Comments on Branko Milanovic's Presentation at the Vatican

Francis T. Lui

(Hong Kong University of Science and Technology)

Branko Milanovic' research in recent years has generated important findings on the empirical patterns of global income inequalities that academics and policy makers must reckon with. By using newly available household survey data of many countries from 1988 to 2008, he is able to construct a better measure of global inequality. The concept behind this measure is to mix people from different countries together as if they all live in the same global village. This avoids the problems of treating every country as having the same population or everybody in the same country as having the same income. Some of the findings that emerge with this new measure are:

(1) Global inequality is much bigger than inequality within any individual country. The poor people in the rich countries are often richer than the rich people in the poor countries.

(2) Inequalities in income distribution within many countries, as measured by Gini coefficients or other methods, have increased. (The Gini estimates in the developed countries may be biased upwards due to the ageing of their populations. Those who have retired may report little or no income in the household surveys, and yet they are not necessarily poor.) However, probably for the first time since the Industrial Revolution, contrary to the popular view, global inequality had declined in recent years. From 2002 to 2008, the global Gini had gone down by 1.4 points.

(3) There were winners and losers. This reversing trend in the Gini was mainly caused by the rapid rise in real income in some populous but previously poor countries, notably China and India. For example, in 1988, the median income in China was only higher than the 10 percentile income of the global population, but in 2008, it had exceeded the global median. The winners also included those who belonged to the richest 1% of the global population. Those who belonged to the 75 to 95 percentile of the richest global populations were the losers. They gained very

little during the sample period of 1988 to 2008. This implies that there was polarization among the richest 25% of the global population, some being much richer and some experiencing stagnation. The poorest 5% of the global population were also losers. They had very little increase in income.

(4) Location now matters a lot in income distribution. Global inequality today is higher than that in the 19^{th} century. However, two-thirds of this inequality can be attributed to the differences in income across countries (location), while one-third is due to inequalities within individual countries (class). This was not true in the 19^{th} century world as depicted by Marx. At that time, two-thirds were due to class and one-third to location.

These are remarkable results that raise a lot of questions about how we should proceed to reduce income inequality of humanity. In principle, there are several approaches to do this.

The **first** focuses on pursuing policies aims at reducing inequalities *within* countries. While these policies could be beneficial, there are limitations on what they can achieve. As said before, the increases in income in some less developed countries were the main reasons responsible for reducing global inequality in recent years. Thus, income redistribution within a country may not help too much. It may even be possible that egalitarian policies, if taken to the extreme, can slow down economic growth in the less developed countries.

The **second** involves redistributing income from the rich to the poor countries. This could be in the form of international development assistance or foreign aids. From the humanitarian point of view, this approach seems well justified. However, past history indicates that foreign aids were not very effective in helping the poor countries to raise their income levels.

Since much of global inequality is due to the fact that even the rich people in poor countries generally have income levels lower than the poor people in rich countries, immigration of people from the poor to the rich countries could be an effective way of raising the income levels of those from the poor countries.
This can be regarded as the **third** approach. The problem is that large scale migrations may not be politically feasible. People in the rich countries may fear

that the new immigrants may force the wage rates to go down and they may consume a lot of welfare benefits.

The **fourth** approach relies on international trade. When free trade occurs, the so-called "factor price equalization" could come into effect. Labor wages of the same trading partners have the tendency to converge to the same level even when migration does not take place. In fact, there have been numerous examples, such as Hong Kong, Singapore, Taiwan, South Korea, indicating that economies intensively engaging in trade can grow very fast from being poor to being rich.

The **fifth** approach is a generalization of the fourth one. If we can improve the rates of economic growth of the poor countries, global inequality can be vastly reduced. This requires us to understand the driving forces of economic growth. Replicating the success stories of the fast-growing economies in poor countries can be an effective means to reduce inequality.

The last 30 years has seen the emergence of a vast literature on identifying the factors that can serve as the engines of economic growth. Some important ones are: engagement in trade (as discussed above), sound institutions, investments in human capital and technology, improvement in health and life expectancy, inducing people to save more for investing in the future, and so on. Some of these factors could be more fundamental than the others.

Examining critically the experiences of the success stories is a simple way for us to find out what should be done and what should not be done.

Use China as an example. The real per capita GDP of China had increased by 1700 percent from 1978 to 2013. This would put it as one of the greatest success stories in the history of economic development. Paradoxically, one of the factors contributing to this outcome was China's willingness to accept a higher level of income inequality. In the late 1970s, any attempt to make one's material well-being better than others would be regarded as capitalistic and therefore discouraged. Deng Xiao Ping at that time had to make a fundamental strategic move of abandoning egalitarianism. He pronounced, "Let some people become rich first."

China also pursued an open-door policy and engaged extensively in international trade. Global competition forced domestic enterprises to be more efficient, lest that they be driven out of the market. To improve efficiency, these enterprises had to exploit their comparative advantage, i.e., to make use of the abundant labor available and specialize in producing labor-intensive goods. The emergence of private enterprises also took place. Investment in human capital was taken more seriously, though probably not enough. Students admitted to higher education had gone up by 600 percent in the last 17 years.

There were unique features of China's economic policy. Without sufficient theory to guide its progress, it adopted the policy of *crossing the river by feeling the stones*. In particular, it first tested the consequences of various policies by confining their implementations only to some *Special Economic Zones*, before the successful ones were replicated in the entire nation. Hong Kong had also served as the role model of modern institutions for these *Special Economic Zones,* and as the supplier of capital and management skills in the initial phase.

The role that Hong Kong had played and the policy of establishing *Special Economic Zones* indicate that the concept of *Charter Cities* as advocated by economist Paul Romer may be important. It means that a city in a poor country is allowed to adopt a set of laws and modern institutions that are conducive to economic growth but are different from those in that country. The usefulness of these new laws and institutions can be tested before they are extended to other parts of the country. The successful experience in China of such an approach indicates that this could be a very effective means to raise the economic growth rates in poor countries and thereby reduce global inequality.

Economist Angus Deaton of Princeton University has pointed out that economic growth had been the driving force of international income inequality. The Industrial Revolution, in particular, had led some countries to achieving high levels of income sooner than others and thereby created inequality. The proper way to address the issue of inequality is to ensure that those countries and individuals that have been left behind are given the opportunities and means to catch up. This is not an easy process. The rise in productive capabilities of the previously poor people or nations could transform themselves into competitors of those in the developed countries. The stagnation of income among many of those in these countries may be partly caused by this competition. Yet we have no justifiable reason to prevent others from catching up.