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Spreading the Wealth

By David Dollar and Aart Kraay

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Summary: Antiglobalization activists are convinced that economic integration has been widening the gap between rich and poor. The best evidence, however, proves them wrong. Thanks to higher growth driven by greater openness to trade and investment, global inequality has narrowed and global poverty has been reduced.

David Dollar and Aart Kraay are economists at the World Bank's Development Research Group. The views expressed here are their own.

A RISING TIDE

One of the main claims of the antiglobalization movement is that globalization is widening the gap between the haves and the have-nots. It benefits the rich and does little for the poor, perhaps even making their lot harder. As union leader Jay Mazur put it in these pages, "globalization has dramatically increased inequality between and within nations" ("Labor's New Internationalism," January/February 2000). The problem with this new conventional wisdom is that the best evidence available shows the exact opposite to be true. So far, the current wave of globalization, which started around 1980, has actually promoted economic equality and reduced poverty.

Global economic integration has complex effects on income, culture, society, and the environment. But in the debate over globalization's merits, its impact on poverty is particularly important. If international trade and investment primarily benefit the rich, many people will feel that restricting trade to protect jobs, culture, or the environment is worth the costs. But if restricting trade imposes further hardship on poor people in the developing world, many of the same people will think otherwise.

Three facts bear on this question. First, a long-term global trend toward greater inequality prevailed for at least 200 years; it peaked around 1975. But since then, it has stabilized and possibly even reversed. The chief reason for the change has been the accelerated growth of two large and initially poor countries: China and India.

Second, a strong correlation links increased participation in international trade and investment on the one hand and faster growth on the other. The developing world can be divided into a "globalizing" group of countries that have seen rapid increases in trade and foreign investment over the last two decades -- well above the rates for rich countries -- and a "nonglobalizing" group that trades even less of its income today than it did 20 years ago. The aggregate annual per capita growth rate of the globalizing group accelerated steadily from one percent in the 1960s to five percent in the 1990s. During that latter decade, in contrast, rich countries grew at two percent and nonglobalizers at only one percent. Economists are cautious about drawing conclusions concerning causality, but they largely agree that openness to foreign trade and investment (along with complementary reforms) explains the faster growth of the globalizers.

Third, and contrary to popular perception, globalization has not resulted in higher inequality within economies. Inequality has indeed gone up in some countries (such as China) and down in others (such as the Philippines). But those changes are not systematically linked to globalization measures such as trade and investment flows, tariff rates, and the presence of capital controls. Instead, shifts in inequality stem more from domestic education, taxes, and social policies. In general, higher growth rates in globalizing developing countries have translated into higher incomes for the poor. Even with its increased inequality, for example, China has seen the most spectacular reduction of poverty in world history -- which was supported by

opening its economy to foreign trade and investment.

Although globalization can be a powerful force for poverty reduction, its beneficial results are not inevitable. If policymakers hope to tap the full potential of economic integration and sustain its benefits, they must address three critical challenges. A growing protectionist movement in rich countries that aims to limit integration with poor ones must be stopped in its tracks. Developing countries need to acquire the kinds of institutions and policies that will allow them to prosper under globalization, both of which may be different from place to place. And more migration, both domestic and international, must be permitted when geography limits the potential for development.

THE GREAT DIVIDE

Over the past 200 years, different local economies around the world have become more integrated while the growth rate of the global economy has accelerated dramatically. Although it is impossible to prove causal linkage between the two developments -- since there are no other world economies to be tested against -- evidence suggests the arrows run in both directions. As Adam Smith argued, a larger market permits a finer division of labor, which in turn facilitates innovation and learning by doing. Some of that innovation involves transportation and communications technologies that lower costs and increase integration. So it is easy to see how integration and innovation can be mutually supportive.

Different locations have become more integrated because of increased flows of goods, capital, and knowledge. From 1820 to 1914, international trade increased faster than the global economy. Trade rose from about 2 percent of world income in 1820 to 18 percent in 1914. The globalization of trade took a step backward during the protectionist period of the Great Depression and World War II, and by 1950 trade (in relation to income) was lower than it had been in 1914. But thanks to a series of multilateral trade liberalizations under the General Agreement on Tariffs and Trade (GATT), trade dramatically expanded among industrialized countries between 1960 and 1980. Most developing countries remained largely isolated from this trade because of their own inward-focused policies, but the success of such notable exceptions as Taiwan and South Korea eventually helped encourage other developing economies to open themselves up to foreign trade and investment.

International capital flows, measured as foreign ownership of assets relative to world income, also grew during the first wave of globalization and declined during the Great Depression and World War II; they did not return to 1914 levels until 1980. But since then, such flows have increased markedly and changed their nature as well. One hundred years ago, foreign capital typically financed public infrastructure projects (such as canals and railroads) or direct investment related to natural resources. Today, in contrast, the bulk of capital flows to developing countries is direct investments tied to manufacturing and services.

The change in the nature of capital flows is clearly related to concurrent advances in economic integration, such as cheaper and faster transportation and revolutionary changes in telecommunications. Since 1920, seagoing freight charges have declined by about two-thirds and air travel costs by 84 percent; the cost of a three-minute call from New York City to London has dropped by 99 percent. Today, production in widely differing locations can be integrated in ways that simply were not possible before.

Another aspect of integration has been the movement of people. Yet here the trend is reversed: there is much more international travel than in the past but much less permanent migration. Between 1870 and 1910, about ten percent of the world's population relocated permanently from one country to another; over the past 25 years, only one to two percent have done so.

As economic integration has progressed, the annual growth rate of the world economy has accelerated, from 1 percent in the mid-nineteenth century to 3.5 percent in 1960-2000. Sustained over many years, such a jump in growth makes a huge difference in real living standards. It now takes only two to three years, for example, for the world economy to produce the same amount of goods and services that it did during the entire nineteenth century. Such a comparison is arguably a serious understatement of the true difference, since most of what is consumed today -- airline travel, cars, televisions, synthetic fibers, life-extending drugs

-- did not exist 200 years ago. For any of these goods or services, therefore, the growth rate of output since 1820 is infinite. Human productivity has increased almost unimaginably.

All this tremendous growth in wealth was distributed very unequally up to about 1975, but since then growing equality has taken hold. One good measure of inequality among individuals worldwide is the mean log deviation -- a measure of the gap between the income of any randomly selected person and a general average. It takes into account the fact that income distributions everywhere are skewed in favor of the rich, so that the typical person is poorer than the group average; the more skewed the distribution, the larger the gap. Per capita income in the world today, for example, is around \$5,000, whereas a randomly selected person would most likely be living on close to \$1,000 -- 80 percent less. That gap translates into a mean log deviation of 0.8.

Taking this approach, an estimate of the world distribution of income among individuals shows rising inequality between 1820 and 1975. In that period, the gap between the typical person and world per capita income increased from about 40 percent to about 80 percent. Since changes in income inequality within countries were small, the increase in inequality was driven mostly by differences in growth rates across countries. Areas that were already relatively rich in 1820 (notably, Europe and the United States) grew faster than poor areas (notably, China and India). Global inequality peaked sometime in the 1970s, but it then stabilized and even began to decline, largely because growth in China and India began to accelerate.

Another way of looking at global inequality is to examine what is happening to the extreme poor -- those people living on less than \$1 per day. Although the percentage of the world's population living in poverty has declined over time, the absolute number rose fairly steadily until 1980. During the Great Depression and World War II, the number of poor increased particularly sharply, and it declined somewhat immediately thereafter. The world economy grew strongly between 1960 and 1980, but the number of poor rose because growth did not occur in the places where the worst-off live. But since then, the most rapid growth has occurred in poor locations. Consequently the number of poor has declined by 200 million since 1980. Again, this trend is explained primarily by the rapid income growth in China and India, which together in 1980 accounted for about one-third of the world's population and more than 60 percent of the world's extreme poor.

UPWARD BOUND

The shift in the trend in global inequality coincides with the shift in the economic strategies of several large developing countries. Following World War II, most developing regions chose strategies that focused inward and discouraged integration with the global economy. But these approaches were not particularly successful, and throughout the 1960s and 1970s developing countries on the whole grew less rapidly than industrialized ones. The oil shocks and U.S. inflation of the 1970s created severe problems for them, contributing to negative growth, high inflation, and debt crises over the next several years. Faced with these disappointing results, several developing countries began to alter their strategies starting in the 1980s.

For example, China had an extremely closed economy until the mid-1970s. Although Beijing's initial economic reform focused on agriculture, a key part of its approach since the 1980s has involved opening up foreign trade and investment, including a drop in its tariff rates by two-thirds and its nontariff barriers by even more. These reforms have led to unprecedented economic growth in the country's coastal provinces and more moderate growth in the interior. From 1978 to 1994 the Chinese economy grew annually by 9 percent, while exports grew by 14 percent and imports by 13 percent. Of course, China and other globalizing developing countries have pursued a wide range of reforms, not just economic openness. Beijing has strengthened property rights through land reform and moved from a planned economy toward a market-oriented one, and these measures have contributed to its integration as well as to its growth.

Other developing countries have also opened up as a part of broader reform programs. During the 1990s, India liberalized foreign trade and investment with good results; its annual per capita income growth now tops four percent. It too has pursued a broad agenda of reform and has moved away from a highly regulated, planned system. Meanwhile, Uganda and Vietnam are the best examples of very low-income countries that

have increased their participation in trade and investment and prospered as a result. And in the western hemisphere, Mexico is noteworthy both for signing its free-trade agreement with the United States and Canada in 1993 and for its rapid growth since then, especially in the northern regions near the U.S. border.

These cases illustrate how openness to foreign trade and investment, coupled with complementary reforms, typically leads to faster growth. India, China, Vietnam, Uganda, and Mexico are not isolated examples; in general, countries that have become more open have grown faster. The best way to illustrate this trend is to rank developing countries in order of their increases in trade relative to national income over the past 20 years. The top third of this list can be thought of as the "globalizing" camp, and the bottom two-thirds as the "nonglobalizing" camp. The globalizers have increased their trade relative to income by 104 percent over the past two decades, compared to 71 percent for rich countries. The nonglobalizers, meanwhile, actually trade less today than they did 20 years ago. The globalizers have also cut their import tariffs by 22 percentage points on average, compared to only 11 percentage points for the nonglobalizers.

How have the globalizers fared in terms of growth? Their average annual growth rates accelerated from 1 percent in the 1960s to 3 percent in the 1970s, 4 percent in the 1980s, and 5 percent in the 1990s. Rich countries' annual growth rates, by comparison, slowed to about 2 percent in the 1990s, and the nonglobalizers saw their growth rates decline from 3 percent in the 1970s to 1 percent in the 1980s and 1990s.

The same pattern can be observed on a local level. Within both China and India, the locations that are integrating with the global economy are growing much more rapidly than the disconnected regions. Indian states, for example, vary significantly in the quality of their investment climates as measured by government efficiency, corruption, and infrastructure. Those states with better investment climates have integrated themselves more closely with outside markets and have experienced more investment (domestic and foreign) than their less-integrated counterparts. Moreover, states that were initially poor and then created good investment climates had stronger poverty reduction in the 1990s than those not integrating with the global economy. Such internal comparisons are important because, by holding national trade and macroeconomic policies constant, they reveal how important it is to complement trade liberalization with institutional reform so that integration can actually occur.

The accelerated growth rates of globalizing countries such as China, India, and Vietnam are consistent with cross-country comparisons that find openness going hand in hand with faster growth. The most that these studies can establish is that more trade and investment is highly correlated with higher growth, so one needs to be careful about drawing conclusions about causality. Still, the overall evidence from individual cases and cross-country correlation is persuasive. As economists Peter Lindert and Jeffrey Williamson have written, "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 that "there are no anti-global victories to report for the postwar Third World."

Contrary to the claims of the antiglobalization movement, therefore, greater openness to international trade and investment has in fact helped narrow the gap between rich and poor countries rather than widen it. During the 1990s, the economies of the globalizers, with a combined population of about 3 billion, grew more than twice as fast as the rich countries. The nonglobalizers, in contrast, grew only half as fast and nowadays lag further and further behind. Much of the discussion of global inequality assumes that there is growing divergence between the developing world and the rich world, but this is simply not true. The most important development in global inequality in recent decades is the growing divergence within the developing world, and it is directly related to whether countries take advantage of the economic benefits that globalization can offer.

THE PATH OUT OF POVERTY

The antiglobalization movement also claims that economic integration is worsening inequality within countries as well as between them. Until the mid-1980s, there was insufficient evidence to support strong conclusions on this important topic. But now more and more developing countries have begun to conduct

household income and consumption surveys of reasonable quality. (In low-income countries, these surveys typically track what households actually consume because so much of their real income is self-produced and not part of the money economy.) Good surveys now exist for 137 countries, and many go back far enough to measure changes in inequality over time.

One way of looking at inequality within countries is to focus on what happens to the bottom 20 percent of households as globalization and growth proceed apace. Across all countries, incomes of the poor grow at around the same rate as GDP. Of course, there is a great deal of variation around that average relationship. In some countries, income distribution has shifted in favor of the poor; in others, against them. But these shifts cannot be explained by any globalization-related variable. So it simply cannot be said that inequality necessarily rises with more trade, more foreign investment, and lower tariffs. For many globalizers, the overall change in distribution was small, and in some cases (such as the Philippines and Malaysia) it was even in favor of the poor. What changes in inequality do reflect are country-specific policies on education, taxes, and social protection.

It is important not to misunderstand this finding. China is an important example of a country that has had a large increase in inequality in the past decade, when the income of the bottom 20 percent has risen much less rapidly than per capita income. This trend may be related to greater openness, although domestic liberalization is a more likely cause. China started out in the 1970s with a highly equal distribution of income, and part of its reform has deliberately aimed at increasing the returns on education, which financially reward the better schooled. But the Chinese case is not typical; inequality has not increased in most of the developing countries that have opened up

to foreign trade and investment. Furthermore, income distribution in China may have become more unequal, but the income of the poor in China has still risen rapidly. In fact, the country's progress in reducing poverty has been one of the most dramatic successes in history.

Because increased trade usually accompanies more rapid growth and does not systematically change household-income distribution, it generally is associated with improved well-being of the poor. Vietnam nicely illustrates this finding. As the nation has opened up, it has experienced a large increase in per capita income and no significant change in inequality. Thus the income of the poor has risen dramatically, and the number of Vietnamese living in absolute poverty dropped sharply from 75 percent of the population in 1988 to 37 percent in 1998. Of the poorest 5 percent of households in 1992, 98 percent were better off six years later. And the improved well-being is not just a matter of income. Child labor has declined, and school enrollment has increased. It should be no surprise that the vast majority of poor households in Vietnam benefited immediately from a more liberalized trading system, since the country's opening has resulted in exports of rice (produced by most of the poor farmers) and labor-intensive products such as footwear. But the experience of China and Vietnam is not unique. India and Uganda also enjoyed rapid poverty reduction as they grew along with their integration into the global economy.

THE OPEN SOCIETIES

These findings have important implications for developing countries, for rich countries such as the United States, and for those who care about global poverty. All parties should recognize that the most recent wave of globalization has been a powerful force for equality and poverty reduction, and they should commit themselves to seeing that it continues despite the obstacles lying ahead.

It is not inevitable that globalization will proceed. In 1910, many believed globalization was unstoppable; they soon received a rude shock. History is not likely to repeat itself in the same way, but it is worth noting that antiglobalization sentiments are on the rise. A growing number of political leaders in the developing world realize that an open trading system is very much in their countries' interest. They would do well to heed Mexican President Vicente Fox, who said recently,

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 the rule of law. ... When you

do your part, we are convinced that you get the benefit.

But today the narrow interests opposed to further integration -- especially those in the rich countries -- appear to be much more energetic than their opponents. In Quebec City last spring and in Genoa last summer, a group of democratically elected leaders gathered to discuss how to pursue economic integration and improve the lives of their peoples. Antiglobalization demonstrators were quite effective in disrupting the meetings and drawing media attention to themselves. Leaders in developed and developing countries alike must make the proglobalization case more directly and effectively or risk having their opponents dominate the discussion and stall the process.

In addition, industrialized countries still raise protectionist measures against agricultural and labor-intensive products. Reducing those barriers would help developing countries significantly. The poorer areas of the world would benefit from further openings of their own markets as well, since 70 percent of the tariff barriers that developing countries face are from other developing countries.

If globalization proceeds, its potential to be an equalizing force will depend on whether poor countries manage to integrate themselves into the global economic system. True integration requires not just trade liberalization but wide-ranging institutional reform. Many of the nonglobalizing developing countries, such as Myanmar, Nigeria, Ukraine, and Pakistan, offer an unattractive investment climate. Even if they decide to open themselves up to trade, not much is likely to happen unless other reforms are also pursued. It is not easy to predict the reform paths of these countries; some of the relative successes in recent years, such as China, India, Uganda, and Vietnam, have come as quite a surprise. But as long as a location has weak institutions and policies, people living there are going to fall further behind the rest of the world.

Through their trade policies, rich countries can make it easier for those developing countries that do choose to open up and join the global trading club. But in recent years, the rich countries have been doing just the opposite. Gatt was originally built around agreements concerning trade practices. Now, institutional harmonization, such as agreement on policies toward intellectual property rights, is a requirement for joining the WTO. Any sort of regulation of labor and environmental standards made under the threat of WTO sanctions would take this requirement for harmonization much further. Such measures would be neoprotectionist in effect, because they would thwart the integration of developing countries into the world economy and discourage trade between poor countries and rich ones.

The WTO meeting in Doha was an important step forward on trade integration. More forcefully than in Seattle, leaders of industrial countries were willing to make the case for further integration and put on the table issues of central concern to developing nations: access to pharmaceutical patents, use of antidumping measures against developing countries, and agricultural subsidies. The new round of trade negotiations launched at Doha has the potential to reverse the current trend, which makes it more difficult for poor countries to integrate with the world economy.

A final potential obstacle to successful and equitable globalization relates to geography. There is no inherent reason why coastal China should be poor; the same goes for southern India, northern Mexico, and Vietnam. All of these locations are near important markets or trade routes but were long held back by misguided policies. Now, with appropriate reforms, they are starting to grow rapidly and take their natural place in the world. But the same cannot be said for Mali, Chad, or other countries or regions cursed with "poor geography" -- i.e., distance from markets, inherently high transport costs, and challenging health and agricultural problems. It would be naive to think that trade and investment alone can alleviate poverty in all locations. In fact, for those locations with poor geography, trade liberalization is less important than developing proper health care systems or providing basic infrastructure -- or letting people move elsewhere.

Migration from poor locations is the missing factor in the current wave of globalization that could make a large contribution to reducing poverty. Each year, 83 million people are added to the world's population, 82 million of them in the developing world. In Europe and Japan, moreover, the population is aging and the labor force is set to shrink. Migration of relatively unskilled workers from South to North would thus offer clear economic benefits to both. Most migration from South to North is economically motivated, and it

raises the living standard of the migrant while benefiting the sending country in three ways. First, it reduces the South's labor force and thus raises wages for those who remain behind. Second, migrants send remittances of hard currency back home. Finally, migration bolsters transnational trade and investment networks. In the case of Mexico, for example, ten percent of its citizens live and work in the United States, taking pressure off its own labor market and raising wages there. India gets six times as much in remittances from its workers overseas as it gets in foreign aid.

Unlike trade, however, migration remains highly restricted and controversial. Some critics perceive a disruptive impact on society and culture and fear downward pressure on wages and rising unemployment in the richer countries. Yet anti-immigration lobbies ignore the fact that geographical economic disparities are so strong that illegal immigration is growing rapidly anyway, despite restrictive policies. In a perverse irony, some of the worst abuses of globalization occur because there is not enough of it in key economic areas such as labor flows. Human traffic, for example, has become a highly lucrative, unregulated business in which illegal migrants are easy prey for exploitation.

Realistically, none of the industrialized countries is going to adopt open migration. But they should reconsider their migration policies. Some, for example, have a strong bias in their immigration rules toward highly skilled workers, which in fact spurs a "brain drain" from the developing world. Such policies do little to stop the flow of unskilled workers and instead push many of these people into the illegal category. If rich countries would legally accept more unskilled workers, they could address their own looming labor shortages, improve living standards in developing countries, and reduce illegal human traffic and its abuses.

In sum, the integration of poor economies with richer ones over the past two decades has provided many opportunities for poor people to improve their lives. Examples of the beneficiaries of globalization can be found among Mexican migrants, Chinese factory workers, Vietnamese peasants, and Ugandan farmers. Many of the better-off in developing and rich countries alike also benefit. After all the rhetoric about globalization is stripped away, many of the policy questions come down to whether the rich world will make integrating with the world economy easy for those poor communities that want to do so. The world's poor have a large stake in how the rich countries answer.

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