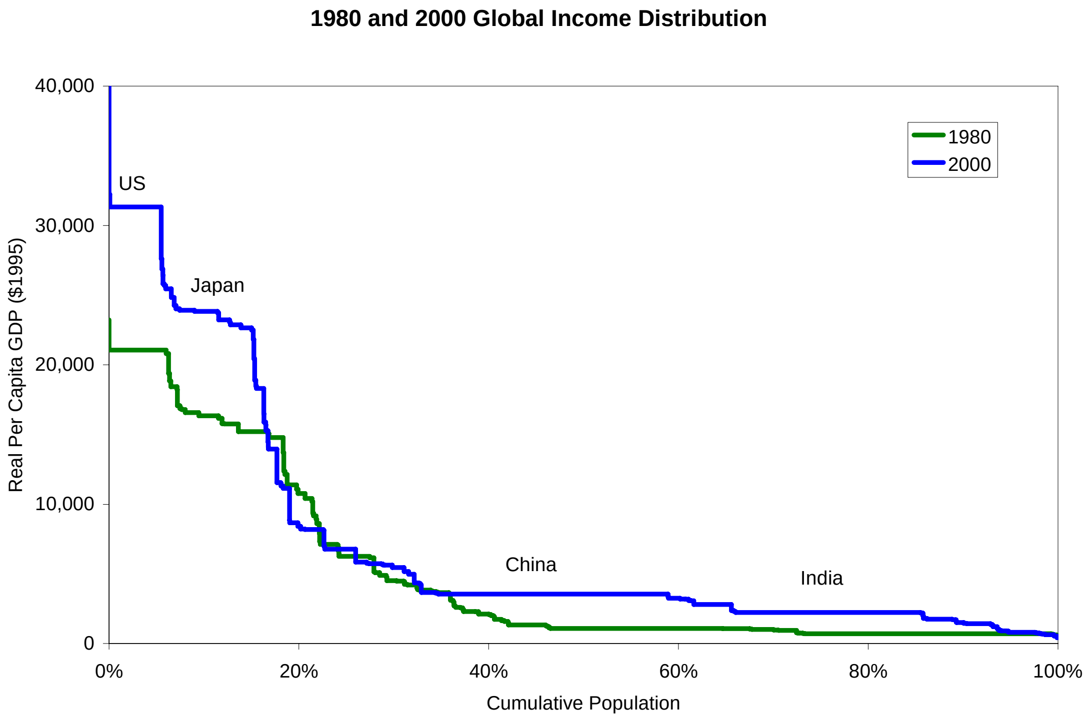
The Rich(and Poor) Keep Getting Richer
By Ed Leamer and Peter K. Schott

Fact: Earnings have risen for the poorest and the wealthiest countries, while earnings of the world's middle class countries have stagnated.



This chart compares the per capita gross domestic product (pcGDP) of the world's countries in 1980 with their pcGDP in 2000. Each country is represented by a horizontal line segment, with the segment's vertical position indicating the country's pcGDP, and its length indicating the country's share of the world's population. Thus the U.S., with its small population and high pcGDP appears as a short horizontal line high up. China (large population, low pcGDP) appears as a long line near the bottom.

In 1980, isolationist barriers in low-wage countries like India and China prevented businesses in high-wage countries from employing the poorer nation's cheap labor. Many believed that eliminating these barriers would unleash a flood of outsourcing that would concentrate GDP growth in low-wage countries at the right of the graph and reduce wages in developed countries on the left. That hasn't happened. While the 60% of the world's people living in poorer countries have seen substantial pcGDP growth since 1980, so have the 20% who live in wealthy countries. It's the globe's middle class – 20% of the world's people – whose earnings have stagnated.

Why is this? Media reports notwithstanding, global competition has not been very intense between the poorest and the wealthiest countries. Few of the labor-intensive products made in India and China are also made in high-income countries. Consequently, workers in wealthy countries have not felt the force of competition from low-wage producers. Middle-class countries, however, have not escaped direct competition with these poorer nations. This is not likely to change anytime soon. Technological advance will continue to drive growth in the high-income countries, while the middle class and the poor compete for the mundane work. In that competition, large, poorer nations – by virtue of their vast labor supply – will retain the upper hand. Businesses' should weigh this continued dispersion of growth in building their global strategy. Avoid strategies premised on high growth in the middle-income markets. Look for strong growth in the same places that had strong growth from 1980 to 2000: the wealthy and select poor countries.

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HOMEWORK PROBLEM:

Design a Heckscher-Ohlin Model that Can Explain These Facts