

# Global Income Inequality

**A**s part of my PhD thesis, I calculated a time series of exchange-adjusted (FX) global income distribution for the period 1964-1999 (see figure). This shows that the trend of global income inequality, measured in US dollars, has increased enormously, using both the quintile ratio (the ratio of annual income received by the world's wealthiest 20% compared to the income received by the world's poorest 20%) and the Gini coefficient, a measure of inequality that uses slightly more information.

The recent fall in global income inequality is encouraging and intriguing. It appears to be caused mainly by unusually large increases in the per capita incomes of several populous poor nations, including China, India and Bangladesh.

## Purchasing power parity

Contrary to the pattern shown in the figure, some economists and statisticians contend that the trend of global income inequality measured by income adjusted for 'purchasing power parity' (PPP) is far less clear. Some claim that global income distribution has become less unequal in recent decades. While there is insufficient space here to fully rebut these claims, I'd like to make a few points.

The issue is not just academic. Most commentators on global inequality who use FX measures simply ignore the PPP issue. There is thus very little criticism of PPP measures by critics of the status quo. At the same time, most supporters of PPP incomes simply assert that their measure is superior.

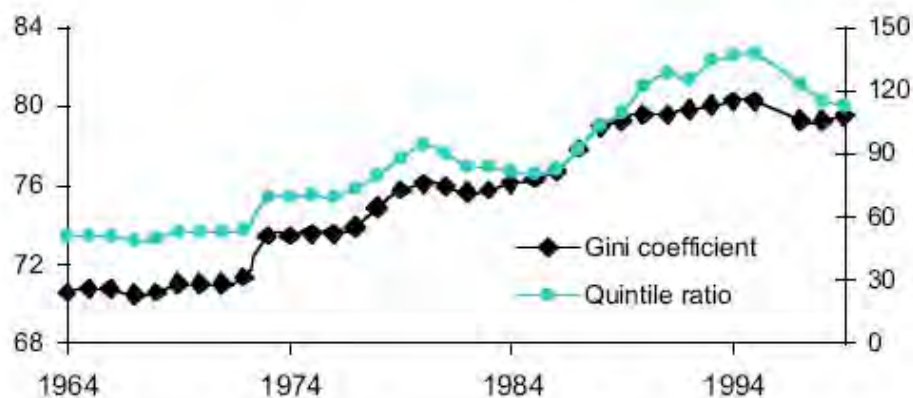
PPP incomes attempt to measure the 'real' value of goods and services consumed in any economy. 'Real' in this case means purchasing power adjusted not for inflation but for the lower cost of many goods and services in many relatively poor economies, especially goods and services that are not internationally traded.

An inverse relationship exists between the rank of a country's average per capita FX income and the size of the multiplier used to

The distribution of income, globally, is far more unequal than in any single country, including Brazil, which has a Gini coefficient of less than 65%.

estimate the PPP-adjusted income from the FX income. For example, in 1990 the average annual FX income for the poorest 10% of Guinea-Bissau, one of the world's poorest countries, was only US\$9. This equals 40 PPP-adjusted dollars. The multiplier was about 4. In comparison, the multiplier for the reference economy, the USA, is always one. PPP-adjusted incomes, like FX incomes, make no attempt to account for economic 'externalities' such as the availability and quality of centrally provided goods and

Global exchange adjusted income distribution: 1964-1999



services, including safe water and the function of civil society. These contribute substantially to domestic living standards. However, their quality is more likely to correlate with FX than with PPP incomes.

## Haircuts, bricks and racism

National incomes are composed of both traded and non-traded goods and services. The relative cost of the latter largely determines PPP incomes. A country with comparatively cheap non-traded services (a haircut is the classic example) will have comparatively large multiplier. The price of non-tradeables is principally determined by the price of labor and externalities, such as work safety standards. Lower absolute wages in poor countries causes less impoverishment than in wealthy countries because of the lower price structure which permeates poor economies.

In some poor countries, this low wage structure is underpinned not only by poor standards of safety and centrally provided services but also by child and forced labor, debt bondage and slavery. For example, a brick house of identical quality will be substantially cheaper if built in India than Australia. But most of the bricks in India are handmade by families held in inherited debt bondage. The price of bricks is so low that machine-made bricks cannot compete.

Higher PPP-adjusted incomes are also enabled by inadequate social safety nets, including for insurance, health care and retirement. The misfortune of those at the lowest income levels subsidises the purchasing power of higher earners. Although the same analysis—that the labor of the poor subsidises the well-being of the wealthy—also applies in richer countries, the minimum standards of wages and working conditions in such countries are, generally, far superior.

Resources available for collecting PPP data are also very poor. As much as 95% of the total country-year observations are based on extrapolation, rather than repeated measurement. This greatly reduces confidence in the precision and validity of any detected trends in global PPP-adjusted inequality.

But the most important difference between FX and PPP measures of income may relate to international influence. International negotiations such as for the WTO are rarely held in poor countries. US or Swiss hotels do not give discounts to delegates from countries with low FX incomes. Travel by residents of countries with low FX incomes is almost entirely restricted to similarly poor countries. Arguments that the incomes of such populations are far higher than apparent reek of economic racism, particularly if the world is viewed as a single economic unit.

## Rural apartheid

In Australia, proposals occasionally surface for the payment of lower wages to populations living in rural areas where, for example, the price of housing is cheaper. Adoption of such policies would lead to economic apartheid, effectively imprisoning people with lower incomes to permanent residence in economically depressed areas.

Importantly, the reverse is not true. People with higher incomes would retain the freedom to go wherever they care, either living in affluent enclaves, or enjoying bargain basement priced travel in areas populated by the comparatively (and increasingly subservient) poor. PPP measures of income have a role, but they must not be used to justify or disguise economic apartheid on a global scale.