



Pro-Poor Globalisation: an Elusive Concept or a Realistic Perspective?

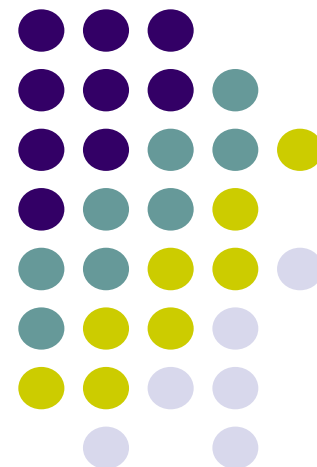
Machiko Nissanke

Department of Economics

School of Oriental and African Studies

University of London

23 July 2007





Globalisation-Poverty Nexus:

- **Questions** frequently asked:
 - Whether the actual distribution of gains is fair ?
 - The downside of globalisation – Who bears most the costs?
 - Whether changes in inequality (both ‘between- countries’ and ‘within-countries’) and the observed poverty dynamics are related to globalization?
- **Controversy** in the Debate
 - Globalisation is a policy -induced condition.
Globalization as a **Technology-Driven** Phenomenon
vs
Globalisation associated with *Policy Choices for Liberalisation and Privatisation*

Introduction: Research Topics, Objectives and Structure



- My **research** related to this topic:
 - UNU/WIDER Project, “The Impact of Globalisation on the World Poor”
 - Commodities and Macroeconomic Adjustment, External Debt and Foreign Aid
 - International Trade & Finance and Economic Development
 - African Development and Comparative Studies in Asia and Africa
- **Objectives & Structure**
 - To examine transmission mechanisms in the globalisation-poverty nexus
 - To present a policy framework for **Pro-Poor** Globalisation

Transmission Mechanisms

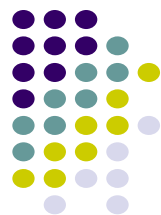


- The Globalisation-Inequality-Poverty Nexus
 - The globalisation-poverty relationship is complex and heterogeneous, involving multifaceted channels.
 - It may involve several **thresholds effects**.
 - Each link within the chain **globalisation-growth-income distribution- poverty nexus** is contentious and controversial.
 - Multifaceted channels interact dynamically over time and space, so the net effects of globalisation on the poor are **context-specific** and cannot be captured in cross-country regressions which require precise measurements, definition of **globalisation** and **poverty**.

Channels and Transmission Mechanisms(Cont'd)



- The **Growth** channel (the effects of globalisation on income inequality and poverty filter through economic growth)
- **Other** Channels through which globalisation can produce winners and losers affecting both *vertical* and *horizontal* inequality and poverty dynamics
 - changes in relative factor and good prices;
 - Differential cross-border factor mobility and associated changes in global market and power structures;
 - the nature of technical progress and the technological diffusion process;
 - the impact on volatility and vulnerability;
 - the impact on the flow of information;
 - Global disinflation and erosion of the re-distributional capacity of the nation-states
 - Institutions acting as a filter intensifying or hindering impacts



- *The Openness-Growth Link*

- Through trade and FDI, technology transfer: the direction of causality and how they may be inter-linked into a virtuous circle;
- the positive openness-growth link is neither spontaneously achieved nor universally observable.

- *The Openness-Inequality Link*

- There is much empirical evidence that openness contributes to more ‘within-country’ Inequality.

Globalisation-Inequality-Poverty : the **Growth-Inequality-Poverty Relationships**



- *The Inequality-Growth Link*

- The Traditional literature (the Growth-enhancing effects of inequality) vs.

The 'New' political economy of development literature linking greater inequality to reduced growth through high rent seeking activities, less secure property rights or social tension and political instability, underinvestment in human capital.

- *The Growth- Inequality Link*

- Growth does not have to lead to more inequality but often does;
- Growth patterns yielding more inequality in the income distribution would, in turn, engender lower future growth paths.

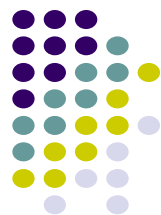


- [The Inequality-Future Growth-Poverty Link](#)

- High inequality tends to reduce growth, resulting in less of a growth-induced poverty reduction.

VS

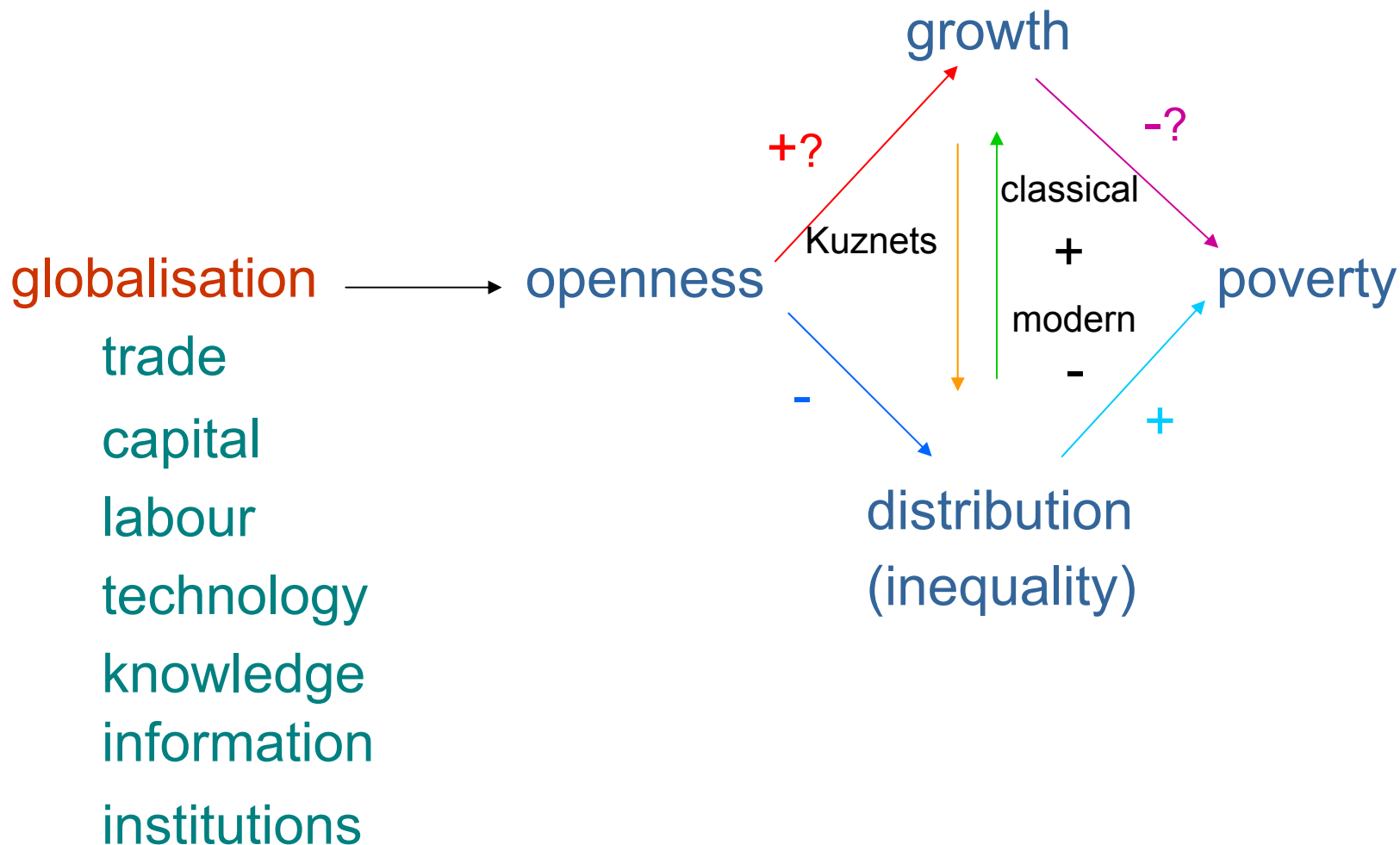
- Dominant Mainstream Views
 - the long-term distribution is broadly stable and liberalization does not affect distribution;
 - there is no association between growth and inequality (growth is distribution- neutral) and growth is the only realistic option;
 - “trade is good for growth and growth is good for poverty” (Dollar-Kraay, 2001)



The Inequality-Future Growth-Poverty Link (continued)

- A critical question: whether or not inequality is an impediment to poverty-reducing growth, i.e. whether high inequality attenuate the growth elasticity of poverty;
- The elasticity of poverty with respect to growth declines with the extent of inequality.
- Inequality is the **filter** between growth and poverty reduction;
- the **pattern** of economic growth and development, rather than the rate of growth per se, has significant effects on a country's income distribution and poverty dynamics.

The Globalization-Openness-Growth-Distribution (Inequality)-Poverty Nexus



Other Channels in the Globalisation-Poverty Relationship



- Changes in relative **product** prices (**wage** goods vs other goods), induced by globalisation, could have adverse effects on the poor;
- Relative **factor** prices induced by relative product price change with the advent of globalisation(the Stolper-Samuelson effects);
 - *Theoretical* prediction: unskilled labour are winners in low-income countries and losers in developed countries;
 - *Empirical* evidence: wage gaps between skilled and unskilled labour have been increasing in many developing countries (in particular, in Latin America and Africa)

Technical Progress and Technological Diffusion in the Globalisation-Poverty Relationship



- The nature of new technology is heavily biased in favour of skilled and educated labour
 - Technical change emanates from R&D activities in the developed countries in response to local developed-country conditions (labour-saving and skill-biased);
 - New technology is complementary to capital and skilled labour, while it is a substitute for unskilled labour;
 - Technical change will tend to increase inequalities in both developed and developing countries;
 - Technological diffusion and access to new technology is not universal and spontaneous;
 - Intensified privatisation of research in bio-technology and pharmacology may have adverse effects (e.g. TRIPS issues);
 - Widened productivity differences due to the asymmetric access to technology explain cross country wage/income inequality.

Factor Mobility in the Globalisation-Poverty Relationship



- **Perverse** factor movements :
 - Capital and skilled labour do not migrate to poor countries as much as among developed countries;
 - Tendency for skilled labour to migrate from developing countries to developed countries;
 - Propensity for capital flight to developed countries, particularly during periods of instability and crisis;
 - Portfolio capital flows are **diversification** finance than **development** finance (asset swapping for risk hedging and shedding);
 - FDI is dominated by intra-industry FDI among developed countries;

Factor Mobility in the Globalisation-Poverty Relationship (Cont'd)



- The **differentiated** degree of cross-border factor mobility (skilled labour and capital vs unskilled labour and land) affecting functional income distribution between **labour** and **capital**:
 - `Wage equalisation' does not take place through labour migration (as was the case in the previous globalisation)
 - *De facto labour* mobility through the increasingly free cross-border capital mobility and TNCs' ability to re-locate 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;
 - In fear of tax competition and asset migration, the capacity of governments to raise revenues for redistributive purposes has been eroded;
 - The poor is disadvantaged in relations to TNCs in commodity chain.

Income Divergence in the South



- The mere adoption of **open** trade and investment regimes per se would not guarantee developing countries' entry into the income “**convergence club**” ;
- Countries need to have reached the take-off point before benefiting from globalisation;
- the effects of international trade on growth are critically dependent on the pattern of specialisation and integration;
- The sectors are not symmetrical due to the **TOT** effects and the extent of **dynamic economic scales**;
- The effect of FDI also depends on which sectors FDIs are attracted into;
- The **divergence** in the **South** is explained in the difference in the internal pattern of economic growth and the forms of integration: some are able to benefit from **virtuous** cycles of globalisation-induced growth, while others are left behind in **vicious** cycles of globalisation-induced decline.

International Poverty Trap: Commodities, Debt and Aid



- The failure of the international community to deal with commodity-related issues in low-income countries;
- The demand management of commodity-dependent economies governed by external shocks should be **counter-cyclical** to the commodity price movements. In reality, **pro-cyclical** stabilization has been implemented;
- The **debt crisis** of poor countries coincided with the **commodity crisis** in the 1980s (Maizels 1992);
- The effective and flexible facility of **state-contingency financing** to deal with external shocks on an *ex-ante* basis has been absent;
- State-contingent contracts are **incentive-compatible** by indexing repayment to the state of nature rather than the ability to pay;
- The CIPA-based aid allocation mechanisms are not an ideal base to conduct a meaningful policy dialogue;
- Under the new aid architecture, recipient governments and donors tend to position themselves in an '**aid power**' game, resulting in an **inferior non-cooperative equilibrium**.

Growth Dynamics in Asia



- Many countries in East Asia have benefited from powerful growth-enhancing effects of international trade and FDI ;
- Registered ‘admirable’ **growth** rate but also accomplished a substantial **poverty** reduction ;
- This pattern of ‘shared’ growth is explained in terms of the region-wide **comparative advantage recycling** in production and export of labour-intensive goods, involving strong demand for unskilled and semi-skilled labour, driven by exporting labour intensive goods and pro-trade FDI through effective technology and knowledge, skill transfer;
- the **structural transformation** of their production and trade structure with continuous **upgrading** of their human skill endowments and technology/knowledge base, hence that of their comparative advantages.
- In turn, the integration into the global economy has in no small measures facilitated the process of structural transformation in Asia.

Policies of Strategic Integration



- The need for policies of *strategic integration*, not policy of *passive integration* or *de-linking* from the global economy;
- Whether global market forces establish a *virtuous* circle or *vicious* circle will depend on the initial conditions at the time of exposure and the effective design and implementation of policy to manage the integration process;
- National policies should be strategically designed in the light of the skewed nature of the on-going process of globalisation;
 - dynamic externalities and rent-rich activities are increasingly concentrated in high-skill, knowledge-intensive sectors;
 - trade is largely mediated through international production with an increasing share of intra-firm trade undertaken by TNCs
 - a hugely *skewed* distribution of gains from trade;
- Globalisation offer potential benefits for those countries with a strategic position (benefits are neither automatic nor guaranteed), requiring a capable nation-state. Passive liberalisation would lead to *marginalisation*.

Policies for Structural Transformation



- the path towards *structural transformation* of the agrarian economies, as a necessary condition for successful integration;
- critical *thresholds* for positive effects of globalisation on poverty reduction or a *non-linear* Laffer-type relationship between globalisation and poverty
 - At low income levels, openness is bad for equality: at medium and high income level it promotes equality;
 - Openness helps those with 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 can exert an income equalising effect;
- sizable *public investment* in skill upgrading as a specific pro-poor measure is a key for ensuring positive benefits from globalisation;
- a need to invest in rural physical and social infrastructures;
- The need for a continuing *gross* flow of resources to agriculture to increase this sector's productivity and potential capacity of contributing an even larger flow to the rest of the economy and hence a *net* surplus.

Policies for Structural Transformation (Cont'd)



- **East Asian Experiences:** the pro-poor pattern of public expenditure in favour of rural poor at the early stages, not a market driven process;
 - building productive **assets** of the **poor**
 - **wealth-sharing** mechanisms provided legitimacy for governments to pursue pro-growth and pro-business economic policy;
- **Sub-Saharan Africa:**
 - failure to undertake pro-poor public investment in rural areas in the early decades;
 - Fiscal retrenchment with advent of the debt crisis leading to little capacity and resources to undertake public investment in physical and social infrastructure for a nation-state building on a sustained basis;
 - used more the rationing of *divisible benefits* (e.g. subsidies and preferential credits) on the basis of favouritism to buy political support or to appease various interest groups;
 - Disenfranchised private agents and rural farmers refrained from making forward-looking productive investments.
 - Given a high degree of sovereign fragmentation, ethnolinguistic fractionalization, such a situation has led to several incidences of **fragile states** or state breakdown.

A Framework for Pro-Poor Globalisation



- Market-driven globalisation and growth would increase inequality everywhere;
- ‘within country’ income inequality has been steadily increasing. Asia is no exception to this trend;
- In both India and China, income inequality between provinces and states as well as interpersonal inequality has been increasing;
- The poor in Asia have been particularly subject to increased vulnerability from globalised market forces;
- *pro-poor globalisation* can be defined as the *inclusive* process of globalisation, wherein sharing opportunities for growth takes place *ex-ante*, inclusive of poorer segments of population in a global scale.
- *pro-poor* globalization would remain an *elusive concept* forever, if the process is left to market forces alone.
- Making pro-poor globalization a *realistic perspective*, there is a need for instituting mechanisms for *redistribution* of assets and income in favour of the poor as well as for *social protection* of the poor at the national, regional and global levels.

A Framework for Pro-Poor Globalisation (Cont'd)



- relationships between **equity/inequality** and **growth/efficiency**
 - The traditional view by economists: the existence of a fundamental **trade-off** between **productive** efficiency/growth and **social justice** represented by equity/equality considerations, on grounds of the incentive effects.
 - The alternative view: there is a long-run **complementarity** between the two;
 - If there are no clear trade offs on *economic* grounds, equitable and shared growth should be good for efficiency and growth;
 - wealth **redistribution** to the less endowed is **growth-enhancing**, as redistribution is a key to creating a virtuous circle in the **growth-equality nexus**.
 - a practical policy **choice** over the weight given to the ‘**equity**’ consideration against the ‘**efficiency**’ one reflects a social norm prevailing in a society
 - a strong **rational economic** case on the ‘**efficiency**’ grounds for **pro-poor globalisation**.

A Framework for Pro-Poor Globalisation (Cont'd)



- restructure **governance** mechanisms over economic policies at both national and global levels;
- At the **national level**, the need for a genuine **policy space** for choice over development strategy and institutional innovation in pursuing home-grown developing agenda;
 - A lack of sense of **ownership** propagates and promotes a cheating behaviour;
 - The need for allowing a process of **policy learning and policy experimentation** and different development models;
 - The need for allowing experimentations with different institutional set ups (development is associated with institutional **innovation**).
 - In reality, the policy-space of nation states has been eroded considerably in the name of globalisation with so many policy trilemma;
 - Globalisation cannot be used as a reliable substitute for a domestic development strategy.

A Framework for Pro-Poor Globalisation (Cont'd)



- At the **Global** Level;
 - A meaningful ‘**level playing field**’ could be created only if **effective** and fair ‘**differential**’ treatments are legitimately instituted as a guiding rule governing multilateral negotiations and institutions;
 - Reconstituting effective **global governance** structures over the globalisation process, including in addressing **global negative externalities** as well as in provision of **global public goods**;
 - more effective **re-distributional** instruments at both national and global levels;
 - The existing system of foreign aid should be replaced by more efficient mechanisms to mobilise and utilise resources for development finance as well as for provision of global public goods (e. g. innovative sources for development finance);
 - The need for a **global social contract** to finance equal opportunity investments in the weak and the disadvantaged, as well as the need for appropriate global arrangements to minimise the asymmetric risks and costs of global market failures.