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THE UNREMARKABLE RECORD OF LIBERALIZED TRADE

After 20 years of global economic deregulation, poverty and inequality are as pervasive as ever

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Recently, a growing number of policy makers have touted the potential for global economic integration to combat poverty and economic inequity in the world today. On September 24, 2001, for instance, U.S. Trade Representative Robert Zoellick (2001), arguing for new "fast track" trade promotion authority, cited a World Bank study claiming that globalization "reduces poverty because integrated economies tend to grow faster and this growth is usually widely diffused" (World Bank 2001a, 1). Yet the empirical evidence suggests that reductions in poverty and income inequality remain elusive in most parts of the world, and, moreover, that greater integration of deregulated trade and capital flows over the last two decades has likely undermined efforts to raise living standards for the world's poor.

In 1980, median income in the richest 10% of countries was 77 times greater than in the poorest 10%; by 1999, that gap had grown to 122 times. Inequality has also increased within many countries. Over the same period, any gains in poverty reduction have been relatively small and geographically isolated. The number of poor people rose from 1987 to 1998, and the share of poor people increased in many countries—in 1998 close to half the population were considered poor in many parts of the world. In 1980, the world's poorest 10%, or 400 million people, lived on 72 cents a day or less. The same number of people had 79 cents (nominally) per day in 1990 and 78 cents in 1999.

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While many social, political, and economic factors contribute to poverty, the evidence shows that unregulated capital and trade flows contribute to rising inequality and impede progress in poverty reduction. Trade liberalization leads to more import competition and to a growing use of the threat to move production to lower-wage locales, thereby depressing wages. Deregulated international capital flows have led to rapid increases in short-term capital flows and more frequent economic crises, while simultaneously limiting the ability of governments to cope with crises. Economic upheavals disproportionately harm the poor, and thus contribute to the lack of success in poverty reduction and to rising income inequality.

The world's poor may stand to gain from global integration, but not under the unregulated version currently promoted by the World Bank and others. The lesson of the past 20 years is clear: it is time for a different approach to global integration, whereby living standards of the world's poor are raised rather than jeopardized.

Deregulated global trade and capital markets as the culprit

Over the past decades international capital mobility has grown as capital controls were reduced or eliminated virtually everywhere. Consequently, capital flows to developing countries have grown rapidly, from $1.9 billion in 1980 to $120.3 billion in 1997, the last year before the global financial crisis, or by more than 6,000%. Even in 1998, in the wake of the financial crisis, capital flows remained remarkably high at $56 billion. A substantial share of these capital flows (e.g., 36% in 1997) consisted of short-term portfolio investments (IMF 2001b).

Faster capital mobility in a relatively deregulated environment leads to rising inequality, both within countries and between countries, and to less poverty reduction or even increasing poverty.

The probability of financial crises in developing countries rises in direct relation to increases in unregulated short-term capital flows (Weller 2001; Easterly and Kraay 1999). Rising short-term capital inflows result in increased speculative financing and, subsequently, rising financial instability. Financial crises reduce the likelihood for the poor to escape poverty through economic growth because they are ill-equipped to weather the adverse macro-economic shocks (Bannister and Thugge 2001; Lustig 1998, 2000). Financial crises also lower short-term growth rates, and it is estimated that poverty increases by 2% for every percent decline in growth (Lustig 2000).

The burdens of financial crisis are disproportionately borne by a country's poor. Since higher-income earners have better access to insurance mechanisms that protect them from the fallout of a crisis (including capital flight), macro-economic crises lead to a more unequal income distribution within countries (Lustig 2000). Thus, economic crises increase the need for well-functioning social safety nets. Yet unfettered capital flows limit governments' abilities to design policies to help the poor when they need it most—in the middle of a crisis. The International Monetary Fund often opposes increased government expenditures to assist the poor during economic crises, and investors withdraw their funds following increased government expenditures (Blecker 1999).

Finally, developing countries are prone to experience more severe economic crises with greater frequency than are developed economies (Lustig 2000; Lindgren, Garcia, and Saal 1996), leading to greater inequality between countries.

Trade liberalization—the complement to deregulated capital markets in the global deregulation agenda—also plays a significant role in raising inequality and limiting efforts at poverty reduction. By inducing rapid structural change and shifting employment within industrializing countries, trade liberalization leads to falling real wages and declining working conditions and living standards (Bannister and Thugge 2001; Scott et al. 1997; Scott 2001a; Scott 2001b; Mishel et al. 2001).

Trade liberalization also gives teeth to employers' threats to close plants or to relocate or outsource production abroad—where labor regulations are less stringent and more difficult to enforce—and undermines workers' attempts to organize and bargain for improved wages and working conditions (Bronfenbrenner 1997, 2000). This trend fuels a race to the bottom in which national governments vie for needed investment by bidding down the cost to employers (and livings standards) of working people.

The connection between rapid trade liberalization and inequality appears to be universal, indicating downward wage pressures and rising inequality following trade liberalization in industrializing and industrialized economies (USTDRC 2000). A report by UNCTAD (1997) found that trade liberalization in Latin America led to widening wage gaps, falling real wages for unskilled workers (often more than 90% of the labor force in developing countries), and rising unemployment.

Rising inequality is common within many countries

Defenders of the current regime of global deregulation, including the World Bank, acknowledge that inequality has increased within countries. But in its most recent and rather comprehensive document on globalization and poverty (World Bank 2001a), the Bank raised two issues that supposedly mute the fact of rising intra-country inequality. First, data for China dwarfs observations for all other countries, thereby suggesting that rising inequality in globalizing countries does not exist outside of China (World Bank 2001a, 47). However, data for other countries show that growing inequality is indeed a widespread trend. Second, the World Bank also claimed that rising inequality is not a result of increasing poverty, which thus makes it presumably less troubling (World Bank 2001a, 48). While this claim may hold true in China, it does not describe the trend in many other parts of the world.

There is a broad consensus that income inequality has risen in industrialized countries since 1980. The World Bank reports that there was a "serious…increase in within-country inequality in industrialized countries] reversing the trend of [the period 1950-80]" (World Bank 2001a, 46). Similarly, Gottschalk and Smeeding (1997, 636) found that "almost all industrial economies experienced some increase in wage inequality among prime-aged males" in the 1980s and early 1990s. Further, data from the Luxembourg Income Study (LIS 2001) show that, among 24 countries, 18 experienced increasing income inequality, five (Denmark, Luxembourg, the Netherlands, Spain, and Switzerland) experienced declining inequality,

and one (France) saw no change.

Income inequality is also rising in industrializing countries. There was been an unambiguous rise in inequality in Latin America in the 1980s and 1990s (Lustig and Deutsch 1998; IADB 1999; UNCTAD 1997; ECLAC 1997). Other areas also saw inequality rise in the 1980s and 1990s (Faux and Mishel 2000; Ravallion and Chen 1997). Deininger and Squire (1996) found rising inequality in East Asia, Eastern Europe, and Central Asia since 1981, and growing polarization in South Asia. Only sub-Saharan Africa shows a trend toward more income equality since the 1980s.

While a widening gap between the rich and the poor within countries is not universal, it appears to have occurred at least in the majority of countries, and is affecting the income of the majority of people around the globe, contrary to claims by the World Bank that rising inequality within countries has been rare.

Poverty remains a large and widespread problem

The World Bank tries to divert attention from rising inequality by emphasizing its analyses of poverty reduction. It argues that “the long [term] trends of rising global inequality and rising numbers of people in absolute poverty have been halted and perhaps even reversed” due to greater globalization (World Bank 2001a, 49). However, the purported success in poverty reduction is elusive: the number of poor people is on the rise, relative poverty shares remain high in many parts of the world, and poverty shares are rising in many regions.

In assessing global poverty trends, the World Bank relies on a study that highlights the World Bank’s *Global Poverty Monitoring* database and provides an overview of poverty trends from 1987 to 1998 (Chen and Ravallion 2001). The authors themselves, though, conclude that “[i]n the aggregate, and for some large regions, all…measures suggest that the 1990s did not see much progress against consumption poverty in the developing world” (Chen and Ravallion 2001, 18). Also, the IMF (2000, Part IV, p. 1) reports that “[p]rogress in raising real incomes and alleviating poverty has been disappointingly slow in many developing countries.”

The assessment of poverty trends by the World Bank suffers from several problems. First, measuring poverty is a difficult undertaking that can easily lead to errors. Different measures of poverty exist. The World Bank’s *Global Poverty Monitoring* database, for example, uses an international poverty line of $1.08 per day in 1993 dollars based on purchasing power parity (PPP) exchange rates (Chen and Ravallion 2001; World Bank 2001b). But absolute poverty lines such as this one ignore regional or country-by-country differences.

The evidence shows that the use of an international poverty line tends to understate the share of people living in poverty, compared to other poverty measures. For example, a method using individual national poverty lines finds an additional 14% of the population to be considered poor compared to a method using the international poverty line (World Bank 2001b). An alternative to both the national and international poverty line methods is to use a relative poverty line based on mean consumption or income

TABLE 1
Share of people living below relative poverty lines

	1987	1990	1993	1996	1998
East Asia	33.01%	33.69%	29.82%	19.03%	19.56%
East Asia, excluding China	45.06	38.68	30.76	23.16	24.55
Eastern Europe and Central Asia	7.54	16.19	25.34	26.08	25.60
Latin America and Caribbean	50.20	51.48	51.08	51.95	51.35
Middle East and North Africa	18.93	14.49	13.62	11.40	10.76
South Asia	45.20	44.21	42.52	42.49	40.20
Sub-Saharan Africa	51.09	52.05	54.01	52.80	50.49
Share of world:					
Living under $1.08/day	28.31%	28.95%	28.15%	24.53%	23.96%
Living under relative poverty lines	36.31	37.41	36.73	32.79	32.08
Maximum daily consumption of world's poorest 400 million (nominal)	$0.79	$0.79	$0.56	$0.84	$0.75

Notes: The drop in 1993 reflects sharp decreases in per capita GDP in Nigeria, Ethiopia, Myanmar, and the Democratic Republic of Congo that, combined, made up 58% of the sample population in 1993. Calculations for the world's poorest 400 million are based on average nominal per capita GDP.

Sources: Chen and Ravallion (2001); IMF (2001a, 2001b); and authors' calculations.

levels in each country. Using such a relative poverty line instead of the international poverty line shows on average an additional 8% of the population to be considered poor (Chen and Ravallion 2001).

Second, poverty lines are often inadequate to measure the true hardships people are facing in meeting the basic necessities of life. For instance, a recent U.S. study showed that 29% of working families did not earn enough to afford basic necessities, suggesting that a better approach to understanding poverty may lie in measuring household budgets rather than simple poverty lines (Boushey et al. 2001).

The third problem with the Bank's poverty assessment is that even the poverty reduction gains it does find are small and geographically isolated. In 1998, the share of the population living in poverty in industrializing countries was 32%, under a relative poverty line. Although that percentage was down from 36% in 1987, the actual number of people living in poverty increased from 1.5 billion to 1.6 billion. In 1998, the share of the population in poverty remained very high in some regions: over 40% in South Asia and over 50% in sub-Saharan Africa and Latin America (**Table 1**). Since 1987, the share of the poor has stayed relatively constant in sub-Saharan Africa and Latin America but more than tripled in Eastern Europe and Central Asia.

Another way to look at the global trends in poverty is to consider the incomes of an absolute number of poor people. Take, for instance, the poorest 10% of the population in 1980, consisting of about 400 million people, based on average per capita GDP. The poorest 400 million lived on a nominal $0.72 a day

in 1980, $0.79 a day in 1990, $0.84 in 1996, and $0.78 in 1999 (Table 1). In other words, the income of the world's poorest did not even keep up with inflation. Clearly, the economic burden worsened for a large number of people in the 1990s.

Fourth, since the data do not extend beyond 1998, the full impact of the crises in Asia, Latin America, and Russia is not included, making it likely that future revisions will show less progress in poverty reduction. Lustig (2000) argues that frequent macroeconomic crises are the single most important cause of rapid increases in poverty in Latin America. Consequently, future revisions to the poverty trends in the late 1990s could show smaller average reductions or larger increases in the crisis-stricken areas. In fact, revisions to past data already show less success in poverty reduction than previously assumed. Chen and Ravallion (2001), for example, show that the reduction of people living below the poverty line between 1987 and 1993 was not four percentage points, as estimated in 1997 (Ravallion and Chen 1997), but less than one percentage point.

Finally, the World Bank's conclusion that the lot of the poor has improved during the era of increasing trade and capital flow liberalization relies substantially on data from China and India, but the experiences of both countries are anomalies. In reality, the facts in these countries undermine the case for a connection between greater deregulation of capital and trade flows and falling poverty and inequality. While in China the percentage who are poor has fallen, there has been a rapid rise in inequality (World Bank 2001a). Most notably, inequality between rural and urban areas and provinces with urban centers and those without grew from 1985 to 1995. Also, a large number of China's workers labor under abhorrent, and possibly worsening, slave or prison labor conditions (USTDRC 2000; U.S. Department of State 2000, 2001). This situation not only means that many workers are left out of China's economic growth, it also makes China an unappealing development model for the rest of the world. Thus, improvements in China are not universally shared and leave many workers behind, often in deplorable conditions.

Using India to illustrate the benefits of unregulated globalization is equally problematic to the World Bank's position, since India's progress was accomplished while remaining relatively closed off to the global economy. Total goods trade (exports plus imports) was about 20% of India's gross domestic product in 1998, or 10 percentage points less than in China and only about one-fifth the level of such export-oriented countries as Korea (IMF 2001a). Moreover, that the IMF (1999, 2000) continuously recommended further liberalization of India's trade and capital flows—the only large developing economy for which this was the case—suggests that the IMF viewed India as a laggard in deregulating its economy.

Continued income divergence across countries (besides China)

The arguments on changes in income inequality between countries take a few perspectives. The World Bank's conclusion that incomes between countries are converging is based on differentiating between countries that have embraced unregulated globalization and those that have not. The World Bank's

TABLE 2
Distribution of world income, ratio of top 10% to bottom 10%

	1980	1990	1999
By countries			
Ratio of average incomes	86.2%	125.9%	148.8%
Ratio of median incomes	76.8	119.6	121.8
By population			
Ratio of average incomes	78.9	119.7	117.7
Ratio of median incomes	69.6	121.5	100.8
By population, excluding China			
Ratio of average incomes	90.3	135.5	154.4
Ratio of median incomes	81.1	131.2	153.2

Note: Distributions are based on per capita GDP in current U.S. dollars (IMF 2001a).

Source: Authors' calculations based on IMF (2001a, 2001b).

assertion that "between countries, globalization is mostly reducing inequality" (World Bank 2001a, 1) seems to contrast directly with the IMF's assessment that "the relative gap between the richest and the poorest countries has continued to widen" in the 1990s (IMF 2000, Part IV, p. 1). Given this confusion, it is useful to take a global perspective that looks at all countries and the distribution of world income across all countries and across all people.

The distribution of world income between countries grew unambiguously in the 1980s and 1990s. In other words, rich countries have gotten richer and poor countries have gotten poorer (**Table 2**). The median per-capita income of the world's richest 10% of countries was 76.8 times that of the poorest 10% of countries in 1980, 119.6 times greater in 1990, and 121.8 times greater in 1999. The ratio of the average per capita incomes shows a similar, yet more dramatic, increase.

The distribution of world income across people, rather than countries, witnessed some equitable improvement in the 1990s after a dramatic increase in inequality during the 1980s. While the richest 10% of the world's population had, on average, incomes that were 78.9 times higher than those of the poorest 10% of the world population in 1980, their incomes were 119.7 times higher in 1990. That ratio dropped to 117.7 in 1999. The improvement in equality in the 1990s was somewhat more pronounced in terms of median incomes, yet even under this measure the distribution of incomes was remarkably more inequitable in 1999 than at the beginning of the period in 1980.

Furthermore, the gains in the 1990s come solely from rising incomes in China. If China is excluded, there is an unambiguous trend toward growing income inequality across the remaining world population in the 1980s and 1990s (Table 2). Without China, the richest 10% of the world population had, on aver-

age, 90.3 times as much income as the poorest 10% in 1980, 135.5 times more in 1990, and 154.4 times more in 1999. However, since China's income distribution has become substantially more unequal in the 1990s, including China's per capita GDP in the distribution of world income across all people exaggerates improvements in the world's income distribution in the 1990s. Thus, the world's income is significantly more unequally distributed at the end of the almost 20-year experiment with unregulated global capitalism than at the beginning of it.

Conclusion

Criticism of the unregulated globalization agenda has been met with policy makers' renewed adherence to the doctrine that greater global deregulation of trade and capital flows helps to improve inequality between countries, to raise equality within countries, and to accelerate poverty reduction. But income distribution between countries worsened in the 1980s, and its apparent improvement (or leveling off) in the 1990s is the result solely of rising per capita income in China, where the enormous population tends to distort world averages. Within-country income inequality is also growing and is a widespread trend in countries with both advanced and developing economies. Success in reducing poverty has been limited. The number of poor people has risen, and the share of poor people has grown in many areas, especially in Eastern Europe and Central Asia. And the share of poor people remained high at 40-50% in Latin America, sub-Saharan Africa, and South Asia.

The promises of more equal income distribution and reduced poverty around the globe have failed to materialize under the current form of unregulated globalization. Thus, it is time for multinational institutions and other international policy makers to develop a different set of strategies and programs to provide real benefits to the poor.

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