Poverty in an Age of Globalization

The World Bank

October 2000

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Poverty in an Age of Globalization

Abstract

Tremendous advances have been made by large segments of the world population in this age of globalization. Yet, there is a fear that globalization is exacerbating inequality, and perhaps even worsening the lot of the poor by eroding their incomes, increasing their vulnerability, and adding to their disempowerment. This fear may not be universal, but it does play a role in the public perception that cannot be ignored.

Against this backdrop, this note reviews the empirical evidence on the impact of globalization on poverty, income distribution and vulnerability. There is compelling evidence that globalization has played an important catalytic role in accelerating growth and reducing poverty in developing countries. Its impact on inequality is more complex: global inequality has been reduced because of the inclusion of the most populous developing countries in the benefits of globalization, but many countries are still falling behind and there has been some increase in inequality within countries with a large number of poor. Trade integration does not increase income volatility; financial integration, however, can increase the propensity to develop crises which can have a severe detrimental impact on the poor. Globalization has put a premium on good governance – or conversely, increased the costs of weak governance characteristic of many poor performing economies "left out" by globalization.

This note argues that poverty is a global "bad" which calls for concerted collective action. In a globalized world, societies everywhere gain from poverty reduction, because of the negative externalities associated with poverty such as conflict, the spread of communicable diseases, and harm to the environment. Nonetheless, while the percentage of the world's poor has declined, the absolute number of people living in poverty has not. Poverty reduction remains the central challenge in today's global economy and society, and the note concludes with specific action steps that should be considered to help address this challenge.

Hopes and Fears in an Integrating World

The past century has seen more advances in global prosperity, and more people lifted out of poverty, than in all of human history. There are many reasons for this achievement, but globalization has played an important catalytic role. Yet, paradoxically, there is a widespread perception that globalization is having a detrimental impact on the poor.

In spite of the wide usage and the intensive debate that is now underway, there is no precise or widely-accepted definition of globalization. Globalization can be summarized as the global circulation of goods, services and capital, but also of information, ideas and people. It has shaped all of the 20th century, albeit with large cyclical variations, and has become an increasingly visible force in recent decades. Although there are many factors that have spurred and in turn have been reinforced by globalization, two have played a particularly important role in contributing to its accelerating pace in the 1980s and 1990s. The first is technical progress especially in information technology, international communication and global transportation. Not only goods but also services and knowledge can flow much more easily because of innovations such as the Internet. The second major development is the shift in policy orientation as governments everywhere have reduced barriers that had curbed the development of domestic markets and their links to the international economy.

These forces of integration have contributed to global prosperity and development transformation. Despite a population increase from 1.8 billion to 6.0 billion, and despite giant political upheavals and wars, real average income per person has at least quintupled over the past century. Average global per capita income today exceeds that of the richest country at the turn of the century. And today's average life expectancy exceeds that of the lead country 100 years ago.

The pace of progress has also accelerated. It took the United Kingdom some 60 years to double income per capita in the 19th century. Today we have seen that countries with populations ranging from millions to a billion can double income per head in a decade (China, Japan, Korea) and quickly reach life expectancy of more than 70 years. By enabling and indeed "pressuring" countries to adopt best practice pioneered elsewhere in the world, globalization has been an important agent for change and transformation.

Yet there are sharply divided views on the benefits that it has brought developing countries and the poor. One view is that globalization has "left out" most developing countries because they have been unable to reap its benefits. Another, contrasting view (often advanced together with the former observation) is that there has been "too much" globalization and that this has been detrimental to the poor.

Facets of Globalization

The evidence suggests that developing countries are becoming more integrated with the global economy and that the pace has accelerated over the past decade. But except for the successful East Asian economies, the level and pace of their integration has until recently lagged that of the developed countries. Moreover, progress on integration has been uneven between developing countries, in trade and international finance and more recently in terms of information technology.

Trade. There has been a growing divergence over the last three decades in shares of trade, between those countries actively participating in the global economy and those that do not. For many of the poorest, Least Developed Countries (LDCs) the problem is not that they are being impoverished by globalization, but that they are in danger of being largely excluded from it. The minuscule 0.4 percent share of these countries in world trade in 1997 was down by half from 1980.

Financial flows. Similarly, although financial flows to developing countries have also grown dramatically, they remain concentrated: fifteen emerging market countries, mainly in East Asia, Latin America and Europe, accounted for 83 percent of all net long-term private capital flows to developing countries in 1997. Sub-Saharan Africa as a whole received only 2 percent of the total.

Information Technology. Rapid technological change and global connectivity has generated an information and knowledge gap between countries, the so-called "digital divide." About half of the world's population has never made a phone call, while Africa has only 2 percent of the world's telephone mainlines. Only 2.4 percent of the world population are users of the internet, almost all of whom are concentrated in the OECD countries. Roughly 90 percent of Internet host computers are located in high-income countries that account for only 16 percent of world population. Overcoming this digital divide is going to be a key challenge for developing countries in the coming years.

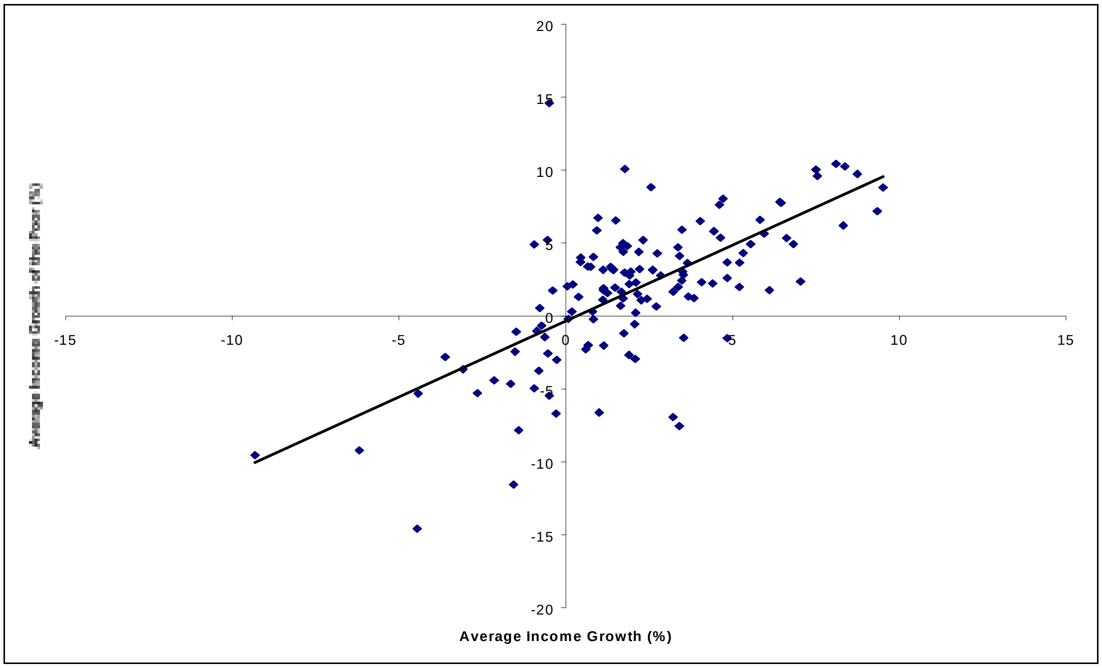
Globalization and Poverty

Poverty Trends. It is important to distinguish between the incidence of poverty as a percentage of a total population and the absolute number of the poor. The share of the population in poverty has declined for developing countries as a whole (from 28.3% in 1987 to 24% in 1998 based on $1/day and from 61% in 1987 to 56% in 1998 based on $2/day) and in all developing regions except Sub-Saharan Africa and Eastern Europe and Central Asia. Declines have been pronounced and sustained over a longer time period for the most populous developing countries. For example, the incidence of poverty in India measured by the official poverty line fell from 57% in 1973 to around 35% in 1998, whereas the incidence of poverty fell from 60% to 20% between 1985 and 1998 for Indonesia. Standards of living have also improved. Infant mortality rates globally have been cut in half during 1970-1997, from 107 to 56 per thousand; and life expectancy has risen from 55 years to 67 years. However, in spite of this broad based progress, more than 40 developing countries with 400 million people have had negative or close to zero per capita income growth over the past thirty years. And the absolute number of poor have continued to increase in all regions except East Asia and the Middle East. Overall, despite impressive growth performance in many large developing countries, absolute poverty worldwide is still increasing.

Globalization, Growth and Poverty. Globalization has played an important catalytic role in reducing poverty in developing countries through its impact on growth. More open economies, and those who have been more successful in accelerating their pace of integration, have recorded the best growth performance, whereas developing countries with inward-oriented policies have suffered from poor growth rates. A recent study estimates that an increase in the ratio of trade to GDP by one percent raises the level of income by one-half to two percent (Frankel and Romer, 1999). By stimulating higher growth, integration can have a strong positive impact on poverty reduction. There is now robust cross-country empirical evidence that growth is on average associated one-for-one with higher incomes of the poor (see figure 1). There are, however, significant variations in this relation between countries. In the aggregate, no more than 50% of the variation in the poverty measure is explained by differences in growth. Another way to state this is to say that poverty is affected by many factors other than growth. For example, initial levels of income inequality and changes in inequality may also impact poverty. There seems to be, therefore, large scope for designing more pro-poor growth policies although more research is needed to deepen our understanding of the poverty impact of specific policies. Also, average changes in poverty mask a great deal of churning associated with growth and structural change, in which some lose and others gain.

Direct Impact of Trade Integration on the Poor. Trade integration can also affect the poor beyond and above its impact through higher growth, but these effects are not clear cut. In general, for the poorest countries, opening up trade will expand the production of goods intensive in the use of low-skilled labor, but the demand for the least-skilled labor may not be boosted by trade and may be adversely affected by technological change spread by globalization. For middle-income countries, the impact on the poor is likely to be even less clear cut based on the prevalence of the poor in previously sheltered sectors relative to

Figure 1: Income of the poor grows one-for-one with average income



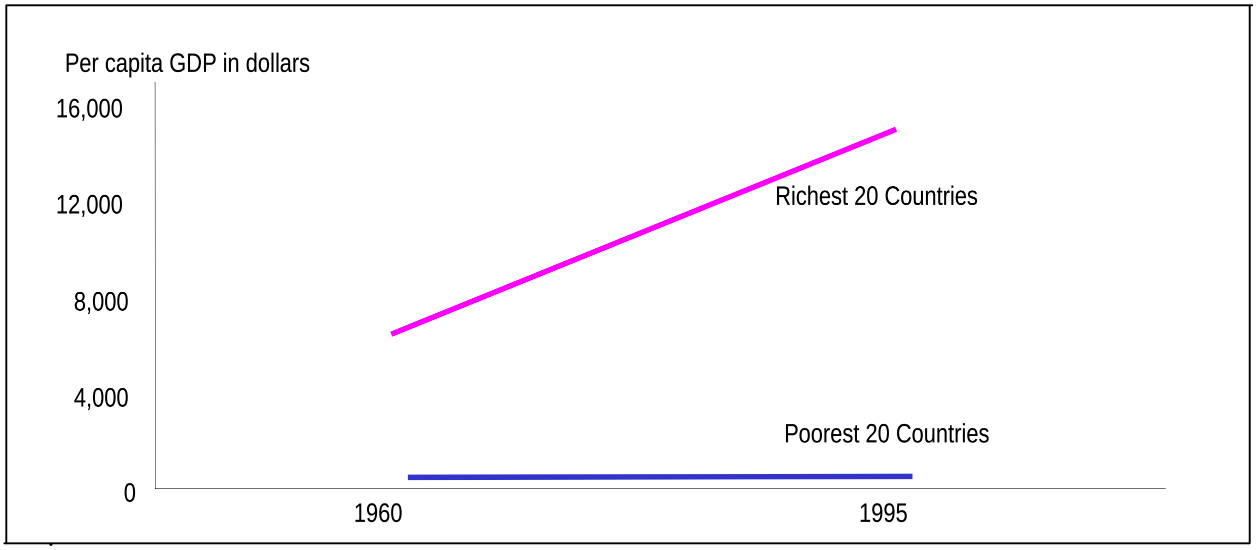
Source: Dollar and Kraay 2000.

potentially expanding sectors, and the competition coming from large low-income countries. The impact of trade liberalization will also vary depending on the post-liberalization pattern of inequality, which in turn will depend on the way trade reform is managed and on other accompanying reforms. There is evidence, however, from a large developing country sample of medium-to-long term growth episodes that, on average, in economies/periods of fast trade integration, income growth of the poor has kept pace with mean income growth (*Global Economic Prospects 2001*, forthcoming). By contrast, in economies/periods of slow or declining outward orientation, on average the poor have tended to fall behind.

Globalization and Inequality

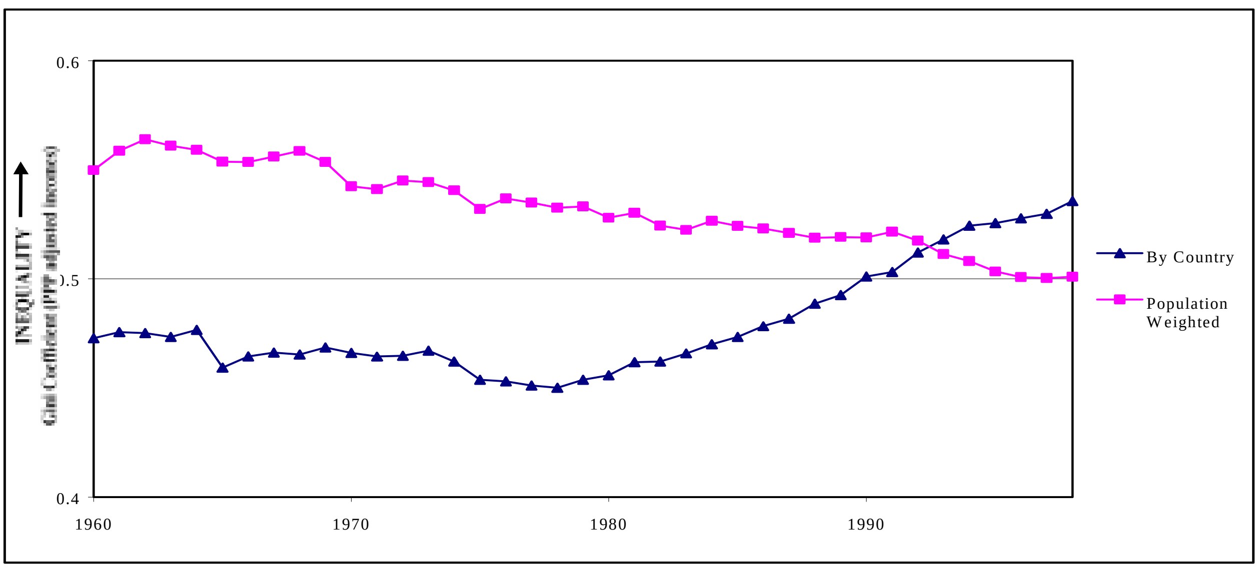
Trends in Inequality. Trends in global inequality depend on changes in inequality *between* and *within* countries. Inequality between countries has been characterized by two divergent trends in recent decades. The gap between the richest and the poorest countries has progressively widened (for example, doubling between the top 20 and bottom 20 countries over the past 40 years -- figure 2) as a significant number of countries are falling further behind compared not only to industrial countries but to other developing countries. The income distribution between countries has consequently worsened (figure 3). At the same time, there has been an acceleration in growth in many developing countries, including the most populous ones, so that the gap between their average incomes and that of industrial countries has begun to narrow. Overall, inter-country inequality weighted by population has decreased as a result (figure 3). China and India account for the bulk of this improvement. While inter-country inequality has improved, inequality within many of the most populous countries, with a large number of poor, has increased modestly (see figure 4).

Figure 2: The gap between the richest and poorest countries has increased …



Source: World Bank staff estimates

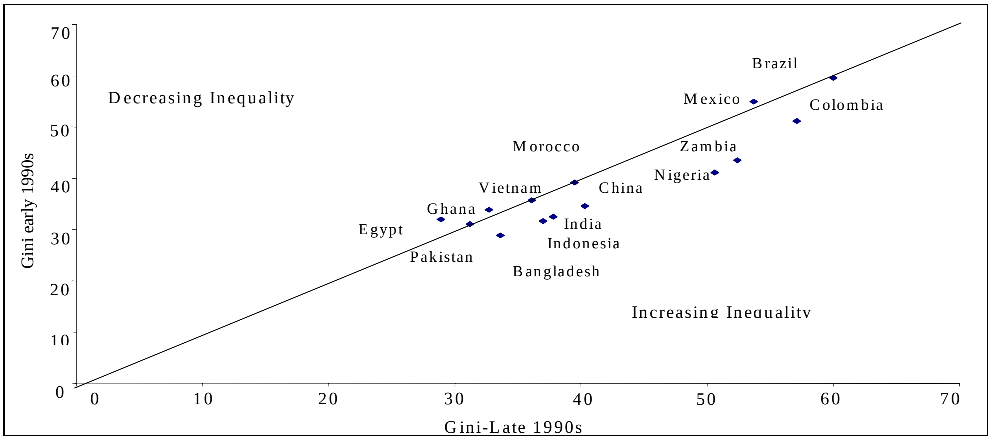
Figure 3: ... but inter-country inequality weighted by population has decreased…



Source: Milanovic 2000, draft.

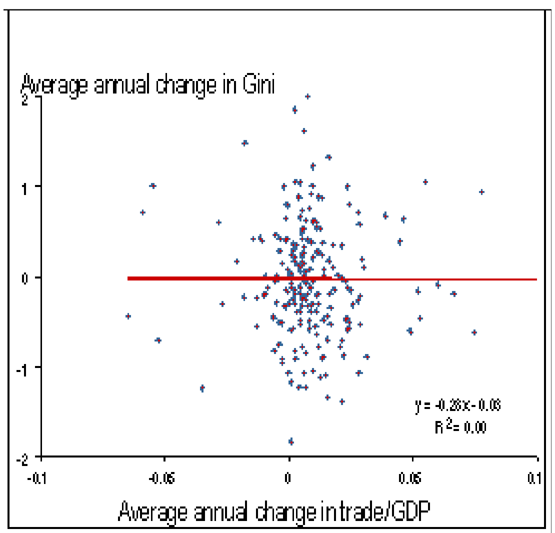
Role of Globalization. There is compelling evidence that increased openness to trade and investment has played an important facilitating role in accelerating growth and poverty reduction in an increasing number of developing countries, and hence in reducing overall global inequality. Conversely, lack of openness increases inequality between countries since closed developing economies have performed much more poorly than more open ones (see figure 6). The poor performance of these countries is not, therefore, the result of integrating with the world economy, but on the contrary it is due to their inability to achieve greater integration. This inability is largely due to domestic conditions (including wars and chronic macro instability), but it is often worsened by barriers to integration still imposed by the rich countries (see also Box 1). At the same time, there is no clear evidence of a systematic relationship between globalization and inequality trends within countries, either through growth or directly. The inverted-U relationship between growth and inequality suggested by Kuznets is not borne out by evidence for a large sample of countries spanning several decades. Periods of growth are almost as often associated with increases in inequality as they are with declines. Similarly, there is no simple association between openness to trade and changes in inequality (see figure 5). There are about as many cases where inequality fell with more trade openness as cases where it increased.

Figure 4: ... while inequality within many countries with a large number of poor has increased



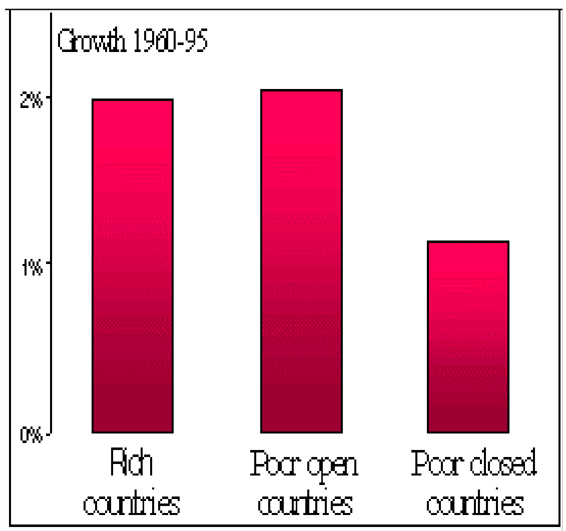
Source: Global Economic Prospects 2001, World Bank, forthcoming.

Figure 5:
Trade does not increase inequality within countries



Source: World Bank staff estimates.

Figure 6:
Lack of openness increases inequality between countries



Source: Ades and Glaeser, 1999.

Box 1: Patterns of Protection

Developed countries impose very low tariffs on imports of manufactures from other industrial countries. However, developing countries tariffs on manufacturing imports from other developing countries are four times as high. At the same time, both industrialized and developed countries heavily discriminate against agricultural imports – a bias which is exacerbated, in the case of industrialized countries, by huge subsidy programs for the agricultural sector. In this context, preferential regimes for least developed countries provide only very limited reprieve.

Patterns of protection on merchandise trade, 1995

	Importing Region	
Exporting region	**High Income**	**Developing**
Manufactures	%	%
High Income	0.8	10.9
Developing	3.4	12.8
World	1.5	11.5
Agriculture		
High Income	15.9	21.5
Developing	15.1	18.3
World	15.6	20.1

Source: Hertel, T. and Martin, W. (1999)

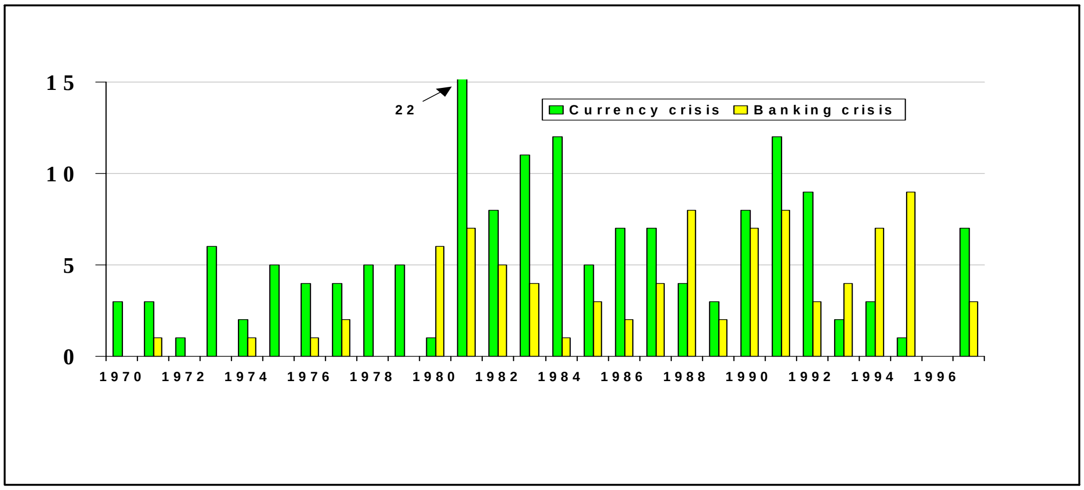
Globalization and Vulnerability

Trends in vulnerability. Has growing trade and financial integration increased the vulnerability of developing countries and of the poor? Evidence suggests that the volatility of both GDP and terms-of-trade adjusted export growth for developing countries declined significantly during the 1990s compared to the 1980s despite significant expansion of world trade and integration of the world economy (*Global Economic Prospects 2001*, forthcoming). The only region where GDP volatility increased was East Asia on account of the 1997-98 crisis. The data do reveal, however, that volatility affecting developing countries is much greater than for developed countries. There is no evidence however to suggest that more open economies have higher volatility of output. Nor is there any strong relationship between the product concentration of exports and GDP volatility.

Role of Globalization. While trade integration does not appear to increase vulnerability, and foreign direct investment flows have been remarkably stable, integration with financial markets can increase the propensity to develop crises (figure 7). The increased susceptibility to and costs of crises are due to inadequacies in the domestic policy and institutional framework and larger and more volatile private capital flows. Although the increased prevalence of financial crises has not raised GDP volatility (with the exception of East Asia), it can have a large detrimental impact on the poor both through output declines and the socialization of large resolution costs (see figure 8). Beyond these aggregate effects, globalization can increase insecurity of particular groups, especially workers, in a more foot-loose and fast changing world.

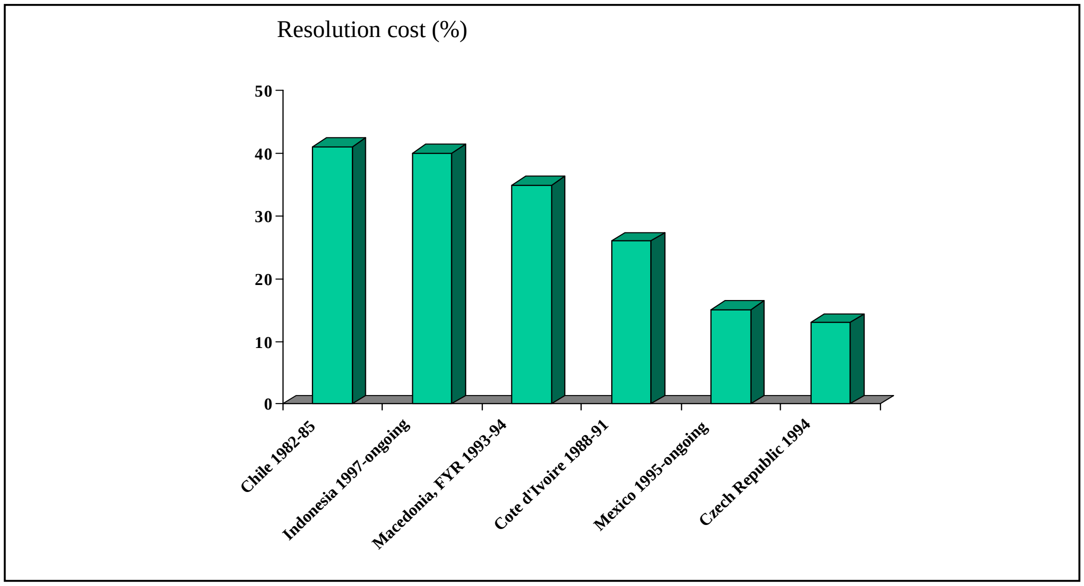
There are concerns, although with no systematic evidence, about greater instability in earnings and duration of employment, reflected in the antipathy towards globalization amongst labor unions in both developed and developing countries. The heightened sense of insecurity also reflects the sheer speed of change and the pressure to acquire new skills which is associated with the global spread of technical change.

Figure 7: Increased incidence of financial crises since 1980….



Source: Caprio and Klingebiel 1996, Frankel and Rose 1996, and Kaminsky and Reinhart 1997.

Figure 8: …which can cost up to 40% of GDP to resolve



Source: World Bank staff estimates.

Globalization, Governance and Empowerment

Good governance has emerged as one of the most important prerequisites for development. This is both because of the role of government as a builder and provider of institutions, and because the failure of governance can lead to an overall political breakdown. Once a country becomes a "failed state" (Yugoslavia, several African countries) development can be set back by decades. Weak governance has been an overriding characteristic of the poorest performing economies. Globalization has put a premium on good governance, because of the need to put in place policies and institutions demanded by an increasingly competitive global market place, because of pressures on governments to be transparent and more accountable to their citizens, and because of the higher costs of mismanagement.

Globalization has also raised new challenges for governance above the level of the nation-state. Technological gains, shifting geopolitics, expanding trade and financial flows and cheaper communications have created tremendous opportunities and lifted barriers to global knowledge and problem solving. They have also raised new risks and challenges—for example, financial instability, disease transmission and cross-border criminality. These challenges raise several questions for which there are no simple answers. How to adapt political and governance institutions to the new technological, financial and economic realities? How to secure the support and financing needed for collective action since many of these concerns are of a public good (or public "bad") nature? How should the global community deal with the problems of "failed states" and conflict resolution? How to deal with wide ranging misperceptions and concerns of legitimacy on issues related to globalization?

People everywhere want to be "empowered", and there is a heightened concern that global trends and forces are affecting people and societies without there being channels or institutions through which people could participate in influencing or controlling these trends. This is a challenge for the international community. A huge education effort is needed so that there can be greater legitimacy and political backing for international collective action. In this, there is an important role for global civil society, and post-Seattle, for a better dialogue and partnership between the official community and global civil society.

An Agenda for Action

Poverty in the midst of plenty is the central challenge in today's global economy and society. There are some striking contrasts that underlie this challenge at the turn of the millennium:

- While, for the first time in history, developing countries as a group have grown faster during the past decade than industrial countries—indeed almost twice as fast—and while some developing countries are becoming major players in the world economy, the least developed countries have seen large declines in living standards and are almost becoming invisible on the world scene.
- While the real income of the "average" person in developing countries has risen rapidly over the past ten years, the number of people in absolute poverty has not declined. Even countries that have benefited from globalization have large pockets of poor people, and in many countries, the divide between the rich and poor is increasing. Of the 2.8 billion

people living on less than $2 per day, approximately 1.9 billion people reside in emerging markets. 1.7 billion, or 59 percent of the world's poor, live in G20 countries.

Notwithstanding the positive impact of globalization on growth and poverty, if the trends of the past decade are extrapolated forward, inequalities between and within many countries will likely increase and many of the international development goals set by the international community for poverty reduction will not be achieved.

With a legacy of poor policies and poor performance, too many of the least developed countries and, worldwide, too many poor people are being left behind, in trade, in finance, in technology, in precisely the things that could help them grow and reduce poverty.

Policies at the ***country level*** remain key for poverty reduction even in an age of globalization. Assessment of development experience suggests several lessons for a more pro-poor development strategy at the country level:

- Attainment of sustained growth (in excess of 2 percent per capita income growth over a long period of time) is essential for poverty reduction.
- Macro stability, more open trade regimes and a vibrant private sector are core requirements to facilitate growth.
- Good governance and institutions have a crucial role in these processes. Governments should provide or foster the institutions which make markets work efficiently, thereby promoting entrepreneurship, competition and a positive investment climate. With weak institutions, poor governance and unsound policies, market reforms can go badly awry with great costs, particularly for the poor.
- Combating poverty involves much more than fostering sound market-oriented growth. The *World Development Report 2000/1* highlights the importance of actions in three main areas:
  - First, to enhance the *capabilities of the poor*, particularly through the improved provision of education and health, which are fundamental to well-being and which promote participation in market opportunities.
  - Second, to facilitate *empowerment* by making institutions more responsive and accountable to the poor, by strengthening the participation and influence of the poor in political processes and by removing social barriers. A particularly important dimension relates to gender: the Policy Research Report *Engendering Development* (World Bank, 2000) provides compelling evidence that removing barriers faced by women can have a significant positive impact on growth performance.
  - Third, to understand better and reduce the *vulnerability* of the poor to ill-health, economic shocks, natural disasters, violence, and transitional costs arising from market reforms.

All of these policies must be designed in a way that takes account of financial constraints and local realities—with special attention to the impact on the poor and on transitional losses—and secures ownership of key stakeholders through participatory processes. The comprehensive development framework and the new Poverty Reduction Strategy Papers are built on these principles and can provide the basis both for concerted action at the country level, and for mobilizing effective support from the international community.

Poverty reduction also requires **global collective action** because it is a global public good. Societies everywhere gain from poverty reduction, especially in a globalizing world, not just because of the moral imperative, but because of the negative externalities associated with poverty—such as conflict and violence, the spread of communicable diseases, illegal immigration and pressures on the environment. Public goods carry free-rider problems that are better addressed through collective action, because individual countries may be unwilling or unable to expend as much resources as is desirable. This need for collective action through pooling of knowledge and financial resources is also the ultimate rationale for global public institutions.

The following are the most critical areas where global collective action is needed to complement and reinforce country-based efforts on poverty reduction:

- **Sustain steady global economic expansion, and reduce the likelihood of, and contain the effects of global volatility.** Poorer countries, and especially the least developed, remain dependent on the sustained growth of demand in both OECD and emerging market countries. Developing countries also remain more vulnerable to shocks in the global economy. There is a continued need therefore for careful international policy coordination, and for efforts to strengthen the international financial architecture so as to reduce volatility and manage financial crises better when they occur.
- **Mobilize adequate and more effective aid for poverty reduction.** A first priority is eliminating the debt overhang of the poorest heavily indebted countries through concerted support for the HIPC initiative. But accelerated progress will also require more and better targeted financial support for poverty reduction in both low and middle income countries. Poverty cannot be fought effectively at the global level if the approach to foreign assistance is based on an oversimplified dichotomy of the very poor countries getting grants or concessional assistance and other countries relying solely on financial markets. Given that poverty reduction is a global public good, global collective action is needed to support poverty reduction in both low and middle income countries, even if the strongest and most focused support is for the poorest countries. Different degrees of concessionality, therefore, constitute a better response to the geographic incidence and political economy of poverty reduction.
- **Remove barriers to trade and provide preferential access to the poorest countries.** Elimination of barriers by industrial countries and emerging markets in some key areas (agriculture, labor intensive manufactures and services) can bring large benefits to the poor in developing countries. OECD import restrictions are especially harmful to the least developed countries, given that they are much more dependent on those export markets. Trade restrictions are exacerbated by agricultural subsidies: during 1997-99, the average annual value of industrial country subsidies amounted to 60 percent of total world trade in agriculture, and almost twice the agricultural exports of developing countries. Beyond removal of barriers, preferential access could help accelerate integration of the least developed at little cost to industrialized countries at large. Capacity building to support policy formulation and implementation, including for trade negotiations, also remain critical for these countries.
- **Provide increased support for international public goods.** The trend towards global problem solving has potentially significant implications for international institutions and for development assistance more broadly: new approaches and instruments will need to be developed to formulate and implement global collective action. There are a number of

critical areas from the perspective of poverty reduction and the inclusion of the least developed countries in the benefits of globalization. These include: communicable disease control, including tackling the HIV/AIDS pandemic as well as malaria, tuberculosis and childhood disease that together account for 60% of the global disease burden; protecting the global environment commons; information and knowledge sharing, including establishing the infrastructure and software capabilities needed in the poorest countries; and agricultural research in semi-arid conditions with large benefits for poor farmers in many of the poorest countries.

- **Help prevent conflict, and support countries emerging from conflict.** Wars and civil conflict remain a major factor holding back several of the poorest countries, and threatening many others. Better conflict prevention and resolution mechanisms can have huge payoffs in reducing human suffering and deprivation in which the poor suffer the most. It will always be very costly for the international community to pay for military intervention to stop or contain a conflict. Large financial resources – and many human lives—could be saved if global collective action could help prevent conflict by appropriate and timely measures focusing on good governance and poverty reduction.