# Approaches to Globalization and Inequality Within the International System

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Overarching Concerns
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**Figure**

## Acronyms

| | |
|---|---|
| **BWIs** | Bretton Woods institutions |
| **ECA** | Economic Commission for Africa |
| **ECLAC** | Economic Commission for Latin America and the Caribbean |
| **FDI** | foreign direct investment |
| **G7** | Group of Seven |
| **G8** | Group of Eight |
| **GDP** | gross domestic product |
| **GNP** | gross national product |
| **HDI** | Human Development Index |
| **IDB** | Inter-American Development Bank |
| **ILO** | International Labour Organization |
| **IMF** | International Monetary Fund |
| **NAFTA** | North American Free Trade Agreement |
| **NEPAD** | New Partnership for African Development |
| **OECD** | Organisation for Economic Co-operation and Development |
| **RDB** | regional development bank |
| **UNCTAD** | United Nations Conference on Trade and Development |
| **UNDESA** | United Nations Department of Economic and Social Affairs |
| **UNDP** | United Nations Development Programme |
| **UNICEF** | United Nations Children's Fund |
| **UNU** | United Nations University |
| **WDR** | World Development Report |
| **WIDER** | World Institute for Development Economics Research |
| **WTO** | World Trade Organization |

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## Summary/Résumé/Resumen


### *Summary*

There is increasing evidence that inequality within countries has been growing for the last few decades. Increasing income disparities, in addition to contributing to social and political tensions, mean that higher economic growth rates are necessary to reduce poverty. There is also growing evidence that lower inequality leads to better growth performance. While there is considerable international debate about the causes of increasing domestic inequality, many agencies of the United Nations have recently pointed to globalization and liberalization policies as significant contributors.

There is sufficient international consensus on these matters to support policies that would reduce inequality through building the assets of the poor (education, access to land and credit), through reversing discrimination against the poor and biases against agriculture and rural development, and through a more cautious approach to financial and capital-account liberalization. Other policies would also help to reduce inequality, including income and asset redistribution toward the poor, as well as more equitable labour market policies, and policies to foster skills and technological development. However, such prescriptions as yet carry less consensus.

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### *Résumé*

Il semble de plus en plus avéré que l'inégalité à l'intérieur des pays s'est creusée au cours des dernières décennies. Non seulement les disparités croissantes de revenus contribuent aux tensions sociales et politiques mais il faut aussi des taux de croissance économique plus élevés pour faire reculer la pauvreté. Il semble avéré aussi qu'une réduction des inégalités entraîne une meilleure tenue de la croissance. Si les raisons pour lesquelles les inégalités se creusent à l'intérieur des pays sont âprement débattues au niveau international, de nombreuses institutions des Nations Unies ont récemment dénoncé la mondialisation et les politiques de libéralisation comme des facteurs y contribuant.

Ces questions font l'objet d'un consensus international suffisant pour plaider en faveur de politiques qui réduiraient les inégalités en renforçant les actifs des pauvres (éducation, accès à la terre et au crédit), qui mettraient fin à la discrimination envers eux et au parti pris à l'encontre de l'agriculture et du développement rural, et qui aborderaient de manière plus prudente la libéralisation financière et celle du compte de capital. D'autres politiques contribueraient également à réduire les inégalités: redistribution des revenus et des biens en faveur des pauvres, politiques plus équitables sur le marché du travail et mesures destinées à encourager l'acquisition de qualifications et le développement technologique. Mais ces politiques ne sont pas encore aussi consensuelles.

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### *Resumen*

Cada vez hay más evidencia de que la desigualdad dentro de los países se ha incrementado en los últimos decenios. Las crecientes disparidades en materia de ingresos no sólo contribuyen a las tensiones políticas y sociales, sino que también ponen de relieve la necesidad de tasas de crecimiento económico más elevadas para reducir la pobreza. Asimismo, cada vez hay más motivos fundados para suponer que una menor desigualdad propicia el crecimiento. Si bien las causas de la creciente desigualdad dentro de los países son objeto de considerable debate en el plano internacional, muchos organismos de las Naciones Unidas han señalado recientemente

que la mundialización y las políticas de liberalización contribuyen considerablemente al respecto.

El consenso internacional sobre estos temas es suficiente para apoyar políticas que reducirían la desigualdad al incrementar los activos de los pobres (la educación, el acceso a la tierra y el crédito), al erradicar la discriminación contra los pobres y los prejuicios contra el desarrollo la agricultura y el desarrollo rural, y al adoptar un enfoque más prudente de la liberalización financiera y de la cuenta de capital. Otras políticas también contribuirían a reducir la desigualdad, incluida la redistribución de los ingresos y el activo en beneficio de los pobres, así como políticas del mercado de trabajo más equitativas, y políticas que fomentaran las competencias y el desarrollo tecnológico. Sin embargo, se ha alcanzado un menor consenso en lo que respecta a estas fórmulas.

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## 1. Introduction

Accelerating globalization and rising inequality were two strong tendencies emerging from the 1990s. This paper examines the relationship between these trends—in particular, the possibility that globalization is causing the rise in inequality. The paper surveys the rapidly growing literature and attempts to distinguish areas of consensus and issues on which there is disagreement. It also compares and contrasts the approaches to these issues in various international organizations.

The following section sets the stage by recounting the policy debates during the 1990s as trade and capital account liberalization moved to the forefront of the global agenda. The paper then turns in section 3 to the accumulating evidence on rising inequality around the world, and the policy debate it has spawned, before considering—in section 4—the theoretical framework in which inequality trends have been addressed, with particular attention to recent theories that represent a sharp break with the past.

Section 5 offers a simple model in which various transmission mechanisms associated with globalization—trade, capital flows, migration, technology transfer—can be associated with increasing or decreasing inequality in developed and developing countries. This model builds on the Heckscher-Ohlin hypothesis, according to which trade tends to equalize factor prices in trading countries; the section ends with some criticisms of the model. Following that, in section 6, the paper examines the impact of economic liberalization policies on inequality.

Section 7 then identifies points of agreement and disagreement, and section 8 surveys the differences of approach to these issues among the major international organizations. Next, in section 9, some policy implications are drawn, before concluding in section 10 with some final observations.

## 2. The Return of the Poverty Focus in an Era of Globalization

The World Bank's *World Development Report 1990* (WDR90) marked a turning point in the international discussion of poverty (World Bank 1991). Having launched its "poverty focus" campaign in 1973, and then having abandoned it subsequently in the 1980s—years of debt crisis, structural adjustment and the Washington consensus—the World Bank again announced that poverty reduction is its overarching objective. Other agencies, notably the principal multilateral development banks and bilateral aid agencies, soon followed suit.

Following WDR90, much of the debate during the early 1990s swirled around the World Bank's policy prescriptions: poverty reduction requires, first and foremost, sound growth-oriented economic policies, such as non-inflationary fiscal and monetary policies, a foreign exchange regime that does not lead to chronic overvaluation, lower barriers to trade, a considerable degree of deregulation and privatization, as well as getting the prices right domestically. There was much continuity here with the Washington consensus prescriptions of the 1980s. Second, however, the strategy called for social investments in health and education that would give the poor greater access to opportunities in a growing economy, and, as an afterthought, social safety nets for those among the poor who lost income or employment through economic reforms and/or could not take advantage of new opportunities. Together, these three prongs constituted the World Bank's strategy of "pro-poor growth".

By mid-decade the debate had shifted ground, thanks to multilateral and regional—principally the North American Free Trade Agreement (NAFTA)—trade negotiations, the emergence of the World Trade Organization (WTO) at the end of the Uruguay Round, and discussions at the International Monetary Fund (IMF) on capital account liberalization. These discussions became the main vehicles for the debate on globalization. Moreover, the "sound, growth-oriented

policies" endorsed by WDR90 absorbed the globalization policy agenda, by emphasizing the development potential of greater openness to trade and foreign investment.

A significant part of this new agenda, namely advocacy of greater openness in the capital account, was set back by the severity of the Asian and other financial crises of 1997–1999. Restrictions on short-term capital inflows—such as the Chilean reserve requirement or *encaje*—and, in some quarters, even temporary controls on capital outflows—such as those imposed by Malaysia in September 1997—became acceptable as prudential, stability-enhancing measures. Capital account liberalization was not entirely abandoned; rather, it became part of the longer-term globalization agenda. Consequently, "openness" has come to mean trade liberalization plus promotion of longer-term foreign investment, particularly foreign direct investment (FDI). Along with sound domestic economic policies, developing countries were now being told that openness, in this sense, is central to poverty-reducing growth.

By the end of the 1990s, the World Bank was also emphasizing governance and institutions; accordingly, its decennial report on poverty, *World Development Report 2000/2001: Attacking Poverty* (WDR2000/2001), restated its three-pronged strategy as "promoting opportunity, facilitating empowerment and enhancing security" (World Bank 2001:6). This report assigned a greater role to the state than did its predecessor, WDR90, acknowledging—as did the earlier *World Development Report 1997: The State in a Changing World* (WDR97)—that market forces by themselves cannot ensure efficient outcomes, let alone equitable ones. A proper institutional framework—read as a well-functioning, incorrupt state—is necessary both to guide market actors and intervene on behalf of the poor.

## 3. The Re-Emergence of Inequality

Meanwhile, alongside the rehabilitation of poverty reduction as the overarching goal of development activity, another debate started to gain momentum in the 1990s, this one prompted by increasing income disparities, at the global level, and within industrial countries as well as in many developing countries.[1] At the global level, the consensus is that the trend ever since 1820 has been one of divergence, with increasing disparity between the world's richest and poorest households, at least up until the Second World War (Pritchett 1997; and several editions of the United Nations Development Programme/UNDP's *Human Development Report*). Some, however, argue that because of China's extraordinarily rapid growth since 1980, global divergence not only slowed down, but also may have reversed in the last decade (O'Rourke 2002). Berry (2002) goes even further to assert that, after increasing for more than a century, global inequality has not changed very much since around 1950.

At the same time, intracountry inequality has tended to increase, particularly since the 1970s, in both the developed North and the developing South. For this reason, the focus of this paper is on intracountry inequality rather than global inequality. Moreover, national inequality is more easily modifiable through policy interventions, and is more likely to pose challenges to social cohesion and to be a source of political friction, since people are more wont to draw invidious comparisons with their fellow citizens rather than with those living in other countries (Altimir 2002). However, it is also true that for the very poorest countries—for example, most of sub-Saharan Africa—the most compelling issue is not widening internal inequality, even though this may be occurring; rather, it is pitifully low average incomes and living standards generally: the challenge in such countries is to induce substantial, sustained and broadly-shared economic growth. Only then, over time, will the huge discrepancies in living standards between such

[1] The nature and scope of inequality is not captured by income disparities alone. For example, asset inequality (discussed below) is typically greater than income inequality. Inequality in educational attainment, health standards, access to clean water and sanitation, or access to government services, including the protection of the law, constitute the social face of deprivation cited by the poor themselves. Hence, a range of economic and social indicators is needed to gauge inequality, and some of these indicators are not easily quantifiable or comparable across communities or nations. Income inequality is difficult enough to capture through consistent data sets, but more data are available than for other indicators. However, by itself income inequality is an inadequate gauge of the extent and depth of inequality.

countries and the North be reduced. Put differently, no amount of internal redistribution in the world's poorest countries begin to meet the needs of the vast majority.[2]

A critical contribution to knowledge about intracountry inequality has recently been made by the United Nations University/World Institute for Development Economics Research (UNU/WIDER) with the support of UNDP, which has constructed a World Income Inequality Database covering 151 countries—developed, developing and transition—and includes 5,000 observations over the period 1950–1998. The database, which is continually updated, represents the most comprehensive, highest-quality source of statistical information on income inequality available. In turn, the database has served as the cornerstone for a research project, Rising Income Inequality and Poverty Reduction: Are They Compatible?, jointly sponsored by UNU/WIDER and UNDP. The key findings are summarized in Cornia and Court (2001); the project includes a series of 16 background studies, analyzing trends in income distribution, examining traditional and more recent factors causing widening income disparities, including some country case studies.[3]

The UNU/WIDER project distinguishes between traditional and newer sources of income inequality. It concludes that traditional sources of inequality, such as land concentration, urban bias and inequality in education, although still significant, do not appear to be the causes of worsening inequality. Nor do trade and technology seem to be the causes, notwithstanding perceptions to the contrary. Instead, the project points to new causes of inequality such as excessively liberal economic policy regimes, and the way in which such policies have been carried out (Cornia and Court 2001:6–7). In particular, macroeconomic stabilization policies, financial sector and capital account regulation, and labour market policies—in medium- and high-income countries—have all contributed toward widening inequalities, and therefore need to be reconsidered (see section 6).

At the national level, there is more debate both as to the evidence on inequality and its interpretation. The shift toward greater inequality started in the United States and United Kingdom in the 1970s and became more widespread by the mid-1980s, both as liberal economic policies became the norm around the world (Cornia and Court 2001), and as the globalization agenda began to accelerate. Increasing inequality in the industrial countries reversed a trend toward greater equality predicted by Kuznets (1955, see section 4). However, increasing inequalities in the developing countries, or at any rate in low-income countries at a relatively early stage in their growth, were consistent with the Kuznets theory.

Increasing inequality is not only a matter for economic theorists, of course. It is seen as a concern in its own right, particularly for those who tend to put a premium on distributional equity. And those less concerned about inequality and distribution per se, for example, Cooper (2002), but now in agreement with the overarching priority of poverty reduction—read at a minimum of lowering the proportion of people living on $1 or less a day—are caught in a dilemma. If pro-poor growth plus openness—that is, the globalization strategy—results in widening inequalities, then there are several challenges to the strategy. At best, if the benefits of growth are heavily skewed to the rich, while the poor benefit only slightly, then a much faster—and possibly unattainable—overall rate of growth would be required to achieve the desired result of poverty reduction. For example, in countries with high income inequality—for example, a Gini coefficient[4] of 0.60, as in the case of Brazil—a 2 per cent per capita growth rate

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[2] The question is how can such growth be induced in the poorest countries? This would also take us far afield from the focus of the current paper, but the short answer would be increased levels of investment, far above the 10 per cent of gross domestic product (GDP) prevailing in much of Africa, for example. Alternatively, could massive redistributive transfers from North to South reduce global inequalities? To a certain extent, that is precisely what official development assistance is for—to help raise local investment levels rather than support local consumption. Again, this would be the subject of another paper, and has been the focus of a considerable literature, as well as the International Conference on Financing for Development, held in Monterrey, Mexico, in March 2002. The key issues are the effectiveness of aid in increasing investment and growth levels, and whether better targeted aid, and/or a greater volume of aid would help bring about substantial, sustained and broadly based growth.

[3] UNU/WIDER has sponsored a number of related studies on income inequality, including the Dagdeviren et al. (2002) study cited here.

[4] A measure of inequality within a population.

will allow poverty reduction at 3 per cent per year, while countries with lower inequality—a Gini of 0.30—will experience poverty reduction at 5.5 per cent per year (Ravallion 2001). At equal growth rates, countries where the Gini is 0.2 experience poverty reduction at twice the rate of countries where the Gini is 0.6 (World Bank 2001:chapter 6). Worse, if widening inequalities mean that the poor are not benefitting at all or are experiencing a real deterioration in their living standards, then no amount of growth can help. The only solution would be to redistribute in favour of the poor (Aghion et al. 1999; Dagdeviren et al. 2002).

The prospect of redistribution poses a serious challenge to those who believe strongly that any interference in market-determined incomes undermines incentives to invest and prosper, and therefore undermines growth itself. Easterly (2001) is a good example of this; however, Easterly (2002) also finds that inequality is a hindrance to development. Others have questioned whether inequality has, in fact, grown within countries (Deininger and Squire 1996; Dollar 2001). This is a debate on the interpretation of the statistical evidence. In other words, if the trend is to greater inequality in some countries, and less inequality in others, then there is no global tendency to greater domestic inequality in the first place, let alone a presumption that globalization is universally increasing (domestic) inequality. Moreover, even if there is a general trend toward greater intracountry inequality, globalization is not necessarily the culprit; domestic factors could be the principal causes.

Yet others, on the other hand, make a distinction between the distribution of income and the distribution of assets such as land. These observers acknowledge that even if there are unhindered incentives to grow and prosper, unequal land distribution provides large landowners with greater opportunities than smallholders or the landless. But the fact that land reform is so politically contentious has meant that substantial redistribution of this asset is unlikely to take place, unless market-based mechanisms are available (World Bank 2001; Thomas et al. 2000).

Therefore, for those resistant to policies of income redistribution, the focus with respect to assets has remained on human capital, as in the World Bank's 1990 pro-poor strategy. Investment in education and health, skewed in favour of the poor—via primary education and basic health services—is politically easier than land reform, and it can be expected to build the assets of the poor over time.

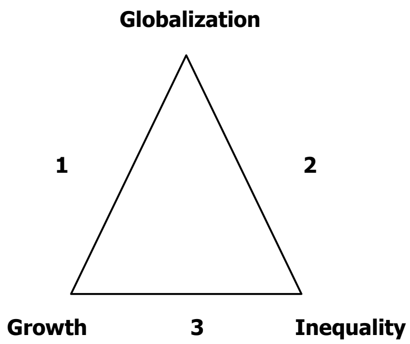
## 4. The Theoretical Context

The evolving policy context of the debate on globalization and inequality makes it clear that the issues cannot be properly addressed without incorporating economic growth and poverty reduction into the discussion. According to proponents, the ultimate rationale of globalization, facilitated by policies of economic openness and liberalization, is poverty reduction. The principal means of achieving poverty reduction is economic growth—preferably "pro-poor" growth. Whether or not openness facilitates growth, or whether the causality flows in the opposite direction, is itself the focus of another debate, which would take us too far afield (Rodriguez and Rodrik 2001; Cooper 2002). Suffice it here to say that there is as yet no consensus on the direction of causality, particularly if the appropriate sequencing of "openness" is subject to varying interpretations—trade liberalization all at once, or phased over time, with export promotion taking place earlier and import liberalization much later. It is clear, however, that the Bretton Woods institutions (BWIs) are firm in their belief that openness—closer to the all-at-once variety, with an exception for the capital account—facilitates growth and poverty reduction (Dollar and Kraay 2000).

Given the crucial role of growth in poverty reduction, particularly important is the relationship between growth and inequality, which has been the subject of an extensive and rapidly growing literature over the past decade. For present purposes, the issues may best be posed as a set of triangular relationships between globalization, growth, and inequality (figure 1). Globaliz-

ation—defined as openness to trade and factor movements—may induce growth as well as greater inequality. But what of the relationship between inequality and growth?

**Figure 1: Relationships between globalization, growth and inequality**




The points of the triangle represent a process (globalization) and two generic outcomes (growth and inequality). Therefore, studies on the relationships represented by sides 1 and 2 are necessarily about the efficacy and impact of globalization. Is it conducive to growth? Does it increase or decrease inequality? Thus, these kinds of studies are inherently debates about the policy agenda of globalization. Does increased openness to trade, investment, migration or technology have predictable growth or distributional impacts, or do they vary among different countries, and if so, via what circumstances? Can policies of openness be shaped or complemented by other policies—for example, public investment in education or infrastructure in order to catalyze better (higher) growth or (lower) inequality outcomes?

The debates on side 3, on the other hand, enquire whether growth leads to rising or falling inequality (and why), and whether greater inequality facilitates or impedes higher growth. These studies essentially revisit and challenge the Kuznets (1955) inverted U-shaped curve, which held that in the long-term process of transformation, developing countries are likely to experience increased inequality over several decades, and if (or when) they reach a turning point in their industrialization, inequality will begin to fall. However, while Kuznets (1955) felt he expounded a "positive" and universal relationship based on his empirical work, which led in the decades after he wrote to a certain passivity about income distribution, recent studies often have a more normative character. If there is a variable rather than an immutable relationship between growth and inequality, then policy makers may, for example, wish to intervene to mitigate the impact of growth on inequality or reduce inequality in order to stimulate growth.

Increasing inequality in developing countries is quite consistent with the Kuznetsian hypothesis. It was also consistent with Lewis's (1954) model of growth, which held that until surplus labour is absorbed by the growing modern and urban sector, rural and traditional sector wages will remain at the subsistence level while profits and urban wages grow. But it was at odds with the predictions of more conventional economic theory—based on the Heckscher-Ohlin and Stolper-Samuelson models[5]—in the context of greater openness to trade and factor mobility, that is, globalization. This body of theory hypothesizes that specialization in trade would lead to higher unskilled wages in developing countries and lower unskilled wages in developed countries, ultimately converging to a common level (see section 5).

The opposite was predicted for returns to capital—higher returns in developed and lower in developing countries, also ultimately converging—with the result of falling inequality in developing countries and widening inequality in developed countries—consistent with the

[5] See Ohlin (1933), Samuelson (1948, 1949) and Stolper and Samuelson (1941). John Williamson (1983:chapter 3) provides a textbook exposition of both Heckscher-Ohlin and Stolper-Samuelson.

observed trends noted above. Thus, neither the Kuznetsian hypothesis nor conventional theory could wholly explain the universal trend toward greater inequality: both only got it half-right—Kuznets for the developing world and conventional theory for the developed world. Moreover, globalization could be seen through the lens of conventional theory as part of the problem (of increasing inequality) in developed countries, but not part of the solution (of falling inequality) in developing countries.[6]

Neither Kuznets nor conventional theory, however, anticipated more recent studies analyzing the interrelationship between growth and inequality. In Kuznets' hypothesis, inequality during the early stages of development was a regrettable but unavoidable, and ultimately worthwhile, price to pay. For its part, the Lewis surplus labour model supposed that the traditional sector (agriculture) is primarily important for supplying unlimited low-wage labour to the modern sector (industry) where increasing profits would be earned, thereby increasing inequality, and investment and capital accumulation would take pace, providing the engine of economic growth for the economy as a whole. Ultimately, the industrial (modern) sector would supersede the agricultural (traditional) sector, the supply of surplus labour would be exhausted, wages would rise with growing demand for industrial workers, and inequalities would fall.

More recently, however, scholars have subjected the relationship between growth and inequality to greater scrutiny. In particular, a growing body of critics claim that far from being an unavoidable price to pay on the road to industrialization and development—à la Kuznets—greater inequality actually penalizes poor countries by reducing their growth potential.[7] Essentially, these critics reject the surplus labour model of accumulation, along with its simple two-sector characterization of the economy, in which only the modern sector can be the source of growth. Instead, they argue capital markets are highly imperfect, which results in considerable underinvestment, particularly when there are wealth and income inequalities, by those who are underendowed with assets and income. The policy implication is that redistribution of income and assets to the poor can increase the level of investment and enhance growth (Aghion et al. 1999).

The implicit theoretical framework of these revisionist thinkers is New Growth Theory, particularly models of endogenous growth, for example, Benabou (1996). These models are free of the stark binary choices imposed by the older labour surplus model, with its overwhelming emphasis on industrialization. In the context of development, such models suggest that the so-called traditional sector, agriculture, should itself be the source of growth, and not simply a source of "unlimited" labour at subsistence wages.

The robustness of the relationship between inequality and growth is critically dependent on the quality and consistency of the underlying data. Knowles (2001) asserts that when income inequality is measured in a consistent manner, as in the aforementioned UNU/WIDER World Income Inequality database, the inverse correlation between inequality and growth is not statistically robust. However, Knowles goes further to argue that the key variable for measuring inequality is not gross income—the usual basis for such empirical studies—but disposable income. In his study, Knowles captures inequality through expenditure rather than income data, and he finds a significant negative correlation between inequality—measured by expenditure data—and growth. Knowles' useful study serves as a cautionary reminder that inferences made from statistical evidence are only as good as the quality of the underlying data.

For his part, Rodrik (1999) argues that the openness required by globalization is no guarantee of better growth performance or poverty reduction; indeed, he cites the historical record to show how growth performance—particularly in Latin America—was superior under the import-substituting industrialization regimes until the 1970s. However, he also adduces evidence to

6 Adrian Wood (1994) is a proponent of this view.

7 Key contributions were by Alesina and Rodrik (1994), Perotti (1996), and Persson and Tabellini (1994), and summarized recently by Aghion et al. (1999).

demonstrate that countries characterized by greater inequality—of income, or between ethnic or regional groups—fare poorly when faced with the economic shocks that accompany globalization. Indeed, there is a strong negative relationship between growth performance and the Gini coefficient of inequality: for example, a 10-point difference in the Gini—the difference between highly unequal Brazil and less unequal Costa Rica—is associated a growth rate lower by 1.3 percentage points.

The reason for this differential growth performance, according to Rodrik, is that countries such as Brazil with greater inequality have greater difficulty in implementing the necessary adjustment policies required to respond to the economic shocks—for example, deterioration in the terms of trade, sudden capital flight—that accompany greater openness. Because such adjustment policies often involve depreciation of the local currency, public expenditure cuts or tax and interest-rate increases, they cause losses of income, employment or other social and economic turmoil. Where disparities are large to begin with, as in Latin America, governments are unwilling or unable to mediate the heightened social and political conflicts caused by adjustment. As a result, they defer needed adjustments and rely on growth-reducing or inflationary policies. On the other hand, Rodrik also finds that countries with more social insurance—such as the Republic of Korea—fare better in coping with openness and economic shocks (Rodrik 1999:83–88).

Long before the advent of these revisionist critics, from the mid-1960s until 1990, empirical evidence from the Asian tigers weakened the Kuznetsian presumption that rising inequality was the unavoidable price of growth. Land redistribution following the Second World War, followed by an interventionist policy to support agriculture and the rural sector, formed the basis of the early growth strategy of Japan, the Republic of Korea and Taiwan Province of China. Indeed, agriculture remains a highly protected sector in these countries, long after they have moved on to become predominantly industrial economies. Support of the agricultural sector, in which most of the pre-industrial labour force was employed, served to underpin the incomes of agricultural workers and their communities. Moreover, complemented with government programmes and public sector investment to improve agricultural productivity, the development strategy of the Asian tigers served to increase rural sector incomes. Finally, the Asian tigers have put considerable emphasis on social investment in the health and education sectors. And the tradition of lifetime employment, while economically inefficient, has served to provide social security and stability for millions of workers. As a result of all these policies, East Asian income disparities are relatively low by world standards.

While the growing weight of evidence is on the side of the revisionists, it should be pointed out that there is still resistance in some quarters. In particular, the World Bank argued in WDR2000/2001 that there is no systematic relationship between growth and inequality. However, it does acknowledge that lower "initial inequality" in income, and even more so in assets, can raise economic growth.

> These results open the possibility that policies to improve the distribution of income and assets can have a double benefit—by increasing growth and the share…that accrues to poor people. This is not to say that every pro-equity policy will have such desired effects. … Expropriation of assets on a grand scale can lead to political upheaval and violent conflict, undermining growth (World Bank 2001:56–57).

The report cites "win-win" examples of land reform in West Bengal, mass public school education in Indonesia and Taiwan Province of China, and distributing pensions to women in South African households (World Bank 2001:box 3.8).

## 5. Inequality Transmission Mechanisms: A Simple Model

Economic globalization usually connotes economic integration among countries, brought about by the movement of goods, services, technology and factors of production, which would otherwise be restricted to their countries of origin. In other words, trade—referring to the international movement of goods and non-factor services—and factor mobility—referring to international capital investment and labour migration, as well as technology transfer—are the concrete expressions of economic globalization. The movement of goods and factors among countries has a direct impact on relative factor earnings between and within countries, and hence will impact income distribution and inequality.

The following stylized facts are assumed for analytical purposes. There are two categories of countries, developed and developing. There are two factors of production, capital and labour—or two classes of labour, skilled and unskilled. Relative to developing countries, developed countries have abundant capital (or skilled labour) and scarce unskilled labour. Owners of capital enjoy higher incomes than workers (owners of labour). The distribution of income, or income inequality, is thus reflected in the spread between the relatively high earnings of capital and the relatively low earnings of labour. When this spread narrows, inequality falls, and vice versa.

### *Trade*

Trade between countries brings about a tendency to equalize factor prices across boundaries.[8] Each country's comparative advantage attaches to goods or services intensive in its abundant factor. Thus, developing countries with abundant labour (earning low wages) and scarce capital (yielding high returns) will specialize in and export labour-intensive goods, while developed countries with scarce labour (high wages) and abundant capital (low returns) will specialize in and export capital-intensive goods. As a result, trade will increase demand for labour and hence wages in labour-abundant countries, while decreasing labour demand and lowering wages in labour-scarce countries. Ultimately, falling wages in developed countries and rising wages in developing countries will converge to a common level. Similarly, returns to capital will converge, by increasing in capital-abundant countries and falling in capital-scarce countries. This is what the theory of global "convergence" is all about.

Assuming there are two classes of income-earners, low-income workers and high-income capitalists, how does trade affect income inequality within countries that trade with each other? The answer, in this simple model, is that it has opposite tendencies in developed and developing countries. Trade will increase inequality in developed countries that import labour-intensive goods from low-wage developing countries, since such imports create competition in labour-intensive industries, and thereby put downward pressure on unskilled workers' wages. In contrast, workers in developing countries exporting labour-intensive goods will enjoy rising wages. Inequality will fall in such countries. These tendencies will be reinforced by the corresponding trends in returns to capital, which increase in developed countries—capitalists' returns rise while workers' wages fall—and decrease in developing countries—capitalists' returns fall while workers' wages rise.

If trade liberalization were uneven across sectors, for example, if developed countries maintain trade barriers in sectors in which the developing countries are competitive (textiles and agriculture), then this would retard the impacts on inequality on both sides.

### *Factor mobility*

If there are two productive factors—capital and labour—that are mobile across boundaries, then their movement will impact factor earnings and income distribution. Typically, if they were free to move, then the simple model would predict factors that would travel from countries in which

[8] This is the celebrated Heckscher-Ohlin theorem, as later embellished by the Stolper-Samuelson hypothesis on factor price equalization.

they are abundant, and therefore earn low incomes, to countries in which they are scarce and earn higher incomes. In so doing, they will decrease factor supply and increase factor earnings in countries of origin, and increase factor supply and reduce earnings in countries of destination. Thus, workers moving from labour-abundant developing countries to labour-scarce developed countries would reduce wages in the developed countries and increase wages of workers remaining in the developing countries.[9] Correspondingly, capital moving from developed to developing countries would decrease yields in the latter, while increasing them in the former.

How would free factor mobility affect income distribution? In developed countries, capitalists' incomes would rise further, and workers' incomes would fall; income inequality would therefore increase. In developing countries, the opposite would happen: capitalists' incomes would fall and workers' incomes would rise; income inequality would therefore decrease. The impact of factor mobility on inequality exactly parallels that of trade between developed and developing countries. It follows that if globalization features trade in goods and non-factor services, as well as internationally mobile factors, then these will reinforce the tendency each would have separately, namely to increase inequality within developed countries and decrease inequality within developing countries.

There is, however, an important distinction between capital and labour as productive factors. Workers embody their own labour, and therefore when labour migrates, workers move from their countries of origin to their countries of destination. In contrast, owners of financial capital—bond and shareholders, banks making loans, owners of transnational corporations—typically do not move with their capital to the points of destination. Rather, they remain resident in their countries of origin, that is, the developed countries. This distinction between residency and deployment would seem to reinforce the above tendencies further. Capitalists from the developed countries investing in the developing countries would not only enjoy rising returns at home by reducing the supply of domestic capital; they would also benefit from higher returns on their portfolios abroad. In so doing, income inequality between owners of capital and workers would widen further in the capital-sending developed countries, while it would fall in the developing country destinations.

In the twentieth and twenty-first centuries, another distinction between capital and labour mobility emerged. Capital, with a significant hiatus between the First and Second World Wars, has been relatively mobile, while labour has been relatively immobile. However, skilled labour is more globally mobile than unskilled labour. The theoretical impact on inequality of these differential factor mobilities would be to attenuate both growing inequality in the developed countries, since there is relatively little unskilled immigration to keep wages down and falling inequality in the developing countries—that is, no unskilled emigration to push wages up.

With regard to both capital and skilled migration, the presumption would be that since developed countries would be relatively abundant in these factors, they would both migrate to the developing countries. In fact, the evidence suggests that capital and skilled labour do not migrate to the poor countries as much as among the developed countries. There is also a tendency for skilled labour to migrate from the developing to the developed countries—that is, a "brain drain". Indeed, with capital market liberalization, there is a propensity for capital flight to the developed countries, particularly during periods of crisis or instability—globally or regionally. Such "perverse" factor movements would also result in the opposite tendencies in inequality to those suggested above: developed countries, with abundant capital and skilled labour, would see inequality fall while developing countries would experience rising inequality.[10]

[9] Aghion and Williamson (1998) show the huge impact of large-scale migration of unskilled labour from Europe to North America—and the other parts of the New World—in the nineteenth century. Consistent with this simple model, migration contributed to wage convergence as well as to greater income equality in the countries of origin, and growing inequality in the destination countries.

[10] However, skilled emigration from the developing countries would also reduce the size and total income of the high-wage group, with the possibility that household inequality will fall. The net effect would depend on the speed and extent of wage increases on the one hand, and the speed and extent of the decline in the size of the high-wage cohort on the other.

### Technology

Technology and technical change will impact on the distribution of income depending on how it uses or displaces productive factors. Labour-intensive technology should increase labour employment and incomes; labour-displacing (or capital-intensive) technology will do the opposite. In a two-factor economy, labour-intensive technology will reduce income inequality and capital-intensive technology will increase it. The actual impact on inequality will then depend on the factor bias of the technology. If technical change is exogenous and universally biased toward capital- (or conversely labour-) intensity, then it will universally increase (decrease) income inequalities within countries. If technical change is endogenous, and responds to profitable opportunities in favour of relative factor abundance (for example, if labour is relatively abundant and cheap, technology will be labour using), then it will favour capital in developed countries and labour in developing countries. It will therefore increase inequality in developed countries and decrease it in developing countries.

When labour is differentiated by skill level, that is, there are at least two classes of labour—high-wage skilled and low-wage unskilled—the interaction of technology with different classes of labour is critical. However, the analytics are similar to the case in which there are two homogeneous factors, capital and labour, with skilled labour taking the place of capital. Thus, if technical change is biased in favour of (un)skilled labour, then it drives up the relative incomes of the (un)skilled. If technical change is endogenous, then it will be biased in favour of the category in more abundant supply. In this case, if developed (developing) countries have an abundance of skilled (unskilled) labour, then technical change favouring skilled labour will increase inequality in developed countries—or at least stop it from falling—and technical change favouring unskilled labour will decrease it in developing countries—or stop it from rising.

In a globalized economy in which technical change emanates predominantly from the developed countries—where research and development headquarters are located—in response primarily to local developed-country conditions and if it is skilled-biased, then technical change will increase inequalities universally, much as capital-biased technical change would.

To sum up, the above simple model is based on neoclassical precepts of how an idealized market economy would work, rather than on reality. Nonetheless, given the strong drift toward market-based economic policies in the last quarter of the twentieth century, the model is useful in suggesting the underlying tendencies in distribution in the presence of globalization.

### Criticisms

On the other hand, it is true that the model is too simple, and does not do justice to the complexity of the world and to the way markets actually operate. As mentioned, capital does not tend to flow in great volumes from rich to poor countries, despite the fact that in the last two decades many poor countries have abolished earlier restrictions on foreign investors, and have adopted more "business-friendly" environments. Moreover, recent empirical work suggests that imports from developing countries have played only a minor role in widening income disparities in the United States, for example Aghion et al. (1999:1636–1637).

Atkinson (1999), who focuses only on rising inequality within the Organisation for Economic Co-operation and Development (OECD) countries, postulates a three-bloc model, involving two industrialized countries—"Europe" and "the United States"—and the developing countries. He shows the inadequacies in such a model of the Heckscher-Ohlin hypothesis in the presence of effective minimum wage protection or social security benefits in the European bloc, which result in rising unemployment in Europe rather than increasing wage inequalities either in Europe or the United States. He also adduces data to show that market-determined increases in inequality—due to trade liberalization and technical change—can be, and in many countries, for example, Canada, have been largely offset by redistributive fiscal policy, that is, through higher taxes on the "winners" and income transfers to the "losers". But such redistributive policies are

socially determined through the political process. In particular, Atkinson (1999) argues that social norms in OECD countries have shifted against the degree of policy-determined redistribution effected in earlier decades, causing governments to reduce the progressivity of tax measures as well as the scale of income transfers. Hence, Atkinson concludes that rising inequality is not inevitable: it is subject to political choice and leadership, so that fiscal policies of the 1980s and 1990s accommodating greater dispersion in income could be reversed.

Bhagwati (2000), writing predominantly within the neoclassical paradigm, takes issue with the simple model, arguing that forces other than trade liberalization, particularly capital accumulation and technical change, have offset the tendency of unskilled labour-intensive goods prices to fall; indeed, he believes such prices have risen mildly. According to the simple neoclassical model, these forces should have served to increase unskilled wages in developed countries. At the same time, Bhagwati (2000:132–133) does not deny that real wages in the United States have evinced a prolonged decline. He therefore concludes that unskilled wages in the developed countries are higher than they otherwise would have been.

More generally these problems suggest there may be a need for economics to free itself from the strictures of the neoclassical model, which posits capital as a homogeneous and measurable factor of production. Neo-Keynesian scholars such as James Galbraith and his colleagues (2001) have made an encouraging start in this direction.

## 6. Policies of Economic Liberalization

Globalization can affect inequality in other ways as well. First, "market-friendly" policies of economic liberalization, in the form of greater openness to trade, capital flows or migration, whose fundamental rationale may be to stimulate growth in sectors with comparative advantage, may also negatively impact income distribution, particularly in exposing previously protected domestic industries to greater foreign competition, causing income and employment losses.[11] Stiglitz (2002:chapter 3) argues that the fundamental problem of market-oriented reforms urged on developing countries is the unreasonable rapidity and sequencing of their implementation. Thus, hasty privatization and trade liberalization often lead to considerable and long-lasting unemployment before the private sector takes up the slack.

Second, greater openness may be associated with greater volatility and economic shocks, for example, through capital surges or shifts in the terms of trade. Volatility, in turn, tends to affect the vulnerable and the poor the most.

Third, economic stabilization and adjustment measures implemented as part of a policy of greater openness may increase inequality through rapid compression of demand, fiscal deficit reduction, and expenditure and subsidy cuts that affect the poor disproportionately. Fourth, liberalization of the financial sector leads to interest rate increases that adversely affect low-income borrowers, while benefitting more wealthy lenders or creditors.

Fifth, economic liberalization has also entailed policies impinging on the domestic social compact and income distribution (Berry and Stewart 2000). For example, labour-market policies have been subjected to reforms that were meant to reduce "rigidities" and increase the flexibility of managers to hire and fire workers, but have also led to rising wage inequality in middle-income developing and OECD countries. Greater downward wage flexibility, reduced regulation, reduction of employment protection and dilution of labour unions' bargaining power—plus dwindling union membership—and erosion of minimum wages have all contributed to this tendency (UNDP 1999). And to the extent that liberalization policies have reinforced the prevailing inequality in asset distribution through reaffirmation of existing

[11] Berry 1998; Berry and Stewart 2000; Cornia and Court 2001.

property rights, or privatization of public assets, this is likely to be another source of growing inequality (Berry and Stewart 2000).[12]

Finally, reducing the role of the state has been a key element of the liberalization trend of the 1980s and 1990s. In the postwar decades, more open developed countries established progressive taxation, social programmes and income transfers to protect their populations against the risks of fluctuating import or export prices. But progressive income taxation has increasingly given way to consumption and indirect taxes, and the level and composition of expenditure, insofar as such policies affect social spending or other entitlements, have become less redistributive. Indeed, in a time-series analysis, Rodrik (1997) shows that social protection expenditure and government consumption both decline as openness increases. In developing countries, the tax and transfer system has typically never been progressive to begin with, thus liberalization has served to make it even less so.

To what extent are any of these trends caused by globalization, rather than the resurgence of liberalization (or neoliberal policies)? One of the legacies of the inflationary 1970s is that fiscal deficits constitute "unsound macroeconomic fundamentals". It follows that jurisdictions wishing to maintain a higher level of public expenditures in order to discharge their public responsibilities, including investment in education or infrastructure, or the redistribution of income, must also maintain a commensurately high level of taxation or revenue generation. However, faced with internationally mobile capital and skilled labour, high-tax jurisdictions are increasingly at a disadvantage as countries—or state and provincial jurisdictions—around the world compete to attract and retain foreign investment and skilled workers. Accordingly, income taxes have become less progressive and taxation on capital has fallen.

There are other forces at work, stemming from the nature and scope of globalization. Tanzi (2001) points to "fiscal termites" gnawing away at the foundations of tax systems, reducing the capacity of states to raise revenues. His fiscal termites include the rapidly rising trend toward electronic commerce, much of it untaxable; multinationals' intracompany trade, utilizing tax-evading transfer pricing; the rise of offshore financial centres reported to sequester some $5 trillion in deposits, interest on which is not fully taxed; derivatives and hedge funds, which are both difficult to tax and are used for tax-avoidance; and the unwillingness or inability to tax internationally mobile financial capital. To Tanzi's list could be added the often-overlooked fiscal implications of trade liberalization, particularly for the poorest countries. The latter typically have a thin income and sales tax base, both because of the impoverishment of their people and absent or rudimentary tax administration, and therefore rely heavily on import tariffs for government revenues. To the extent that trade liberalization policies result in the reduction or abolition of tariffs, government revenues can be substantially reduced.

It seems clear that the trends eroding the capacity of states are caused both by globalization—the international integration of economies—and by liberalization—policies that facilitate globalization, including domestic macroeconomic and structural policies. Therefore, if an international consensus were to be built to arrest these tendencies, then it would necessarily have to deal with both the growing volume and complexity of cross-border transactions, and sophisticated financial innovation, as well as the political legacy of liberalization. In other words, it would have to advance a political agenda including more taxation, more expenditure and more redistribution.

[12] Proposals such as those advance by De Soto (2000) to bestow legal title on the de facto property holdings of the poor (rural or urban dwellers), are based on the notion that legal ownership would give the poor greater access to credit (or capital). However, it would also serve to reaffirm the existing unequal distribution of property.

## 7. On What Issues Is There Agreement?

First, is inequality increasing? There is agreement that global inequality—the disparity between the world's richest and poorest households—has continued to increase, although some would maintain that the rate of divergence has slowed down or even stopped in the last two decades.

Second, has intracountry inequality increased? This question is more contentious, and the literature is often confusing. Part of the problem is this question tends to get conflated with the issue of global inequality, because some argue that inequality between countries is more important than inequality within countries (O'Rourke 2002). Generally speaking, the World Bank has viewed the evidence on inequality trends within countries as ambiguous, with some countries' inequality increasing and others' decreasing.[13] However, as a result of the more extensive World Income Inequality Database constructed by UNU/WIDER and UNDP (Cornia and Court 2001), the weight of opinion at the time of writing has shifted in favour of those arguing that inequality in most countries has indeed increased.

Third, is increasing inequality a problem? Some experts think not; Cooper (2002) puts it thus, "Greater global inequality is a natural consequence of uneven growth, which is better than none. The key question is whether people's lives are improving". However, there is a consensus that (i) growing inequalities make poverty reduction more difficult; and, more contentiously, that (ii) inequality makes growth more difficult. In other words, lower inequalities make for greater productivity and efficiency, as well as greater equity. The strongest area of consensus is that greater equality in assets, particularly land and education, can lead to better growth performance, and conversely. Partly because it overturns our previous understanding, the relationship between growth and inequality promises to be a crucial area for further research.

Fourth, what is causing increasing inequality, and is globalization—or liberalization—a key cause? On this key set of issues, there is considerable debate and little agreement. The World Bank argues that

> stable monetary policy, openness to international trade, and a moderate-size government raise the incomes of poor people as much as average incomes. In other words, these policies do not systematically affect income distribution. Other policies, such as stabilization from high inflation, may even disproportionately favour poor people. And greater financial development favours growth and may lower income inequality by improving access to credit (World Bank 2001:52–53, citing Dollar and Kraay 2000 and Li et al. 1998).

This is in stark contrast to the recent UNU/WIDER study claiming that the key causes of growing inequality are excessively liberal economic policies of macroeconomic stabilization, financial liberalization and deregulation, labour market deregulation, and the downsizing of the state (Cornia and Court 2001:2–3). This view is substantially presaged in the earlier report of the United Nations Conference on Trade and Development (UNCTAD 1997), which also maintains that trade and price liberalization have reduced real wages for workers in many developing countries and has not benefitted farmers as predicted.

The World Bank argues instead that the roots of growing inequality—where it actually is growing—are specific to each country. However, a common cause in many low-income countries is the policy bias against agriculture and rural development, which is the locus of most of the population as well as most of the poverty in such countries. Other country-specific causes include internal rigidities to prevent migration of the poor to growing regions, or other forms of discrimination against poorer regions; inequalities in education or inadequate physical

13 This position is based on the Deininger and Squire (1996) dataset, which has been criticized by James Galbraith et al. (2001) and Dagdeviren et al. (2002), inter alia.

infrastructure; biases against women or ethnic minorities in the labour force; and institutional restrictions, for example, on property ownership.

Others argue that technology, or technical change, is the main source of growing inequality by increasing the discrepancy between skilled and unskilled wages. For example, Acemoglu (2002) argues that technical change is endogenous and skill-biased. This has resulted from a growing pool of educated workers, and in rising skilled wages and employment. (Although he focuses on the United States, the brain drain from the rest of the world to the United States may also be explained in his model.) Aghion et al. (1999) also argue that growth in the developed countries has increased earnings inequalities because of skill-biased technical change.

## 8. Differences of Approach in the International System

As the above narrative has suggested, among the international organizations, the World Bank, along with IMF, has taken a leading role in promoting policies of openness and liberalization as means to foster growth and poverty reduction. However, during the three-year tenure of its chief economist, Joseph Stiglitz, its positions became more attenuated with increasing criticisms of policies based on the Washington consensus of the 1990s. Since Stiglitz's departure in January 2000, the World Bank's positions have tended to return to greater orthodoxy.[14] However, given the size and complexity of the World Bank, it accommodates a spectrum of viewpoints, predominantly consistent with a "market-friendly" approach, but in varying degrees recognizing market failures and the need to offset them through government action. Thus, it may be misleading to cite positions taken in any World Bank publication, even its flagship WDR, as representative of a consensual "World Bank position" held by all its affiliates, operating departments and staff.

The same caveat applies to any large international organization, for example, the various departments and specialized agencies of the United Nations. That being said, it can nonetheless be maintained that there are important divergences among the international organizations on the issues discussed here—as mentioned above, UNU/WIDER and UNCTAD have been more critical of the impacts of liberalization than the World Bank. Here, a brief survey will serve to illustrate these divergences and to speculate about deeper theoretical and conceptual differences on which these may be based.

These differences have likely always been present, but began to emerge more visibly during the crisis-ridden 1980s, also the decade that gave birth to the Washington consensus. The pathbreaking publication of United Nations Children's Fund (UNICEF), *Adjustment with a Human Face* (Cornia et al. 1987), drew attention to the plight of the debt-distressed countries implementing adjustment, and proposed strategies to protect vulnerable populations, to generate employment and incomes for the poorest, and to support and even expand programmes of health, education and nutrition for children. This work did not fundamentally challenge the need for adjustment policies—the nascent Washington consensus—in response to the debt crisis. Rather, it urged the adoption of policies to mitigate the effects of adjustment on those least able to protect themselves. However, in maintaining that vulnerable populations had to be supported by maintaining or expanding social programmes, the UNICEF team was in fact challenging the distributional impact and design of the adjustment programmes.

The UNICEF Innocenti Research Centre was established in Florence shortly afterward (1988) to facilitate the implementation of the Convention on the Rights of the Child, by focusing on the equity and financing of social programmes to benefit children. Over the next decade and a half, the centre undertook a considerable amount of empirical work rooted in the adjustment challenges and policy responses of particular countries. Such country-specific analysis is of

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[14] Meanwhile, having returned to academic life, Stiglitz (2002) has become even more critical of liberalization policies, particularly those imposed by IMF.

fundamental importance if policy approaches are to be differentiated according to country circumstances, rather than hewing to a "one-size-fits-all" model—implicit, according to critics, in the Washington consensus.

A complementary, and similarly pathbreaking, initiative emerged in 1990 with the UNDP's *Human Development Report*, with its Human Development Index (HDI), proposed by Mahbub ul Haq. The HDI challenged the metric of gross domestic product (GDP) per capita as the sole and unqualified basis of gauging progress. By devising a measure of welfare that integrated with per capita GDP indexes of educational and health attainment—proxied, respectively, by measures of literacy and longevity—the HDI went beyond UNICEF's insistence on social spending, to focus on tangible results in the social sphere. Although not as yet couched in these terms, both UNICEF and UNDP were implicitly addressing growing inequality emerging from the crises and adjustment—or liberalization—policies of the time.

The decade of the 1990s was remarkable for the number of global conferences convened by the United Nations to address a number of burgeoning development issues in the new post–Cold War order: environment and sustainability, the gender dimension, human rights, social equity, and population. Hopes for a peace dividend were disappointed at these conferences, which resulted in few additional resources being mobilized. And optimism about the benefits of a rapidly integrating global economy was soured, moreover, by the instability emanating from the financial crises of 1995 and 1997–1999.

Accordingly, UNDP (1999:2) addressed the subject of *Globalization with a Human Face*, a report that criticized a growing imbalance between rapidly expanding global markets and inadequate global governance:

> When the market goes too far in dominating social and political outcomes, the opportunities and rewards of globalization spread unequally and inequitably—concentrating power and wealth in a select group of people, nations and corporations, marginalizing the others…The challenge is…not to stop the expansion of global markets [but] to find the rules and institutions for stronger governance—local, national regional and global…to ensure that globalization works for people.

As with UNICEF's earlier critiques of adjustment policy, UNDP's agenda for action consists largely of measures to offset or mitigate the erosion to equity caused by globalization. However, in calling for "global governance with a human face" or "[global] reform driven by concern for people, not for capital", UNDP (1999:98) also offered a vision in which the global system would be far more coherent, by integrating the principles of economic efficiency with social and cultural rights, and meshing the policies of the United Nations, the BWIs and the WTO. UNDP's proposed changes to the global architecture amount to a radical reform, with the formation of new, powerful institutions, such as a global central bank able to create liquidity and a global investment trust able to mobilize international taxation—for example, through Tobin taxes on currency transactions. Basic to the envisaged reform is a new balance of power between the rich and poor countries, with much greater representation and influence accorded to the latter. Moreover, there would be monitoring and oversight of multinational corporations in the new system.

Such sweeping changes in global governance would undoubtedly bring about profound changes in the global rules of the game, presumably in favour of the world's poorest countries and people. Indeed, some may consider them completely unrealistic. Perhaps for this very reason, however equitable and well considered, they are unlikely to come about in the foreseeable future. But they reflect an underlying assumption by the authors of the UNDP report that current globalization policies are not going to change, either, until the entire superstructure of global governance is altered.

It is quite conceivable that a coalition of social forces would help the world to move toward the radical reform in global governance envisaged by UNDP. Indeed, after the International Conference on Financing for Development convened in Monterrey, Mexico, in March 2002, considerable efforts have been made by the BWIs, United Nations agencies and other international agencies including the World Trade Organization, civil society organizations and some countries—for example, Finland, through the Helsinki Process on Global Governance—to bring about greater coherence in the multilateral system among its component parts. It seems unlikely that such efforts, which are unprecedented in their nature and scope, will bring about the specific outcomes preferred by UNDP (1999), such as a global central bank. Nonetheless, even if UNDP's specific ideas do not materialize, the idea of far-reaching reforms to the global system, aimed at serving a sustainable human development agenda, can no longer be dismissed on the grounds of lacking a constituency or willingness among some of the key actors.

A different approach has been taken by UNCTAD in its *Trade and Development Reports* (1997, 2001, 2002). In its 1997 report on globalization, distribution and growth, it stated:

> no economic law exists that will make developing economies converge automatically towards the income levels of developed countries…growth and development do not automatically bring about a reduction in inequality…moreover, various episodes in the East Asian development experience suggest that governments have an important role to play in reconciling rapid growth with distributional objectives (UNCTAD 1997:vii).

In asserting that developing country governments must do more to manage profits, integration and distribution in order to increase domestic investment and growth, UNCTAD challenged the laissez-faire version of the liberalization doctrine, which presses for a smaller state less engaged in the economy, and endorses a trickle-down approach to growth and distribution. It also went beyond UNDP's less critical stance toward global markets. This does not imply that UNCTAD (1997) rejects the need for global reform; on the contrary, it argued that the policy efforts of developing countries should be "accompanied by an accommodating global environment". At the same time, it took a more realistic view of the potential for global reform in the current system—which it presumed likely to first and foremost meet the needs and objectives of the industrial countries, before those of the developing countries.

UNCTAD's (2001:x) scepticism about reforming the global financial architecture was articulated in its review of the proposals implemented in the wake of the East Asian crisis, which put the onus on developing countries to better manage risk in a more open financial environment, as though they were the primary cause of international crises. By contrast, it said, little attention was given to the role and responsibilities of institutions and policies in creditor countries. It argued that the latter have far more scope to prevent crises and stabilize the global economy through co-ordinating their monetary, fiscal and exchange-rate policies. In the absence of multilaterally agreed approaches to financial stability, UNCTAD urges developing countries to avoid commitments that restrict their policy autonomy, and to consider regional arrangements to protect themselves against systemic instability.

UNCTAD's (2002) most recent critique of globalization examines the emerging world trading system and the challenges and opportunities it offers developing countries. It overturns conventional wisdom, which holds that developing countries will reap greater gains in moving from primary commodity product specialization to manufactures, by indicating the value added from manufactured exports is often very low. It also argues that transnational corporations are increasingly able to manage the distribution of gains from trade and investment around the world. Moreover, increasing competition for investment and in low-wage manufactured goods sectors make established producers vulnerable to new lower-wage entrants in their markets.

The report concludes that the basic policy issue facing developing countries "is not, fundamentally, one of more or less trade liberalization, but how best to extract from their

participation in that system the elements that will promote economic development" (UNCTAD 2002:x). Again, rather than seeking solutions in sweeping reforms of the entire global system, the emphasis is on giving developing countries policy space in the current system to manage their integration into the global economy, to rely more on domestic markets and make better use of instruments such as industrial policy, and to extract better terms from foreign direct investment.

The approach of the International Labour Organization's (ILO) *World Labour Report 2000: Income Security and Social Protection in a Changing World* on these issues parallels UNCTAD's in that it expresses deep concerns that globalization is eroding national policy autonomy, particularly in the context of providing social security (ILO 2000). Specifically, ILO's report argues that financial globalization, along with regional economic integration—as in the case of the European Union—has reduced the range of macroeconomic policy options for governments, while tax competition to attract multinational corporations reduces their spending capacity, including social security expenditures (ILO 2000). Moreover, the tax burden is shifting from relatively mobile capital to relatively immobile labour, attenuating redistributive effects of the tax system.

ILO's critique of financial market liberalization encompasses the impact of some social security reform policies of industrial countries on capital-importing developing countries. In moving away from social insurance schemes to advance-funded mandatory retirement savings, the industrial countries have contributed to the enormous growth of pension funds eager to maximize short-term returns in a competitive global environment. Much of this capital has contributed to the volatility and instability experienced by emerging markets in the 1990s (ILO 2000:70–71). Particularly when global markets experience a substantial downturn, such reforms seem to be in the interest neither of Northern pensioners nor of Southern economies.

A considerably more complacent view of globalization emerges from the United Nation's Department of Economic and Social Affairs (UNDESA) in its *World Economic and Social Survey*. For example, contrast the critical review of UNCTAD (2001) on the recent global financial reforms with that of UNDESA (2001:151):

> In the aftermath of the Asian crisis, a broad consensus quickly developed on the need to reduce excessive instability in international economic and financial activity. By the end of the decade, there was agreement on broad policy goals with respect to doing so, including a sound and stable macroeconomic environment and well-functioning and robust financial systems in both capital exporting and capital importing countries. There has also been considerable agreement on many of the elements needed to achieve these goals…This means not that there are no disputes, but rather that policy makers around the world are operating largely from a common assessment of what policies to implement in several areas.

Similarly, UNDESA's (2001:156–166) treatment of the trade-growth relationship is far more uncritical than that of UNCTAD (2002). The report puts considerable weight on market access for the poorest countries as "a route out of poverty" and therefore appeals to industrial countries to take the necessary measures to eliminate protectionism, and to international institutions to provide increased protection for countries vulnerable to commodity price fluctuations. It is not certain why UNDESA would be more sympathetic to the views of the World Bank and IMF, than, say, UNDP or UNCTAD. One explanation might be the fact that UNDESA is much more closely associated with the United Nations Secretariat at its New York headquarters, and that it would be politically more difficult for the Secretariat to challenge the BWIs than it is for more autonomous members of the United Nations family like UNDP or UNCTAD—the latter based in Geneva. Another plausible explanation would point to particular individuals associated with UNDESA. Ultimately, all multilateral organizations, no matter how complex or bureaucratic, rely on the individuals who staff and lead them, and conversely such

organizations inevitably reflect the personalities and proclivities of the individuals representing them.

It is not possible here to survey all, or even most, of the international organizations, but a brief allusion to some regional organizations is illuminating. First, the regional development banks (RDBs)—the African Development Bank, Asian Development Bank, and Inter-American Development Bank (IDB)[15]—have no formal relationship with the United Nations system, unlike the BWIs, which are United Nations specialized agencies. Moreover, the RDBs' governance is similar to the World Bank's, in that member countries' representation is based on a weighted voting system, which accords a larger voting share to countries with a larger gross national product (GNP). Unlike the World Bank, however, where OECD members—all non-borrowing—account for a voting majority, the RDBs were all explicitly designed to preserve a voting majority for regional member countries. For the African and Inter-American Development Banks this has meant that regional borrowing, that is, developing country members account for a voting majority, although the size of the majority has diminished during the 1990s. In the Asian Development Bank, Japan, Australia and New Zealand are non-borrowing regional members, whose voting shares are relatively large, leaving the regional borrowers in a voting minority (Culpeper 1997).

In many ways, the RDBs embody the principles, idealized by UNDP, that developing countries be much better represented in the global order. Yet, despite the majority voting share of regional member countries, the RDBs have increasingly followed the policy leads of the World Bank since the late 1980s. A significant debate erupted during the late 1980s in the course of the Seventh Replenishment negotiations of the IDB between the borrowing members and the United States, the largest shareholder, on the role of the World Bank in policy-based—that is, structural adjustment—lending. The United States did not trust a multilateral bank, in which borrowing members had a voting majority, to carry out the conditionality of policy-based loans. Eventually the issue was decided in favour of the United States, without which an increase in the World Bank's resources would not have been possible. The deal that was brokered included a higher voting majority to approve policy-based loans, and a requirement that the IDB work with the World Bank in the design of the lending operations (Tussie 1995:52). The agreement on the Seventh Replenishment was instrumental in forming the "Washington" consensus, since the Washington-based IDB was now regarded as a full partner along with the World Bank, IMF and the United States. Since then, IDB has remained a steadfast ally of the World Bank and IMF.

The IDB (2002) continues to be an advocate of an agenda of global economic integration for the Latin American–Caribbean region on the grounds of its potential for the region's growth and development prospects. The World Bank is unquestionably cognizant of the fact that Latin America is, notoriously, home to the world's greatest income inequalities (IDB 1998); but its policy prescriptions tend to hew to the formula: maximize growth, while protecting the poor and increasing opportunities for the less fortunate in order to narrow disparities (IDB 2000). In sum, on the issues of globalization and inequality, the IDB has tended to reaffirm its support of the Washington consensus—not too far removed from the positions of the BWIs or the US Treasury.

However, there have been, and to some extent remain, important differences among the RDBs. In the case of the Asian Development Bank, regional members' resistance to adjustment policies and the Washington consensus emanated not only from the borrowers, but also from Japan, the largest voting member, with the United States. As a result, the Asian Development Bank has always been far less enthusiastic about policy-based lending than the other RDBs. It was only with the onset of the Asian financial crisis that the Asian Development Bank came "on board" with the BWIs during the emergency lending operations in the region. By that time, Japan was itself in an economically weakened position due to a decade-long depression. However, the

[15] The European Bank for Reconstruction and Development is much more recent, and quite different in a number of ways, from the established regional banks.

interventions in East Asia were highly controversial and Japan, along with regional borrowing members, pressed for a regional stabilization mechanism that would obviate reliance on the resources or policies of the BWIs, an idea that was at first rebuffed by IMF and the Group of Seven (G7) countries. Eventually, in May 2000, the Chiang Mai initiative, announced at an annual meeting of the Asian Development Bank, gave expression to such a regional mechanism, which as of 2003 was still under development.

Perhaps because inequality has historically been lower in the Asian region than in other regions of the developing world, the Asian Development Bank tends to focus on poverty reduction rather than on addressing inequality per se (Asian Development Bank 2001). As to the challenges posed by globalization, the Asian Development Bank's approach parallels that of the IDB. In order to seize the opportunities presented by international trade and investment, Asian countries need to invest in infrastructure, human resources—especially knowledge—and institutional development. Of course, there are downside risks, as painfully demonstrated by the financial crises of 1997–1998. In this respect, the ADB urges developing member countries to strengthen the financial sector, particularly the banking system, deepen financial markets, strengthen monetary and fiscal institutions, and manage exchange rates better, in order to contain volatility that inevitably is hardest on the poor and most vulnerable (Asian Development Bank 2003). But these prescriptions virtually converge with those emanating from the BWIs.

Turning to the United Nations regional economic commissions, it is worth noting the contrasting positions of the Economic Commission for Latin America and the Caribbean (ECLAC) and the Economic Commission for Africa (ECA). ECLAC comes from a tradition of articulating heterodox doctrines, from the time of Raoul Prebisch, its former executive secretary. While the activism with which it has played this role has varied with Prebisch's successors, in the later 1990s—under José Antonio Ocampo—ECLAC has again come to the forefront in providing a sustained critique of the prevailing orthodoxy.

For example, ECLAC (2002a, 2002b) provides a trenchant analysis of the pitfalls of globalization for the Americas. Macroeconomic vulnerability and instability in the real economy has followed openness to volatile capital flows; there has been a structural deterioration in the relationship between economic growth and the trade balance, with lower growth and higher deficits or surpluses required in successive cycles, and despite rapid growth in FDI, weak linkages with fast growth and high value-added sectors. ECLAC's (2002a, 2002b) analysis leads it to proposing an action agenda on three levels—national, regional and global—and with respect to national actions, insisting that "there are no universally valid models" for the management of the economy, the environment and social equity. In this respect, ECLAC spans the visionary global agenda of UNDP with the more practical agenda of UNCTAD.

For its part, ECA appears to have moved in the opposite direction. During the 1980s it was the focal point of regional opposition to structural adjustment policies in Africa, even proposing an alternative policy framework that it argued would be more appropriate to African requirements and absorptive capacities. Such policy pronouncements only served to isolate ECA, however, from the decision-making debates held among the donor countries and the BWIs. (The African Development Bank played a more subservient role, co-financing the World Bank's structural adjustment loans with little or no role in formulating policy.) However, under its present executive secretary, K.Y. Amoako, ECA has positioned itself in the forefront of the policy dialogue on Africa. It has done this through astute negotiations with key African leaders, on the one hand, and the Group of Eight (G8) countries on the other. It played a key facilitating role in the formulation of the New Partnership for African Development (NEPAD), which the G8 leaders agreed to discuss at their 2002 summit held in Canada. This resulted in a possible commitment by donors of $6 billion in additional official development assistance to the region in coming years (ECA 2001).

There was a quid pro quo for winning the G8's attention. Fundamentally, ECA and NEPAD gave considerable lip service in favour of political and economic reform, sentiments that resonated with positions of the G8. In that respect, the ECA of 2002 is profoundly different from the ECA of the 1980s. Some regional critics have expressed considerable opposition to NEPAD, on the grounds that it has been generated without any discussions among Africans, other than among a few leaders; this is a glaring shortcoming for an initiative that emphasizes the need for democracy in Africa. It was still uncertain, as of 2003, whether this flaw would prove to be fatal to the whole NEPAD enterprise. Many regional critics also have deep reservations about the appropriateness or even workability of liberalization policies for Africa, home to three dozen of the world's poorest countries (Culpeper and Schmidt 2002).

A much more exhaustive and in-depth survey of international organizations would be necessary in order better to understand the different approaches that they take on issues of globalization and its impacts. Here, it is possible only to offer some speculative suggestions.

First, there are differences in mandate between the BWIs—and the WTO—on the one hand, and the United Nations organizations on the other. The former group has focused pre-eminently on economic rather than social issues. This difference narrowed somewhat during the 1990s, with a greater emphasis on poverty reduction by the World Bank and the IMF, and growing involvement in a range of social and even political issues, from education and health to governance. Beneath these differences in mandate lies a difference in bureaucratic culture: the BWIs are heavily staffed by economists and technical specialists, and interact with finance ministries of member countries; United Nations agencies are staffed by a number of different specialists, and interact with foreign and aid ministries.

Second, there are differences between institutions that function as lenders, including the BWIs and the regional development banks, and those that either do not disburse any funding or only disburse grants—such as the specialized United Nations agencies such as UNDP and UNICEF. Lenders are likely to endorse more conservative policies on the part of their borrowers, to ensure repayment.

Third, the BWIs and WTO negotiate binding policy commitments, which are likely to echo the policy preferences and doctrines of the industrialized countries and the status quo. United Nations agencies that act as policy advisers, think-tanks or discussion fora, but do not have to implement their policies, may be bolder in their policy positions, and reflect the positions of developing countries.

Fourth, resources carry weight. Even in the regional banks, where regional or developing countries retain a formal voting majority, the position of the donor minority is still typically decisive.

Fifth, among the industrial countries, the United States is extraordinarily influential in all international organizations, including in the United Nations system, where it is only one of more than 180 member countries. This is partly a matter of resources as well, since the US contribution to the United Nations is the largest among member countries. Ironically, being in arrears to the United Nations gives the United States more leverage to the extent that it can make demands before discharging its obligations.

Sixth, individuals matter greatly, particularly when they are in leadership positions and are able to articulate a vision and an action programme that commands the support of their organizations and member countries.

## 9. Toward Policy Options

Given the areas of agreement and disagreement above, it is clear that the policy agenda will also occasion considerable debate in the foreseeable future. The focus of this paper is on globalization and inequality. However, as argued at the outset, if a fundamental rationale of globalization—and by implication the economic policies of liberalization—is that it stimulates growth and reduces poverty, then part of the policy debate has to involve the relationship between growth and inequality.

In particular, given poverty reduction as an overarching objective, it follows at a minimum that lower inequality gives a "bigger bang for the buck", that is, a faster reduction in poverty. There is clearly enough consensus on these issues to support:

> **Policy Implication No. 1.** Building the assets of the poor through investment in education and redistribution of other assets, particularly land, along with access to credit, is not only equitable, it also improves growth performance and future poverty reduction. Investing in basic education for the poor is not entirely uncontentious, since resources must be raised and allocated for the purpose, imposing an opportunity cost on elites or others. But the more contentious part of this policy relates to redistribution of fixed assets such as land; what are the benefits and costs of "market-based" redistribution, and are there other alternatives?

If income inequality is actually growing, and if lower income inequality is not only avoidable but is bad for growth, then that would lead to:

> **Policy Implication No. 2.** Redistributive policies through taxes and subsidies biased toward the poor are necessary on a continuous basis. However, there is not enough consensus on this score; the measures used would have to be compatible with maintaining incentives for growth and with the concept of "sound macroeconomic fundamentals" in fiscal policy, particularly in the context of increasing tax competition.

Alternatively, if income inequality is actually growing due to structural factors specific to a country such as internal rigidities inhibiting labour mobility, discrimination against women or ethnic minorities, or policy biases against sectors in which the poor predominate—notably agriculture, then there would be considerable agreement on:

> **Policy Implication No. 3.** Policies that discriminate against poor people, or sectors or regions in which the poor predominate, should be remedied and policies that are neutral or biased in favour of the poor put in their place. Policy biases against agriculture and rural development in low-income countries deserve particular attention.

As to the impact of policies of domestic liberalization and increased openness on inequality, there is more debate than consensus, and a need for further research.[16] However, there is agreement that financial volatility and economic crises are particularly harsh on the poor. Accordingly, there should be consensus on:

> **Policy Implication No. 4.** Prudential and other measures should be taken to inhibit volatility through a cautious approach to financial liberalization and openness in the capital account. There is less consensus, however, on how to avoid sharp recessions to resolve crises. A more general rethinking of macroeconomic, foreign exchange, structural and institutional policies is required, in order to mobilize more domestic savings for investment and allow greater latitude to conduct counter-cyclical policies.

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[16] There is need to absorb the considerable amount of research done at the country level, for example, by the International Development Research Centre, through its project on the Microeconomic Impact of Macroeconomic Adjustment Policies.

Equitable labour market policies to combat wage inequalities and unemployment are likely to be another area of contention. Equitable policies should not mean protecting elite labour sectors. On the other hand, there is more likely to be consensus if labour market policies are job-creating:

> **Policy Implication No. 5.** Active labour market policies should be pursued, through investing in workers' skills, supporting the unemployed in finding jobs, promoting labour rights and making informal work more productive and remunerative. The aim should be to protect incomes rather than jobs. Among more contentious issues would be the promotion of collective bargaining and minimum wage laws.

If technology is the fundamental driver of growth—as well as widening income inequalities globally and nationally—then developing countries are highly disadvantaged, since most technological development occurs in the OECD countries, whose research and development spending in 1998 amounted to $520 billion, more than the combined output of the world's 30 poorest countries. In the same year when global health research spending was $70 billion, only $100 million was devoted to malaria research (UNDP 2001:3). This suggests going beyond strategies aimed principally at basic (primary) education, to more proactive strategies of technological development (Altimir 2002; ECLAC 2002b):

> **Policy Implication No. 6.** Domestic technological development means expanding human skills to elevate productivity, raise skilled wages and expand skilled employment by investing in secondary and tertiary education, vocational and on-the-job training, and the establishment of technology strategies to facilitate co-ordination and economies of scale among private actors. The problem is that technological development is not high on most developing countries' agendas and the resources are not available for this purpose.

## 10. Conclusion

Global poverty reduction is being taken a lot more seriously in the early decades of the twenty-first century, thanks partly to the consensus forged in the United Nations over the Millennium Development Goals, which aim at a 50 per cent reduction in poverty levels by the year 2015. Even if this ambitious challenge is not met in many countries—and it will not be, particularly in Africa—it is likely that the principal equity issue will be growing inequality within countries rather than "absolute poverty".

Whether the issue will generate enough concern to stimulate an effective policy response remains to be seen. This paper has suggested that the weight of evidence is on the side of those who assert that inequalities are actually increasing. Moreover, revisionist thinking that has led to the finding that lower inequality is good for growth, overturns the conventional wisdom that there is a trade-off between equity and efficiency, thereby giving greater scope for initiatives to reduce income and asset inequality. Finally, there is growing evidence, albeit with considerable debate, that policies of economic liberalization and openness to facilitate globalization are exacerbating inequalities.

At the same time, it is also true that globalization, defined as increased international economic integration, could provide substantial benefits in the form of growing income and employment opportunities. The trick, particularly for developing countries, is to capture the benefits available from trade, capital flows and migration, while avoiding or mitigating the costs, as well as the strong possibility that the benefits will be biased against the poor (UNDP 1999).

Moreover, any initiatives to tackle growing inequality will run headlong into the prevailing policy consensus favouring market-friendly policies. Furthermore, over time the international

mobility of capital and skilled labour, along with other developments made possible by technology and globalization—such as e-commerce and offshore financial centres—is likely to undercut the revenue-raising capacities that nation-states need in order to undertake such initiatives—whether they involve reallocation of funding to education, health and social expenditures, redistribution of assets such as land, or simply using income taxation.

These considerations suggest that achieving "equity in one country" through redistributive measures at the national level will be difficult and inadequate, unless they are complemented by commensurate changes in the current policy consensus, dominated by the international financial institutions and the leading industrial powers. The challenge is to convince the "policy establishment" to support these changes and help pave the way to policies, both at the global and national levels, compatible with the pursuit of more equitable development.

As Rodrik (2001) has put it, the key point is to "put development first"—that is, to give highest priority to the social and economic objectives of developing countries: poverty eradication, greater well-being and a decent quality of life for all people. To such a list could be added the objective of reducing inequality, both on equity and efficiency grounds.

In this light, globalization—or greater integration into the global economy—is seen as a means toward these fundamental objectives, rather than an end in itself. And to the extent that policies facilitating globalization (openness, liberalization) impede the attainment of fundamental objectives, developing countries should be allowed to adopt a pragmatic approach. For example, if liberalization has a pronounced negative impact on income, employment and inequality, then developing countries should choose the speed and sequencing of liberalization measures that have the most positive impact. Rodrik (2001) goes further by arguing for the right of developing countries to protect institutional arrangements that work in the right directions, for example, by protecting domestic markets. Thus, the reciprocal nature of global trade negotiations does not meet the needs of many developing countries very well. Put otherwise, increased access to industrial country markets should not only be achieved by giving industrial countries commensurate access to developing country markets, where such access undermines vulnerable domestic populations. This is particularly the case where industrial countries distort markets through lavish subsidies, as in agriculture.

In other words, the aforementioned policy establishment should be much more willing to countenance national autonomy and diversity. The principal concern should be on the progress in achieving fundamental social and economic objectives, including the reduction of inequality, not on whether the policies adopted strictly adhere to preconceived notions of what is correct. The task of the multilateral organizations and the "policy establishment" would then be, as Rodrik (2001) puts it, to manage the interface between different (but viable) national systems, rather than to reduce these differences toward some global common denominator.

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