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GLOBALIZATION, POVERTY AND INCOME DISTRIBUTION: DOES THE LIBERAL ARGUMENT HOLD?

Robert Hunter Wade[1]

"Globalization" is a ragbag, but the "anti-globalization" movement—a combination of trade union protectionists, passionate environmentalists, Third World sympathizers, and antinomian activists who now substitute "globalization" for the earlier "capitalism" and "multinationals"--is proving to be a force not lightly dismissed. Organizations like the World Bank, the UK's Department for International Development, *The Economist*, and *The Financial Times* have mounted a vigorous defense based on four main propositions.

1. Poverty and income inequality have both fallen on a world scale over the past two decades for the first time in more than a century and a half. As Martin Wolf of *The Financial Times* puts it, "Evidence suggests the 1980s and 1990s were decades of declining global inequality and reductions in the proportion of the world's population in extreme poverty".[2] The World Bank goes further: not only has the proportion in extreme poverty fallen, but also the absolute number. "Since 1980 faster growth, particularly in China and South Asia, has contributed for the first time in recent history to a steady decline in the number living in destitute poverty", from 1.4 billion in 1980 to 1.2 billion in 1998.[3]

2. These falls are due to the rising density of economic integration between countries ("globalization"), and would have gone further had the poorer countries been more integrated into the world economy.

[1] Professor of Political Economy, London School of Economics and Political Science. I thank Sanjay Reddy, Michael Ward, Branko Milanovic, Ron Dore, Martin Wolf, and James Galbraith for good dicussions. This paper began as my end of the Wade-Wolf debate in *Prospect*, March 2002. See further my essays, "Winners and losers: The global distribution of income is becoming more unequal; that should be a matter of greater concern than it is", By Invitation, *The Economist*, April 28, 2001, 79-81, republished in *Globalisation*, The Economist, 2001; "The rising inequality of world income distribution", *Finance and Development*, 38 (4), December 2001.

[2] Martin Wolf, "Doing more harm than good", *Financial Times,* 8 May 2002.

[3] World Bank, *Global Economic Prospects and the Developing Countries 2002: Making Trade Work for the World's Poor*, p.30.

3. Therefore the empirical grounds of the anti-globalization movement—the grounds on which it claims to be thinking for the world—collapse. Its policies would cause more poverty and more inequality. The evidence is so clear that Martin Wolf concludes, "The argument about globalisation, as such, must stop". [4]

4. The governments of poorer countries should take as their top development policy objective, raising the economy's integration into the world economy, or increasing the economy's "openness".

This argument makes the current wave of globalization fit well with the great liberal tradition, which presumes that the more liberal or open economies have the fastest economic progress, that the process of liberalization increases the rate of progress, and that resistance to economic liberalization is the result of "special interests". Many academics, including those not champions of liberalism, have embraced similar arguments. They point especially to the dispersal of manufacturing capacity to developing countries as a force that is eliminating the structural divide between First and Third Worlds. In the words of two of them, "Worldwide convergence, through the global restructuring of capitalism, means that the geographic breakdown of the world into north-south, core-periphery or First and Third worlds, while still significant, is diminishing in importance". [5]

Can such arguments be tested? Are theories linking such a ragbag concept as globalization with such multifaceted concepts as poverty and inequality bound to be vacuous? In the end the question of whether or not by some statistical measure China's getting richer counterbalances Africa's reversion to barbaric misery does not matter much compared with the question of what to do about Africa's misery or narrower questions like whether protectionism is justified in country x at time y. But the fact is that a lot of people do make strong claims about the trends in poverty and inequality, and they say that globalization is the main driving force behind the trends--whether for good or ill. It is worth discussing the empirical basis of the claims.

In this paper I raise doubts about the claims that world poverty and world income inequality have both fallen over the past two decades or so, and that more open economies have better economic performance in terms of growth and poverty reduction than less open economies (or a

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[4] Martin Wolf, "A stepping stone from poverty", *Financial Times*, 19 December 2001. See also his "The big lie of global inequality", 8 February 2000.

[5] Roger Burbach and William I. Robinson, "The Fin De Siecle Debate: Globalization as Global Shift". *Science and Society*, 63:1, 1999, 10-39, at 27-8.

related but distinct proposition which is often conflated with the former, that countries that have globalized faster have had faster economic growth and bigger falls in poverty). I then discuss a few of the deep structural causes at work in the world economy that may be invoked to explain the failure of the liberal claim. At the end I give some normative conclusions.

POVERTY

As the economist Richard Cooper says, the record on poverty alleviation in the late twentieth century is "unambiguously positive".[6] Things may have got worse in Africa, he admits, but the improvements in China and India mean that "the fraction of the world's population living in poverty has gone way down".

These and other such statements are based on World Bank figures, for the Bank is effectively the sole producer of the world poverty headcount. It declares in the opening sentence of the *World Development Indicators 2001*, "Of the world's 6 billion people 1.2 billion live on less than $1 a day".[7] This number, says the Bank, was the same in 1998 as in 1987. Since world population increased, the proportion of the world's population in absolute poverty fell sharply in only 11 years from around 28 percent to 24 percent, an extraordinary historical reversal of trend.

Other Bank sources give different numbers, however. *The World Development Report 2000/2001: Attacking Poverty* says that the number of people living on less than $1 a day *increased* by 20 million from 1.18 billion in 1987 to 1.20 billion in 1998. Less than two years later *Globalization, Growth, and Poverty: Building an Inclusive World Economy* claimed that the number of people living in poverty *decreased* by 200 million in the 18 years from 1980 to 1998.[8]

My strong conclusion is that we cannot have much confidence in the Bank's numbers.[9] My weaker conclusions are that the absolute numbers in extreme poverty are probably higher than the Bank's, that the trend is probably upwards, and that, nevertheless, the proportion of the

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[6] Richard Cooper, quoted in Jim Hoagland, "Is the global economy widening the income gap?", *International Herald Tribune*, 27 Apr 1999, p.8.

[7] *World Development Indicators 2001*, The World Bank, p.3. The $1 a day is measured in purchasing power parity.

[8] *Globalization, Growth, and Poverty: Building an Inclusive World Economy*", World Bank and Oxford University Press, 2002. See Angus Deaton, "Is world poverty falling?", *Finance and Development*, forthcoming as of May 2002.

[9] I am indebted to Sanjay Reddy for discussions of the points made here. His paper with Thomas Pogge, " How not to count the poor", typescript, June 2002, at www.socialanalysis.org, discusses them in much greater detail. Also, Massoud Karshenas, "Measurement and nature of absolute poverty in least developed countries", typescript, Economics Department, SOAS, University of London, January 2002.

world's population living in extreme poverty has indeed probably fallen over the past twenty years, as the liberal argument claims.

The Bank's world poverty headcount emerges from a process in which it first calculates an international "extreme poverty" line (defined in terms of income or consumption) from the official national poverty lines in a sample of countries. It applies purchasing power parity exchange rates (PPP exchange rates, expressed as so many units of national currency per US dollar), rather than current market exchange rates, to the national poverty lines in order to arrive at the international poverty line defined in US dollars. When the Bank began this world poverty headcount exercise in 1990[10] it took a sample of 33 low- and middle-income countries (using a selection criterion that it has not explained), and found that a cluster of eight countries had poverty lines at around $31 per month or $1 per day, using the Penn World Tables to get the PPP exchange rates between national currencies and US dollars for 1985. This "typical" line is the origin of the famous "$1/day" extreme poverty line. National poverty lines so calculated were then adjusted by the national consumer price index for years after 1985. (The Penn World Tables are based on a large-scale international price comparison made in 1985. It took a large number of goods and services and compared the prices for a given unit in the US against the prices in other countries. So the price comparison showed the US$ price of a kilo of wheat over the price of a kilo of wheat in India expressed in rupees, the US$ price of a massage in the United States over the rupee price of a massage in India, and so on. This gave a purchasing power parity exchange rate for each good or service with respect to the US and India. These individual PPP exchange rates were then aggregated into a single PPP exchange rate between the US$ and the Indian rupee, taking some account of regional price variation within countries. The same exercise was done for all countries in the survey using the same basket of goods and services.)

In the late 1990s, the Bank changed the poverty headcount methodology. It took the same 33 countries and the same basket of goods and services that had been included in the earlier poverty line, and revalued them using a new international price survey of 1993. With the 1993 prices the earlier cluster of national poverty lines around $31 per month disappeared. So the Bank arbitrarily took the 10 lowest of the 33 national poverty lines and selected the median, roughly the fifth lowest. This gave a "rebased" international poverty line of $PPP 1.08 per day. The Bank then used the new set of 1993 prices to convert this new international poverty line back into national poverty lines expressed in national currencies. Then it recalculated the number of people in each

[10] *World Development Report 1990*, World Bank, 1990.

country, and the world, living on incomes below this new level. In short, the Bank's change of methodology in the late 1990s (the new results were published in *World Development Report 2000/01*) amounted to: (1) a change in the way the international poverty line was calculated from a set of official poverty lines for a sample of low- and middle-income countries, (2) a change in the international poverty line from $PPP 1 per day to $PPP 1.08 per day, and (3) a change in the procedure for aggregating the relative price changes between 1985 and 1993 for each of the goods and services in the standard bundle for each country (a change that the Bank has never reported publicly, let alone explained). [11]

Some of the reasons for agnosticism about the number of people in extreme poverty come from the change in methodology, others from problems that the change did not address.

First, the Bank's comparison between 1980 and 1998—1.4 billion in extreme poverty in 1980, 1.2 billion in 1998--is not legitimate, because the two figures are calculated using different methodologies. The Bank has recalculated the poverty numbers with the new methodology only back to 1987. We do not know what the 1980 figure would be if calculated by the same methodology as the later figures.

Second, we do know that the Bank's new methodology using the relative prices from the 1993 survey caused a huge change in the poverty count even for the same country in the same year using the same survey data. Table 1 shows the impact of the revision in terms of the poverty rate in different regions, for 1993. Angus Deaton concludes from these figures, "Changes of this size risk swamping real changes, and it seems impossible to make statements about changes in world poverty when the ground underneath one's feet is changing in this way".[12]

TABLE 1. 1993 POVERTY RATE, USING OLD AND NEW WORLD BANK METHODOLOGY

	Old poverty rate (%)	New poverty rate (%)
Subsaharan Africa	39.1	49.7
Latin America	23.5	15.3
Middle East/N Africa	4.1	1.9

Source: Deaton, "Counting the world's poor".
Note: The poverty rate is the proportion of the population living on less than $1 a day. The old rate is based on the 1985 PPP benchmark survey, the new rate is based on the one of 1993.

[11] From the Geary-Khamis method to the EKS method.
[12] Angus Deaton, "Counting the world's poor: problems and possible solutions", *The World Bank Research Observer,* 16 (2), 2001, 125-47, p.128.

Third, the new methodology did not address a basic problem with the Bank's global (old or new) poverty line to do with *which* goods and services are included in the bundle against which relative purchasing power is being measured. The problem is that the Bank's line relates to a "general consumption" bundle, not to a basket of goods and services that makes sense for measuring poverty, such as food, clothing and shelter (though "$1 per day" does have intuitive appeal to a western audience being asked to support aid). We have no way of knowing what proportion of food-clothing-shelter needs the Bank's poverty line captures. If the Bank used a basic needs poverty line rather than its present artificial one the number of absolute poor would probably rise, because the national poverty lines equivalent to a global basic needs poverty line expressed in US dollars would probably rise by a lot (maybe 25-50%). They would rise a lot because the present PPP price indices include many services that are very cheap in developing countries (eg. massages) but irrelevant to the poor—to the consumption bundle needed to avoid poverty—and therefore give a misleadingly high measure of the purchasing power of the incomes of the poor. Food and shelter are relatively expensive, and if they alone were included in the PPP exchange rate used to express the incomes of the poor in US dollars, national poverty lines would go up.[13] Indeed, the rates of "extreme poverty" for Latin American countries using poverty lines based on calorific and demographic characteristics are roughly twice as high as those based on the World Bank's $1/day line.[14]

Fourth, the poverty headcount is very sensitive to the precise level of the global poverty line because income distribution in the vicinity of developing country poverty lines is typically fairly flat. Even a small increase in the line brings a large increase in the number of people below it. Hence we can expect that a shift to a poverty line based on basic needs, excluding services that are very cheap but irrelevant to the poor, would raise the number of people in extreme poverty by a significant amount.

Fifth, the Bank's poverty headcount comes from household surveys. Household surveys have a number of limitations that add up to a large margin of error in national poverty numbers and so also in the world totals. Some are well known, such as the exclusion of most of the benefits that people receive from publicly provided goods and services. Others are less well known, such as the sensitivity of the poverty headcount to the

[13] It is remarkable that the International Comparison Project (ICP), which has orchestrated systematic collection of international price data since its founding in 1967, held its first ever panel meeting to discuss designing a purchasing power parity factor specifically relevant to the consumption bundle of the poor as recently as March 2002, yet has been chaired by the World Bank for the past decade. The ICP's central concern has been to design ways of comparing GDPs.

[14] For example, Brazil's extreme poverty rate according to the CEPAL line was 14%, according to the World Bank for roughly the same recent year, 5%; Bolivia, 23%, 11%; Chile, 8%, 4%; Colombia, 24%, 11%, Mexico, 21%, 18%. *Panorama Social de America Latina 2000-01*, CEPAL, September 2001, p.51.

recall period used in the survey. The shorter the recall period the more expenditure is reported. India provides a striking example. A recent study suggests that a switch from the standard 30 day reporting period to a 7 day reporting period itself lifts 175 million people from poverty using the Indian official poverty line, a nearly 50 percent fall. Using the $1/day international line, which is higher, the fall would be even greater.[15]

Sixth, when new household surveys for a country are not available the Bank assumes that income distribution is the same as it was under the last available household survey and then increases the consumption of the poor in the old survey by the growth in *average* consumption in the national accounts data, no matter that national income distribution may have changed a lot. This procedure can make poverty fall as an artifact of the methodology.

Seventh, the PPP-adjusted income figures for China and India—the two most important countries for the overall trend--contain an even bigger component of guess work than for most other significant countries. I noted earlier that the main sources of purchasing power parity income figures (the Penn World Tables and the International Comparison Project) are based on two large-scale international price benchmarking exercises for calculating purchasing power parity exchange rates, one in 1985, the second in 1993, carried out in 60 countries in 1985, 110 countries in 1993.[16] The government of China declined to participate in both. The purchasing power parity exchange rate for China is based on guestimates from small, ad hoc price surveys in a few cities, adjusted by rules of thumb to take account of the huge price differences between urban and rural areas and between eastern and western regions. The government of India declined to participate in the 1993 exercise. The price comparisons for India are extrapolations from 1985 qualified by small, ad hoc price surveys in later years. The lack of reliable price comparisons for China and India must compromise any statement about trends in world poverty.[17]

Finally, we need to bear in mind that the number of absolute poor is a politically sensitive number, because critics use it to attack the Bank. The majority report of the Meltzer Commission, for the US Congress, said the Bank was failing at its central task of poverty reduction—as shown by the fact that the number of people in absolute poverty remained constant at 1.2 bn between 1987 and 1998.[18] (A spurious argument if ever

[15] Reported in Deaton, "Counting the world's poor".
[16] An ICP benchmark survey was also done in 1996, but the quality of the data was poor because many more countries participated than expected and resources were insufficient for central coordination and data quality control.
[17] See Reddy and Pogge, above.
[18] United States Congressional Advisory Commission on International Financial Institutions (Meltzer Commission), *Report to the U.S. Congress on the International Financial Institutions*, 2000. Available

there was one.) People who calculate politically sensitive numbers—in the Bank or anywhere else—may be inclined to make choices that flatter the result even if they remain within the bounds of the professionally defensible, even if they remain far from behavior that could be construed as "cooking the books".

In short, we should be cautious about accepting the World Bank's poverty headcount as approximately correct; we should acknowledge the large margin of error. We do not know for sure whether the late 1990s revisions to the methodology and to the PPP numbers have the effect of raising or lowering the poverty headcount, and whether they alter the direction of the trend over the 1980s and 1990s. But it is likely that (a) the Bank's numbers underestimate the true numbers, and (b) the new methodology applied in the late 1990s underestimates the true numbers by more than the old methodology and by more in later years than in earlier years. The new methodology makes the trend look better than it really is because the new international poverty line of $PPP 1.08 translates into *lower* national poverty lines in most countries (to be exact, in 77 percent of the 94 countries for which data are available, containing 82 percent of their population). The new international line lowers the old national line for China by 14 percent, for India, by 9 percent, for the whole sample by an average of 13 percent.[19] It is likely that future "updating" of the international poverty line will continue to depress the true trend, because worldwide average consumption patterns (on which the international poverty line is based) are shifting toward services whose relative prices are much lower in poor than in rich countries, giving the false impression that the increase in the cost of the basic consumption goods required by the poor is lower than it is.

Some people argue that the whole exercise of constructing a global poverty line and then counting the number of poor below it is futile; not only are our current numbers not meaningful, they *could not* be meaningful. They propose to use national poverty lines to count the number of poor in each of the world's 200+ countries, and then make an interpretation based on 200 data points for one year, or 400 data points for two years. The problem is obvious. My response is that if we are to assess globalization as a world-scale phenomenon and not simply as the aggregate of national phenomena we need world aggregate data to measure the overall trends. Our task is to find measures that survive

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at www.house/gov/jec/imf/ifiac. Meltzer later described the fall in the proportion of the world's population in poverty from 28% in 1987 to 24% in 1998 as a "modest" decline, the better to hammer the Bank (Allan Meltzer, "The World Bank one year after the Commission's report to Congress", hearings before the Joint Economic Committee, U.S. Congress, March 8, 2001).

[19] Reddy and Pogge, "How not to count the poor".

scrutiny. For this we need measures and price indices specifically related to poor people, in contrast to what is presently available.

Having said all this, I think it is quite plausible that the proportion of the world's population living in extreme poverty (facing periods of food consumption too low to maintain health and wellbeing) has indeed fallen over the past twenty years or so, thanks largely to fast economic growth in China and India. The broad trends in national data for these two countries, including life expectancy and other non-income measures, give grounds for confidence in this conclusion, even allowing for large margins of error.[20] Moreover the magnitude of world population increase over the past twenty years is so big that the Bank's poverty numbers would have to be *huge* underestimates for the proportion in extreme poverty not to have fallen. But any more precise statement about the absolute number of the world's people living in extreme poverty and the change in the number over time currently rests on statistical quicksand.

The statistical problems behind the poverty numbers also mean that we cannot give a confident answer to one of the most central of all questions about economic development—the effect of economic growth on the number of people living in extreme poverty. The liberal argument says that economic growth lifts people out of poverty. Indeed, some analysts claim that the income of the poor rise "one-to-one" with average income.[21] Other analysts say, on the contrary, that the lack of a fall in the number of people in extreme poverty despite historically high rates of economic growth—both in the world as a whole and in specific countries (notably India)—suggests that economic growth may do little to reduce poverty. The truth is that our currently available data preclude a confident conclusion. [22] The reason is not only the uncertainty in the poverty numbers, but also the fact that the poverty numbers and the economic growth numbers come from different and quite inconsistent sources. The poverty numbers come from household surveys, while the economic growth measures come from the national income accounts, and in many countries there are large and growing discrepancies between income and consumption estimates from the two sources. In Asia the consumption estimates from household surveys tend to be well *below* the consumption estimates from the national accounts. The ratio of household survey-based consumption to national accounts-based consumption in India (the biggest single contributor to the world poverty count) fell from around unity in the 1950s to little more than 50 percent in recent years. A similar

[20] See David Dollar, "Global economic integration and global inequality", this volume.

[21] "[O]n average there is a one-to-one relationship between the growth rate of income of the poor and the growth rate of average income in society", *Globalization, Growth, and Poverty*, World Bank and Oxford University Press, 2002, p.48.

[22] Deaton, "Counting".

drift is found in China, the second biggest contributor to the world poverty count; and also in Pakistan, Bangladesh, and Indonesia. In some sub-Saharan African countries, on the other hand, the estimate of consumption from household surveys is two to three times *above* the estimate from the national accounts. As Angus Deaton concludes, we have no consistent empirical basis for conclusions about the extent to which economic growth reduces poverty.[23]

INEQUALITY

Many analysts claim that world income inequality fell sharply in the second half of the 20th century, especially in the final quarter.[24] But in the past several years world income distribution has become a hot topic of debate in international economics and in sociology, and there is now even less agreement about the trend of income distribution than about the poverty numbers. Whereas we *could* get better data on the poor to the extent that the numbers would command general agreement, the issues in the measurement of inequality do not admit of best solutions even in principle. The answer to the question, "What is happening to world income inequality?", depends on choices among the following: (a) alternative measurements of income (GNP per capita converted to US

[23] David Dollar and Aart Kray in “Growth is good for the poor” (Development Research Group, World Bank, March, 2001) conclude that, in a large sample of countries, the incomes of the poorest fifth rise “one-to-one” with the average income. (A 4 % growth rate of GDP per capita is associated with a 4 % rate of increase in the income of the bottom quintile.) This implies a flat statistical relationship between per capita income and inequality, not a Kuznets curve (an inverted U relationship between per capita income and inequality). The conclusion appears to be hard-wired in by the choice of a linear regression equation with no quadratic term. With this assumption the share of the poor in total income cannot increase at one point in the range and decrease at another; it cannot be an inverted-U. The share of the poor in total income goes up at the rich country end because of social security transfer payments. Given the assumption of a linear relationship, this means that at the low per capita income end the share of the poor in total income cannot go down. The authors justify the linear form by saying that the evidence does not allow them to reject the statistical hypothesis that the share of the bottom 20 percent in uncorrelated with per capita income. This may be true, but does not exclude the possibility that a quadratic specification would have been a better fit. A quadratic specification would have allowed for the plausible possibility that different categories of countries-- by average income, by region--show different relationships between average income and distribution. I thank Graham Pyatt and Sanjay Reddy for clarifying this point.

[24] For example, Paul Omerod, “Inequality: the long view”, *Prospect*, August/September 2000. See also Robert Wright, “Global happiness”, *Prospect*, December, 2000. They both make the same strong statement about world income distribution: it has become more equal at the same time as globalization has accelerated. Martin Wolf of the *Financial Times* champions the idea that globalization improves global income distribution. See for example, “Growth makes the poor richer: reversing the effects of globalization might increase equality as the critics claim, but it would be an equality of destitution”, *Financial Times*, 24 January 2001. Ian Castles, former Australian Statistican, claims that “most studies suggest that the past 25 years have seen a reversal in the trend towards widening global inequalities which had been proceeding for two centuries” (letter to *The Economist*, May 26 2001).

dollars using market exchange rates or GNP per capita adjusted for differences in purchasing power across countries); (b) alternative samples of countries and alternative weightings of countries (each country weighted as one unit or by population); (c) alternative measures of distribution (the Gini or other average coefficient of inequality or ratios of the income of the richest decile of world population to that of poorer deciles or average income of a set of developed countries to that of a set of developing countries; (d) national income accounts or household income and expenditure surveys. These choices make a big difference to the results, and there is no single best measure. Here are my abbreviated conclusions. [25]

Market Exchange Rates

If we use market exchange rates to convert national incomes into a common numeraire (the US dollar) the evidence is clear: whatever the other choices of measurement, world income distribution has been stable or widening for the past several decades.

For example, if we take the GNP per capita of developing countries as a group and express as a proportion of the GNP per capita of the developed countries (all countries weighted by population), the share remains steady at around 4.5 percent from 1960 to 1999 (table 2). There is no fall in the (huge) relative income gap, and there is a big widening of the absolute gap. Looking at a more disaggregated level we find that the great majority of developing countries experienced a *growing* relative income gap in *both* 1960-1980 and 1980-1999.[26] At the regional level, Latin America, Sub-saharan Africa, and the Middle East/North Africa all experienced a growing relative income gap with the core between 1980 and 1999; South Asia remained constant; only China, and East Asia minus Japan and China, reduced the gap. China's average income rose between 1980 and 1999 from 0.8 % to 2.6 % of the average of the developed countries. If we had been asked in 1970 to indicate what would constitute development "success" by 1999 we would surely have set the threshold far above an increase in developing countries' (current

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[25] In addition to the studies referenced elsewhere I draw on: Glen Firebaugh, "Empirics of world income inequality", *American Journal of Sociology*, 104, 1999; C. Jones, "On the evolution of world income distribution", *Journal of Economic Perspectives*, 11, 1997; Lant Pritchett, "Divergence: big time", *Journal of Economic Perspectives*, 11, 1997; Danny Quah, "Empirics for growth and distribution: stratification, polarization, and convergence clubs", *Journal of Economic Growth*, 2, 1997; United Nations Development Program, *Human Development Report 1999*, 1999; Ravi Kanbur, "Conceptual challenges in poverty and inequality: one development economist's perspective", WP2002-09, Dept. of Applied Economics, Cornell University, April 2002.

[26] Giovanni Arrighi, Beverly Silver, Benjamin Brewer, "Industrial convergence, globalization, and the persistence of the North-South divide", typescript, Sociology, Johns Hopkins University, April 2002. The former Soviet Union countries are not included.

exchange rate) income from 4 percent of the West's, to 5 percent. We would have said that an increase from 4 percent to 5 percent in 30 years would constitute development failure.

TABLE 2: GNP PER CAPITA OF REGION AS % OF DEVELOPED COUNTRIES' GNP PER CAPITA

Region	1960	1970	1980	1990	1999
Sub-Saharan Africa …………………………...	5.2	4.4	3.6	2.5	2.2
Latin America ………………………………...	19.7	16.4	17.6	12.3	12.3
West Asia and North Africa …………………	8.7	7.8	8.7	7.4	7.0
South Asia ……………………………………	1.6	1.4	1.2	1.3	1.5
East Asia (w/o China and Japan) ……………..	5.7	5.7	7.5	10.4	12.5
China …………………………………………	0.9	0.7	0.8	1.3	2.6
Developing countries………..………………	4.5	3.9	4.3	4.0	4.6
North America ………………………………...	123.5	104.8	100.4	98.0	100.7
Western Europe ……………………………….	110.9	104.4	104.4	100.2	98.4
Southern Europe ………………………………	51.9	58.2	60.0	58.7	60.1
Australia and New Zealand …………………...	94.6	83.3	74.5	66.2	73.4
Japan ……………………………………………..	78.6	126.1	134.1	149.4	144.8
Developed countries…………………………	100	100	100	100	100

Source: Arrighi and Silver, 2002, calculations based on World Bank, *World Tables*, 1984, *World Development Indicators*, 2000.

But many economists say that exchange-rate-based income measures are irrelevant. GNP incomes should always be adjusted by purchasing power parity (PPP) exchange rates to take account of differences in purchasing power, they say. The adjustment is made by using the same relative prices for all goods and services in all countries. Since the market prices of goods and services sold only locally (not internationally traded) are significantly cheaper in poor countries relative

to the market prices of goods and services facing international competition, the adjustment generally raises the income of poor countries and lowers income of rich countries, making the distribution between them less unequal.

It is true that market-exchange-rate-based income comparisons suffer from distortions in official exchange rates (overvaluation is common in poor countries with trade barriers and non-convertible currency), and from sudden changes in the official exchange rate. Nevertheless, the argument that incomes converted via PPP exchange rates should always be used in preference to market-exchange-rate-converted incomes should be rejected, for conceptual and practical reasons. The practical reasons concern the intractable problems of knowing what the purchasing power parity (PPP) figures mean, especially for China and India, and before the early 1990s, for countries of the former Soviet Union. The conceptual reasons have to do with the fact that we may be interested in income and its distribution not only to measure relative total purchasing power (for which purpose PPP-adjusted income is a better proxy, *in principle*), but also to measure the relative purchasing power that residents of different countries have over goods and services produced in other countries. If we are interested in any of the questions about the economic and geopolitical impact of one country (or region) on the rest of the world—including the capacity of developing countries to repay their debts, to import capital goods, and to participate in or avoid marginalization in the international political-economy--we should use market exchange rates. Afterall, the reason why many poor countries are hardly represented in negotiations that concern them directly is that they can't afford the cost of hotels, offices, and salaries in places like Washington DC and Geneva, which must be paid in hard currency bought at market exchange rates, not in PPP dollars.

To repeat, all the plausible measures of inequality using market exchange rates to compare incomes in different countries show that world income distribution has been stable or widening for the past several decades. It is plausible that this matters not only as a cause of the marginalization of developing countries but also as a cause of trends in relative PPP-based living standards.

Purchasing Power Parity

Purchasing power parity figures show trends in world income distribution that are more ambiguous than market exchange rate figures, more conditional on precisely which combination of measures one uses. But the evidence does strongly support the following three propositions.

- If one uses decile measurements of inequality (richest decile of the world's population to poorest decile) rather than the Gini or other measure of inequality over the whole distribution, then PPP-adjusted income distribution has become *much more unequal* over the past two decades, whether countries are weighted equally or by population. World income *polarization*, in other words, has increased unambiguously.

- If one uses a measurement of the entire distribution and weights countries equally (China = Uganda), inequality between countries' average PPP-adjusted income has also *increased* since at least 1980. And if one measures inequality in terms of the dispersion of per capita GDPs across the world's (equally weighted) countries, this too *rose* between 1950 and 1998, and especially fast over the 1990s. The dispersion of per capita GDP growth rates has also risen, suggesting wider variation in performance among countries at each income level. One study using these dispersion measures concludes that there is "no doubt as to the existence of a definite trend towards distributive inequality worldwide, both across and within countries" .[27]

- If one uses a measurement of the entire distribution but weights countries by population, inequality between the country averages has been *constant or falling* since around 1980. This is the result that Martin Wolf, *The Economist*, and many others celebrate. But it comes entirely from fast average growth in China and India. If they are excluded even this measure of inequality shows inequality widening since 1980.

In any case this last measure—the average income of each country weighted by population--is interesting only as an approximation to what we are really interested in, which is income distribution among all the world's people or households regardless of which country they live in. We would not be interested in measuring income inequality within the United States by calculating the average income for each state and weighting it by their populations if we had data for all households.

[27] *Globalization and Development*, ECLA, April 2002, p.85. The dispersion of per capita GDP/PPP is measured as the average logarithmic deviation, the dispersion of growth rates as the standard deviation.

One recent study makes an approximation to the distribution of income among all the world's people by combining between-country inequality in PPP-adjusted average incomes with within-country inequality. It finds that world inequality *widened* between 1980 and 1993 using all of four common measures of inequality over the entire distribution (and weighting countries by population). [28]

Another recent study, based on the most comprehensive set of data drawn only from household income and expenditure surveys (it does not mix data from these surveys with data from national income accounts), finds a sharp *rise* in world inequality over as short a time as 1988 to 1993, using both the Gini coefficient and ratio (or polarization) measures (table 3). [29]

TABLE 3. WORLD INCOME DISTRIBUTION BY HOUSEHOLDS, 1988, 1993

	1988	1993	% change
Gini	0.63	0.67	+ 6
Richest decile/median	7.28	8.98	+ 23
Poorest decile/median	0.31	0.28	- 10

Source: Branko Milanovic, op.cit.

We have to be cautious about this finding partly because household surveys have the kind of weaknesses described above (though these weaknesses do not make them worse than the alternative, national income accounts, which have their own problems), and partly because the five year interval is very short, suggesting that some of the increase may be statistical noise.

What about the much-cited article by David Dollar and Aart Kraay of the World Bank that reports a sizeable decline in worldwide income

[28] Steve Dowrick and Muhammad Akmal, "Explaining contradictory trends in global income inequality: a tale of two biasses", Faculty of Economics and Commerce, Australia National University, 29 March 2001. Available on http://ecocomm.anu.edu.au/economics/staff/dowrick/dowrick.html. They use between-country comparisons of "true" PPP-adjusted incomes, complemented by the Deininger-Squire measures of within-country inequality. (They make the PPP adjustment with Sidney Afriat's "true index" methodology designed to counter the upwards, "developed country" bias in the Summers-Heston price relativities.) With this methodology they find a slight increase in world inequality between 1980 and 1993 on four common measures of inequality: Gini, Theil, coefficient of variation, and variance of log income. Their results are sensitive to assumptions made about Chinese PPPs, as are results from other authors.

[29] See Branko Milanovic, "True world income distribution, 1988 and 1993: first calculations based on household surveys alone", *Economic Journal*, 112 (476), January 2002, 51-92. Milanovic is currently working on 1998 data.

inequality since its peak in about 1970?[30] The underlying method is to calculate the percentage gap between a randomly selected individual and the world average. The bigger the gap, the more unequal the distribution of world income. The article reports that this gap peaked at 88 per cent of world average income in 1970, before falling to 78 per cent in 1995, roughly back where it was in 1950.

This study illustrates again how the conclusion about the trend in world income distribution depends on the choice of measures. Dollar and Kraay's choice flatter the result for the following reasons. (a) The person chosen as the random individual is most likely to be Chinese or Indian. (b) China and India have had much faster growth than the world as a whole over the recent period. (c) The gap between the income of the "random person" (likely to have risen with the average income of China or India) and the world average has been falling. (d) But this does not straightforwardly suggest that world inequality has been falling, because it omits the increasing poverty of less populous countries (Africa), and because it omits rising internal inequality in both China and India (see below). In short, Dollar-Kraay's methodology weights heavily what happens in the *middle* swathe of world population and gives little weight (compared to other accepted measures) to what happens towards the lower and upper ends of the distribution.

By way of summary, a fourth proposition regarding PPP-adjusted incomes:

- The only set of measurements where the evidence clearly supports the liberal argument of falling inequality is the one using *population-weighted countries' per capita PPP-adjusted incomes, plus a measure of inequality over the whole distribution.* On the other hand, the ratio of richest decile to poorest decile (and richest decile to median and median to poorest decile) show clear evidence of rising polarization, whatever the choices of other measures. And even measures of inequality over the whole distribution, when applied to either household survey data or to the combined inequality between countries and within countries (as distinct from only inequality between countries' average income), show a widening of inequality. We can conclude that world income inequality among households has probably been widening even when measured across the whole distribution, and emphatically so when measured in terms of richest 10 percent to poorest 10 percent.

[30] David Dollar and Aart Kraay. "Spreading the Wealth." *Foreign Affairs*, 81 (1), January/February, 2002, 120-33.

China and India

China and India have grown fast over the past decade (India) or two (China) and together account for nearly 38 percent of world population. If the figures are to be believed, China has experienced a quite extraordinarily fast rise in its average purchasing power parity income from 0.3 of the world average in 1990 to 0.45 in 1998, or 15 percentage points in only eight years. The biggest single issue in world income distribution is how China and India have moved through the hump of world income distribution. Don't they create a presumption that world income distribution has become more equal over the past 20 years? Not necessarily.

First, recall the point made earlier, that the governments of China and India declined to participate in one (India) or both (China) of the benchmarking price comparison exercises, and therefore the PPP-adjusted figures for China and India contain an even bigger component of guess work than for most other countries.

Second, problems with the PPP adjustments aside, many analysts have recently been revising China's growth statistics downwards by large amounts. Whereas government figures show annual real GDP growth of 7-8 percent in 1998 and 1999, one authority on Chinese statistics estimates that the economy may not have grown at all. He puts the real figure at between minus 2 and plus 2 percent.[31]

Even the Chinese government has been pressing the World Bank to revise its per capita income downwards—though not necessarily in the interests of accuracy. Look at table 4. It shows China's average GNP in US$ for 1997-99 and the corresponding growth rates according to the World Bank. The level of average (exchange rate-converted) income *fell* sharply between 1997 and 1998, while the growth rate between 1997 and 1998 was *plus* 6.4 percent! Behind these numbers is a tale of the Chinese government's arm twisting of the World Bank (especially after the allegedly accidental US bombing of the Chinese embassy in Belgrade in May 1999) to lower China's average income below the threshold of eligibility for concessional IDA lending from the Bank. China wanted not so much the cheap IDA loans as the privilege extended to companies

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[31] See James Kynge, "Pyramid of power behind numbers game", *Financial Times*, February 27, 2002, drawing on work of Thomas Rawski. As another example from Rawski's analysis, Chinese government figures show total real GDP growth of 25 percent between 1997 and 2000, whereas energy consumption figures show a drop of 13 percent. (Some of the fall may be due to replacement of inefficient coal-fired furnaces.) See further Arthur Waldron, "China's disguised failure: statistics can no longer hide the need for Beijing to instigate painful structural reforms", Personal View, *Financial Times*, July 4, 2002.

from IDA-eligible countries to add a 7.5 percent uplift on bids for World Bank projects.

TABLE 4: CHINA'S GNPPC AND GROWTH RATE, 1997-99

	1997	1998	1999
GNPPC/PPP (US$)	3,070	3,050	3550
GNPPC (US$)	860	750	780
Annual growth rate of GNPPC (%)	7.4	6.4	6.1

Source: World Bank, *World Development Indicators*, 1999, 2000, 2001.

China's annual growth rate over the 1990s is more likely to have been around 5-6 percent than the 8-10 percent that the official statistics show. This one change (assuming constant internal distribution) probably makes a tangible difference to our conclusions about what has been happening to world income distribution. If we use the official figures and choose one particular combination of inequality measures (rather than other plausible ones), world income inequality has narrowed. If we use the more plausible lower range for China's economic growth most of the other plausible measures of world inequality show constancy or widening, especially once we include China's widening internal income distribution.

This is the other reason for being sceptical of the claim that China and India's fast growth is reducing world income inequality. Whatever reduction in world income inequality comes from relatively fast growth of average income in China and India may be offset by the widening income inequality within the two giants—though careful calculations of the relative strength of the two contrary effects have not yet been made.[32] China's surging inequality is suggested by the ratio of the average income of the richest to poorest province: 7 in the early 1990s, 11 in the late 1990s. The corresponding figure for India in the late 1990s was 4.2, the United States, 1.9.

Pay Inequalities

More doubts are cast on the falling inequality hypothesis by a distinctly different kind of data--trends in industrial pay inequality within

[32] Evidence for rising inequality in India over the past two decades is set out in Raghbendra Jha, "Reducing poverty and inequality in India: has liberalization helped?", November 2000, at www.wider.unu.edu/research/1998-1999-3.1.publications.htm. Deaton agrees that inequality in India has been increasing "in recent years", and that consumption by the poor did not rise as fast as average consumption. "Is world poverty falling?", above.

countries. Pay inequality within countries was stable or declining from the early 1960s to 1982, then sharply increased from 1982 to the present. 1982 marks a dramatic turning point towards greater inequality in industrial pay worldwide.[33]

Some might claim that this data is irrelevant because few of the world's poor earn wages that get reported. It is true that few of the world's poor are included in figures of pay, but not true that this makes pay dispersions irrelevant to the overall distribution of household incomes. The dispersion of industrial pay measures the difference in pay rates for relatively skilled workers in activities like petroleum refining, chemicals, machinery, and transportation equipment, and the pay rates for the relatively numerous, less-skilled workers in textiles, garments, food processing and similar activities. Workers in, say, garments are readily recruited from the masses in agriculture or services, whereas workers in oil or machinery are not. For this reason of elastic supply, wages in the low-wage industries are likely to bear a close relationship to the wages of the uncounted masses, whereas wages in the high-wage industries are much less likely to have that relationship. Therefore, when the industrial pay dispersion widens, it is usually because low wage workers in general are suffering relative to high wage workers. (We can check this for some countries, including the US and China, and the broader national data sets for these countries bear this out. But they are not available on an internationally comparative basis.) When the pay data show rising inequality in Chile after the coup in 1973, or falling inequality in Iran in 1979, or rising inequality throughout Central Europe after 1989, it is clear that these measures reflect larger social phenomena beyond formal industry.

Their great advantage is that they are available, accurately and consistently, for many countries on an annual basis over many years, which is not true of the World Bank's inequality data set. (The Bank's data set does not do well on the laugh test—it shows Spain as the most equal country in Europe, France as much more unequal than Germany, India and Indonesia in the same equality league as Norway.[34]) In short, the pay dispersions should not be disregarded, and they suggest a sharp increase in inequality since the early 1980s.

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[33] See the work of James Galbraith and collaborators in the University of Texas Inequality Project, http://utip.gov.utexas.edu. Galbraith has not yet attempted to calculate trends in world pay dispersions. It is not clear what would be appropriate country weights. GDP and population, the absolute size of each country's manufacturing sector, the per capita inequality between countries?

[34] This is the Deininger and Squire data set.

The bottom line

All the thunder and lightening about trends can divert attention from what should be our central preoccupation, the sheer magnitude of poverty and inequality. For all the earlier caveats about the statistics we can be confident in saying that roughly 85 percent of world income (measured at market exchange rates) goes to 20 percent of the world's population, 6 percent to 60 percent of the world's population. Can this meet any plausible test of distributive justice? Difficult to see how it could meet the Rawlsian principle, for example, that a given degree of inequality is acceptable if it is somehow necessary for the worst off to be better off.[35]

It might be judged less of a problem if country mobility was reasonably high, if countries that adopted “good policies” and “worked hard” rose in the hierarchy of inequality while those with the opposite characteristics fell. In fact, country mobility up and down the income hierarchy is very limited. Very few countries over the past several decades have changed their quintile in a ranking of countries’ per capita income (up to 1990), and they account for an insignificant proportion of world population.[36] If economic performance was as sensitive to pro-globalizing or anti-globalizing policies as the globalists say one would expect to find more mobility up and down. The low rate of country mobility over several decades is a big fact in need of explanation.

On the trends themselves, the number of people in extreme poverty has a large margin of error and is probably higher than the World Bank says. Whether the trend between 1980 and 1998 is up or down we cannot say, because the Bank changed its methodology. We can be reasonably sure, though, that the number has *risen* significantly since 1987, not remained constant as the Bank says (using the same methodology at both ends). On the other hand, it seems quite plausible that the *proportion* of the world’s population living in extreme poverty has fallen over the past one to two decades.

World income distribution has certainly become more unequal over the past two decades if measured in terms of market exchange rates. Measured in terms of purchasing power parity and in terms of *average*

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[35] Rawls thinks in terms of distribution within states (or “peoples”), and claims, unconvincingly, that his principles support only meagre income redistribution beyond these units. See Simon Caney, “International distributive justice”, *Political Studies,* 49 (5), 2001, 974-97.

[36] The data relate to 1965-90. Roberto Korzeniewicz and Timothy Moran , “World-Economic Trends in the Distribution of Income, 1965-1992”, *American Journal of Sociology,* 102, 4, 1997, 1000-1039; Roberto Korzeniewicz and Timothy Moran , “Measuring World Income Inequalities”, *American Journal of Sociology*, 106, 1, 2000, 209-14

inequality (using the Gini coefficient) it has *probably* either remained fairly constant or increased, almost certainly not decreased as the liberal argument claims. Measured in terms of top to bottom ratios, income polarization has *increased,* even using PPP-adjusted incomes. A rising proportion of the world's population is living at the extremes of the world income distribution; and a rising share of the world's income is going to those at the top. Some 60 countries have lower average real incomes than they had in 1980.

One other point. Our measures of inequality refer to relative income gaps, not absolute income gaps. We say that income inequality is constant if the ratio of developing country income to developed country income remains at 5 percent. But this of course implies a big increase in the absolute size of the gap. In the general case the absolute gap between a country with average income of $1,000 growing at 6 percent and a country with average income $30,000 growing at 1 percent continues to widen until after the 40th year! China and India are reducing the absolute gap with the faltering middle-income states like Mexico, Brazil, Russia and Argentina, but they not reducing the absolute gap between their average incomes and the averages of the countries of North America, western Europe and Japan. In the world at large, absolute gaps are increasing fast and will continue to do so for several generations.

So what? Many people say that we should not be concerned about rising inequality, relative or absolute, provided the poor are not becoming worse off. This applies within countries and even more so to inequalities between countries. The question of whether we should be concerned about rising inequalities between countries needs a good deal more research than it has received.

On the face of it, the more globalized the world becomes, the more that the reasons why we might be concerned about within-country inequalities also apply to between-country inequalities. Educated people who earlier compared themselves to others in their neighborhood or nation now compare themselves to others in much richer nations, and feel relatively deprived. In this way the high and rising (relative and absolute) gap in incomes of the richest countries and the poorer ones is bound to affect national political economy in the poorer states. It may, for example, predispose the elites to be more corrupt as they compare themselves to elites in rich countries and squeeze their own populations in order to sustain a comparable living standard. It may encourage the educated people of poor countries to migrate to the rich countries, and encourage unskilled people to seek illegal entry. It may generate conflict between states, and—because the market-exchange-rate income gap is so big—make it cheap for rich states to intervene to support one side or the other

in civil strife. These effects may be presumed to operate even if relative income gaps are declining but absolute income gaps are widening.

GLOBALIZATION

Now let us examine the second main proposition of the globalists' argument, that globalization—in the sense of rising integration of poorer countries into the world economy, as seen in rising trade/GDP, foreign direct investment/GDP, and the like--is the world's most powerful means of reducing poverty and inequality.

Clearly the proposition is not well supported at the world level if we agree that globalization has been rising while income inequality and poverty have not been falling. But it might still be possible to argue that globalization explains differences between countries: that more globalized countries have a better record of economic growth, poverty reduction and inequality reduction than less globalized ones.

This is what World Bank studies claim. One of the best known, *Globalization, Growth and Poverty*,[37] distinguishes "newly globalizing" or "more globalized" countries from "nonglobalizing" or "less globalized" countries. It measures globalizing by *changes* in the ratio of trade to GDP between 1977 and 1997. Ranking developing countries by the change, it calls the top third the globalizing or more globalized countries, the remaining two thirds as less globalized countries or weak globalizers. The globalizing countries are then found to have had faster economic growth, no increase in inequality, and faster reduction of poverty than the weak globalizers. The conclusion? "Thus, globalization clearly can be a force for poverty reduction".

The first question about this conclusion concerns the "changes in trade/GDP" criterion of globalization.[38] The list of "globalizers" includes China and India, as well as countries like Nepal, Cote d' Ivoire, Rwanda, Haiti, and Argentina. As the cases of China and India suggest, it is quite possible that "more globalized" countries are less open in terms of *levels* of integration than "less globalized" countries; and also less open in terms of trade policy than "less globalized" countries. A country with very high trade/GDP and very free trade could still be categorized as a weak globalizer. Indeed, it turns out that the globalizing countries are mainly ones that initially had very *low* trade/GDP in 1977. Many of them still had relatively low trade/GDP at the *end* of the period, in 1997—and

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[37] *Globalization, Growth, and Poverty: Building an Inclusive World Economy*, World Bank Policy Research Report, World Bank and Oxford University Press, 2002.

[38] In this section I draw on the arguments of Dani Rodrik, *The New Global Economy and the Developing Countries: Making Openness Work*, Overseas Development Council, Washington DC, 1999; "Trading in illusions", *Foreign Policy*, 123, Mar/Apr 2001.

this does not just reflect the fact that larger economies tend to have lower ratios of trade/GDP. To call them globalizers, and countries with much higher ratios of trade/GDP nonglobalizers, is an audacious use of language.

The criterion shapes the conclusions. Excluding countries with high but not rising levels of trade to GDP from the category of more globalized excludes many very poor countries dependent on a few natural resource commodity exports, which have had very poor economic growth. The structure of their economy and the low skill endowment of the population makes them very dependent on trade. If they were included as globalized their poor economic performance would question the proposition that the more globalized countries have the best performance.

On the other hand, the inclusion of China and India as globalizers—whose good economic performance over the past one or two decades is attributed in large part to their globalization—guarantees that the globalized will show better performance than the nonglobalized. But two big facts question the Bank's argument. First, China and India experienced a sharp increase in the trend rate of growth about a decade prior to their liberalizing trade and investment reforms. Second, they have achieved their relatively fast rise in trade/GDP with policies far from the liberal trade and investment policies advocated by the globalists. They remain highly protected economies. The World Bank would be first to denounce their current trade policies and internal market-restricting policies as growth- and efficiency-inhibiting if they had not been growing fast.

Their experience, and that of Japan, South Korea and Taiwan earlier, shows that countries do not have to adopt liberal trade policies in order to reap benefits from trade and in order to grow fast.[39] They all experienced relatively fast growth behind protective barriers, and their fast growth fuelled the expansion of their trade. As they became richer they tended to liberalize their trade—providing the basis for the common misunderstanding that trade liberalization fuelled their growth. Yet for all the Bank study's qualifications (such as "We label the top third "more globalized" [that is, they had a bigger increase in trade/GDP] without in any sense implying that they adopted pro-trade policies. The rise in trade may have been due to other policies or even to pure chance"), it concludes that trade liberalization has been the driving force of the

[39] Robert Wade, *Governing the Market*, Princeton University Press, 1990. As I document, many neoclassical economists have tried to argue that the economic success of Taiwan and Korea is a function of their shift towards free markets, coupled with investment in education, law and order, and the like. They argue as though the only positive causal impact of a fall in tariffs from, say, 50 % to 40% is the 10% fall, nothing to do with the 40% that remains. They airbrush away the policies for building competitive industries and firms, some of which entailed some sectoral targetting.

increase in developing countries' trade. "The result of this trade liberalization in the developing world has been a large increase in both imports and exports". On this doubtful proposition the Bank rests its case for trade liberalization as a central element in its core development prescription.

IF POVERTY AND INEQUALITY ARE NOT FALLING DESPITE GLOBALIZATION -- WHY NOT?

If the number of people in absolute poverty is probably not falling and is probably higher than the World Bank says, and if income inequality by several plausible measures (especially those that measure polarization) is not falling and probably rising, why? Certainly not because of the failure of industrialization in developing countries. If we take the share of GDP in manufacturing in each country and aggregate up to developing countries as a group and developed countries as a group, we find a remarkable convergence—developing countries as a group now have a *larger* share of GDP in manufacturing than developed countries (table 5). But each additional increment of what is measured as manufacturing in developing countries is yielding less income, while each additional increment of what is measured as services in developed countries is yielding more income. This is quite contrary to the understandings of the "modernization" champions of the 1950s to 1980s, ancestors of today's globalization champions. They thought that industrialization was the route to development, that (market-friendly) industrialization would be the vehicle to carry developing countries to the living standards of the developed world. The failure of this prediction may help to explain why industrialization as such is given little attention in today's development debates. It has virtually disappeared from the agenda of the World Bank.

TABLE 5: SHARE OF MANUFACTURING IN GDP (%)

	1960	1980	1998
Developed countries	28.9	24.5	19.8
Developing countries	21.6	24.3	23.3

Source: Arrighi and Silver, 2002.

If failure to industrialize is not the culprit, what other factors might explain widening or at least non-declining income inequality? Differential population growth is one: population is rising several times faster in the low income parts of the world than in the rich, raising the

share of world population living in countries in the low income zone. Falls in the terms of trade facing developing countries are another: the prices of exports from developing countries, especially primary commodities, have fallen sharply over the past two decades in relation to the prices of exports from developed countries, at the same time as globalization has accelerated.[40] By regions, Latin America and Africa concentrate on export products that experience slow-growing demand, while developing Asia has a higher concentration in export products with above-average export growth, like machinery and equipment.

Spatial clustering of high value-added activities

Underlying these patterns of trade and prices is a general property of modern economic growth related to spatial clustering. We know that some kinds of economic activities and production methods are more lucrative than others, have stronger spillover benefits, and more positive effects on growth and productivity; and that countries with higher proportions of such activities enjoy higher levels of real incomes than others. We also know that in free market conditions (and not as a result of market "imperfections") the high value-added activities cluster spatially; and that these poles are located predominantly in the already high cost, high wage zone of the world economy.

This—superficially surprising--clustering of new rounds of high value-added activities in the high wage zone occurs for several reasons. First, costs per unit of output, especially labor costs, may not be lower in the lower wage zone, because lower wages may be more than offset by lower productivity.

Second, the "capability" of a firm relative to that of rivals (the maximum quality level it can achieve, and its cost of production) depends on the knowledge and social organization of its set of employees, where both knowledge and social organization are collective properties of the firm rather than of the individuals who make it up; and where much of the knowledge and the social organization is essentially *tacit*, transferred mainly through face-to-face relationships—because not able to be transferred easily from place to place in the form of (technical and organizational) blueprints or embodied in machinery.[41] If a firm were to move to a lower wage zone and some of its employees were not mobile,

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[40] *Globalizqtion and Development,* ECLA, Box 2.1, p.38.

[41] I draw on John Sutton, "Rich trades, scarce capabilities: industrial development revisisted", Keynes Lecture, British Academy, October 2000. Also, Ralph Gomory and William Baumol, "Toward a theory of industrial policy-retainable industries", C.V. Starr Center for Applied Economics, New York University, RR 92-54, December 1992; and Michael Porter, "Clusters and the new economics of competitition", *Harvard Business Review*, 76, 6, 77-90.

the costs to the firm's capacity, including the loss of tacit knowledge, may outweigh the advantages of relocation.

Third, manufacturing firms in the OECD countries are engaged in dense input-output linkages with other firms. (About two thirds of manufacturing output in the OECD is sold by one firm to another firm.) The presence of a dense and spatially concentrated network of input-output linkages provides spillover (non-priced) benefits to other firms in the network. So does the presence of well-functioning factor markets and a supply of formally educated people able to gain technology-specific (and partly tacit) knowledge at low cost. And as noted, tacit knowledge, whose economic value typically increases even as the ratio of tacit to codified knowledge falls with computerization, is transferred more easily within networks underpinned by social relationships, cultural similarity, and the disposition to trust. These network effects compound the tendency for any one firm not to move to a low wage zone, or to move only its *low* value added activities by outsourcing or establishing subsidiaries.

All the more so because for many products and services, quality—and value added—goes up not continuously but in steps. Getting to higher steps may require big investments, critical masses, targeted assistance from public entities, long-term supply contracts with multinational corporations seeking local suppliers; and "normal" market processes may keep producers and countries stuck at low steps. (Ballbearings below a certain quality threshold are useless, they have to be given away.)

But this is still not the end of the story. At the next round the greater wealth and variety of economic activities in the high wage zone mean that it can more readily absorb the Schumpeterian shocks from innovation and bankruptcies in the high wage zone, as activity shifts from products and processes with more intense competition to those with less competition closer to the innovation end. There is less resistance to the "creative destruction" of market processes, even though organizing people to pursue common objectives, including resistance, tends to be easier than in the low wage zone. Enron may go bankrupt, but there are plenty more companies to take on its business and employ its employees.

These effects—plus limited labor movement from the low wage zone to the high wage zone when international borders intervene—help to explain a stably "divided world" in which high wages remain high in one zone while low wages elsewhere stay low. The important point is that "normal" free markets in a highly economically interdependent world produce, "spontaneously", a stable equilibrium division of activities between the high wage zone and the low wage zone—one that is hardly desirable for the low wage zone.

This mechanism can explain the reproduction of the income gap between developing and developed countries even as whole developing regions have eliminated the industrialization gap. It is not offset by what one might expect—a tendency for more rapid technological progress in developed countries to *worsen* the terms of trade for their manufactured exports (and therefore improve those for manufactured and primary commodity exports from developing countries). That this does not happen in practice is the result, not of technological progress in the manufacturing segment of the world economy not being "passed on" in the form of lower prices while such technological progress as there is in primary commodities is passed on (this was Prebisch's hypothesis), but of features of industrial organization in developed countries. Oligopolistic markets for both products and labor support mark-up pricing in the developed countries, while non-oligopolistic markets for the primary commodities and the unsophisticated manufactured goods that make up most of developing country manufactured exports do not. These differences in industrial organization help to explain the deterioration in the terms of trade for the bulk of the exports from developing countries noted earlier.

Empirically, of course, the picture is more complicated. We do see a rapid growth in the capabilities of firms—domestic and foreign—in China, and we even see the early stages of China-based networks of firms dense enough to bestow sizable spillover benefits on individual firms and hence keep them in China close to other participant firms even as cheaper wage locations open up. Technological learning (a proxy for capabilities) is also proceeding at a furious pace elsewhere in East Asia;[42] at a more sedate pace in Southeast Asia and India; a snail's pace in most of Latin America; even slower in sub-saharan Africa, the Middle East and Central Asia. But it is not just that some regions are doing better than others; the scope for diversification into the more sophisticated manufactured products is limited, so China's success makes it much more difficult for other developing regions to enter or remain competitive in the same industries, as Southeast Asia and Mexico are currently finding out.

Even about East Asia we should not get too optimistic. Only a miniscule portion of world R & D work is done in (non-Japan) East Asia; virtually all of it continues to be done in the developed countries of North America, western Europe and Japan. Even Singapore, that looks to be an

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[42] John Mathews and Dong-sung Cho, *Tiger Technology: The Creation of a Semiconductor Industry in East Asia*, Cambridge University Press, 2000; John Mathews, *Dragon Multinational: A New Model For Global Growth*, Oxford University Press, 2002; Sanyaya Lall, *Competitiveness, Technology and Skills*, Elgar, Cheltenham, 2001; Alice Amsden, *The Rise of the Rest: Challenges to the West from Late-Industralization Economies*, Oxford University Press, New York, 2001; James Kynge, "China's reverse shock: having established joint ventures to obtain parts and technology, the country's domestic car manufacturers are preparing to invade the export market", *Financial Times*, June 7, 2002.

Asian center of R & D, does not do “real” R & D; its R & D labs mostly concentrate on adapting products developed in North America and Europe for the regional market and listening in on what competitors are doing. [43] So much for the “globalization of R&D”.

The international monetary system

We have seen how well-functioning global markets for goods and services can yield a stably divided world and falling terms of trade for the low wage zone. The impact of these trends in goods markets is powerfully reinforced by a causal mechanism based in markets for finance. The post-Bretton Woods international monetary system generates financial instability and slow growth in the world economy “endogenously”, and particularly handicaps the growth of developing countries. Four features combine to produce this result:

1. The “original sin” of not allowing economic actors to engage in international payments in their own national currency, requiring them to obtain hard currency, generally US$, for paying for imports or for repaying foreign loans.
2. *Private* foreign exchange markets and settlement systems—via private banks, not via central banks.
3. A fiduciary currency, the US$, as the dominant international currency. Its issuance is unconstrained from the supply side (such as a $-gold link); and though its value is not tied to a commodity like gold, its value is nevertheless stable or falls only slowly, because wealth-holders around the world consider it as a primary medium for holding wealth.
4. Largely unrestricted capital flows.

This post-Bretton Woods (PBW) system gives hard currency (= some rich country) governments, above all the US government, a much freer hand than before to print money and incur fiscal and current account deficits. The amount of US currency in circulation and the size of total international reserves (mostly in US assets) have grown almost exponentially since the early 1970s, associated with rapidly rising trade imbalances and cross-border flows of short-term capital. These trade imbalances and short-term capital flows have become major sources of instability and slow growth in the world economy at large. In particular:

[43] Alice H. Amsden, Ted Tschang, Akira Goto, “A New Classification of R&D Characteristics For International Comparison (With a Singapore Case Study)”, Asian Development Bank Institute, Tokyo, December 2001.

1. The US current account deficit is a "facilitating condition" of the economic overheating and asset price booms in Japan, the East Asian Crisis countries, China and the United States. Chronic deficits have caused an explosion of international liquidity (credit). They are financed by the sale of US assets (especially bonds of corporations and government-sponsored agencies like Fannie Mae, as well as stocks and Treasury bills). They accumulate in surplus countries' banking systems where they have the same impact as high-powered money injected by the central bank into the banking system: they are deposited, lent, redeposited, and relent many times over. They can easily blow out asset price bubbles and industrial overinvestment, which end in recessions or depressions. This was the story of the Japanese bubble and crash in the second half of the 1980s and 1990s, also the story of the East Asian bubble and crash in the 1990s, and China is currently well along this path. The continuing credit expansion being created by record US external deficits ensures that credit bubbles will blow out around the "emerging market" world with much higher frequency than in the Bretton Woods era; and their bursting will cause bigger economic and social costs. As crisis-affected countries devalue their currencies or switch to floating exchange rates in order to increase their current account surpluses (a practice sanctioned by the IMF and the World Bank), they can make the systemic instability worse. [44]

2. The PBW system makes foreign exchange markets prone to volatility, reflecting essentially speculative movements of funds related to changes in the prices of financial assets rather than to changes in demand for goods and services or costs of production. The movements are *pro-cyclical*, they amplify rather than dampen swings in economic activity.[45]

3. The PBW system makes indebted developing countries vulnerable to exchange rate slides. When the domestic currency falls in value the burden of debt service denominated in US$ rises, which can tip domestic firms into insolvency and precipitate social unrest, amplifying panicky selling of the domestic currency for the safer dominant currency, worsening the slide. Interest rate hikes and other measures to depress the domestic economy are unlikely to arrest the slide and may make it worse.[46] In short, developing country currency slides are not likely to be

[44] Richard Duncan, 2002, "Disequilibrium and denial", processed, February 10.

[45] Michael Pettis, *The Volatility Machine: Emerging Economies and the Threat of Financial Collapse*, Oxford University Press, 2001.

[46] See for example the evidence of no positive correlation between higher interest rates and exchange rate appreciation during the Asian crisis of 1997-98 in *Global Economic Prospectsand the Developing Countries 1998/99: Beyond Financial Crisis*, World Bank, 1998, "Responding to the East Asian crisis", chapter 2. For a theoretical argument linking terms of trade movements with capital market

self-limiting within large margins, and difficult to correct by standard deflationary policies.

4. The PBW system forces developing countries to restructure their economies towards exports with which to earn the hard currency needed to pay for imports and to service debt; which can *short-change* domestic demand and national economic articulation (rising density of national, perhaps regional input-output linkages) as sources of growth.

5. The PBW system encourages a long term movement of wealth out of developing country currencies into the dominant currency (and other hard currencies), hence it encourages the tendency for the exchange rates of developing countries to depreciate, and hence for the terms of trade to move against developing countries.

6. The PBW system liberates the US government from concerns about what other governments do, while constraining other governments more tightly by what the US does. This is the great paradox of globalization: debtor countries are generally not masters of their fate, but globalization and the PBW monetary system allow the biggest debtor country of all to harness the rest of the world to its rhythms. The system forces all countries to lend to the US at cheap rates, because they hold their reserves mainly in US public and private securities. Other countries' willingness to accumulate US securities (without redeeming them in the form of US-made goods and services) allows the US to continue living far beyond its means. The fact that the world's savings are flowing disproportionately to the US, the richest country, impoverishes everyone else, including the Europeans-- European investment levels are held down because European savings flow to the US. On the other hand, the US's platinum credit card, on which it need only pay (low) interest, not principal, allows the US to invest heavily, to accumulate military armaments, and generally to accelerate the density of its hegemony.

In short, I have suggested that the benign effects of free markets in spreading benefits to regions, as celebrated in the liberal argument, may be offset by tendencies for high value-added activities to cluster in areas of other high-value added activities which can create a stable division between a high value-added, high wage zone, and a low value-added, low wage zone—even as ratios of manufacturing to GDP, total trade/GDP, and manufacturing exports/total exports rise in the low value-added, low wage zone. Differences in industrial organization, that support more

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liberalization see Prabhat Patnaik, "Globalization of capital and terms of trade movements", in *Agrarian Studies, Essays on Agrairian Relations in Less-Developed Countries*, eds. V.K. Ramachandran and Madhura Swaminathan, Tulika Books, New Delhi, 2002, 94-110.

mark-up pricing in the high wage zone, reinforce the tendency by prompting declining terms of trade for the low wage zone. I have also suggested that non-convergence may be compounded by something as apparently remote from matters of poverty and inequality as the international payments system. No doubt there are other basic drivers as well. By highlighting these two I mean to illustrate how “ordinary” market processes may operate to block the development process, suggesting the need for “extraordinary” measures of intervention if sizable fractions of the world’s population are to catch up in living standards over the next half century or so.

CONCLUSIONS

The globalists set up a manichean dichotomy between pro-globalist and anti-globalist positions. My conclusions constitute a third way. I agree with the globalizers that to raise the living standards of the world’s poorer people economic growth is essential (as are changes in our measures of economic growth to weigh environmental quality and public services properly). I agree that more open markets in the West for labor-intensive and land-intensive exports from developing countries would help, and that more foreign direct investment from the West, more technology transfer, are generally to be welcomed. Attempts at national self-sufficiency are foolish, though few countries apart from North Korea are trying and nobody is claiming that China would be better off if it had remained as closed as before 1978. Protectionist business associations and trade unions in the wealthiest countries, who claim that any threat to jobs must be because of “unfair competition” from elsewhere, are generally to be resisted; and if industry-specific protection is granted in the wealthiest countries it should be for a limited period and be accompanied by open access to foreign firms to establish their own production facilities in the country and compete against domestic firms in the same industry.

The trends?

I part company from the globalists in my reading of the trends in poverty and income distribution. My strong conclusion about the magnitude and trend in world poverty is that we must be agnostic, on the grounds that our current statistics are too deficient to yield a confident answer (though it is quite plausible that the *proportion* of the world’s population in extreme poverty has fallen in the past two decades). Further, the numbers are probably higher than the Bank says—though whether rising or falling over time we cannot say with confidence.

On the trends in income distribution my strong conclusions are that world inequality is increasing when incomes are measured in current exchange rates (and this is more relevant than PPP-incomes for judging relative impacts of one part of the world on others, including the participation or marginalization of developing countries in international rule-making fora, and the ability to borrow and repay loans). Income inequality is increasing too when PPP-adjusted inequality is measured in terms of ratios of richer to poorer, which better captures the idea of polarization than the Gini coefficient or other average. My weaker conclusion is that all the several other combinations of measures yield more ambiguous trend results, more contingent on things like the precise time period and the precise countries included in the sample. But as I have shown, several recent independent studies, using different methodologies, different samples, different time periods, do find that world income inequality has risen since the early 1980s. It is simply dishonest to keep repeating that world income distribution has become more equal as though this is undeniable fact. The evidence, taken as a whole, allows no such confidence.

Finally, absolute income gaps between the West and the rest are widening, even in the case of relatively fast growing countries like China and India, and are likely to go on widening for another half century at least. No one disputes this, but globalists tend to focus on relative incomes only. I suggested earlier several kinds of negative effects likely to follow from widening absolute income gaps even when relative income gaps are falling.

The value on inequality?

I also part company with the globalists by giving higher priority to reductions not only in world poverty but also in world income inequality. This cannot be a direct objective of public policy, which has to focus on inequalities within nation states or (via trade rules, aid, etc.) inequalities among states. But it can be taken as a higher-level objective and built into our measures of world development. We should not accept the commonly heard assertion that widening world income inequality is not a negative provided that "real" indicators like life expectancy are improving and the proportion living in extreme poverty is going down.

Globalization as the driver?

I again part company with the globalists over the proposition that globalization is the driver of the allegedly positive poverty and inequality results. The point is not that "globalization" cannot be precisely defined

for these purposes; it is that the definitions used in the globalists' studies do not survive scrutiny. In particular, the main World Bank studies, by defining globalization in terms of *increases* in trade/GDP or FDI/GDP and ignoring the level, manage to include China and India as "globalizers" or "open economies" and many highly open, trade dependent, badly performing African countries as "non-globalizers". As I said earlier, this is an audacious use of language.

Having constructed a definition of a globalized country that puts China and India into this category, the Bank does not go on to emphasize that the economic policies of the best-performing "globalizers"—China in particular—are far from the core economic policy package that it has recommended over the past two decades. The disingenuousness echoes the *World Development Report 1987*, which defined "strongly outward oriented countries" as those where "Trade controls are either nonexistent or very low…There is little or no use of direct controls and licensing arrangements", then found that in a set of 41 developing countries in 1963-73 and 1973-85 the strongly outward oriented countries performed much better than the moderately outward, moderately inward, and strongly inward oriented countries. But only three economies met the criteria for strongly outward oriented: South Korea and the city-states of Hong Kong and Singapore, and the excellent performance of the category came from South Korea because the results were weighted by GDP. Only the most determinedly one-eyed advocate could cite South Korea in 1963-85 as meeting the WDR's criteria for strongly outward oriented trade policy.[47] That the Bank did so without a blush shows—as does its more recent distortion of China's policy regime, and many other cases in between—how it deploys evidence with selective inattention to data that would upset the prior beliefs of its G7 member states about how the rest of the world should behave.

At the very least, analysts have to separate out the effect of country size on trade/GDP levels, from other factors determining trade/GDP, including trade policies; and make a clear distinction between statements about levels and statements about changes in levels. This distinction is occluded in common globalist assertions that "openness is a necessary—though not sufficient--part of modern economic growth", or assertions that the World Bank studies referred to earlier demonstrate that "more open" economies perform better than "less open". (To repeat, the studies measure *changes* in trade dependence.)

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[47] Wade, *Governing the Market;* Richard Luedde-Neurath, *Import Controls and Export-oriented Development: A Reassessment of the South Korean Case,* Boulder, Westview, 1986; Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization,* New York: Oxford University Press, 1989.

The policies for catch-up

Evidence from the countries and regions that have succeeded in significantly reducing the relative and absolute income gaps with the West—to the point of rising above 50 percent of the West's average income—suggests that the current development emphasis on openness, deregulation, privatization and good governance is not likely to go with sufficient technological learning for a large demographic mass--think of one billion people--to move over the next two to four decades from material living standards less than a quarter of the West's to more than a half. Most of the now developed countries (including the United States, Germany and Japan) used more active measures to promote the growth of new industries at the time of their catch up, and there is no reason to suppose that markets or technology have changed to the point of making deliberate industrial nurturing unnecessary today. [48] Indeed, the United States today still has an industrial policy in all but name for aerospace and electronics—it is called the "national missile defense program"; and the US government gives several other "strategic" sectors heavy R&D subsidies. A high proportion of new US companies receive subsidized loans from the state—in 1999 70 percent of all new companies receiving venture capital funding also received co-financing from the public sector Small Business Administration.[49] When the US Treasury presses the World Bank and the IMF to dissuade borrower governments from industrial policy subsidies and protection it is saying, "Do as I say, not as I do". Developing country governments today should take steps to nurture new industries and upgrade technologies in existing industries, and liberalize trade in line with the growth of domestic capacities—they should aim to expose domestic producers to enough competition to make them more efficient but not enough to kill them, which is very different from presuming that trade liberalization is always a powerful propulsive force whose costs will be short term as resources shift to more productive uses. China and India today (Vietnam too), and Japan, South Korea and Taiwan earlier, suggest a policy prescription that is not close to what the Bank says, but it is also not "anti-globalization". [50]

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[48] Richard Kozul-Wright, "The myth of Anglo-Saxon capitalism: reconstructing the history of the American state", in *The Role of the State in Economic Change*, (eds.) Ha-Joon Chang and Robert Rowthorn, Clarendon Press, Oxford, 1995, 81-113; Ha-Joon Chang, *Kicking Away the Ladde: Development Strategies in Historical Perspective*, Anthem Press, London, 2002; Alice Amsden, *The Rise of the Rest*.

[49] European Commission, *European Competitiveness Report 2002*, Brussels: European Commission, 2002.

[50] The folly of presenting integration and openness as anything close to a sufficient condition of development is also suggested by the long experience of southern Italy, which operates in a completely free market with northern Italy but has an output and income gap with the north that has resisted determined state investment to reduce it. Robert Wade, "Regional policy in a severe international

More generally, we must make a distinction between two senses of the word "integration". One is "external integration", the meaning of "integration" in today's discussion. The other is "internal integration", creating a national (or regional) economy with denser input-output linkages, a matter of much interest to development economists of the 1950s to the 1970s but more or less dropped from the agenda of the international development community since the 1980s. The experience of the successful developers shows that "export orientation" (external integration) and "import substitution" (part of internal integration) need not be opposed, they can be complements. The question of public policy is how to nurture new competitive industries and upgrade technologies in existing industries—for example, how to use the power of the state to encourage supply linkages between subsidiaries of multinational corporations and domestic firms, and to encourage firms to invest in higher technology processes sooner than they would in free market conditions without inter-firm coordination.

We also badly need a theory of "implementability"—a theory about the conditions in which different kinds of policy instruments can be made to work in line with intended effects—or not. Notions of "state capacity" are relevant here. A theory of implementability would have to recognize that the standard liberal argument against restrictions on transactions and in favor of regulation of some kinds of transactions is too simple: in the conditions of weak states some kinds of restrictions may have higher implementability than some kinds of regulations. Restrictions on capital inflows or outflows, for example, may be more implementable than prudential regulations on banks. A dual exchange rate regime—strongly disapproved of by the IMF--may be more implementable than either of the two regimes supported by the IMF, a free float or a pegged rate; it can allow a "low capacity" developing country government to do what most governments want to do, which is to stabilize the currency, without locking the economy into a single rate that either sells exports at the cost of employment in domestically-oriented activity or protects against imports at the cost of exports.

If we are to slow down and even reverse the present tendency to widening absolute (and relative, depending on how measured) income gaps these issues of technological learning and implementability must be returned to center stage. So too must the questions implied in my discussion of the Post-Bretton-Woods monetary arrangements. We should

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environment: Politics and markets in South Italy," *Pacific Viewpoint*, 23(2), 1982, October: 99-126. I describe the fight between the World Bank and the Japanese government over appropriate development strategies in Southeast Asia, in "Japan, the World Bank, and the art of paradigm maintenance: *The East Asian Miracle* in political perspective", *New Left Review*, 217, May/June 1996, 3-36.

recognize at the international level—in the form of IMF and World Bank policy statements—that states have acceptable recourse to an array of forms of capital controls, including not only prudential regulation but also quantitative restrictions. This is to make it more difficult for the owners and managers of financial capital, and the G7 deputies, to relaunch the campaign to hard-wire a norm of open capital accounts into the basic rules of the world economy, that was in high gear in the years before the Asian financial crisis of 1997-98. The campaign has been dormant since the crisis, but will be restarted as memories fade.

We should go further and consider establishing—as an extreme option, the better to concentrate minds on more realistic improvements to the world financial architecture--a system that allows countries to make cross-border payments in their own currency, and that gives public institutions (central banks and a new international clearing agency) the central management role in international transactions. [51] Banks receiving payments in foreign currency would be required to exchange them for domestic currency deposits at their national central banks; and the national central banks would in turn be required to present the foreign currency payments to an international agency for clearing. Net payments through the international agency would be debited or credited against a member country's reserve account (held in the country's own currency). Exchange rate changes would be made in-house in accordance with changes in reserves, at regular intervals. The exchange rates would reflect costs of production and demand for goods and services, not speculation against future movements. They would become an order of magnitude more stable than under the PBW system. This system, I suggest, could hasten the catch-up of developing countries, or hold them back less.

Exogenous statistics and exogenous research

The discussion about the potential bias in the World Bank's statistics on poverty should remind us of the dangers of having the Bank as the near-monopoly provider of key development statistics; and the discussion of the Bank's recent study of globalization, growth and poverty should remind us of the dangers of having the Bank as the world's main center of development economics research. The Bank is too committed to an Official View of how countries should seek

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[51] Jane D-Arista, *Reforming the Privatized International Monetary and Financial Architecture.* Philomont, VA: Financial Markets Center, 1999 (www.fmcenter.org). Reprinted in *Challenge,* vol. 43, no. 3, May-June 2000.

development, too exposed to arm-twisting by the G7 member states, too compelled to defend itself against criticism. It faces constant pressures from within and without for its statistics and its research to be made "endogenous" to the debate.

The problem stems from the Bank's strategy for maintaining legitimacy. Lacking coercive power, it depends on "voluntary" compliance. It seeks to bolster its legitimacy—its chances of obtain voluntary compliance-- by appealing to "technical" economics findings that show that the policies behind the Bank's market-opening conditionalities will generate higher growth and faster poverty reduction in developing countries while also bringing benefits to the rich non-borrowing members in terms of better market access in developing countries. Mutual benefit must reign overall. Indeed, the more politically intrusive the Bank's conditionalities have become—the more its rich non-borrowing countries have required it to adopt policies that require borrowing governments to agree to politically-sensitive things they may not wish to do ("participation" and "indigenous peoples' protection plans" in China, for example, or rapid trade liberalization everywhere)—the more the Bank must justify the conditionalities and policies on "technical" grounds, as being thoroughly in the interests of the borrowing countries, as demonstrated by the best research using the best statistics. The Bank needs to present its research and its statistics as wholly "exogenous" so as better to convince *developing* country governments and other important audiences that they should trust what the Bank says, but at the same time the Bank's research and statistics must justify its saying what the powerful *developed* country governments and business firms want it to say, and hence must become to some degree endogenous to the Bank's struggle for legitimacy in the eyes of its developing and developed country principals.

Perhaps we can understand in this light the apparent discrepancy between the *World Development Report 2000/2001*, which said that the number of people in extreme poverty *increased* between 1987 and 1998, and *Globalization, Growth, and Poverty*, which said that the number of people in extreme poverty *decreased* between 1980 and 1998. When the first was being written in the late 1990s the key ideas-controlling positions in the Bank were held by Joe Stiglitz and Ravi Kanbur (respectively, chief economist and director of the *World Development Report 2000/2001*), not noted champions of the Washington Consensus; [52] and at that time the Bank was trying to mobilize support for making the Comprehensive Development Framework the template for all its work,

[52] See my "US hegemony and the World Bank: The fight over people and ideas", *Review of International Political Economy*, May 2002. This uses Stiglitz's firing and Kanbur's resignation to illuminate the US role in the Bank's generation of knowledge.

and hence emphasised the lack of progress in development in order to justify a new approach. By 2000/2001 the Bank needed to defend itself against attacks from the US Congress and the Meltzer Commission; hence it wished to show progress in development. Also, both Stiglitz and Kanbur were gone and David Dollar, a prominent Bank economist, was in the ascendancy. He was chief author of *Globalization, Growth and Poverty*. The data and the choice of methodologies seem to change with the people and the organization's tactical objectives.

Data provided by a monopoly that is then used to judge the performance of the monopoly is doubly unreliable. We would not want Philip Morris' research labs to be the only source of data on the effects of smoking, even if the research could be shown to lie within the bounds of professional standards. At the least the Bank should have an independent auditor to verify its main development statistics; or else the Bank should give up producing statistics and cede the work to an independent agency, perhaps under UN auspices, with a carefully specified contract. Perhaps the same should be done with the Bank's development research function.

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