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Does Economic Globalization affect Regional Inequality? A Cross-country Analysis

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Summary. — This paper investigates the relationship between economic globalization and regional inequality in a panel of 47 countries over the period 1990–2007, using a measure of globalization that distinguishes the different dimensions of economic integration. The results show that there is a positive and statistically significant association between economic globalization and the magnitude of regional disparities. Countries with a greater degree of economic integration with the rest of the world tend to register higher levels of regional inequality. This finding is robust to the inclusion of additional explanatory variables and to the choice of the specific measure used to quantify the relevance of spatial inequality within the sample countries. Our analysis also reveals that the spatial impact of economic globalization is greater in low- and middle-income countries, whose levels of regional disparities are on average significantly higher than in high-income countries.
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Key words — regional inequality, economic globalization

1. INTRODUCTION

The territorial impact of globalization remains a hotly debated topic (e.g., Bhagwati, 2004; Stiglitz, 2002). The unprecedented levels of integration have surpassed the previous peak reached before the First World War (Findlay & O'Rourke, 2007) and are leaving a profound imprint on economic growth (Alcalá & Ciccone, 2004; Frankel & Romer, 1999), income inequality and poverty (Milanovic, 2005a; Wade, 2004), labor markets (Dreher & Gaston, 2007; Tomohara & Takii, 2011), environmental quality (Antweiler, Copeland, & Taylor, 2001; Frankel & Rose, 2005), democracy and human rights (Dreher, Gassebner, & Siemers, 2012; Rudra, 2005), or the quality of government (Al-Marhubi, 2004; Ezcurra, 2012).

Globalization also has an important impact on regional inequality (i.e., inequality across the various regions within a country) worldwide (e.g., Rodríguez-Pose, 2012; Rodríguez-Pose & Gill, 2006). However, our understanding of the link between globalization and regional inequality is still highly partial. Previous contributions to this field have tended to measure the incidence of economic globalization using mostly different indicators of the degree of trade openness of the countries considered. While from a policy perspective, the relationship between trade openness and regional inequality is undoubtedly relevant (World Bank, 2008), the degree of trade openness is not an adequate measure to capture the incidence of other aspects of economic globalization, such as the extent of capital controls or the amount of Foreign Direct Investment (FDI). This is potentially important as it is not evident that the various dimensions of economic globalization affect regional inequality in the same way. Thus, the impact observed for one aspect may be caused by the omission from the analysis of other important aspects of economic integration. Overlooking capital controls or FDI, while focusing exclusively on levels of trade, can seriously affect our perception of the relationship between globalization and spatial inequality (Dreher, 2006).

This paper aims to overcome this omission in the literature and to provide a comprehensive analysis of the relationship between economic globalization and regional inequality. In order to achieve this aim, we use the KOF index of globalization constructed by Dreher (2006) and updated by Dreher, Gaston, and Martens (2008). This aggregate index distinguishes between the different aspects of economic integration, which allows us to adopt a broader perspective than existing studies. We are thus capable of approaching the analysis of the effects of economic globalization on regional disparities taking into account the challenges posed by integration in a more comprehensive way than hitherto and to identify who wins and who loses, not only within each country, but also across countries.

The remainder of the paper is organized as follows. After this introduction, Section 2 provides a necessarily brief review of the theoretical and empirical literature on the link between globalization and spatial inequality. Section 3 describes the different measures used in our study to quantify the incidence of globalization and regional inequality in the sample countries. Section 4 presents the empirical analysis carried out in the paper to examine the relationship between economic globalization and regional inequality. The final section offers the main conclusions from our work.

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2. ECONOMIC GLOBALIZATION AND SPATIAL INEQUALITY IN THE LITERATURE

Although globalization and spatial inequalities on their own have attracted considerable attention in recent years, their relationship has, somewhat surprisingly, been overlooked by the scholarly literature (Brülhart, 2011; Rodríguez-Pose, 2012). This contrasts with the large interest accorded over the last two decades to the impact of economic integration on growth (e.g., Alcalá & Ciccone, 2004; Alesina, Spolaore, & Wacziarg, 2000; Frankel & Romer, 1999), and interpersonal inequality and poverty (e.g., Dollar & Kraay, 2004; Dreher & Gaston, 2008; Milanovic, 2005a; Wade, 2004). The situation, however, has begun to change recently, coinciding with the resurgence of interest in economic geography and with the improvements in the availability and quality of regional data.

From a theoretical perspective, the development of the so-called "new economic geography" (NEG) has played a crucial role in pushing forward the early interest of some neoclassical studies (e.g., Henderson, 1982; Rauch, 1991) on the analysis of the consequences of rising trade—as trade with the rest of the world became less costly—on the spatial distribution of economic activity within a country. While early urban systems models were based on the assumption of perfectly competitive markets with exogenous scale economies at the regional level, and lacked a welfare-relevant dimension of spatial inequality (Brülhart, 2011), the emergence of the NEG school has allowed for monopolistically competitive markets and endogenous regional scale economies.[1] Within this framework, the NEG has conceptualized the effect of economic integration on the spatial distribution of income in terms of changes in cross-border access to markets that affect the interactions between agglomeration and dispersion forces.

The NEG has provided a framework for determining the dynamics of the location of economic activity across regions within a country, which has led to the publication—beginning with the seminal paper by Krugman (1991)—of numerous theoretical models concerned with the spatial implications of trade integration over the last 20 years. These models tend to employ different sets of assumptions and functional forms, which has resulted, however, in contradictory and ambiguous conclusions. While some of the proposed models (e.g., Alonso-Villar, 2001; Behrens, Gaigne, Ottaviano, & Thisse, 2007; Krugman & Livas Elizondo, 1996) suggest that trade liberalization increases the internal dispersion of economic activity, thus reducing the level of spatial inequality, others (e.g., Monfort & Nicolini, 2000; Monfort & van Ypersele, 2003; Paluzie, 2001) point toward a link between trade integration and internal agglomeration, which gives rise to greater regional disparities. It is difficult to determine a priori which type of model provides a better representation of reality (Brülhart, 2011). Empirical research is therefore key to shedding light on the spatial implications of economic integration. Yet, the number of empirical analyses on the topic so far is relatively limited.

Most existing empirical analyses on this issue tend to be based on single-country case studies, reflecting the scarcity and limited reliability of regional comparable data sets across countries. In particular, the literature has paid special attention to the experience of two emerging countries: China and Mexico. The results of analyses dealing with China (e.g., Jian, Sachs, & Warner, 1996; Kanbur & Zhang, 2005; Zhang & Zhang, 2003) are far from conclusive, but tend to suggest that the process of trade liberalization has played a relevant role in explaining the important increase in the level of regional inequality registered over the last two decades. In China openness to international trade and capital flows have benefited mostly to the developed coastal regions, often at the expense of the less accessible and poorer inland provinces (World Bank, 2008). Studies dealing with Mexico (e.g., Faber, 2007; Jordaan, 2008; Sánchez-Reaza & Rodríguez-Pose, 2002) also tend to highlight a positive association between the evolution of regional inequality and the rise in the degree of trade openness. The integration of Mexico in the General Agreement on Tariff and Trade (GATT) and the North American Free Trade Agreement (NAFTA) contributed to the development of states bordering the US and to further industrialization in and around the former economic hubs of the Centre of the country, while the more impoverished South languished behind.

In stark contrast to the number of single-country case studies, there are few cross-country analyses to date addressing the spatial implications of a greater degree of economic integration. In a recent review of this literature, Brülhart (2011) only identifies 11 cross-country studies exploring this issue. The majority of these papers use an indicator of urban primacy as dependent variable, which does not allow to properly discern the extent to which changes in trade patterns influence regional convergence or divergence trends. Research by Rodríguez-Pose and Gill (2006) and Rodríguez-Pose (2012), by contrast, tackles the spatial consequences of trade openness head on. These analyses use different measures of spatial inequality in order to quantify the relevance of regional disparities within the sample countries. Rodríguez-Pose and Gill (2006) focus their attention on eight countries—Brazil, China, Germany, India, Italy, Mexico, Spain, and the United States—over various time spans during 1970–2000. The authors conclude that there is no clear-cut connection between changes in the degree of trade openness and regional inequality, although the association seems to be stronger when sectoral shifts in trade composition are considered. Rodríguez-Pose (2012), using a range of panel data techniques, examines this issue in a sample of 15 developed and 13 emerging countries throughout the period 1970–2005. His results show that trade openness has a positive and statistically significant association with regional inequality in combination with certain country-specific conditions. Rodríguez-Pose (2012) also finds that the spatial impact of international trade is greater in low- and middle-income countries than in high-income countries.

A limited number of additional studies not dealing specifically with the spatial implications of trade liberalizations include a measure of the degree of trade openness as a control variable in cross-country regressions whose dependent variable is an indicator of within-country spatial inequality. The results obtained by these studies are not conclusive. Some papers report that greater trade openness leads to higher levels of regional disparities (Rodríguez-Pose & Ezcurra, 2010), while others find that the relationship is not statistically significant (Milanovic, 2005b), or depends ultimately on the countries included in the sample (Petrakos, Rodríguez-Pose, & Rovolis, 2005).

One important characteristic of all the above-mentioned cross-country analyses is that they use different measures of trade openness to examine the spatial consequences of economic globalization. While this approach is undoubtedly useful in order to investigate the impact on regional disparities of changes in trade patterns, it neglects the role played by other potentially important dimensions of economic integration. Trade is not the only factor driving economic globalization. As has been noted by the literature on the death of distance, in a more integrated world firms and companies are becoming much more mobile and pursuing integration strategies

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