

Bayer, Kurt

## Article

# Does Globalization Make the World More Equitable?

Intervention. European Journal of Economics and Economic Policies

## Provided in Cooperation with:

Edward Elgar Publishing

*Suggested Citation:* Bayer, Kurt (2008) : Does Globalization Make the World More Equitable?, Intervention. European Journal of Economics and Economic Policies, ISSN 2195-3376, Metropolis-Verlag, Marburg, Vol. 05, Iss. 1, pp. 45-54,  
<https://doi.org/10.4337/ejeep.2008.01.05>

This Version is available at:

<https://hdl.handle.net/10419/277119>

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## Does Globalization Make the World More Equitable?

*Kurt Bayer\**

### *Trends in Globalization*

Globalization is not a new phenomenon. A first phase occurred during the colonization of Africa, Asia and Latin America when raw materials for Europe were extracted, slave labor shipped across the world and markets developed as outlets for European commodities. This critical phase can be dated from the 1850s to World War I. During that time the share of exports in world GDP doubled to eight percent, 60 million Europeans emigrated to America, similar numbers from China and India to other South Asian and African countries. Migration flows reached ten percent of world population, trade relations flourished. This trend reversed after World War I: by the 1950s, the share of exports in world GDP had fallen back to its 1870 level of four percent, per capita growth was lower by one third, partly as a result of the wars, partly as a result of the breakdown of trade and investment relations due to protectionist policies and a dramatic fall in world demand in the course of the Great Depression.

\* European Bank for Reconstruction and Development, London.

After World War II a dynamic phase of trade liberalization enabled the strong growth of the world economy until the oil price shocks in the 1970s and 1980s. A wave of integration among rich countries occurred; income inequality in the OECD countries fell, developing countries remained primary commodity producers and fell back in income and growth.

The ongoing globalization phase started with the dismantling of restrictions on the free movement of capital, technological advances in transport and communication and the opening of large developing countries to world trade and foreign direct investment (FDI) during the 1980s. In 1982 FDI amounted to 0.5 percent of global GDP and 2.5 percent of global investment, more than 20 years later FDI has grown to 1.6 percent of GDP, and 7.5 percent of global investment. The share of manufacturing exports in total exports of developing countries increased from 25 percent to 80 percent, many developing countries doubled their export ratios, but many others stayed behind. While in 2006 China became the fourth largest economy of the world and in summer 2007 surpassed the USA in export volume – and similar, albeit slower developments occurred in India –, many developing countries around the world (with a combined population of about two billion people) registered negative growth rates in the 1990s, with increasing poverty rates. This has led once more to large migration flows into rich countries.

GDP growth rates since 2004 have been higher than during the last 30 years (around five percent for global growth), also for developing countries (around seven percent), but differences in growth performance have also widened. While especially a number of emerging economies have grown extremely fast (e.g. China, India, Vietnam), a number of very poor countries, especially in Africa, the Pacific and Latin America, still do not achieve significant growth. In some of these countries, population growth has continued to be high, thus per capita income growth has been negative during the past decades.

Economic globalization has also enhanced other types of globalization – with diverse effects on populations: higher trade exposure brings along more transport, with corresponding effects on the environment and the spread of diseases; extension of market relations to previously non-traded goods and services, e.g. waste, leads to unequal burdens (see, for instance, hazardous waste exports to less developed countries [LDCs]); emissions trading, on the other hand, can bring about benefits to both industrial and less developed countries – given the right framework<sup>1</sup> and circumstances – and promotes environmental protection in LDCs and the world as a whole; transport, trade and travel, on the other hand, have brought about faster disease contagion across the globe; and, lastly, modern communication and transport facilities have also opened the whole world to transborder crime, including attacks by individuals and groups, motivated mainly by local and/or regional problems.<sup>2</sup>

While globalization can be seen as just another further extension of market penetration and commodification of social relations, it also constitutes an irreversible trend of capital-

1 Yet the international community has fallen short of implementing a functioning global framework for emissions trading.

2 I consciously avoid the term »terrorism«, since it is fraught with many undesirable connotations.

ist development; but certainly not a force of nature which befalls the world no matter what. While some of its effects promote efficiency, wellbeing and progress for some groups, it also leads to marginalization of populations / regions / countries and thus impairs social cohesion, in this way creating severe dangers for stability on a global scale. It is my contention, however, that the forces of globalization can be harnessed by political processes, in order to maximize benefits to as many populations as possible and minimize the negative effects.

### *Trends in Income Inequality*

There is an extensive – controversial – discussion on whether global income distribution has become more unequal as a result of globalization. In the most extensive study to date by Xavier Sala-i-Martin (2002) the author points to the need for analysis along several dimensions: First, income distributions within countries; second, income distributions between countries; third, the combined effects of within- and between-country distributions. His starting point of analysis is the following quote from the United Nations (UN) Human Development Report of 1999:

»Poverty is everywhere. Gaps between the poorest and the richest people and countries have continued to widen. In 1960, the 20 percent of the world's people in the richest countries had 30 times the income of the poorest 20 percent. In 1977, 74 times as much. This continues the trend of nearly two centuries.« (UN [ed.] 1999: 29, 36)

One also must distinguish between absolute poverty and income distribution (Bayer 2006). The latter is a relative concept, measuring the incomes of different groups relative to each other, the former counts people as poor according to an agreed standard which defines a poverty level, most commonly the number or share of persons living on one or two US-\$ per day. Frequently these concepts are confused with each other. Birdsall (2005: 2 ff., figure 1) shows that only a very weak link exists between relative income inequality (measured by the Gini coefficient) and absolute poverty levels (one US-\$ per day).

Sala-i-Martin concludes in his study:

»The ›dramatic‹ and ›disturbing rise‹ in income inequality during the globalization period is nowhere to be seen. On the contrary, income disparities during the last two decades have declined substantially [...]. The reduction in income inequality can be fully accounted for by the decline in across-country income inequalities [...]. Most income inequalities in the world are explained by differences in per capita incomes across countries rather than differences within countries [...]. Within-country inequalities have increased slightly over the last thirty years; however, this increase has been so small that it does not offset the substantial reduction in across-country disparities.« (Sala-i-Martin 2002: 39)

Sala-i-Martin aims to debunk the UN's assessment of growing inequalities as a result of globalization and »neo-liberal« policies promoted by the international financial institutions. Much more interesting than his derision of the above-cited UN confusion of poverty, within-

and between-country income differences, are the policy questions of what effects persistent and grave poverty and income inequality have on the development process.

It is no surprise that if countries like China and India which together account for one third of world population grow fast, that this influences the statistical picture of global income distribution more strongly than if a small African country with a population of two million improves its within-country distribution by bringing significant parts of its population out of absolute poverty. Lining up all the world's individuals by income – and thus measuring global income distribution – reveals extremely high inequality, more unequal than the most unequal countries. This is due to the extreme differences between the richest and poorest countries (e. g. Mali with US-\$ 330 per capita income and Luxembourg with US-\$ 56,000 per capita income).

Table 1 shows that during the past quarter century rich countries and some large emerging countries have grown faster, and these groups contained fewer countries with negative growth rates.

*Table 1: Annual Per Capita GDP Growth by Region, Average 1980–2003*

| Region                 | Mean | Share negative growth in percent <sup>1</sup> |
|------------------------|------|---|
| High income OECD       | 2.2  | 0   |
| Middle income OECD     | 1.1  | 23  |
| Low income OECD        | -0.3 | 59  |
| Sub-Saharan low income | -0.5 | 67  |
| China                  | 8.2  | –   |
| India                  | 3.7  | –   |

1 Share of countries with negative per capita GDP growth in total number of countries/category.

*Source: Birdsall 2005: 21*

Empirical studies show that global poverty rates have fallen significantly during the past decades. This is mainly due to the success that a few very large countries have had with growth and poverty alleviation, bringing several hundred million people out of poverty (as measured by the one-US-\$ and two-US-\$ rates, see table 2), but that in the majority of poor countries the number (and frequently also the percentage) of persons living in poverty has increased.

The policy-relevant questions are: if it is true that during the past years in most countries income inequality has risen within the countries and that the dispersion of growth rates has increased such that some countries exhibit a significantly higher growth trend than others – a) can this be attributed to »globalization«, b) is this relevant for the development process, and c) even more importantly, what can be the policy responses to prevent a further widening of the income distribution in the future?

*Table 2: Poverty Rates, Selected Countries*

| Country           | Population below 1 US-\$ /day<br>in percent | Population below 2 US-\$ /day<br>in percent |
|-------------------|---|---|
| <b>Bangladesh</b> | 36  | 83  |
| <b>Brazil</b>     | 8   | 22  |
| <b>Cameroon</b>   | 17  | 51  |
| <b>China</b>      | 16  | 47  |
| <b>Egypt</b>      | 3   | 44  |
| <b>Ethiopia</b>   | 23  | 78  |
| <b>Haiti</b>      | 67  | 83  |
| <b>Laos</b>       | 26  | 73  |
| <b>Nicaragua</b>  | 45  | 80  |
| <b>India</b>      | 36  | 81  |

*Source: The World Bank (ed.) 2006: table A1*

### *Globalization and Income Inequality*

Birdsall (2005: 22) distinguishes three reasons why globalization sustains or worsens income inequality.

1. Global markets reward more fully those (countries and /or individuals) with more productive assets.
2. Negative externalities increase and compound risks for the weaker and more disadvantaged through globalization.
3. Rules for the global economy are set by those with more power (and income), and they tend to fashion rules according to their own interests.

All these reasons are valid both within and across countries (see e. g. IMF 2007). They exert not only static, but also dynamic effects on countries. If e. g. globalization rewards scarce skills, an individual might benefit from emigrating to richer countries in order to be able to reap the rewards of her/his skill. But the brain drain puts the source country in a less favorable position, since it loses valuable human capital (for whose training it has paid). While the individual rewards to education seem to widen with time also in LDCs, for many countries such attempts to jump-start the development process have contributed to increasing income differentials and emigration. Such processes may create vicious circles of development. The fact that more than three fourth of FDI are conducted among rich countries, and that FDI to LDCs are concentrated in a very small number of countries, also shows that the classic factor-endowment model of equalizing trade and factor flows needs not hold (Easterly 2007).

Poor countries suffer more from externalities as globalization proceeds: waste is exported, climate change (caused by high emissions, predominantly from industrial countries) has

harsher effects on LDCs (who also have fewer means to prevent and adapt), financial crises hit poor countries (and poor people) more likely and more severely than rich countries (and rich persons).

Premature liberalization of the capital account puts pressure on poor and weak countries to adopt tighter fiscal and monetary policies than richer countries (for lack of credibility) during recessions when they should rather stimulate their economies. Since unemployment is sticky, the poor in poor countries will be affected by job loss longer than in richer countries with less stringent austerity/stability requirements exerted by global financial markets. Birdsall (2005: 30) mentions among the costs also the bail-out burdens on public budgets of financial crises, which in turn force affected governments to cut public expenditures for their populations in favor of repayments and interest payments.

In addition, contagious disease transmission, transnational crime, violence associated with the fight over control of natural resources or narcotics/drugs, trafficking in humans, transborder corruption, etc. – all these are associated with more open borders and have more severe negative effects on poor persons and countries.

The formulation of trade rules, especially intellectual property rights conventions, customs unions agreements, investment rules, financial supervision rules and national/regional migration regimes, all tend to be dominated by the richer and more powerful countries. The present criticism of the Bretton Woods Institutions also maintains that rich countries exert power on rule-setting and implementation beyond their »legitimate« role (see e.g. Dervis/Ozer 2005). Birdsall (2005: 31) reports that about one half of all anti-dumping actions are directed against LDC producers who account for only eight percent of all exports.

If globalization is a further step in the development of global capitalism by extending the reach of the market economy into further geographical and sectoral regions, recent history shows that further globalization will go further hand in hand with increasing inequality. Since factor endowments are unequal to begin with (among persons and countries), factor price equalization does not occur because of institutional and power-related factors and inequality increases. In this situation, relying even more on market forces will only exacerbate the problem. Only market-correcting intervention by non-market authorities (state, civil society, cooperatives) will be able to counter this growing trend towards inequality. But if such rule-setting institutions are again captured by the powerful, they will rather pursue their own interests than those of solidarity and social cohesion.

### *Globalization, Inequality, Development and Policy*

Inequality has not been the focus of Western development research and practice until rather recently. Mainstream economists hold that inequality is good for growth because it tends to counteract the lack of capital in LDCs, since middle class and richer people tend to save and invest more and will be induced by unequal returns to work more and harder.

Recently, development economists have begun to recognize the importance of analyzing distribution trends as essential for the development process (see e.g. Bourguignon 2002, Birdsall 2005) and to recognize that inequality can hinder development.

Birdsall (2005: 5) mentions three reasons why inequality inhibits development.

- a. Where markets are underdeveloped, inequality inhibits growth through economic mechanisms.
- b. Where governmental institutions are weak, inequality exacerbates problems of maintaining and creating accountable government, increasing the probability of growth and poverty-reducing economic and social policies.
- c. Where social institutions are fragile, inequality further discourages civil and social life which is an essential basis for functioning societies and collective decision making.

I would add a fourth category:

- d. Strong inequality discourages poor citizens from participating in social and political life, as it reinforces their perception that the state has been captured by better-off elites.

Studies find differential effects from inequality on growth. Barro (1999) estimates that a per capita GDP of US-\$ 5,000 forms a threshold below which inequality has negative effects on growth, and above positive ones. This would point to the negative impact of weak institutions in LDCs, and the functioning of the savings-investment argument in richer countries. Birdsall (2005: 7 f.) distinguishes between »constructive inequality« which is good for growth and its converse »destructive inequality«. The former reflects individuals' preferences with respect to equal opportunities and is thus consistent with efficient resource allocation, the latter reflects »privileges of the rich«. In the end, it is the balance of constructive and destructive inequalities which determines a country's overall position. This conceptual differentiation seems artificial, but it points to the important fact that inequality has many dimensions, both real and perceived.

»Cultural Theory« (see e.g. Thompson et al. 1990) distinguishes, for the purpose of risk policy analysis, among five types of »cultures« or personal inclinations/lifestyles – all of which and their overlaps exist in every society. These are »individualist«, »egalitarian«, »hierarchical«, »fatalist« and »autonomous«, each describing an idiosyncratic personal preference pattern. In finding policy solutions, they all need to be taken into account, because neither of them is »right« or »wrong«. This is a fruitful approach in categorizing »more egalitarian« or »more individualistic« preferences and behavioral patterns.

The growth-reducing effects of income inequality usually are argued via capital market inefficiencies (e.g. lack of collateral, information asymmetries), wealth effects (especially unequal land distribution), education effects (human capital) and public choice theories where government institutions and decision-making are captured by status-quo-oriented elites.

The growth nexus of income inequality also has effects on poverty reduction, since this is closely linked to economic growth. In the absence of static redistribution of assets (a revolution), absence of growth prevents poverty alleviation, while growth in itself does not always lead to poverty reduction. This is the reason for the more recent focus on »pro-poor growth« which means basically two things: it may refer to the growth process itself, which can either be broad-based, relying on indigenous small- and medium-sized enterprises (SMEs),

domestic supply chains, employment-rich growth – or consist of FDI-induced growth in special tax-exempt and privileged export-processing zones, relying e. g. on cheap domestic unskilled and semi-skilled labor and imported raw materials and supplies for export where profits are reinvested abroad.<sup>3</sup> The second, more common concept of pro-poor growth points to the importance of investing a significant part of government revenue in the development of education, health, skill formation, a social network and other social benefits, in order to form a future basis for more growth. Both concepts need to be combined in an »optimal« development strategy (Bayer 2004).

In a recent book, Collier (2007) makes an interesting and highly relevant observation that warrants attention: if none of the preconditions for economic growth exist in a region (he talks about 58 stagnant countries containing approximately one billion persons) then the usual growth-enhancing interventions are futile and will not produce »higher« growth. Collier focuses on conflict /post-conflict situations and weak governance capacity as debilitating such stagnating regions in which very specific directed interventions would be necessary, in order to jump-start indigenous growth. These are countries /regions which have been by-passed by globalization and continue to be by-passed, because investment tends to flow into areas where other investment exists already (agglomeration effects). Even resource-rich countries frequently lack essential growth factors, not so much as a result of »Dutch disease« phenomena, but more because of the devastating effect of political capture, corruption, and easy revenue source which prevents structural reforms.

### *Conclusions*

Several conclusions can be drawn from this discussion:

- Globalization is going hand in hand with growing inequality, especially within countries, but also widens the welfare gap between rich and poor countries, while a good number of LDCs have grown significantly and in some of them also significant numbers of poor have been brought above the poverty line.
- Globalization-enhanced growth is a necessary, but not sufficient condition for poverty alleviation. Market mechanisms tend to reward scarce factors and those in already strong positions and do not – given unequal starting points and present power situations – lead to a narrowing of income differentials.
- Directed interventions in the form of promoting »pro-poor« growth patterns, such as promotion of labor intensive growth based on SMEs; the promotion of local /national value chains; redistribution via taxes and government expenditures, the free or subsidized provision of public services to all citizens, especially the poor; the promotion of the preconditions for collective decision making and broad participation of

3 These are relatively extreme characteristics, intended more as a typology than a description of actual growth patterns. Frequently it is also not possible for a LDC government to choose freely between these two types, since global competition for capital, weak domestic capacity, lack of indigenous resources and skilled workers do not provide a large portfolio of choices.

citizens in local, regional and national decision-making, accountability of government, citizen monitoring and many democratic reforms, collective bargaining schemes and promotion of labor unions – all these form necessary, if not sufficient building blocks for more equal income distribution plus growth.

- For fragile states and communities, especially those coming out of internal or external conflicts, stabilization of the political post-conflict system, the reintegration of former fighters and displaced families and governance capacity building in general form the most urgent and basic interventions, always in the form of »help for self-help«, in order to set in motion a virtuous circle of good governance, strong capacity, accountability.
- Alleviation of absolute poverty should form the main direction of outside help and domestic effort. While widening relative income differentials are a threat towards social peace and cohesion, bringing as many people as possible out of poverty is an absolute precondition for a serious development process.
- It is in the well-understood interest of the rich parts of the world not to neglect severe poverty problems in other regions: apart from humanitarian aspects, poverty also drives migration to more prosperous regions, causes a negative brain drain, threatens global dispersion of contagious diseases and violence and thus is prone to threaten the high standard of living which most citizens in the industrial world enjoy.
- Harnessing the market forces of globalization in order to prevent even more severe income inequality across the globe, requires not only political will, but also appropriate institutions at a global level (see e.g. Bradford/Linn 2006, Bayer 2007). While globalization has dismantled the effectiveness of many national regulatory regimes, they have not been »re-created« on a global level. In addition, many of the existing global institutions stem from completely different times and have not adjusted adequately to the challenges of globalization (Bayer 2007: 10f.).
- Even within rich countries, widening income disparities threaten social peace. The »obscene« salary levels of many top managers, especially financial sector CEOs, of some artists and sports personalities, and the falling wage shares in nearly every country, lead to political disillusionment, envy and social strife which threaten future productivity and enhancement of well-being.

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## **Wage Flexibility or Wage Coordination? Economic Policy Implications of the Wage-led Demand Regime in the Euro Area**

*Engelbert Stockhammer\**

Functional income distribution has shifted dramatically in the past 25 years. The wage share in the Euro area has fallen by ten percentage points since 1981.

This is the outcome of economic forces like globalization and technical change, but it has also been the result of deliberate policy pursued by the European Commission (EC) and by some national governments. Despite this drastic fall in wages relative to productivity unemployment has not decreased substantially. It is still higher than it was in 1981. The recommendations of the OECD and the EC to fight unemployment center around making labor markets more flexible. Wages should respond to national (or regional) conditions and increasing wage inequality is explicitly recommended. Wage moderation is regarded as golden way out of unemployment.

\* Vienna University of Economics and Business Administration. I am grateful to Torsten Niechoj and Özlem Onaran for helpful comments. Support from FWF Project Nr. P18419-G05 is acknowledged. All errors are mine.