, poverty will be concentrated in Africa, so that if its slow growth persists, global inequality will eventually rise again.

**Figure 11. Global household inequality has declined...  
...but will rise again if same growth as 1980-98**

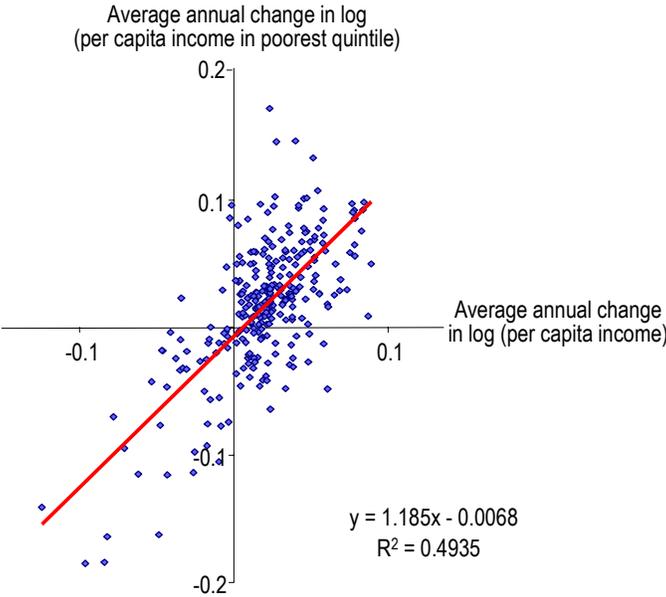


*Trend #4. There is no general trend toward higher inequality within countries.* The analysis immediately above shows that inequality within countries plays a relatively small role in measures of global income inequality. Nevertheless, people care about trends in inequality in

their own societies (arguably more than they care about global inequality and poverty). So, a different issue is, what is happening to income inequality within countries. One of the common claims about globalization (see the quotes in the introduction) is that it is leading to greater inequality within countries and hence fostering social and political polarization.

To assess this claim Aart Kraay and I (2002a) collected income distribution data from over 100 countries, in some case going back decades. We found first of all that there is no general trend toward higher or lower inequality within countries. One way to show this is to look at the growth rate of income of the poorest 20% of the population, relative to the growth rate of the whole economy.

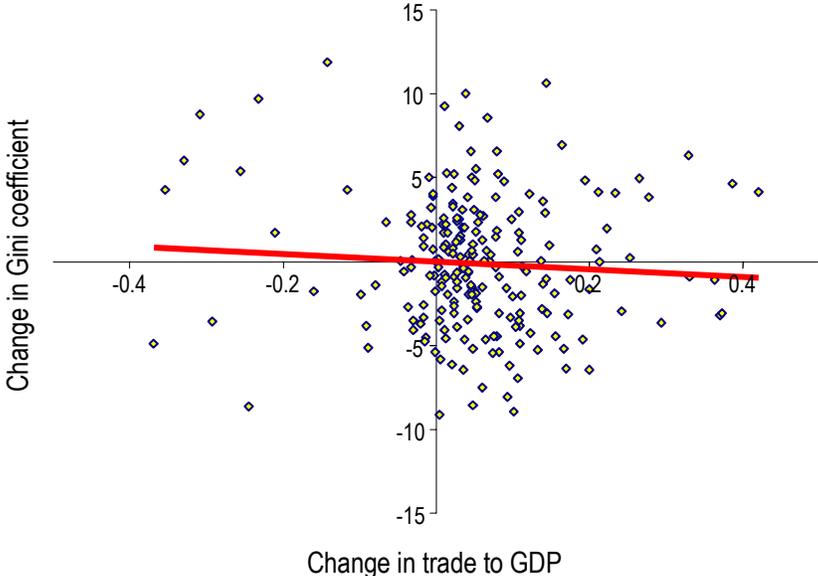
Figure 12. Growth is good for the poor



In general, growth rate of income of the poorest quintile is the same as the per capita growth rate (Figure 12). This is equivalent to showing that the bottom quintile share (another common measure of inequality) does not vary with per capita income. We found that this relationship has not changed over time (same for the 1990s as for earlier decades). In other

words, some countries in the 1990s had increases in inequality (China and the U.S. are two important examples), while other countries had decreases. Most important for the debate about globalization, we tried to use measures of integration to explain the changes in inequality that have occurred. But changes in inequality are not related to any of these measures of integration. For example, countries in which trade integration has increased show rises in inequality in some cases and declines in inequality in others (Figure 13). So too for other measures such as tariff rates or capital controls. Figure 7 showed five good examples of poor countries that have integrated aggressively with the world economy: in two of these (Uganda and Vietnam) income distribution has shifted in favor of the poor during integration, which is why poverty reduction has been so strong in these cases. In low-income countries in particular much of the import protection was benefiting relatively rich and powerful groups, so that integration with the global market can go hand-in-hand with declines in income inequality.

Figure 13. Increased trade has no correlation with changes in inequality

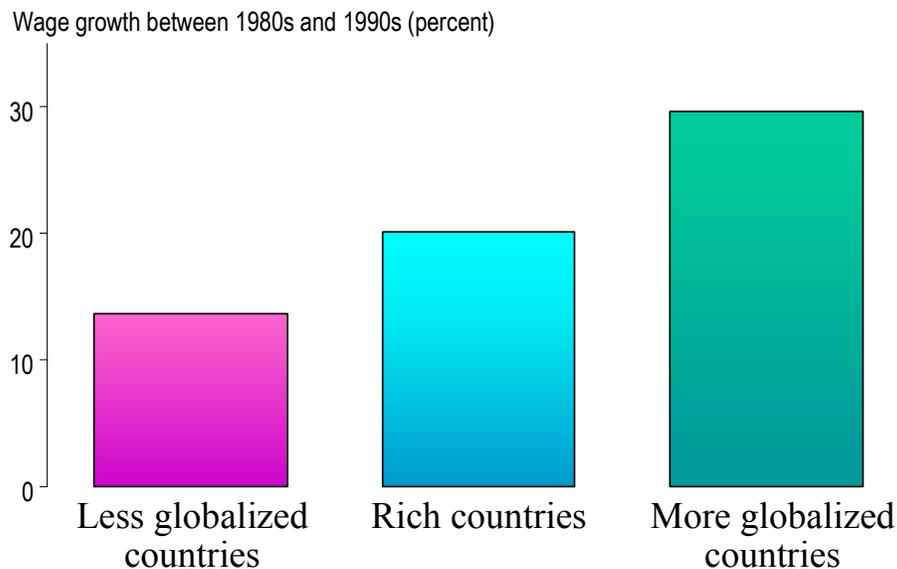


While it is true that there is no general trend toward higher inequality within countries when looking at all the countries of the world, the picture is not so favorable if one looks only at rich countries and only at the last decade. The Luxembourg Income Study (LIS) has produced comparable, high-quality income distribution data for most of the rich countries. This work finds no obvious trends in inequality up through the mid-to-late 1980s. Over the past decade, on the other hand, there have been increases in inequality in most of the rich countries. Because low-skilled workers in these countries are now competing more with workers in the developing world, it is certainly plausible that global economic integration creates pressures for higher inequality in rich countries, while having effects in poor countries that often go the other way. The good news from the LIS studies is that “Domestic policies and institutions still have large effects on the level and trend of inequality within rich and middle-income nations, even in a globalizing world.... [G]lobalization does not force any single outcome on any country.” (Smeeding, 2002) In other words, among rich countries some have managed to maintain stable income distributions in this era of globalization through their social and economic policies (on taxes, education, welfare).

*Trend #5. Wage inequality is rising worldwide.* Much of the concern about globalization in rich countries relates to workers and what is happening to wages and other labor issues. The most comprehensive examination of globalization and wages used International Labour Organization data on very detailed occupational wages going back two decades (Freeman, Oostendrop, and Rama, 2001). These data look across countries at what is happening to wages for very specific occupations (bricklayer, primary school teacher, nurse, auto worker). What the study found is that wages have generally been rising faster in globalizing developing countries than in rich ones, and faster in rich ones than in non-globalizing developing countries (Figure

14). The globalizing developing countries here are the top third of developing countries in terms of increased trade integration over the past 20 years (Dollar and Kraay 2004). The non-globalizers are the rest of the developing world. The point is that the fastest wage growth is occurring in developing countries that are actively increasing their integration with the global economy.

**Figure 14. Poor countries that globalized have seen the fastest growth in wages**



While the general rise in wages is good news, however, the detailed findings from the Freeman, Oostendorp, and Rama study are more complex and indicate that certain types of workers benefit more than others. First, increased trade is related to a decline in the gender wage gap. More trade appears to lead to a more competitive labor market in which groups that have been traditionally discriminated against, eg., women, fare especially well (Oostendorp, 2002). Second, the gains from increased trade appear to be larger for skilled workers. This finding is consistent with other work showing that there has been a worldwide trend toward greater wage inequality – that is, a larger gap between pay for educated workers and pay of less

educated/skilled workers. Galbraith and Liu (2001), for example, find a worldwide trend toward greater wage inequality among industries; that is, wages in skill-intensive industries such as aircraft production have been going up faster than wages in low-skill industries such as garments.

If wage inequality is going up worldwide, how can it be that income inequality is not rising in most countries? There are several reasons why these two trends are not inconsistent. Most important, in the typical developing country wage earners are a small fraction of the population. Even unskilled wage workers are a relatively elite group. Take Vietnam as an example, a low-income country where we have a survey of the same representative sample of households early in liberalization (1993) and five years later. The majority of households in the sample and in the country are peasants. What we see in the household data is that the price of the main agricultural output (rice) went up dramatically while the price of the main purchased input (fertilizer) actually went down. These price movements are directly related to globalization, because over this period Vietnam became a major exporter of rice (supporting its price) and a major importer of fertilizer from cheaper producers (lowering its price). The typical poor family got a much bigger “wedge” between its input price and output price, and their real income went up dramatically (Benjamin and Brandt, 2002). So, one of the most important forces acting on income distribution in this low-income country has nothing to do with wages.

Quite a few rural households also sent a family member to a nearby city to work in a factory for the first time. I worked on Vietnam for the World Bank from 1989 to 1995, and one of the issues that I covered was the manufacturing sector. When I first started visiting factories in the summer of 1989, the typical wage in local currency was the equivalent of \$9 per month. Now, factory workers making contract shoes for U.S. brands often make \$50 per month or more.

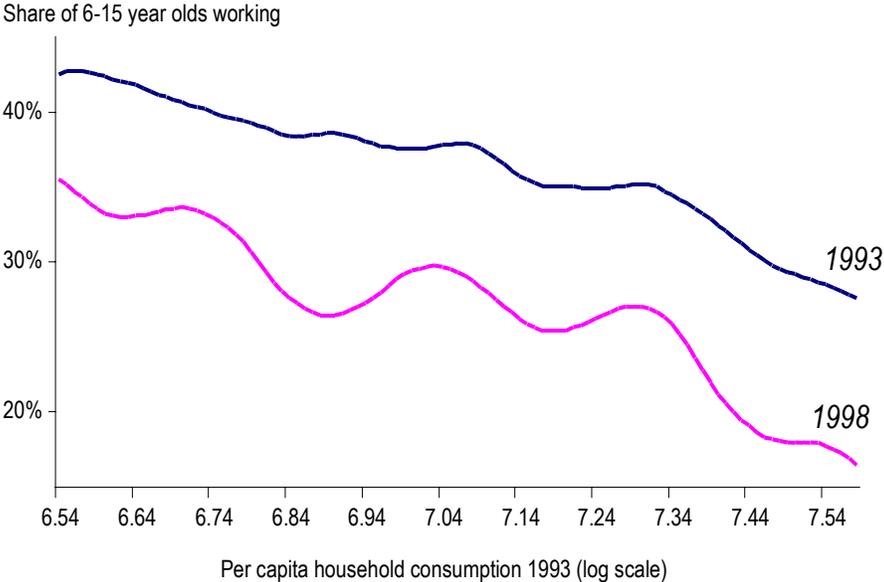
So, the wage for a relatively unskilled worker has gone up something like five-fold. But wages for some of the skilled occupations – say, computer programmer or an English interpreter – may have gone up ten times or even more. Thus, a careful study of wage inequality is likely to show rising inequality. However, how wage inequality translates into household inequality is very complex. For a surplus worker from a large rural household who gets one of the newly created jobs in a shoe factory, earnings go from zero to \$50 per month. Thus, if a large number of new wage jobs are created and if these typically pay a lot more than people earn in the rural or informal sector, then a country can have rising wage inequality but stable or even declining income inequality (in Vietnam the Gini coefficient for household income inequality actually declined between 1993 and 1998). In rich countries, on the other hand, where most people are wage earners, the higher wage inequality is likely to translate into higher household income inequality, which is what we have seen over the past decade.

A third point about wage inequality and household income inequality that is relevant for rich countries is that measures of wage inequality are often made pre-tax. If the country has a strongly progressive income tax, then inequality measures from household data (which are often post-tax) do not have to follow wage inequality, pre-tax. Tax policy can offset some of the trends in the labor market.

Finally, there is the important issue that households can respond to increased wage inequality by investing more in the education of their children. A higher economic return to education is not a bad thing, provided that there is fair access to education for all. In Vietnam, there has been a tremendous increase in the secondary school enrollment rate in the 1990s (from 32% to 56%). This increase partly reflects the society's and the government's investment in schools (supported by aid donors), but more kids going to school also reflects households'

decisions. If there is little or no perceived return to education (that is, no jobs at the end of the road), it is much harder to get families in poor countries to send their children to school. Where children have decent access to education, a higher skill premium stimulates a shift of the labor force from low-skill to higher-skill occupations.

**Figure 15. Child labor and household consumption levels in Vietnam**



It should also be noted that there has been a large decline in child labor in Vietnam since the country started integrating with the global market. There is ample evidence that child labor is primarily driven by poverty and educational opportunities. Figure 15 shows the share of 6-to-15 year-olds working for different households ranked in terms of their 1993 level of income. Child labor is more prevalent in poor households. The figure also shows the share of children working in the same families five years later; child labor has declined for all income groups. The change results from the fact that everyone is richer than they were five years before as well as from the expansion of schooling opportunities.

From this discussion of wage trends it is easy to see why some labor unions in rich countries are concerned about integration with the developing world. It is difficult to prove that the integration is leading to the greater wage inequality, but it seems likely that integration is one factor. Concerning the immigration side of integration, Borjas, Freeman, and Katz (1997) estimate that flows of unskilled labor into the U.S. have reduced wages for such labor by 5% from where they would be otherwise. The immigrants who find new jobs earn a lot more than they did before (ten times as much in one study), but their competition reduces wages of the U.S. workers who were already doing such jobs. Similarly, imports of garments and footwear from countries such as Vietnam and Bangladesh create jobs for workers there that pay far more than other opportunities in those countries, but put pressure on unskilled wages in the rich countries.

Thus, overall the era of globalization has seen unprecedented poverty reduction and a modest decline in global inequality. However, it has put real pressure on less skilled workers in rich countries, and this competitive pressure is a key reason why the growing integration is controversial in the industrial countries.

### ***3. Is there a link from integration to poverty reduction?***

*To keep track of the wide range of explanations that are offered for persistent poverty in developing nations, it helps to keep two extreme views in mind. The first is based on an object gap: Nations are poor because they lack valuable objects like factories, roads, and raw materials. The second view invokes an idea gap: Nations are poor because their citizens do not have access to the ideas that are used in industrial nations to generate economic value... Each gap imparts a distinctive thrust to the analysis of development policy. The notion of an object gap highlights saving and accumulation. The notion of an idea gap directs attention to the patterns of interaction and communication between a developing country and the rest of the world.*

*--Paul Romer, "Idea Gaps and Object Gaps in Economic Development"*

Developing countries have become more integrated with the global economy in the past two decades, and growth and poverty reduction have accelerated. A natural question to ask is whether there is a link. In other words, could countries such as Bangladesh, China, India, and Vietnam have grown as rapidly as they have, had they remained as closed to foreign trade and investment as they were in 1980? This is not the kind of question that can be answered with scientific certainty, but there are several different types of evidence that we can bring to bear on it.

It is useful to begin with one what would expect from economic theory. As suggested by the quote from Paul Romer, traditional growth theory focused on accumulation and the “object gap” between poor countries and rich ones. If the important thing is just to increase the number of factories and workplaces, then it does not matter if this is done in a closed environment or a state-dominated environment. That was the model followed in the extreme by China and the Soviet Union, and to a lesser extent by most developing countries, who followed import-substituting industrialization strategies throughout the 1960s and 1970s. It was the disappointing results from that approach that led to new thinking both from policy-makers in developing countries as well as from economists studying growth. Romer was one of the pioneers of the new growth theory that put more emphasis on how innovation occurs and is spread and the role of technological advance in improving the standard of living. Different aspects of integration – sending students abroad to study, connecting to the internet, allowing foreign firms to open plants, purchasing the latest equipment and components – can help overcome the “idea gap” that separates poor and rich nations.

What is the evidence on integration spurring growth? There are a large number of case studies that show how this process can work in particular countries. Among the countries that

were very poor in 1980, China, India, Vietnam, and Uganda provide an interesting range of examples:

### *China*

China's initial reforms in the late 1970s focused on the agricultural sector and emphasized strengthening property rights, liberalizing prices, and creating internal markets. As indicated in Figure 4, liberalizing foreign trade and investment were also part of the initial reform program and played an increasingly important role in growth as the 1980s proceeded. The role of international linkages is described in this excerpt from a case study by Richard Eckaus (1997):

After the success of the Communist revolution and the founding of the People's Republic of China, the nation's international economic policies were dominated for at least thirty years by the goal of self-reliance. While this was never interpreted as complete autarky, the aspiration for self-reliance profoundly shaped trade policy, especially with the market economies.

China's foreign trade began to expand rapidly as the turmoil created by the Cultural Revolution dissipated and new leaders came to power. Though it was not done without controversy, the argument that opening of the economy to foreign trade was necessary to obtain new capital equipment and new technology was made official policy.

The creation of an "open door" policy did not mean the end of foreign trade planning. Although Chinese policy became committed to the expansion of its international trade, the decision-making processes and international trade mechanisms of the prereform period continued in full force for several years, to a modified degree for several more years, and still continue to be evident in the licensing controls. At the same time, international transactions outside of the state planning system have been growing. Most obviously, enterprises created by foreign investors have been exempt from the foreign trade planning and control mechanisms. In addition, substantial amounts of other types of trade, particularly the trade of the township and village enterprises and private firms, have been relatively free.

The expansion of China's participation in international trade since the beginning of the reform movement in 1978, has been one of the most remarkable features of its remarkable transformation.

While GNP was growing at 9 percent from 1978 to 1994, exports grew at about 14 percent and imports at an average of 13 percent per year.

The successes contradict several customary generalizations about transition economies and large developing countries—for example, that the transition from central planning to market orientation cannot be made without passing through a difficult period of economic disorganization and, perhaps decline; and that the share of international trade in very large economies cannot grow quickly due to the difficulties of penetrating foreign markets on a larger scale.

### *India*

It is well known that India pursued an inward-oriented strategy into the 1980s and got disappointing results in terms of growth and poverty reduction. Bhagwati (1992) crisply states the main problems and failures of the strategy:

“I would divide them into three major groups: extensive bureaucratic controls over production, investment and trade; inward-looking trade and foreign investment policies; and a substantial public sector, going well beyond the conventional confines of public utilities and infrastructure.

The former two adversely affected the private sector’s efficiency. The last, with the inefficient functioning of public sector enterprises, impaired additionally the public sector enterprises’ contribution to the economy. Together, the three sets of policy decisions broadly set strict limits to what India could get out of its investment.” [p.48]

Under this policy regime India’s growth in the 1960s (1.4% per annum) and 1970s (-0.3%) was disappointing. During the 1980s India’s economic performance improved. However, this surge was fueled by deficit spending and borrowing from abroad that was unsustainable. In fact, the spending spree led to a fiscal and balance of payments crisis that brought a new, reform government to power in 1991. Srinivasan (1996) describes the key reform measures and their results as follows:

“In July 1991, the government announced a series of far reaching reforms. These included an initial devaluation of the rupee and subsequent market determination

of its exchange rate, abolition of import licensing with the important exceptions that the restrictions on imports of manufactured consumer goods and on foreign trade in agriculture remained in place, convertibility (with some notable exceptions) of the rupee on the current account; reduction in the number of tariff lines as well as tariff rates; reduction in excise duties on a number of commodities; some limited reforms of direct taxes; abolition of industrial licensing except for investment in a few industries for locational reasons or for environmental considerations, relaxation of restrictions on large industrial houses under the Monopolies and Restrictive Trade Practices (MRTP) Act; easing of entry requirements (including equity participation) for direct foreign investment; and allowing private investment in some industries hitherto reserved for public sector investment.

In general, India has gotten good results from its reform program, with per capita income growth above 4% per annum in the 1990s. Growth and poverty reduction have been particularly strong in states that have made the most progress liberalizing the regulatory framework and providing a good environment for delivery of infrastructure services (Goswami et al. 2002).

### *Vietnam*

The same collection that contains Eckaus's study of China also has a case study of Vietnam (Dollar and Ljunggren, 1997):

Vietnam has made a remarkable turnaround during the past decade. In the mid-1980s the country suffered from hyperinflation and economic stagnation; it was not able to feed its population; and hundreds of thousands of people were signaling their dissatisfaction by fleeing in unsafe boats. A decade later, the government had restored macroeconomic stability; growth had accelerated to the 8-9 percent range; the country had become the second largest rice exporter in the world; and overseas Vietnamese were returning with their capital to take advantage of expanding investment opportunities. During this period there has also been a total transformation of Vietnam's foreign trade and investment, with the economy now far more open than ten years ago.

That Vietnam was able to grow throughout its adjustment period can be attributed to the fact that the economy was being increasingly opened to the international market. As part of its overall effort to stabilize the economy, the government unified its various controlled exchange rates in 1989 and devalued the unified rate to the level prevailing in the parallel market. This was tantamount to a 73 percent *real*

devaluation; combined with relaxed administrative procedures for imports and exports, this sharply increased the profitability of exporting.

This ... policy produced strong incentives for export throughout most of the 1989-94 period. During these years real export growth averaged more than 25 percent per annum, and exports were a leading sector spurring the expansion of the economy. Rice exports were a major part of this success in 1989; and in 1993-94 there was a wide range of exports on the rise, including processed primary products (e.g., rubber, cashews, and coffee), labor-intensive manufactures, and tourist services.

The current account deficit declined from more than 10 percent of GDP in 1988 to zero in 1992. Normally, the collapse of financing in this way would require a sharp cutback in imports. However, Vietnam's export growth was sufficient to ensure that imports could grow throughout this adjustment period. It is also remarkable that investment increased sharply between 1988 and 1992, while foreign aid [from the Soviet Union] was drying up. In response to stabilization, strengthened property rights, and greater openness to foreign trade, domestic savings increased by twenty percentage points of GDP, from negative levels in the mid-1980s to 16 percent of GDP in 1992.

### *Uganda*

Uganda has been one of the most successful reformers in Africa during this recent wave of globalization, and its experience has interesting parallels with Vietnam's. It too was a country that was quite isolated economically and politically in the early 1980s. The role of trade reform in its larger reform is described in Collier and Reinikka (2001, pp. 30-39):

Trade liberalization has been central to Uganda's structural reform program. During the 1970s, export taxation and quantitative restrictions on imports characterized trade policy in Uganda. Exports were taxed, directly and implicitly at very high rates. All exports except for coffee collapsed under this taxation. For example, tea production fell from a peak of 20,000 tons in the early 1970s to around 2,000 tons by the early 1980s, and cotton production fell from a peak of 87,000 tons, to 2,000 tons. By contrast, coffee exports declined by around one-third.

Part of the export taxation was achieved through overvaluation of the exchange rate, which was propelled by intense foreign exchange rationing, but mitigated by an active illegal market. Manufacturing based on import substitution collapsed along with the export sector as a result of shortages, volatility, and rationing of import licenses and foreign exchange. President Amin's policy toward foreign investment was dominated by confiscation without compensation, and he expelled more than 70,000 people from the Asian community.

In 1986 the NRM government inherited a trade regime that included extensive nontariff barriers, biased government purchasing, and high export taxes, coupled with considerable smuggling. The nontariff barriers have gradually been removed since the introduction in 1991 of automatic licensing under an import certification scheme. Similarly, central government purchasing was reformed and is now subject to open tendering without a preference for domestic firms over imports.

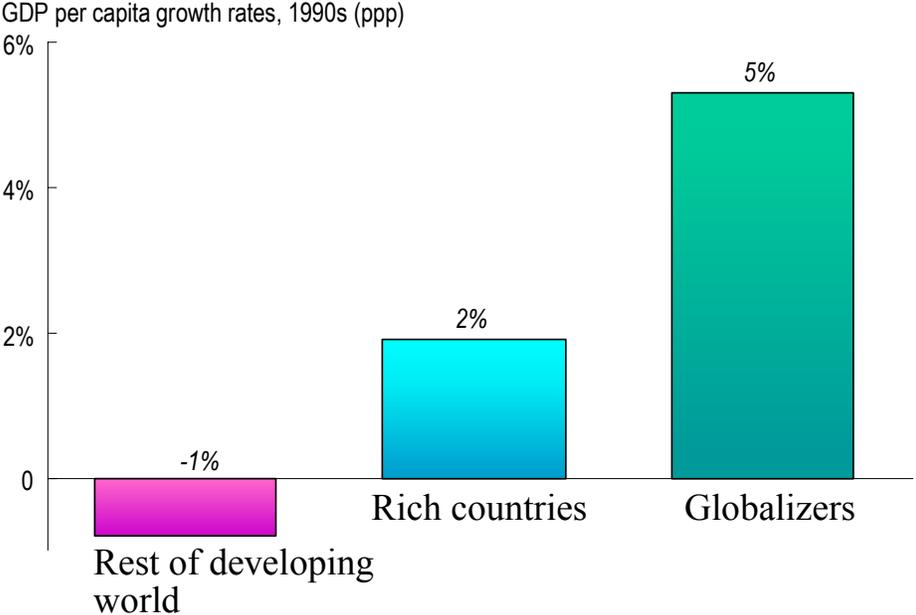
By the mid-1990s, the import tariff schedule had five *ad valorem* rates between 0 and 60 percent. For more than 95 percent of imported items the tariff was between 10 and 30 percent. During the latter half of the 1990s, the government implemented a major tariff reduction program. As a result, by 1999 the tariff system had been substantially rationalized and liberalized, which gave Uganda one of the lowest tariff structures in Africa. The maximum tariff is now 15 percent on consumer goods, and there are only two other tariff bands: zero for capital goods and 7 percent for intermediate imports.

The average real GDP growth rate was 6.3 percent per year during the entire recovery period (1986-99) and 6.9 percent in the 1990s. The liberalization of trade has had a marked effect on export performance. In the 1990s export volumes grew (at constant prices) at an annualized rate of 15 percent, and import volumes grew at 13 percent. The value of noncoffee exports increased fivefold between 1992 and 1999.

These cases provide persuasive evidence that openness to foreign trade and investment—coupled with complementary reforms—can lead to faster growth in developing countries. However, individual cases always beg the question, how general are these results? Does the typical developing country that liberalizes foreign trade and investment get good results? Cross-country statistical analysis is useful for looking at the general patterns in the data. Cross-country studies generally find a correlation between trade and growth. To relate this back to the discussion in Section 1: among developing countries, some developing countries have had large increases in trade integration (measured as the ratio of trade to national income), while others have had small increases or even declines. In general, the countries that have had large increases in trade integration, have also had accelerations in growth. The group of developing country globalizers identified by Dollar and Kraay (2004) had population-weighted growth of 5 percent per capita in the 1990s, compared to 2 percent for the rich countries, and –1 percent for the rest

of the developing world (Figure 16). This relationship between trade and growth persists after controlling for reverse causality from growth to trade and for changes in other institutions and policies (Dollar and Kraay, 2002b).

Figure 16. Convergence and divergence in the 1990s



A third type of evidence about integration and growth comes from firm-level studies and links us back to the quote from Paul Romer. Developing countries often have large productivity dispersion across firms making similar things: high productivity and low productivity firms co-exist and in small markets there is often insufficient competition to spur innovation. A consistent finding of firm-level studies is that openness leads to lower productivity dispersion (Haddad 1993, Haddad and Harrison 1993, Harrison 1994). High cost producers exit the market as prices fall; if these firms were less productive, or were experiencing falling productivity, then their exits represent productivity improvements for the industry. While the destruction and creation of new firms is a normal part of a well-functioning economy, too often attention is simply paid to the

destruction of firms, missing half of the picture. The increase in exits is only part of the adjustment. Granted, it is the first and most painful part. However, if there are not significant barriers to entry, the other side is that there are new entrants. The exits are often front loaded, but the net gains over time can be substantial.

Wacziarg (1998) uses eleven episodes of trade liberalization in the 1980s to look at the issue of competition and entry. Using data on the number of establishments in each sector, he calculates that entry rates were 20% higher among countries that liberalized compared to ones that did not. This estimate may reflect other policies that accompanied trade liberalization such as privatization and deregulation, so this is likely to be an upper bound of the impact of trade liberalization. However, it is a sizeable effect and indicates that there is plenty of potential for new firms to respond to the new incentives. The evidence also indicates that while exit rates may be significant, entry rates are usually of a comparable magnitude to the exit rates. Using plant level data from Morocco, Chile, and Columbia spanning several years in the 1980s when these countries initiated trade reforms indicates that exit rates range from 6 to 11% a year, and entry rates from 6 to 13%. Over time, the cumulative turnover is quite impressive, with a quarter to a third of firms having turned over in 4 years (Roberts and Tybout, 1996, p.6).

The higher turnover of firms is an important source of the dynamic benefit of openness. In general, dying firms have falling productivity and new firms tend to increase their productivity over time (Liu and Tybout 1996, Aw, Chung and Roberts 1997, Roberts and Tybout 1996). In Taiwan, Aw, Chung and Roberts (2000) find that within a five-year period, the replacement of low productivity firms with new, higher productivity entrants accounted for half or more of the technological advance in many Taiwanese industries.

While these studies shed some light on why open economies are more innovative and dynamic, they also remind of us why integration is controversial. There will be more dislocation in an open, dynamic economy – with some firms closing and others starting up. If workers have good social protection and opportunities for developing new skills, then everyone can benefit. But without such policies there can be some big losers.

Finally, if integration is on balance good for developing countries, it is natural to ask whether one finds evidence for this as well in opinion surveys. The Pew Center for the People and the Press (2003) released a global attitudes survey that provides an interesting perspective on different views of globalization in the developing and developed countries. The Pew Center surveyed 38,000 people in 44 nations, with excellent coverage of the developing world in all regions. In general, there is a positive view of growing economic integration worldwide. But what was striking in the survey is that views of globalization are distinctly more positive in low-income countries than in rich ones.

While most people worldwide expressed the view that growing global trade and business ties are good for their country, only 28% of people in the U.S. and Western Europe thought that such integration was “very good.” In Vietnam and Uganda, in contrast, the percentages who thought integration was very good were 56% and 64%, respectively. While these countries stood out as particularly pro-globalization, developing Asia (37%) and Sub-Saharan Africa (56%) were far more likely to find integration “very good,” than respondents from rich countries. Conversely, a significant minority (27% of households) in rich countries thought that “globalization has a bad effect on my country,” compared to negligible numbers of households with this negative view in developing Asia (9%) or Sub-Saharan Africa (10%).

Developing nations also had a more positive view of the institutions of globalization. In Sub-Saharan Africa 75% of households thought that multinational corporations had a positive influence on their country, compared to only 54% in rich countries. Views of the effect of the WTO, World Bank, and IMF were nearly as positive in Africa (72% finding these to have a positive effect on their country). On the other hand, only 28% of respondents in Africa thought that anti-globalization protestors had a positive effect on their country. Views of the protestors were more positive in the U.S. and Western Europe (35% positive).

I want to close this section with a nice point from the economic historians Peter Lindert and Jeffrey Williamson (2001) concerning the different pieces of evidence linking integration to growth: “The doubts that one can retain about each individual study threaten to block our view of the overall forest of evidence. Even though no one study can establish that openness to trade has unambiguously helped the representative Third World economy, the preponderance of evidence supports this conclusion.” They go on to note the “empty set” of “countries that chose to be less open to trade and factor flows in the 1990s than in the 1960s and rose in the global living-standard ranks at the same time. As far as we can tell, there are no anti-global victories to report for the postwar Third World. We infer that this is because freer trade stimulates growth in Third World economies today, regardless of its effects before 1940.” (pp. 29-30)

#### ***4. Making globalization work better for the poor***

What are the implications of these findings – for developing countries, for rich countries, and for NGOs that care about global poverty? So far, the most recent wave of globalization starting around 1980 has been a powerful force for equality and poverty reduction. But it would be naïve to think that this will inevitably continue.

Whether global economic integration continues to be an equalizing force will depend on the extent to which poor locations participate in this integration, and that in turn will depend on both their own policies and the policies of the rich world. True integration requires not just trade liberalization, but also wide-ranging reforms of institutions and policies. If we look at some of the countries that are not participating very strongly in globalization, many of them have serious problems with the overall investment climate: Kenya, Pakistan, Burma, and Nigeria would all be examples. Some of these countries also have restrictive policies toward trade, but even if they liberalize trade not much is likely to happen without other measures. It is not easy to predict the reform paths of these countries. (If you think about some of the relative successes that I have cited – China, India, Uganda, Vietnam – in each case their reform was a startling surprise.) As long as there are locations with weak institutions and policies, people living there are going to fall further and further behind the rest of the world in terms of living standards.

Building a coalition for reform in these locations is not easy, and what outsiders can do to help is limited. But one thing that the rich countries can do is to make it easy for developing countries that do choose to open up, to join the club. Unfortunately, in recent years the rich countries have been making it harder for countries to join the club of trading nations. The GATT was originally built around agreements concerning trade practices. Now, however, a certain degree of institutional harmonization is required to join the WTO (for examples, on policies toward intellectual property rights). The proposal to regulate labor standards and environmental standards through WTO sanctions would take this requirement for institutional harmonization much farther. Power in the WTO is inherently unbalanced: size matters in the important area of dispute settlement where only larger countries can effectively threaten to retaliate against illegal measures. If the US wins an unfair trade practices case against Bangladesh it is allowed to

impose punitive duties on Bangladeshi products. Owing to the asymmetry in the size of these economies the penalties are likely to impose a small cost on US consumers and a large one on Bangladeshi producers. Now, suppose the situation is reversed and Bangladesh wins a judgment against the US. For Bangladesh to impose punitive duties on US products is likely to hurt its own economy much more than the US. Thus, developing countries see the proposal to regulate their labor and environmental standards through WTO sanctions as inherently unfair and as a new protectionist tool that rich countries can wield against them.

So, globalization will proceed more smoothly if the rich countries make it easy for developing countries to benefit from trade and investment. Reciprocal trade liberalizations have worked well throughout the post-war period. There still are serious protections in OECD countries against agricultural and labor-intensive products that are important to developing nations. It would help substantially to reduce these protections. At the same time, developing countries would benefit from further openings of their own markets. They have a lot to gain from more trade in services. Also, 70% of the tariff barriers that developing countries face, are from other developing countries. So, there is a lot of potential to expand trade among developing countries, if trade restrictions were further eased. However, the trend to use trade agreements to try to impose an institutional model from the OECD countries on Third World countries makes it more difficult to reach trade agreements that benefit poor countries.

Another reason to be pessimistic concerns geography. There is no inherent reason why coastal China should be poor – or southern India, or Vietnam, or northern Mexico. These locations historically were held back by misguided policies, and with policy reform they can grow very rapidly and take their natural place in the world income distribution. However, the same reforms are not going to have the same effect in Mali or Chad. Some countries have poor

geography in the sense that they are far from markets and have inherently high transport costs. Other locations face challenging health and agricultural problems. So, it would be naïve to think that trade and investment can alleviate poverty in all locations. Much more could be done with foreign aid targeted to developing medicines for malaria, AIDS, and other health problems of poor areas and to building infrastructure and institutions in these locations. The promises for greater aid from the U.S. and Europe at the Monterrey Conference were encouraging, but it remains to be seen if these promises are fulfilled.

The importance of geography also raises the issue of migration – the missing flow in today’s globalization. Migration from locations that are poor because of either weak institutions and/or difficult physical geography could make a large contribution to reducing poverty in the lagging regions. Most migration from south to north is economically motivated. This migration raises the living standard of the migrant and benefits the sending country in three ways – reducing the labor force raises wages for those who remain behind, migrants typically send a large volume of remittances back home, and their presence in the OECD economy can support the development of trade and investment networks. These benefits are strongest if the migrant is relatively unskilled, since this is the part of the labor force that is in over-supply in much of the developing world.

Each year 83 million people are added to world population, 82 million of these in the developing world. Furthermore, populations in Europe and Japan are aging and the labor forces there will begin to shrink without more migration. So, there are clear economic benefits to more migration of unskilled workers from the south to the north, and yet this flow remains highly restricted and very controversial because of its impact on society and culture. Because the economic pressures are so strong, however, growing volumes of illegal immigration are taking

place – and some of the worst abuses of “globalization” occur because we are not globalized when it comes to labor flows.

Realistically, none of the OECD countries is going to adopt open migration. But there is a good case to be made to revisit migration policies. Some of the OECD countries have a strong bias in their immigration policies toward highly skilled workers, spurring “brain drain” from the developing world. This policy pushes much of the unskilled flow into the illegal category. If OECD countries would accept – legally – more unskilled workers, it should help with their own looming labor shortages, improve living standards in sending countries, and reduce the growing illegal human trade with all of its abuses.

So, integration of poor economies with richer ones has provided many opportunities for poor people to improve their lives. Examples of the beneficiaries of globalization will be found among Mexican migrants, Chinese factory workers, Vietnamese peasants, and Ugandan farmers. Lots of non-poor in developing and rich countries alike also benefit, of course. But much of the current debate about globalization seems to ignore the fact that it has provided many poor people in the developing world unprecedented opportunities. After all of the rhetoric about globalization is stripped away, many of the practical policy questions come down to whether we are going to make it easy for poor communities that want to integrate with the world economy to do so, or whether we are going to make it difficult. The world’s poor have a large stake in how the rich countries answer these questions.

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