# The Controversy over Global Inequality

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Over the past year, a debate has boiled to the surface over whether global income inequality has been declining or growing service the late 1980s when many countries and institutions embraced a Ragan-Thatcherite view of economics. The issue goes to the very roots of data analysis and touches on important questions concerning the nature of acceptable statistical evidence and how this should be interpreted. The outcome of the controversy has major implications for economic policy. An increase in global inequality poses fundamental questions about the efficacy and allocate efficiency of market economics and its effectiveness in resolving one of the world's most important problems, the persistence of poverty.

Until recent research drew on more extensive raw data, the groundwell of opinion was that, globally, incomes were converging and that this desirable situation arose from the spread of new technologies and the transfer of resources from rich nations to the poor in terms of aid and private foreign investment. Together these were believed to have promoted economic progress in low income countries. Donor countries would embrace this view because it vindicates their overall strategy for poverty alleviation. But a recent paper by Milanovic (2000) using detailed micro data pours cold water on this widely held perception. Far from a gradual closing of the income gap, he argues that income inequality has been growing at least since the end of 1980s. Using the same household survey data which they match to recent purchasing power parity (PPP) estimates of GNP per capita to locate and assess the importance of a national income distribution, Dikhanov and Ward (2000) produce further evidence to support Milanovic's conclusions. They derive a continuous distribution of global income on to which they map the corresponding distribution of global population. These are both measured along a common PPP adjusted logarithmic scale of per capita income. The primary concern of these two authors is to depict the changing extent and incidence of poverty and to measure the disparity of incomes. They note the widening difference between, on the one hand, the distance between the lowest average (decite) income group and the median and, on the other, the distance between the median and highest (decite) income level.

At the outset, it is important to define clearly the scope of this argument. It is about global income inequality. It is not concerned with a more holistic perception of global inequality which would need to incorporate some notional value of the non-marked goods and services delivered by governments and NGOs to individual recipients across the world. This would require a far more specific and sophisticated set of impact measures than is currently available in the existing range of collective social indicators.

It is also not about the distribution of wealth or productive assets which is perhaps even more important in explaining the extent of global inequality. Drawn primarily from household surveys, the concept of income refers to disposable income rather than gross personal income (which includes unrealized capital gains and taxes which can be especially significant) which relates better to consumption and levels of well-being.

The controversy draws attention to three major statistical concerns: -

(i) The over-riding relevance and quality of the basic data;
(ii) The choice of methodology for international comparisons,
(iii) The need to distinguish the separate "between" and "within" differences.

In the first case, the data are not perfect and there is a problem of mapping micro household information ( not necessarily representative) with national accounts data. The re-estimation of observed benchmark numbers, applies official price indices and other indicators to adjust everything to a common reference year basis. As to the second, the studies use PPPs rather than currently reported official exchange rates to convert data expressed in national currencies into a common international unit of account (the dollar). While some econometric techniques are required to extend the PPPs reported for 118 countries to other countries for which such data are not available, the use of PPPs to equalize underlying price level differences obviates the problems caused by the volatility of exchange rates both over time and between countries. In the third, the "within" profiles are based on national household surveys and 'between' differences are calculated from PPP estimates of World Bank GNP per capita. The preferred methodology utilizes a formalized continuous distributor distribution of function, rather than a more disjoint directly derived discrete distribution. The magnitudes involved (which necessitate the adoption of a log scale standard) plus sparsity of observation points underline the desirability of this approach.

The results have direct relevance to economic theory and policy. They throw doubt on the merits of economic growth based mainly on private foreign investment as a means of alleviating the plight of the poor. It poses questions about the role of globalization and it exposes some conceptual weakness of liberal market economics in development theory. In particular, it reveals the error of maintaining "a degree of inequality to create appropriate incentives" to encourage the poor to climb out of their poverty. (As far back as 1776, Adam Smith noted "no lack of energy on the part of the poor in matters of common travail"). New approaches may be required, therefore, to resolve the world's primary moral and economic problem.