The Impact of Globalization on the Poor

by

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Abstract

In this paper we provide an analytical account of the mechanisms through which globalization, in the sense of increased foreign trade and long-term capital flows, affects the lives of the poor in developing countries (in their capacity as workers, recipients of public services or users of common property resources). Globalization can cause many hardships for the poor, but it also opens up opportunities which some countries can utilize and others do not, largely depending on their domestic political and economic institutions, and the net outcome is often quite complex and almost always context-dependent, belying the glib pronouncements for or against globalization made in the opposing camps.

Executive Summary

Taking globalization in a limited sense of openness to foreign trade and long-term capital flows, and looking at only absolute poverty, this paper provides a brief analytical account of the various processes through which globalization affects the lives of the poor in low-income countries. We consider the poor in their capacity as (a) workers, (b) as recipients of public services, and (c) as users of common property resources. As workers they are mostly either self employed (on their tiny farms or shops or firms in the informal sector) or wage-employed. The major constraints the self-employed face are in credit, marketing, extension services for new technology, infrastructure and government regulations. These often require substantial domestic policy changes, and foreign traders and investors are not directly to blame (in fact they may sometimes help in relieving some of the bottlenecks in infrastructure and services and in essential parts, components and equipment). If these changes are not made and the self-employed poor remain constrained, then, of course, it is difficult for them to withstand competition from large agri-business or firms (foreign or domestic).

When small producers are heavily involved in exports (for example, coffee producers of Uganda, rice growers in Vietnam, garment producers in Bangladesh or Cambodia) the major hurdle they face is often due to not more globalization but *less*. As is by now well-known, developed country protectionism and subsidization of farm and food products and simple manufactures (like textiles and clothing) severely restrict their export prospects for poor countries.

On the wage-employed, the paper discusses different mechanisms through which the opening of the economy can affect wages and employment, in some cases positively and in other cases negatively. The latter cases are particularly important to keep in mind for poor countries, where there is very little effective social protection available from the state. Rich countries have better social safety nets and some programs in place helping displaced workers to adjust (like the federal adjustment assistance program in the US). International organizations that preach the benefits of free trade should take the responsibility of funding and facilitating such adjustment assistance programs in poor countries that can help workers in coping with job losses and getting retrained and redeployed.

Until issues of general economic security for poor workers in developing countries are satisfactorily resolved, globalization is bound to raise anxiety and hostility among workers worried about their job security. If mass politics in a country is organized, as it usually is, in such a way that the nation-state is the primary political forum for demanding and getting the necessary redistributive and insurance functions of a society (rendered more important by the economics of international specialization), to the extent that nation state is weakened by forces of international economic integration, it is a matter of serious concern. Much depends, of course, on a society's institutions of conflict management and coordination. It is not a coincidence that countries that have a better record in building these institutions have coped better with the dislocations brought about by international trade: the major example is the case of Scandinavian countries where in spite of a strong tradition of organized labor movement and worker solidarity over many decades of the last century, the unions there in general have been in favor of an open economy.

In the case of the poor as recipients of public services (like health and sanitation, education, etc.) the low quantity and quality of public services that reach the poor is often due to domestic institutional failure, not largely an external problem. The major effor required here is to trengthen the domestic institutions of accountability. In the case of the poor as users of common property resources (like, forests, grazing lands, irrigation water, fishery, etc.), the relationship withtrade and foreign investment liberalization is rather complex and closing the economy is not a solution. Large changes in the legal-regulatory or community institutional framework are often necessary.

In general I believe that globalization can cause many hardships for the poor in these countries, but it also opens up opportunities which some countries can utilize and others do not, largely depending on their domestic political and economic institutions, and the net outcome is often quite complex and almost always context-dependent, belying the glib pronouncements for or against globalization made in the opposing camps. In many countries poverty alleviation in the form of expansion of credit and marketing facilities or land reform or public works programs for the unemployed or provision of education, training, and health need not be blocked by the forces of globalization. This, of course, requires a restructuring of existing budget priorities and a better and more accountable political and administrative framework, but the obstacles to these are often largely domestic (particularly in countries where there are some coherent governance structures in place). In other words, for these countries, globalization is often not the main cause of their problems, contrary to the claim of critics of globalization; just as globalization is often not the main solution of these problems, contrary to the claim of some gung-ho free traders.

All this, of course, does not absolve the responsibility of international organizations and entities in helping the poor of the world, by working toward a reduction of rich-country protection on goods produced by the poor, by energetic anti-trust action to challenge the monopoly power of international (producing and trading) companies based in rich countries, by facilitating international partnerships in research and development of products (for example, drugs, vaccines, crops) suitable for the poor, and by organizing more substantial (and more effectively governed) financial and technology transfers and international adjustment assistance for displaced workers, and help in (legal and technical) capacity building for poor countries in international negotiations and quality certification organizations. 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 when it comes to the matter of relieving the poverty that oppresses the life of billions of people in the world.

I

A raging issue of academic and public debate (that has spilled over into the streets in noisy demonstrations in recent years) concerns the impact of globalization on the well-being of the world's poor. Of course, as is common in most contentious public debates, different people mean different things by globalization; some interpret it to mean the global reach of new technology and capital movements, some refer to outsourcing by domestic companies in rich countries, others protest against the tentacles of corporate capitalism or US hegemony (economic, military or cultural) . In this paper I shall limit myself to interpreting globalization simply as openness to foreign trade and *long-term* capital flows. I shall ignore here the important issues arising from the devastation caused to fragile economies by billions of dollars of volatile *short-term* capital stampeding around the globe in herd-like movements, or the substantial poverty-reducing potential of international (unskilled) labor flows from poor to rich countries (even in temporary and regulated doses).

In this paper I mainly provide a brief analytical account of the various processes through which globalization in our sense of the term affects the lives of the poor. (By poverty I shall primarily refer to the absolute poverty in low-income countries). In general I believe that globalization can cause many hardships for the poor in these countries, but it also opens up opportunities which some countries can utilize and others do not, largely depending on their domestic political and economic institutions, and the net outcome is often quite complex and almost always context-dependent, belying the glib pronouncements for or against globalization made in the opposing camps.

Barring a few, deeply flawed, attempts at generalization on the basis of cross-country regressions most of the general statements on the impact of globalization on poverty are essentially those of correlation. Pro-globalizers point to the large decline in poverty in China and India in the recent decades of international economic integration. We still lack convincing demonstrations that this decline is not to a large extent due to internal factors like expansion of infrastructure or the massive 1978 land reforms or the relaxation of restricts on rural-to-urban migration in China, or the spread of green revolution in agriculture, large anti-poverty programs or social movements in India. Those who are more dubious of global processes point out that in the same decades poverty has remained stubbornly high in sub-Saharan Africa. But this may have little to do with globalization, and more to do with unstable or failed political regimes, wars and civil conflicts which afflicted several countries in Africa; if anything, such instability only reduced their extent of globalization, as it scared off many foreign investors and traders.

If one goes beyond correlations, the causal processes through which international economic integration can affect poverty primarily involve the poor in their capacity as workers and as recipients of public services or users of common property resources. (I am ignoring here the case of the poor as consumers; whether they gain as consumers from trade depends on whether they are net consumers of tradeable goods or how important non-tradeables like subsistence sector produce and services are in their consumption pattern, or how monopolistic is the retail market structure which blocks the pass-through from border prices to domestic prices). Let us first take the case of poor workers. They are mainly either self-employed or wage earners. The self-employed work on their own tiny farms or as artisans and petty entrepreneurs in small shops and firms. The major constraints they usually face are in credit, storage, marketing and insurance, access to new technology, extension services, and to infrastructure (like roads, power, ports, telecommunication, and irrigation), and government regulations (involving venal inspectors, insecure land rights, etc.). These often require substantive domestic policy changes, and foreign traders and investors are not directly to blame (in fact they may sometimes help in relieving some of the bottlenecks in infrastructure and services and in essential parts, components and equipment). If these changes are not made and the self-employed poor remain constrained, then, of course, it is difficult for them to withstand competition from large agri-business or firms (foreign or domestic).

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Another increasingly important barrier to trade many small farmers of developing countries face in world markets is that rich countries now shut out many of these imports under a whole host of safety and sanitary regulations (sometimes imposed under pressure from lobbyists of import-competing farms in those countries). This actually increases the importance of the need for involving rich-country transnational companies in marketing poor-country products. These companies can deal with the regulatory and lobbying machinery in rich countries far better than the small producers of poor countries can and at the same time can provide to consumers credible guarantees of quality and safety. Of course, these companies will charge hefty fees for this marketing service (usually much larger than the total production cost), but the small farmers will usually be better off with them rather than without.

Similarly, it may be very difficult, costly, and time-consuming for small producers of manufactures or services in developing countries to establish brand name and reputation in quality and timely delivery, which are absolutely crucial in marketing, particularly in international markets (much more than comparative costs of production which traditional trade theory emphasizes). This is where multinational marketing chains with global brand names, mediating between domestic suppliers and foreign buyers, can be very helpful for a long time, and paying the high marketing margin they charge may sometimes be worth it. At the same time coordinated attempts on the part of developing countries, with technical assistance from international organizations, to build international quality certification institutions for their products should be a high priority. Those who are justifiably outraged by the extremely high marketing margins the monopoly multinational companies currently charge the poor producers should agitate more for anti-trust action, not anti-trade action. There should be 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.

The question of high marketing margins is related to the general issue of market structure. An area where more empirical work needs to be done in poor countries is on this question of comparative market structure with or without an open economy. On the one hand, an open economy is likely to be more ‘contestable’ (with even monopoly sellers facing more threats of potential entry) than an economy where domestic sellers are sheltered from foreign competition. On the other hand, the giant multinational companies with deep pockets can afford to resort to predatory pricing vis-à-vis smaller domestic sellers, particularly in industries where economies of scale and other such entry barriers are important. One can only note that over the years competition among multinationals in international markets has increased. Besides, it is not clear if domestic consumers (and workers) always prefer domestic monopolists to foreign ones. Some may prefer to be exploited by Citibank rather than by the local loan shark.

Trade liberalization, even when increasing the mean incomes of the poor, may heighten their vulnerability, particularly by increasing the variance of prices or income sources. Theoretically, there can be conflicting factors working here, and whether in a particular case variability increases or not can only be resolved empirically. For a brief summary of the empirical literature on this question, see Winters, McCulloch, and McKay (2004).

II

Turning to poor wage earners, the theoretical literature on how international trade affects the absolute level of the real wage of unskilled workers is extremely small relative to the one on wage inequality (which, though an important issue, is not my concern here). I can think of at least eight types of theoretical mechanisms through which this effect may be significant in developing countries, and *the net effect can go either way*.

(a) The traditional Stolper-Samuelson mechanism applied to a simple two-country (rich-poor) two-factor (capital-labor) world suggests that the workers in the poor country (presumably having abundant supplies of unskilled labor) having a comparative advantage in products intensive in unskilled labor should benefit from trade liberalization. This is, of course, complicated by the fact that developing countries (say, Brazil or Mexico or Turkey) may import labor-intensive products from even poorer countries (say, China or Indonesia or Bangladesh), so that trade even in terms of this mechanism may lead to lower wages in the former set of developing countries. Also, if a poor country has large supplies of other factors of production (like land or mineral resources), trade liberalization may not benefit the labor-intensive sectors, quite consistently with the traditional theory.

(b) If some factors of production are intersectorally immobile, and some goods are non-traded, real wage of an unskilled worker in a poor country may not go up with trade liberalization even in an otherwise standard model of trade theory. Take a three-good model in a hypothetical African country: one is a non-tradable good (say, a subsistence food crop) largely grown by women who for various social and economic reasons cannot move to other sectors, another good (say, an exportable tree crop) is produced largely by men in a capital-intensive way (maybe simply because tree crops lock up capital for a long period), and the third good is an importable (say, processed food) which is somewhat substitutable in consumption for the subsistence food. In this three-sector model it is not difficult to show that the real wage of women may go down when the importable processed food is made cheaper by trade liberalization (under the condition that the elasticity of substitution in consumption of the two foods is sufficiently high).

(c) Take a two-period model where labor on a long-term contract is trained in the first period and this training bears fruit in the second period, when these long-contract workers are more productive than untrained short-contract casual laborers. If opening the economy increases the competition and the probability of going out of business, employers may go more for short-contract and less productive and lower-wage laborers, bringing down the average wage. By a similar reasoning a firm may have less incentive in an open economy to invest in developing a reputation for fairness in wage payments.

(d) On the other hand, increased foreign competition may lead to exit of old inefficient firms and entry of new more efficient firms, or a better allocation of resources within existing firms[1]—this may lead to a rise in average wages in industries that attain such productivity gain.

(e) If firms facing more foreign competition and pressure to reduce costs outsource activities to smaller firms or household enterprises in the informal sector, the average wage (of those formerly employed in the formal sector) may go down, but this need not impoverish workers in general if the poorer informal workers get more employment this way.

(f) If the involvement of a large transnational company in the local labor market of a poor country raises the employers' monopsony power, wages (and employment) may fall. But there is little evidence that poor unskilled workers get lower wages (or fewer jobs) in the presence of those companies, compared to what they will get in their absence, other things remaining the same[2]. Contrary to the impression created by the campaign in affluent countries against 'sweatshops' run by transnational companies in poor countries, it can be pointed out that the poor are often banging at the

[1] See Pavcnik (2002) and the literature cited there.

gates of these sweatshops for a chance of entry, since their current alternative is much worse, in inferior occupations or work conditions or in unemployment. This is not an argument against efforts to improve their work conditions (and certainly not in favour of the totally indefensible cases of forced labor or hazardous or unsafe work conditions[3]), but it is an appeal for looking at the reality of the severely limited opportunities faced by the poor and the unintended consequences of trying to restrict rich-country imports of 'sweatshop' products in terms of the harm it causes to the displaced poor workers.

(g) If technical change in rich countries is biased against the services of unskilled labor (for which there is plenty of evidence) and if globalization means their impact reaches remote corners of the world, then again employment and wage of unskilled labor in poor countries will go down, as has been reportedly the case, for example, with global tenders to construction companies like Bechtel or Mitsui using labor-saving technology rendering many construction workers unemployed in India.

(h) As foreign competition (or even the threat of it) lowers profit margins, the old rent-sharing arrangements between employers and unionized workers come under pressure. Rents decline both for capital and labor, but labor may have to take a larger cut if, as has been argued, the increase in the (perceived) elasticity of demand in the product market (due to opening of the economy to trade and foreign investment) leads to an increase in the elasticity of demand for labor, lowering its bargaining power and generally weakening unions[4]. This may lead to lower wages, and, sometimes more important,

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[2] See, for example, Aitken, Harrison, and Lipsey (1996).

[3] Conceptually, one should distinguish between unsafe or hazardous work conditions and forced labor on the one hand and low-wage jobs on the other. Under capitalism just as workers willing to sell themselves as serfs are not permitted, unsafe work conditions that can cause bodily injury are to be strictly regulated. That is the reason why they are part of the ILO core labour standards that have been ratified by most countries. But the case for stopping workers from accepting low-wage jobs is much weaker.

[4] See Currie and Harrison (1997), Rodrik (1997) and Leamer (1998). The theoretical relation between product market demand elasticity and the elasticity of derived demand for labor is somewhat more complex than usual in the case of imperfect competition is not always clear-cut. The empirical evidence in developing countries on the trade-induced changes in the elasticity of demand for labor is rather scanty. Krishna, Mitra, and Chinoy (2001) do not find much support for a positive effect of trade on labor demand elasticity on the basis of plant-level data in Turkey. Fajnzylber, Maloney and Ribeiro (2001), on the basis of plant-level data and taking both incumbent and exiting or entering firms into account, find in Chile and Colombia very ambiguous effects of trade liberalization on wage elasticities.

increased risk of unemployment. Scheve and Slaughter (2002) show how globalization of production through multinational enterprises in particular and related trade can make labor demand more elastic (through increased product market competition and substitution of foreign factors of production including intermediate inputs for domestic factors) and thereby raise economic insecurity for workers.

Even when poor unskilled workers lose from trade liberalization, it may be possible to combine a policy of trade liberalization with a domestic policy of compensating the losers at low cost. Harrison, Rutherford, and Tarr (2003) have used a computable general equilibrium model for Turkey to show with a numerical exercise that a direct income subsidy to the losers of trade reform, financed by a VAT, is quite cost-effective. The main problem, of course, is that of credible commitment on the part of the ruling politicians that losers will be compensated. Recent history in many countries is full of reneged promises on the part of governments to displaced workers. Obviously, this is a particularly important matter in poor countries where there is very little effective social protection available from the state. Rich countries have better social safety nets and some programs in place helping displaced workers to adjust (like the federal adjustment assistance program in the US). International organizations that preach the benefits of free trade should take the responsibility of funding and facilitating such adjustment assistance programs in poor countries that can help workers in coping with job losses and getting retrained and redeployed. There should be more of income support programs like the Trabajar program in Argentina or programs to train and help the unemployed in finding new jobs like the Probecat in Mexico.

Until issues of general economic security for poor workers in developing countries are satisfactorily resolved, globalization is bound to raise anxiety and hostility among workers worried about their job security. If mass politics in a country is organized, as it usually is, in such a way that the nation-state is the primary political forum for demanding and getting the necessary redistributive and insurance functions of a society (rendered more important by the economics of international specialization), to the extent that nation state is weakened by forces of international economic integration, it is a matter of serious concern. Much depends, of course, on a society's institutions of conflict management and coordination. It is not a coincidence that countries that have a better record in building these institutions have coped better with the dislocations brought about by international trade: the major example is the case of Scandinavian countries where in spite of a strong tradition of organized labor movement and worker solidarity over many decades of the last century, the unions there in general have been in favor of an open economy.

III

Let us now briefly turn to the case of the poor as recipients of public services. In the low-income developing countries the poor, particularly those who are in the preponderant informal sector, do not receive much of effective social protection from the state (which make them particularly vulnerable in case of job displacement brought about by international competition), but the public sector is usually involved in basic services like education and health and public works programs. Cuts in public budgets on these basic services are often attributed to globalization, as the budget cuts to reduce fiscal deficits often come as part of a package of macro-economic stabilization prescribed by international agencies like the IMF. While there is a lot of scope for improvement in the stabilization programs to minimize the adverse impact on the poor, one should keep in mind that the fiscal deficit in these poor countries (except for the decline in customs revenue due to tariff cuts) are often brought about in the first place more by domestic profligacy in matters of subsidies to the rich, salaries for the bloated public sector or military extravaganza. Faced with mounting fiscal deficits the governments often find it politically easier to cut the public expenditures for the voiceless poor, and that is primarily due to the domestic political clout of the rich who are disinclined to share in the necessary fiscal austerity, and it is always convenient to blame an external agency for a problem that is essentially domestic in origin.

The low quality and quantity of public services like education and health in poor countries is not just due to their relatively low share in the public budget. To a large extent even the limited money allocated in the budget does not reach the poor because of all kinds of top-heavy administrative obstacles and bureaucratic and political corruption. Again this is a domestic institutional failure, not largely an external problem. The major effort required here is to strengthen the domestic institutions of accountability.

Since public services depend on the general nature of the state, an important question (which international economists usually ignore) is how the pressures of the international economy may shape the domestic political equilibrium. Large transnational companies, working through the rich country governments and with their threats of financial withdrawal, can sometimes shift the political equilibrium particularly in small countries and weak states (although it has to be noted that crass manipulations and 'gunboat diplomacy' of the past are getting somewhat more difficult than before). Others suggest that in countries with some established political and bureaucratic structures the internationally exposed sector if it becomes better-off may undermine older alliances that may have retarded economic progress. We need more systematic empirical studies of how opening the economy may change the nature of politics in a developing country, controlling for other factors. It can be argued that in Mexico the post-NAFTA exposure to international trade helped in bringing about the erosion of support for the long-dominant and corrupt ruling party (PRI). The mechanisms that are involved or if they work at all in forging political coalitions and institutions that may ultimately help the poor are likely to vary from one country to another.

Apart from basic public services, the poor are also users of common property resources, the decline in which is not usually taken into account in the standard estimates of poverty, based as they are on either household surveys of private consumer expenditure or national income accounts. Environmentalists argue that trade liberalization damages the poor by encouraging overexploitation of the fragile environmental resources (forestry, fishery, surface and groundwater irrigation, grazing lands, etc.) on which the daily livelihoods of particularly the rural poor crucially depend. Here also the answers are actually complex and mere trade restriction is not the solution. The environmental effects of trade liberalization on the rural economy depend on the crop pattern and the methods of production. Take, for example, an African rural economy where the exportable product is a capital-intensive tree crop (like coffee or cocoa), the import-substitute is a land-intensive crop (like maize), and there is a labor-intensive subsistence (non-traded) crop (like roots and tubers). The economy may have a comparative advantage in tree crops. In this case an increase in import substitution leads to an expansion of cultivated land under the land-intensive crop as well as a shortening of the fallow period, leading to depletion of natural vegetation and biomass. Trade liberalization in this context, through encouraging the production of the less land-intensive tree crop, can significantly improve the natural biomass, as has been shown by Lopez (2000) for Côte d'Ivoire in the latter part of the 1980's, using the data from the Living Standards Survey and some remote sensing data from satellite images.

One reason why land-intensive crops may lead to overuse of land and depletion of natural vegetation (or that expansion of the agricultural frontier in general leads to deforestation) is the lack of well-defined property rights or lack of their enforcement in public or communal land. In such cases private cost of expanding production is less than the social cost and there is overuse and degradation of environmental resources. If the country exports such resource-intensive products, foreign trade may make this misallocation worse. International trade theorists point out that trade restriction is not the first-best policy in this situation, correcting the property rights regime is. But the latter involves large changes in the legal-regulatory or community institutional framework which take a long time to implement, and given the threshold effects and irreversibilities in environmental degradation (a forest regeneration requires a minimum stock, for example), one may not afford to wait. In that case some program of (time-bound) trade restriction coupled with serious attempts at the overhaul of the domestic institutional framework may be necessary. In other cases domestic policy changes can be implemented much more quickly, and restricting trade is unnecessary and undesirable. For example, administered underpricing of precious environmental resources (irrigation water in India, energy in Russia, timber concessions in Indonesia, etc.) is a major cause of resource depletion and correcting it should not take much time. Domestic vested interests, not globalization, are responsible for the prolongation of such socially damaging policies.

In the case of some resource-intensive exports it is difficult for a country by itself to adopt environmental regulations if its international competitors do not adopt them at the same time and have the ability to undercut the former in international markets. Here there is an obvious need for coordination, in the environmental regulation policies of the countries concerned. Given the low elasticity of demand for many resource-intensive primary export commodities from developing countries in the world market, such coordinated policies, while raising prices and the terms of trade need not lead to a decline in export revenue.

A common charge against multinational companies is that they flock to developing country 'pollution havens' to take adavantage of lax environmental standards. In one of the very few careful empirical studies on the question Eskeland and Harrison (2003) examine the pattern of foreign investment in Mexico, Venezuela, Morocco and Côte d'Ivoire. They find no evidence that foreign investment in these countries is related to pollution abatement costs in rich countries. They also find that within a given industry foreign plants are significantly more energy-efficient and use cleaner types of energy compared to their local peers.

IV

In general while globalization in the sense of opening the economy to trade and long-term capital flows can constrain some policy options and wipe out some existing jobs and entrepreneurial opportunities for the poor and for small enterprises, in the medium to long run it need not make the poor much worse off, *if* appropriate domestic policies and institutions are in place and appropriate coordination among the involved parties can be organized. If the institutional prerequisites can be managed, globalization opens the door for some new opportunities even for the poor. Of course, domestic institutional reform is not easy and it requires political leadership, popular participation and administrative capacity which are often lacking in poor countries. One can only say that if we keep the focus on agitating against transnational companies and international organizations like the WTO, attention in those countries often gets deflected from the domestic institutional vested interests, and the day of politically challenging them gets postponed. In fact in some cases opening the economy may unleash forces for such a challenge.

As in the debates several decades back around 'dependency' theories in development sociology, there is often a tendency to attribute much of the problems of underdevelopment to the inexorable forces of the international economic and political order, ignoring the sway of the domestic vested interests. In many countries poverty alleviation in the form of expansion of credit and marketing facilities or land reform or public works programs for the unemployed or provision of education, training, and health need not be blocked by the forces of globalization. This, of course, requires a restructuring of existing budget priorities and a better and more accountable political and administrative framework, but the obstacles to these are often largely domestic (particularly in countries where there are some coherent governance structures in place). In other words, for these countries, globalization is often not the main cause of their problems, contrary to the claim of critics of globalization; just as globalization is often not the main solution of these problems, contrary to the claim of some gung-ho free traders.

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