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Conclusion: Roads Not Taken

This book has attempted to evaluate the data and to draw conclusions on four important and related subjects: the nature and level of economic growth; the level and change in world income distribution; the level and change in absolute poverty; and the effect of globalization on all of the above. Globalization was identified as a time period, the period of the past 20 years. What are the major conclusions, the megatrends?

There is no welfare indicator for which the world economy has not done better in the past 20 years. And poor people do better, much better than the average with globalization. They began the process of catch-up, and in 2000 mean incomes in the developing world were 14 percent of mean incomes in the industrialized world—up from a ratio of 12.6 percent two decades earlier.

Today, these poor nations account for almost 50 percent of world output, their education levels are reasonably high, and their wages relative to their productivity are relatively low. Globalization has meant that Stolper-Samuelson (or the law of one price and one wage) is in easy play—the drive toward greater competition, and greater convergence, is inexorable. This same force has led to a reversal of a centuries-old global trend of greater inequality; since 1973, the trend is down, and by the end of this decade, world inequality is likely to be lower than what it was in 1910—with a Gini of about 61. Today, the world inequality level has a Gini of 65.1—almost the lowest in 100 years.

It is a firm and happy ending to the twentieth century. On virtually every measure, the past 20 years have witnessed tremendous progress, to great improvement for all, and especially for the world's poor people.

Using the old $1-a-day poverty line ($1.50 at 1993 prices), there are ''only'' 650 million poor people in the world today, and they constitute 13 percent of the developing world's population. On the basis of the lower ''official'' World Bank poverty line of $1.08 a day, at 1993 prices, there are 450 million poor people, and they constitute only 9.1 percent of the developing world's population, or 6.4 percent of the world's population. On the basis of the higher and recommended $2 a day poverty line, the developing world has a poverty rate of 23.3 percent, or 1.15 billion poor people.

This result on poverty—both on the level today, and its trend—is at odds with the ''official'' World Bank results on world poverty for the $1.08 poverty line. The official results are 23 percent, or 1.15 billion, poor people in 1999; this book finds the same level of poverty, but for a poverty line that is 85 percent higher! Only one of the two conclusions can be right.

This exploration of world poverty and inequality started off with some puzzling conventional wisdom on globalization and its not-so-good side effects. Was their divergence as revealed by the divergent growth rates in poor and rich countries? No, because the developing world exceeded the growth of the industrialized world for 50 years, from 1950 to 2000. And for the globalization subperiod, the average developing country grew at almost twice the rate of the average (all population weighted) industrialized country—3.1 versus 1.6 percent.

The puzzle of only a slow, painful reduction in world poverty during the period from 1987 to 1999, in the face of this high per capita growth, was the result of puzzling methods and puzzling data. A conventional, and straightforward, use of widely available data shows poverty to have declined by at least triple the rate indicated by the official statistics—by about 16 percentage points, to a level of about 13 percent, rather than by 5 percentage points to a level of 23 percent.

No matter what statistic is used, the revealed truth is that we have just witnessed the 20 best years in world history—and doubly certainly the 20 best years in the history of poor people. Yet this is not the perception of many, if not most, of the participants in the global debate on globalization. It certainly is not the perception of most nongovernmental organizations to the left of the Cato Institute—which means more than 99 percent of the world's nongovernmental organizations. It certainly is not the perception of the media, the liberal press. It is not the perception of international institutions dedicated to bringing about the miracle we have all witnessed. Most interesting, and perhaps most important, it is not the perception of most academics, the intellectual elite, the women and men who are supposed to know better.

Different Forks for Different Folks

Why do so many have this distorted perception of reality? One explanation, if not *the* explanation, is that at every moment of methodological choice, the wrong one was made. The wrong fork in the road was taken by the guardians of conventional wisdom. In no particular order, the following points stand out. First, we were mesmerized into believing that instead of convergence, there had been divergence; and instead of a measure of divergence, there had been ''big-time'' divergence. This clarion call echoed throughout the institutions inside the Washington Beltway and, if I may be excused for saying so, at apparently all the left-of-center policy outposts of the world.

The intellectual basis for this conclusion: that the relative income of the United States had widened with respect to that of the poorest country, Tanzania in 1950 and Sierra Leone in 2000. A better alternative would have been to compare the trend in relative incomes of the richest and poorest countries, benchmarked to a particular date, say 1960. This would still not have been correct, but it would have been a better method—and it would have shown a trend toward convergence. This choice was not made. Instead, we were told about the relative incomes of the always changing top and bottom 20 countries, with China conveniently, and perhaps deliberately, excluded from the calculation.

When a defendable method, however, was used—comparing relative incomes of the 20th percentile in the United States with the 20th percentile in the developing world (the people might change, but not the percentiles) or relative incomes of the medians in the two sets of countries—the result was quite different. Rather than divergence, one obtained an even bigger-time convergence.

The next fork in the road involved the measurement of absolute poverty. After being employed for the first two decades in the new field of ''poverty economics,'' the method of measuring a country's mean incomes got changed. Instead of continuing to rely on national accounts data—the bread and butter of most (good and bad) economists—the institution in charge of measuring poverty, the World Bank, decided that henceforth only survey data would be used.

But a funny thing happened after this edict was handed down in the late 1980s. Survey data started capturing fewer and fewer of the changes revealed by national accounts. In one of the largest countries of the world, with the largest concentration of poor people, India, the survey method showed that between 1987 and 1998, mean per capita consumption had *declined* by about 10 percent, in real terms. The national accounts data, in contrast, suggested that there had been an *increase* in consumption of more than 40 percent. Even in Indonesia, a country affected the most by the financial crisis, per capita income in 1998 was 21 percent higher than in 1987. (Indonesian survey data also show a similar increase, because the survey capture ratio has stayed relatively constant at a low 50 percent.)

This methodological mistake also led researchers to take another wrong fork and miss another forest. Exclusive reliance on survey data meant that South Korea was deemed richer than the United Kingdom in 1993; and the Central African Republic was richer than India. These same assumptions yielded the result that not only had inequality worsened, but worsened at an unprecedented pace—more than 1 percent a year for 5 continuous years, from 1988 to 1993.

In the initial eureka moment of discovering this ''forbidden inequality truth,'' analysts did not stop to note that such a fast change for the world's 5.5 billion people was not only unlikely but impossible. The last such documented change took place between 1910 and 1950 and encompassed the Great Depression and two world wars. An analogous change between 1988 and 1993 was just not possible—even as an academic, one must state this. Yet we all lapped up this ''revealed'' truth and started looking for explanations as to how it might have happened.

Yet another wrong fork on the methodological road was taken in 1999. The revised 1993-base purchasing power parity (PPP) exchange rates had just been released, and the World Bank distributed these data to all the researchers and policymakers in the world. Its own staff, however, used the then-unpublished PPP ''consumption'' exchange rates for calculations of global poverty.

There was no backing for this choice, and its results were peculiar; it inexplicably showed South Asia to have 18 percent lower consumption than that revealed by the existing, and official, PPP data. Thus it was no surprise that, according to the World Bank, South Asian poverty was much higher than believed by anyone (e.g., for a higher national poverty line, equal to PPP $1.25 a day, official statistics showed a 26 percent poverty rate in India for 1999, rather than the 36 to 39 percent suggested by the World Bank).

Then came the time to interpret what had happened to growth and poverty. Here again, note was not taken of the warning signals—warnings about possibly a wrong method. Suddenly, it was observed that growth was not delivering. But no one paused to ask why. Instead, new models of development were offered, the quality of growth was emphasized, and policymakers and development specialists were asked to look for policies pertaining to the redistribution of income. Left unattended was the reality that if a proper method had been used, it would have been observed that growth had been propoor, and especially so during the globalization period 1980-2000; that these years were the best in the past 200 years in terms of poverty reduction; that poverty reduction in other periods had been less than half as much for every given unit of growth; and that the Millennium Development Goal of 15 percent poverty by 2015 had already been reached in 2000.

Answers to Often-Asked Questions

In closing, let us consider answers to four often-asked questions. *First, what is happening to global individual inequality?* Global individual (as opposed to country) inequality has shown a gradual, but significant, decline since 1973. The Gini coefficient of individual income inequality has declined from an average level of about 68 before the 1980s to close to 65 today. This surprising *reduction* in inequality during the globalization period (mid-1980s to now) has not been uniform. Industrialized countries have witnessed no change, Asia has recorded more than a 10 percent increase, and the postcommunist structural change in Eastern Europe has not been good for growth or for inequality. Per capita incomes are lower, and inequality has increased by an unprecedented amount—from an average Gini level of 32 before the 1990s to an average of almost 50 today.[1]

Several heuristic arguments have been made above to emphasize that the conclusion that *the world is becoming more equal* must be accepted if one believes that there are more than 1 billion people in China and that their incomes are rising at a faster rate than the average. And if one adds the fact that Indian incomes are also rising faster than the average, then the conclusion of increasing world equality is even more inescapable.

Another way to look at the reality is as follows. What the data suggest is that while the average poor country may be losing ground (the divergence literature), the average *person* in a poor country is gaining ground because her income is increasing at a faster rate than the income of the average rich person in a rich country. This is a result of several big, poor countries doing very well—the giants, China and India, and also Indonesia and Vietnam. There is no room for the fiction that the world is becoming more unequal if the revealed facts of growing big, poor countries are incorporated into the analysis.

Second, is there divergence or convergence? Divergence is a myth. If data on income distribution are available, then calculations of divergence based on differences in average country income growth are not that significant. Yet differences in individual income growth are very significant. For the globalization period, 1980 to 2000, the relative incomes of poor people soared: The elasticity of the bottom 20 percent is estimated to be 1.58 (i.e., for a 10 percent increase in average global income, the incomes of poor people increased by 15.8 percent). This is in large part due to the high growth experienced by the many poor people in China and India.

Third, has growth been propoor? A proper response to this question is twofold—theoretical and empirical. Theoretically, how much poverty reduction *should* a given amount of growth be associated with? What is neutral—is a 5 percent reduction in the head count ratio okay with 10 percent growth in consumption? Or is it 10 percent? It depends—on the "shape of the distribution elasticity," a concept introduced to help estimate the neutral impact of growth. This elasticity varies with the level

1. These inequality levels are for the distribution in Russia and Eastern and Central Europe, which is considered as one region or "country."

of the poverty line, and where in the distribution the poverty line is at any point in time. Typically, the value of this elasticity is about 0.5 (i.e., 10 percent neutral growth is associated with a 5-percentage-point reduction in poverty).

Moreover, empirically, there is no evidence to suggest that growth has been biased against the poor. In more than 80 percent of cases, gains (or losses) in consumption have resulted in declines (or increases) in the head count ratio. Further, the pattern of growth has almost invariably been at least neutral—poverty has declined by as much as it was expected to, given the poverty line and the shape of the distribution elasticity.

Further, according to a simple measure of propoor growth—comparing the consumption growth of poor people with the consumption growth of nonpoor people—poor people in the developing world (defined as the fraction of people who were poor in 1980, approximately the bottom 45 percent) have enjoyed much higher growth than nonpoor people (for every 10 percent growth in consumption of the nonpoor, the poor have increased their consumption by 18 percent). Little additional evidence is needed to suggest that globalization has been manifestly propoor. In a causal sense, globalization has made it possible for the developing world to compete with (and sometimes outcompete) the industrialized world in the global marketplace.

Fourth, can growth alone be sufficient for poverty reduction? Yes. If the discussion is about income poverty, then by definition, only two factors can affect the head count ratio: output growth and a change in income distribution. Given that within countries income distribution changes have tended toward inequality, it definitionally follows that growth has been more than sufficient to reduce poverty. In this important regard, the conclusion differs from the conventional wisdom that "attacking poverty requires actions beyond the economic domain."[2] Such actions are not needed. Growth is sufficient, period.

2. World Bank, *World Development Report 2000/2001: Attacking Poverty*, 33; emphasis added.