Executive Summary

This report highlights the complex, multidimensional nature of inequality in the era of globalization. It documents that despite the impressive strides by nations like China and India, absolute inequality between the richest and poorest countries is greater than ever before in history. It demonstrates that the rise of China and India creates a new dimension to the persistent problem of inequality.

This report's central argument is that, under conditions of high inequality, elites—both international and within individual nations—may create socially suboptimal institutions and policies, and they may resist changes that promote development but threaten their dominance. The high levels of inequality documented here pose a persistent problem for the world. The problem manifests itself in three major ways:

1. International economic inequality enables powerful countries to shape the growth of global markets in ways that limit the benefits globalization might deliver to poorer countries. Similarly, capital flows are shaped in ways that disadvantage poorer nations while increasing the frequency of financial crises.
2. Economic inequality within developing countries often enables elites to establish policies and institutions yielding patterns of development that disproportionately favor their own interests. Domestic inequality also allows them to resist useful institutional changes.
3. Inequality of status within nations may produce hierarchies that empower elites to establish institutions that discriminate against, and marginalize, weaker groups, often provoking resistance that promotes violent conflict.

The problem of inequality will become more urgent as rapidly improving communications and transportation technologies increase people's awareness of it. We conclude there are no universal policy prescriptions. In an increasingly interdependent world, international institutions should be made more accountable to poor countries if they are to maintain their legitimacy and effectiveness . Democracy and capitalism offer the promise of alleviating the problems of inequality in developing countries, but they flourish best only if the peoples of those nations can develop economic and political institutions that reflect their own histories and cultures. In developed countries, policymakers and citizens must learn more about the distinctive conditions in each developing country; their ability to help remedy inequalities depends on

listening to and engaging with social and political goals formulated by actors within those countries. Effective change will be interactive, not imposed.

The report first discusses measures of global inequality, and then examines how international inequality has shaped the world trade regime and financial markets in ways that diminish potential benefits to weaker nations. Next it explains how inequalities within developing countries often warp or diminish economic and infrastructure development, limiting benefits to the poor. Then the report looks at ways in which hierarchies of status produce discrimination, marginalization, and outbreaks of violent conflict within developing nations. Finally, it concludes with issues and institutions to re-examine in order to overcome persistent inequalities.

The report first points out disturbing global trends:

- Inequality between the United States and the world's poorest country, in terms of per capita income, rose from 38.5 to 1 in 1960 to 64 to 1 in 2005.
- In 2000, the wealthiest 1% percent of the world's people earned 415 times more than the earnings of the poorest 1%—up from 216 times in 1980, despite hurtling advances by a few nations.
- The global distribution of household wealth is even more unequal. In 2000, the top 10% of adults (over age 20) in the world owned 85% of such wealth, while the bottom half owned barely 1%.
- From the 1960s to 1990s, domestic income inequality rose in 65% of developing countries, declining in only 13%.
- A population-weighted measure of each nation's GDP comfortingly registers a small decline in inequality in the world from 1967 to 2000. In truth, the entire decline this measure records is due to China's economic miracle. Among the rest of the countries of the world, the trend is toward greater inequality.
- A recent World Bank study warns that only one of the eight Millennium Development Goals it set—that of halving poverty—will be achieved. The failure of wealthy nations to fulfill their commitments to fund foreign assistance will be a key factor if this occurs.

The world trade regime and capital flows show marked inequalities. The huge markets of the U.S. and the European Union give them disproportionate leverage. Being excluded from these markets can be devastating for most developing nations, while exclusion from developing markets means little to the U.S. or Europe. Wealthy countries have used their power to reap benefits at the expense of the poorest countries. At the same time, globalization has given rise to a new economic geography characterized by an upper tier of emerging markets whose economies

are more globally competitive. Will the growing power of countries like Brazil, Russia, India, and China (the "BRICs") benefit poorer countries or will it lead to new inequities? Specific findings include:

- Though developing countries account for less than one-third of imports by developed countries, they pay two-thirds of their tariffs. On average, the U.S. has imposed tariffs on imports from developing countries more than three times higher than those on imports from developed nations. For the poorest countries, U.S. tariffs are more than 10 times higher than tariffs for wealthy OECD nations.
- Agricultural subsidies of rich nations surpass the entire GDP of sub-Saharan Africa, and they amount to six times all foreign aid from rich nations. European cows, each with an implicit income of $2.50 a day from subsidies, have higher incomes than one-third of the world's people.
- Under the new regime for intellectual property rights that was created with the founding of the WTO, 96% of all patent revenues from developing countries go to firms from developed countries. These firms are far more likely to invest these funds to satisfy demand in markets like the United States where health care spending is $4,000 per person than in sub-Saharan Africa where health expenditures are just $20 per person.
- In the 1990s, just six Asian countries plus Mexico accounted for 63.5% of all manufacturing exports from the developing world, even though these countries contain less than 29% of the developing world's population.
- Just 11 nations—with 35% of the developing world's population—received 75% of all foreign direct investment in the 1990s. More recently, Asian nations' FDI share has grown from 23% in 1980 to 62% in 2005, while Latin America's share dropped from 67% to 25%.
- The BRICs—Brazil, Russia, India and China—now comprise more than one-fourth of world GDP and they are 4 of the world's 10 largest economies.
- Chinese investments in Africa are overwhelmingly in extractive industries. African exports to China have grown tenfold since 1995, but they are predominantly primary commodities.

The report next examines how domestic inequalities affect the politics of economic development, with sidebars on India and China. Very great inequalities diminish growth by making property rights less secure, reducing incentives for those at the bottom of the social hierarchy, and hindering efficient operation of labor, capital and product markets. In the past 30 years, the world has seen a dramatic spread of democratically elected governments, from 39 in 1974 to 122 in 2005. Yet domestic inequality has grown in most developing nations. Why? Some findings:

- Economic crises, often caused by greater exposure to international markets, cause greater inequality in developing nations. Poor nations are obliged to

undertake austerity measures that reduce social benefits, while their wealthy disproportionately benefit from fiscal bailouts.

- Though many developing countries adopt the trappings of democracy, the quality of their democratic process has been poor. Of nearly 100 such countries considered in transition to democracy, less than 20 are clearly en route to becoming well-functioning democracies.
- Inequalities cumulate and create the most formidable challenges for those least capable of surmounting them. Lower caste women and female children in India's poorest state of Bihar are not only the least educated (female literacy rates in some districts are below 3%) but also the most malnourished.
- Economic liberalization has coincided with an increase in economic insecurity in many developing countries. One manifestation of this is that the share of workers in the informal economy—where employment is casual and work conditions are not subject to safety and health protections—has grown in Africa, Latin America and Asia. In Africa, 90% of new employment was in the informal sector during the 1980s and 1990s. In Latin America, the figure was 80%.

Next, the report focuses on how developing nations meet the formidable challenge of their social differences. Many nations must democratize while nation-building, and they have often inherited colonial-era boundaries fashioned more for administrators' convenience than demographic reality. The political demands of historically marginalized groups present democratic political systems with what has been called "the post-liberal challenge" to traditional assimilationist policies. The myth of "primordial" ethnic conflict has been exposed by recent studies, which find that peaceful relations are more characteristic of societies with greater ethnic diversity, providing the government is strong and intent on averting conflict rather than weak and controlled by leaders who stir up ethnic conflict for political advantage. That said, violence is a major obstacle to economic advancement:

- Low-income nations are 15 times likelier to have violent civil conflict than the richest countries.
- A significant positive relationship exists between income inequality and violent crime, even after controlling for other causes of crime. A recent World Bank survey of people in developing countries found that, in the minds of the poor, physical insecurity is a more serious problem than poverty.
- Truth and reconciliation commissions in several countries identified economic inequality and political exclusion as major factors promoting cycles of political violence and repression. Studies show that absolute poverty and inequality are correlated with high levels of repression.

- Violence in the world's 52 poorest nations reduced their average per capita growth rate by 2.4% each year.
- Participatory democracy facilitates building good institutions that contribute to higher quality economic growth – growth that is less volatile, better able to adjust to shocks, and which produces superior distributional outcomes.

In conclusion, the report suggests issues and institutions to examine in overcoming persistent inequalities at a time when global differences, increasingly visible to people throughout the world, call into question the legitimacy of international institutions. Among these issues and institutions are:

- The World Trade Organization process, TRIPs, tariffs and subsidies in wealthy countries.
- Excessively restrictive bilateral and regional trade agreements.
- Carefully liberalizing barriers to international labor markets.
- Capital account liberalization that takes account of distinctive conditions in LDCs, especially their poorly-developed regulatory institutions.
- Reforming market reforms in developing countries that promote elite interests without improving economic welfare and security for the whole society.
- The important role in achieving high quality economic growth in poor countries played by more participatory and accountable democratic institutions through their more equitable enforcement of the rule of law, political and property rights, civil liberties and their more equitable investments in human and physical capital.
- More sophisticated attention by developed nations to differences among LDC societies, cultures, and government structures in framing aid and investment policy.