GLOBALISATION, POVERTY AND INEQUALITY: FRIENDS, FOES OR STRANGERS?

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Introduction

My thanks to Peter Dawkins and David Armstrong for inviting me to speak here today.

I have been asked to discuss how globalisation might affect poverty and inequality.

Globalisation is a big topic. But I propose to focus on just the more economic of the many aspects of globalisation — essentially my focus will be on the closer international integration of national markets through trade, investment and information flows. I shall review briefly the movements in poverty and inequality both across countries, and within countries, and explore what role economic globalisation may be playing in these movements. I will then say a little about what seems to be happening to wage and income distribution in Australia, in the light of that broader picture.

World Bank President James Wolfensohn recently noted that:

"Over the past 40 years, life expectancy at birth in developing countries has increased by 20 years — about as much as was achieved in all of human history prior to the middle of the twentieth century.

¹ I am grateful to a number of my Treasury colleagues for their contributions to this paper, especially Terry O’Brien, Andrew Beaumont and Vanessa Lapthorne.
Over the past 30 years, illiteracy in the developing world has been cut nearly in half, from 47% to 25% in adults.

Over the past 20 years, the absolute number of people living on less than $1 a day, after rising steadily for the last 200 years, has for the first time begun to fall, even as the world's population has grown by 1.6 billion people.²

In apparent contrast to this picture, critics of globalisation have frequently claimed that it is worsening poverty and widening inequality, both nationally and internationally.

Which view provides the more accurate picture of the impact of economic globalisation on the world’s poor? The view of the critics permits several interpretations. On one interpretation, the poor are actually getting poorer — absolute poverty is increasing. On another interpretation, the poor are getting richer, but the rich are getting richer at an even faster rate, and inequality is increasing.³ Those who hold to this latter perspective will invariably argue that relative poverty is increasing, and they will be dismissive of views based on trends in the poor’s absolute command over commodities and resources.⁴ Moreover, both camps will argue that the

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³ Moreover, when the incomes of the very poor first start growing at a faster rate than rich countries' incomes, the absolute (dollar) increases in incomes of the poor will still be smaller for many years than the absolute increases for the rich, even though the relative gap is closing. While this is an arithmetic and economic inevitability given widely different starting point incomes, it may nonetheless be a problem in popular perception.

⁴ Treasurer Costello observed recently "One of the constant claims made against the process described as "globalisation" is that it is making the world's rich, richer and the world's poor, poorer. Let me say at the outset that I am interested in making the world's poor, richer. If there are policies that can pull the world's poor out of poverty and increase their standards of health care and education, it does not concern me that in the process the world's rich become
rising trend of poverty — whether absolute or relative — is a consequence of economic globalisation.

Poverty and inequality are complex and subjective concepts that are only imperfectly measured with available statistics. Moreover, globalisation's effects differ over time and across countries, and even differ across countries that are superficially very similar or very closely economically linked.

It would be prudent, therefore, to proceed carefully, even tentatively. Yet even with that caution, I want to argue today that economic globalisation is no friend of inequality and poverty — absolute or relative. Rather, economic globalisation would better be described as an enemy of poverty. And it seems to be something of a stranger to movements in national inequality — economic globalisation may be impacting on national income distributions, but these are overwhelmingly determined by what are essentially nationally-driven developments.

The international picture

The dawn of the new century and the upsurge in anti-globalisation protests has produced a welter of recent historical studies of globalisation.5

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By measuring the historical intensity of international economic links through trade, foreign investment and immigration, the World Bank has identified three stages of globalisation: 1870 to 1914, 1950 to about 1980, and 1980 to the present.

Between the two World Wars and through the Great Depression the world 'de-globalised' markedly (Chart 1). In that period there can be no doubt that global poverty rose strongly and inequality widened. Whatever the policy challenges that might be posed by globalisation, they were most assuredly not avoided or solved by de-globalisation. De-globalisation worsened the very trends that 'globaphobes' now protest against.

But what of the periods of globalisation? Interestingly, the first two surges of globalisation did not produce any general catch-up by the population of developing countries on the steadily improving living standards in Western Europe and the New World.

During the first period of globalisation before World War I, it seems likely that colonialism and the pattern of ownership and exploitation of raw materials and land in the colonies ensured that the benefits from closer economic integration accrued mostly to the colonising powers. Notwithstanding Australia's own rise to affluence during that period, the general outcome doesn’t seem very surprising: if one party in a bilateral trading relationship is a colonial dependency, its share of the gains from trade is unlikely to be large.

In the second period of globalisation, following World War II, there was catch-up among the OECD economies on the living standards of the most developed economy, the United States. Moreover, some initially very poor countries such as Hong Kong, Korea, Singapore and Taiwan grew strongly from implementing more outward looking policies.

Analysts have noted that weak per capita GDP growth in the rest of developing world during the second globalisation period was associated with statist, inward-looking development policies. Most developing countries were unwilling from the 1950s to the 1970s to lower their trade barriers as the OECD economies were doing through successive GATT rounds and in their regional and unilateral actions.6

In the third, current wave of globalisation since about 1980, the World Bank has identified a group of 24 developing countries, home to some 3 billion people, as 'recent globalisers'. These countries are defined by having strongly improved their trade performance. China, India, Bangladesh, Brazil, Malaysia, the Philippines, Indonesia, and Thailand are among these examples of how economic reforms and outward-looking trade policies can rapidly lift hundreds of millions out of poverty. Their progress seems closely linked to their participation in the remarkable recent global growth of trade in manufactures (Chart 2).

However, some 2 billion people in some 49 other developing countries have not been able to achieve comparable increases in trade and

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investment linkages, nor in income growth. Trade shares of their GDPs have contracted in the last two decades, and in the last decade their per capita incomes contracted too (Chart 3).

In the May 2001 centenary edition of its *Economic Roundup*, Treasury published an overview of the evidence on trends in living standards. We showed that inter-country inequality appeared to have reached a peak around the late 1960s, and seemed since to have slightly declined (with small fluctuations). This can be pictured in Lorenz curves for the world economy which use purchasing power parties to compare national per capita GDPs weighted by population size, and rank countries from poorest to richest (Chart 4). Such curves show that inter-country inequality was still wider at the end of the 20th century than at the start, because of the very long history of faster productivity growth compounded over centuries in the countries that launched the industrial revolution, and subsequently in their new world offshoots. But inter-country inequality has narrowed over the last thirty or so years for the first time since the original industrial revolution.

These Lorenz curves also show another key point, corresponding to the World Bank's observation that some 2 billion people have not yet benefited from globalisation: the curves cross at the point representing about the poorest 17 per cent of the world's population, illustrating that those poorest have a smaller share of the world's GDP than thirty years

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ago. Some of those 17 per cent even have a lower absolute standard of living.

Notwithstanding the challenge of broadening growth to benefit the very bottom of the world's income distribution, we ought not to lose sight of the wood for the trees: the late 20th century witnessed a remarkable achievement. In the words of the World Bank,

"the long trend of rising global inequality and rising numbers of people in absolute poverty has been halted and even reversed."8 (Chart 5)

In 1980, the 3 billion residents in the group of 'recent globalisers' had an average per capita GDP about US$ 460 below that of the 2 billion still to benefit from globalisation. By 1997, the 'recent globalisers' per capita incomes had grown by 67 percent to be some US$ 350 above those in the non-globalisers, whose incomes had grown by less than 10 percent.9

Those 2 billion yet to benefit from globalisation often face special problems of civil war, geographical and associated climatic handicaps, and AIDS, but with the right policies they should be able to improve their income growth towards the rates of the 'recent globalisers'.

8 World Bank: Globalization, Growth and Poverty: Building an Inclusive World Economy, op cit, p 50
9 ibid, Table 1.1 p 35.
Cause or mere correlation?

So far I have followed common practice among both proponents and critics of globalisation in merely assuming that the current wave of closer international economic integration somehow contributed to the catch-up that has been under way for the last thirty or so years.

However we should consider Dani Rodrik's challenge that perhaps the relationship might be merely correlation, with the real causes of economic success lying elsewhere, and being more complex, than lower trade barriers and economic globalisation.10

It is difficult to shed light on this challenge through econometric comparisons across countries.

For one thing, protectionism is hard to measure, especially in developing countries where trade barriers typically include opaque import licensing schemes, often erratically and corruptly administered.11

Moreover, countries that are lowering trade barriers and becoming more integrated with the world economy are typically making many other

10 "Well-trained economists are justifiably proud of the textbook case in favor of free trade. For all the theory's simplicity, it is one of our profession's most significant achievements. However, in their zeal to promote the virtues of trade, the most ardent proponents are peddling a cartoon version of the argument, vastly overstating the effectiveness of economic openness as a tool for fostering development. Such claims only endanger broad public acceptance of the real article because they unleash unrealistic expectations about the benefits of free trade. Neither economic theory nor empirical evidence guarantees that deep trade liberalization will deliver higher economic growth. Economic openness and all its accouterments (sic) do not deserve the priority they typically receive in the development strategies pushed by leading multilateral organizations." Dani Rodrik, Trading in Illusions, Foreign Policy, March-April 2001, available at http://www.foreignpolicy.com/issue_marapr_2001/rodrick.html

11 Lant Pritchett recounts a study of five developing country schemes, in four of which there were three categories of import licenses, interactive with a separate system of licensing foreign exchange, all administered with substantial discretion through officials' judgements about 'the national interest'. See Michael D Bordo, Alan Taylor and Jeffrey G. Williamson, op cit, Comments on Williamson and Lindert.
reforms at the same time: strengthening the rule of law; building modern economic institutions; reducing corruption (including by lowering the scope for corrupt administration of import licences); educating their population; improving public health measures; closing, selling or reforming loss-making state enterprises; investing in more efficient infrastructure, and so on.

When all such improvements happen at once, it can be difficult to measure their separate influences. Doubtless all make a contribution. Trade and investment liberalisation alone will rarely constitute a sufficient development policy, and to suggest otherwise would be to erect a 'straw man'.

Given the numerous analytical difficulties for cross-country econometric analysis, it is fortunate there is by now a large literature of case studies that look in detail at individual country experiences. These studies confirm that trade liberalisation has usually played an important role in lifting economic performance, including through supporting and driving many other necessary reforms.¹² For example, successfully participating in trade, or hosting foreign investors (who of course are themselves frequently engaged in trade), invariably exposes workers and management to improved practices, intensifies competition, emphasises the importance of reliable contract performance in a transparent framework, and generally builds awareness of the requirements of modern commercial life.

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Nor is this tendency for trade and investment liberalisation to support other desirable reforms just a matter for developing countries: Australia's own experience of globalisation fits this picture.\(^\text{13}\)

Another suggestive window on the contribution of economic globalisation can come from studies within a country with common national policies and institutions, but with significant regional variations in exposure to national and international markets.

Historical studies of the United States in the 19\(^{th}\) century show income growth rising in formerly isolated regions as canals and railways linked them to national and international markets.\(^\text{14}\) A fascinating study of contemporary China by Shang-Jin Wei and Yi Wu has shown that comparing some 100 Chinese regions, the more any region has become integrated into the global economy, the faster has been its income growth and the faster its decline in intra-regional poverty and inequality.\(^\text{15}\)

We also gain some confidence in the causation from trade and investment liberalisation to improved performance from the inability to find contrary examples: there is not a single country that chose to be less open to trade and investment flows in the 1990s than in the 1960s, and yet rose in the

\(^{13}\) The way Australian trade liberalisation has contributed to the remarkable lift in productivity growth through the 1990s (including through differential impact on various sectors of the economy) is discussed by Productivity Commission Chairman Gary Banks in *The Drivers of Australia's Productivity Surge*, 7 March 2002 paper to Outlook 2002.


\(^{15}\) This is true notwithstanding the fact that overall income inequality in China has undoubtedly widened, partly because some regions are geographically hindered in integrating into the national and international economies, and restrictions on internal migration hinder movement to where economic opportunities are greater. See Shang-Jin Wei and Yi Wu, *Globalization and Inequality: Evidence from Within China*, NBER Working Paper No 8611, November 2001, available at: [http://www.nber.org/papers/w8611](http://www.nber.org/papers/w8611).
global living standard ranks at the same time. Lindert and Williamson wryly note that, "(a)s far as we can tell, there are no anti-global victories to report for the postwar Third World."16 And Dani Rodrik has himself observed that "(n)o country has developed successfully by turning its back on international trade and long-term capital flows. Very few countries have grown over long periods of time without experiencing an increase in the share of foreign trade in their national product."17

Difficult as it is to prove that trade and investment liberalisation drive growth and development, that task is as nothing compared to the challenge confronting those who would wish to argue that development would be better secured by erecting barriers to international integration.

If the last century teaches us anything about development it should be that people cannot be liberated from poverty while being denied their liberty. Liberty, that is to say, is generally indispensable to development. I have, on a number of occasions, endorsed Amartya Sen’s emphasis18 on the substantive freedoms of political and civil liberty, social inclusion, literacy and economic security, as ‘constituent components’ of development. Sen refers also to the fundamental importance of the freedom to engage in economic exchange:


a denial of opportunities of transaction, through arbitrary controls, can be a source of unfreedom in itself. People are then prevented from doing what can be taken to be — in the absence of compelling reasons to the contrary — something that is within their right to do. This point does not depend on the efficiency of the market mechanism or on any extensive analysis of the consequences of having or not having a market system; it turns simply on the importance of freedom of exchange and transaction without let or hindrance. This argument for the market has to be distinguished from a second argument, which is very popular right now: that markets typically work to expand income and wealth and economic opportunities that people have. Arbitrary restrictions of the market mechanism can lead to a reduction of freedoms because of the consequential effects of the absence of markets. Deprivations can result when people are denied the economic opportunities and favourable consequences that markets offer and support.'

According to Sen, market liberalising policies may have ‘favourable consequences’ for development, and in that way also support economic freedom. But Sen notes that there is a more fundamental reason for supporting market liberalising policies that does not turn on an analysis of any of its consequences: the ‘freedom of exchange and transaction’, ‘without let or hindrance’, is a constituent component of development. As I have argued elsewhere, the regulation of markets to prevent two people’s

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engaging voluntarily in commercial exchange is as indefensible in principle as legislating to prevent those same two people’s sharing a conversation, a public bar, a classroom, a house or a family. In respect of the globalisation debate, I would merely extend that argument with the proposition that the freedom to engage in exchange and transaction — a constituent component of development — is not one that can be qualified by the existence of geo-political borders.

National inequality movements

While trends in inequality between the per capita GDPs of countries are an important window on changing global living standards, it is also useful to examine what has been happening to income inequality within each country. There is no simple generalisation possible, either for rich countries or for poor countries. According to a recent World Bank paper, there is "...no evidence whatsoever of a systematic relationship between changes in trade and changes in inequality."20

Inequality has indeed risen in some developing countries that have intensified their international economic links (such as China), but it has gone down in others (such as the Philippines). In yet others, such as Vietnam, it has not changed, notwithstanding enormous economic transformation.

Among rich countries, the diversity of experience is equally wide. From the mid-1970s to the mid-1990s, the income distribution widened in the United States but narrowed slightly in Canada, to consider two rather similar economies that have intensified their already profound trade links with each other, and with the rest of the world. Income distribution did not change significantly in the small, very open economies of Europe during this period.

This diversity of experience reminds us that economic globalisation is only one influence among many on the domestic income distribution. Other important influences are the rapidity with which countries embrace technological change, and their education, training and health policies. More generally, decisions about taxation and social spending are still potent.

Even the direction of the impact of globalisation on income distribution before taxes and transfers is not clear cut, depending on the country's starting point, its comparative advantages, and the nature of its international economic links. For example, was the initial income distribution very compressed because of wage regulation and the absence of property income, as in China? Have growing trade links been through agricultural exports or simple manufacturing exports, so that many of the benefits go directly to low skilled workers, as in Vietnam? And in rich countries, has large scale public investment in human capital formation driven a pattern of comparative advantage that favours skilled labour\textsuperscript{21}, or

\textsuperscript{21} Education can be thought of as a process that transforms unskilled into skilled labour, thereby increasing the skill-intensity of factor endowments and modifying comparative advantage in favour of skilled labour.
have the education and retraining systems acted, rather, to keep pace with essentially autonomous technological change that just happens to favour the high-skilled?

**The intriguing case of the United States**

The United States provides the clearest case among the advanced economies of a widening income distribution through the 1980s and early 1990s. Because the United States has both led technological change and lowered trade barriers (eg through GATT rounds and through NAFTA), it has posed most sharply the question of the relative contributions of skill-biased technological change (SBTC) and trade liberalisation to widening wage distributions, skill premia and earning distributions.22

Earlier studies of the timing and magnitudes of the trade, technology and labour supply changes affecting the United States suggested that technological change has accounted for some 70 to 80 percent of the widening of the wage distribution, with trade competition accounting only for a minority of the change.23 Of course, the distinction is not clear cut, as trade liberalisation might have been one competitive factor accelerating technological change. But a puzzle for this mainstream view is that the rise in the US wage differential for skill slowed markedly after about 1986,

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22 The reason trade liberalisation which raises national income might nonetheless be expected to lower the relative (and possibly event the absolute) return to unskilled labour in rich countries is the so called Stolper-Samuelson theorem. In a simplified model, if countries specialise in the exports which use most intensively their relative cheap factors of production, poor countries would export labour-intensive goods and rich countries would export skill-intensive goods. Global income distribution would narrow, income distribution in the poor country would narrow, but income distribution in the rich country would widen. See, for example, Kevin H O'Rourke, *Globalization and Inequality: Historical Trends*, paper to the Annual World Bank Conference on Development Economics, 1-2 May 2001.

and the real wages of both educational groups grew strongly in the late 1990s, notwithstanding a presumed acceleration of technological change. More recent studies suggest that the pattern of at first widening, and then recently more stable wage distribution in the United States is consistent with the gradual diffusion of information and communication technology throughout the economy. This technology presumably favours the high-skilled, but as a 'general purpose technology' with pervasive effects, it has been deployed to raise productivity in most areas of the US economy, permitting all capital to be used more efficiently.

The impact on the wage distribution of these complex changes over time depends on the relative growth rates in supplies of skilled and less-skilled labour — including through the operation of the education system as noted earlier, in rates of capital formation, and in rates of deployment of the new technology. Recent analysis supports the intuition that the wage distribution widened more in the United States than in continental European countries because it implemented more skill-biased technological changes — and, incidentally, enjoyed more productivity growth — than in Europe. Finally, the impact (if any) of changes in the wage distribution on the income distribution depends on an even wider range of factors, including taxes and transfers.


Is it meaningful to consider a 'world income distribution'?

So far, I have noted two recent conclusions: first, the long historical trend of widening of the inter-country income distribution stopped around the late 1970s, and has since slightly narrowed; and second, movements in national income distributions show no systematic relationship to globalisation.

For completeness, I should mention a third issue which has gained some recent attention, the so-called "world income distribution". This involves comparison of how changes in national income distributions interact with changes in the inter-country distribution of income. Unlike earlier concepts I have used this afternoon, this last concept requires the comparison across countries of national data on income distribution (rather than the comparison within each country of movements in its own income distribution over time).

While the concept of a "world income distribution" is obviously interesting, recent uses of its current approximations seem to me problematical, for two reasons: dubious policy relevance and measurement problems.

First, the concept's policy relevance is not clear. On the one hand, national governments alter the inter-county distribution of income, through their roles in international institutions such as the World Bank and international negotiations such as the Doha trade round, and so improve the global environment in which countries can create wealth and transfer aid. On the other hand, the distribution of income within countries is a responsibility
of national governments. It is unclear what we gain from tracking the relative incomes of, say, a rich Saudi Arabian who may be richer than a poor American, or a rich Vietnamese who may be richer than a poor Indonesian. There is no world government to transfer the income from the one to the other, or achieve the domestic policy reforms that will raise the productivity of the poorest.

Second, at the level of data comparison, national distributional data differs radically in concepts and quality. Notwithstanding a recent effort led by the Australian Bureau of Statistics to improve and broadly standardise the international methodology for collecting household income statistics, some countries survey income, others expenditure; some survey households, others individuals; some consider gross income, others income net of taxes and transfers; and some collect data regularly and with short recall periods, others infrequently and with long delays.²⁶

Efforts to assemble such diverse national data into data sets for international comparison have experienced considerable problems.²⁷ Nonetheless, the efforts have been made, and I should illustrate the range of them.

As representatives of one family of work, Clark, Kraay and Dollar have compared movements over time in the proportion by which the world's


average income exceeds the median income (which can be considered the income of the world's 'typical person'). For example in 1998, while the world's average income was about US$ 6300, its median income was more like US$ 1200. By combining national accounts estimates of per capita GDP and household survey estimates of Gini coefficients (to estimate the likely distribution of that per capita GDP), the authors note that the excess of the average over the median doubled from 40 percent in 1820 to a peak of about 85 percent in 1965-1969, but then declined slightly to a little under 80 percent by 1995-1999. This finding is roughly consistent with the estimates mentioned earlier of the recent peak and subsequent small decline in inter-country income distribution.

A novel approach by Branko Milanovic uses household survey data alone for some 90 countries to estimate an actual world income distribution, nominally for 1988 and 1993. His estimates suggest that for these two nominal benchmark years, the world's income distribution widened, mainly because incomes in urban China grew much faster than in rural China and India. The views derived from this one study gain much attention.

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While this study has been published in a prestigious journal, it is difficult to know what sense to make of its results, as the problems of adding together data from widely different household surveys are prodigious. For example:

- The data are not actually for 1988 and 1993, but for whichever years country surveys are available within the two years before or after the two benchmark dates. Survey results were then projected back or forward to the benchmark dates by national CPIs. To illustrate with the two most extreme cases, survey data for Switzerland were 10 years apart, while those for Pakistan were less than one year apart.\(^{31}\)

- China, India, Indonesia and Bangladesh were notionally divided into eight 'countries' by separating their (comparatively rich) urban and (comparatively poor) rural components. While this makes sense as an approximation to the concept of a world income distribution, it also nicely illustrates the puzzle of what the resulting numbers might actually mean, in terms of political accountability for productivity-enhancing measures, or actual income redistribution, that would close income gaps. Relatively rich urban Indians are not going to be aiding poorer rural Chinese, who in turn are not going to be aiding still poorer rural Indians. And raising the productivity of poor Indians - ultimately the only sustainable basis for them to enjoy better lives - will only be achieved by Indian policy reforms, not by anything under Chinese influence.

- Surveys are accepted at face value, adding together results from income surveys and expenditure surveys, and disregarding known biases in national survey practice (such as the serious under-representation of farmers and one-person households in the Japanese survey, which is known appreciably to understate inequality in that country). It is well-known that income surveys and expenditure

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surveys give widely differing results from each other, and their aggregations into national household income and expenditure differ from national accounts measures of the same concepts.

- The unit of global measurement is the individual, measured as the household's reported income (or expenditure) divided by the number of people in the household. That is, there is no attempt to use 'equivalence scales' as is common in national survey work, to allow for the fact that children have lower consumption requirements than adults, and that there are economies of scale in living together. And of course equivalence scales differ widely over countries at different stages of development: it is cheaper to maintain relevant community living standards for large families in poorer countries.

Whatever the meaning of numbers aggregated from diverse household surveys, Branko Milanovic's approach reiterates a key finding from other studies: "Differences between countries' mean incomes is (sic) the most important factor behind world inequality." They account for between three-quarters and 80 percent of the total inequality; intra-national inequality is both a relatively small contributor and generally a slow-changing one. So one must wonder again what is gained for public policy by attempting to measure, extremely imperfectly, the "world income distribution"?

The case of Australia

Since the 1980s, a range of reforms have helped create a more open internationally integrated Australian economy. These reforms include the deregulation of financial markets, floating of the exchange rate, the removal of capital controls and greater trade and investment liberalisation.

32 Branko Milanovic, True World Income Distribution, op cit p 88.
In its most recent survey of Australia, the OECD reported that Australia has the lowest barriers to trade and investment of all OECD countries.

Complementing those internationalising reforms, the "tyranny of distance" has been reduced by rapid falls in transport, data processing and communication costs.

Intensified competition arising from all these sources drove the productive diffusion of information and communication technology, further stimulating productivity-enhancing advances throughout the economy.\textsuperscript{33}

All these changes have triggered far-reaching social change: couples had fewer children, later in life; women completed tertiary education and entered the workforce in record numbers; levels of female skills rose; students stayed longer at school and entered extended tertiary study in record numbers; household sizes fell; and mature age workers underwent training and retraining.

These social developments would have had a major impact on labour markets and income distribution. Indeed, it is inconceivable that such huge changes could have washed through society without necessitating major changes in how work was organised, and it would be remarkable if they had not also necessitated significant changes in the wage distribution.

Of course, from the later 1980s, these social changes have been accompanied by major reforms to labour markets and industrial relations,

\textsuperscript{33} See, for example, Dean Parham’s paper to this conference (\textit{Productivity growth in Australia: Are we enjoying a miracle?}).
and education and training — the former particularly so in the second half of the 1990s. Those reforms too would have impacted the domestic income distribution.

What, then, can we say about the impact of globalisation on Australia’s income distribution, inequality and poverty?

A recent OECD publication on trends and driving factors in income distribution and poverty in the OECD area notes that relative and absolute poverty declined in Australia between the mid 1980s and 1990s. But not all local researchers would agree, as illustrated in the recent debate over the Smith Family report and the critique of it by the Centre for Independent Studies.

In Australian studies relative poverty is usually defined with respect to a ‘poverty line’ benchmarked on a certain percentage of the median or mean income in society. The percentage chosen and the choice of benchmark — mean or median — are, it would seem, matters for judgement.

The recent NATSEM report *Financial Disadvantage in Australia*, commissioned by the Smith Family, defined the poverty line as 50 per cent of the income of the average Australian family. Using this measure, the report found that poverty had increased during the 1990s even though the incomes of the poorest families had increased in real terms during this period. Absolute poverty had declined, but relative poverty, as defined, had risen.
In contrast, the Centre for Independent Studies notes that choosing the more commonly used poverty threshold of 50 per cent of median income would show that not only did absolute poverty decline, the incidence of relative poverty remained reasonably stable over the 1990s.

Which definition of relative poverty is to be preferred? Should, instead, an absolute concept of poverty be preferred?

According to Amartya Sen in an important lecture 20 years ago, the concept of relative poverty must have an absolutist basis. A ‘fully relativised view of poverty, making poverty just “an issue of inequality”’ must be rejected. Sen finds an absolute basis for poverty in capabilities. Absolute deprivation in respect of capabilities (such as the potential to participate in community politics) means relative deprivation in terms of commodities, incomes and resources (such as transport and education).

Among the capabilities of importance to poverty analysis, Sen identifies one sub-set including such things as the capability ‘to meet nutritional requirements, to escape avoidable disease, to be sheltered, to be clothed, to be able to travel, and to be educated’. He notes that the commodity (or income, or resource) requirements of this sub-set of capabilities might not

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vary much between communities. Accordingly, poverty lines, defined in income terms for example, that captured these capabilities would not vary much from one community to another, and would not, for the same reason, vary much over time. With respect to these capabilities, the difference between an absolute and relative poverty line might scarcely be significant.

But Sen notes that a second sub-set of other capabilities reveal a different picture:

‘The capability to live without shame emphasised by Adam Smith, that of being able to participate in the activities of the community discussed by Peter Townsend, that of having self-respect discussed by John Rawls, are examples of capabilities with extremely variable resource requirements. And as it happens the resource requirements typically go up in these cases with the average propensity of the nation…’

Sen goes on to argue that:

‘While the commodity requirements are sensitive to the opulence and the affluence of the community in general, this relationship is neither one of instant adjustment, nor is it a straightforward one to be

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38 In Sen’s analysis communities are separated spatially (eg, Australia and sub-Saharan Africa). But the analysis would also, presumably, extend to communities separated temporally (eg, Australia in the 1950s and Australia in the 1990s).

39 Sen, *op. cit.* p.163.
captured simply by looking at the average income, or even the current Lorenz curve of income distribution.\textsuperscript{40}

According to Sen’s concept of capability deprivation, it would not be appropriate, therefore, to base a poverty line on average income. And it takes little more than a moment’s reflection to realise that the concept of average used here would cover both ‘mean’ and ‘median’.

Consider the Peter Townsend capability of ability to participate in the activities of the community. The broad classes of goods and services that people need to participate in the full life of the community doubtless broaden over time. Cars, TVs, videos, mobile phones, computers and internet connections were recently rare or non-existent, then restricted to the very rich or especially interested, and then became (or are becoming) necessary for everyday participation in the community.

But what happens when, without major new product classes, people in the middle and upper parts of the income distribution obtain sufficient income to acquire, and actually do acquire, higher performance or more luxurious cars, digital TVs, smaller mobile phones, faster computers, and so on? Do the poor need commensurately higher incomes so that they can follow these trends, or can they participate equally fully in the life of the community as long as they can afford serviceable examples of these broad product classes? Sen’s answer is unambiguous: ‘It would be absurd to call someone poor, just because he had the means to buy only one Cadillac a

\textsuperscript{40} ibid.
day when others in that community could buy two of these cars each day’.

Neither mean nor median income, then, provides a sensible basis for constructing a poverty line that captures the capability of community participation.

To pose another example of the odd results that can be produced by arithmetic application of unsophisticated concepts of relative poverty, consider the impact of a large number of unemployed people finding work, and thereby obtaining higher incomes. Average income rises, and median income might also rise. The 'poverty line' rises. Some people not previously considered to be living in poverty will now be identified as its victims. Yet everyone has at least as much income as before and the newly-employed have more income.

Twenty years ago Amartya Sen urged researchers to think about ‘some kind of an efficiency-adjusted level of income with “income” units reflecting command over capabilities rather than over commodities’.

Clearly, even twenty years later, we have a long way to go before meaningful poverty measures find their way into public policy analysis.

Indeed, the studies that have recently sparked controversy in public debate in Australia scarcely bother to draw a distinction between poverty and income inequality. It is to the latter that I will now turn.

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41 Sen, op. cit. p 159.

42 Sen, op. cit. p 165.
The ABS Survey of Income and Housing Costs (SIHC) for 1999-2000 shows trends in income over the period 1994-95 to 1999-2000. The findings reveal that the income shares in 1999-2000 were virtually unchanged from the shares in 1997-98, and that there has not been a significant change in income shares in the period since 1994-95. The Gini coefficient has also not changed significantly since 1994-95.

Professor Peter Saunders of the Social Policy Research Centre found that while there was some increase in inequality between 1990 and 1999-2000, there was no statistically significant changes in the second half of the decade.43

In contrast to these findings, NATSEM, after analysing both the Survey of Income and Housing Costs (SIHC) and the Household Expenditure Survey (HES), concludes that there is some evidence that income inequality has continued to increase since the mid-1990s.44

Importantly, both studies show that the social security and income tax systems have a considerable redistributive impact. The studies differentiate the degree of income inequality generated in the market from the impact of government transfer and tax programs on the distribution of disposable income. The data shows that in 1999-2000, for example, social transfers reduced income inequality (as measured by the Gini coefficient) by 22 per cent while income taxes reduced it by around 12 per cent. In


that year, the overall tax transfer system reduced income inequality by around one-third.

NATSEM find that the SIHC generates lower household inequality estimates than the HES. Both surveys suggest increasing income inequality over the course of the 1990s. However, the results differ somewhat from 1994 onwards: the HES suggests income inequality continued to increase after 1993-94, whereas the SIHC suggests no statistically significant change in inequality over this period.

Of course, these ‘static’ income distribution studies provide only a snap-shot at a point in the lifetime of individuals. They provide no guidance on the question of life-time inequality. Thus, for example, people leaving work to acquire enhanced skills in education and re-training will be revealed as worsening income inequality in static studies of income distribution. Yet, from the perspective of those undertaking the retraining, the life-time earnings experience will presumably be enhanced. In general, many people do not remain on low incomes over their entire lifetime. As noted by Peter Saunders, the degree of mobility in people’s income and distributional positions over time should be taken into account when considering inequality in the income distribution.

Data are also a problem.

A common criticism of the SIHC is that it measures only cash income such as wages and salaries, government pensions and allowances, business profits and investment income. It ignores the tax system and a range of other non-cash benefits such as education, health, housing and child care
which are targeted to people on low incomes, thereby helping reduce disparities and improve the standard of living of those on low wages.

The Household Expenditure Survey used by NATSEM has a range of reporting and conceptual problems, perhaps the principal of which is that people's reported expenditure/income ratios vary over the 'life cycle' in ways that have no relevance to the concepts of poverty or inequality. I would discount particularly heavily the HES-based results reported by NATSEM.

But even supposing income inequality had increased slightly over the second half of the 1990s, should this be of concern to economic policy makers?

The answer to this question is not clear-cut. Importantly, there is no clear consensus on what an acceptable level of inequality is.

A perfectly egalitarian distribution, with each quintile having the same proportion of income is neither plausible nor desirable. People have different capacities, different productivities, different attitudes to bearing risk and different preferences between income and leisure.

Wider income differentials may be bound up with higher education, faster skill building, higher productivity growth and greater work incentives — all vital factors for a dynamic and innovative society. As we have seen from recent research into the US experience, fluctuations in the wage and income distribution may be an inescapable, complex but perhaps transient
consequence of rapid technological change that raises productivity and produces greater community wealth.

Moreover, the policy lesson to be drawn from a reform-induced widening of income inequality is not obvious. Policy makers are very likely to believe that the market liberalising reforms of the past couple of decades in Australia have contributed to rising average incomes, and that the income gains have been widely shared. Is anybody seriously suggesting that those reforms should be reversed, in the certain expectation of significantly reduced average incomes and the highly speculative hope of a more egalitarian distribution of a smaller cake?

Finally, let me turn specifically to the question of whether the lowering of barriers to trade and investment might have widened the earnings distribution in Australia.

It turns out that there is little evidence to support this contention. As in the United States, far the majority of the recent Australian changes in income distribution are thought to arise from technological and productivity changes that have produced strong growth in the employment of high wage workers, and in part-time and casual employment, rather than changes in relative wages.45

First, the increase by the 1990s in the ratio of Australian exports or imports to GDP has only returned us to a little above the levels prevailing around 1920 (Chart 6).
Second, there is no evidence of an Australian widening of the returns to skill differentials. The wages of high-skill and low-skill employees have grown by about the same amounts between the mid-1980s and the late 1990s, and the widening of the earnings distribution owed most to rapid growth in the numbers of those earning higher wage rates, not a disproportionate increase in those wage rates (Chart 7). The only manufacturing industry where the decline in employment was consistent with the decline in protection was the textiles, clothing and footwear industries.

Australia’s growth in real per capita income in the 1990s outperformed most other OECD countries. Continued gains depend upon the maintenance of sound macroeconomic policies, low inflation and interest rates and an active structural reform agenda.

Continued growth will also require an open global trade and investment environment. Trade creates wealth through specialisation based on comparative advantage. Australia has been taking advantage of its greater openness. Exports have continued to trend upwards since the 1970s from around 15 per cent of GDP in the late 1970s to about 23 per cent of GDP in 2000-01. But this performance has only returned Australia to trade intensities last seen at the peak of the first wave of globalisation around

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1919. Many other OECD economies had achieved by the 1990s much greater trade intensities than their 1919 peaks (Chart 8).\textsuperscript{46}

Analysis of income distribution statistics shows that unemployment, rather than low wages, is a major factor underlying low household incomes. NATSEM finds that the unemployed and those not in the labour force are over-represented in the lowest percentile of the income distribution, while wage and salary earners are under-represented. While it should be recognised that there is considerable movement between these groups over time, these findings suggest that a key factor in reducing poverty in Australia is through employment creation. That is, the best way out of poverty is through a job — an observation that sits rather well with Sen’s conceptualisation of poverty as capability deprivation.

On the supply side, further attention needs to be given to the interaction of the social security and taxation systems to ensure that there are appropriate incentives for participation in the labour market.

The tax and social security systems play a direct role in reducing poverty and inequality. As discussed earlier, the tax and transfer system has been effective in largely offsetting in disposable income terms the changes in the distribution of wages. But as the Reference Group on Welfare reform noted recently, the social support system had its origins "…in a fundamentally different economic and social environment. It was designed during a time of low unemployment, generally of short duration,

\textsuperscript{46} Robert Feenstra, cited in Perter Dawkins and Peter Kenyon, Globalisation and Labour Markets: Implications for Australian Public Policy, Conference of Economists, La Trobe University, September 1999.
and when the most common [household] type was a couple with children and a principal male breadwinner."

The current environment is quite different. Not only are peoples' values, aspirations and lifestyles already much changed, but there is likely to be continuing extensive economic change as applications of computer and other new technologies have pervasive impact on how corporations and the work place are designed.

In this new environment, improved education and training such as outlined in the Government's policy statements on *Investing in Higher Education*, *Skilling up Australia*, and *Backing Australia's Ability* are likely to play an increasing role in sustainably supporting equitable income growth. Pure 'redistribution' through traditional taxes and transfer spending may have a lesser role than in the mid 20th century.

Nor should we assume that increasing the skill level of the labour force, which in turn increases employment opportunities and incomes, requires only taxes and public spending (though there is certainly an important role for them). Since the main tasks involve allocative subtlety, creating skills that match commercial opportunities and personal preferences, there is intrinsically a large role for markets in allowing individuals to allocate resources efficiently.

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**Conclusion**

A central focus of the international debate on globalisation has been its likely impact on poverty and income inequality and the role that economic policy can and should play in managing outcomes in those areas.

Australia has established a sound and responsible macroeconomic policy framework conducive to low inflation, low interest rates and high investment and has pursued ongoing structural reforms, including more flexible labour markets. This has encouraged competition and created a strong incentive to apply productivity-enhancing information and communication technologies throughout the economy.

In the second half of the 1990s, Australia experienced very strong economic growth by historical and international standards and falling unemployment.

Poverty and income distribution are impacted by policies applied at geopolitical borders, but national income distributions are subject to many influences, not least accelerating technological change that generates productivity growth and higher incomes. Flexible labour markets and effective education and training programs are likely to be the best answer to the challenges of maximising income growth with equity through productive use of the new technologies.

Let me conclude with an observation first made over a decade ago, well before the recent debates about globalisation, poverty and inequality. It seems pertinent both to the international and the national dimensions of
inequality. Herbert Stein, former Chairman of the US President's Council of Economic Advisers, criticised debate about international 'league tables' of per capita GDP rankings and growth rates by observing:

"It is a distraction from our real problem, which is not to get richer than someone else or to get richer faster than someone else but to be as good as we can be, and better than we have been, in the areas of our serious deficiencies, such as homelessness, poverty, ignorance and crime." 48

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48 Herbert Stein, "Who's number one? Who cares?" Wall Street Journal, 1 March 1990 p A16