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The Global Divide

Inequality in the world economy

By Marc Lee

Global inequality, the gap between the world's rich and poor, is one of the most pressing issues of our time.

Inequality differences between people around the world could be discounted when most people's economic context was limited to what happened within their national borders. But the immense growth of trade and investment flows, the development of standardized rules across nations, and the globalization of production, distribution and marketing, mean people in different nations are interconnected as never before.

As a result, widening disparities between nations and individuals are cause for concern. If we are all global citizens now, most people would consider stark inequalities to be a moral outrage. But even beyond this sense of our common humanity, wealthy countries like Canada need to address inequality out of enlightened self-interest: today's growing gap may be fuelling tomorrow's act of terrorism.

This brief looks at recent statistics and studies on growing global inequality, and considers the role of the globalization—more specifically, the orthodox ideological framework of globalization, known as neoliberalism or the Washington consensus—as a driving force behind the change. The plight of the world's poor is now invoked regularly by politicians at international fora, such as the recent Financing for Development conference in Mexico, the upcoming G-8 meeting in Kananaskis, Alberta, and the semi-annual meetings of the IMF and World Bank. Unfortunately, the “cure” emanating from these gatherings too often resembles the disease.

The Global Inequality Picture

The growth in global inequality stems from two factors: increased inequality between countries, and increased inequality within individual countries. The long-term trend for global inequality is that of a widening gap, with the exception of the “Golden Age” decades after World War II. Since the mid-1970s, global inequality has resumed its upward trend.

Inequality between countries

Interestingly, two hundred years ago, the gap between the richest countries and the poorest was not very large. Economic historian Angus Maddison estimates that the richest countries were about three times richer than the poorest countries in 1820, based on GDP per capita. As shown by Table 1, this ratio rose to 15 to 1 in 1950, then dropped to 13 to 1 in 1973, before resuming its increase to 19 to 1 in 1998.¹

The UN's Human Development Report adds that in 1960, the top 20% of the world's people in the richest countries had 30 times the income (in terms of total GDP) of the poorest 20%. This grew to 32 times in 1970, to 45 times in 1980, and to 59 times in 1989. By 1997, the top 20% received 74 times the income of the bottom 20%.²

A recent World Bank paper by Branko Milanovic calculates gini coefficients (a standard measure of inequality) based on international rankings of GDP per capita. He finds that inequality trends were relatively flat from the mid-1960s to the early 1980s, but from the early 1980s onward inequality begins to rise significantly.³

Table 1
Per capita GDP by Region, 1820 to 1998

	1820	1870	1913	1950	1973	1998
	(1990 international dollars)					
Western Europe	1,232	1,974	3,473	4,594	11,534	17,921
Western Offshoots ¹	1,201	2,431	5,257	9,288	16,172	26,146
Japan	669	737	1,387	1,926	11,439	20,413
Asia (excluding Japan)	575	543	640	635	1,231	2,936
Latin America	665	698	1,511	2,554	4,531	5,795
Eastern Europe and former USSR	667	917	1,501	2,601	5,729	4,354
Africa	418	444	585	852	1,365	1,368
World	667	867	1,510	2,114	4,104	5,709
Inter-regional spread ²	3:1	5:1	9:1	15:1	13:1	19:1

Notes:

¹ Western offshoots includes Canada, US, Australia and New Zealand.

² Inter-regional spread is the ratio of the highest income to the lowest income for that year. For 1820, this is the ratio of Western Europe to Africa; for the remaining years, Western Offshoots to Africa.

Source: Maddison (2001), Table 3-1b, p. 126

Milanovic also estimates an alternate approach to inequality, similar in methodology but based on *population-weighted* GDP per capita. Intriguingly, this approach shows *declining*, not increasing, inequality. However, this result is explained by the inclusion of China and India. China has experienced a rapid increase in inequality in recent decades, while India has had relatively flat levels of inequality (though rising in recent years). But both countries have had fast GDP growth rates, and because of their size (over 2 billion people between them), this fact biases the measure of global inequality. Dropping China from the list leaves inequality flat over 40 years; if India is dropped as well, the pattern again shows an increase in global inequality.⁴

Inequality within countries

Like the pattern for inequality between countries, within-country inequality fell in a large number of countries during the Golden Age from the 1950s to the early-1970s. Since then, however, inequality has increased in most countries. Summarizing the results of a large research project on globalization and inequality, Cornia and Kiiski (2001) note that inequality has risen over the past two decades in 48 out of 73 countries for which high quality data are available (Table 2). These 48 countries represent 59% of the population and 78% of the GDP of the 73 country sample. Sixteen countries had constant levels of inequality, while only nine experienced decreasing inequality during this period (some of

this latter 25 are suspected of higher inequality in the wake of recent financial crises, but data are not yet available).

Inequality has some distinct regional dimensions. African economies have been in stagnation since the 1980s in terms of GDP, with inequality on the rise. Latin America experienced a “lost decade” after the early 1980s “debt crisis,” reversing declines in inequality during the 1970s. For Russia and the Eastern European “transition economies,” the 1990s heralded a collapse of the middle class that drove up inequality. China has experienced an upsurge in inequality since mid-1980s (timed with its economic reforms), especially with regard to differences between urban coastal areas and the rural interior.

In the rich OECD countries, rising inequality has been driven by greater disparities in market income (although this can be offset by decent minimum wages and collective bargaining). Inequality has been more pronounced in recent years, due to regressive changes in tax systems, public services and income transfers. Canada, for example, experienced growing inequality of market incomes through the 1980s and 1990s, but managed to keep the lid on after-tax inequality, at least up the mid-1990s. Recent federal and provincial tax cuts and spending cuts have been pushing up after-tax inequality.

There has also been a growing concentration of income and wealth at the very top of the distribution in most countries. Merrill Lynch’s World Wealth Report 2001 finds that an exclusive club of 7.2 million

Table 2
Income Inequality Changes in 73 Countries from 1960s to 1990s

Inequality	Developed countries	Developing countries	Transitional countries	Total
Rising	12: Australia, Canada, Denmark, Finland, Italy, Japan, Netherlands, New Zealand, Spain, Sweden, UK, USA	15: Argentina, Chile, China, Colombia, Costa Rica, Guatemala, Hong Kong, Mexico, Pakistan, Panama, South Africa, Sri Lanka, Taiwan, Thailand, Venezuela	21: Armenia, Azerbaijan, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Slovakia, Slovenia, Ukraine, Yugoslavia	48
Constant	3: Austria, Belgium, Germany	12: Bangladesh, Brazil, Cote d'Ivoire, Dominican Republic, El Salvador, India, Indonesia, Puerto Rico, Senegal, Singapore, Tanzania, Turkey	1: Belarus	16
Declining	2: France, Norway	7: Bahamas, Honduras, Jamaica, South Korea, Malaysia, Philippines, Tunisia	0	9
All	17	34	22	73
Notes: The length of the time series and the number of observations varies from country to country. In the countries underlined, very recent information suggests that income inequality may have risen from 1998-2000, i.e. in the wake of recent financial crises.				
Source: Cornia and Kiiski (2001)				

“high net worth individuals” had financial assets valued at US\$27 trillion in 2000, almost the size of the world’s total GDP (\$31 trillion in 2000). Moreover, the wealth controlled by a small cadre of “super-rich” is truly staggering. According to the UN, the assets of the three richest people in 1998 were larger than the combined GDP of all least developed countries. And the combined assets of the top 200 richest people—more than \$1 trillion—are more than the combined income of 41% of the world’s people.⁵ Unfortunately, the distribution of the world’s wealth (rather than income) has not been adequately studied.

Global Income Inequality

Milanovic (1999) puts together the two components of inequality, within-country and between-country, into an overall measure of “true” global inequality. His research compares 1988 to 1993 data for 91 countries. This analysis puts some numbers to the distribution of global income, summarized in Table 3.

The global distribution of income is profoundly unequal, and became increasingly so from 1988 to 1993. The top 5% captured one-third of world income

in 1993, while the top 10% received just over half. The share of income going to the top increased in 1993 over 1988. In contrast, the bottom 75% received 22% of world income, the bottom 50% received 8.5%, and the bottom 10% received just 0.8% of world income.⁶

There is no shortage of jaw-dropping statistics in this study. Milanovic adds:

- Not only did the share of the bottom 5% drop, but their real income decreased by one-quarter from 1988 to 1993.
- The ratio between the average income of the world’s top 5% and world’s bottom 5% increased from 78 to 1 in 1988 to 114 to 1 in 1993.
- The richest 1% in the world (50 million people) receive as much income as the bottom 57% (2.7 billion people).
- The richest 10% of the US population (25 million people) has total income equal to the total income of the poorest 43% of people in the world (almost 2 billion people).⁷

In a more recent study, Milanovic (2001) confirms an increase in global inequality over the 1988 to 1993

period, based on two alternative indicators of inequality (gini coefficient and theil index). The increase is primarily due to between-country increases in inequality (75 to 88% of the increase depending on the measure).⁸ He identifies three main contributors to the rise in inequality: the slow growth of rural incomes in Asian countries relative to OECD countries; the pulling ahead of urban China relative to rural China and India; and the “hollowing out” of the middle class in Eastern Europe.

What’s going on here?

Getting to the bottom of rising inequality is a complex question, a full treatment of which is beyond the scope of this paper. However, several recent studies have contemplated this scope, and suggest some broad strokes that explain much of the story.

How the West Grew Rich

Over a longer time frame, the increase in inequality between nations is the result of the “take-off” of economies in Western Europe and North America. Maddison (2001) argues that three broad and interactive forces explain the shift:

- *Conquest and settlement*—Colonial systems persisted from the 16th Century to the 1960s. They revolved around the extraction of natural resources (for example, gold and silver extraction from the Americas during this period was worth US\$36 billion, valued at modern prices), agricul-

tural production for export (e.g. sugar and cotton) and the exploitation of slave labour (some 10 million slaves “exported” from Africa). Mass immigration to the Americas, in the wake of native populations decimated by European diseases, was also a major factor. The legacy of the colonial period has modern echoes in the persistence of inequality within countries and the variation in economic performance between countries.

- *International trade and capital movements*—Trade flows played a substantial role in the rise of Venice (as a city-state), Portugal, the Netherlands and the United Kingdom as dominant maritime powers in their respective eras. Each expanded and consolidated trade networks (through coercive force if necessary) in a manner that provided markets for European producers while importing items that were not locally available.
- *Technological and institutional innovation*—Advances in Western technology vis-à-vis the rest of the world, in terms of military might, shipping capacity and industrial production, contributed to the ascendancy of the Western powers. Since 1820, technological change has advanced at a much more rapid pace than ever before. Institutional structures, such as banking, credit, property, insurance, and corporate forms of organization also played a significant role in the growth of capitalist economies.

Table 3
Global income distribution, 1988 and 1993

Percentage of world's population	Percentage of world income		
	1988	1993	Difference, 1988-93
Top 1%	9.3	9.5	0.2
Top 5%	31.2	33.7	2.5
Top 10%	46.9	50.8	3.9
Bottom 10%	0.9	0.8	-0.1
Bottom 20%	2.3	2.0	-0.3
Bottom 50%	9.6	8.5	-1.1
Bottom 75%	25.9	22.3	-3.6
Bottom 85%	41.0	37.1	-3.9

Source: Milanovic (1999), table 18, p. 29.

These factors in part attest to the dynamic of capitalist development, but also highlight a significant role played by the state in facilitating internal development and colonial expansion. From Crown financing of early Portuguese “trade missions” in the 15th century to countless infrastructure projects to the role of government in the advance of the Asian tigers, this has been the case. Non-market institutions such as legal structures and central banks have also played an important role in economic development.

From Golden Age to Neoliberal Order

The post-war period is the most relevant for policy-makers in assessing the patterns of global inequality. The Golden Age from 1950 to 1973 was a period characterized by faster rates of economic growth around the world than any other period of history. The only exception to this is the Asian economic “miracles” that achieved very fast growth rates in the post-1973 period.

The Golden Age also saw falling inequality within most countries. Domestic policies were infused by the ideas of Keynesian economics that focused on creating “full employment” and high levels of aggregate demand via low interest rates and demand-side policies (such as unemployment insurance and income assistance). These domestic policies were in a supportive international context based on stability and cooperation through the creation of new institutions (the United Nations, the IMF, the World Bank, the GATT). This period was also one of “decolonization” with efforts by new states to develop through industrial strategies and import-substitution policies.

In contrast, the post-1973 “neoliberal order” has seen much slower rates of economic growth amid rising inequality. Cornia and Court (2001), reporting on the results of a project on international inequality, find that “traditional” sources of inequality—land concentration, urban bias, inequality in education—do not explain the rise in inequality over the past two decades. They find that rising inequality is strongly linked to neoliberal policy reforms adopted in industrialized, transitional and developing countries alike. In particular, they highlight:

- *Tight fiscal and monetary policies*—IMF adjustment programs to stabilize inflation and reduce budget deficits have generated recessions and poverty surges. Cutting public spending to reduce deficits is a drag on growth, especially when the needs of the poor are not taken into consideration. High interest rate policies to curb inflation and maintain the confidence of foreign investors also adversely affect the domestic economy.
- *Financial liberalization*—Opening up to international capital flows has caused growing volatility in the form of financial crises, particularly since the mid-1990s (i.e. major financial crises in Mexico, East Asia, Russia and Brazil).
- *Privatization of industrial assets*—Ill-conceived privatization programs have in many cases led to the concentration of former state assets in the hands of former managers and a small financial elite.
- *Changes in labour market institutions*—Reduced regulation and employment protection, erosion of minimum wages, restrictions on collective bargaining, lower public sector employment and reduced public education expenditures have led to more informal employment, a declining wage share of GDP, and a growing wage gap between skilled and unskilled workers.
- *Tax and transfer systems*—Tax systems have become more regressive through greater reliance on sales taxes, while public expenditures have become less redistributive.⁹

Comparing the 1960-1980 period against the 1980-2000 period, the Washington-based Center for Economic and Policy Research looked at changes in economic growth, plus health, education and other social indicators, for 116 countries. After sorting countries into five groups based on common starting points, they found that economic growth rates for all five groups were much lower in the second period than the first period. Indeed, the poorest group went from average per capita GDP growth of 1.9% per year from 1960-80 to -0.5% per year from 1980-2000. The

second lowest group dropped from 3.6% per year in the earlier period to less than 1% in the later period. The study also found that progress in health and education indicators was reduced for most countries.

This empirical result is an indictment of the period of globalization of the past 20 years, heavily characterized by the imposition of liberalization, privatization and deregulation via IMF and World Bank structural adjustment programs. The authors note that this presents "a very strong *prima facie* case that some structural and policy changes implemented during the last two decades are at least partly responsible for these declines. And there is certainly no evidence in these data that the policies associated with globalization have improved outcomes for most low- and middle-income countries."¹⁰

The Empire Strikes Back

Recently, the World Bank has gone on the offensive to demonstrate that its brand of market liberalization is good for the poor and does not contribute to inequality. Bank economists David Dollar and Aart Kraay write that a group of "globalizers" have outperformed the "non-globalizers" in terms of GDP growth, and that globalization is good for the poor.¹¹

The group of "globalizers" selected is based on increased trade to GDP and reduced tariff barriers. For each indicator, the top 24 out of 73 developing countries are chosen (but only nine countries make both lists). In a critique of this paper, Rodrik (2001) argues that Dollar and Kraay's selection process is biased, and finds that a "clean" sample using the same dataset provides results that do not support the conclusion that the "globalizers" did significantly better.

A number of shortcomings suggest that Dollar and Kraay are exaggerating their findings in ways that are misleading. They report growth rates of 3.5% per year for the globalizers in the 1980s and 5.0% per year in the 1990s, but these numbers are pulled upwards substantially because they are weighted by population. Among the globalizers are India and China, the two most populous countries on the planet, both of which have had very fast growth rates in recent decades. Based on an unweighted average, the globalizers' performance looks less spectacular: 0.5% per year in the 1980s and 2.0% per year in the 1990s.¹²

Moreover, China and India are not exactly textbook cases of globalization, at least the sort promoted by the IMF and World Bank. China and India have had an export orientation, but have also moved slowly and strategically, and both still maintain quite protected domestic markets. China does not even have a convertible currency. Similar remarks can be made about other "globalizers," such as Malaysia, Thailand and Brazil. Indeed, this is the lesson of the Asian "miracle" economies, all of which protected domestic markets and had substantial government industrial policies while pursuing export markets.

This is in contrast to the experience of many Latin American and African countries that Dollar and Kraay seem to write off as "non-globalizers." Through IMF and World Bank structural adjustment programs, these countries have:

- had their import markets forced open, thereby undermining local industries;
- been coerced to sell off their water, electrical and telecommunications utilities to foreign investors, leading to unequal access and higher prices;
- been pushed to slash funding for social programs and implement user fees for health care and education; and,
- had to implement macroeconomic "stabilization" measures that jacked up interest rates.

In other words, the adherence of countries to structural reforms designed explicitly to increase their integration with the world economy has, in most cases, been a failure. Yet, Dollar and Kraay argue that these countries actually need more global integration.

Dollar and Kraay also conclude that "globalization is good for the poor," based on their finding that, on average, the incomes of the poorest quintile grew by as much as the per capita growth of income. The authors are again over-reaching in making such a sweeping conclusion. That economic growth raises the incomes of the poor is not particularly contentious among economists, although there are also many cases where this has failed to be the case. Even at face value, this study finds that growth has *no impact* on income distribution, a contentious finding. Whether globalization, and more specifically,

IMF and World Bank policies, lead to growth is simply assumed to be true, not tested.¹³

The evidence above suggests that rising inequality comes in the wake of adjustment programs and financial crises, and that the middle class might take the biggest hit as part of rising inequality (the poorest do not have much to begin with). Thus, measures that focus on the bottom quintile may be missing the real action in terms of rising inequality. Other aspects of neoliberal reforms have led to rising expenditures in the form of user-fees, higher utility bills and regressive taxes, factors that clearly hurt low- and middle-income people more, but that are not as easily captured in the statistics.

Conclusions

What is clear from the evidence is that global inequality is growing, and, in the context of a global economy, this is undesirable. Research indicates that higher levels of inequality are associated with higher levels of crime and political unrest, and with lower levels of human capital development and civic cooperation. Moreover, many studies find that countries with greater equality grow faster, other things being equal.¹⁴

Redistribution from rich countries to poor countries needs to come to the forefront of the agenda of the G-8, the IMF and the World Bank. To date, "aid" is synonymous with loans, often tied to purchase of goods and services from the donor country. Increasingly, private sector investment is being touted as a panacea, as rich countries fail to live up to commitments of allocating a mere 0.7% of their GDP to overseas development assistance. Governments need to get serious: aid budgets should be increased, grants should replace loans, and IMF-style conditionality should be eliminated. Moreover, debt cancellation would free up billions of dollars in resources currently allocated to payment of interest to Northern creditors.

Policy makers would also do well to heed the lessons of the post-war Golden Age that combined national industrial policies with an international framework to promote economic development, full employment and stability. The result was high rates of growth, low unemployment and falling inequality.

Instead, the past two decades have moved in the

opposite direction. Globalization has been premised on the expansion of unregulated markets, privatization and free capital flows. Worse still, these policies have been *imposed* on countries that need loans in order to service foreign debt and stay solvent with regard to the international financial system. The IMF and, to a lesser extent the World Bank, essentially set economic policy in poor countries, leaving them dependent on export of primary commodities and light manufacturing in *maquiladoras*, neither of which leave much income in the hands of the poorest.

WTO rules go further by locking in neoliberal reforms, preventing countries from taking measures for industrial development and building public sector services and enterprises—measures that played an important role in the development of already industrialized countries. But even rich countries have abandoned these measures in favour of the neoliberal policy fashion. All over the world, inequality has been growing as an inevitable result of a free market system.

Rectifying the situation calls for radical measures, as radical as the post-war Bretton Woods system was for its time. In the wake of the Asian crisis, a great deal of thinking occurred about a new "international financial architecture" but proposals for reform have since fallen off the table. A fundamental rethink of international institutions—the IMF, World Bank and WTO, in particular—is still in order. If not, another aspect of globalization—the globalization of protest and resistance—will continue to grow in accordance with rising inequality.

Endnotes

1. Using GDP per capita over such large time spans is problematic as a proxy for standard of living. However, in this area, comparable statistics are rare, and Maddison is very transparent about his underlying methodology.
2. HDR 1999: 36-37 and HDR 1992: 34.
3. Milanovic 2001:22-23; His data go back to 1950, but only after 1965 is the sample relatively consistent in total number of countries.
4. *ibid*: 30-33.
5. UNDP 1999:37.
6. Milanovic 1999: 29.
7. *ibid*: 52
8. Milanovic 2001: table 12, p. 44
9. Cornia and Court 2001: 13-21.

10. Weisbrot et al 2001.
11. Two papers are relevant: "Growth is good for the poor" and "Trade, growth and poverty", both published by the authors in 2001.
12. Dollar and Kraay 2001b:38, Table 3.
13. See Weisbrot et al 2000 for a detailed methodological critique of "Growth is Good for the Poor."
14. See Osberg 1995.

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