Chapter 13

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INEQUALITY MATTERS

AFTER SPENDING THE LATE 1980s working on Latin America for the World Bank, I became involved in a major study of East Asia's postwar growth. The contrast between the two regions was notable: Latin America was stagnating while East Asian economies were growing rapidly, with tremendously high rates of private and public investment and savings. The emphasis on exports and the pressure to compete in global markets seemed to have worked.

The impressive growth in Taiwan, Korea, Hong Kong, and Singapore, and later in Malaysia, Indonesia, and Thailand, reflected and was reinforced by equally impressive changes in people's behavior and lives: unprecedented gains in small farmers' productivity, high demand for schooling (including schooling for girls), and declines in fertility far steeper and at lower income levels than in industrialized economies. These changes contributed to income gains for households that, in a virtuous circle over many years, fueled further economic growth, demand for education, productivity increases, and declines in fertility. I was familiar with many of the household-level changes through my earlier research in the postwar developing world. What particularly surprised me was that the rapid growth had not led to higher inequality.

Textbook economics describes a tradeoff between growth and equality. Increasing inequality (as in China today) seems to be a natural outcome of the early stages of development, for example as the shift from low-productivity subsistence agriculture to high-productivity manufacturing brings income gains for some people but not for others. In addition, inequality is likely to enhance growth by concentrating income among the rich, who save and invest more. Moreover, inequality reflects a system that rewards hard work, innovation, and productive risk-taking – which ultimately ensures higher output and productivity, and thus higher average income and rates of growth. These inequality-related incentives are the backbone of the argument against tax-financed redistribution: such transfers undermine individual responsibility and the work ethic and thus slow growth.

For economists, then, inequality has typically represented at worst a necessary evil and at best a reasonable price to pay for growth. So, for the most part, they have not been concerned with the apparent trend of rising inequality. Development economists in particular have focused instead on the reduction of absolute poverty. But in East Asia the textbook story seemed altogether wrong. One key to East Asia's success seemed to be its low initial levels of inequality, which were associated with the legacy of postwar redistribution of farm land in the northern economies and with subsequent high public investments in education, agricultural extension, and other programs in rural areas.

In 1993 I left the World Bank to become the executive vice president at the Inter-American Development Bank. By then I was persuaded that Latin America's high inequality was an economic problem, slowing its growth, as well as a social problem. I advocated more research on the issue. By that time – soon after the fall of the Berlin Wall had liberated the mainstream from the taboo of Marxian thought – academic economists were also beginning to study inequality as a possible cause of low growth, and thus as a phenomenon that mattered, at least for understanding growth itself.

Subsequent work by many economists has strengthened my conviction that while inequality may be constructive in the rich countries – in the classic sense of motivating individuals to work hard, innovate, and take productive risks – in developing countries it is likely to be destructive. That is especially true in Latin America, where conventional measures of income inequality are high. It also may well apply in other parts of the developing world, where our conventional indicators are not so high but there are plentiful signs of other forms of inequality: injustice, indignity, and lack of equal opportunity.

Distinguishing between constructive and destructive inequality is useful. To clarify the distinction: inequality is constructive when it creates positive incentives at the micro level. Such inequality reflects differences in individuals' responses to equal opportunities and is consistent with efficient allocation of resources in an economy. In contrast, destructive inequality reflects privileges for the already rich and blocks potential for productive contributions of the less rich.

Inequality of income in an equal-opportunity society would be wholly constructive: there would be high lifetime mobility (up and down) and high intergenerational mobility; children's place in the distribution of lifetime income would be independent of their parents' place. (Income inequality in the United States is higher than in most countries of Western Europe. The perception of the United States as a highly mobile society compared to Western Europe is likely the result of its higher average income growth, which has lifted all boats.)

Since there are no international measures of relative opportunity or mobility, development economists who care about inequality have been measuring "money inequality" – inequality of income, consumption, and wealth. Assessing the effects of money inequality on growth within and across countries can provide a rough indicator of inequality of opportunity and limited social mobility in a particular setting. This brings us to the crux of why inequality can matter, especially in developing countries. Evidence over the last decade and a half suggests that it has a large destructive component: it is associated with unequal mobility and limits economic growth.

Why would this be the case? First, where markets are underdeveloped, inequality inhibits growth through market mechanisms. In developing countries, by definition, markets are relatively weak and governments are less effective in compensating for market failure. When creditworthy borrowers, for example, cannot borrow because they lack

collateral, then their lack of income or wealth limits their ability to invest productively – in their own farms, small businesses, and in the health and education of their children.

Governments can compensate for market failures; provision of public education is a classic example. But in developing countries, public systems of all kinds tend to be less adequately funded and are often poorly managed. That means that public policy is less likely to correct for the inherent inability of markets alone to compensate for differences across households in endowments of all kinds.

In fact, some of my own research in Latin America suggests that differences in social mobility across countries, controlling for other factors, are closely associated with differences in public spending on primary education and the depth of financial markets. (Ironically, policies ostensibly designed to address the latter problem and help the poor, such as repressed interest rates and directed credit programs, generally end up limiting access to credit in general, except for privileged insiders.)

Land inequality (and unequal access to education) when combined with poor markets for land and credit may also be destructive for growth itself, and especially for growth that benefits the poor. Some evidence suggests that large landowners captured most of the benefits of agricultural growth in Latin America in the 1970s and 1980s. In contrast, in Indonesia, where small farmers provide the bulk of agricultural production, agricultural productivity and growth were greater in that period, and were better for the rural poor.

Secondly, where the institutions of government are weak to start with, inequality makes strengthening them harder, and in general of maintaining accountable government. That in turn makes it less likely that the government will provide adequate public services, thus reducing the economy's growth potential. If the rich fail to support public education, for example, favoring public policy that preserves privileges even at the cost of growth, inequality not only inhibits growth given government failure (as outlined above), but itself contributes to government failure. The problem is worse in countries with substantial poverty at the bottom and without a strong middle class to demand accountability from government.

Again Latin America and East Asia illustrate the point. In the 1990s in Latin America, with its high inequality, basic education systems were poor and the children of the rich attended private school. On average the children of the richest 20 percent of households in many Latin countries had about six more years of education by age 24 than the children of the poorest 20 percent; in countries of East Asia, some poorer than their counterparts in Latin America, the comparable gap was just four and a half years. Why the difference? In East Asia, public spending on basic education has been higher, school systems have been better run, and better access and more equal distribution of land have given more households the assets to send their children to school and the incentives to demand that their schooling be adequate.

The difference between East Asia and Latin America in educational opportunities for the poor illustrates the apparent relationship between a high concentration of income in a society and access to education. The supply of publicly subsidized education is likely to be limited where the rich resist a large tax burden to finance services they can buy privately. Targeting services to the poor, an approach encouraged by the World Bank, can help reduce the fiscal burden of greater public spending, but it easily leads to a loss of political support from the working and middle classes. Without middle-class interest and pressure, the quality of schooling deteriorates, and the middle class resorts to private services. On the demand side, low public spending combined with pressure to maintain

or expand enrollment leads to low-quality schools, reducing for poor families the economic returns of sending children to school who can otherwise help at home or by working. This may explain the high dropout rates throughout much of Latin America, even in the face of high returns on average to those who manage to complete secondary school.

In the case of the poor's extreme political weakness, the privileged can easily exercise sufficient political control – through contributions to political campaigns, access to the media, and even bribes and even extortion – to constitute what Charles Beitz called an "abridgement of liberty." When this kind of influence in turn affects job availability, workplace safety, or local environmental conditions, then large inequalities are having large political repercussions.

But there may be bad political outcomes even when the disadvantaged do have political voice. There are many examples of populist programs designed to attract working-class political support – for example in Garcia's Peru in the 1980s or Perón's Argentina – that hurt workers in the long run. Financed by unsustainable fiscal largesse, they brought the inflation or high interest rates that exacerbated inequality. (The rich can better protect themselves from inflation with indexed financial assets and by placing capital abroad; and from high interest rates by pressing for privileged access to credit.) Price controls imposed on food products hurt rural producers, or end with products disappearing from stores as they are hoarded and resold at prices out of reach of most consumers. A high minimum wage may make it harder for the unemployed to find work. Regulatory privileges, trade protection, and special access to cheap credit and foreign exchange – all bad economic policies – tend to increase the profits of a wealthy minority. Not all bad policy can be blamed on income inequality, but it would be foolish to ignore the risks of inequality to sound policy.

Finally, where social institutions are fragile, inequality discourages the civic and social life that undergirds the collective decision-making necessary to healthy, functioning societies. Robert Putnam defines the asset of social capital in terms of trusts, norms, and networks that can improve the efficiency of society, "facilitating coordinating actions." Social capital has economic value because it is likely to reduce the cost of transactions and contract enforcement and, as Dani Rodrik points out, reduce resistance of the losing groups to political compromises.

There is good evidence from microeconomic analyses that income inequality adversely affects some of the correlates of social capital. In Tanzania, informal insurance is higher in communities where income inequality is lower. Among sugar cooperatives in India, those in which land ownership is more unequal are less productive. Differences across countries in homicide rate are associated with differences in the income gap between the middle class and the rich.

In developing countries, inequality itself is not always so much the problem as is the interaction of inequality with other factors: weak markets or unaccountable or incompetent governments. Weak markets, weak governments, weak institutions – these are the very characteristics that define a country as developing. Reducing inequality might not in itself lead automatically to higher growth or better government or more stable and healthy societies. But development economists should take note: to ignore inequality altogether is to invite setbacks on the development path.

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Now globalization is creating pressures that tend to increase inequality. We need to understand what those pressures are and how they operate as today's increasingly

integrated global economy raises the bar of competitiveness. How might they best be managed, within countries and at the global level, to avoid their potentially destructive effects on growth?

Proponents of globalization have hailed the rapid economic growth of China, India, and other large and poor countries of Asia. And indeed several decades of rapid growth in some poor countries has moved millions of people out of poverty, shifting a large enough portion of the world's people out of the poorest parts of the world income distribution so that inequality among individuals, regardless of country, has declined. But these successes do not mean, as the title of Thomas L. Friedman's best-selling book suggests, that the world is flat. Globalization is not leveling the global playing field for everyone. Between the average income of the richest countries – those of Europe, North America, and Australia – and the poorest – many in Africa – the gap is increasing. And within China, India and other fast-growing countries where inequality has not been high in the past, it is now rising. It also rose dramatically in most of Eastern Europe and the former Soviet Union in the 1990s, as minimal growth left the poor worse off than they were under communism. And it has remained high in Brazil, Mexico, Panama, and Peru, where there was modest growth.

In other developing countries, income inequality has not changed, and in a few – Bangladesh, Ghana, and the Philippines – it appears to have declined. So it would be an exaggeration to say that rising inequality within countries has been the norm. Nor does it make sense to condemn "globalization" because inequality is rising in countries like China and India. These may be cases of a constructive inequality that reflects new prosperity for some.

But in the case of the poorest countries, we need to explore whether the common assumption always holds: that the pressures of the global economy will enable them to benefit by exploiting the technologies others have developed.

We can start by looking at how the regular workings of the global economy affect inequality.

The market works: global markets reward productive assets. Globalization is shorthand for global capitalism and the extension of global markets. Markets that are bigger and deeper reward more efficiently those who already have productive assets – financial assets, land, physical assets, and perhaps most crucial in the technologically driven global economy, human capital. For countries, the key productive asset seems to be stable and sound institutions. Countries that are already ahead – with stable political systems, secure property rights, adequate banking supervision, reasonable public services, and so on – are better able to cope with market-driven changes in world prices.

Consider the plight of a large group of the poorest countries, including Bolivia and many countries in Africa. Highly dependent on primary commodity and natural resource exports in the early 1980s, their markets have been "open" for at least two decades, if openness is measured by their ratio of imports and exports to GDP. But unable to diversify into manufacturing (despite reducing their own import tariffs) they have been victims of the decline in the relative world prices of their commodity exports, and have, literally, been left behind. These countries have not been xenophobic or in any way closed to the global economy. But despite rising exports, tariff reductions, and, in most of them, economic and structural reforms, including greater fiscal and monetary discipline and the divestiture of unproductive state enterprises, they have been unable to increase their export income, have failed to attract foreign investment, and have grown little, if at all.

What many countries in sub-Saharan Africa – as well as Haiti, Nepal, and Nicaragua – have in common is a vicious circle of low or unstable export revenue, weak and sometimes predatory government, inability to cope with terrible disease burdens (the HIV/AIDS pandemic is only one recent and highly visible example), and failure to deliver to children basic education and other services critical to sustainable growth. Their governments have made, from time to time, fragile efforts to end corruption, to undertake economic reforms, and, more to the point, to enter global markets. But globalization has not worked for them – even those such as Nigeria and Ecuador that are rich in at least one asset, oil, but poor in institutions. In contrast, countries that have the "asset" of strong political and social institutions (Australia and Norway, for example, or among developing countries, Chile and Botswana) have benefited from entering global markets with their natural resources.

William Easterly argues that in the new global economy, we should not expect the convergence between rich and poor countries that conventional economic models based on differences in wealth and other traditional assets predict. He suggests instead that it is existing productivity differences across countries that matter. Productivity differences make "capital" and "skilled labor" economically scarce even in high-productivity settings where they are apparently plentiful, explaining why skilled people continue to move to those settings. This also explains why 80 percent of all foreign investment occurs among the industrialized countries (just 0.1 percent of all U.S. foreign investment went to sub-Saharan Africa last year). The productivity differences arise, presumably, because of differences in physical infrastructure and human capital, themselves a product of long-standing differences in social and political institutions.

The global market for skilled and talented people is a good example of the tendency of markets to benefit the stronger – individuals as well as countries. Advanced economies are now competing with each other in encouraging immigration of highly skilled workers from developing countries. Indian engineers can quadruple their earnings by moving from Kerala to the Silicon Valley, and Indian biochemists by moving from Delhi to Atlanta or Cambridge. More integrated markets thus increase inequality across countries, via emigration from smaller and poorer countries of highly skilled citizens, who naturally are inclined to move to settings where they can deploy their skills productively. For the individuals who emigrate, their mobility is a good thing, and what has been called a "brain drain" can generate offsetting remittances that raise welfare in the sending countries (as migrants send money home). Moreover, if the institutional and policy setting in sending countries improves, as it did in India recently, emigrants are likely to begin investing in their home country and returning permanently. At the same time, however, the ability to emigrate makes tougher the poorer countries' crucial tasks – building institutions and improving policies – if they lose their most talented citizens. (The annual cost to India of its brain drain to the United States is estimated at $2 billion, an amount equal to all the foreign aid it receives.)

Global markets similarly create new pressures for inequality within countries. Healthy global markets can generate unequal opportunities between different individuals. The relative return of a university education has been increasing for years everywhere, despite the fact that more and more people are going to university, including across the developing world. More integrated trade markets, capital flows, and global technology, including the Internet, are increasing the worldwide demand for skills more rapidly than the supply.

Just about everywhere in the world, education is reinforcing initial advantages instead of compensating for initial handicaps among individuals.

Rising wage gaps in open and competitive markets may be a short-term price worth paying for sustainable growth. They create incentives for more people to acquire more education, in principle eventually reducing inequality. The same can be said for the development of institutions at the country level. Many poor countries have responded to global opportunities by strengthening the rule of law, building and strengthening democratic processes, and investing in public health and education. But just as poor families can benefit from public assistance to help them invest in their children's education, so poor countries can benefit from aid and the incentives of a level global playing field to help them build better institutions.

Even when participation in the global market brings growth, as it has in China and India, it is a mixed blessing, bringing political pressures for populist measures and, especially if growth falters, for protectionism. Even Europe and the United States are subject to those pressures – but with more resilient institutions and well-developed social insurance programs they can better afford temporary policy errors. The political risks are greater still when engagement in global markets fails to bring growth.

The market fails: in the global economy, failures hurt the weak most. Global markets are far from perfect. They fail in many domains. The classic example of a market failure is pollution: the polluter captures the benefits of polluting without paying the full costs. The United States, for example, the biggest global polluter per capita, is imposing costs not only on its own future citizens, but also on the children and grandchildren of the world's poor, whose countries have fewer resources to manage or mitigate the effects. Likewise in the case of global financial crises. The financial crises of the late 1990s that rocked Mexico, Thailand, Korea, Russia, Brazil, and Argentina resulted in part from policy errors in those countries. But a healthy portion can be blamed on panic in global markets of the kind that periodically plagues all financial markets. In East Asia many investors reacted by accumulating high reserves for insurance against future crises; the costs of maintaining high dollar reserves (given the low interest rates compared to potential returns) represent a perverse transfer from the developing world to the United States.

The volatility and financial risks that come with participation in global markets tend to increase inequality over the long run within countries. Analysis indicates that trade shocks hurt the bottom 20 percent of the income distribution disproportionately. The evidence is that volatility, whatever its source, is particularly bad for the poor. In Korea, Mexico, and Thailand, financial crises in the 1990s reduced the income shares of the bottom 80 percent of households. During the accompanying recession in Mexico in 1995, many children of the poor dropped out of school – and subsequent studies show that many never returned.

Global financial markets have not only brought instability and reduced growth to the emerging market economies; they have affected their capacity to develop and sustain the institutions and programs that would protect their poor. One culprit has probably been the premature opening of capital markets. In some emerging market economies, premature opening of the capital market – before adequate banking supervision and financial regulation were in place – brought pressures for increased inequality along with volatility, for at least two reasons. First, with global market players doubting the commitment of these countries' governments to fiscal rectitude they were forced to reestablish market confidence by adopting tight fiscal and monetary policy, when ideally

in the face of recession they would have implemented macroeconomic measures to stimulate their economies. The austerity policies that the global capital market demands of emerging markets at the time of a shock are the opposite of what the industrial economies implement: for example, reduced interest rates, unemployment insurance, increased availability of food stamps, and public works employment – fundamental ingredients of a modern social contract. The resulting effects of unemployment and bankruptcy can be permanent for the poor, so repeated shocks constitute a structural factor in increasing inequality.

Second, the bank bailouts that followed crises generated high public debt (amounting to ten to 40 percent of annual GDP, compared to two to three percent due to banking crises in advanced economies on average). High public debt still keeps domestic interest rates high in some emerging market countries, stifling investment, growth, and job creation – all bad for the poor – and increases the pressure on those economies to generate primary fiscal surpluses, in the long run reducing their ability to finance sound broad-based investment in health and education – and their ability to spend more on the unemployment and safety-net programs that would protect the poor in bad times.

Global climate change and global financial crises both result from market failures. They are two examples of market failures that hurt poor countries and poor people more. In general, the ability to adjust to change, or to finance mitigation costs, is smaller for poorer countries, and within countries, for poorer people. So market failures tend to increase inequality.

Global rules and regimes tend to favor already rich countries and people. In the end, global markets tend to be disequalizing, because trade, intellectual property, and migration regimes naturally reflect the greater market power of the rich. The battle to reduce rich country agricultural subsidies and tariffs that discriminate against poor countries is a good example. Domestic politics in Europe, the United States, and Japan, as perverse as they are even for those countries themselves, matter more at the negotiating table than unequal opportunities for cotton farmers in West Africa.

As the design of multilateral rules favors the rich, so too does their implementation. In 2003 developing countries finally got clarity on their right to issue compulsory licenses to import and produce generic medicines during public-health emergencies. But the rules for exercising that right are complicated, and many countries eager to maintain or improve their access to the U.S. market for their own exports are acceding to WTO "plus" patent protection, in effect giving up those rights, in bilateral trade with the United States.

The cost and complexity alone of negotiation and dispute resolution processes in the WTO put poor and small countries with limited resources at a disadvantage. About one half of anti-dumping actions are initiated against developing-country producers, who account for eight percent of all exports. These create legal and other costs to current producers in developing countries, and are likely to chill new job-creating investment in sensitive sectors.

International migration is also governed by rules that clearly exacerbate inequality between the richest and poorest – countries and individuals. Permanent migration is small relative to the past because today higher-income countries restrict immigration. In the last 25 years, only two percent of the world's people have changed their permanent country residence, compared to ten percent in the 25 years before the First World War. Yet more movement, especially of less-skilled workers, would reduce world inequality considerably, as did the tremendous movements of Europeans to the Americas in the 19th

century. But current policy encourages instead the movement of the highly skilled into the more advanced economies.

Economic power affects the rules and the conduct of those rules by international institutions other than the WTO. The International Monetary Fund is the global institution designed to help countries manage macroeconomic imbalances and minimize the risks of financial shocks. But in the 1990s, the IMF was more enthusiastic about developing countries' opening their capital accounts than subsequent evidence about the costs warranted. This is one example where the IMF and the World Bank have been insufficiently humble in their recipes, perhaps too heavily influenced by their more powerful members. Another is their indiscriminate support for adjustment programs that in some countries, though technically sound on paper, worsened the situation of the poor because transition costs were inadequately considered and safety net programs underfunded.

In advanced market economies there is a well-defined social contract that tempers the inequalities of income and opportunity that efficient markets naturally generate. Progressive tax systems provide for some redistribution, with the state financing at least minimal educational opportunities for all and some social and old-age insurance. Yet in developing countries, where the social contract is less well developed, the economic reforms that competitiveness in global markets require, and the risks to economic stability it brings, tend to exacerbate existing inequality, and in turn generate political pressure for populist redistribution. The political leadership must then manage a delicate balance between enacting the structural reforms that will generate growth and minimizing the short-term political risks they entail.

Politics is local, and the politics of inequality is doubly so. One lesson for the international community is to do no harm as leaders in developing countries cope with the difficult challenges that globalization presents. When donors condition their grants and loans on, for example, less corruption or more open trade regimes, they may complicate the situation – a health program may be cut because of corruption in the oil ministry, or unskilled jobs in local industry or farming may be lost after a reduction in import tariffs. Skepticism and humility about the timing and details of policy reforms pushed from the outside seems warranted.

And in terms of actual resource transfers, the international community needs something closer to a global social contract to address unequal endowments – to rapidly ramp up educational opportunities for the poor in developing countries, and to find ways to help societies build their own sound institutions. Spending by the rich world on the "global social contract," now reflected in the idea of the UN's Millennium Development Goals, is less than one percent of rich-country GDP. That is surprisingly low compared to the typical 20 percent spent on public transfers for education and social insurance within rich countries. The comparison is relevant: we now have a more and more integrated global economy – creating legitimate new demands for more shared prosperity.

The business of foreign aid needs to be reinvented if it is to become reasonably effective – with a premium on financing global public goods such as agricultural research and development, on results or output-based transfers, and on systematic evaluation. And the imperfect record of foreign-aid programs should not be an excuse for the rich countries' minimal spending.

Most important, the global and regional institutions – the most obvious mechanisms for managing a global social contract – need reform. It is ironic that the World Bank and

the IMF have together been the lightning rod for anti-globalization protests. In the end they are not too powerful but too ineffective and limited in their resources. To play an effective role in managing a global social contract, they must be more representative. Why should China and India support a World Bank initiative to reduce greenhouse-gas emissions through carbon trading if they have no real power over that use of resources? And they must be more accountable to those most affected by their programs. Why should the financial institutions not share in the costs when the programs they support fail to generate the returns that would warrant those costs – as was almost surely the case in some of the world's poorest countries that ended up with substantial unpayable debt to the official multilateral lenders?

Governments are meant to temper market failures through regulations, taxes and subsidies, and fines, and to share the benefits of such public goods as public security, military defense, management of natural disasters, and public health through their tax and expenditure decisions. Ideally those decisions are made in a democratic system with fair and legitimate representation of all people, independent of their wealth. For the global community, an equivalent system to manage global market failures only barely exists. Because global markets are imperfect, we need global regulatory arrangements and rules to manage the global environment (Kyoto and beyond), help emerging markets cope with global financial risks (the IMF and beyond), and ways to discourage corruption and anti-competitive practices. The Extractive Industries Transparency Initiative, under which countries and multinational firms commit to transparency in their agreements, is a nongovernment initiative created in this spirit. Like this initiative, global agreements on bankruptcy procedures, on reducing greenhouse-gas emissions, on protecting biodiversity and marine resources, on funding food safety and monitoring public health are all development programs in one form or another – because they reduce the risks and costs of global spillovers and enhance their potential benefits for the poor.

The same goes for the provision of global public goods: the returns on spending that benefits the poor have been extraordinarily high. This is the case with tropical agricultural research, public-health research and disease control, and the limited global efforts to protect regional and global environmental resources. The Green Revolution brought shared prosperity to millions of agricultural producers and consumers in India by raising crop yields; a malaria vaccine would save millions of lives in Africa. These sorts of global programs need to be financed by something that mimics taxes within national economies. Proposals for a tax on international aviation or on carbon emissions fall squarely into this category and might be more attractive (even in the anti-tax United States) were they to be used to increase provision of such global public goods.

Within the advanced market economies, democratic politics help temper the inevitable tendency for the rich and powerful to set the rules to their own short-term advantage. There is no equivalent global polity – only the hope that the rich world will resist short-term advantages in favor of long-term enlightened self-interest. Many developing countries – especially smaller and poorer countries – need transfers from rich countries to participate effectively in global trade and other negotiations.

Rich counties would do well to open their doors further to unskilled and not just skilled immigrants, allocating resources at home to ease the adjustment of native workers through job training. Even within political constraints, much more could be done by the rich countries in their own interests to make immigration regimes more consistent with their overall development policies. Sharing of tax receipts of skilled immigrants across

sending and receiving countries is one example. Another is the effort to reduce the transaction costs of remittances.

In general the developing countries should be more fully and fairly represented in international institutions; this is especially the case in the international financial institutions, whose policies and programs are so central to their development prospects. The same can be said for other international forums: the UN Security Council, the Basel Committee for Banking Regulation and Supervision, the G-8, and so on.

We have a potentially powerful instrument to increase wealth and welfare: the global economy. But to support that economy we have an inadequate and fragile global polity. A major challenge of the 21st century will be to strengthen and reform the institutions, rules, and customs by which nations and peoples complement the global market with collective management of the problems, including persistent and unjust inequality, which markets alone will not resolve.

Note

This essay is based on Nancy Birdsall's 2005 UNU-WIDER (United Nations University World Institute for Development Economics Research) Annual Lecture. The full lecture is available on the Web site of the Center for Global Development at www.cgdev.org.

REVIEW AND DISCUSSION QUESTIONS

1. How might inequality promote economic growth?
2. What are the channels through which inequality is likely to hinder economic growth in developing countries?
3. Why does Birdsall believe that inequality may lead to political outcomes that hurt the poor?
4. Why is it, according to Birdsall, that certain aspects of globalization hurt the poor more than the rich?
5. What can rich countries do to help reduce inequality in poor countries? Do you agree with Birdsall's recommendations? Why or why not?