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A Quest for Pro-Poor Globalization

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Abstract

While the opportunities offered by globalization can be large, the question is often raised whether the actual distribution of gains is fair and, in particular, whether the poor benefit proportionately less from globalization and could under some circumstances actually be hurt by it. The paper discusses channels and transmission mechanisms through which the process of globalization affects different aspects and dimensions of poverty in the developing world. It examines how these numerous channels interact, as the net effects on poverty depend on the relative strength of the positive and negative forces of globalization. On the basis of our analysis of these transmission mechanisms from globalization to the world's poor, the paper discusses what may constitute a policy framework for encouraging globalization to be pro-poor.

Keywords: pro-poor globalization, inequality, poverty
JEL classification: F0, I3, O1

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1 Introduction

Globalization offers participating countries new opportunities for accelerating growth and development but, at the same time, it also poses challenges to, and imposes constraints on policymakers in the management of national, regional and global economic systems. While the opportunities offered by globalization can be large, the question is often raised whether the actual distribution of gains is fair and, in particular, whether the poor benefit proportionately less from globalization and could under some circumstances actually be hurt by it. The risks and costs brought about by globalization can be significant for fragile developing economies and the world's poor.[1] The fear that the poor have been by-passed or actually hurt by globalization has been highlighted by the findings from a number of recent studies, which point towards a continuing high inequality in world income distribution and limited, if not a lack of, convergence among participating national economies and across regions as globalization has proceeded.[2] There is much empirical evidence that openness contributes to more within-country inequality. China is a good example with coastal provinces benefiting but not inland provinces

The progress on poverty reduction has also been uneven. The share of the population of the developing countries living below US$1 per day declined from 40 per cent to 21 per cent between 1981 and 2001, but this was mainly achieved by the substantial reduction of the poor in Asia, in particular in China (Chen and Ravallion 2004). Furthermore, the total number of people living under US$2 per day actually increased worldwide. In particular, poverty has increased significantly in Africa in terms of poverty incidence as well as the depth of poverty.[3] Though any trend in poverty and income inequality observed so far cannot be exclusively or even mainly attributed to the 'globalization' effect, as such, these various estimates, even the most optimistic ones, cannot dismiss the concerns raised that globalization as it has proceeded so far may have had at least some adverse effects on poverty and income distribution.[4] Indeed, globalization has created winners and losers at numerous levels throughout modern history.[5] The losers include many of those who have

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[1] Birdsall (2002), for example, argues that it is the poorer countries and the poor who tend to bear the risks and costs of the higher volatility brought about by globalization.

[2] See Nissanke and Thorbecke (2006b) for a review of literature and more detailed discussion on the concepts used for analysing the trends in world inequality and empirical evidence. For historical trends towards income divergence see Pritchett (1997). Quah (1996) also discusses the twin peaks in the world's distribution dynamics, which are characterized by the tendency for stratification and polarization.

[3] 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.

[4] 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 systematically discussed.

[5] See Williamson (2002) for winners and losers from globalization in modern history

keenly participated in the process of globalization. These concerns have generated a passionate debate worldwide as well as a powerful anti-globalization movement.

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. Indeed, each subset of links embedded in the *globalization (openness)-growth-income distribution-poverty nexus* can be contentious and controversial. Besides the 'growth' effects of globalization on poverty (that is, the effects of globalization on poverty filtered through economic growth), globalization/integration is known to directly create winners and losers through other channels, affecting both vertical and horizontal inequalities (Ravallion 2004a). Because these multifaceted channels interact dynamically over space and time, the net effects of globalization on the poor can only be judged on the basis of context-specific empirical studies. Cross-country studies requiring precise measurements and definition of the two key concepts—globalization and poverty—tend to fail to give a deeper insight into this critical nexus. 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 initiated a project on 'The Impact of Globalization on the World's Poor' in 2004. The project aims at producing a set of rigorous theoretical and empirical economic analyses, which could allow us: (i) to deepen our understanding into how conditions facing the world's poor have been evolving under globalization; and (ii) to provide a framework yielding the elements of a strategy for 'pro-poor globalization'.

This essay brings out some of the highlights from the papers presented at the first project conference in Helsinki, October 2004.[6] That conference focused on conceptual and methodological issues with a view of identifying and discerning channels and transmission mechanisms through which the process of globalization affects different aspects and dimensions of poverty in the developing world. In this study we examine how these numerous channels interact, as the net effects on poverty depend on the relative strength of the positive and negative forces of globalization. On the basis of our analysis of these transmission mechanisms from globalization to the world's poor, we also discuss what may constitute a policy framework for encouraging globalization to be more pro-poor.

In Nissanke and Thorbecke (2006b), we identified and explored various transmission mechanisms in detail. 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

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[6] See Nissanke and Thorbecke (2006a) for a more comprehensive summary of main findings from the papers presented at the first conference in Helsinki, October 2004. The full set of the conference papers appear in two publications: a special issue of *World Development* and in a Palgrave Macmillan volume, both of which will be forthcoming in 2006.

nature of technological change and technological diffusion, the impact of globalization on volatility and vulnerability, the worldwide flow of information, global disinflation, and institutions. Following this approach, the paper is structured as follows: In Section 2, we discuss various relationships embedded in the openness-growth-inequality-poverty nexus. In Section 3, the paper analyses how globalization affects poverty through the various other channels listed above. In the concluding section, some preliminary thoughts are presented aimed at formulating a set of measures to make globalization more pro-poor.

2 The openness-growth-inequality-poverty nexus and channel

The 'growth' channel, through which globalization affects the poor, is examined by scrutinising the causal chain in the *openness-growth-inequality-poverty* nexus link by link.

2.2 The openness-growth link

Policies of openness through liberalization of trade and investment regimes, and capital movements have been advocated worldwide for their growth and welfare enhancing effects on the basis of the propositions embedded in the economic theories of international trade and investment (for instance, the Ricardian comparative advantage theory, the Heckscher-Ohlin-Samuelson model, the new trade theories à la Krugman, and the model of intertemporal international borrowing/lending). In these models, the main growth-enhancing effects of openness are assumed to filter through: (i) static efficiency gains associated with improved resource allocation for national economies as well as for the world economy due to increased specialization; (ii) dynamic efficiency gains from such factors as economies of scale, diffusion of information, technology transfers, knowledge spillover effects as well as intertemporal trade gains from cross-border borrowing/lending for increased investment and consumption smoothing and portfolio risk diversification.

Indeed, openness through trade, foreign direct investment (FDI) and financial markets could increase the flow of goods and capital across national borders and could 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 could be interlinked into a virtuous circle. Furthermore, the positive openness-growth link is neither automatically guaranteed nor universally observable. The growth-enhancing effect of trade openness depends critically on the way a country is integrated into the global economy, as discussed below. Similarly, the transfer of technology, skills and management know-how that is assumed to accompany FDI is not necessarily automatic or guaranteed. Further, the postulated positive effects of portfolio and other capital flows (hot money) on growth have been questioned increasingly in recent years. The recent IMF study (Prasad et al. 2003) acknowledges that it is difficult to establish a strong positive causal relationship between financial globalization and economic growth.[7] Furthermore, these short-term capital flows

[7] See Nissanke and Stein (2003) for a critical view on the effect of financial globalization on economic growth in emerging market economies.

contribute to the increased vulnerability to external shocks of the recipient developing countries. A large number of empirical studies based on cross-country regressions have been conducted to show the beneficial effects of an open economy regime on growth; for example, Dollar (1992); Sachs and Warner (1995); Dollar and Kraay (2001a, b).[8] However, the validity of these empirical exercises has been contested on technical grounds by many researchers.[9]

2.3 The growth-inequality-poverty interrelationship

The second link in the causal chain from openness to poverty is the interrelationship between growth and inequality. There are two conflicting theoretical strands relating income inequality and wealth inequality to growth. The classical approach best reflected by Kaldor (1956) argues that a higher marginal propensity among the rich to save than among the poor implies that a higher degree of initial income inequality will yield higher aggregate savings, capital accumulation and growth. Additional arguments in favour of the growth enhancing effect of inequality are based on the existence of investment indivisibilities and incentive effects.[10] From this theoretical perspective, the desirability of an unequal income distribution is thus rationalized on economic grounds, that is on the basis of the claim that 'more poverty today is a precondition to more economic growth and less poverty in the future' (Thorbecke 2004).

The contrasting new political economy theories linking greater inequality to reduced growth operate through a number of subchannels (Thorbecke and Charumilind 2002). These subchannels are, respectively:

(i) unproductive rent seeking activities that reduce the security of property;
(ii) the diffusion of political and social instability leading to greater uncertainty and lower investment;
(iii) redistributive policies encouraged by income inequality that impose disincentives on the rich to invest and accumulate resources;
(iv) imperfect credit markets resulting in underinvestment by the poor, particularly in human capital; and
(v) a relatively small income share accruing to the middle class—implying greater inequality—has a strong positive effect on fertility, and this, in turn, has a significant and negative impact on growth.

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[8] See World Bank (2002) for a summary of these cross-country studies on the openness-growth link.

[9] See Rodriguez and Rodrik (1999) for an excellent critical assessment of these cross-sectional studies. See also Pritchett (1996) for detailed discussion and comparison among various measures used in empirical analyses of outward trade orientation in least developed countries. Clearly, the simple trade intensity index (exports plus imports/GDP)—a standard variable frequently used to measure a country's outward policy orientation in cross-country regressions—is unsatisfactory and inappropriate to be used for testing the hypothesis on the trade openness-growth link.

[10] See Aghion et al. (1999) for detailed discussion on this debate.

In addition, wide income and wealth disparities can impact on education, health and crime, through such manifestations as underinvestment in human capital, malnutrition leading to low worker productivity, stress and anxiety. In turn these manifestations may contribute to lower long-term growth. With particular reference to capital market imperfections and the role of resultant credit constraints, Aghion et al. (1999: 1617) make a similar point, emphasizing that 'wealth inequality determines investment in physical or human capital, which in turn affects the long-run growth rate'.

The rejection of the Kuznets hypothesis of the inverted U-shaped relationship between growth and inequality (as per capita income increases) by a number of empirical studies provided much impetus to the new political economy literature that postulates that high initial inequality is detrimental to economic growth.[11] The proponents of this approach, while rejecting the immutability of the Kuznets curve, argue that growth patterns yielding more inequality in the income distribution would, in turn, engender lower future growth paths.

In the light of the new literature that emphasises the impact of inequality on incentives, social conflicts, transaction costs and property rights, the possible link between growth and poverty is examined in the previous UNU-WIDER studies on growth-inequality-poverty interrelationships (Addison and Cornia 2001; Cornia 2004, Shorrocks and van der Hoeven 2004). They argue that the widespread increase in inequality has been detrimental to the objective of poverty reduction, because large rises in inequality have stifled growth, and because poverty, at any given growth rate of GDP, falls less rapidly in the case of a more unequal distribution than in the case of a more equitable one. The obvious policy implication following from these studies is that successful poverty alleviation depends not only on favourable changes in average GDP per capita growth but also on favourable changes in income inequality.

The conclusions drawn from these recent studies challenge the dominant mainstream views derived from a number of World Bank studies such as Deininger and Squire (1996); Li et al. (1998); Dollar and Kraay (2001a, b). The conventional views argue that there is no clear association between inequality and growth and that growth is distribution-neutral, hence growth is the only realistic option. For example, Dollar and Kraay (2001a, b) state that 'since the share of income going to the poor does not change *on average* with growth, the poor benefit from growth', and 'trade is good for growth and growth is good for the poor'. However, the methodology used in yielding these results has since then been challenged. Ravallion (2002) argues, for example, that average neutrality found in the Dollar and Kraay study and other studies is not inconsistent with strong distributional effects at the country level. A critical question, according to Ravallion, is whether or not inequality is an impediment to poverty reducing growth, or in other words, whether high

[11] See Thorbecke and Charumilind (2002) for a comprehensive review of this new political economy literature on the subject.

inequality attenuates the growth elasticity of poverty. His analysis confirms that the elasticity of poverty with respect to growth is found to decline with the extent of inequality.

Thus, we argue that 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 filter between growth and poverty reduction.[12] If growth leads to an increase in income inequality the poor may benefit only slightly or, in some instances, actually be hurt by the globalization process. 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 notes (2004b), and in our view, growth is considered pro-poor if in addition to reducing poverty it also decreases inequality.

2.4 Diverse approaches for examining the globalization-poverty relationships

Given the complex relationships embedded in the globalization-poverty nexus, as discussed above, it is not surprising to see the diversity in approaches adopted by researchers in examining the physiology of the causal chain in the openness-growth-inequality-poverty.

Taking an aggregate approach, Heshmati (2006) computes two composite indices of globalization and examines how poverty and inequality are affected by four globalization components. 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 (2006). They examine the impact of globalization on poverty, focusing on the responsiveness of poverty to aggregate changes in income distribution. 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 the initial income distribution, has an important indirect effect on poverty through diminishing prospects for pro-poor growth.

[12] See Naschold (2004) for empirical evidences showing that in least developed countries distribution effect is as important as growth effects for poverty reduction, while growth effect is larger in other low-income and middle-income countries.

Ravallion (2006) examines more specifically the relationship between trade openness and poverty, using three different lenses and techniques: (1) a macro aggregate cross-country regression of the impact of trade on poverty; (2) a macro time series analysis of China; and (3) a micro lens based on a computable general equilibrium model scrutinizing, respectively, the impacts on households of WTO accession in China and cereal deprotection 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 relationship. 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 some specific set of conditions openness to trade could clearly be very effective in alleviating poverty.

Jenkins (2006) focuses his analysis on the impact of integration within the global economy (rather than 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 categorises Kenya as a unsuccessful globalizer, while Vietnam is successful in integrating in terms of *outcome* though remaining relatively closed in terms of *policy*.

In presenting the case studies, Jenkins first emphasises that the outcomes of globalization processes are highly context-specific, dependent both on the institutional framework and government policies which mediate global processes. Several patterns emerge 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 employment and income security. 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 trade liberalization per

se. On the whole, he 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.

3 Other channels in the globalization-poverty relationship

3.1 How these other channels work?

We 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 these channels on the poor (Nissanke and Thorbecke 2006b). 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 when equity is adversely affected. However, the empirical evidence reveals that wage gaps between skilled and unskilled workers 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 heavily biased in favour of skilled and educated labour, as technical change emanates from 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 it is a substitute for unskilled labour. Hence, 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 biotechnology, may have adverse effects on access of 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 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 the ability of transnational corporations (TNCs) 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 most adversely affected by asymmetries in market power and access to information, technology, marketing and TNC activities and the dominance of TNCs in commodity and value chain.

Greater openness tends to be associated with greater volatility and economic shocks. Poor households tend to be more vulnerable to these shocks.[13] 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 adversely affected 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 recent 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 explain the diversity, heterogeneity and non-linearity of outcomes.

3.2 Technology channel

Focusing exclusively on the technology channel, Graff et al. (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. As international diffusion of technology and sustainable innovation are determined by the institutional and financial capacity and the levels of human capital in developing countries, they argue that policies to facilitate North-South and South-South technology transfer and diffusion need to recognise global complexity of innovation sources and absorption capacities, and adapt accordingly. To realise the potential positive effects of biotechnology

[13] See Birdsall (2002) for a discussion of many country cases where open capital markets adversely affected inequality and the poor.

on poverty reduction, they argue that the public and private sectors must establish institutions with local capacity for technology innovation and adaptation, reduce transaction costs in the process of international transfer of technology, and provide standardization, transparency, and access to information for property rights over technologies. In addition to significant investment in higher education and research capacity in low-income countries, they argue for a new type of institution potentially capable of overcoming the lack of access to intellectual property rights, namely the Intellectual Property Rights Clearinghouse (IPRC).

The technology diffusion process by which new technologies are introduced in developing countries is analysed by Zhao (2006). He emphasises that technology adoption and diffusion are critical factors determining whether developing countries could truly benefit from new technologies through the globalization process. Even if a new technology can potentially increase the income level of rural farmers, its diffusion may be slow due to sunk costs of adoption 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. An 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 (so-called ‘leaders’, those who have already adopted the technologies) to obtain vital information about new methods.

Aggarwal (2006) analyses the combined effects of *openness*, *technology* transfer and *institutions* on *environmental* degradation. She examines various mechanisms through which globalization may affect the wellbeing of the poor through its effects on local ecosystems on which the poor depend for their livelihood. Focusing on the concept of resilience, that is the capacity of an ecosystem to maintain its structure and pattern of behaviour in the face of disturbance, she argues that the transfer of (essentially agricultural) technology often funded by external sources may lead to a shift towards more modern resource management practices that have very short-term time horizons. Firms and even farmers expect quick results and payoffs. These changes such as, for example, mono-cropping, carried out over vast tracts of land reduce functional diversity and increase spatial uniformity in grassland ecosystems thus leading to a loss of resilience. As a consequence primary producers become more vulnerable to price volatility and shocks such as droughts. The loss of biodiversity results in a reduced number of pathways through which stress in the environment can be absorbed. An important observation of the study is that very often the governance structure of institutions (at village, state or national levels) does not overlap with the scale of ecosystems that often transcend political boundaries. Hence the closer matching of ecosystems and governance structures calls for the design of new and appropriate institutions—a key challenge for policymakers intent on reducing some of the negative effects of globalization on the environment and the rural poor.

3.3 Vulnerability channel

Even if one accepts the argument that globalization contributes to an increase in aggregate income measures, a second consequence of globalization is increased uncertainty resulting from greater variation in income and expenditure caused by global shocks. Ligon (2006) focuses his analysis on how globalization affects poverty through this vulnerability channel. Poor households, in particular, who tend to be risk-averse may be harmed by greater volatility in their income streams. He 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, *global shocks*, *country-specific shocks* and *globalization shocks*. Ligon finds that global shocks and globalization shocks are of minor importance relative to country-specific shocks in explaining variation in poorer quintile consumption growth. However, he finds that the total risk facing households within a country-quintile is large, with households willing to sacrifice on average 8.4 per cent of their expected consumption in exchange for eliminating all risk.

The issue of increased vulnerability, resulting from trade liberalization, as experienced by countries in Central and East Europe (CEECs) since the early 1990s, is taken up by Montalbano et al. (2006). Focusing on macro vulnerability, their analysis shows that the extremely high volatility of consumption observed in this region is strongly related to trade shocks and 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; that is, policies both to mitigate the impact of trade shocks and to enhance coping mechanisms. They also call for improvement in the governance of the globalization process by establishing a new 'culture of prevention' and designing mechanisms for limiting the size and frequency of shocks at the international level.

3.4 Information diffusion channel

The increased insecurity and vulnerability in the process of globalization is discussed by Graham (2006) with reference to '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 explain these 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. Focusing on income mobility and on reported wellbeing of the poor and near poor as a way to gauge 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. For example, individuals in a given developing country compare their incomes increasingly with those of relatively similar individuals in developed countries rather than within their own country. Graham's 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 accompany integration into global markets. In the absence of these measures, she warns that globalization will only create opportunities for those that are best positioned to take advantage of them, leaving behind large sectors of poor and vulnerable individuals.

3.5 Institutions as a channel

Institutions mediate the various channels and mechanisms through which the globalization process affects poverty. Sindzingre (2006) suggests that institutions act as a filter: intensifying or hindering the positive and negative pass-through between globalization and poverty and can help explain the diversity, heterogeneity and non-linearity of outcomes. For example, on the one hand, the impact of globalization on the poor is intermediated 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 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 arising directly from globalization effects.

In particular, Sindzingre distinguishes two causal processes in the globalization-poverty relationships. The first one 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 on the aspects of institutions that are already experiencing rapid change (for example, formal political or economic rules), and less likely on 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 the country and micro levels (villages and households).

4 Paths towards pro-poor globalization

It should be clear from the above discussion that the globalization-poverty relationship is complex and heterogeneous, involving multifaceted channels. Hence, it is understandable why the globalization debates tend to raise many emotive issues. As Bardhan (2006) notes, however, these debates often involve a clash of counterfactuals. 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 actively participate in trade liberalization are more likely to lose. They explore the impact of globalization on countries excluded from the process of globalization, that is 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 multilateral 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 most favoured nation (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 (2006b), a mere adoption of open trade and investment regimes per se does not guarantee developing countries' entry into the 'income convergence club'. Dowrick and DeLong (2001) suggest that (i) openness to the world economy does not necessarily promote convergence; (ii) many poor countries that have opened their economies since the 1980s have fallen behind, not just relatively but absolutely in terms of both income levels and structural development. The conundrum of the persistent 'non-convergence' of world income should be explicitly addressed in terms of structural features of the global economic relationships as they evolved over time and the institutional conditions found in participating countries. The income convergence trend among nation-states, to the extent that it has been observed historically, is likely to be explained more effectively by the nature of integration and specialization of subgroups of countries, rather than by the degree of openness of the trade and investment regimes per se, as is often claimed. In particular, in the current phase of globalization, developing countries have to reach a certain threshold by undergoing substantial changes in trade and production structure before they experience income convergence.

Clearly, countries need to have reached the takeoff point before they can take advantage of the potential benefits of openness and globalization. One of the critical reasons why globalization may not be working for low-income developing countries lies in the fact that the effects of international trade on growth are critically dependent on the pattern of specialization and integration. By treating two sectors symmetrically, the conventional Heckscher-Ohlin trade model (consisting of two countries, two sectors and two factors) shows that two countries equally reap aggregate gains from trade through efficiency gains.[14] In reality, however, the pattern of specialization does matter for welfare implications of a trade-induced growth path on at least two accounts.

Two sectors need not be symmetrical, first, through the well-known immiserizing effect of trade à la Bhagwati—that is to say the terms of trade (TOT) effects. Though many dismiss the likelihood of such an effect in a small economy, low-income countries dependent on the exports of a limited range of primary commodities face a deterioration of TOT, in particular if the 'fallacy composition effect' is seriously taken into account. In the 1980s and 1990s, many primary commodity exporting countries, which implemented structural adjustment programmes, underwent simultaneous export drives leading to depressed prices in many export commodities (Nissanke and Ferrarini 2001). In this context, Birdsall (2002) draws attention to the fact that measured by the trade-GDP ratio or tariff rates, most commodity-dependent countries have not been more reticent than less commodity-dependent countries about participating in international trade, but the former group has

[14] This two-sector model of international trade can be easily extended to N-sector model (for example, see Dornbusch et al. 1977).

failed to grow (especially after 1980) as they have remained dependent on exports of primary commodities.

Furthermore, two sectors are not necessarily symmetrical because of the possible impact of dynamic scale economies, i.e. dynamic externalities through technological spillover benefits and the accumulation of knowledge capital. As the endogenous growth theory emphasises, it is this factor that largely accounts for diverging growth rates among countries. An application of this phenomenon to the trade model implies that a country specializing in an industry with a larger positive externality would experience a faster growth rate compared with the trading partner that specializes in an industry with a weaker externality. Thus, the growth rate of the two trading countries could differ considerably, depending on the pattern of specialization.

If a country follows the Rybczinski line dictated by static comparative advantage with given relative resource endowments, the country with an initial comparative advantage in 'non-dynamic' sectors may end up in a low equilibrium trap. Countries that have benefited from globalization and integration—such as those found in East Asia—are the ones which have successfully completed the structural transformation of the composition of their production and trade structure with continuous upgrading of their human skill endowments and technology/knowledge base. Consequently, their comparative advantages have evolved over time to maximize the benefit from dynamic externalities.

Seen from this perspective, openness per se is not sufficient to ensure that development will follow. The internal pattern of growth and forms of integration are critical for countries to benefit from globalization-induced growth. Many low-income countries could be locked in an international poverty trap through integration (UNCTAD 2002). This points to the importance of reaching the takeoff stage before countries can benefit from globalization.

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 mere passive adoption of free trade policy, or a simple fine-tuning of the pace and sequence of liberalization measures. At the same time, there is no place for an old-style, poorly designed and implemented protection policy, which is mired in unproductive rent seeking activities and patron-client relationships between governments and private agents. Import substitution strategy can work only when protection is granted to firms with a clearly specified 'graduation' clause. That is, protection should always be seen as temporary and 'time bound' by agents. Thus, as Kaplinsky (2000) notes, the issue

confronting policymakers is not *whether* to integrate into the global economy but *how* to integrate so as to have a stable foundation for sustainable and equitable growth. The strategic integration 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. To succeed, developing country governments should consciously engage in building institutional capacities for integration, including a capable nation-state that is ready to take on the enormous challenges posed by globalization. The positive benefits from globalization are neither automatic nor guaranteed and passive liberalization would risk perpetual marginalization.

In particular, national policies should be strategically designed in the light of the skewed nature of the ongoing process of globalization. First, dynamic externalities and rent-rich activities are increasingly concentrated in high-skill, knowledge-intensive sectors. In short, the skill- and technology-related divide has become wider over recent decades. This trend is clearly reflected in the continuously declining terms of trade of less skill-intensive manufactured goods relative to high-skill and technology-intensive goods over the recent decades. The markets for many labour-intensive products, consisting increasingly of internationally standard goods, have come to resemble those for primary products. The entry of China and India into global markets for these products has depressed and will continue to depress real wages and returns in these sectors.

Second, trade in the current phase of globalization is largely mediated through international production with an increasing share of intra-firm trade undertaken by TNCs, which command a lion's share of global production and marketing networks. Trade is no longer conducted in arm's length relationships, with final products being largely manufactured in a particular country and then exported. Instead, international production with vertical integration has increasingly dominated, in which production processes are sliced up and located globally (Kaplinsky 2000). There has been a tremendous growth in offshore outsourcing and global divisions of labour. Consequently, intra-firm trade within TNCs and inter-industry trade with highly differentiated products command a predominant share of global trade. At the same time, considerable asymmetries in market power and access to information, technology and other intangible knowledge assets between TNCs, on the one hand, and local farmers and traders in developing countries on the other hand, have resulted in a hugely skewed distribution of gains from trade. This is reflected in TNC dominance in commodity and value chains of international traded goods, as well as in frequently observed conditions such as the sharp decline in real wages in export processing zones. The benefits of productivity improvements, instead of going to the fragmented producers and farmers, are largely appropriated by TNCs and global supermarket chains that can exploit oligopolistic commodity markets.

This uneven distribution of market power points to the need to improve the negotiating positions of developing country governments vis-à-vis TNCs, aiming at a strategic, targeted approach to FDI, so that FDI could facilitate skill- and technology-transfers and

generate strong positive productivity spillovers for domestic firms. In this context, Bardhan (2006) calls for a greater co-ordination of many regulations on an international scale as well as more energetic international attempts to certify codes against international restrictive business practices and to establish an international anti-trust investigation agency, possibly under WTO auspices. 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 ground that there are critical thresholds for positive effects of globalization on poverty reduction to realise. 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.

Sizable public investment in skill upgrading, as a specific pro-poor measure, is a key for ensuring positive benefits from globalization. At the same time those countries which have not yet reached the critical threshold, need (i) to invest in agriculture in order to reach the takeoff point to allow the structural transformation of their economies to proceed; (ii) to build both physical and social infrastructure in conjunction with development of healthy, educated and skilled human resources; and (iii) 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 studies suggest that globalization indeed produces adverse distributional consequences at both the 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 on the key issue: what 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 redistributional instruments at both national and global levels is required. This would call for exploring alternative, more equitable forms and processes of globalization to start with. However identifying such new forms would requires a much better grasp of the concept of 'pro-poor globalization' than we presently hold.

In analysing the various processes through which *openness* to foreign trade and long-term capital movements affects the lives of the rural poor, Bardhan (2006) argues for pro-active public programmes to help poor farmers adjust and co-ordinate, and suggests that international agencies that preach the benefits of free trade have an obligation to contribute to such programmes with financial, organizational and technical assistance. He also calls

for a greater co-ordination of many regulations on an international scale as well as more energetic international attempts to certify codes against international restrictive business practices and to establish an international anti-trust investigation agency, possibly under WTO auspices.

For the WTO and other multilateral agencies to become a true development forum, it is important to recognise explicitly the hugely asymmetrical unequal economic power relationships as observed currently among member countries. These global agencies should endeavour at creating a genuine 'policy space' to allow developing countries to engage in their development agenda in the integration and globalization process. The current rules adopted by the WTO and other international agencies such as the principles of 'single undertaking' and 'reciprocity' should be critically reappraised in this light. It can be agued that a meaningful 'level playing field' could be created only if 'differential' treatments are legitimately instituted as a guiding rule governing multilateral negotiations.

For advancing our understanding of what pro-poor globalization may entail, Basu (2006) 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 prices in developing countries but closer to the former. Since (a) labour is less mobile across borders than goods and services; and (b) 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 especially 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.

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 which should be adopted in evaluating a country's wellbeing is that of the per capita income of the bottom 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 corporate equity earnings from all firms. He envisages that in a today's globalizing world, such an 'equity' scheme should be extended to that of inter-country transfers. He suggests that developing rules for some inter-country transfer of equity income would insure 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 a creation of a new international co-ordination organization that helps co-ordinate inter-country anti-poverty policies.

As Bardhan (2006) 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 as well as the international front. On the basis of our review, we argue that 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 in the process. However, for making globalization more inclusive and truly pro-poor, we should go probably beyond this minimalist approach. We should start giving some serious consideration to more radical distributional measures such as proposed by Basu.

Birdsall (2002) also advocates the need for a global social contract to finance equal opportunity investments in the initially weak and disadvantaged as well as for appropriate global arrangements to minimize the asymmetric risks and costs of global market failures. Indeed, we should get engaged earnestly in a fresh debate on developing new governance structures of the 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 more equitably shared by the worlds' poor.[15]

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[15] 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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