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Point/Counterpoint

Making Globalization Work for the Poor

Kevin Watkins

Economists are sometimes chastised for their inability to reach a consensus view. George Bernard Shaw, the Irish playwright, captured the mood rather neatly when he wrote: "If all economists were laid end to end, they wouldn't reach a conclusion." If he were writing today, he would be forced to concede the rider "unless they were discussing the benefits for the poor of openness to trade."

"Openness" has become the great religion of the globalization era. No meeting of international financial institutions is complete without a homily to its benign effects. In the view of the IMF, the World Bank, and most northern governments, removing barriers to trade is one of the most powerful things that governments can do to give the poor a bigger stake in global prosperity. As a World Bank research report published in 2001 concluded, openness explains why "globalization leads to faster growth and poverty reduction in poor countries." Expressed differently, openness—along with associated free market reforms—holds the key to making globalization work for the poor.

Some critics respond by asserting that globalization can never work for the poor and that integration into global markets will inevitably cause more poverty and inequality. Widespread as it is, such "globaphobia" is unjustified. International trade has the potential to act as a powerful catalyst for poverty reduction, as the experience of East Asia demonstrates. It can provide poor countries and people with access to the markets, technologies, and ideas needed to sustain higher and more equitable patterns of growth.

But if globaphobia is unjustified, so too is "globaphilia"—an affliction, widespread on Nineteenth Street in Washington, that holds that increased integration through trade and openness is an almost automatic passport to more rapid growth and poverty reduction.

Growing income inequalities

Bluntly stated, the argument that globalization is working for the

poor does not deserve to be taken seriously. Between 1988 and 1998, the incidence of global poverty fell by the derisory rate of 0.2 percent a year. Already obscene global income inequalities are widening. At the end of the 1990s, high-income countries representing 14 percent of the world's population accounted for over three-fourths of world income—roughly the same as at the start of the decade. The world economy ended the 1980s more unequal than any national economy, and since then it has become even more unequal (the global Gini coefficient rose by 3 points between 1988 and 1993 alone). These figures come from a 1999 World Bank report, "True World Income Distribution, 1988 and 1993," authored by Branko Milanovic of the World Bank Development Research Group. Of course, they can be disputed. Some economists, on the basis of no credible evidence, assert that the incomes of rich and poor countries are starting to converge. Surely, the real issue is that current patterns of global inequality are inconsistent not just with civilized values but also with the international commitment to halve poverty by 2015.

International trade is reinforcing income inequalities. Because exports are growing faster than global GDP, they have an increasingly important bearing on income distribution. And world trade shares mirror income distribution patterns. Thus, for every $1 generated through export activity, $0.75 goes to the world's richest countries. Low-income countries receive around $0.03. Unless developing countries capture a far larger share of exports, trade will continue to fuel widening gaps in absolute income.

Within many developing countries, globalization is exacerbating inequalities at various levels. Income gaps based on access to markets, productive assets, and education are widening, acting as a brake on poverty-reduction efforts. At the same time, integration into global markets is reinforcing other forms of deprivation, notably in relation to gender. Globalization has drawn millions of women into employment, but increased income has gone hand in hand with extreme forms of exploitation, the erosion of workers' rights, and increased vulnerability to global markets. "Flexibility" in labor markets has become a euphemism for stark violations of basic rights. As one Colombian flower worker recently interviewed by Oxfam put it: "Yes, I have more money, but I have lost my health. I have a job—but I have no rights and no security." One of the problems with the current debate on globalization is that the non-income dimensions of poverty—such as self-respect, security, and health—have been ignored.

The problem with openness

The champions of openness claim that a renewed commitment to liberalization holds the key to making globalization work for the poor. Econometric survey results have been cited as evidence of the scientific veracity of this claim. Confidence in that evidence is reflected in policy conditions on trade liberalization attached to IMF-

World Bank loans and in the advice of northern governments to their southern counterparts. One recent IMF review of seven Poverty Reduction and Growth Facility programs found that each loan came with seven trade policy conditions attached. Following the 1997 financial collapse in East Asia, the IMF's rescue loans again came heavily laden with import-liberalization requirements. Most northern governments fully support this approach. For example, the U.K. Department for International Development's white paper on globalization provided a ringing endorsement of trade openness—as ever, citing World Bank "evidence." Unfortunately, the evidence in question is based on dubious economics and a highly selective interpretation of data and does not justify the confidence in policy prescription.

The most widely cited case for openness has been set out by David Dollar and Aart Kraay of the World Bank. Briefly summarized, their case rests on two core arguments. The first is that openness is associated with higher growth. Dollar and Kraay identify 24 developing countries that have seen large increases in openness, defined as a rising share of trade in GDP. These "globalizers"—a group that includes Brazil, China, India, Mexico, and Thailand—achieved per capita growth rates that were 4 percent higher than those of non-globalizers in the 1990s, a huge difference. The second argument is that increased trade is not associated, on average, with a systematic tendency to increased inequality: the poor share in growth in proportion to their existing share of national income. Other things being equal, the combination of higher growth and no change in income distribution translates into more rapid poverty reduction.

Some of the problems with this approach stem from the use of large samples to derive weighted averages. Using an unweighted average, the per capita growth rate for the "globalizers" falls to 1.5 percent (roughly the same as the non-globalizers)—and 10 of the 24 countries in the group record growth rates for the 1990s of 1 percent or less. Hardly an impressive foundation for sustained poverty reduction.

The more serious problem concerns what is being measured. Essentially, Dollar and Kraay are capturing an economic outcome in the form of a trade-to-GDP ratio. They then proceed to use changes in this ratio as a proxy for changes in trade policy. The implicit assumption is that trade liberalization is responsible for successful integration, with success in this case being defined as faster growth and poverty reduction.

In reality, this is little more than a speculative leap of faith. Countries such as China, Thailand, and Vietnam may be premier globalizers. They also have a strong record on economic growth and poverty reduction. Yet they have liberalized imports very slowly and still have relatively restrictive trade barriers. Conversely, countries such as Brazil, Haiti, Mexico, Peru, and Zambia have been world-

beaters when it comes to import liberalization, but have a weak record on growth and poverty reduction. In short, many first-rate globalizers have fifth-rate records on poverty reduction.

The point here is not to replace an openness blueprint with a protectionist one. But surely we need to look more closely at such issues as the sequencing, pace, and structure of import liberalization. To the extent that any broad lessons emerge from East Asia, one of the most important appears to be that export liberalization and promotion were pursued both in advance of, and far more aggressively than, import liberalization.

The position of Latin America is striking. Governments in the region have liberalized imports far more rapidly than in any other region, turning their countries into models of trade openness. The returns in terms of poverty reduction have been abysmal. At the end of the 1990s, some 15 million more people were living below the $1 a day poverty line than in 1987, despite economic recovery. In much of Latin America, rapid import liberalization has been associated with further concentration of already extreme inequalities. For example, in Peru, the livelihoods of the rural poor have been adversely affected by surges of cheap—often subsidized—food imports, while large-scale commercial farms have the resources to take advantage of export opportunities. On the balance sheet of winners and losers from trade liberalization, the poor are all too frequently to be found on the wrong side of the ledger.

What Latin America demonstrates is that distribution does matter. To assert that, on average, the incomes of the poor rise on a one-to-one basis with economic growth is to miss the point. Countries with low levels of income inequality can expect to register far higher rates of poverty reduction than highly unequal countries. The reasons are obvious. If the poor account for only a small share of national income, the rate of poverty reduction will be far slower. A highly unequal country like Brazil has to grow at three times the rate of Vietnam to achieve the same average income increase among the poorest one-fifth of its population. In Uganda, the ratio of economic growth to poverty reduction was 1:1 in the first half of the 1990s, compared with 1:0.2 in Peru. While it is true that rising inequality can be counteracted by rapid growth—as in China—it also reduces the rate of poverty reduction.

What really matters for the debate on globalization is why some countries have been more successful than others in combining export growth with poverty reduction. Increasing the share of the poor in market-based growth requires strategies that range from land redistribution to investment in marketing infrastructure, improved access to education and health care, and measures to tackle corruption. It may also require policies that have become anathema in the "openness" era, including border protection for smallholder farmers and (on a selective and temporary basis) for infant

industries, the restoration of basic labor rights, and minimum-wage protection.

The critical point is that openness in and of itself is not a poverty-reduction strategy. Poverty Reduction Strategy Papers (PRSPs), the documents prepared by governments entering IMF-World Bank programs, provide a real opportunity to develop a genuinely poverty-focused approach to trade policy. Unfortunately, that opportunity is being lost. Most PRSPs do little more than restate the familiar mantras on the benefits of openness, often with grave implications for poverty reduction. For instance, Cambodia's interim PRSP envisages rapid across-the-board import liberalization, with tariffs being lowered to an average of 5 percent even for sensitive agricultural products, such as rice. Yet, in a country where one-third of the population lives below the poverty line, it offers no assessment of the implications for rural poverty and income distribution, notwithstanding the fact that rice is the mainstay of the rural economy.

Selective openness

In one respect, openness is a curious economic doctrine. Northern trade and finance ministries are among its most ardent exponents, especially when directing policy advice to poor countries. Yet when it comes to their home economies, the principles of free trade are honored more in the breach than in the observance. The underlying ethos is "do as we say, not as we do," which is not a constructive basis for more inclusive globalization.

The costs of northern protectionism to developing countries have been well documented. On a conservative estimate, they are losing $50 billion annually. When poor countries enter global markets, they face tariffs some four times higher, on average, in industrial countries than those faced by other industrial countries. The most punitive tariffs are to be found in precisely those areas—such as labor-intensive manufacturing and agriculture—where developing countries enjoy the strongest potential advantage. Nowhere are the double standards more staggering than in agriculture. While developing countries liberalize, industrial countries spend $1 billion a day subsidizing overproduction and export dumping, destroying on an epic scale the livelihoods of vulnerable smallholder farmers in the process. The beneficiaries of this jamboree are a handful of politically influential large-scale farmers, such as the grain barons of the Paris Basin and the peanut magnates of Georgia.

One analytical tool that throws some light on the extent of northern hypocrisy is the IMF's Trade Restrictiveness Index (TRI)—a scale of openness that ranks countries from 1 (completely open) to 10 (completely closed). The countries of the European Union and the United States and Japan measure 4 on the TRI. Meanwhile, countries as poor as Uganda, Peru, and Bolivia measure between 1 and 2.

Uneven liberalization is one of the reasons that industrial countries continue to capture the lion's share of the benefits from globalization. Developing countries are absorbing the costs of adjusting to more open trade regimes, while northern protectionism excludes them from market opportunities. Current approaches to IMF-World Bank loan conditionality are reinforcing this unequal trade bargain. It is certainly hard to imagine the governments of France or the United States accepting liberalization conditions in agriculture routinely applied in poor countries.

Toward a new consensus

If we are to meet the challenge of poverty reduction, the sterile debate between "globaphobes" and "globaphiles" needs to be consigned to its proper place in the dustbin of the last decade of the old millennium. Governments, international financial institutions, and civil society need to engage in a real dialogue over how to make globalization work as a more powerful force for poverty reduction and social justice. At a national level, trade policy has to be brought into the mainstream of national strategies for poverty reduction and redistribution.

At the global level, northern governments need to do far more to create the conditions under which developing countries can capture a larger share of the benefits from trade. They could usefully start with a bonfire of tariff and nontariff measures applied to developing country exporters. But this is only a first requirement. At present, the rules of the multilateral trading system are designed to concentrate advantage in the rich world. The major beneficiaries of World Trade Organization agreements on intellectual property rights will be northern transnational companies, not the world's poor. Meanwhile, issues of vital concern to developing countries, such as the protracted crisis in commodity markets, do not even register on the global agenda. Making trade work for the poor requires rules that do something more than reflect the self-interest of the rich.

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Response

David Dollar and Aart Kraay

Kevin Watkins's article, "Making Globalization Work for the Poor," contains much that is consistent with our article in Finance & Development (September 2001), which was based on our working paper, "Trade, Growth, and Poverty." We agree with Watkins that globaphobia is unjustified and that international trade, rather than causing more poverty and inequality, can be a powerful catalyst for

poverty reduction by providing poor countries with access to the markets, technologies, and ideas they need for faster and more equitable growth. And, although it is not the subject of our paper, we do agree with Watkins's emphasis on the costs for poor countries of rich country protectionism—a view also expressed in the World Bank's *World Development Report 2000/2001: Attacking Poverty*.

Although there is much that we agree on, naturally we do not agree with Watkins's claim that our work is based on "dubious economics and a highly selective interpretation of data." Our research on the links between trade, growth, and poverty reduction was partly stimulated by the globaphobes' claims that increased flows of foreign trade and investment were making poor countries and the poor people in them worse off. We took these popular claims—as well as academic critiques of the evidence on trade and growth—seriously. Contrary to what some critics have been saying, we found that integration of poor countries with the global economy is associated with faster growth and poverty reduction. This does not mean that we subscribe to the simplistic view that "a renewed commitment to liberalization holds the key to making globalization work for the poor," as Watkins suggests. Rather, our finding is that increased participation in world trade, *together with good economic and social policies*, has worked well for a diverse group of poor countries. To quote from our paper,

> It would be naïve to assert that all of this improvement in growth should be attributed to the greater openness of these globalizing economies: all of them have been engaged in wide-ranging economic reforms. . . . China, Hungary, India, and Vietnam . . . strengthened property rights and carried out other reforms. . . . Virtually all of the Latin American countries included in the grouping stabilized high inflation and adjusted fiscally. . . ." (pp. 9-10)

Watkins criticizes our work on the grounds that our "implicit assumption is that trade liberalization is responsible for successful integration, with success in this case being defined as faster growth and poverty reduction." This is somewhat puzzling. To be clear, we define increased integration as a rise in the ratio of constant-price exports and imports to constant-price GDP, and we show that increased integration is associated with faster growth and poverty reduction. We also recognize explicitly, in our paper and in our *Finance & Development* article, that these changes in trade shares are only an imperfect proxy for measures of trade policy. Our only claim is that *changes* in trade shares are likely to be better proxies for *changes* in trade policy than *levels* of trade volumes are for *levels* of trade policy. It is also undeniable that some of the countries that have lowered trade barriers have not seen increases in trade and growth or a reduction of poverty; we recognize this in our paper. But this brings us back to another point on which we do agree with Watkins: "openness in and of itself is not a poverty-reduction strategy." We do

not claim that it is. The evidence suggests that a more liberal trade regime is one part of a policy package for successful growth and poverty reduction.

Finally, Watkins argues that personal income inequality is widening worldwide and points to globalization as the main culprit. We disagree on both points. First, Watkins selectively cites just one estimate of an increase in the global Gini coefficient of 3 points between 1988 and 1993. But other estimates, including our own, which are cited in the *Finance & Development* article, show either little change in inequality between the 1980s and 1990s or even a modest decline. And, as discussed in our article, given the vast measurement problems one encounters in constructing such estimates, none of these small changes in either direction over relatively short periods is likely to be statistically robust. In our view, what can be said robustly about global inequality is that it clearly rose between 1820 and 1980 and then stabilized, with perhaps a modest decline, afterwards. Similarly, concerning extreme poverty —the term used to characterize those living on less than $1 a day— the number of poor people continued to climb historically, until about 1980. Since 1980, the number of poor people has declined by an estimated 200 million.

Second, the experience of the countries we identify as globalizers has in fact been a force for reduced global inequality since 1980. The vast majority of the world's poor in 1980 lived in China, India, and a few other poor Asian countries, such as Bangladesh and Vietnam. Rapid growth in these countries has narrowed the gap in living standards relative to the developed world for a large fraction of the world's population, and all of these countries have reduced poverty significantly as they have integrated with the global economy. Their success makes a mockery of the extreme claims of the antiglobalization movement.