

Editorial

# Introduction: The Impact of Globalization on the World's Poor

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**Summary.** — This paper is an introduction to eight papers included in this special issue on the impact of globalization on the world's poor, arising out of the first conceptual and methodological workshop for the UNU-WIDER project in Helsinki, October 2004. The authors of the papers in this issue focus on the different channels and transmission mechanisms through which the process of globalization affects different aspects and dimensions of poverty in the developing world. These numerous channels interact and the net effects on poverty depend on the relative strength of the positive and negative forces of globalization.

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Over the 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 residents of different nation states interact with each other. National economies are increasingly linked through, first, international markets for products and factors, leading to increased cross-border flows of goods, capital and labor, and second through flows of information, technology, and management know-how. The world economy is clearly 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 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, a question

is often raised as to whether the actual distribution of gains is fair, in particular, whether the poor benefit less than proportionately from globalization—and could under some circumstances actually be hurt by it.

The theme of this special issue is the impact of globalization on the world's poor.<sup>1</sup> The authors of the papers in this issue focus on the different channels and transmission mechanisms through which the process of globalization affects different aspects and dimensions of poverty in the developing world. These numerous channels interact and the net effects on poverty depend on the relative strength of the positive and negative forces of globalization.

Nissanke and Thorbecke in their overview identify and explore in some detail these transmission channels. Openness through trade and financial liberalization increases the flow of goods and capital across national borders and

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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 interlinked 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 filter between growth and poverty reduction. 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. Indeed, the growth–inequality link is much more complicated than what the classical approach postulated with its emphasis on the growth-enhancing effects of inequality. There are many consequences of and phenomena linked to inequality that, at least potentially, could reduce future growth and hence future poverty alleviation such as the diffusion of social and political instability which could have a negative impact on investment caused by greater uncertainty. Each of the links in the causal chain *openness–growth–inequality–poverty* needs to be scrutinized to assess the impact of globalization on poverty.

In addition to the “growth” conduit, the paper discusses 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 labor 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); *the flow of information* and *institutions* in both developed and developing countries that mediate the effects of the above channels on the poor.

Basu examines the relation between globalization, inequality, and poverty within and across countries with its focus 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 countries and prices in developing countries but closer to the former. Since (a) labor is less *mobile* across borders than goods and services; and (b) the nature of *technological*

progress favors capital and skill-intensive innovations, it seems reasonable that for sections of the labor force in poor countries, and especially the illiterate and unskilled who are unable to take advantage of the new technology, 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 trickle-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 well-being 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 is obtained under the alternative case where income maximization is assumed to prevail. In order to escape from what amounts to a Prisoner's Dilemma situation, Basu suggests two policies: (1) the creation of a new international coordination organization that helps coordinate inter-country anti-poverty policies; and (2) workers in all firms as well as currently unemployed laborers be given a fraction of equity earnings from all firms. The latter would insure that the functional income distribution between capital and labor (especially unskilled labor) does not become too uneven.

Ravallion, Bardhan, Deardorff and Stern, and Aggarwal focus on the impact of the *openness* channel (trade and financial liberalization) on different aspects and dimensions of poverty. Bardhan and Aggarwal also explore the impact of the interaction among *openness*, *technology transfer* and *institutions*. Graff, Roland-Holst, and Zilbersmit concentrate on the *technology transfer* channel and Ligon analyzes how the process of globalization affects the *vulnerability* of poor households to external shocks.

Ravallion examines more specifically the relationship between trade openness and poverty, using three different lenses and techniques: (1) a macroaggregate 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 de-protection in Morocco. Both the macro and microapproaches cast doubt on some widely heard generalizations from both sides of the globalization debate. In particular, he points to the inadequacy of the conventional "macrolens" 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 a set of specific conditions, trade opening could clearly be very effective in alleviating poverty.

A valuable lesson from Ravallion's paper 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 de-collectivization and increases in food prices procurement rather than in the subsequent trade-opening phase. His microstudies 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 also emphasizes the complex and context-dependent nature of the 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, market-

ing 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 sub-optimal policy for the poor. Furthermore, protectionism in the industrialized world and subsidization of farm and food products severely restricts export prospects 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, actually gain or lose from openness depends on whether or not they are net buyers of tradable goods (such as rice) and the extent to which the retail market structure is monopolistic 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 expenditures for the voiceless poor. In their capacity as users of common property resources, the rural poor can potentially be hurt if trade liberalization encourages overexploitation (such as massive deforestation) of fragile environmental resources. However, he argues strongly that it is easy to blame the globalization process for domestic institutional failures, which could at least partially be remedied through an attack on corruption and insisting on greater accountability by domestic institutions.

In general, he holds the view that the distributional issue raised in the globalization debate is not an argument against globalization (open trade and investment regimes) *per se* but for pro-active public programs to protect the poor and help poor farmers adjust and coordinate. He suggests that international agencies that preach the benefits of free trade have an obligation to contribute to such programs with financial, organizational and technical assistance. He argues that 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.

Aggarwal analyses the combined effects of *openness* (trade liberalization and short term capital), *technology* transfer and *institutions* on one important phenomenon affecting the poor,

that is, environmental degradation. She examines various mechanisms through which globalization (defined as the interaction among the above three channels) may affect the well-being of the poor through its effects on the local ecosystem on which the poor depend for their livelihood. In her analysis, she draws on models on ecosystem dynamics and the New Institutional Economics (how institutions and technologies evolve) to assess the environmental consequences in a number of specific prototypical configurations.

An important concept emphasized by Aggarwal is that of resilience, that is, the capacity of an ecosystem to maintain its structure and pattern of behavior in the face of disturbance. She argues that the transfer of (essentially agricultural) technology often funded by external sources may lead to a shift toward more modern resource management practices that have very short term time horizons. Firms and even farmers expect quick results and pay-offs. These changes such as, 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 bio-diversity 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.

Deardorff and Stern focus exclusively on one of the key manifestations of *openness*, namely, globalization as the reduction in barriers to international trade, and its effects on the countries that do not themselves participate in that process. In that sense, the starting point of their study is the converse of the papers discussed so far. Deardorff and Stern explore the impact of globalization on countries excluded from the process of globalization, whereas all the other contributions to this volume investigate the effects of globalization on the countries included and participating in the globalization process. The excluded countries would be 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 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 countries 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 suggests that it is likely to have a welfare-increasing effect by stimulating economic growth for previously excluded countries.

Graff, Roland-Holst, and Zilberman focus entirely on the *technology* channel. The paper argues and makes the case that a strong 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, biotechnology transfers. The authors observe that while biotechnology has advanced agricultural productivity growth in the more developed countries, it has had little actual impact so far in the Third World. As international diffusion of technology and sustainable innovation has been 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 diffusion need to recognize global complexity of innovation sources and absorption capacities, and adapt accordingly.

They argue that biotechnology holds significant potential for reducing poverty through agricultural productivity gains raising the incomes of small scale farmers and through a concomitant reduction in food prices benefiting the net food buyers, including landless farm workers, net food-purchasing smallholders, non-agricultural rural poor, and the urban

poor. However, the extent to which this promise is fulfilled will depend as much as on institutions as it does on innovation.

To realize the potential positive effects of biotechnology 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 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, the authors describe a new type of institution potentially capable of overcoming the lack of access to intellectual property rights, namely, the Intellectual Property Rights Clearinghouse (IPRC), and elaborate on how this institution can be further modified to speed up the technology transfer.

The last paper in this special issue is by Ligon who focuses entirely on how globalization affects poverty through the *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. Poor households, in particular, who tend to be risk averse may be harmed by greater volatility in their income

streams. The paper 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*. Globalization shocks measure the extent to which the fortunes of a particular income quintile, for example, poor households, are linked across national boundaries by events such as skill-biased technological change. Hence, they are "quintile-specific" shocks with global effects.

Using a large scale panel data set yielding the changes in quintile income distribution over the last 50 years for a sample of 53 countries (mostly developing) and treating each country-quintile-year as an observation, 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. He interprets this as evidence, with a caveat due to the incompleteness of data, against the hypothesis that the forces of globalization have had an important effect on global inequality, even conditioning on changes in inequality *across* countries. However, he finds that the total risk facing households within a country-quintile is large, with households willing to sacrifice on average 8.4% of their expected consumption in exchange for eliminating all risk.

#### NOTE

1. This special issue contains eight selected papers presented at the first conceptual and methodological

workshop for the UNU-WIDER project, held in Helsinki, October 2004.