



Globalisation and income inequality

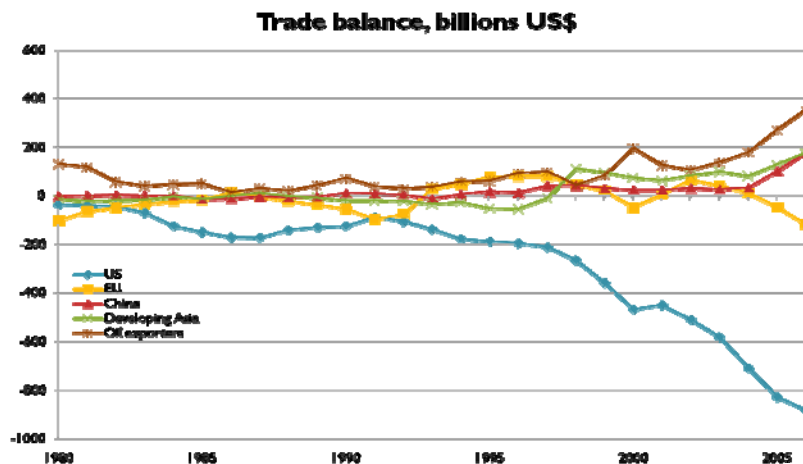
Danny Quah, professor and head of the Department of Economics at the LSE
Globalisation and social justice breakfast meeting
11 December 2007, Policy Network, London

Speaking at the eighth globalisation and social justice breakfast meeting hosted by Policy Network, Danny Quah, professor and head of the Department of Economics at the London School of Economics, examined both the widely debated implications of globalisation on income inequality and the global impact of domestic economic policy choices. In his intervention, Quah questioned conventional wisdom regarding the effect of China's economic policies on the world trade balance; the nature of the US trade deficit and its implications for the global economy; and the consequences of globalisation for poverty levels worldwide.

Global imbalances: US trade deficit and the role of China

Since 1999, the trade balance in the US has plummeted into a massive deficit that today exceeds the GDP of India. The severity of this downward trend is unique to the US and is not reflected in the EU or other large economies. Common wisdom advances the notion that the US deficit has been spurred by a savings glut in the rest of the world coupled with a trade surplus in China, often associated with a general undervaluing of Chinese exports which are

said to 'flood' the international market.



However, Danny Quah suggested that the evidence does not support a strong correlation between the opening of Chinese markets and the remarkable increase in the US trade deficit. As Quah pointed out, whereas the US trade deficit began to swell from the early 1990s, the Chinese trade

surplus has not increased dramatically over the same period, as illustrated in the below graph. Additionally, Chinese trade only accounts for one quarter of the total US global-trade imbalance. So, the question remains, if it is not a result of increased trade with China, where does the remaining US deficit stem from?

Quah asserted that the answer lies primarily with increased trade between the US and the oil exporting countries. According to Quah's analysis, the US deficit is mirrored not primarily by

a Chinese trade surplus, but rather by the accumulation of growth in emerging markets in Asia, including China, and the oil exporting countries.

Global patterns of consumption and savings

Quah also took issue with current arguments surrounding an ‘international savings glut’ and its alleged impact on the US trade deficit. According to Quah, the US’s claim that its consumption pattern and low interest rates are driven by excessive international savings is misguided.

Considering the US trade deficit results from a multiplicity of trading partners, Quah asserts that it is unlikely that the global community is leaving the US to compensate for the liberalisation of Chinese markets through over consumption. A more likely causal driver of the global trade imbalance is in fact the consumption pattern in the US.

Role of the US in the global economy

Quah also challenged the common perception that given the size of the US economy, stagnation of US growth would have disastrous implications for the global economy as a whole. Despite its relative size, the contribution of the US economy to growth of the global economy is similar to that of India and China, although India and China’s proportion of GDP are significantly lower. This suggests that the world economy could adapt to a shifting global market place if the US rate of consumption proves unsustainable.

Global poverty and inequality

In the final part of his intervention, Quah illustrated the global shift in growth and poverty by region over the past decade. Based on his current work, Quah juxtaposed the number of people living on less than one US dollar a day with per capita income by region. Over the period from 1990 to 2004, he illustrates that for the majority of regions, growth has occurred and poverty levels have fallen. Whilst it is commonly argued that the opening of markets is accompanied by a sharp increase in domestic inequality (due in large part to an increase in skills premiums) he argues that in general, the so-called trade-off between equality and efficiency, if it exists, is not great enough to overcome the general benefits of economic growth. However, Quah also stressed that although the last 25 years have seen more than 500 million people raised out of \$1 per day poverty, this reduction in poverty can largely be attributed to developments made in China. Poverty levels outside of China have remained unchanged and in some cases even increased. You can access Danny Quah’s graph on global poverty and inequality here:

<http://econ.lse.ac.uk/staff/dquah/p/1-2007.11-wpdyn.gif>

Discussion

The discussion touched on a variety of issues, including the current US financial crisis and its implications for the world economy. Participants mentioned that if it is true that the bottom 10% of the US population, who were hardest hit in the current crisis, account for only 1% of US overall consumption, then US consumption rates are unlikely to be dramatically dampened by the current crisis.

Participants also explored the argument that growth in emerging markets was depressing domestic wages and employment in OECD countries. Quah replied that he is not convinced there is a direct correlation between growth in China and lower wages in industrialised countries. The real political challenge in his view is not to protect domestic jobs, but rather to take a globalist view and promote widespread growth whilst mitigating excessive individual risk at home.