Globalization and the Economic Well-Being of Citizens

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Abstract

This paper contributes to the ongoing debate about the impact of globalization on the economic well-being of citizens in the developing world. It begins with a brief history of the process of world integration over the past century or so, highlighting the differences between the current and previous episodes of globalization. The study then attempts to provide answers to the following questions: Does globalization reduce or increase poverty? Does it equalize income across and within nations, or does it worsen income distribution? More broadly, does it improve the quality of life or not?

The paper offers two broad conclusions. First, no one country can reverse globalization, nor ignore its impact on citizens. Second, the impact of globalization is endogenous; it depends on what policy makers do at home to maximize the benefits and reduce the costs of globalization.

ملخص

تسهم هذه الورقة في الجدال الدائر حول تأثير العولمة على رفاهية الشعوب في الدول النامية. وبداية، تقدم الدراسة عرضا موجزا لمسيرة الاندماج الاقتصادي العالمي خلال القرن الماضي، مع إلقاء الضوء على الاختلافات بين العولمة حاليا مقارنة بالفترات السابقة؛ بعدها تحاول الورقة الإجابة على التساؤلات الهامة الآتية: هل تعمل العولمة على تزايد أم الحد من الفقر؟ هل تؤدي إلى التساوي في توزيع الدخول داخل الدول وبين بعضها البعض أم العكس؟ وبشكل عام، هل تساعد العولمة على تحسين مستوى المعيشة أم لا؟

وختاما، تخلص الورقة إلى نتيجتين رئيسيتين. أولا، لا توجد دولة تستطيع منفردة إلغاء مسيرة العولمة أو تجاهل أثرها على المواطنين. ثانيا، إن تأثير العولمة يتوقف على عوامل داخلية تتمثل في قيام راسمي السياسات على المستوى المحلي باتخاذ الإجراءات الكفيلة بتعظيم فوائد العولمة والحد من مخاطرها.

I. Introduction

There is intense debate over the economic impact of globalization on the well-being of citizens in the developing world. On one side, there are those who see the increasing flow of goods, capital, and labor as a step toward increased poverty in developing countries, inequality locally and internationally, the destruction of national industry and social dislocation.[1] On the other, there are those who see globalization as the only way forward to achieve rapid economic growth and poverty reduction, while maintaining social progress (e.g., Sachs and Warner, 1995). In between, it can be argued that the impact of globalization on the well-being of citizens is conditional. It depends on how the international community addresses issues of capital volatility, trade liberalization, harmonization of domestic policies and support for countries in distress. Equally, if not more importantly, the economic impact of globalization on developing countries depends on how these countries position themselves to benefit from globalization.

In this paper, I argue that the third view is both realistic and desirable for developing countries. The insulation from the world market deprives countries from the much-needed capital, technology, low cost and better quality of goods and services, as well as the opportunity to create jobs in exporting sectors. The unqualified integration of developing countries in the world markets can be equally costly, as the recent crises in East Asia, Russia and Brazil demonstrate. Capital flight can happen suddenly, leading to a collapse of national currencies and a rise in unemployment. Industries could fail to cope in a more competitive environment due to excessive protection in the past. Wage disparity between skilled and unskilled labor could escalate. And developing countries may only be able to attract polluting industries.

To elaborate on these views, I begin in the next section by giving a brief account of the extent of world integration and the qualitative differences between this episode of globalization and previous episodes. Section 3 discusses the potential benefits and costs of globalization, focusing on the link between globalization and poverty, inequality and

[1]To cite but one example, the Sienna Declaration prepared by the International Forum for Globalization states that: “Rather than leading to economic benefits for all people, it (globalization) has brought the planet to the brink of environmental catastrophe, social unrest that is unprecedented, economies of most countries in shambles, an increase in poverty, hunger, landlessness, migration and social dislocation." Source: http://www.twnside.org.sg/title/siena-cn.htm.

the quality of life. Section 4 offers some concluding remarks.

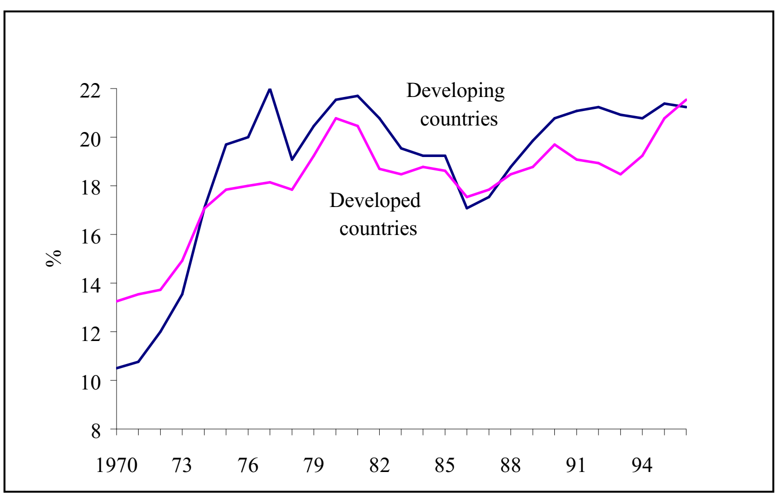
II. The Extent and Nature of Globalization

How well connected is the world economy? Is this wave of globalization different from previous episodes? These are the questions addressed below.

Trade in Goods and Services

The combination of falling trade barriers and advancements in the technology of communication and transportation has brought the world much closer together. Aggregate data show that the ratio of exports and imports to GDP has increased sharply, especially in the period following 1972 (Figure 1). These data, furthermore, tend to underestimate the extent of world integration, in view of the increasing share of non-tradable goods and services (e.g., education, health, finance, insurance, real estate and domestic trade) in the GDP of most economies. While developed countries are trading more with the rest of the world, so are developing countries. In addition, developing countries are now exporting more manufactured goods and less primary commodities (like food and raw materials).

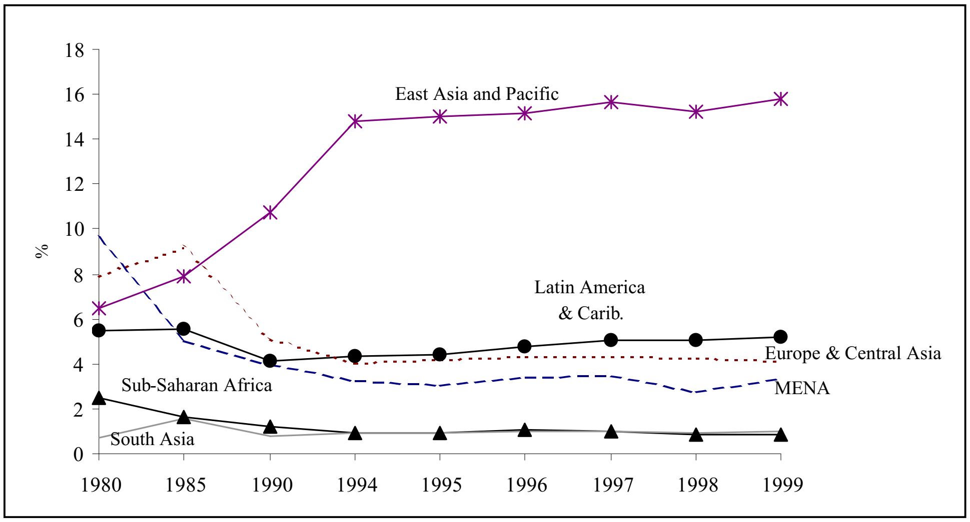
Figure 1. Trade in Goods and Servicesas Share of GDP



Source: Slaughter, Matthew J. and Phillip Swagel (1997).

But these developments do not apply evenly across the board (Figure 2). The bulk of exports of the developing world is mostly concentrated in East Asia. Sub-Saharan Africa and South Asia export a much lower proportion compared to the rest of the world. In between, lie Latin America, Europe and Central Asia, and MENA. Over the past two decades, MENA and Europe have been losing ground while East Asia has become increasingly integrated in the world economy.

Figure 2. Share of Developing Region in World Exports, 1980–1999

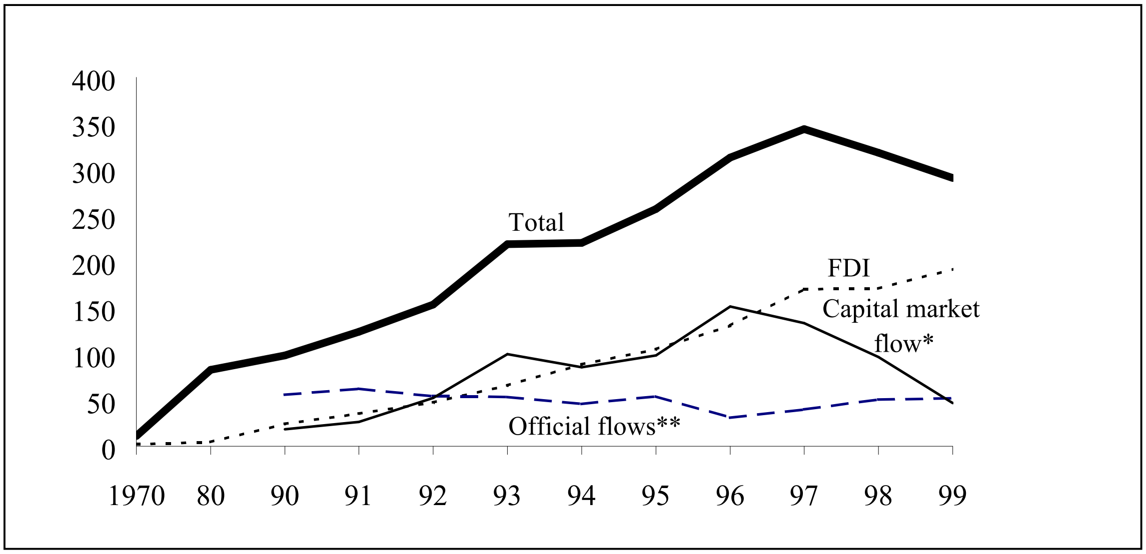


Source: Calculated from UNCTAD 2000.

Factor Mobility

Trade expansion has been accompanied by unprecedented capital mobility, especially since the 1980s (Figure 3). The bulk of the increase in capital flows came from the private sector (in the form of FDI and portfolio investment). Net official flows of aid have fallen, but foreign direct investment became a much more important channel for capital mobility than portfolio investment. In addition, FDI is increasing steadily, while portfolio investment and credit have fallen in the wake of the financial crises in the late 1990s.

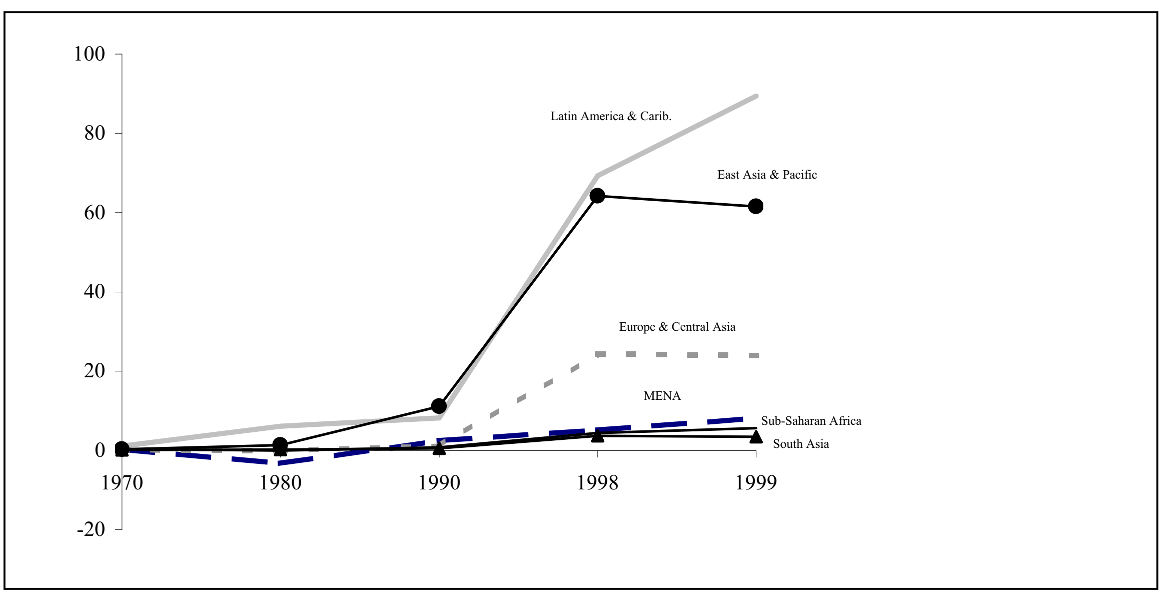
Figure 3. Net Long-Term Flows to Developing Countries, 1970-1999 ($ billion)



*Capital market flows include portfolio investment and debt flows in form of bank lending and bond financing.
**Concessional and non-concessional official flows.
Source: World Bank, Global Development Finance, 2000.

Like trade, the flow of capital to different developing regions has become increasingly non-uniform. Figure 4 illustrates this for FDI flows to developing countries. While Latin America and East Asia attracted around 78 percent of FDI flows to developing countries in the late 1990s, Sub-Saharan Africa, MENA and South Asia collectively attracted only 8 percent.

Figure 4. Net FDI by Developing Region, 1970-1999 ($ billion)



Source: World Bank, Global Development Finance, 2000.

The importance of capital inflow to developing countries lies partly in that it supplements domestic savings to levels that enable the recipient economies to grow more rapidly. Furthermore, it enables these economies to access advanced knowledge about production techniques, management practices, and sometimes export markets. These benefits are as important for development as physical capital itself. However, capital inflows can be costly. Indeed, they complicate macroeconomic management and expose countries to the risk of sudden capital flight. These costs can be high in terms of economic activity and employment.

As for labor mobility, data are hard to come by. However, the IMF (World Economic Outlook 2000) reports that the size of the labor force born in other countries has increased by one-half during the period 1965-90. The same report further notes that most migration is among developing countries. The remittances from migration in countries like Egypt constitute an important source of foreign exchange earnings. Where migration of labor occurs from developing to developed countries, it has the effect of reducing wage divergence.

The Nature of the Recent Episode of Globalization

The current episode of world integration is not new. Historically, the ratio of trade to GDP grew from 1820 to 1913, followed by a period of low integration between 1913 and 1950 due to the two world wars and protectionism during the Great Depression (Table 1). Since 1950, however, industrial economies led the integration process to reach in 1970s the level of integration that was prevalent at the turn of the century (Krugman, 1995; Irwin, 1996). Since then, the trade liberalization policies adopted by several developing countries have intensified the level of world integration to unprecedented levels.

Table 1. Globalization measured by share of exports in GDP (%)

Years	World Merchandise exports/GDP
1820	1.0
1870	5.0
1913	8.7
1929	9.0
1950	7.0
1973	11.2
1992	13.5
1995	16.0

Source: ILO, (1999).

While the recent wave of globalization is not new, trade is now much deeper and capital flows are more far-reaching. According to Krugman (1995), the current wave of globalization in trade is characterized by: (1) a rise of intra-industry trade, (2) increased break of production geographically, (3) new countries with high trade-GDP ratios, and (4) large exports of manufactured goods from low-to high-wage countries. Similarly, although the current level of capital inflow to GDP is not higher than it used to be a hundred years ago, it is different in character. Fishlow (1985) notes that earlier capital inflows were received by governments in colonized countries, and were devoted to a narrow range of infrastructure projects. Today, the nature of both borrowers and the allocations of capital is more diverse.

What is equally interesting is that the potential for reversal of the current wave of globalization is considered much lower than before. Indeed, there are those who argue that political pressure will eventually mount to erect higher trade barriers, slow down immigration, and restrict capital flows (Jeffrey Williamson, 1998). Echoes to that effect are heard, for example, in the US. However, the probability of reversal of the current wave of globalization seems low. Bordo, Eichengreen and Irwin (1999) provide the following rationale: The steady expansion and cyclical stability experienced by developed countries in the post-war period support open trade regimes. Most countries now have social insurance schemes (e.g., for unemployment) and escape clauses in world trade agreements, both of which ease the negative effects of competition from imports. In addition, the new wave of globalization is creating its own supporters at home, especially those engaged in exports. Accordingly, globalization seems to be here to stay.

III. Globalization and Human Development

If globalization is here to say, at least in the foreseeable future, it is important to ask such questions as: does it reduce or increase poverty? Does it equalize income across and within nations, or does it worsen income distribution? More broadly, does it improve the quality of life or not? We discuss these questions in turn.

Globalization and Poverty

The most basic argument in favor of a positive association between globalization and poverty reduction is that greater openness increases competition, access to capital, technology, cheaper imports, and export markets. Greater competition leads to more efficient allocation of resources and a division of labor that enables countries to focus on doing what they can do best. Greater access to capital, technology, cheaper imports and markets enables countries to do more than they would have been able to do on their own. As a result, per capita income, including per capita income of the poor, increases faster than otherwise.

There are reasons, however, why this argument may not hold. First, there is no guarantee that openness will increase per capita income, since openness is but one of the preconditions for faster economic growth. Indeed, standard growth regressions often include on the right hand side a number of initial conditions (e.g., initial per capita income, human capital stock, a measure of inequality) and a number of policy variables (including openness, rule of law, size of government). Where countries do not possess other pro growth conditions, openness may not necessarily lead to a higher per capita income.

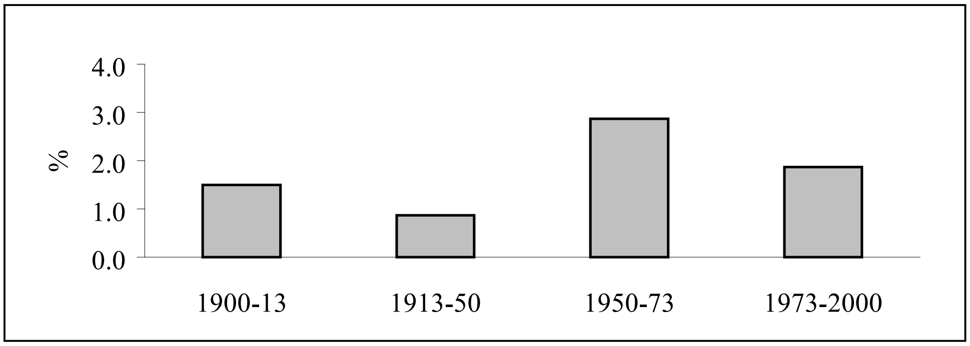
By the same token, even if openness is associated with faster growth in per capita income, there is no guarantee that poverty will decline. Poverty is influenced by a host of factors in addition to growth. These factors include the pattern of public expenditures, the nature of existing safety nets, and the institutional arrangements for sharing the benefits of growth. Moreover, openness could affect employment adversely, at least in the short run, as it takes time for labor and capital to shift from import-competing industries to expanding competitive export industries.

Given the theoretical ambiguity about the relationship between openness, growth, and poverty, what does the evidence say? There is mounting evidence to support three broad conclusions. First, openness is associated with faster economic growth. Second, economic growth is associated with a reduction in poverty. Third, these positive results hold on average, leaving some countries, regions, and groups adversely affected by globalization.

On the link between openness and growth, an IMF study (2000) shows that global per capita growth increased five-fold during the 20th century. Most of the increase took place in the second half of the century, when trade and later financial liberalization increased rapidly

(Figure 5). In contrast, per capita income declined to less than 1 percent in the period 1913-1950, when the world became less integrated because of excessive protection and pervasive capital controls.

Figure 5. Global Per Capita Real GDP Growth (Average annual percentage change)

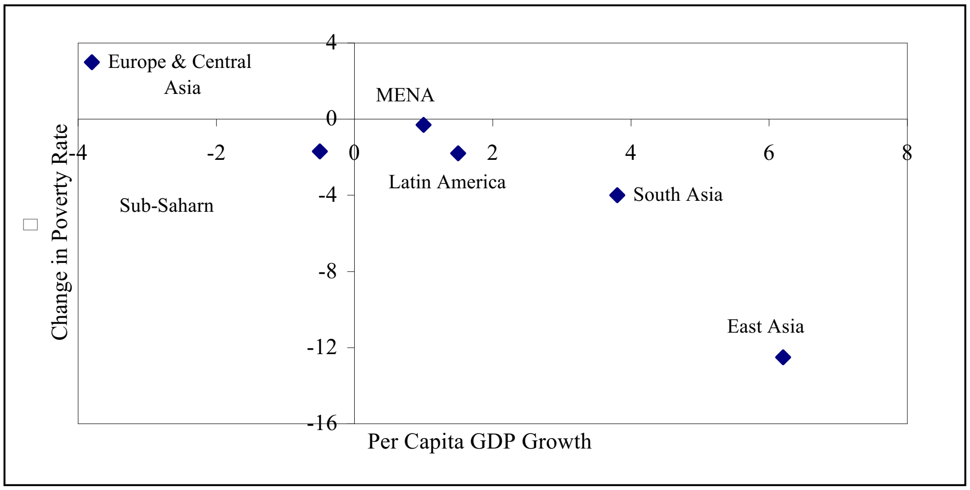


Source: IMF 2000.

Other studies have reached similar conclusions. For example, Sachs and Warner (1995) find a positive association between growth and openness. Frankel and Romer (1999) show that an increase of one percent in the ratio of trade to GDP increases per-capita income by 1.5-2 percent. Edwards (1998) finds supporting evidence to the notion that openness improves total factor productivity and accelerates economic growth.

Regarding the link between globalization and poverty, Figure 6 shows that countries, which achieve rapid economic growth also manage to reduce poverty (East Asia). Also, it shows that countries that grow the least fail to eradicate poverty (Sub-Saharan Africa). MENA and Latin American countries fall somewhere in between, where both regions grow modestly and reduce poverty also modestly. The impact of growth in per capita income on the poor has been estimated by Dollar and Kraay (2000). They show, for a large sample, that growth in the income of the poor (defined as the bottom fifth of the population) rises about one-for-one with the growth rate of overall per-capita income.

Figure 6. Relation between Poverty Reduction and Growth, 198998 (%)



Source: World Bank, Global Economic Prospects and the Developing Countries, 2000.

This is not to say that poverty has been eliminated. On the contrary, despite an overall reduction in the number of the poor worldwide, the variations across regions are striking. Most importantly, the absolute number of the poor has declined appreciably only in East Asia, but increased almost everywhere else. The incidence of poverty, defined as the share of population living on less than $1 a day, also declined in East Asia, and to a lesser degree in the rest of the developing world. However, the poverty rate has increased in Europe and Central Asia, following the dramatic change in their economic systems. In short, not all developing countries are benefiting from the nexus of globalization, growth and poverty reduction. Much depends on what these countries do along with integration in world markets.

Table 2. Income Poverty by Region, 1990 and 1998

	Number of people earning below US$1 a day (Millions)		Poverty rate	
	1990	1998*	1990	1998*
East Asia	452.4	278.3	27.6	15.3
East Asia excl. China	92.0	65.1	18.5	11.3
South Asia	495.1	522.0	44.0	40.0
Sub S. Africa	242.3	290.9	47.7	46.3
Latin America	73.8	78.2	16.8	15.6
MENA	5.7	5.5	2.4	1.9
Europe and Central Asia	7.1	24.0	1.6	5.1
Total	1276.4	1198.9	29.0	24.0

* Estimates

Source: WB, Global Economic Prospects and the Developing Countries, 2000.

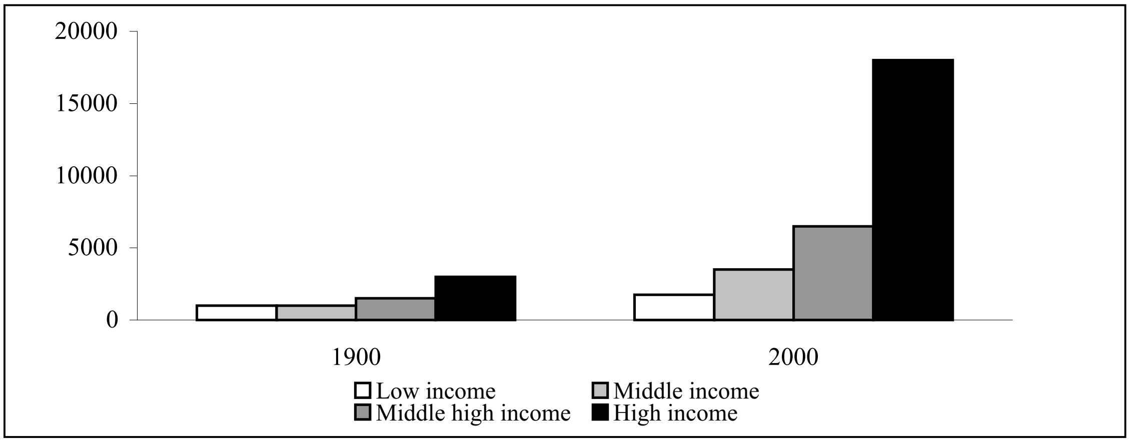
Globalization and Inequality

In principle, openness should reduce inequality between developed and developing countries. This is because openness increases the demand for the factor of production that is relatively abundant in the liberalizing country (labor in developing countries), but relatively scarce in the rest of the world. Higher demand for labor in developing countries should bring about pressure for price (wage) equalization across countries (according to the Stolper-Smuelson theorem), thereby raising the standard of living in the poorer countries. Within rich countries, openness is expected to increase income disparity between skilled and unskilled labor as capital migrates to developing countries for cheaper unskilled labor.

These predictions may not hold for several reasons, however. Because labor is less mobile than capital, it is more vulnerable to taxation. Put differently, while capital can escape taxation, labor cannot. The relative mobility of capital and the relative fixity of labor also tend to weaken the bargaining position of trade unions for higher wages in countries where trade unions are strong. Last but not least, globalization is not the only factor that affects the demand for and incomes of different factors of production. The pattern of production, investment and technology has significant effects on the demand for labor of different skills, while these effects on income distribution within countries are unpredictable.

In view of this ambiguity, it is important to look at the evidence to see whether there is any association between globalization and equality across and within countries. As for inequality across countries, the data show a significant increase in the average per capita income of the rich and poor countries during the 20th century. However, progress has been uneven, with the richest countries doing relatively better than the poorest. According to the IMF study (2000), the richest quarter of the population saw a six-fold increase in their per capita income, while the poorest quarter only saw an increase of less than three-fold (Figure 5). In recent decades, which coincided with increased globalization, data from the World Bank show that the average per-capita income in the richest 20 countries was 15 times that of the poorest 20 in 1960. This gap has since doubled to reach 30 times, with per capita incomes in the poorest 20 countries hardly changing if not falling in some cases. It can therefore be concluded that globalization is associated with greater inequality across countries.

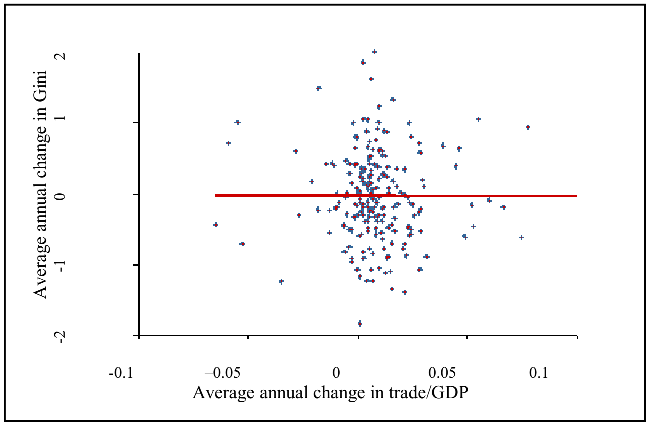
Figure 7. Per Capita GDP (1990 purchasing-power-parity dollars)



Source: IMF, 2000.

As for inequality within countries, the evidence suggests that there is no simple association between changes in trade openness and changes in inequality (Figure 7). There are of course countries that experienced increased inequality as they integrated globally. In the developing world, such countries include Argentina, Chile, Colombia, Costa Rica, Uruguay and China (Robin, 1996). Similarly, Feliciano (1995) finds that trade liberalization in Mexico in the mid-to-late 1980s led to a relatively higher increase in the wages of high-skilled workers relative to the unskilled. And in the US, the evidence shows that wages of high school educated males fell 20 percent between the mid 1970s and mid 1990s. However, Figure 8 suggests there are also many countries where inequality fell with more trade openness. Accordingly, it can be concluded that the changes in inequality will very much depend on the initial conditions (such as the distribution of human capital, land and capital) at the time of globalization, as well as on government actions enabling the poor and the unskilled to benefit from more openness.

Figure 8. The Relation Between Inequality and Growth



Source: WB, Global Economic Prospects and the Developing Countries, 2000.

Globalization and the Quality of Life

Incomes do not tell the whole story, and it is indeed possible to find countries that did not make a lot of progress in terms of per capita income but succeeded in improving the quality of life for its citizens (e.g., Sri Lanka).[2] The question is whether globalization is necessarily associated with such improvements.

On the one hand, it could be argued that globalization improves the quality of life because it exposes the population of the world to living conditions across nations. As a result, it increases the pressure on governments to allocate public investment to improve health, education and the environment. At the same time, globalization facilitates the process of acquiring the latest innovations that have bearing on the quality of life. On the other hand, the counter-argument is that globalization encourages conspicuous consumption of goods and services that cannot be afforded by the poorer consumers in developing countries. It also leads to greater competition from imports, which causes dislocation and unemployment, at least in the short run. In addition, it encourages the migration of polluting industries from developed to developing countries, to benefit from less restrictive environmental regulations and weak enforcement.

Given these divergent views, the issue collapses once again to an inquiry into the results of empirical investigations regarding the link between globalization and the quality of life. But this is a difficult task. Defining and measuring the changes in the quality of life over time is not easy. Nor are the attempts to relate this change to

[2] More on the meaning of the quality of life below.

globalization. On the measurement issue, the Human Development Index (HDI), which was developed by UNDP, seems to be the best available proxy. The HDI is a composite of education, income and health. According to this measure, all regions of the world, developed or not, made significant progress in the last century (Table 3). Moreover, the data show that the human development gap between poor and rich nations has declined over time. But the data also reveal that progress has been uneven across regions. In the developed world, North America and Western Europe, as expected, enjoy an HDI above the cutoff point of 0.8 for the category of high human development. In the developing world, only Latin America and East Asia (excluding China) fit this category. At the other end of the scale, South Asia and Africa lag behind, with an HDI below the low development cutoff point of 0.5.

Table 3. Weighted Averages ofHDI*

	1870	1913	1950	1995
North America	0.462	0.729	0.864	0.945
Western Europe	0.374	0.606	0.789	0.932
Eastern Europe		0.278	0.634	0.786
Latin America		0.236	0.442	0.802
East Asia			0.306	0.746
South Asia		0.055	0.166	0.449
Africa			0.181	0.435
Egypt			0.178	0.612

*HDI is an aggregate index of three components: education, income and health standards. It is scaled to lie between 0 and 1. Human development in different countries is categorized according to the value of HDI index: high human development corresponds to index values equal to or above 0.8, medium development corresponds to values between 0.5 and 0.79 and low development is for values below 0.50.

Source: Crafts, Nicholas, (2000).

On the link between the improvements in the HDI and globalization, the data show that Western Europe and North America made the most progress during the earlier period of globalization (1870-1913). They also show that progress in these developed countries was sluggish during the period of the two world wars and protectionism (1913-1950). Therefore, it is tempting to conclude that globalization is associated with improvements in the HDI. This view has to be qualified, however. To begin with, the data also show that progress was modest in the developed world during the current wave of globalization

(1950-1995).[3] In addition, there is no question that the improvements in the HDI can also be traced to other factors, such as medical discoveries prolonging life expectancy.

Whatever the relationship between the quality of life and globalization may be, three observations are worth noting. First, there are synergies among the triangle of rapid growth in per capital income, poverty reduction and the quality of life. More specifically, the most recent World Development Report (2000) clearly demonstrates that poverty reduction trails economic growth (WDR, 2000). With the rise in income and poverty reduction, the quality of life inevitably improves as countries can then afford to spend more on health and education. The second observation, though, is that these positive synergies occur much more forcefully when governments consciously take certain actions to ensure that the benefits of growth are shared widely, poverty pockets are addressed head on, and the quality of life is valued.

The third observation is that the data show that the human development gap between poor and rich nations has declined over time. But the data also reveal that progress has been uneven across regions. In the developed world, North America and Western Europe expectedly enjoy an HDI above the cutoff point of 0.8 for the category of high human development. In the developing world, only Latin America and East Asia (excluding China) fit this category. At the other end of the scale, South Asia and Africa lag behind, with an HDI below the low development cutoff point of 0.5.

IV. Concluding Remarks

Perhaps the best way to conclude this review of the debate over the impact of globalization on the economic well-being of citizens of the world is by citing a metaphor I first heard from Michael Mussa. According to him, globalization is like fire. Too much of it can burn your house. A fireplace, however, can bring warmth in cold winters.

Clearly, no single country can reverse or ignore globalization. The challenge for policy makers in developing countries is to undertake the necessary reforms at home so as to maximize the benefits from and minimize the costs of globalization to all citizens.

[3] There may be diminishing returns to the improvement in the HDI, with possible big discrete improvements at an earlier stage of development.

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