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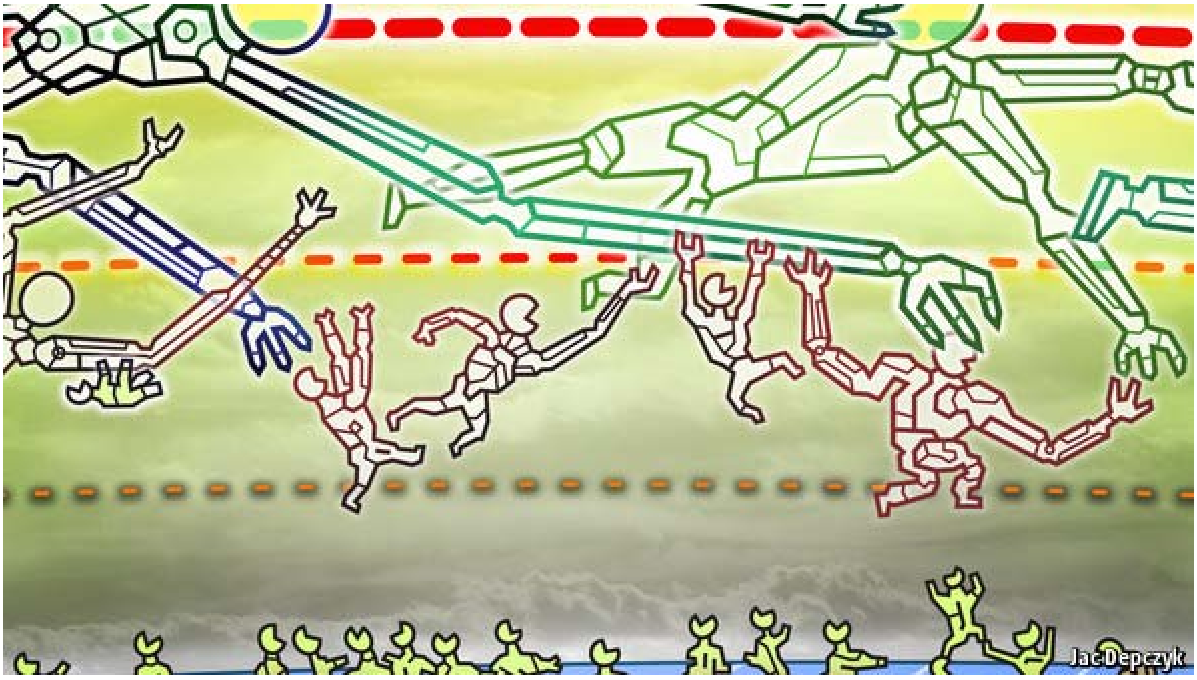
Revisiting Ricardo

Why globalisation is not reducing inequality within developing countries



DEFENDERS of globalisation often say that, whatever distress it may cause for rich-world workers, it has been good for poor countries. Between 1988 and 2008, global inequality, as measured by the distribution of income between rich and poor countries, has narrowed, according to the World Bank. But within each country, the story is less rosy: globalisation has resulted in widening inequality in many poor places.

This can be seen in the behaviour of the Gini index, a measure of inequality. (If the index is one, a country's entire income goes to one person; if zero, the spoils are equally divided.) Sub-Saharan Africa saw its Gini index rise by 9% between 1993 and 2008. China's soared by 34% over 20 years. In few places has it fallen.

Economists are puzzled: the data contradict the predictions of David Ricardo, one of the founding fathers of their discipline. Countries, said Ricardo, export what they are relatively efficient at producing. Take America and Bangladesh now. In America the ratio of highly skilled to low-skilled workers is high. In Bangladesh it is low. So America focuses on products requiring highly skilled labour, such as financial services and software. Bangladesh focuses on downmarket products such as garments.

Comparative advantage predicts that when a poor country starts to trade globally, demand for low-skilled workers will rise disproportionately. That, in turn, should boost their wages relative to those of higher-skilled locals, and so push down income inequality within that country. The theory neatly explains the impact of the first wave of globalisation. In the 18th century, Europe had a high ratio of low-skilled workers relative to America. When Euro-American trade took off, European inequality duly tumbled. In France in 1700 the average real incomes of the top 10% were 31 times higher than the bottom 40%. By 1900 (admittedly after several revolutions and wars) they were 11 times larger.

But growing inequality in developing countries leaves Ricardo's disciples befuddled and suggests the theory needs updating. Eric Maskin of Harvard University has attempted just this at the Lindau Meeting on Economic Sciences, a get-together of economists in a Bavarian lakeside town featuring many Nobel laureates. (Mr Maskin won his in 2007 for his work on the design of market mechanisms, which economists use to improve regulation schemes and voting systems.)

Mr Maskin's theory relies on what he calls worker "matching". Unskilled workers can be more productive when matched with skilled ones—that is, when they work together. Assigning a manager to a group of workers can do more for total output than just adding another worker. He places workers into four classes: skilled workers in rich countries (A); low-skilled workers in rich countries (B); high-skilled workers in poor countries (C); and low-skilled workers in poor countries (D). Crucially, he thinks low-skilled workers in rich countries (the Bs) are likely to be more productive than high-skilled workers in poor ones (the Cs).

Before the current wave of globalisation started in the 1980s, skilled and unskilled workers in developing countries—the Cs and Ds—worked together. Mr Maskin gives the example of a rural Indian man, fluent in English, who helped local farmers understand modern agricultural methods. Wage growth of high-skilled workers (Cs) was weak, because poor transport and communication links made it hard for them to work with skilled workers in rich countries. But low-skilled workers (Ds) did well: their interactions with the Cs boosted total output, which let them demand higher wages, so pushing down inequality.

The latest bout of globalisation has jumbled the pairings: high-skilled workers in poor countries can now work more easily with low-skilled workers in rich ones, leaving their poor neighbours in the lurch. Take "intermediate goods", the semi-finished products that account for about two-thirds of world trade. The production processes outsourced by big companies in factories or call-centres are by rich-world standards unskilled. But when jobs are sent offshore, they are snapped up by C workers, the relatively skilled ones. According to research from Cornell University, the typical call-centre employee in India has a bachelor's degree.

Globalisation in its latest guise means such workers come into more regular contact with less-skilled people in the rich world. The Anglophone Indian cited by Mr Maskin may go to work in an export factory where he meets tight deadlines laid down by its American owners. The Cs work with Bs and end up being more productive. The Ds are left by the wayside.

D-graded workforce

The result of booming trade in intermediate goods is higher demand and productivity for skilled poor-country workers. Higher wages ensue: multinationals in developing countries pay manufacturing wages above the norm for the country. One study showed that in Mexico exportoriented firms pay wages 60% higher than non-exporting ones. Another found that foreign-owned plants in Indonesia paid white-collar workers 70% more than locally owned firms.

Globalisation, though, does not boost wages for all. The least skilled cannot “match” with skilled workers in rich countries; worse, they have lost access to skilled workers in their own economies. The result is growing income inequality.

Mr Maskin’s approach is not entirely satisfying. He does not offer data to back up his theory (such is the privilege of the Nobel laureate). “We need micro-data on matches between firms in developing countries to examine whether skilled workers benefit through the mechanism Mr Maskin suggests,” says Pinelopi Goldberg of Yale University. But if he is right, he poses a challenge to globalisation’s advocates: figuring out how to reap its rewards without leaving the least-skilled in poor countries behind.