

Globalization, Growth and Poverty
Building an Inclusive World Economy
(World Bank Policy Research Report)

Edited by Paul Collier and David Dollar

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reviewed by Dr. Stella Balfoussias*

This report is written by Paul Collier (Director, Development Research Group) and David Dollar (Research Manager in the Development Research Group) and draws on a large body of existing empirical work, much of it original research conducted at the World Bank by the authors and by a number of other researchers. It is a very interesting book offering useful insight into the current policy debate about globalization. It focuses on the impact of growing economic integration on developing countries, especially with regard to inequality and poverty, and addresses the key policy issues involved.

The main message of the book is that global integration is already a powerful force in reducing poverty, for a significant part of the developing world, but is not, nevertheless, universally effective. The challenge is to bring more countries into this process - an objective that calls for sound policies, at the global and local level.

The book comprises a balanced account of the forces that determine the effects of economic integration on the lives of poor people living in developing countries. It examines the global architecture for flows of goods, capital, and people, focusing on measures which improve existing structures and have the potential to enable areas currently left out of globalization to participate and benefit.

The report addresses existing concerns involving issues of power, culture, and the environment, presenting evidence about the effect of globalization in these important areas and assessing global opportunities and global risks.

In their conclusion the authors propose an agenda for action, “both to enhance the potential of globalization to provide opportunities for poor people and to reduce and mitigate the risks it generates”. This agenda overlaps, in part, with the agenda of those who protest against globalization, it is however “diametrically opposed to nationalism, protectionism, and anti-industrial romanticism”.

* Centre of Planning and Economic Research, Athens, Greece

In what follows we present the main arguments as they appear in the five chapters of the report.

In Chapter 1, the authors examine the process of global integration from a long term perspective and distinguish three waves of globalization from 1870 to the present day. They analyze the economic characteristics of these distinct processes and contrast the present wave of globalization with two previous ones with a view to showing how it is affecting poverty and equality.

The first wave of globalization (1870 – 1914), was led by advances in transportation and reductions of trade barriers, which generated a dramatic increase in the flow of goods and capital, and an unprecedented rise in global per capita income. The flows of labour were even more dramatic, as nearly 10 percent of the world's population migrated from the less developed and densely populated areas to North America and other parts of the world. Among the globalizing countries there was convergence in income per capita, primarily a result of migration; however, world inequality increased as the gap between the globalizers and the countries left behind widened.

The inward-looking economic policies, driven by nationalism, that prevailed during the periods of the First World War, the Great Depression, and the Second World War, resulted, according to the authors, in a giant step backward in global economic integration. During this period the growth of per capita income fell substantially, the number of poor people continued to rise and world inequality continued to increase. despite the great advances in life expectancy due to the global spread of improvements in public health.

The second wave of globalization, (1950 to 1980) was marked by the multilateral trade liberalization under the auspices of the General Agreement on Tariffs and Trade (GATT). Integration occurred mainly among rich countries, (Western Europe, North America, and Japan). As the relatively poor industrial countries grew faster than the richer ones, there was a modest trend toward greater equality (aided by social welfare policies and programs). The developing countries also experienced some growth recovery during this period; however, most of them were unable to advance beyond primary commodity exporting and were largely isolated from capital flows. So the gap between rich and poor countries widened. The number of poor people continued to increase.

The present wave of globalization, starting around 1980, has been spurred by technological advance in transport and communications technologies and by the decision of large developing countries to open up to foreign trade and investment. The authors characterise the rise of the new globalizers as the most spectacular feature of this process. For the first time poor countries have broken into the global market for manufacturing and services.

Countries that dramatically increased their participation in global trade and investment include Brazil, China, Hungary, India, and some 24 developing countries with 3 billion people. Their growth rates now substantially exceed those of the rich countries, allowing them to catch up, just as during earlier waves of globalization there was convergence among OECD countries.

The crucial question is whether growing integration is leading to greater inequality within countries. The authors assert that this is not generally the case. Most of the globalizing developing countries have seen only small changes in household inequality, and inequality has declined in such countries as the Philippines and Malaysia. However, there are some important examples of an opposite trend: in Latin America, due to previous extreme inequalities in educational attainment, and in China, due to the initial extreme equality. Nevertheless, this increase in inequality in China has been accompanied by a massive reduction in poverty (from 250 million in 1978 to just 34 million in 1999). The reduction of poverty is illustrated by the examples of Chinese provinces, Indian states, and the countries of Bangladesh and Vietnam and Uganda. While some aspects of the data are controversial, the evidence for substantial poverty reduction is strong.

There is however another trend, that of declining incomes and rising poverty, for the rest of the developing world - involving about 2 billion people, for whom globalization is not working. These economies participate less in trade today than they did 20 years ago, owing to unfavourable geography, weak policies, poor governance, lack of appropriate institutions, or simply owing to civil war. The key policy issue is how to address the marginalized areas and how they can strengthen their participation in economic integration.

Chapter 2 examines the prospects for growing trade, investment, and labour integration between rich and poor countries, and analyses how the international architecture can be improved to support that integration.

The authors argue that while many developing countries have chosen to become more open economically, they continue to confront protectionism in the rich countries. Rich countries maintain significant barriers against the products of poor countries, inhibiting this poverty-reducing integration. They call for a "development round" of trade negotiations that could do much to help poor countries better integrate with the global economy.

During recent years, private capital flows to the new globalizers have risen dramatically, but the less globalized countries have often experienced capital flight, while, at the same time, official development assistance from rich countries to poor ones has declined. The authors discuss the risks often attached to the exposure to world capital markets in the absence of good institutions and stress the need for sound

domestic financial systems. Foreign investment in financial and accounting services can help in that respect. Better international coordination is also needed on issues like accounting standards, transparency and the management of financial crises. Disclosure of information is considered useful for the purpose of reducing the frequency and severity of international financial crises.

The authors are more cautious in drawing conclusions about the effect of migration, as the latter is a controversial topic (in rich countries), for both economic and social reasons. They discuss the economic benefits of the outflow of unskilled migrants for countries of origin through the rising wages for those who remain behind and through the generation of a flow of remittances. On the other hand they draw attention to the pressures generated by a large inflow of low-skilled workers on wages for those native workers without a high degree of education. Regarding the anticipated mounting pressures for migration from south to north, especially of unskilled workers, they take the view that rich countries should avoid immigration policies that focus exclusively on “brain drain” migration of highly skilled workers from south to north.

Chapter three is devoted to the role of **domestic institutions and policies** in strengthening the potential benefits of openness. The discussion evolves around the need of developing countries for a good investment climate and the importance of institutional arrangements and policies in promoting such a climate, and secure social protection.

As suggested by micro evidence, a good investment climate is particularly important for small and medium enterprises that create the bulk of new jobs. Elements of a sound investment climate include efficient regulations for entry and exit, a healthy financial system, good infrastructure, good economic governance (mainly in the area of tax administration) and safeguards against corruption.

Given the importance of effective institutions in obtaining strong benefits from openness, a question of interest is whether countries should wait until they have such institutions to open up. The authors believe this is not necessary. Allowing foreign firms to provide financial services, telecommunications, and power can be a good strategy for strengthening the domestic investment climate. Indeed many successfully globalizing developing countries are using the international market for services to strengthen the investment climate. Liberalization of trade in services is therefore very important.

One of the most disruptive aspects of global economic integration relates to higher labour market turnover, and to short-run effects on wages. In the long run workers gain from integration, however, the short-run effects can be quite different. Evidence is reported that the wages of formal sector workers are reduced by trade

openness and increased by direct foreign investment. Thus, in an economy that liberalizes trade and gets little foreign investment opening up can lead to temporary declines in formal sector wages. There is also evidence that openness, especially in the form of FDI, increases the return to education by raising the skill premium. This can be a good thing, provided that there is a sound education system providing services to all. However, the education system in many developing countries is not serving all levels of society well - which leads to even more unequal wages. Hence it is vital to use resources generated by rapid growth in new globalizing economies to strengthen the education and health services.

The more dynamic environment calls also for new types of wider social protection for those individual families, especially in protected sectors, that are the losers from globalization. The authors discuss unemployment insurance and severance pay systems that can provide protection and create a solid social foundation which will help people - especially poor people - feel more comfortable about participating in a more strongly expanding economy. They also stress the importance of self-targeting programs such as food-for-work schemes for the poorest people.

Chapter 4 discusses issues of power, culture, and the environment and examines the widespread concerns regarding cultural or institutional homogenization and environmental degradation.

The authors recognise the cultural challenges that globalization poses, but they also point to the fact that governments have many degrees of freedom in managing the interaction between the flow of goods, capital and labour, on the one hand, and national culture on the other. Indeed many countries subsidize cultural products and cultural preservation in different ways. The authors propose that trade in cultural products should retain the special exemptions already allowed within WTO rules. At the same time they indicate that, in many circumstances, globalization is consistent with the maintenance of a vibrant culture. As societies integrate in many respects they become more culturally diverse.

Globalization does limit the independence of national governments in certain areas, nevertheless governments retain a wide range of choice, most notably in distributional policies. The weak participants in integration need more rules than the strong ones. However, there is a danger that the rules will come to favour the strong. At the same time, as global trade becomes more firmly based upon a legal framework, this potentially enhances the power of the developing countries. In other words globalization involves shifts in power but these do not always favour the already powerful.

Global growth also threatens the environment, but there is great variation in environmental conditions in developing and developed countries, including successful globalizers. Rapid industrialization in the new globalizers will increase pollution un-

less checked by improved regulation. Developing countries usually have serious problems enforcing regulations in the face of powerful vested interests. On the other hand, many countries and communities are improving environmental conditions, as globalization proceeds, showing that it is possible to protect the environment through local collective action.

Some environmental issues, such as global warming, are intrinsically global. They require international cooperation. Although action in this area has been, so far, rather weak, in relation to the challenges ahead, the habit of such cooperation becomes stronger in an integrated world.

Rich and poor countries have somewhat different interests regarding global warming. Developing countries will suffer most from global warming, while rich countries are generating most of the carbon dioxide (CO₂) that is causing the problem. In bargaining to achieve fair rules on such issues, poor countries are “handicapped by both their poverty and their fragmentation”.

There are however reasons for optimism. The broad agreement among scientists on the environmental impact of human activity and on the necessary collective action to improve the long term prospects is a cause for optimism. Also, for the first time in history a global civil society has emerged which can become a powerful impetus to global collective action, both for improving the environment and for reducing poverty. At the level of the results so far, the Kyoto protocol is an important step forward in collaborative action to address global warming.

Chapter 5 brings the arguments together and summarizes an agenda for action.

In sum, global economic integration has supported poverty reduction and should not be reversed, but the world economy should become much more inclusive. In that way globalization could be much more effective for poor people, and its adverse effects could be substantially reduced. What is needed is a combination of policy reform both at the global and local level.

The authors emphasize seven areas for action which they regard as particularly important for making globalization work for the poor.

The first area for action is a “development round” of trade negotiations. This round of multilateral negotiations should aim to bring about improvements in market access by lowering protective arrangements of rich countries in areas where developing countries have comparative advantage. At the same time trade agreements should respect institutional and cultural diversity leaving countries free to take different approaches to environmental standards, social protection, cultural preservation, and other issues.

The next three elements in the agenda are measures of primarily national and local responsibility. In particular:

- Measures to improve the investment climate in developing countries.
- Measures to improve the delivery of education and health services
- Measures to provide social protection tailored to the more dynamic labour market in an open economy

Developing countries should be engaged in a major effort to promote good governance, efficient bureaucracies, control of corruption, regulation, and protection of property rights. The presence of foreign service providers is considered a positive influence in this respect.

The importance of education in poverty reduction is well documented. The impressive progress in educational attainment and infant mortality observed in the newly globalizing developing countries, suggests that investments in social services are critical to ensure that the poor benefit from growth.

In the area of social protection workable measures should be put into place taking into account not only what works in relatively rich countries, and for formal sector workers, but also what works in poor countries and for the large number of poor people in the informal sector and rural areas.

The *fifth* component of the action program is a greater, and better managed, volume of foreign aid. Large-scale aid is necessary to address some of the specific health and geographic challenges of marginalized countries and people, but also to keep things going at a time of reform and until domestic and foreign private investment starts to respond. More aid should be targeted to research into health and agricultural technologies

The *sixth* area for action is debt relief. The authors separate debt relief from the general call for greater aid, to emphasise the role of debt reduction in enabling many of the marginalized countries to participate more strongly in globalization.

The *seventh* item in the action program is global warming, and the need to tackle greenhouse gases through international cooperation. The authors call for effective global cooperation to promote corrective action, in the belief that the problems to be addressed are serious but manageable.

In conclusion, this is a well-documented book of important topical interest. It deserves to be widely read in both the developing and developed worlds.