

Missing the Wood for the Trees

A Response to Hughes

Terry O'Brien

Dear Editor

Helen Hughes' review of two Reserve Bank of Australia/Treasury volumes dealing with globalisation, poverty and inequality issues, seems to me (as a co-editor of one of the volumes) to miss the wood for the trees. ('Is Globalisation Good Or Bad For Poor People?', *Policy*, Summer 2002-03, pp.49-55.)

Remaining technical arguments about the size of the decline in poverty are worth resolving, as far as deficient historical data allow. But surely the main message from that data is the virtual unanimity of serious economic research on two of the most remarkable (but still widely unnoticed) economic achievements of the late 20th century: the unprecedented decline in the absolute numbers in poverty; and the cessation and probable partial reversal of the widening in international income inequality, for the first time since the industrial revolution.

Professor Hughes attributes to Surjit Bhalla the view that (in her words) '... the World Bank has been using its monopoly of data to double the estimated extent of poverty in developing countries' (p.49). But in implying that Bhalla, among the many researchers grappling with inadequate primary data, has got the numbers right and that higher estimates should be disregarded as anti-poverty advocacy, Professor Hughes disregards the fact that Bhalla's estimates inevitably also rest on the same families of limited data she criticises when used by others: national poverty and inequality estimates that come from incomparable, irregular and often poor-quality household surveys by national authorities, compared across countries using imperfect data on Purchasing Power Parities (PPPs).¹

These data deficiencies ought to give us some caution in using any single point estimate. But we can nevertheless be confident of the two big-picture breakthroughs

noted above, because all credible estimates by several different methods are in broad agreement, both with each other, and with the rise and convergence among national living standard indicators (such as life expectancies, nutrition indicators and basic education measures).

Bhalla's book is a valuable contribution, both in his criticism of World Bank stewardship of some of the key data and estimates, and in his ingenuity in seeking to work around the data problems. His resultant estimates of poverty numbers and inequality trends are of the same magnitudes as Sala-I-Martin's estimates by broadly similar methodology.² But given the present limitations in the underlying data we all have to use, both approaches are best regarded at this stage as broadly consistent with, rather than supplanting, the more aggregated and longer-sweep estimates by François Bouguignon and Christian Morrisson (*American Economic Review*, September 2002). These last estimates, which also use many of the desirable statistical approaches Professor Hughes advocates, have inequality peaking in the 1950s but then roughly stable, rather than declining as estimated from more disaggregated and more recent numbers.³ They also show a decline in the numbers in poverty more in line with the World Bank estimates.

Looking forward, we are unlikely to avoid similar differences among estimates of tomorrow's poverty and inequality trends unless we start collecting better data today. The Australian Bureau of Statistics presentation by

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Peter Harper in the RBA/Treasury Conference volume explains how data problems can be resolved, through the Canberra Group's principles for better household surveys, and a rejuvenated International Comparison Program for better PPPs.

Professor Hughes implicitly criticises the RBA/Treasury conference for giving any standing at all to globalisation critics such as political economist Professor Robert Wade, who doubts the breakthroughs against poverty and inequality. But views such as his remain influential, and his evidence needs to be presented and tested. Not everyone has had the benefit of access to the unpublished portions of Ian Castles' excellent critique of Professor Wade's analysis.

It would indeed have been surprising if (as Professor Hughes claims, p.52) Professor Wade's views had not been critiqued in the Conference discussions. But they were: papers by David Dollar, Steve Dowrick, Tim Smeeding, Peter Harper and Ken Henry all took issue with one or more aspects of his analysis, including his frequent (but not consistent) use of exchange rates rather than PPPs, his use of survey-only (but PPP) evidence by Branko Milanovic for just two years, his excessive discounting of Chinese and Indian successes, his focus on absolute (dollar) income gaps rather than relative income growth rates, and so on. While those criticisms apparently escaped Professor Hughes's attention, they were understood by officials from the participating G-20 economies—see for example Melih Nemli's summing up of the balance of those arguments (RBA/Treasury, pp. 254–256).

Professor Hughes takes an odd reading of several individual contributions to the RBA/Treasury conference volume, most notably the paper from Tim Smeeding.

Professor Hughes says, 'Smeeding claimed at the Reserve Bank-Treasury Conference that in industrial economies inequality of income distribution—measured by the gap between low and high income individuals in each country—was inversely related to liberalisation. Relatively liberal Economic Freedom Index economies—the United States, the United Kingdom, Canada and Australia—had the highest income gaps according to Smeeding' (p.53).

However Smeeding doesn't ever mention 'liberalisation' or the Economic Freedom Index (which measures factors including corruption, the rule of law, the burden of regulation and the size of government). Such broader factors illustrate why 'liberalisation' is not an interchangeable concept with 'globalisation', which is normally considered to be the extent of a country's international economic integration through trade and investment.

What Smeeding said was that there is no connection from globalisation to inequality in industrial countries, but rather many contributing causes (RBA/Treasury, pp. 188-200). He summarises: 'In particular, there is no evidence that we know of that trade and globalisation is bad for rich countries . . . Globalisation does not force any particular [distributional] outcome on any country. Domestic policies and institutions still have large effects on the level and trend of inequality within rich and middle-income nations, even in a globalising world economy' (RBA/Treasury, p.179).

Professor Hughes characterises the contribution from the World Bank's David Dollar as 'weak' and 'ambivalent' in various respects, but misses the point of the approach he chose for the Conference. Acknowledging that some of the World Bank's critics (such as Robert Wade) would never be persuaded by the World Bank's own studies, Dollar instead showed that the turning point in poverty could be demonstrated just from the trends in the major developing regions, using national numbers and national poverty lines.

In his paper, Dollar demonstrates five key trends, two of which are 'The number of poor people in the world has declined significantly, the first such decline in history'. And 'Global inequality (among citizens of the world) has declined—modestly—reversing a 200-year-old trend toward higher inequality' (RBA/Treasury, p.10) .

That sounds a pretty strong and unambiguous message to me, and suggests that both Dollar and Bhalla agree on the big picture. It's a shame *Policy* readers would never have divined that key message from Professor Hughes' review.

Endnotes

- ¹ Thus it is not only Branko Milanovic or David Dollar who are reliant on '100 income surveys of dubious accuracy', (*Policy*, p.52). Everybody is ultimately reliant on such surveys, including Bhalla (*Imagine There's No Country*, p.208). There is no other evidence on national poverty and inequality (as distinct from average living standards). The main problems which make Milanovic's results implausible are that he used surveys alone, not recalibrated off national accounts and other evidence of rising living standards, and then projected them to just two unrepresentative years, not a longer observation of trends.
- ² NBER and Columbia University Working Papers, April, May and November 2002. Papers are available at <http://www.columbia.edu/~xs23/papers/GlobalIncomeInequality.htm>; <http://www.columbia.edu/~xs23/papers/WorldDistribution.htm>, and <http://www.columbia.edu/cu/economics/>
- ³ The range of these credible results is why David Dollar reported them both in his paper, contrary to Professor Hughes's apparent preference to report only the lowest estimates (*Policy*, p.52).