

## Competing Concepts of Inequality in the Globalization Debate: A Comment on Ravallion

Lant Pritchett  
Harvard University

One of the difficulties of commenting on Martin Ravallion is that he very rarely, if ever, makes mistakes. I know this from having had many, many debates with him, none of which I can claim to have won--in his mind--and actually few of which I can claim to have won even in my own mind. As the title of the conference is “Globalization, poverty, and inequality” and Martin talked mostly about inequality, I will talk about globalization and poverty. That way I won't have to engage head to head with anything he said about inequality.

What I would like to make is two points, if I have time. The first is, current globalization talk is and is almost bound to be nonsense, for reasons that I will go into. And secondly, I would argue that most economists should not buy into poverty using a low poverty line as being a principal social objective to which policy should be devoted.

First, let's talk about “globalization.” We as economists keep talking about globalization as if the central driving phenomena of the period in which we live is in fact globalization whereas I would argue that the central driving phenomena of the last century and even of the last 50 years is in fact nearly the opposite: the division of the global economy into smaller and smaller units. Those smaller and smaller units limit the mobility of the key factor that matters most for inequality, which is the mobility of persons.

So while we are arguing whether “globalization” is good or bad for the poor or good or bad for inequality, we ought to be discussing whether the recent set of processes called X has this or that effect. Before naming X we should see what its central features are. I would argue that there are four central processes over the last 50 years. First, there has been the proliferation of sovereigns (Braun, Hausmann, and Pritchett 2004). This means that there are more borders, more legal jurisdictions and more independent judiciaries, more monies, more flags, more representatives of the UN. Second, technological innovations have meant that the transport costs of many things, including information, money and goods, decline. Third, there are a set of processes in which some of the many nation states pursue policies which are modestly more liberal policies towards the movement of some items of economic relevance across the increasing numbers of national borders. Fourth, by and large the movement of labor is completely excluded from the policies of liberalization.

There are two key points. First, I would argue we have no particularly strong reason to call this set of four processes “globalization.” Suppose that in 2004 the state of Idaho seceded from the United States and set up as a new sovereign entity with army, borders, a currency, disallowed all movement of persons from all other countries—including the USA--and imposed a tariff of 10 percent on all

goods from the rest of the United States. Then suppose ten years later in 2014 Idaho lowers its tariff on USLI (that is, United State less Idaho) products to 3 percent. Wouldn't we think it odd if studies of the impact of that policy change referred to the study of the process of integration when *disintegration* was the central phenomena?

The second point is that whatever we call the process X economists should have no strong priors about the answer to that particular question about how X should have affected inequality. Let me just review quickly some of the kind of factual elements why we shouldn't have particularly strong priors about the way in which the process that I am calling X and which this conference is calling globalization might affect inequality.

First of all, this is the increase in the per year increase in number of sovereigns in the world. So the number of sort of sovereign entities that control borders and hence, inhibit economic transactions across geographic space, has gone from something like 50 to something like 200. This is an enormous anti-globalizing force, and it has divided the world economic base up into smaller and smaller, not larger and larger units. And even with sort of full liberalization, there are literatures that suggest border effects *per se* are large even across highly liberalized environments. For instance, trade between U.S. and Canada appears to be enormously lower because of a border in spite of the fact that one can hardly imagine more liberalization between two countries in the absence of true integration.

One thing that has happened over the historical scale is that only around 10 percent of the total global inequality was cross country variation in 1820--it was about the same to be a peasant in England or in India in 1820. Today, something like 60 percent of the total global inequality across individuals is accounted for by differences in average income across countries. So for some reason, this process called X has been associated with a huge increase in the amount of inequality that is accounted for by differences across these borders that are called nation states.

The second thing is the current era of X inhibits the mobility of persons across national boundaries. These barriers are huge—in that they prevent large amounts of movement. The differentials in the real, purchasing power adjusted, wages of unskilled labor between the U.S. and countries that sent substantial fractions of their population to the U.S. around the turn of the century were between two to one or four to one. That is, the wage differentials that drove people out of Ireland, out of Italy, out of Norway, into Minnesota, into New York were substantial but not astronomic.

The current wage differentials between potential sending and receiving countries are enormously higher—from six to one to ten to one. Enormously higher wage differentials with enormously lower migration flows (as proportions of both

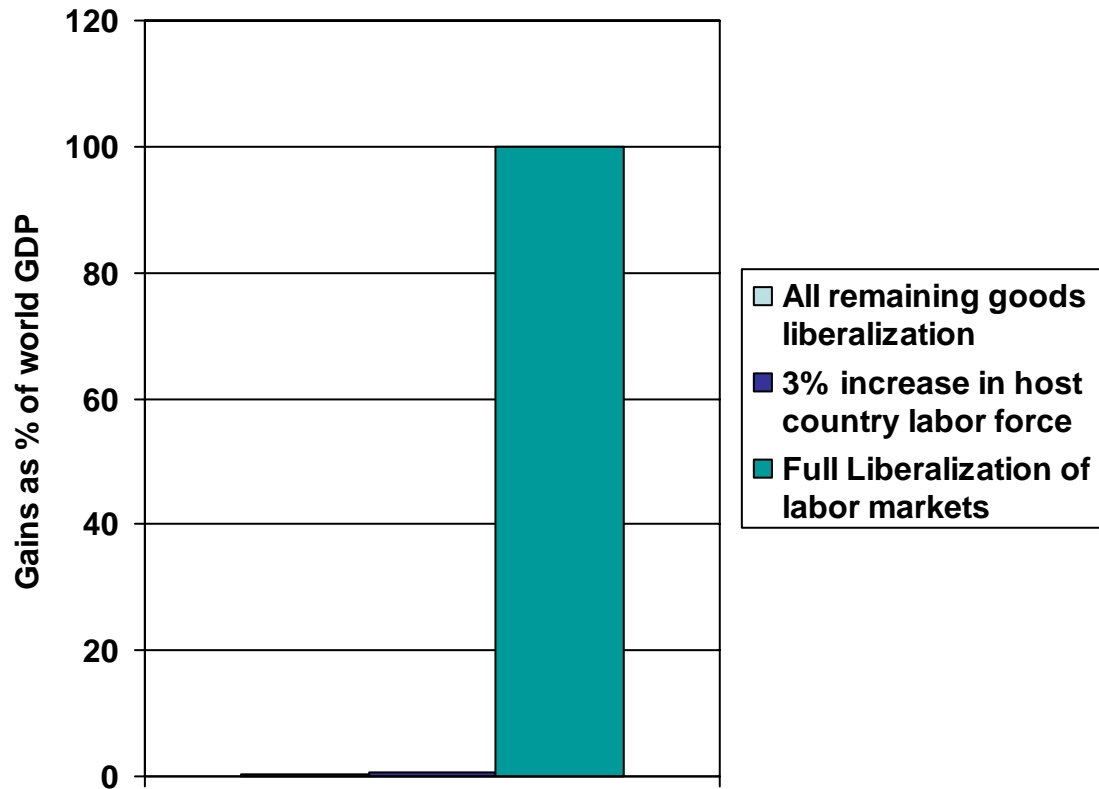
sending and receiving country populations) suggests that the obvious is true: the guys with guns guarding the borders are a binding constraint on labor mobility.

There are implications of barriers to labor mobility to the dynamics of population and real wages. If the economic process has large region-specific shocks to the desired population of geographic regions (which might have to do with technological changes, changes in agriculture, economies of scale, urbanization) those shocks have to be accommodated. If there is labor mobility, those shocks get accommodated by people moving out of Kansas to California. If there is not labor mobility, those geographic shocks get accommodated by people getting poor, but being trapped in the region they are in and people who are having positive shocks get rich. If regions receive a negative shock and people move out of it, it creates a ghost region but with barriers to the mobility of labor one produces zombies—as everyone knows a zombie is the living dead. A zombie is a country in which the real wage wants to go down dramatically because of a negative shock to the desired population, but the population can't get out. So the only way to accommodate that shock is a huge fall in the real wage.

Comparing data on GDP per capita and population of regions within countries to across countries shows striking results. Within countries (particularly large countries) there are large differences in the growth of population, with small differences in the growth of income per head. Whereas, across countries the opposite is true, there is enormous disparity in the growth rate of income per head and very little disparity in the growth rate of population less rate of natural increase.

So what I would argue that one of the things we have learned about the world from the processes called X is that the world isn't, in fact, globalized. The key market that isn't globalized is the market for labor and that when one doesn't, in fact, have a liberal market for labor, one can't, in theory, predict with any accuracy with existing models how other policies and liberalizing other markets will or will not affect inequality.

I close this section of what *isn't* globalization with a question of



why figure 1 is facetious. Figure 1 is an estimate of the welfare gains as a percent of GDP from removing restrictions on labor mobility which estimates suggest would double world GDP, versus the gains from everything that is on the WTO agenda for the current round. You notice that the number that cannot even be seen is what the literature is about while the huge number is facetious. The graph is facetious because, for some reason, we simply because we don't want to talk about liberalizing or globalization in the only market where it really matters.

The second question often asked is: do the processes called X affect poverty? Well, that requires a definition of poverty. Nearly all of the poverty numbers in the public domain are the Foster-Greer-Thoerbecke measures of poverty. When the World Bank, via Martin Ravallion, reports on the number of the poor, it is a calculation like this. These numbers all depend on there being a poverty line.

The thing about a poverty line is that income gains above the poverty line count zero towards the reduction of poverty. This isn't about how much being below the poverty line counts. With the 'poverty intensity' parameter of the FGT measures you can vary that is a variety of semi-plausible ways. But if you say "poverty reduction is my objective" and you set a poverty line, every gain to income above that line counts for *zero* in your objective function.

Hence before we can ask “how does X affect poverty?” we must draw a poverty line. It would seem a reasonable poverty line, particularly an upper bound on poverty lines for global analysis, should be set where the analyst is comfortable that *zero* is a reasonable approximation to his/her true social welfare function.

A huge problem with nearly all of the literature to date is that it has bought into a monopoly of very low poverty lines for global absolute poverty—a monopoly of the ‘dollar a day’ or ‘two dollars a day’ poverty lines. But it is simply ludicrous in my view to set those as upper bound poverty lines. Zero is not a reasonable approximation to the appropriate weight in the social welfare function of any reasonable policymaker at a poverty line drawn through “dollar a day’ or ‘two dollars a day’ for the following three reasons.

First, people do not regard gains to their income as being anywhere near zero at ‘two dollars a day’ and I am a big believer that SWF should be non-paternalistic. If you look at the relationship between subjective well-being and income across nations from the world value survey, in fact, it is very difficult to argue that this flattens out at anything like \$2 a day. It might flatten out at \$20,000 a year, but it doesn't flatten out at \$730 a year.

Second, “the rich” of poor countries have enormously lower incomes than “the poor” of rich countries. Dani Rodrik has made the calculation of whether the “rich” (defined as the top 10 percent) in the bottom 10 percent of countries have higher income than the “poor” (defined as the bottom 10 percent) in a rich country. By his calculation the PPP income of a “rich” individual in a “poor” country by his calculation is P\$2,800—only P\$7/day--while the income of a “poor” individual in a “rich” country three times as higher P\$ 8640 (\$23/day). If the bottom 10 percent of the rich country population are poor then so are the top 10 percent in poor countries. If you suspect PPP adjustments I suspect you are wrong--“the poor” of rich countries are better off than the top quintile in nearly every poor country by every non-money metric indicator of well-being—food share, child mortality, malnutrition, schooling. Malnutrition among the *top* 20 percent of households by a measure of wealth -- the asset index in India, Nepal or Nigeria, malnutrition is 30 percent. I think it is ludicrous to think that “we” don’t care about the impact of globalization on “the rich” in India when in fact 30 percent of the people who are “rich” have children who are malnourished. If the poor of rich countries are poor then so are people in the upper tails of the income distribution of poor countries.

Finally, even if you don’t care about income and only think money should be instrumental towards some warm and cuddly goal like schooling there is still no reason to cut off poverty at a low line like ‘two dollars a day’ as the increments of incomr to well-being at those low levels are still very high.

I think the word ‘poverty’ should always have an adjective that makes it clear what the relevant standard is. The ‘dollar a day’ standard should define “destitution poverty” while the ‘two dollars a day’ line should define “extreme

poverty” while a poverty line “ten dollars a day’ (in 1993 PPP\$) should define “global poverty.”

Then, when we talk about things like what is the impact of processes called X (not globalization) on poverty there is neither an unwarranted monopoly of a single standard nor confusion. After all, the ‘dollar a day’ standard is sharply penurious—only 7 percent of people in Sri Lanka are “destitution poor.” While it might be *one* interesting question about whether globalization benefits the ‘destitution poor’ certainly that is not the only question of interest. We might conceivably have non-zero concern for people in the tenth percentile in Sri Lanka, who are excluded from concern by the ‘dollar a day’ standard. So we can also ask, “does globalization benefit the ‘ten dollar a day’ poor”? If some policy changes produce large gains in aggregate incomes in India and the gain is slightly larger for the 35th percentile—who by any reasonable *global* standard are very poor people—than for the 15<sup>th</sup> this won’t be called “globalization did not benefit ‘the poor’.”

What you will see I am pleading for is a bit more economics of how identifiable policy changes affect the distribution of income (both central tendency and dispersion) in validated theories and empirical evidence and a bit less attention to questions in which one badly defined concept is related to another badly defined concept like, for instance, the question, “Is globalization good or bad for poverty.”

*References*

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