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Part I Overview

1

Overview

Machiko Nissanke and Erik Thorbecke

Background

Over recent decades, the world economy has experienced not only a quantitative leap in the volume and value of international trade and financial transactions, but also a qualitative transformation in the way different nation states interact with each other. National economies are increasingly linked through international markets for products and factor markets, leading to increased cross-border flows of goods, capital, labour and, through flows of information, technology and management know-how. The world economy is becoming increasingly integrated.

This process of globalization is one of the most critical developments affecting the evolution of national economies. Globalization offers participating countries new opportunities to accelerate growth and development but, at the same time, it also poses challenges to, and imposes constraints on, policy-makers in the management of national, regional and global economic systems. While the opportunities offered by globalization can be great, a question is often raised as to whether the distribution of gains is fair and, in particular, whether the poor benefit proportionately less from globalization – and might under some circumstances in fact be damaged by it. The risks and costs brought about by globalization can be significant for fragile developing economies and the world's poor.

The downside of globalization is most vividly epitomized at times of periodical global financial and economic crises. The costs of the repeated crises associated with economic and financial globalization appear to have been borne overwhelmingly by the developing world, and often disproportionately so by the poor, who are the most vulnerable. On the other hand, benefits from globalization in booming times are not necessarily shared widely and equally across the global community.

The fear that the poor have been by-passed or even harmed by globalization has been highlighted by findings from a number of recent studies which examined explicitly the extent of, and changes in, inequality of world

income distribution as it evolved during the heyday of the globalization era. Many of these studies point towards a continuing high inequality in world income distribution, and limited, if not a total lack of, convergence among participating national economies and across regions. The progress on poverty reduction has also been uneven. The share of the population of developing countries living on less than US\$1 per day declined from 40 per cent to 21 per cent between 1981 and 2001, but this was achieved mainly by a substantial reduction of the number of poor people in Asia, in particular in China (Chen and Ravallion, 2004). Furthermore, the total number of people living on less than US\$2 per day in fact increased worldwide. In particular, poverty has increased significantly in Africa in terms of poverty incidence as well as the depth of poverty.¹

Though any trend in poverty and income inequality observed so far cannot be attributed exclusively or even mainly to the globalization effect as such without rigorous analyses, these various estimates, even the most optimistic ones, cannot dismiss the concerns raised that the globalization process, as it has proceeded so far, may have had at least some adverse effects on poverty and income distribution.² These concerns have generated a passionate debate worldwide as well as a powerful anti-globalization movement. While some of the critics are clearly against globalization in the sense of advocating a protectionist, autarkic and nationalist course of 'de-globalization', others advance and promote alternative policies towards a more global world.

The extent of controversy surrounding this debate reflects the fact that globalization is not a process proceeding neutrally in a policy vacuum, but rather a policy-induced condition.³ Globalization is not driven purely by technological innovation and progress, or by 'neutral' market forces and other inescapable sociopolitical forces, as is often depicted in popular writings.⁴ In particular, the contemporary phase of globalization is to a certain extent an outcome emerging from the global consolidation and diffusion of the economic policy paradigm, which emphasizes benefits and positive features of the liberalized policy regime. In this paradigm, trade and financial liberalization are seen – along with other market-based institutional reforms such as privatization, legal and other regulatory systems – as the sine qua non of a successful integration into a globalizing world economy. This kind of position with a particular ideological stance might be questioned in the context of the fiercely contested debate on the appropriate roles of markets versus states. Indeed, in this regard, the recent discussion over the effects of globalization on poverty mirrors very much the earlier controversy over the appropriateness of structural adjustment programmes as a development strategy for low-income countries, and the poor in particular.

Cornia (2004) argues, for example, that growing polarization among countries has been accompanied by a surge in inequality within most nations, where growth and poverty alleviation have suffered substantially. He suggests

that the rising trend in inequality within countries in recent decades cannot be explained by the 'traditional causes of inequality' (those responsible for income inequality during the 1950–70s), which include high concentration of land and other assets, dominance of natural resources and associated rents, unequal access to education, and urban bias. While noting that these traditional conditions remain important factors for cross-country differences in inequality, Cornia argues that the increased global inequality in recent decades is attributable more directly to contemporary globalization effects – for example, the nature of technological changes and policy reform measures, such as frequent application of deflation policy under stabilization-cum-adjustment; trade liberalization; the rise of financial rents following financial liberalization and privatization; changes in labour institutions; and erosion of the redistributive role of the state.⁵

However, despite the utmost importance of understanding the globalization–poverty nexus, the precise nature of various mechanisms, whereby the ongoing process of globalization has altered the pattern of income distribution and the conditions facing the world's poor, is yet to be analysed carefully. This is because the globalization–poverty relationship is complex and heterogeneous, involving multifaceted channels. It is highly probable that globalization–poverty relationships may be non-linear in many aspects, involving several thresholds effects.

While a number of studies have been conducted to investigate globalization–poverty relationships through cross-country regressions, a deeper insight into this critical nexus cannot be obtained by regression studies alone, as it requires detailed empirical research in a country- and region-specific context.⁶ Cross-country studies require precise measurements and a definition of the two key concepts – globalization and poverty, and have been criticized on technical (econometric) grounds. Both concepts are multi-dimensional, and not easily captured in a composite index to be used in a meaningful manner in cross-country comparative studies.

Building on earlier research projects, UNU–WIDER launched a project named 'The Impact of Globalization on the World's Poor', in 2004. The project aims to produce a set of rigorous theoretical and empirical economic analyses, which could allow us to: (i) deepen our understanding of how conditions facing the world's poor have been evolving under globalization; and (ii) provide a framework yielding the elements of a strategy for 'pro-poor globalization'.

It needs to be recognized at the outset that the two critical concepts dealt in this proposed volume – globalization and poverty – are multi-dimensional and complex, and hence could be analysed in an interdisciplinary context. Our aim in this volume is not to provide a fully comprehensive and multi-disciplinary treatment of the impact of globalization on poverty, but rather to focus on the predominantly economic manifestations of globalization. The main channels through which the forces of globalization affect poverty

that are highlighted in the book are related either directly or indirectly to economic factors such as the opening of trade and capital movements, the international migration of labour, and the transfer of technology and information across borders. It would have been overly ambitious to have additionally taken on board the effects on poverty of all other (non-economic) dimensions of globalization – cultural, social and political – and, in all probability, would have resulted in an overly superficial and simplistic treatment of the issue. All the chapters in this book examine and address the issue at hand from the viewpoint of development economics.

The first conference for the project, held in Helsinki in October 2004, focused on conceptual and methodological issues with a view to discerning channels and transmission mechanisms through which the process of globalization affects different aspects and dimensions of poverty in the developing world. These transmission mechanisms are identified and explored in detail in Chapter 2 by Nissanke and Thorbecke. This chapter provided the necessary guidelines and operated as a kind of ‘navigation table’ for the contributing authors. The first and most important of these mechanisms is the growth–inequality–poverty channel. Other channels in the globalization–poverty nexus operate, respectively, through changes in relative factor and goods prices, factor movements, the nature of technological change and diffusion, the impact of globalization on volatility and vulnerability, the worldwide flow of information, global disinflation, and institutions. This volume is a collection of many studies presented at that first conference.⁷ As an introduction and a guide to the subsequent chapters in this volume, this chapter provides a narrative of our quest to examine how the numerous channels interact, as the net effects on poverty depend on the relative strength of the positive and negative forces of globalization. Chapter 2 purposely refrains from defining globalization in too narrow a set of terms, to allow the authors of the subsequent chapters to explore different dimensions and manifestations of globalization without restriction.

This overview chapter is structured as follows: in the next section we discuss various relationships embedded in the openness–growth–inequality–poverty nexus by summarizing the views regarding the physiology of the causal chain in this nexus. After that is a summary of the analyses by the authors of how globalization affects poverty through the various other channels listed above, including institutions, technology and vulnerability. In the concluding section, some preliminary thoughts are presented which aimed at formulating a set of measures to make globalization ‘pro-poor’.

The openness–growth–inequality–poverty nexus and channel

In Chapter 2, Nissanke and Thorbecke examine the ‘growth’ channel by scrutinizing the causal chain of openness–growth–inequality–poverty link

by link. Openness through trade and financial liberalization increases the flow of goods and capital across national borders and can contribute significantly to economic growth (the openness–growth link). However, the direction of causality in this link is still being debated, as well as how trade and capital flows may be linked into a virtuous circle. Furthermore, the positive openness–growth link is neither automatically guaranteed nor universally observable.

While it is most likely that the poor will benefit from growth, the ultimate poverty reduction effects will depend on how the growth pattern affects income distribution. Inequality is the major filter between growth and poverty reduction. If growth leads to an increase in income inequality, the poor may benefit only slightly or, in some cases, in fact be harmed by the globalization process. Indeed, the growth–inequality link is much more complicated than postulated in the classical approach, with its emphasis on the growth-enhancing effects of inequality. There are many consequences of and phenomena linked to inequality that could, at least potentially, reduce future growth and hence future poverty alleviation, such as the diffusion of social and political instability that could have a negative impact on investment as a result of greater uncertainty.

We argue specifically that the *pattern* of economic growth and development, rather than the rate of growth *per se*, may have significant effects on a country's income distribution and poverty profile. Indeed, the recent debate on the meaning of 'pro-poor growth' is related to the complex triangular relationships among poverty, growth and inequality. Clearly, poverty reduction would require some combination of higher growth and a more pro-poor distribution of the gains from growth. Hence what is relevant for poverty reduction is a 'distribution-corrected' rate of growth, as Ravallion (2004) notes, and in our view growth is considered pro-poor if, in addition to reducing poverty, it also decreases inequality.

Heshmati (Chapter 3) takes a rather different, aggregate approach to assessing the impact of globalization on poverty. He first computes two composite indices of globalization; the Kearney index and his own index obtained from principal component analysis, to measure the extent of globalization for sixty-two countries. In order to investigate the very diverse aspects of globalization, the indices are made up of four components – economic integration, personal contact, technology and political engagement – each generated from a number of indicators. These indices are developed to indicate the level of globalization and show how globalization has evolved over time in different countries. He suggests that a breakdown of the globalization index into major components provides possibilities of identifying the sources of globalization at the country level, and associating it with economic policy measures. The indices are also used in a regression analysis to study the causal relationships between income inequality, poverty and globalization.

Heshmati finds a weak and negative correlation between globalization and income inequality and poverty, as very little of the variance in inequality and poverty outcomes can be explained by globalization operating through these four channels. Rather, his results show that the regional variable plays an important role in the explanation of a variation in inequality and poverty, which makes the globalization coefficient insignificant. This suggests that regional characteristics play a dominant role in how poverty and inequality are affected by the four globalization components mentioned above. His results generally confirm that initial endowments, and the degree and nature of integration into the international economy, largely determine the distributional effects of globalization.

The importance of regional variations in understanding the globalization–inequality–poverty nexus is further taken up by Kalwij and Verschoor (Chapter 4). They examine the impact of globalization on poverty, focusing on the responsiveness of poverty to aggregate changes in income distribution. For this purpose, they decompose poverty trends into an income effect and an a distribution effect over the period 1980–98, under the assumption of a log-normal income distribution for six major developing regions: East Asia; Eastern Europe and Central Asia; Central and Latin America; the Middle East and North Africa; South Asia; and sub-Saharan Africa. Their estimates of income and inequality elasticities of poverty vary considerably across regions. For example, for 1990, they find an income elasticity of poverty equal to -1.06 , on average, for six regions, but ranging from -0.47 for South Asia to -4.21 for Eastern Europe and Central Asia.⁸ Similarly, their Gini elasticity of poverty amounts to 0.21 , on average, but ranges from -0.06 in South Asia to 2.94 in Eastern Europe and Central Asia.

Referring to their calculated region-specific elasticities, they suggest that income changes account for most of the variation in poverty trends across regions and over time, and that the impact of changes in inequality is relatively small, except in Eastern Europe and Central Asia. The impact of changes in the income and inequality elasticities of poverty over time is also relatively small, again except in Eastern Europe and Central Asia. However, on the basis of region-specific analysis, they challenge the dominant mainstream view that globalization is good for the poor by generating approximately distribution-neutral income growth, as argued by Collier and Dollar (2001). They reaffirm instead the position emphasized by Ravallion (1997) and Bourguignon (2003: 3–26), that inequality, in particular initial income distribution, has an important indirect effect on poverty through diminishing prospects for pro-poor growth.

Ravallion (Chapter 5) examines more specifically the relationship between trade openness and poverty, using three different lenses and techniques: (i) a macro aggregate cross-country regression of the impact of trade on poverty; (ii) a macro time series analysis of China; and (iii) a micro lens based on a computable general equilibrium model scrutinizing, respectively, the

impacts on households of WTO accession in China and cereal de-protection in Morocco. Both the macro and micro approaches cast doubt on some widely heard generalizations from both sides of the globalization debate. In particular, he points to the inadequacy of the conventional 'macro lens' for revealing strong and robust trade-poverty relationships. Ravallion also shows that the link between trade liberalization and poverty is tenuous, and that it is difficult to ascertain that trade openness is a powerful force for poverty reduction in developing countries. However, the tenuous nature of the trade-poverty relationship cannot necessarily be generalized to all cases. The data presented are more suggestive of diverse (and noisy) impacts of trade openness on poverty. Under a set of specific conditions, trade opening could clearly be very effective in alleviating poverty.

A valuable lesson from Ravallion's study is the crucial importance of the pattern of growth (the sectoral composition of growth) on the extent of poverty reduction. At early development stages the growth of the primary (agricultural) sector has a far greater impact on poverty than either the growth of the secondary or tertiary sectors. For example, he shows that the bulk of the poverty reduction in China occurred during the phase of agricultural decollectivization and increases in food price procurement rather than in the subsequent trade-opening phase. His micro studies also indicate considerable heterogeneity in the welfare impacts of trade openness, with both gainers and losers among the poor. A number of covariates of the individual gains are identified. His results point to the importance of combining trade reforms with well-designed social protection policies.

Bardhan (Chapter 6) also emphasizes the complex and context-dependent nature of openness-poverty relationships by examining the various processes through which openness to foreign trade and long-term capital movements affect the lives of the rural poor. Greater international integration operates on the rural poor through four causal mechanisms in their capacity as: (i) workers; (ii) consumers; (iii) recipients of public services; and (iv) users of common resources. As workers, the rural poor are mainly either self-employed or wage earners. The self-employed tend to work on their small (often subsistence) farms, or as artisans and petty entrepreneurs in what amounts to the rural informal sector. The constraints they face are in credit, marketing and insurance, and infrastructure. Bardhan argues that opening up the product markets internationally without doing anything about the weak and distorted factor markets or poor infrastructural services may be a suboptimal policy for the poor. Furthermore, protectionism in the industrialized world and subsidization of farm and food products restricts export prospects severely for poor countries. At the same time, as producers, the poor could benefit from the international diffusion of technology, as observed in the Green Revolution which led to large reduction in poverty in Asia.

Whether the poor, as consumers, in fact gain or lose from openness depends on whether or not they are net buyers of tradeable goods (such as

rice) and the extent to which the retail market structure is monopolistically blocking the pass-through from border prices to domestic prices. As recipients of public services, globalization can affect the poor in two ways; first, through budget cuts mandated by international agencies to reduce budget deficits and achieve macroeconomic stabilization, and second, through falls in tariff revenues following trade liberalization. Governments often find it politically more expedient to cut public expenditure for the voiceless poor. Bardhan argues that it is easy to blame the globalization process for domestic institutional failures that could, at least partially, be remedied through an attack on corruption and an insistence on greater accountability of domestic institutions.

In their capacity as users of common property resources, the rural poor have the potential to be harmed if trade liberalization encourages over-exploitation (such as massive deforestation) of fragile environmental resources. Bardhan observes that it may be difficult and even counter-productive for a country to adopt environmental regulations if its competitors do not adopt them at the same time and the latter are thereby able to undercut the former in world markets. The policy recommendation that suggests itself is a greater co-ordination of environmental regulations on an international scale.

Similarly, many small farmers are heavily dependent on multi-national marketing chains to establish a foothold in global markets, as these products require new storage and transport infrastructure, large set-up costs and marketing connections. In such a circumstances, what is required to protect the poor are new legal rules and institutional structures that can facilitate contract farming and agro-processing in a way that does not expose small producers to exploitation by large marketing chains. Bardhan calls for more energetic international attempts to certify codes against international restrictive business practices and to establish an international anti-trust investigation agency, possibly under the auspices of the WTO. More generally, he argues for proactive public programmes to help poor farmers to adjust and co-ordinate, and suggests that international agencies preaching the benefits of free trade have an obligation to contribute to such programmes with financial, organizational and technical assistance.

Jenkins (Chapter 7) focuses his analysis on the impact of the integration of the global economy (rather than on trade policies as such) on the poor in their role as producers. His central question about the impact of globalization on employment and income opportunities for poor people is addressed through case studies of three value chains (horticulture, garments and textiles) in four countries – Bangladesh, Kenya, South Africa and Vietnam. In the context of analysing the comparative performance among case study countries, he proposes to make a clear conceptual distinction between ‘non-globalizer’ and ‘unsuccessful globalizer’, and he categorizes Kenya as a unsuccessful globalizer, while Vietnam is successful in integrating in terms of

outcome though remaining relatively closed in terms of *policy*. Further, the impact of increased exports on employment has been much more significant in Bangladesh and Vietnam, where unskilled-labour-intensive industries accounted for 90 per cent and 60 per cent of manufactured exports in the late 1990s, respectively, than in Kenya and South Africa, where the corresponding figures were 16 per cent and 10 per cent, respectively. In these two African countries, skilled workers (as proxied by education levels) benefited from globalization, while unskilled workers were affected adversely.

In presenting the case studies, Jenkins first emphasizes, as do all the other contributors, that the outcomes of globalization processes are highly context-specific, dependent both on the institutional framework and government policies that mediate global processes. Several patterns emerge, none the less, from his four case studies of global value chains. For example, the growth of labour-intensive exports of manufactures and agricultural products does create employment opportunities, particularly for low-income women and migrants from rural areas, as horticulture exports in Kenya or garment exports in Bangladesh and Vietnam reveal. However, the requirements of global value chains mean that these jobs often demand a high degree of labour flexibility, long hours of work and poor working conditions, making workers vulnerable both in terms of security of employment and income. Opening up to global competition has also led to job losses and deterioration in working conditions and employment conditions, as the case of textile industries in South Africa illustrates.

Further, Jenkins shows how gains from globalization are likely to be more widely distributed where the initial structure of assets and entitlements is more equitable, as in Vietnam. In the latter, a strategy of building linkages between the export sector and domestic production has been more effective in creating employment and reducing poverty than has trade liberalization. On the whole, Jenkins concludes that, even in those cases that have been successful in developing labour-intensive exports, the overall impact of globalization on poverty has been relatively small. The majority of the poor are not engaged in global production, and other strategies are required to reach them. Clearly, integration with the global economy is not a substitute for an anti-poverty strategy.

Other channels in the globalization–poverty relationship

How these other channels work

Nissanke and Thorbecke (Chapter 2) suggest that, in addition to the growth conduit, there are other major channels through which globalization affects poverty. They include *technology* (the nature of technological progress and the technological diffusion process); *factor mobility* and more particularly the pattern of labour migration brought about by the process

of globalization; *vulnerability* (increasing world integration and openness tends to be associated with greater volatility and vulnerability of poor households to economic and financial shocks); and *the flow of information* and *institutions* in both developed and developing countries that mediate the effects of the above channels on the poor. These channels may be largely responsible for explaining why the poor have not emerged as larger beneficiaries of contemporary globalization. According to the theoretical prediction embedded in the Stolper–Samuelson theorem, developing countries well endowed with unskilled labour should experience a decline in income inequality through an increased demand for unskilled labour, while unskilled labour in developed countries would lose out, with an adverse effect on equity. However, empirical evidence reveals that wage gaps between skilled and unskilled labour have been increasing in many developing countries, particularly in Latin America and Africa.

Several specific features associated with the current phase of globalization explain why the theoretical prediction does not hold. For example, the nature of technical progress and new technology is biased heavily in favour of skilled and educated labour, as technical change emanates from research and development (R&D) activities in the developed (industrialized) countries in response to local conditions (Culpeper, 2002). Hence technical change tends to be labour-saving and skill-biased, and new technology is complementary to capital and skilled labour, while being a substitute for unskilled labour, so technical change tends to increase inequalities in both developed and developing countries. Furthermore, technological diffusion and access to new technology is not universal and spontaneous, while intensified privatization of research – for example, in bio-technology – may have adverse effects on access by developing countries and the poor to new technology. The resulting widened productivity differences explain cross-country wage/income inequality.

‘Perverse’ factor movements could provide another explanation. Capital and skilled labour do not migrate to poor countries as much as they do among developed countries. Rather, there is a tendency for skilled labour to migrate from developing countries to developed countries, while unskilled labour migration tends to be strictly controlled. With capital market liberalization, there is a propensity for capital flight to developed countries, particularly during periods of instability and crisis. Thus, Culpeper (2002) concludes that, with such perverse movements, as globalization proceeds, developed countries would see inequality fall while developing countries would experience rising inequality.

Furthermore, the differentiated degree of cross-border factor mobility (skilled labour and capital versus unskilled labour and land) affects the functional income distribution between labour and capital against the former. Wage equalization does not take place through labour migration, as was the case in the previous globalization era. Some workers are losing out as de facto

labour mobility takes place through the increasingly free cross-border capital mobility and TNCs' ability to relocate production sites in response to changes in relative labour costs. In fear of driving away TNCs, governments of developing countries are less likely to enact regulations to protect and enhance labour rights (Basu, 2003). Generally, the poor and unskilled are affected most adversely by asymmetries in market power and access to information, technology, marketing and TNCs' activities, and the dominance of TNCs in the commodity and value chain.

Greater openness tends to be associated with greater volatility and economic shocks, and poor households tend to be more vulnerable to these shocks. The process of global disinflation while, on the one hand, helping the poor by containing price increases, might have taken place at the possible cost of slower growth and fiscal retrenchment, thereby reducing the ability of nation-states to provide adequate safety nets to those affected adversely by recurrent global financial and economic crises. Globalization has contributed to the enormous increase in the flow of information and knowledge worldwide. Internet technology and the spread of mass media transmit the most up-to-date information almost instantaneously. At the same time, increased global flows of information can result in changing reference norms and increased frustration with relative income differences, and could increase volatility and insecurity for many cohorts. Finally, institutions act as a filter, intensifying or hindering the positive and negative pass-through between globalization and poverty, and can help to explain the diversity, heterogeneity and non-linearity of outcomes. Several of these channels are further explored in detail by different UNU-WIDER conference authors.

Technology channel

Zhao (Chapter 8) focuses on the diffusion process by which new technologies are introduced in developing countries⁹. He emphasizes that technology adoption and *diffusion* is a critical factor determining whether developing countries can truly benefit from new technologies through the globalization process. Even if a new technology can potentially increase the income level of rural farmers, it may not be adopted by all, and its diffusion may be slow as a result of adoption sunk costs and uncertainties about net payoffs of the technology in question. The lack of capital, credit and risk-sharing possibilities, as well as the limited access to information about new technologies, would hinder technology adoption and diffusion. Adoption of new technologies can be hindered by uncertainties about their efficiency. For example, without independent external information sources, farmers in developing countries have to rely heavily on their neighbours or 'leaders' (those who have adopted technologies) to obtain vital information about new technologies. Hence, by constructing an adoption model, Zhao studies the role of information exchange between early and late adopters of a new

technology, and about each others' likelihood of adoption. Based on his analysis, his study discusses ways of promoting adoption, including initial information provision, timing communication about the technology and about each farmer, and compensating early adopters for their information services.

Vulnerability channel

Montalbano, Federici, Triulzi and Pietrobelli (Chapter 9) take up the issue of increased *vulnerability*, resulting from trade liberalization, as experienced by countries in Central and Eastern Europe (CEECs) since the early 1990s.¹⁰ Focusing on macro vulnerability, their analysis shows that the extremely high volatility of consumption observed in this region is strongly related to trade shocks, the high volatility of trade openness, and terms of trade. Hence they suggest that trade liberalization, as implemented in the 1990s, might have in fact worsened growth and welfare performance in Eastern Europe. They also found that the per capita income of the poorest quintile of the population is most vulnerable to these trade shocks. On the basis of their empirical evidence, they argue for the need to adopt, in the case of emerging and transition countries, forward-looking national policies to support their process of trade liberalization, policies both to mitigate the impact of trade shocks and to enhance the coping mechanisms. They also call for improvement in the governance of the globalization process by establishing a new 'culture of prevention' and designing mechanisms to limit the size and frequency of shocks at the international level.

Information diffusion channel

Graham (Chapter 10) notes the increased insecurity and vulnerability in the process of globalization with reference to one of the newer branches of economics, namely the economics of happiness. She observes that there are noticeable differences between standard money metric measures of poverty and inequality in assessing the effects of globalization and people's subjective assessment of some of the consequences of globalization. She explores how the economics of happiness can help to explain the discrepancies between economists' assessments of the benefits of globalization for the poor and individuals' real and perceived welfare outcomes, such as vulnerability to falling into poverty among the near-poor, distributional shifts at the local, cohort, and sector level; and changes in the provision and distribution of public services, among others. She suggests that the latter trends play a major role in determining public perceptions about the benefits and fairness of the globalization process.

Using the survey results on wellbeing or happiness in Peru and Russia, Graham attempts to draw a broader picture of the dynamics of poverty and inequality in the process of integration in the global economy – in particular, how the poor and the near-poor in developing economies fare during the

process of globalization. Her analysis is very much focused on income mobility and on reported wellbeing as a way of gauging movements in and out of poverty, and distributive trends across time and across cohorts within countries.

She argues that while globalization is a major engine for growth in aggregate, globalization either introduces or exacerbates other trends that affect people's wellbeing as much if not more than income – for example, through the increasing flow of information about the living standards of others, both within and beyond country borders. This flow of information can result in changing reference norms and increased frustration with relative income differences, even among respondents whose own income is rising. Her analysis also illustrates how globalization can bring about increased volatility and insecurity for many cohorts, particularly those that are not well positioned to take advantage of the opportunities created by the opening of trade and capital flows. She argues that this insecurity, and the very real threat of falling into poverty for the near-poor and lower middle classes, contributes to negative perceptions of the globalization process, particularly in countries where social insurance systems are weak, or where existing systems are eroding. Graham concludes that many social and collective measures should be in place for globalization to have positive effects on poverty. These include measures such as public investments in health; institutions that can ensure adherence to basic norms of equity and fairness; and collective investments in social insurance to protect workers from the volatility that often accompanies integration into global markets. In the absence of these measures, she warns that globalization will only create opportunities for those who are best positioned to take advantage of them, leaving behind large sectors of poor and vulnerable individuals.

Institutions as a channel

Institutions mediate the various channels and mechanisms through which the globalization process affects poverty. Sindzingre (Chapter 11) suggests that institutions act as a filter; intensifying or hindering the positive and negative pass-through between globalization and poverty, and can help to explain the diversity, heterogeneity and non-linearity of outcomes. For example, on the one hand, the impact of globalization on the poor is mediated by domestic political economy structures and institutions such as social polarization, oligarchic structures and predatory regimes, which may bias, confiscate or nullify the gains from globalization for particular groups of the poor. On the other hand, the positive effects of globalization on growth and poverty can be found when institutional conditions are characterized by such features as political participation, social cohesion and management of social conflict that arises directly from globalization effects.

In particular, Sindzingre distinguishes two causal processes in the globalization–poverty relationship. The first is the impact of globalization

on institutions. Globalization can induce institutional change, which in turn may have positive or negative effects on poverty reduction. However, the pace of change can be very different among institutions. For example, globalization as a set of flows and policies is more likely to induce transformation of the aspects of institutions that are already experiencing rapid change (formal political or economic rules, for example) and less likely to transform slow-changing institutions such as social institutions. The second causal process is the impact of institutions on globalization. Globalization is filtered (intensified or hindered) by institutions at both country and micro levels (villages and households).

Sindzingre argues that institutions generate threshold effects because of their composite nature: institutions are indeed made of distinct components – form and content (functions or mental models, for example) – that evolve differently over time. Further, forms do not correspond to unique contents and functions, and growth results from contingent combinations of policies, structures (economic and geographic endowments) and institutions. Under certain conditions where these various components interact in a particular combination, institutions may generate processes of cumulative causation and self-sustained poverty traps.

Paths towards pro-poor globalization

It should be clear from the above discussion that the globalization–poverty relationship is complex and heterogeneous, involving multi-faceted channels. Hence, it is understandable why the globalization debates tend to raise many emotive issues. As Bardhan (Chapter 6) notes, however, these debates often involve a clash of counter-factuals. For those against the ongoing process of globalization:

[a] counterfactual is the world of more social justice and less dominant trading and investment companies, which gives some more breathing space to the poor producers and workers. On the other side the counterfactual for pro-globalizers is the case when there is no (or limited) trade or foreign investment, a world which may be worse for the poor (as it is in the extreme cases of the closed economies of North Korea and Burma). The way out of this clash of counterfactuals is to insist that there are policies that may attempt to help the poor without necessarily undermining the forces of globalization.

Hence he holds the view that the distributional issue raised in the debate is not an argument against globalization (open trade and investment regimes) *per se* but for pro-active public programmes to protect the poor.

Indeed, not integrating into the global economy is not a viable or attractive development option for any nation. As noted in Deardorff and Stern (2006),

countries that do not participate actively in trade liberalization are more likely to lose out. They explore the impact of globalization on countries excluded from the process of globalization – for example, those that have chosen (or in some cases were forced to choose) to remain relatively closed off from world markets. They use an analysis of the offer curve and a political economy model to examine the effect on countries that fail to participate in multi-lateral trade negotiations or preferential trading arrangements but nevertheless are engaged to some extent in international trade. They show that the outsiders are likely to be harmed, through the terms of trade effects, by multilateral MFN tariff reductions as well as preferential trading arrangements (PTAs) between insiders. In their analysis, it is the exclusion of some sectors and/or some exporting countries from the benefits of tariff cuts that creates a bias against non-participating and excluded countries. The best cure for these excluded nations is to become active participants in world markets, and the world economy in general. While there is no guarantee that the welfare gains of joining the world economy would contribute to a reduction in the large-scale poverty that reigns in those countries, and particularly in Africa, their analysis suggest that it is likely to have a welfare-increasing effect by stimulating economic growth for previously excluded countries.

However, as noted in Nissanke and Thorbecke (Chapter 2), the mere adoption of open trade and investment regimes does not guarantee developing countries' entry into the 'income convergence club'. Hence policies of *strategic integration* are called for, as the effects of international trade and investment on growth are critically dependent on the pattern of specialization and integration. Whether global market forces establish a virtuous circle or vicious circle depend on the initial conditions at the time of exposure, and the effective design and implementation of policies to manage the integration process.

Hence, in our view, a strategic position towards globalization cannot be equated with a simple fine-tuning of the pace and sequence of liberalization measures. It requires a long-term vision for upgrading a country's comparative advantages towards high-value-added activities by climbing the technology ladder step-by-step through learning and adaptation. In particular, national policies should be strategically designed in the light of the skewed nature of the ongoing process of globalization such as the nature of technical progress that favours high-skill and knowledge-intensive activities, and the uneven distribution of market power caused by TNCs, resulting in a hugely skewed distribution of gains from globalization. The positive benefits from globalization are neither automatic nor guaranteed, and passive liberalization would risk perpetual marginalization.

There is also a need for policy aiming at structural transformation in relation to various transmission mechanisms discussed in the study, in particular on the grounds that there are critical thresholds to realise positive effects of globalization on poverty reduction. The non-linear Laffer-type

relationship between globalization and poverty, noted by both Milanovic (2002), and Agénor (2003), shows that openness helps those with basic and higher education, but reduces the income share of those with no education, and it is only when basic education becomes the norm, even for the poor, that openness exerts an income-equalizing effect. Thus, at low-income levels, openness appears to affect equality negatively, while at medium- and high-income levels it promotes equality. Sizeable public investment in skill upgrading, as a specific pro-poor measure, is a key to ensuring positive benefits from globalization. At the same time, those countries that have not yet reached the critical threshold, need (i) to invest in agriculture in order to reach the take-off-point to allow the structural transformation of their economies to proceed; and (ii) to strengthen institutions of social protection.

Our review also raises the issue as to whether the present form of globalization/integration is conducive to a process of growth-cum-structural-transformation, which is capable of engendering and sustaining *pro-poor* economic growth and favourable distributional consequences. Various project studies suggest that globalization indeed produces adverse distributional consequences at both national and global levels that could slow down or even reverse the present poverty alleviation trend. Hence globalization should not be viewed as a reliable substitute for a domestic development strategy. Designing an active development strategy should be based on a better understanding of the key issue: which structure and pattern of growth contributes most to the alleviation of poverty.

However, it is clear that, to address the distributional consequences of globalization, a set of much more effective redistributive instruments at both national and global levels is required. At the limit, this would call for exploring alternative, more equitable forms and processes of globalization initially. However, identifying such new forms would require a much better grasp of the concept of 'pro-poor globalization' than there is at present.

For advancing our understanding of what pro-poor globalization might entail, Basu (Chapter 12) focuses his analysis more on the process of marginalization resulting from globalization. He argues that the openness channel is likely to result in international prices of goods and services somewhere between prices in industrialized nations and those in developing countries, but closer to the former. Since (i) labour is less mobile across borders than goods and services; and (ii) the nature of technological progress favours capital- and skill-intensive innovations, it seems reasonable to expect, for sections of the labour force in poor nations – and in particular the illiterate and unskilled who are unable to take advantage of the new technology, that wages will lag behind prices. Hence, some of the poorest people may be subjected to a period of hardship before the benefits of opening-up trickles down to them.

Basu is concerned that the emphasis on maximizing per capita income in an era of fast globalization might not place sufficient weight on poverty and

inequality reduction. Instead, he proposes that the normative criterion that should be adopted in evaluating a country's wellbeing is that of the per capita income of the lowest quintile of the population. Such a measure would combine reducing poverty and inequality. He proceeds to build a simple model showing that the adoption of the 'bottom quintile income criterion' in addition to leading to a pro-poor growth pattern would alleviate the erosion of each national government's power to follow an equity-conscious policy – an outcome that obtains under the alternative case where income maximization is assumed to prevail.

On the basis of his welfare analysis, Basu proceeds to suggest a radical distribution policy whereby workers in all firms as well as currently unemployed labourers be given a fraction of equity earnings from all firms. He envisages that, in today's globalizing world, such an equity scheme could be extended to that of inter-country transfers. He suggests that developing rules for some inter-country transfer of equity income would ensure that the functional income distribution between capital and labour (especially unskilled labour) would not become too uneven. In order to escape from what amounts to a Prisoner's Dilemma situation, Basu also argues for the creation of a new international organization to help to co-ordinate inter-country anti-poverty policies.

As Bardhan (Chapter 6) notes, globalization should not be allowed to be used, either by its critics or by its proponents, as an excuse for inaction on the domestic or the international front. What is *at minimum* called for is therefore liberalization to be accompanied by a comprehensive policy package for enhancing the capability of the poor and instituting a safety net for people who lose out in the process. However, for making globalization more inclusive and truly pro-poor, we should probably go beyond this minimalist approach. We should start by giving some serious consideration to more radical distributional measures such as those proposed by Basu above. We should also engage earnestly in a fresh debate on developing new governance structures for international trade and investment regimes, so that the enormous benefits that globalization promises to generate through transfer of knowledge, technology and financial resources could be shared more equitably by the world's poor.¹¹

Notes

1. See Wade (2002) and Deaton (2001, 2002) for critical discussions of the World Bank's estimates of global poverty and inequality used in these studies.
2. See also Culpeper (2002) for a recent critical literature review of the effect of globalization on inequality, where a set of triangular relationships between globalization, growth and inequality is discussed systematically.
3. See Kozul-Wright and Rayment (2004) for an extensive discussion on this policy-induced condition.
4. Helleiner (2001) emphasizes the need to distinguish two different phenomena associated with the term 'globalization'. While the first is referred to as the

shrinkage in space and in time that the world has experienced as a consequence of technological revolutions in transport, communications and information processing, the second usage points to policy choices and external liberalization involving political, economic and social choices. As Helleiner notes, despite this clear distinction, the recent association of external liberalization *policies* with the technology-driven *fact* of globalization has contributed to the terminological confusion.

5. See Culpeper (2002) for further discussion of the effect of economic liberalization policies on income distribution and the poor.
6. See Reimer (2002) for a literature survey of the poverty impacts of trade liberalization in developing countries. In his survey, he classifies empirical studies into four methodological categories: cross-country regression, partial-equilibrium/cost of living analysis, general equilibrium simulation, and micro-macro synthesis.
7. In this overview chapter, we discuss the main findings from the twelve papers contained in this volume as well as those of Deardorff and Stern (2006).
8. These values differ considerably from the 'universal' income growth elasticity of -2 that Collier and Dollar (2001, 2002) use in their influential policy simulations.
9. In a paper prepared for the present UNU-WIDER project, but not included in this volume, Graff, Roland-Holst and Zilberman (2006) argue that the potential exists for globalization to confer dramatically higher food productivity and rural incomes on developing countries, via the mechanism of North-South technology transfer – in particular, bio-technological or medical transfers. In another paper prepared for this project, Aggarwal (2006) analyses the combined effects of technology transfer, openness and institutions on one important phenomenon affecting the poor – that is, environmental degradation.
10. In another paper prepared for the present UNU-WIDER project Ligon (2006) seeks to account for variations in the consumption distribution across countries and time, and then to estimate the welfare loss associated with different types of shocks and, more particularly, global shocks.
11. See Nayyar (2002) for the debate on issues and institutional reforms required for improving the governance mechanisms over the globalization process.

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