April 2001

Inequality, causes and possible futures

Jeff Frieden
Department of Government
Harvard University

Charles Tilly has written, with characteristic insight, about the prospects for inequality around the world over the next 50 years. I can only applaud the breadth and depth of his treatment. My own expertise is too limited for such a comprehensive survey, so I restrict myself to one among many topics related to global inequality.

There is, in my view, one dimension of income inequality whose importance swamps that of others, and that is the inequality due to differences in living standards among nations. This is primarily the result of differential rates of national economic growth, and it is my focus. I start with current conditions, then look at how global inequality has evolved over the past 50 years. After an examination of the causal factors that affect this inequality, I engage in a few speculative observations about what the next half-century might bring.

Current differences among countries in level of economic development. The disparity among countries in level of economic development is far the greatest source of global inequality. Differences between developed and developing countries are massive: the average developed nation's per capita income is seven times that of the average developing country. At the extremes, even controlling for differences in price levels, income in the United States is fifty times what it is in such countries as Angola, Ethiopia, and Tanzania ($30,600 per person, compared with around $600). More generally, per capita income is $1,450 per person in sub-Saharan Africa as a whole, which means that the income of the average American is greater than that of 21 average Africans combined, and that the economy of the state of California is substantially larger than that of all Africa. The average American *living in poverty* has an income *three times* that of the average African.[1]

Inequalities are also great among regions of the developing world. In fact, the gap between Latin America and sub-Saharan Africa (4.3:1) is greater than the gap between the developed world and Latin America (3.9:1). So too are contrasts among countries within regions. The average inhabitant of Botswana has a standard of living ten times higher than the average inhabitant of Angola; the analogous differences are also ten times between South Korea and Bangladesh, eight times between Argentina and Haiti, and eight times between the former Soviet republics of Estonia and Tajikistan.

These differences among countries dwarf any conceivable inequalities within countries. While attempts at improving income redistribution domestically are important, the most effective way to reduce inequality internationally would be to increase the rate of growth of the world's poor countries. I say this fully cognizant of the fact that economic growth does not necessarily translate into broader social development, or even into improvement in living standards. But, while money may not buy equality, poverty does not buy anything. Even with the most equitable distribution of income possible, the average citizen of an only moderately poor country, one with a GDP per capita of $3000 a year (such as Sri Lanka, Albania, or Morocco), would still be extremely poor by industrial-country standards, well below the American poverty line.[2] And, in fact, per capita GDP is by far the strongest predictor of such indicators of social development as infant mortality.[3]

Differences in current standards of living are the result of past differences in rates of economic growth. Indeed, relatively small disparities in growth rates can make an enormous difference when compounded over decades. To take a simple example, Thailand is currently a country at the middle ranges of world income (about $6000 per capita), comparable to Turkey, Costa Rica, Tunisia or Venezuela. With a growth rate of just over 3 percent a year since 1950, it is neither a major developmental success story nor a massive failure. However, if Thailand's rate of growth had been two percent slower over those fifty years, that is 1.3 percent a year instead of 3.3 percent a year, it would now have a per capita income two-thirds lower, about $2000 a year – making it poorer than India, Bolivia, or Papua New Guinea. By the same token, with a two percent faster rate of growth, Thai per capita income would now be roughly equivalent to that of Greece. A couple of percentage points a year, over the course of several decades, can make the difference between living in Bolivia or India, on the one hand, and living in Costa Rica or Thailand, on the other – or between Thailand and Greece.

The principal determinant of global inequality, then, is the extent to which countries converge on or diverge from the income levels of the developed world.

To be sure, successful economic growth does not guarantee an improvement in domestic income distribution. Among countries at similar levels of development, the lot of the urban and rural poor is far worse in some than in others (compare Brazil to Turkey, Pakistan to Sri Lanka). But in the global and historical sense, meaningful mitigation of global inequality requires general convergence, with the four-fifths of humanity living in poor countries raising their living standards toward those of the rich countries. And while such convergence has hardly been common over the past 50 years, there has been enough to allow us to analyze its causes with some accuracy.[4]

Convergence and divergence since 1950. Overall, the world has become substantially more unequal over the past fifty years. The mean growth rate of the developing countries has been about one-third below that of the developed countries, which means that the gap between rich and poor countries has, on average, grown substantially.

But the overall trend toward greater inequality masks significant differences among relatively poor countries, some of which have managed to gain substantial ground on the rich world. There have indeed been striking regional patterns in the convergence of levels of development since 1950, most conveniently seen in terms of the degree to which different areas have fared relative to the United States. East Asia has caught up in dramatic fashion, even leaving Japan aside, as South Korea and Taiwan went from one-tenth to over one-half of American output per person. China has also caught up, albeit more slowly, from about 6 percent to about 12 percent of American levels – still very low, but appreciable both because of the country's sheer size and because almost all of the convergence came in the past 25 years. Latin America has held roughly steady at about one-third of American living standards.

Another relative success story is often overlooked, convergence among the countries that we now consider the developed world. Fifty years ago, the spread between the richest and poorest nations of North America and Western Europe, even leaving Japan aside, was very great. At that point, per capita income around the European periphery – from Greece and Austria through Italy, Iberia, and Ireland – ranged from one-fifth to one-third of American levels, and these poor Western European countries were substantially poorer than the average Latin American country. Even France and Germany hovered around half American living standards. Today, the poorest industrial nation, Greece, has a GNP per person about half that of the United States, and the developed countries are clustered around very similar living standards. To put it somewhat differently, in 1950 the poorest countries in Western Europe were as poor, relative to the United States, as Brazil, Turkey, or Russia is today; by 2000, they had "graduated" to a standing roughly equivalent to where France or Norway stood in 1950. One of the more expressive examples is that of Ireland: starting in 1950 from income per person about half that of its former colonial master Britain, by 2000 it had attained a standard of living roughly equal to that of Britain.

While the poorer nations of Western Europe, and most of East Asia, have tended to do well, and Latin America has treaded water, the clear losers in the battle to catch up with the developed world are Eastern Europe (including the former Soviet Union), South Asia, and sub-Saharan Africa. Most of these nations are now farther behind the industrial West than they were fifty years ago, some very substantially farther behind. The human impact of this growing gap is enormous: it means that one-third of the world's people, many of them already among the poorest of the poor, have fallen even farther behind the rest.

Explanations of convergence and divergence. The extraordinary effect of economic convergence, or divergence, on global inequality, makes it important to understand its causes. This echos Tilly's observation that we cannot hope to forecast the future of global inequality without a sense of the factors that cause inequality to increase or decrease; discussions of trends in inequality require a clear sense of the causal mechanisms at work. We would like to understand why some countries have tended to improve their standards of living relative to the rich nations, while others have not. Here my point is simple: virtually everything we know indicates that the principal source of differential economic growth rates is government policy. This is both bad news and good. It is bad inasmuch as there are powerful social forces that create policy and may cement it in place, even when the result is bad for development and for equity; it is good inasmuch as policy is in fact (unlike climate or geography) amenable to human agency.

The causes of economic growth are complex and controversial. But two things are almost certainly true. First, arguments that relate global factors to national growth in any simple way are implausible: there is plainly too much diversity among similarly positioned nations to be explained on any but domestic terms (Thailand and Burma, North and South Korea, Costa Rica and Honduras, Botswana and Zambia). Second, the economic policies governments pursue are of fundamental importance to economic outcomes – whether the policies in question involve foreign trade and investment, basic education, social services, or public works. Certainly the room for maneuver of governments of desperately poor countries is limited, but even in these cases there is enough variation among countries to make clear that choices are available, and make a difference. And most developing countries are not so close to economic desperation to have such limited choices.

What, then, are the policies most evidently associated with economic growth? A non-exhaustive list of the most important would include:

•**General economic openness**. By this I do not mean to endorse the dogmatic argument that free trade is a prerequisite of development, for the evidence hardly warrants this view. However, extreme forms of "economic nationalism," from high protectionist barriers to the exclusion of foreign capital and technology, clearly have slowed growth. Some on the Left have been sympathetic to these approaches, but their overall impact seems undesirable on almost every account: not only do they impede economic growth, they almost certainly worsen income distribution by channelling money to those powerful enough to obtain government protection. Participation in the world economy allows countries to make better use of their human, natural, and physical resources; to obtain technical expertise, capital, and other inputs into the production process; and, generally, to take advantage of broad and deep global markets for goods, capital, and technology.

•**Socio-political stability.** Uncertainty about social strife, political conflict and the predictability of government policies all dampen economic activity. In precarious conditions, people naturally shy away from risk – yet economic advances require gambling on the future, whether about schooling, land improvement, adopting new techniques, saving, or making new investments. Some have found, on this basis, that inasmuch as great income inequality within countries leads to social and political conflict, it also depresses economic growth.

•**Education.** Probably the single strongest relationship between a policy measure and growth regards education, human capital formation. In study after study, country after country, government unwillingness or inability to provide basic education for their citizens is associated with poor economic outcomes. The most successful growth stories of the past half-century – South Korea, Ireland, Taiwan, and others – were particularly notable for their substantial educational investments and successes. It is no accident that China, which has so significantly out-performed India and Pakistan on broad economic growth, has even more significantly out-done them on education: in 1980, to take the most illustrative indicator, illiteracy among women 15-24 in China was 16 percent, in India 58 percent, in Pakistan 78 percent.[5] The ability of broad swathes of the population to participate in modern economic activity, and to contribute to economic development, is in large part dependent on educational advancement.

Some might also relate it to improvements in such social indicators as health and housing, although the evidence here is less clear-cut.

I regard these conclusions – that societies that are socially stable, economically open, and invest heavily in education grow fastest – as largely encouraging. They are encouraging because the circumstances they suggest as beneficial for economic growth are attainable, and because these circumstances are generally desirable even in and of themselves. Some might question the desirability of economic openness to the rest of the world, but the others would imply advances toward more equitable societies within countries. The possibility that they might also contribute to more equity among societies is an added bonus.[6]

Of course, while the benefits of better educational opportunities, more social stabilty, and access to economic ties to the rest of the world, might seem obvious, there are powerful interests that have and will made their attainment difficult. So while the first step is to identify policies conducive to economic growth, the next – and almost certainly more difficult – step is to understand the social and political forces that make these policies more or less likely to be adopted. To put it differently, while there is no single formula for economic growth, there are fairly clear indications of what does not work, and yet policies that have long since been proven failures continue to be sustained. The social and political underpinnings of policies that slow (or speed) economic growth, like the underpinnings of policies that worsen (or lessen) inequality, are complex. They are also likely to vary from country to country, from time to time. This makes predicting the likely trend of inequality over the next fifty years especially precarious.

Some thoughts on the future of global inequality. My principal points have been that global inequality is largely the result of differential economic growth rates; that economic growth is largely the result of national policies; and that national policies are largely the result of national socio-political conditions. One might also hope for greater technical and other assistance – such as debt relief – from the developed world, but the prospects for this are so dim that this seems barely worth mentioning. This implies that the evolution of global inequality over the next 50 years will largely depend on trends in national political economies that may, or may not, encourage more rapid economic growth. And any attempt to predict how national political economies will behave and evolve is likely to be confounded by the massive and deep-rooted differences among countries.

Nonetheless, there are pressures that may serve to drive countries in one direction or another, thereby allowing some regularities to be identified. I think that current levels of international economic integration ("globalization," if you will) are likely to continue. And this integration tends to strengthen the hands of those who want to ensure that their countries can participate more fully in the world economy – exporters, borrowers, and the like. So I think that the global trend toward international economic opennness is likely to be self-reinforcing, and draw ever more countries into its orbit. Even areas of the world long isolated from global economic activity are likely to be more tightly integrated into it in the future. But this is only one among several developments associated with future growth trends.

Probably the most important policies for growth are in fact those that provide more equitable opportunities for access to the economy to large, and previously isolated, segments of the population. Here the sources of inequalities among countries and within them tend to merge: the most inequitable societies in the developing world have also been among those that have grown most slowly, and even regressed. So the likelihood that such societies as Congo, Burma, Haiti, Nigeria, and Bangladesh will progress economically depends also on their becoming more equitable on social and political grounds. And the prospects for this happening are almost entirely subject to the vagaries of national political conditions. An optimist might point to the wave of democratization of the past twenty years, and the generally greater political power of the poor in many newly democratic countries. A pessimist might point to the persistent inequities of long-democratic societies, such as India, and the continued stubborn resistance by elites in much of the developing world to greater political and economic participation by the poor. I incline toward optimism, but have precious little hard evidence to support this view.

To the extent that the next fifty years are like the past fifty, they will see two countervailing trends, and ever more differentiation among the developing countries. One set of currently poor countries will grow rapidly, gaining on the rich world – in effect, replicating some of the relative successes of South Korea, Ireland, Botswana, and Costa Rica. My leading candidates for this group are in

Latin America, where the socio-political and economic preconditions for more rapid and equitable growth seem to be firmest. Another set of poor countries will lag ever further behind, mired ever more in economic stagnation and social inequality. The most likely candidates for this sad group are in sub-Saharan Africa, which can ill afford yet another few decades of stagnation. But neither political nor economic institutions in Africa seem strong enough to sustain the sort of rejuvenation the region needs. South Asia and the Middle East are probably somewhere in the middle, with the ability to move forward quickly but plenty of vested political and economic interests to overcome.

Recent history reinforces my view that national governments hold the key to the future of global inequality. To the extent that governments in poor countries break through entrenched interests to provide opportunities for economic advance to their peoples, to improve social and educational conditions, and to manage economic integration with the rest of the world, these countries stand a chance of closing the enormous gap between rich and poor nations. Whether in fact social circumstance and political conditions will be conducive to such government action will depend largely on features of national political economies of long standing.

References

Abramovitz, Moses. 1986. Catching Up, Forging Ahead, and Falling Behind. *Journal of Economic History* 46 (June), pages 385-406.

Gerring, John and Strom Thacker. 2001. Infant Mortality in Crossnational Perspective: The Primacy of Politics. Paper presented at the annual meeting of the International Studies Association, February 20-24, 2001.

Jones, Charles. 1997. On the Evolution of the World Income Distribution. *Journal of Economic Perspectives* 11, No. 3 (Summer), pages 19-36.

Nelson, Richard. 1991. Diffusion of Development: Post-World War II Convergence Among Advanced Industrial Nations. *American Economic Review* 81, No. 2 (May), pages 271-275.

Pritchett, Lant. 1997. Divergence, Big Time. *Journal of Economic Perspectives* 11, No. 3 (Summer), pages 3-17.

Notes

[1] Except where indicated, all data are for 1999 per capita GNP, in purchasing power parity terms, as reported in the World Bank's World Development Indicators database. I use the World Bank's categories of "high income" as synonymous with developed, and "low and middle income" as synonymous with developing.

[2] The U.S. poverty line in 1999 was about $17,000 for a family of four.

[3] Gerring and Thacker (2001) is a very useful summary and evaluation.

[4] The literature on convergence, not to speak of economic growth, is enormous. In the interests of brevity, the interested reader is directed to the surveys available in Jones (1997), Nelson (1991), and Pritchett (1997). Much of the recent literature was motivated by Abramovitz (1986).

[5] By 1998, the numbers had dropped to 5, 37, and 53 percent, so that the gap remained roughly as large as before. All figures are from *World Development Indicators 2000*.

[6] It might also be noted that Gerring and Thacker (2001) find that the most powerful causes of reductions in infant mortality are per capita GDP and

democracy; government social spending, trade openness, and low inflation also have powerful positive effects.