Globalisation and poverty

Turning the corner

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Key points

Globalisation — in the form of increased economic integration through trade and investment — is an important reason why much progress has been made in reducing poverty and global inequality over recent decades. But it is not the only reason for this often-unrecognised progress. Good national policies, sound institutions and domestic political stability also matter.

Despite this progress, poverty remains one of the most serious international challenges we face. Up to 1.2 billion of the developing world's 4.8 billion people still live in extreme poverty. But the proportion of the world population living in poverty has been steadily declining. And since 1980, the absolute number of poor people has stopped rising and appears to have fallen in recent years, despite strong population growth in poor countries. If the proportion living in poverty had not fallen, since 1987 alone a further 215 million people would be living in extreme poverty today.

The evidence also shows that international income inequality has narrowed over the past 30 years when countries' population sizes and the purchasing power of local incomes are considered. The very poorest countries now represent less than 8 per cent of the world's population compared with just over 45 per cent in 1970. In countries that have embraced the opportunities created by integration with world markets, globalisation has enabled stronger income growth. But national policies have not always been sufficient to ensure that the benefits of this growth are enjoyed by all.

Most progress has taken place in developing countries that have reformed their policies, institutions and infrastructure to become the 'new globalisers'. Around 3 billion people live in these countries which, spurred by their choice to open up to trade and investment, are slowly catching up on the living standards of rich countries. During the 1990s their growth in gross domestic product per person was 5 per cent a year compared with 2 per cent for rich countries.

Further reductions in poverty remain a challenge for the 'new globalisers'. But far more serious challenges confront the countries that have not integrated with the global economy — countries that account for up to 2 billion people. Often experiencing internal conflict and suffering poor governance, anti-business policies and low participation in international trade, these countries have not joined the process of globalisation, with the consequence of slowly growing incomes or even declining incomes and rising poverty.

Sound policy choices are crucial if the world is to make further inroads into poverty and inequality. Policy choices that enable economies to take advantage of global opportunities and national measures to mitigate inequality, supported by well-targeted development assistance and global action to reduce trade barriers, are the keys to accelerating progress.

The context of poverty today

Economic integration around the world — an important part of the process of globalisation — has allowed remarkable, but frequently unrecognised, progress against poverty and global inequality. One group of developing countries, with a combined population of 3 billion people, has achieved this progress by reforming their policies, institutions and infrastructure to become the 'new globalisers'.

But serious poverty and inequality remain for up to 2 billion people living in countries that have not yet integrated with the global economy. Poor policy choices, weak institutions and sometimes instability have cost these countries dearly.

The tremendous gains made by globalising developing countries and the tragic outcomes for some marginalised developing countries offer contrasting policy lessons that are sometimes confused. In that misunderstanding, poverty and inequality are falsely attributed to the very economic integration that is lifting the majority of the developing world's people out of poverty. So it is important to understand clearly what has been happening in the world and how further inroads can be made into poverty and global inequality.

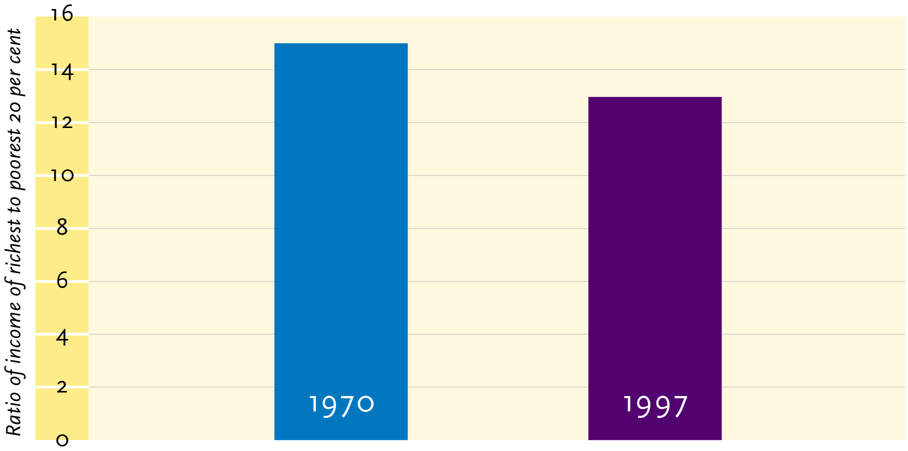
Measuring poverty and inequality

One way that poverty and inequality are often explored is through comparisons of average incomes across countries. But when such comparisons are made, we need to take account of what goods and services the incomes can purchase because the cost of living varies from one country to another. What matters is how much it costs to meet basic needs such as food and shelter. The income needed in one country is an inadequate guide to what is required to meet these needs in other countries. Many goods and services in developing countries are cheaper than they are in developed countries.

So it doesn't make sense to compare living standards on the basis of income per person that has been converted using exchange rates into a common currency such as the US dollar without taking account of these cost differences. As agreed by the world's statisticians who developed the United Nations System of National Accounts, we need to take account of differences in the purchasing power of incomes using 'purchasing power parities', not exchange rates.

The evidence shows that when changes in the average purchasing power in countries around the world are compared, income inequality across countries *has fallen*. When we look at the top and bottom fifth of the world's population ranked by income (sufficiently big groupings to fairly represent the whole income distribution), the ratio of the average income in countries accounting for the richest 20 per cent of people to the average of the poorest 20 per cent fell from 15 to 1 in 1970 to 13 to 1 in 1997 (chart 1).

1 Disparity in the purchasing power of the richest and poorest 20 per cent of people has fallen



Data source: UNDP (2001).

Keeping track of progress

Much of this progress has taken place in developing countries that have reformed their policies, institutions and infrastructure to become the 'new globalisers'. Around 3 billion people live in these countries, which are slowly catching up on the living standards of the rich countries, spurred by their choice to open up to trade and investment. During the 1990s their gross domestic product (GDP) per person grew by 5 per cent a year compared with the rich countries' average of 2 per cent.

Two notable examples among many 'new globalisers' are China and India. When these two countries rose out of the list of the 20 poorest countries in the 1980s, they took a large share of the world's population out of extreme poverty. Around 2.2 billion people in these two countries have, on average, seen their material standards of living rise remarkably over the past two decades.

At the same time, people in some other, smaller countries have remained poor. Many newly formed states have weak institutions and have been impoverished by the conflicts that led to their formation, creating new entrants to the ranks of the world's poorest countries. Encumbered by internal conflict, poor governance, anti-business policies and low participation in international trade, these countries have excluded themselves from the process of globalisation, sometimes even producing declining incomes and rising poverty.

Another way that the extent of poverty and inequality is often examined is by comparing the average incomes of people in the poorest countries with those in the richest, and how they have changed over time. But, to be useful, such comparisons need to acknowledge the fluid nature of the group of the poorest countries, and not overlook the progress made by previously poor countries (box 2).

2 Graduating developing countries cause membership of the poorest group to change

Many comparisons between the richest and poorest groups of countries over time are misleading because they do not take into account changes in the samples of countries. Over the years, China, India, Pakistan, Bangladesh and Indonesia have left the ranks of the poorest countries, and continue to record high economic growth rates. The group of poorest countries has continually changed as the number of countries in the world has increased constantly since 1945. The break-up of the former Soviet Union, post-colonial independence movements in Africa, and the conferring of nationhood on former dependencies in the Pacific region have all led to the creation of new nations. Many of these have suffered devastating wars, are resource poor and have weak institutions. It is such countries that now dominate the group of the poorest countries in the world.

Changes in the group of the world's poorest 20 countries

	Unit	*1970*	*1999*
Total population	million	1 954.0	435.2
Average population per country	million	97.7	21.7
Proportion of world population	%	47.8	7.3

Data source: Commonwealth Treasury of Australia (2001, p. 36).

For instance, China was one of the poorest 10 countries in the world in 1975 and 1980. With very strong economic growth over the past two decades, average incomes doubled every decade. The proportion of China's population living on less than US$1 a day fell by 30 per cent between 1987 and 1998, despite a rise in population of 160 million over that period.

Evidence of change

Incidence of poverty is declining

Despite the world population growing by 1 per cent a year over the past decade, and the population of low income countries growing by 2 per cent a year, the number of people living in extreme poverty has stopped rising since 1980 and appears to have fallen in recent years (World Bank, forthcoming). The proportion of people living below the internationally accepted poverty line has fallen from around 28 per cent in the late 1980s to an estimated 24 per cent (table 3).

Some regions have been particularly successful in alleviating poverty. The largest declines have been recorded in East Asia and the Pacific, where the proportion of people living on less than US$1 a day fell from 27 per cent in 1987 to around 15 per cent in 1998. The incidence of poverty has also fallen in the Middle East and North Africa. However, it has declined little in Sub-Saharan Africa, and even increased in Latin America and the Caribbean.

3 Where people live on less than US$1 a day

	Proportion of people living on less than US$1 a day	
Region	*1987*	*1998* [a]
East Asia and the Pacific	26.6	15.3
Excluding China	*23.9*	*11.3*
Europe and Central Asia	0.2	5.1
Latin America and the Caribbean	15.3	15.6
Middle East and North Africa	4.3	1.9
South Asia	44.9	40.0
Sub-Saharan Africa	46.6	46.3
World	28.3	24.0
Excluding China	*28.5*	*26.2*

[a] Preliminary. Poverty line is measured at US$1.08 a day at 1993 purchasing power parity. **Source:** World Bank (2001a).

International income distribution is becoming more equal

The distribution of world income has become more equal since the late 1960s as trade and investment flows have intensified.

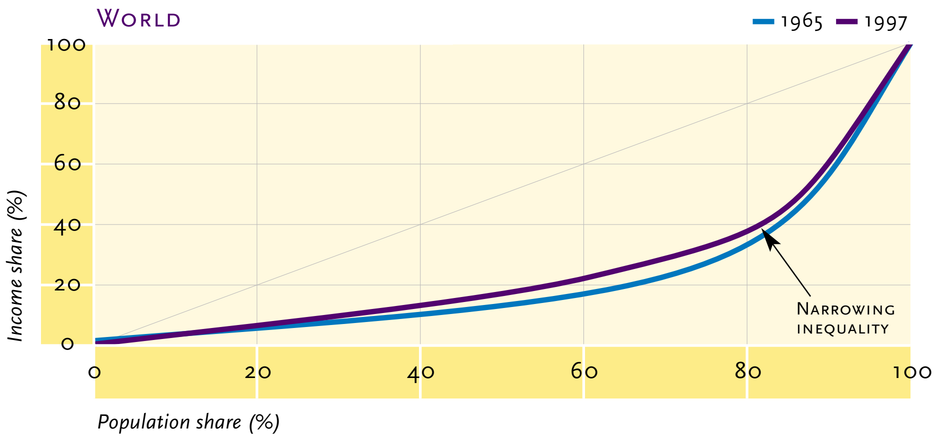
This improvement stands in contrast to early waves of globalisation that followed the Industrial Revolution, which began in the late eighteenth century, when income inequality rose because only some countries got an early start to productivity improvements made possible by new technologies. For nearly two centuries, productivity improvements did not spread quickly, and international inequality widened.

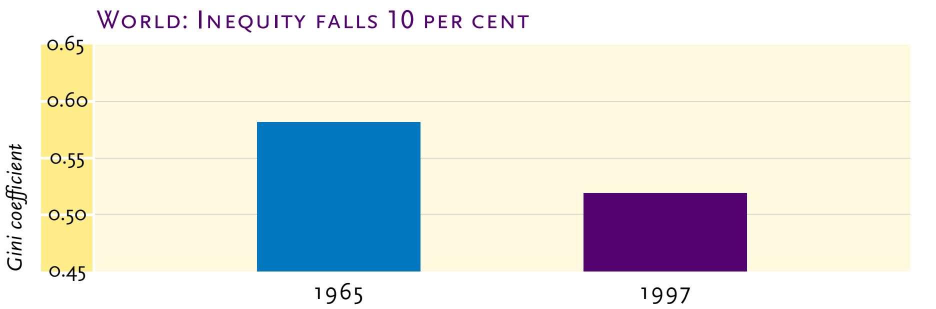
The recent narrowing of the international income distribution also stands in contrast to the early twentieth century's experience of 'de-globalisation'. From 1914 to 1945 during the world wars and the Great Depression, de-globalisation — particularly the adoption of protectionist policies — saw economic growth rates cut by about a third. This hindered the reduction in global poverty, and international inequality widened. Protectionism has never reduced poverty or narrowed inequality.

Since around the late 1960s, most of the developing world's population has experienced faster real income growth than the rich industrialised populations. The growth in international income inequality was halted and the differences began to narrow, largely because of the sustained growth of populous and formerly very poor countries such as China, India and Indonesia.

Income inequality can be measured by comparing national average output or income per person, weighted by the national population. This gives us a comparison between each country's share of the world's income and its share of the world's population, in a so-called 'Lorenz curve'.

4 Between 1965 and 1997, income inequality in the world fell 10 per cent

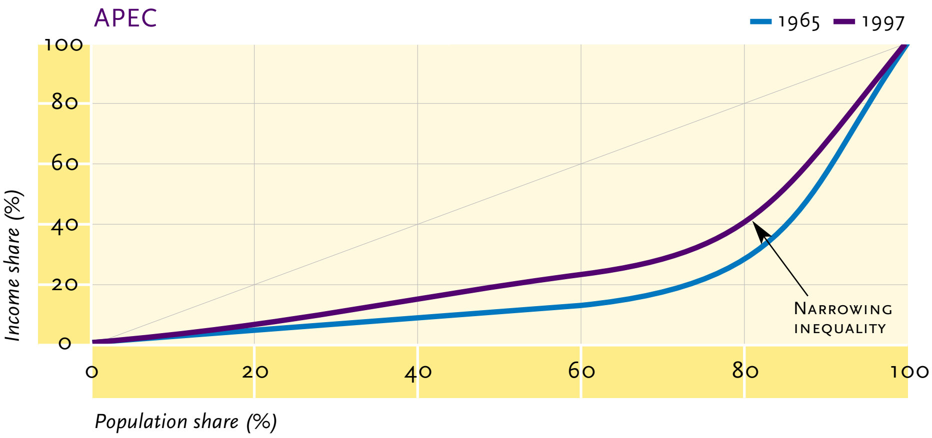


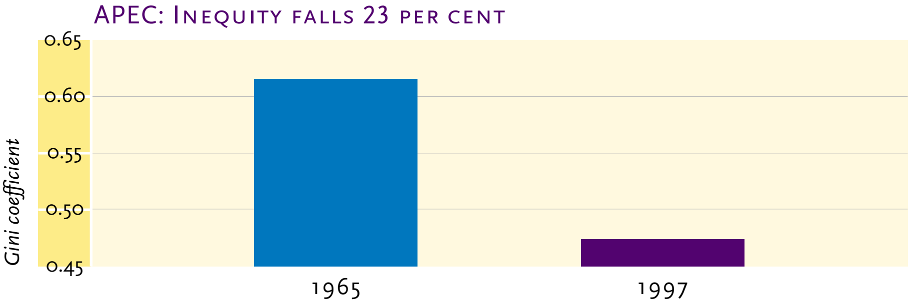


Note: Lorenz curves exclude Russia, Viet Nam and Brunei due to data unavailability. Lorenz curves plot the percentage of income going the poorest 10 per cent, 20 per cent and so on, of the population, drawing the cumulative population shares of global income produced. Perfect equality, where all people's incomes are identical, is represented by the diagonal line shown in the chart. The Gini coefficient is a measure of the area between the diagonal and the Lorenz curve. **Data source:** Melchior, Telle and Wiig (2000).

The world Lorenz curve shows greater income equality in the late 1990s than in the mid-1960s (chart 4). The Lorenz curve for APEC (Asia-Pacific Economic Cooperation) economies also shows narrowing inequality, in fact more so than for the world as a whole (chart 5).

5 Between 1965 and 1997, income inequality in APEC fell 23 per cent





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One widely used measure of income inequality is the Gini coefficient — the higher the coefficient, the more unequal the distribution of income. Using this measure, inequality was higher among APEC members than in the world as a whole prior to 1965, but by 1997 it was lower, having fallen 23 per cent. World inequality fell 10 per cent during this time.

The decline in international inequality occurred simultaneously with an increase in global economic integration. This is no coincidence. Studies that examine data from as far back as 1820 conclude that the rate of growth in income gaps between nations has been *reduced* by globalisation, at least for countries that integrated (Lindert and Williamson 2001).

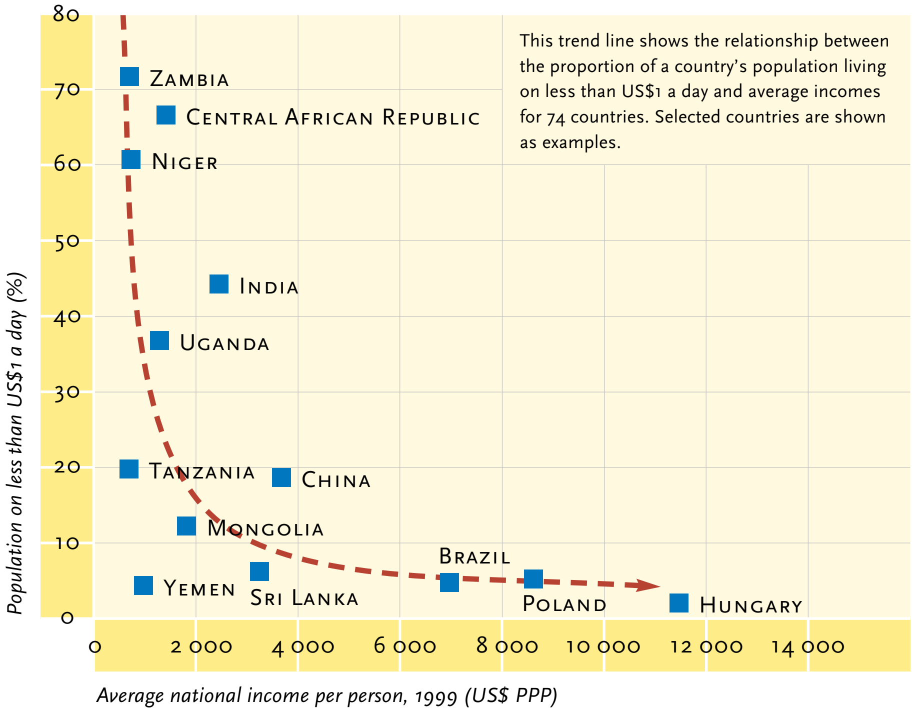
Of the developing world's 4.8 billion people, two-thirds live in countries that have achieved faster growth rates in GDP per person than the United States has since 1973 (Castles 2001). But it will take time for the faster income growth of globalising developing countries to close the large absolute income gap between people in rich and poor countries.

The arithmetic of compounding growth means that hundreds of years of divergent income growth cannot be eradicated in a few decades. The absolute difference in incomes will continue to grow for a while before contracting. But unless we sustain and extend the outward-looking policies that deliver faster economic growth and steady progress against poverty in poorer countries, the gap will never narrow significantly.

The poor are sharing the gains

The evidence shows that the poorest people within countries share in the gains from *national* income growth. Generally, as a country's average income rises, the poorest share proportionately in those gains. More specifically, the poorest 20 per cent in an economy gain by the same percentage as the country does (Dollar and Kraay 2001). And as a country's average income per person rises, the proportion of its population living in extreme poverty falls (chart 6).

6 Levels of poverty fall as incomes rise



Note: PPP refers to purchasing power parity. **Data sources:** World Bank (2001a); UNDP (2001).

Quality of life has improved

The evidence tells us that, across a range of indicators, the quality of life of people around the world is improving, even though much more still needs to be done. Importantly, for most of the developing world's people, improvements are being made at a faster rate than in the past, and faster than in developed countries.

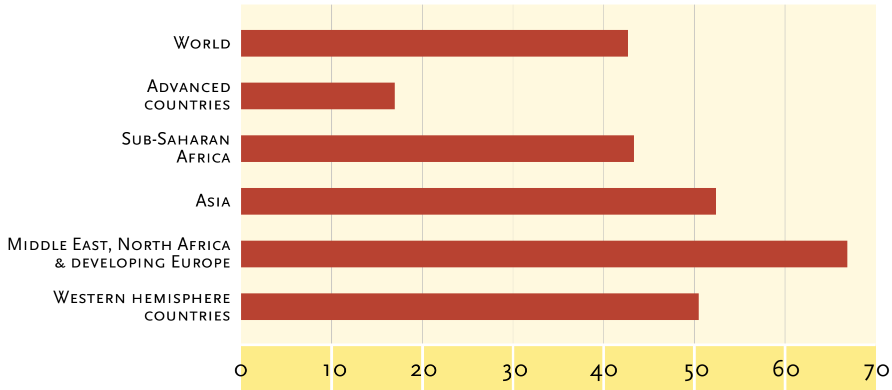
In 1970, 920 million people around the world were undernourished. Despite population growth, which is fastest in low income countries, the number of undernourished people today has dropped to around 810 million people.

Average life expectancy around the world today is about 66 years. In 1970 it was only 58 years. By region, life expectancy remains lowest in Sub-Saharan Africa at 51 years, where AIDS is now having a negative impact — but life expectancy has still increased from 45 years in 1970. The largest improvements in life expectancy have occurred for people in Asia, the Middle East, North Africa and developing Europe, where life expectancy increased on average by 10–12 per cent between 1970 and 1996.

Over the 26 years to 1996, already high infant survival rates in developed countries improved by about 17 infants per thousand. But in developing countries, they improved by between 44 and 67 per thousand (chart 7) — another sign of the gradual 'catch-up' in the quality of life for the developing world.

Gains have also been made in access to education. Today 80 per cent of the world's adult population is literate, a much higher proportion than the 63 per cent in 1970. Worldwide, 99 per cent of children are enrolled at primary school, up from 86 per cent in 1970. The biggest changes in primary enrolment since 1970 have occurred in Asia and Sub-Saharan Africa (chart 8).

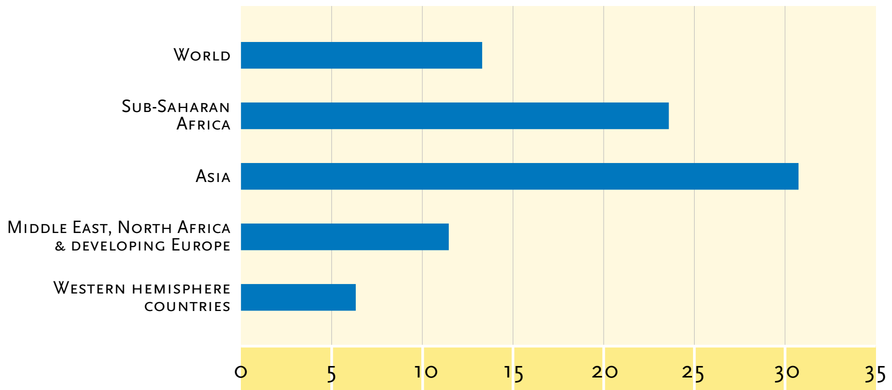
7 Infant survival rate has improved, particularly in developing countries



Improvement in infant survival per 1 000, 1970–96 (no.)

Data source: Sab and Smith (2001).

8 More children are enrolled in primary schools



Change in primary enrolment rates, 1970–96 (% point)

Data source: Sab and Smith (2001).

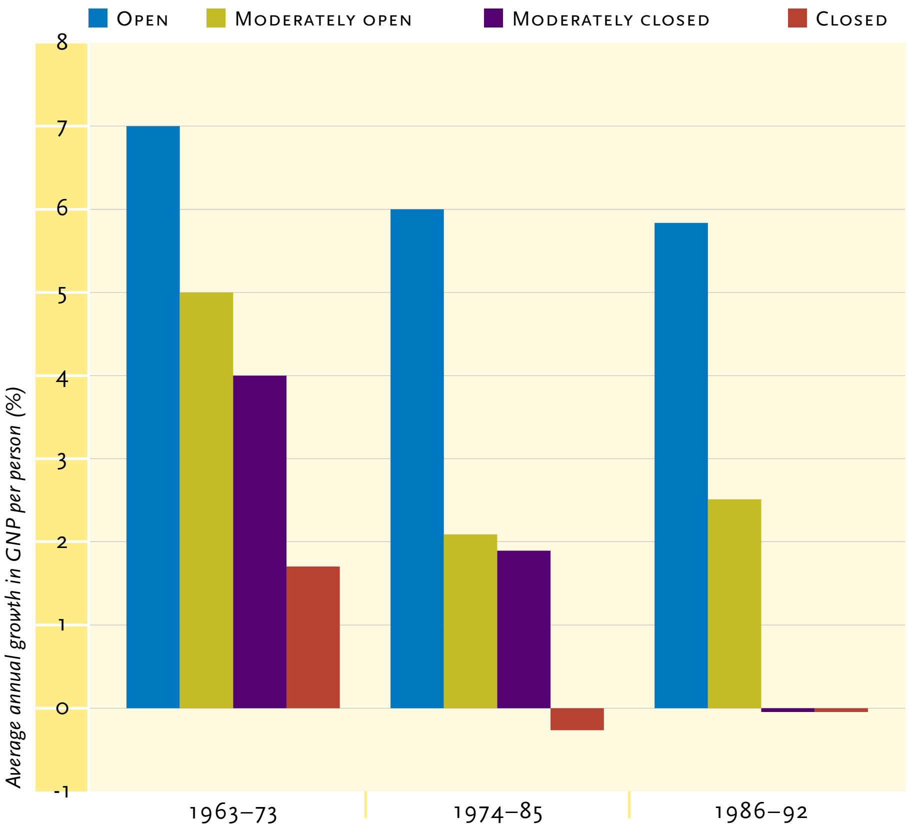
Policies for reducing poverty — sharing globalisation's benefits

Globalisation — in the form of increased economic integration through trade and investment — is an important reason why so much progress has been made against poverty and global inequality over recent decades. Openness to trade and investment flows is a key factor in lifting economic growth. Developing countries that are integrated with world markets have seen their average incomes rise. Those countries open to international trade have achieved double the average annual growth of developing countries that are not (chart 9).

However, lowering trade and investment barriers is not enough to guarantee equitable growth. Good national policies, sound institutions and domestic political stability are also important in generating national income growth and reducing poverty. The poor in particular suffer the consequences of bad macroeconomic management. For instance, there is evidence that high inflation is 'anti-poor'.

As well as being bad for growth, a country's high inflation hurts its poor people more than it does everyone on average. And poorly targeted government spending slows average income growth, and reduces the incomes of the poor more than other income groups.

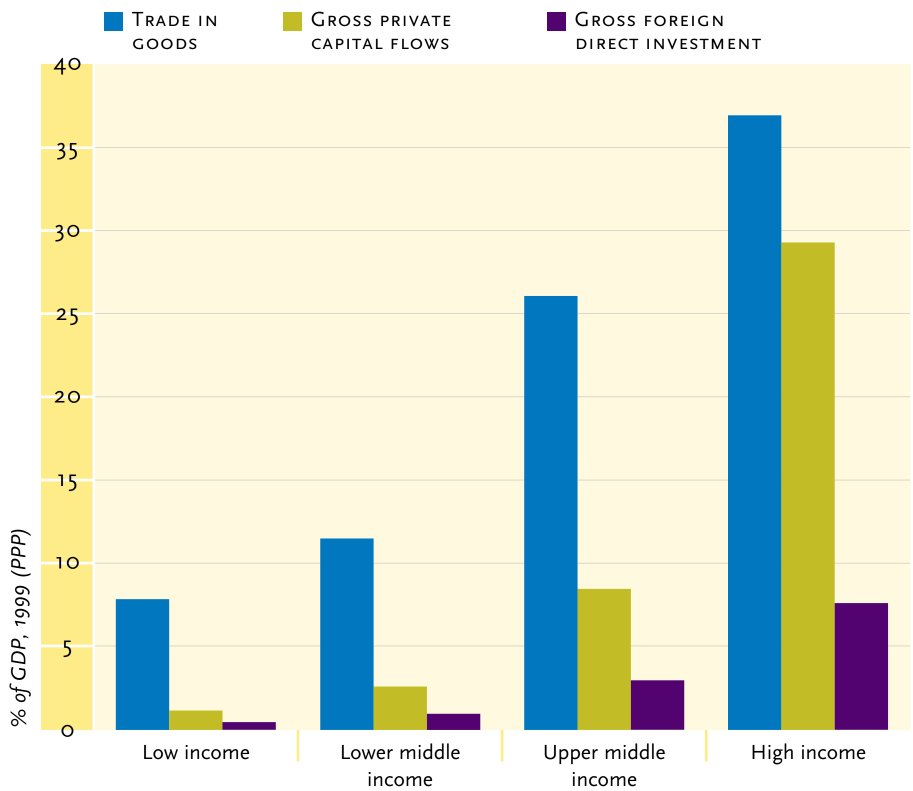
9 Developing countries open to trade grow faster



Data source: OECD (1999).

Countries characterised by higher trade and capital flows and higher foreign direct investment are richer. And countries with lower levels of integration have lower incomes (chart 10). Developing countries will attract international investment if they can offer a stable investment environment. But that will not be the case if they are engaged in conflict or are subject to domestic political instability, which leads to greater uncertainty and risks.

10 Higher income countries are open to all facets of globalisation



Note: PPP refers to purchasing power parity. **Data source:** World Bank (2001b).

Good policy choices matter

No country has succeeded over the past 50 years in reducing poverty or narrowing inequality by choosing less open trade and investment policies. To put it plainly, 'as far as we can tell, there are no anti-global victories to report for the postwar Third World' (Lindert and Williamson 2001, p. 25).

But as we have noted, openness is not enough. The world's poorest countries are typically beset by poor governance and corruption, and often internal conflict. Poor countries that make gains in alleviating poverty are typically those that have social harmony, are governed by effective institutions, and have outward-looking economic policies (box 11).

The challenges posed by globalisation are significant — but so too are the rewards. Countries with high tariffs or barriers to investment might face fiscal pressures when trade liberalisation occurs, and reaping the gains from integration might require adjustments with short-term costs. But making these adjustments when national incomes are rising eases the impact of the reforms.

Strengthening the tax base, removing regulatory and other barriers to domestic adjustment, and developing social programs are all national options to enhance and diffuse equitably the substantial benefits that more open trade policies provide.

11 Developing country experiences differ with different policy choices

Experiences with trade and investment liberalisation

India has substantially liberalised trade and investment since the mid-1980s. As India has become more integrated with the world economy, its people have experienced rapid growth in national income per person, despite the challenges presented by integration. In the three decades following independence in 1947, economic growth in India was limited by a high degree of government planning, strict controls on foreign direct investment and high tariff rates. Output per person rose only 1.5 per cent a year. By liberalising import and industrial controls in 1985, its agricultural performance improved and growth in output per person accelerated to 3.8 per cent a year in the latter part of the 1980s. Despite domestic economic setbacks in the 1990s, output per person is now growing at 4.1 per cent a year.

Egypt began to liberalise its trade policies in 1975 and witnessed a growth spurt of 7.1 per cent a year for the following 10 years. Declining oil prices in the mid-1980s put a brake on growth, which fell to 0.4 per cent in 1992 and 1993. The Egyptian government responded with a significant economic reform package. It tightened fiscal policy, decontrolled interest rates, liberalised the capital account, and undertook reforms to enable privatisation. Foreign investors were quick to react and investment flows rose to US$1.2 billion in 1997, mainly in manufacturing and banking. Tariff revenue as a percentage of imports fell from 25 per cent in 1985 to 17 per cent in 1997, reflecting increasing openness to trade. Income growth then rose to 5.0 per cent in 1996 and 5.5 per cent in 1997. Stronger growth is held back by some inefficient services, such as the major state-owned ports, and bureaucratic delays in processing trade transactions. Signs of renewed momentum for trade reform are emerging within the country.

China's program of domestic reforms and international integration began in 1978. The need to import grains and fertiliser to support agricultural reforms, and import plant and equipment to reduce the technological gap between China and its neighbours meant earning foreign exchange was a priority. China's economy opened to the outside world through trade reforms, the development of foreign exchange markets, and the relaxation of restrictions on foreign investment through the development of special economic zones. During the 1980s and 1990s China recorded real average income growth of 7 per cent a year. Average incomes doubled each decade, and the incidence of extreme poverty dropped dramatically.

Experiences with limited international integration

African countries are only slowly and selectively becoming globalised. Pervasive quantitative restrictions, high tariffs and widespread exemptions to trade reforms put in place continue to characterise trade regimes in many countries, such as Ethiopia, Kenya and Zimbabwe. Tariffs today average around 20 per cent across the continent, compared with 7.2 per cent in the fast growing Asian countries and 5.4 per cent in industrialised countries. Africa's share of world trade has fallen from 2.3 per cent in 1970 to around 0.7 per cent today.

Poverty among the populations of Africa remains worse than anywhere else in the world. In 1999, 19 out of the 20 poorest countries in the world were in Africa.

Data sources: IMF (2000, 2001); World Bank (1996, 2000, 2001a).

Support for good policy choices and global trade reform is essential

Despite the progress that has been made against poverty and global inequality, these problems remain among the most serious international challenges we face. Up to 1.2 billion of the developing world's 4.8 billion people still live in extreme poverty. It is right that people in wealthy countries examine ways to help further reduce poverty and inequality.

We will not succeed in meeting these challenges if we misunderstand the nature of poverty and global inequality — or worse, attribute these problems to the economic integration that is helping to lift the majority of the developing world's population out of poverty. So it is essential that wealthy countries support — through development assistance — policy choices that help to open economies to international trade and investment, strengthen the institutions of governance, and mitigate inequality. And there must be global action to reduce trade and investment barriers.

Well-targeted development assistance can help poor countries build the capacity of their institutions so that they can operate successfully in a global environment. It can provide expertise on the development of sound domestic policies, and help to manage the dislocation caused by change. More fundamentally, aid has an important role to play in facilitating sustainable development in poor countries by helping to address development constraints such as deficient infrastructure, weak health systems and low levels of education.

Global action to reduce trade and investment barriers is crucial in both developed and developing countries. The growth needed to reduce poverty will not happen without trade. Rich countries continue to impose trade barriers on exports from developing countries, which cost developing countries dearly in terms of income forgone (box 12).

12 Developing country income lost as a result of protection

Among the things that hold back growth in the incomes of developing countries are:

- trade restrictions in rich countries against developing country exports; and
- trade restrictions in developing countries against each other's exports.

The World Bank has estimated that protection in rich countries costs developing countries more than US$100 billion a year, twice the total value of aid flows. Just under half of this is caused by tariffs applied by industrialised countries, particularly against agriculture, textiles and clothing. Studies by the International Monetary Fund estimate that, if the European Union, Japan, Canada and the United States eliminated their trade barriers on African trade, exports from Africa would be around US$2.5 billion or 14 per cent higher (IMF 2001).

Developing countries' own trade barriers also hinder income growth. Developing countries now trade much more with each other than in the past, and therefore their own tariff barriers are becoming an important impediment to each other's export growth. Seventy per cent of the tariff barriers placed on developing country exports come from other developing countries.

Modelling by the Centre for International Economics (CIE 2001) shows that if developing countries unilaterally reduced their tariffs and removed all of their production and export subsidies they would boost their own real national incomes significantly. Real national income would rise by 1.2 per cent for the South African Customs Union, 1.6 per cent in the Middle East, 0.8 per cent in China and 1 per cent in Thailand. The modelling also shows that, worldwide, bigger gains would result from liberalisation by all countries and regions — developed and developing alike.

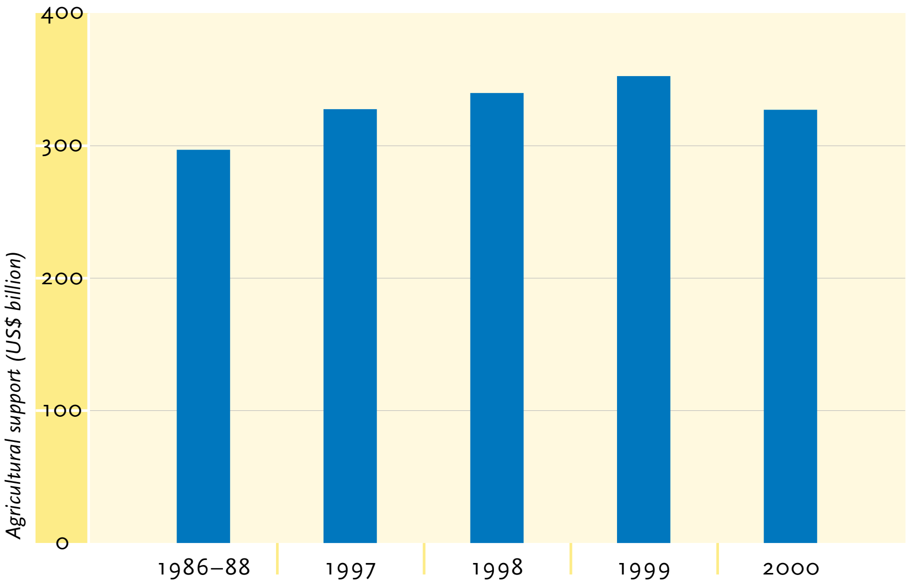
Sources: CIE (1999, 2001); IMF (2001); World Bank (forthcoming).

The cost to developing countries of developed countries' agricultural protection and support is of particular concern because of the significance of agriculture in developing countries. Agriculture accounts for 35 per cent of GDP in least developing countries, compared with 17 per cent in lower middle income developing countries and 8 per cent in upper middle income developing countries (Wolfensohn 2000, p. 7).

Developed countries impose trade barriers on agricultural imports from developing countries at average rates that are nearly five times higher than the barriers on manufactured imports, which typically come from more developed countries.

Adding to this burden is the impact of subsidies and other forms of assistance given to farmers in rich countries. Agricultural support in OECD countries has returned to the high levels of the 1980s (chart 13) and was a staggering US$327 billion in 2000 (1.3 per cent of GDP).

13 OECD agricultural support remains well above US$300 billion a year



Data sources: OECD (2000, 2001).

This support for farmers in OECD countries is almost US$1 billion a day — roughly equivalent to the entire GDP of Sub-Saharan Africa and more than six times the total amount given to developing countries as aid.

Sustaining the momentum

Since economic globalisation accelerated in the second half of the twentieth century, income growth and poverty reduction have been unprecedented.

- The proportion of the world's population in extreme poverty has fallen.
- The absolute number in poverty has stopped rising and appears to have fallen, despite continued population growth.
- Inequality has narrowed across the population of the world as a whole.
- Globalising developing countries, which represent most of the developing world's population, have experienced faster income growth than countries in the developed world. But national policies have not always been sufficient to ensure that the benefits of this growth are enjoyed by all.

Faster and broader progress can be made in eradicating extreme poverty and further reducing inequality if policies for economic openness and reform (including taxation, education, health and social safety nets) are sustained, taken up by more developing countries, and supported by industrialised economies through development assistance and global trade reform.

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