Globalization, Growth, and the Poor

by

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Jeffrey Williamson (2002) points out that “the world has seen two globalization booms over the past two centuries and one bust. The first global century ended with World War I and the second started at the end of World War II, while the years in between were ones of anti-global backlash” (1). The percent of the world population living in extreme poverty ($1 a day, inflation adjusted), meanwhile, declined from 84 percent in 1820 (the beginning of the Williamson’s first global century) to 66 percent in 1910 (just three years before its end). The ongoing second global century, which began in 1950, saw this portion decline, from 55 percent in 1950 to 24 percent in 1992, and no doubt it is even lower in 2003. In the inter-war period of anti-globalization backlash, the proportion was probably stagnant on the average.[1] Although poverty estimates based on a global poverty line for a time span of more than a century are obviously subject to wide margins of error, other non-income-based indicators, such as those of health, nutrition and literacy corroborate the broad picture.

The historical association between globalization and poverty reduction, however, hides substantial variations among countries and also within countries in their experiences with international economic integration. Several decades of rising trade and capital flows, growing

[1] Bourguignon, et al. (2002).

numbers of multinational conglomerates, and increasingly globalized cultural interchange have not silenced the public debate over the merits of globalization. The violent street demonstrations surrounding the ministerial meeting of the World Trade Organization (WTO) and similar protests at World Bank and International Monetary Fund meetings suggest that this debate is still going strong.

Much of the debate appears to be about whether globalization has been good for the poor. There is less debate regarding the positive effects of trade liberalization on growth, and the potential growth-accelerating effects of capital market integration once domestic financial sectors are strengthened. Recent debates have instead focused on whether the benefits of accelerated growth reach the poor and over what time frame they do. Critics' claims that income inequality has risen with globalization-led growth in many countries (claims difficult to assess without more reliable data than are available for many countries) fuel some of the skepticism, even though a rise in inequality need not mean that the poor are worse off than before.[2] The recognition that growth plays an instrumental role in improving the quality of life and reducing poverty does not mean that all mechanisms and policies promoting growth also reduce poverty or that the lags between growth acceleration and poverty reduction are short. However it seems improbable that growth could harm the poor over the longer run.

Jan Tinbergen thought deeply on the distributional issues in general and in particular on the instrumental role of growth for poverty reduction. He argued:

[2] It is not clear that greater openness is, in fact, associated with increased inequality. Berg and Krueger (2003)'s survey of empirical evidence on the linkage between trade, growth, and poverty reduction finds only mixed evidence, with the majority of studies finding that growth does not lead to significant increases in inequality.

> "… the most important single figure representing the set of [goals for improvement of the quality of life] is the rate of growth of real product in the developing world. This is because production is the source of financing social measures, because production implies elements such as food, housing, education, and other social services, because employment is directly dependent on the volume of production envisaged, and because more equal income distribution can be more easily obtained from a high than from a low average income." (12).

Earlier writers (e.g. Lewis (1955), Appendix entitled, "Is Economic Growth Desirable?") had also examined the pros and cons of growth from the perspective of the poor and concluded that pros outweighed the cons.

Several plausible links in the globalization-growth-poverty reduction chain can be postulated in theory, yet the reality is far more complicated and many links could be absent in some countries at some points in time. Agenor (2003), for example, finds that globalization may have a U-shaped effect on poverty: while extensive integration reduces poverty, small amounts of globalization may hurt the poor.[3] Even in theory, not all links need be unidirectional—thus, it is possible that in some links, globalization influences growth positively but the character of growth increases poverty. This being the case, protesters find it easy enough to blame the process of globalization for any observed or imagined deterioration in the condition of the poor rather than look for the missing links or for other factors that could have muted or outweighed the beneficial effects of globalization. Enthusiasts find it equally easy to argue that observed outcomes deviate from globalizations' predicted contributions to poverty reduction only because

[3] The paper presents a variety of theoretical reasons for this finding, though the composite index of "globalization" – a weighted average of trade and financial openness – is difficult to interpret, however, in the context of his cross-country study.

globalization has not gone far enough. It would seem that both sides focus selectively on some aspects of globalization while ignoring that other processes besides globalization also influence the observed outcomes[4].

We focus in this paper on the mechanisms through which globalization could be expected to contribute to poverty reduction and why these expectations have not necessarily been met. In theory, greater international integration should play an important part in reducing poverty around the world. In practice, it has had mixed effects due to domestic policy shortcomings, continued industrial country protectionism, and limited labor market integration across countries. In practice, many of the ways in which globalization is perceived as harmful to the poor are not intrinsic aspects of global integration. They reflect, rather, domestic policy failures such as segmented and distorted internal markets as well as industrial country protectionism and limited labor market integration across countries.

We divide the paper into four sections: i) globalization and growth, ii) growth and poverty reduction, iii) globalization and poverty reduction, and iv) globalization for the poor. The first section summarizes the underlying theory and empirical evidence for the globalization-growth linkage, while the second discusses empirical evidence for the connection between growth and poverty reduction sequence. While there are many mechanisms in theory for expecting greater integration to increase growth and reduce poverty, the theory is not without caveats, and the empirical evidence is not conclusive. The effect of globalization on inequality, in particular, is ambiguous. The third section provides a conceptual analysis of how globalization could be

[4] Deardorff (2003) goes so far as to suggest that globalization's critics are motivated by a different understanding of how the world works than the globalization supporters.

expected to reduce poverty by reducing market distortions that disproportionately affect the poor. We argue in the last section that remaining industrial country protectionism, particularly in agriculture, as well as continued restrictions on international labor mobility are key areas for reform.

This division simplifies the discussion of the effects predicted by economic theory and the policy changes we need to achieve these effects. There are clearly additional links among the three phenomena and all three are endogenous outcomes of countries' varying economic and social processes.

The Poor

For most of this paper, we define the "poor" as those whose income or standard of living is below what the society in which they live deems a minimum that all its members ought to have.[5] These standards vary widely across nations and the poorest in a rich country may be well-off from the perspective of an average person in lower-income countries. We focus on those whose resources are below country-specific poverty lines, rather than those below a global poverty line (such as $1 a day) because the latter suffer from serious conceptual and measurement problems.

[5] Operationally, this social minimum is often identified with the value of a specific bundle of goods and services that can be obtained through home production, market purchases and public provisions. Defining a poverty bundle for individuals is difficult enough, but extending the definition to households with many members and differing age-sex compositions is fraught with additional difficulties. Valuation is also difficult: Deaton (2001a), for example, shows that using a price index based on prices actually paid by households rather than an official consumer price index, "reduces" the number of the poor (as measured by the proportion of population consuming less than the poverty line) in urban India in 1999-2000 from around 254 million to 181 million.

We also distinguish here between absolute poverty and relative deprivation, or inequality. Inequality can rise, even as the numbers in absolute poverty decline. Understanding globalization's effects on relative deprivation is important for understanding some of the obstacles to further integration, but our focus here is on how globalization affects national poverty.[6]

Globalization and Growth

The terms "globalization" and "growth" lump together several different phenomena. Globalization might mean capital market integration, goods and service market integration, migration agreements, cultural interchange, or some combination of all of these. We refer to these separately. We similarly distinguish between forms of growth in the discussion of theory, though the empirical section does not distinguish between steady state (long-run) growth, and growth during transitions to a steady state.

Theory

There are essentially three sources of economic growth: growth in inputs of production; improvements in the efficiency of allocation of inputs across economic activities; and innovation that creates new products, new uses for existing products, or brings about more efficient use of inputs. The combination of changes in these three dimensions that brings about higher long-run

[6] More generally, however, the effects of poverty on human well-being include peoples' feelings of deprivation relative to those around them. Sen (1981, Chapter 2) discusses these and other concepts of poverty. Tinbergen (1971) calls for more research on the intensity of peoples' feelings about what others around them are consuming as a way of obtaining more information about individuals' welfare at some consumption level (5).

growth (as opposed to short-run transition effects) depends on the economy's characteristics. Whether or not a change in rate of accumulation of a factor of production or the efficiency of factor allocation, for example, has long-run or only transitional effects on growth depends in part on the technology of production. An exogenous change in the rate of investment or opening the economy to foreign trade has only a transitional effect on growth in a Solow type two-factor (capital and labor) constant-returns-to-scale growth model if the marginal product of capital declines to zero as capital increases indefinitely relative to labor. On the other hand, if the technology is such that the marginal product of capital is bounded away from zero, transitional as well as steady state growth effects could arise from an exogenous change in investment or foreign trade policy.[7]

Being open to trade and investment contributes to each of the three sources of growth. Domestic resources are allocated more efficiently when the economy can specialize in those activities in which it has comparative advantage. By being open to capital, labor and other resource flows, an economy is able to augment relatively scarce domestic resources and use part of its abundant resources elsewhere where they earn a higher return. Clearly, efficiency of resource use in each nation and across the world is enhanced by the freedom of movement of resources. Finally, the fruits of innovation anywhere in the world become available everywhere in such an open world. Empirical studies suggest total factor productivity (TFP) in poor countries, which do not have domestic research and development (R&D) capacities, is higher when their trade with industrialized countries who account for the bulk of R&D in the world is greater.[8]

[7] Srinivasan (1995).
[8] e.g., Coe, Helpman, and Hoffmaister, 1998

Theory also suggests that globalization and growth have a self-reinforcing relationship, in that higher growth spurs a larger volume of trade flows. While the decision to alter policies to further integration is a policy change that harnesses trade as an "engine of growth," trade also serves as the "handmaiden" of growth once policies support freer interchange of goods and services.[9]

Domestic institutions, however, can offset the contributions of liberalization to growth by limiting labor flexibility, segmenting internal markets, and failing to provide the social infrastructure for education. The traditional argument about static factor price effects and gains from trade, for example, assumes that resources move smoothly and costlessly from import competing to exporting activities. Obviously, if resources cannot or do not move, exporting industries would not expand, while import competing industries surely contract because of increased competition from imports after trade liberalization, thus creating unemployment. This somewhat extreme but elementary argument has been raised by Stiglitz (2002, p. 59) against trade liberalization when he says that: "It is easy to destroy jobs, and this is often the immediate impact of trade liberalization, as the inefficient industries [those created under the protectionist walls] close down under pressure from international competition." Since he assumes that no new, more efficient jobs would be created, he concludes that "moving resources from low-productivity uses [in inefficient industries] to zero productivity [to unemployment] does not enrich any country…" True, but neither does keeping factors in less productive uses forever. There may be a rationale for credibly committing to phase in trade liberalization over a period

[9] The phrases "engine of growth" and "handmaiden of growth" are associated with Dennis Robertson (1940) and Irwin Kravis (1970), respectively.

while at the same time removing impediments to labor mobility, but certainly not postponing liberalization indefinitely, as is sometimes argued.[10]

Globalization's effect on short-term growth also depends upon the exact forms of globalization and pre-existing market distortions. Removing barriers and controls on financial capital flows, for example, may improve resource allocation and give more people access to better-functioning credit markets in the long run. In the short term, on the other hand, it can lead to crisis and lower growth in countries with fragile domestic financial sectors. Capital controls have been advocated by many in the wake of the Asian financial crisis, and some find that controls were useful in helping some countries recover faster than those that had freer capital movements.[11]

To sum up, there is no reason to presume that the effects of globalization on growth have to be the same everywhere and at all times or even if they are similar, that they operate with the same intensity. This variation in country experiences is as important as the expected positive effect of globalization on growth.

Empirical Evidence

Theoretical formulations of a trade-growth linkage are foundations of the globalization-growth links. Empirical demonstrations of the linkage go back to the careful and nuanced cross-country studies in the late sixties and seventies sponsored by OECD (Little, Scitovsky and Scott, 1970), and NBER (Bhagwati, 1978; Krueger, 1978). More recent studies based on simple cross-

[10] Tinbergen (1962) suggests, for example, that subsidies be given to retrain workers and facilitate the transfer of capital from declining industries to new, more dynamic sectors. (42).
[11] Mussa (2000). See Kaplan and Rodrik (2001) on the second point.

country regressions (e.g. Sachs and Warner (1995)) asserting the same linkage have been controversial, though the questions are more about the magnitude than the sign of the linkage between trade and growth.[12] Wacziarg and Welch (2002) find that the Sachs and Warners' cross-sectional results are somewhat weaker when the sample period is extended through the 1990s. Their estimates, however, show that openness has positive effects on growth and investment rates within countries.

Nevertheless, the positive effect of trade and growth emerging from the earlier studies appears to be robust when carefully evaluated using more recent data. Dollar and Kraay (2000a) attempt to respond to some of Rodriguez and Rodrik's econometric criticisms in evaluating the trade-growth linkage for countries—mostly developing countries—that liberalized after 1980.[13] They relate decadal changes in trade volumes (which they see as a better—though not perfect—proxy for changes in trade policy) and decadal changes in growth. Their focus on changes mitigates the effect of geography on growth (and trade) through channels other than trade policy, while their inclusion of "time dummies" controls for shocks common to all countries included in their analysis. By focusing on within country changes in trade and growth, they find a strong positive relationship between the two, and no systematic relationship between changes in trade and changes in household income inequality.

[12] Rodriguez and Rodrik (2000) are the most recent critics, though Warner (2002) refutes the Rodriguez-Rodrik critique. He essentially argues that their finding that the effect of trade openness on growth is not statistically robust are due to the fact that the forms of protectionism vary across countries so that any single indicator of openness will not describe the effective level of integration for all countries.

[13] Whether or not a country is defined as a globalizer is based on the decline in trade-weighted average tariffs and the increase in constant price value of trade (exports plus imports) relative to real GDP. Among the top 40 countries according to each of these two criteria, 16 (including Brazil, China, and India) appear on top in both. Unsurprisingly, none of the African countries is among them, though Ghana and Uganda, two African economies that came closest to their threshold were included in the analysis.

Individual country experiences bear out these cross-country trends. World Bank (2002, Table 1) data show that both China and India enjoyed historically unprecedented average annual rates of growth of GDP of around 10 percent and 6 percent, respectively, as the two countries engaged in opening their economies to foreign trade and investment over 1980-2000. The effect is not entirely attributable to "globalization," as both countries also engaged in domestic economic reforms allowing a greater role for markets and the private sector in the economy, but integration no doubt played a large role.

Growth and Poverty Reduction

Aggregate growth is undoubtedly an instrument for poverty reduction, and it is associated with improvements in the minimum standard of living over some time horizon. Besley and Burgess (2003)'s estimates for the elasticity of poverty with respect to income per capita vary widely across country samples, but all are negative, implying that growth reduces poverty.

This association between growth and poverty reduction, however, could take a long time to be seen. Inequality - which is different conceptually and empirically though as salient as poverty in the eyes of critics - does not necessarily drop with growth. Although the poor may be becoming better off over time, the rich could gain even more. There are many possible mechanisms through which aggregate growth could affect, positively or negatively, poverty at national or sub-national levels on the one hand, and on the other, how levels and trends in poverty could influence growth, again in either direction. The basic mechanisms behind growth and poverty reduction do not fully overlap, and some policies meant to encourage growth will have little or

negative effect on the poor in the short run. These lags can affect the political feasibility of reforms.

It is clear, however, that poverty reduction requires growth, particularly in lower-income countries. The available resources may not, in some cases, provide adequately for all no matter how the country's income is distributed. An early blueprint for development in India, for example, clearly recognized the instrumental role of growth for poverty reduction and specifically estimated the extent of growth necessary to meet a minimum standard of living for all. Its objective:

> was to insure an adequate standard of living for the masses; in other words, to get rid of the appalling poverty of the people . . . the irreducible, in terms of money, had been estimated by economists at figures varying from Rs. 15 to Rs. 25 per capita per month (at prewar prices) . . . *[To] insure an irreducible minimum standard for everybody, the national income had to be greatly increased*, and in addition to this increased production there had to be a more equitable distribution of wealth. We calculated that a really progressive standard of living would *necessitate the increase of the national wealth by 500 or 600 per cent*. That was, however, too big a jump for us, and we aimed at a 200 to 300 per cent increase within ten years." (Nehru 1946, pp. 402-3 emphasis added).

Indian policy makers were by no means unique in seeing rapid income growth as the major instrument for poverty reduction—statements similar to those of the Indians could be found in development plans of many other countries.

A positive association between growth and reduction in poverty is seen in several large countries with a high incidence of income poverty, such as China, India, Indonesia (until the financial crisis) and the Philippines. Angus Deaton (2001b) estimated the proportion of poor in India's rural (urban) population in 1987-88 to have been 39 percent (25 percent). By 1999-2000, the proportion had fallen to 23 percent (13 percent) in rural (urban) areas. Annual data for earlier years suggest that rural and urban poverty proportion fluctuated with no downward trend until 1977-78, when it was 51 percent (41 percent) in rural (urban) areas (Datt, 1998, 1999). It is no coincidence that significant reductions in poverty since 1980 were associated with a near tripling of per capita GDP growth to an average of around 4% per year during 1980-2000 as compared to 1.25% during 1950-80.

According to Park and Wang (2001) official data for China show that rural poverty has been virtually eliminated in China--falling from 31 percent of rural population in 1979 to 10 percent in 1990, and further to 5 percent in 1998. The two authors also point out that World Bank estimates (based on a different poverty line and estimation methodology) put rural poverty at 43 percent in 1990 and 24 percent in 1997. Although, as is to be expected, given the use of different poverty lines, the estimated level of poverty differs between official and World Bank sources, the trend is similar—namely, a halving of poverty between 1990 and 1998. For the longer period of 1979-1998, official data show an association between rapid growth and poverty reduction.

A few sub-Saharan African countries, such as Botswana, Lesotho and Mauritius, also enjoyed high growth resulting in a reduction in those nations' poverty. The association with income

growth of non-income facets of poverty is also evident (Table 1): there has been a general improvement of life expectancy, rates of infant and child mortality, educational attainments, and so on, although some of the gains achieved are being threatened by the AIDS epidemic in some countries of sub-Saharan Africa and Asia. Many developing countries experienced significant growth only during the 1990s, a time period too short to see significant reductions in poverty.

While these specific cases suggest that growth reduces poverty, systematic statistical results are limited.[14] Dollar and Kraay (2000b) is perhaps the most careful (econometrically) study.[15] They define the poor as "the bottom one fifth of the population" so that poverty goes down from their perspective if and only if the mean real income of the bottom 20 percent goes up.[16] Their data on income of the poor and mean income relate to 80 countries covering four decades, providing 236 episodes for evaluating the link between aggregate income growth and poverty reduction. They estimate variants of a basic regression of the logarithm of per capita income of the poor on the logarithm of average per capita income, control variables and a country fixed effect.[17]

Their results suggest that, notwithstanding the variation around the estimated relationship, the positive effect of growth on income of the poor is the same in rich and poor countries. Other findings include that the incomes of the poor do not fall more than proportionately during economic crises, the poverty-growth relationship is stable in recent years, policies that promote

[14] Since there are too few observations to do an econometric analysis of the growth-poverty-reduction experience over time of individual countries, cross country regressions are the only option.
[15] They allow for measurement errors and endogeneity of control variables as well as for the omission of possibly relevant control variables. They also test for over-identifying restrictions.
[16] This relative definition of poverty precludes any simple comparison of their results with those of other studies using an absolute definition based on national or international (e.g., $1 a day) poverty lines.
[17] Their control variables include proxies for openness, capital account restrictions, rule of law, democratic institutions, inflation rate, government consumption and expenditures on social sectors as a proportion of total government spending, and primary school enrollment.

overall growth also benefit the poor, good rule of law and fiscal discipline benefit the poor as much as the rest of the population, inflation is more harmful to the poor than for the rest. Finally, they find no evidence that formal democratic institutions, as well as public spending on health and education, have systemic effects on the poor.

The lags between sustained acceleration in growth and poverty reduction can create political problems, for the reason that horizons of politicians are almost surely shorter than lags. Policymakers in India, for example, a country whose development plan explicitly stated that its efforts to increase growth were essential instruments for its goals of reducing poverty, debated the extent to which the poor benefited from growth. As early as in 1960, at the end of the Second Five-Year Plan, the question of whether growth of the previous decade had improved the lives of the poor was raised by a skeptical socialist member in the Parliament. Prime Minister Nehru responded to this question in introducing the Third Five-Year Plan in Parliament and said:

> "Again it is said that the national incomes over the First and Second Plans have gone up by 42 percent and per capita income by 20 percent. Now a legitimate query is made — where has this gone? To some extent, of course, you can see where it has gone. I sometimes do address a large gathering in the villages, and I can see that they are better fed and better clothed, they build brick houses and they are generally better off. Nevertheless, that does not apply to everybody in India" (Government of India, 1964, p. 1)[18].

[18] Nehru followed up his response by appointing a committee to enquire into the distribution of income and levels of living.

Rising inequality can also accompany periods of growth. In contrast to trends in indicators of absolute poverty, those relating to measures of inequality are ambiguous. The data from China and India, for example, suggest that, although poverty at national level decreased during the period of their globalization and growth, all regions and groups neither grew at the same rate nor did they experience poverty reduction to the same extent. This is not surprising since a change that raises everyone's income and reduces the proportion of the poor in a population could nonetheless increase inequality if the rise in income accrues first to those with the higher skills and resource bases that allow them to take advantage of the change. Tinbergen (1975) argued that rising average incomes implies reduced inequality only if education expands faster than the demand for higher-skilled workers. His argument is likely to be as true today as then.

There is some evidence that regional disparities widened in China and India as these nations liberalized their foreign trade and introduced other reforms. To a certain extent this is natural: those regions (and individuals) which are better placed initially to take advantage of the opportunities opened up by reforms or, for that matter, by any other factor, such as, for example, the information-technology revolution, are likely to grow faster (and richer). For example, India's phenomenal success in software is still confined to a few cities in the south and west. The real issue is not one of increasing regional disparities but of whether the socio-economic system would enable the initially disadvantaged regions and individuals to catch up. If it does not, the social and political consequences could be serious and could lead to secessionist threats.

Whether widening disparities are temporary and would be reversed or permanent and entrenched is an interesting issue. At the aggregate level, one approach to this issue is to ask: do regions

converge over time to the same level and rate of growth per capita income in the long run without conditioning on any characteristics of the regions other than their initially different levels of income? This is the so-called "absolute" convergence hypothesis. It is to be contrasted with the "conditional" convergence hypothesis, which suggests that each region converges to its own steady state or long-run level and growth of per capita income, which, in turn, depends on the region's characteristics such as its savings rate, rate of labour force growth and the rate of exogenous technical progress and initial levels of human capital. Under either hypothesis, a region further from its steady state grows faster than when it is closer. There is a growing literature on testing the hypotheses of absolute and conditional convergence in both China and India. Demurger, et al. (2002) and Dayal-Gulati and Husain (2002) find support only for conditional convergence in China. In India, Cashin and Sahay (1996, 1997) found evidence of absolute convergence. Rao and Sen (1997) suggest that, in fact, the findings of Cashin and Sahay should be interpreted as supporting conditional convergence. Clearly, a finding of conditional convergence, since it is consistent with regions growing at different rates in the long run, could mean growing disparities across regions. Coupled with the fact that the incidence of poverty is higher and the share of the country's population larger in the latter states, there has been legitimate concern that if sustained in the future, these growth disparities will threaten the stability of India's federal democracy.

Globalization and Poverty Reduction

Some individuals or groups in a society may be poor and remain poor because they are disadvantaged in the social and political processes of their society. For example, social

institutions such as the caste system in India or forms of racism elsewhere have denied equal access to socio-political processes to lower castes and racial minorities. While recognizing the importance of addressing this, we have nothing to add. The economic mechanisms for alleviating poverty could be divided into two broad categories: increasing the resources held by the poor through redistribution and affecting the economic environment that perpetuates poverty. We focus primarily on several ways in which globalization affects the latter category, as these economic changes have far deeper impacts on reducing poverty over the long run.[19] While critics focus on globalization's sometimes negative effects on redistribution, they overlook its potential to reduce economic constraints that continue to limit the prospects of the poor.[20] Market integration and increased migration limit the extent of poverty-alleviating redistribution in several ways, but their effect on removing the market distortions that perpetuate poverty over the long run far outweighs these consequences. In the words of Tinbergen (1975), the advantage of such mechanisms for poverty reduction is that they "do not disrupt, but rather shift the equilibrium." (137)

Needless to say, in the developing world, market distortions are ubiquitous, and their impact on the extent and depth of poverty are often serious. Whether an individual (or a household) has adequate resources to purchase the poverty bundle at the relevant prices at a point in time depends, of course, on what she (or her household) can earn from her assets (land, financial and physical capital) and most importantly from her (allowing for skills and educational attainments) labor. The functioning of asset and labor markets, as well as product markets for goods and

[19] Besley and Burgess (2003) discuss the poverty reduction benefits of a similar set of policies, though they do not address the link with globalization.
[20] Critics often associate globalization with a reduction in the state's ability redistribute income. We discuss this point further in the next subsection.

services bought or sold, obviously influence the earnings from assets and their purchasing power.[21] In this analysis we echo Tinbergen's emphasis that the central issue in alleviating poverty is not to simply offset it with transfers, but to tackle the more difficult issues of removing obstacles the poor face in trading, saving, and investing in their assets for a higher standard of living.[22]

The critics of globalization point to some forms of exploitation of workers in developing countries, such as the frequent use of child labor, the damage that a rapid exposure to global agricultural markets can cause for developing country farmers, and other aspects of the increasingly integrated global economy. However, these are not intrinsic or permanent consequences of globalization. They often reflect, rather, domestic institutional policy failures as well as continued industrial country protectionism and the reality that the most powerful forces for alleviation of poverty take time to work.

Redistribution

The critics of globalization generally point to a decline in state spending on price supports and services for the poor as countries becomes more internationally integrated. Clearly in a globalized economy subject to the discipline of international capital markets, fiscal deficits are not sustainable, and taxation of mobile factors will induce their flight. Again, if the growth-accelerating effects of globalization are strong, the revenue expansion (with a buoyant fiscal

[21] Clearly if there are no distortions in all these markets and all individuals and households face the same prices, the extent of poverty would be determined by the distribution of assets and labor in the economy.
[22] See, for example, Tinbergen (1962), Section 1.4 or Tinbergen (1975), Section 10.2.

system) from growth would enable financing of the needed services for the poor and avoidance of taxing mobile factors.

Increased migration flows are also often thought to reduce domestic demand for redistribution, as the original population may not want to finance services for new immigrants to their country. The rise of nationalist parties as well as anti-immigrant violence in several industrial countries reinforces this perception. Razin (2002) shows that immigration generally moves the political voting equilibrium toward less redistribution, unless the new migrants join forces with existing low-income voters in their destination country.

The ramifications of less redistribution for poverty, however, are small relative to potential gains in other areas. Government-led redistribution is one of the more direct, but generally less effective means of reducing poverty in the long run. It has limited effectiveness as a means of affecting the resources that poor households command. It will reduce poverty in the short-run if individuals are poor because the assets they own are too meager. Unless redistribution of income is sustained indefinitely, its poverty reduction effect will be temporary if the conventional belief that the marginal propensity to consume of the poor is close to unity is correct. On the other hand, if credit markets are absent so that investment is constrained by resources owned and marginal returns to investment diminish, the rich would have a lower marginal return to investment than the poor if assets are unequally distributed. A redistribution of resources to the poor from the rich would raise the average rate of return to investment and hence the rate of growth of the economy.[23]

[23] For surveys of relevant analytical and policy issues, see Aghion, et al. (1999) and Bénabou (1996)

Subsidy policies may not even achieve the short-term goals of providing more resources to the poor, as subsidies are not often targeted at the poor or there is hijacking of subsidies intended for the poor by the non-poor. The cost of transferring a dollar to the poor through subsidy schemes (particularly poorly targeted ones) also often exceeds a dollar by a substantial margin. The Indian public distribution system (PDS), through which fixed amounts per person of foodgrains and a few other essential commodities are sold at subsidized prices, for example, has a negligible impact on rural poverty and the central government alone spends four rupees to distribute one.[24]

Lessening market distortions such as those listed in the next subsections, in contrast, has a dynamic effect in that it not only increases the value of present resources but encourages greater investment and future accumulation.

Raising the Productivity of the Poor

The chief asset of the poor is their labor. Raising productivity to create a sustained increase in real returns to labor in wage and self-employment would contribute significantly to poverty alleviation. Domestic public policy has a large role to play: increasing the human capital endowments of the poor, perhaps by providing incentives for investment in human capital or through public expenditure on, and improving the access of the poor to, public education and health care programs, raises the productivity of their labor.

[24] Rao and Radhakrishna (1997) analyzed India's PDS from the national and international perspective. They found that in 1986-87, PDS and other consumer subsidy programmes accounted for only about 3% of the per capita expenditure of the poor, and their impact on poverty and nutritional status of the poor was minimal.

Globalization also contributes to this goal in several ways. First, the growth associated with globalization will generally create an outward shift in the demand for wage labor and for goods and services produced by the self-employed. Second, returns to the abundant factor, which in most poor countries is unskilled labor, would rise with trade liberalization.[25] While multinational companies naturally take advantage of the less developed country's abundance of unskilled workers to pay less than they would pay similar workers in their home countries, these wages are often higher than the wages paid by domestic companies in the host countries. Third, more integrated labor markets are important to ensure that workers receive the best return for their work.[26] This last aspect of globalization has not yet been realized—in fact, national integration is still limited by poor infrastructure, explicit restriction on movement (as in China), and linguistic differences across regions. Unlike commodities, the cost of whose movement within and between countries is primarily determined by costs of transportation and insurance, the cost of mobility of labor involves social and legal barriers as well as economic ones.

Opportunities for and returns from accumulation:

Globalization can also benefit the poor by creating strong competitive pressures for improved financial intermediation. More efficient financial intermediation would have large and long-term benefits for the poor by facilitating their investment in both physical and human capital.

[25] There are, empirically, important exceptions to this general theoretical expectation: Harrison and Hanson (1999) present evidence that trade openness in several Latin American and Asian countries has been associated with an increased return to skilled labor relative to unskilled labor.

[26] Wage labor market policies are obviously not a solution for all of poverty. Only a small part of the labor force in many developing countries (less than 20% in India and South Asia, for example) is in formal wage and salary employment. An overwhelming majority of the labor force is in self-employment (often in subsistence farming, in handicraft activities and household-based production for local markets). For them it is not so much the functioning of labor markets but that of product and credit markets that is more relevant.

Although this is again partly matter for domestic policymakers, international capital market integration may provide an added incentive to move financial sector reforms faster. Banks facing international competition in their traditional markets may be faster to move into microlending or services for small depositors. Similarly, the competition for investment under globalization encourages governments to focus more closely on providing better opportunities for investment in human capital.

The share of savings used to finance direct investment in physical assets depends in large part on the functioning of the financial system and access to it, which together influence the cost of financial intermediation. The costs faced by the poor are high, and a large share of savings and investment by households in developing countries is currently in the form of physical assets which they finance on their own without involving financial intermediaries. This share could be as high as 80%, as in Ghana, or around 50%, as in India. These assets include mostly those related to their production activities and also dual use (i.e. production and consumption) assets.

Even though the poor do not save enough to invest in financial markets (particularly in equity markets), they do invest their meager financial savings in the form of deposits in commercial banks, purchase of life insurance policies, and also lending in informal credit markets. Clearly, the returns they realize on such investments depend on the functioning of the financial sector, including the banking system.

The more important effect of improved financial intermediation—via domestic policy changes or spurred by international competition—would be in providing greater opportunities for financing

education. Just as labor is the major asset owned by the poor, it is their investment in accumulation of human capital that is likely to be the major component of their investment. Although their poverty limits their saving and investment in any form, it is particularly limiting when it comes to human capital accumulation. Indeed, a major reason that the incidence of child labor is very high in many poor countries of South Asia and sub-Saharan Africa is the poverty of the parents of working children. Such parents cannot afford to forego the income from the work of a child (directly from paid work or indirectly in terms of unpaid contribution to the household's farm or non-farm enterprise). The out-of-pocket costs to the parents for sending their children to school are often substantial.[27]

Lack of investment in education has three serious consequences. First, the earning prospects of uneducated (or less educated) children in their adult working life would be less compared to their competitors in labor markets. Second, unless the labor market conditions improve in their adult life as compared to those that prevailed in their childhood, they are likely to end up as poor as their parents were and, as such, unlikely to educate their own children. The prospect of perpetuation of poverty across generations in such circumstances cannot be ruled out. Third, since some minimal education is often needed for an individual to participate effectively in political and social processes that make decisions affecting his social and economic prospects, these individuals may be in effect unable to exercise their right to participate.

[27] National and international attempts to eradicate child labor through restrictions on imports or consumer boycotts of goods produced by children are not likely to succeed unless the basic cause of child labor, namely the poverty of parents, is addressed.

Apart from its beneficial effect on investment in human capital through improved financial intermediation, globalization has a direct effect on the demand for educated labour in poor countries through outsourcing of some service activities by industrialized countries. Already, China and India have benefited from such outsourcing. Unfortunately, there is a protectionist backlash in the United States against outsourcing. Hopefully, policymakers will not cave in to such pressure.

Product Market Efficiency

Product market efficiency, affected by domestic policies as well as international integration, determines the "terms of trade" the poor face in attempting to exchange their production for consumption and investment. Needless to say, the extent of integration of national markets and also the competitiveness of exports in world markets depends in large part on whether or not transport and communications infrastructure exists, and functions efficiently, to minimize costs of transportation and of acquiring market intelligence. Insufficient integration would mean the existence of price differentials across markets which cannot be arbitraged away. Also given the uncertainties, not only about harvests, but also about the prices that would rule at harvest time or at any time thereafter when the harvested output would be sold, it matters whether national markets for forward transactions exist and how costly it is to store commodities for later sale.

Globalization could have a particularly significant impact on poverty by affecting the prices farmers in developing countries receive for their products and pay for inputs. There are currently

two obstacles: lack of competition among intermediaries who aggregate primary products for international trading and continued industrial country subsidies and protection for their farmers.[28]

Economic Institutions

Globalization can be helpful in mitigating or even overcoming the institutional and market failures that affect the poor adversely.

Governance Quality

Tackling corruption is a major challenge of governance in developing countries, as processes of adoption, enforcement, and effectiveness of policy interventions are often distorted by endemic corruption. Inefficient and corrupt bureaucracies raise transactions costs in asset markets important for the poor. Land and tenancy markets, for example, have higher transactions costs than other asset markets because of the difficulty in establishing a claim of ownership in land when records are poorly maintained and officials who have the authority to certify ownership are corrupt. It is also a phenomenon that has been with us for ages. The *Arthasastra*, a Sanskrit treatise on statecraft dated to fourth century B.C. India, lists more than fifty ways in which officials could be corrupt. [29]

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[28] See McMillan, et al. (2002) on how domestic market imperfections limited farmers' benefits from liberalization of the cashew sector in Mozambique.
[29] On the other hand, China, a country in which corruption is thriving, has attracted large flows of investment, particularly from overseas Chinese who apparently are better at operating in a corrupt system! Corrupt practices by transnational enterprises, often with the connivance of the governments in countries of their origin, has received attention in the literature.

Any extra impetus that globalization provides toward more transparent institutions will contribute to poverty reduction. The prospect of losing in the race to attract international capital flows, for example, can act as an important impetus to curb corruption. Wei (2000a) finds that corruption's effects on international investment are as if governments were imposing a tax—investors are significantly less likely to invest in more corrupt countries. The direction of causation between corruption, and globalization, however, is likely to go in the opposite direction for trade: corrupt bureaucrats' bribes act as tariffs limiting imports and exports. [30]

Insurance and Credit

Limited access to domestic credit and insurance markets exposes the poor to substantial uncertainty and potentially to consumption volatility. Domestic financial markets in many developing countries are simply not efficient enough to find it worthwhile to extend services to the poor because it is costly relative to returns to provide small loans to many poor in contrast to providing large loans to few rich. As mentioned previously, globalization can create an impetus to improve financial market and offer such credit and insurance opportunities to the poor.

In addition to being dependent on agriculture, the rural poor also have to cope with uncertainties, some of which relate to the environment for production and consumption (e.g. weather, disease vectors) and others which are idiosyncratic (e.g. health and mortality shocks to humans and livestock). Further, the agricultural production process is one in which inputs have to be committed in advance of the realization of an uncertain harvest, while the process of consumption is more certain and evenly paced over time. In an economy closed to international

[30] Wei (2000b)

agricultural commodity markets, shocks to domestic output and demand have to be absorbed through price changes. To the extent such shocks are not highly correlated across economies, world output and consumption would be more stable than their domestic counterparts. Thus, integration with world markets in effect would provide insurance against price effects of domestic shocks, though not necessarily against their income effects.

It is clear that, even if production and consumption processes were to be free of any risk and uncertainty, still the lack of synchronization between the two would require means for smoothing consumption over time. It is also clear that achieving such smoothing would be less expensive, compared to each individual holding inventories of inputs and consumption goods, if access to smoothly and efficiently functioning credit markets is available. The need for credit is enhanced also if purchased inputs (e.g. fertilizers and pesticides, energy and fuels, hired labor etc.) account for a large share of production costs, as in the case of the cultivation of the so-called "Green Revolution" varieties of crops. With well-functioning insurance markets, insurable risks would be addressed. However, uninsurable (or more precisely, insurable only at a high cost) risks are also significant in rural areas of poor countries.

For well-known and well-understood reasons of moral hazard, absence of collateralizable assets, poorly functioning legal system for enforcement of contracts and the seizing and sale of whatever collateral that has been pledged, formal credit and insurance markets in poor countries are either virtually absent or costly, if not altogether out of reach, of the poor. On the other hand, informal arrangements substitute in part for transactions in formal markets (Townsend (1994), Udry (1993)). However, the cost of informal transactions is not necessarily low and, in any case,

informal arrangements are nowhere near adequate to substitute fully for the incomplete and imperfect functioning of credit and insurance markets.

Globalization for the Poor

The globalization discussed in the last section looks substantially different than the partially integrated goods, capital, and factor markets we have today. The most notable departures, and those with the largest negative effects on the poor, are the continued industrial country protection of agricultural and other markets and the lack of integration in labor markets. Porto (2003) estimates that tariff reforms leading to a 15 percent price increases in agricultural manufactures would lead to 2.5 percentage point decrease in the proportion of Argentines in poverty.[31]

Industrial country protectionism has been a constant part of this most recent wave of globalization. Tinbergen (1971) noted that decisions regarding trade barriers (and other policies) will "tend to be based on the short-term interests of that nation, whereas it would have been in the long-term interest to take also into account the interests of others" (8) and that developed countries' restrictions on trade are "limiting the possibilities for developing countries to expand their industry and employment" (17). The fiasco at the recently concluded ministerial meeting of the World Trade Organization at Cancún, Mexico confirms Tinbergen's analysis.

The industrial countries' practice of protecting vulnerable markets may be thought of as politically difficult to change, but that does not justify acceptance. The answer may be to devote

[31] The paper points out that although domestic trade reforms in Argentina have larger *marginal* poverty reduction effects, the scope for lowering foreign tariffs is much greater and therefore the *overall* poverty reduction possible from industrial country trade reform is greater than that achievable from domestic reforms.

more attention to strengthening international trade policy-making bodies. Tinbergen's (1971) repeated call for more explicit institutional coordination of the world economy appears to be increasingly unlikely to be answered for general cooperation, but it is worthwhile to focus on greater cooperation in specific areas.

Labor market integration has been similarly under-emphasized in the current wave of globalization. Tinbergen (1971) notes that freer migration may be essential for achieving the goal of smaller differences in wage levels across the world, but the issue has not even been on the agenda in most international trade talks. Rodrik (2002) argues that this is the area with the most significant consequences for developing countries. He estimates that a temporary visa scheme that allowed migration from developing to developed countries of up to 3% of rich countries' labor force would "easily yield" $200 billion annually for developing country citizens.

As if these two changes were not substantial enough, it is also important to emphasize that globalization alone will not bring about the changes in the economic and institutional environment that are most effective for reducing poverty. It creates additional pressure for such reforms, but these are ultimately domestic decisions.

Table 1. Development outcomes in the 1980s and 1990s, by growth class (unweighted means)

			High growth	Moderate or improved growth	Low growth
Poverty	Percent with less than $ 1 a day	1990s	24.1	31.4	36.9
		1980s	31.0	32.1	30.2
Infant mortality	Per thousand	1990s	29.2	54.3	60.7
		1980s	41.0	66.6	71.0
Illiteracy	Percent	1990s	17.2	31.2	31.4
		1980s	22.9	37.6	38.8
Life expectancy	Years	1990s	70.0	62.9	59.8
		1980s	66.8	60.6	58.4
Carbon dioxide emission	Tons per capita	1990s	2.4	2.3	1.7
		1980s	1.5	2.3	1.8
Deforestation	Percent per year	1990-95	0.83	1.05	1.11
		1980-85	1.08	0.65	1.15
Water pollution	Kilograms per day per worker	1990s	0.16	0.21	0.21
		1980s	0.18	0.21	0.21
GDP growth	Percent per year	1990s	5.3	4.2	0.3
		1980s	6.5	2.3	2.1
Number of countries			13	53	39

Source: World Bank (2000), Table 1.2

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