

Globalization and Poverty

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August 14, 2000

Poverty is a hot topic these days. The headline in today's Wall Street Journal asks "Can World Bank Lend Money to Third World Without Hurting Poor?" A couple years ago such a query would have seemed purely rhetorical. After all, what else does the World Bank do, anyway? Times have changed. In April, streets in Washington D.C. were closed off and riot police were stationed throughout the World Bank and IMF's neighborhood as protesters accused the Bank of, among other alleged sins, ignoring the very poor. Many of the same groups protesting in Washington were also leading the charge against the World Trade Organization (WTO) in Seattle a few months prior. Among the WTO's alleged sins were advancing the cause of globalization without due regard to its consequences for the poor. Regardless of whether the protesters in Washington and Seattle were right or wrong, they provided a valuable service in any case, for they have elevated the prominence of the set of issues on which they think they know something. Interested citizen groups, non-governmental organizations, and governments all have started to consider how the increased openness of economies impacts the very poor.

But what do we really know? Does globalization harm the poor as some contend? Are the economically disadvantaged segments of the population driven further into poverty as foreign firms set up shop to take advantage of inexpensive labor and as domestic firms and farms are forced to adopt a more competitive stance in their

respective industries? Or does the increased economic growth claimed by others to be associated with increased openness provide an expanding set of economic opportunities that, perhaps in time, benefits the very poor? With this as background, I'd like to ask 3 questions.

1. First, just what is globalization?
2. Second, what are some possible links between globalization and poverty, and, to the extent we know, what are the actual impacts of globalization on the very poor? That is, what are the distributional consequences of globalization?
3. Third, what is an informative way to analyze these issues. Advocates of both the pro- and anti-globalization arguments are often articulate and convincing. How can one sort out these issues and what sort of data is needed? In the end, what conclusions can we draw about how to best understand the links between globalization and the poor?

What is Globalization?

Most of us know what poverty is, even if we disagree on how to best measure it. Globalization, though, is another matter. It is poorly defined and is almost never measured. For purposes of this discussion, I'll define globalization as the marginal impacts of an international economy relative to those of a closed economy. That is, when I speak of globalization, I refer to aspects of economic change that occur because a country is part of an international community over and above those changes that will occur in a closed economy. I'll focus my discussion then, on how having an open economy impacts the poor. I'll stay away from a handful of contentious issues that are often associated with the debates over globalization—environmental

standards and labor standards, for instance. Issues of environmental and labor standards clearly have an international aspect. But the substance of these issues arises in a closed economy too. Firms within a country might try to gain a competitive advantage by paying lower wages or producing with a less costly and more dirty technology. Even in the closed economy, there is an important role for labor and environmental standards. Adding international interactions to this calculus makes things more complicated, but I don't see these issues as being at the core of globalization.

What, then, might be some of the impacts of my narrow definition of globalization? Some answers:

- Globalization leaves an economy potentially much more sensitive to international shocks such as exchange rate crises. If a country was completely closed, there would be no exchange rate and currency crises such as those that hit southeast Asia a couple years ago would not happen.
- Globalization means the prices of internationally traded goods, even at constant exchange rates, are susceptible to changes beyond the control of forces in the domestic economy. A small economy will have no control over the world prices of its imports and exports.
- Globalization conveys access to a new set of goods. These may be goods that are either new varieties of products that already exist in the absence of trade (i.e. new brands of rice) or they may be new goods entirely (i.e. personal computers.)

- Globalization imparts an expanded set of opportunities for what is sometimes called outsourcing or fragmentation of the production process. From the perspective of poorer countries, this typically means that firms headquartered in other countries may elect to do part of their manufacturing processes in the poorer country. In a closed economy, these options do not exist and all parts of the production process take place domestically.

Globalization and the Poor

With the above narrow definition of globalization, how might the poor be impacted by its expansion? The answer depends crucially on which aspects of globalization are most prevalent and on the attributes of the poor. It turns out that the poor, even within a country, are typically a remarkably heterogeneous group. One of the main messages of this note, and probably the single most important message, is that it is dangerous to generalize how globalization, with its many facets, will impact a group as heterogeneous as the very poor. To illustrate this point, I will talk through examples of each of the aspects of globalization listed above.

Exchange Rate Crises: In late 1997 and early 1998, the Thai Bhat, the South Korean Won, and the Indonesian Rupiah (among others) all experienced substantial and sudden devaluations. Volumes will be written about whether the openness of these economies was to blame for the extreme swings in their exchange rates, but it's probably true that currency controls and a more closed economy would have resulted in muted exchange rate swings. Witness, for example, what happened to the Malaysian Ringgit-- the Ringgit had a modest devaluation over the same period that its neighboring currencies

were in many instance collapsing. (Whether these controls would have been sound public policy is an entirely different matter.) Because of the massive exchange rate swings, the southeast Asian currency crisis provided something of a laboratory in which to study how the poor were impacted by this particular aspect of globalization. Work is ongoing and the results are still coming in, but the Indonesian experience (with which I'm most familiar) holds several exemplary lessons.

The first order impacts of the exchange rate devaluations are to make imports much more expensive in domestic currency terms, while exports appear "cheap" to trading partners because the foreign currency price of exports falls. In Indonesia, how did these price changes impact the very poor? It had been argued that the very poor were so poor as to be essentially insulated from the international economy in Indonesia. The truth was just the opposite. The very poor were in fact among the most vulnerable. But being vulnerable to globalization is not always a bad thing and in some instances, this vulnerability conveyed significant economic *benefits* to the very poor. In other cases, the poor were, in absolute as well as relative terms, the most harmed.

There are four main messages from the Indonesian experience. First, the urban poor and the rural poor fared quite differentially. The urban poor had absolutely no reason to welcome globalization's presence in the form of the exchange rate crisis. The urban poor grow virtually none of their food and the prices of the basic staples increased substantially. (For example, the price of rice rose from 110 to 280 percent in the course of about a year and a half, depending on in which province the measurement was taken.) The urban poor not only were most adversely impacted by the exchange rate crisis, but they were also heavily hit by the unemployment that accompanied the macroeconomic

slowdown congruent with the currency crisis. That is, the urban poor paid higher prices for the basket of goods they consumed—prices that rose even more than those for the basket of goods the urban middle class or wealthy consumed, and the urban poor disproportionately lost their jobs and/or suffered large real wage declines.

But not all of Indonesia's poor are urban dwellers and herein lies the second main message of the Indonesian experience. Some rural poor households are net producers (as opposed to consumers) of the very same goods whose prices rose so substantially in urban areas during the currency crisis. Self-production of agricultural commodities muted, substantially in some cases, the impact of the crisis on the rural poor. While most of the rural poor were still adversely impacted by the crisis, they were not disproportionately harmed because the higher prices of what they produced helped balance against the higher prices of what they consumed. This differential impact of the currency crisis on the urban and rural poor and the self-insuring aspect of household agricultural production extends to many other of the world's poorer countries.

The third lesson from the Indonesian experience is that the impacts of the crisis on the poor are dynamic and it may be some time before some of the detrimental effects of the crisis are really felt. This is because there is evidence that the crisis led to disadvantageous health and/or nutritional outcomes among infants and children in poorer households. The long-term impact of these outcomes is likely to be played out over the course of many years.

A fourth lesson from the Indonesian experience is perhaps less general. That lesson is that the price impacts of the crisis varied tremendously by geographic region. Indonesia is a country of islands and in many instances, transportation between locales is

difficult and expensive. In light of this, it is probably not surprising that prices of commodities such as rice varied tremendously across provinces and even across villages within a province. In Indonesia, then, understanding the impact of the crisis on the poor depended crucially on just where the poor resided. While the geography of Indonesia as an island state certainly magnified this differential aspect of the currency crisis, the more general issue of poor infrastructure such that price arbitrage is not complete is important in other countries. Again, in predicting the impact of globalization, the answer is going to depend on where the household resides.

Goods Prices: Even if exchange rates are stable, a small open economy will still take world prices as given. For most commodities, most poorer countries will find themselves in this position. Countries can adjust the domestic prices of their goods by implementing various trade policies and the distributional impacts of these policies is itself an important policy-relevant research area. (I know of no studies investigating the impact on the very poor of trade policies implemented in developing countries.) But if countries adopt a mostly free-trade stance (an assumption that runs pretty counter to the facts), then the prices of traded goods will vary with fluctuations in world markets. Many of the lessons of the Indonesian experience seem to carry over. In particular, it is important to know just who consumes and produces the importables and the exportables. In many agricultural cases, the poor will comprise both groups. Again, one would expect the impact of globalization to differ across the urban and rural poor.

Although it is well understood that free trade conveys overall benefits to a country, it is equally well understood that in the absence of redistributive policies, some are typically made worse off by open trade. I cannot foresee an all-encompassing answer to

whether, on net, the poor are harmed or helped by freer trade. Answering this question means analyzing the consumption patterns and employment patterns of the poor and predicting the changes that freer trade will bring. I am part of a World Bank project that is investigating this question, but it is slow going. Answering this question necessarily requires very disaggregated (probably household-level) data as well as either a model to predict what happens to goods prices with freer trade or a natural experiment in which the economy became much more open (as has occurred in many countries over the past decade.)

It is tempting to simply assert that freer trade will help the very poor. And the argument is often made that freer trade is associated with higher national income levels. While this argument has sound theoretical backing (and empirical support varying from the careful to the shameless), this argument simply does not speak to the impact of freer trade and the associated changes in goods and factor prices on the welfare of the very poor. For example, the poor use a larger fraction of their income to purchase food and staples, and if food is imported, freer trade will tend to help the urban poor disproportionately. On the other hand, in some countries the poor are disproportionately employed in agriculture, relatively immobile there, and the price of agricultural output may fall with freer trade, hence harming those workers.

Globalization and New Goods: With increased globalization, it is not just the prices of goods that are impacted but the available variety of goods expands. How this increased variety impacts poverty is an open question. Again, I know of no studies examining this impact of globalization (on the poor or, in this case, even in the aggregate.) In principle, this is a question of how the gains from this particular aspect of

globalization are distributed. This is because with the advent of new goods, no group of consumers is likely to be made strictly worse off. Consumers can always elect to simply not consume the new products. Many of the new goods that appear on the shelves in richer countries are consumed only by the well-off in poorer countries. New consumer goods in electronics as well as new imported pharmaceuticals, for example, are unlikely to make the poor better off, while they may enhance the standard of living of the wealthier urban consumers. There are, though, many new products that are bought by the poor, and these would typically include newer varieties of imported agricultural inputs. While new goods might work toward increasing the disparity between standards of living of the rich and poor, it is less likely to make the poor strictly worse off. In this sense, this aspect of globalization, while not necessarily helpful, is unlikely to be harmful in terms of worsening poverty.

Globalization and Outsourcing: With globalization comes the possibility of fragmenting the production process and doing some parts of production in a foreign country. Although there are exceptions, richer countries tend to outsource to poorer countries where labor costs are lower. This is especially true in industries that have a labor-intensive component such as the apparel industry, some components of automobiles (i.e. wiring harnesses), and electronics. To analyze whether these outsourcing opportunities impact the very poor in developing countries, one would have to analyze both plant-level data and a survey of the workers within plants. While there are several plant-level surveys in developing countries, I know of none of these that match plants with workers and worker-attributes. Basic economic theory, though, suggests that these outsourcing possibilities are unlikely to actually make the very poor worse off. The rural

poor may well be completely unaffected if the outsourced jobs are urban-based (as they often are) and if the rural poor do not migrate in response to the job possibilities. The urban poor may also be unaffected if their education and skill levels are insufficient for the outsourced jobs. But these are arguments that the very poor are not helped. They do not suggest that the very poor are harmed. Like the impact of new products accompanying globalization, the impact of outsourcing on the poor is likely to be either non-existent or helpful.

Adding it all up—Some Conclusions:

It's reasonable to wonder whether, on net, the very poor are helped or harmed by globalization as defined above. If we have learned anything from the existing research, it is that this is an ill-posed question. The impacts of globalization are sufficiently varied and the life situations of the very poor so very heterogeneous, that there is no clear answer. There are examples of groups of very poor that have clearly benefited from globalization and there are examples of groups who have just as clearly been harmed. I actually do not think that this is a content-less tautological conclusion. Rather, I think some definite lessons have been learned that inform future policy discussion and research. For example:

- If one is going to adequately address the issue of links between globalization and poverty, there is no getting around the need for micro-data. Poverty occurs at the level of the individual or household and understanding the impact of globalization necessitates information at this detailed level. Conversely, it is simply not possible, in my view, to

convincingly address this issue with the sort of national-level data that is readily available and is too-often used.

- There are unlikely to be many all-encompassing answers here. Globalization may, on net, benefit the poor in some countries and harm those in other countries. Also, even within a country, globalization is likely to help some of the poor and hurt others. We tend to like clean answers, and in this regard, future research is likely to prove disappointing. Rather, we need to accept that there are benefits to simply understanding what links exist between poverty and globalization and realize that these links will impact poor households in a non-uniform way.
- That we in fact know so very little about the actual links between poverty and globalization is somewhat frightening. Individually, poverty and globalization are two of the more massive and important economic phenomenon. More research is needed to address the issue in a reasoned and careful manner. In many cases, this research cannot proceed until data are collected and this is a tedious, costly, and time-consuming endeavor. Fortunately, it is an endeavor that is proceeding in some parts of the world. Until we know more, it seems wise to suspend judgment on whether the advocates or detractors of globalization's role in helping the poor are more correct.

Suggested Further Reading:

There are several recent working papers that address the issues discussed in this note. An in-depth overview of links between international trade and poverty is a recent working

paper by Prof. L. Alan Winters, University of Sussex, titled “Trade, Trade Policy, and Poverty: What are the Links?”. Recent papers on the impact of the Indonesian crisis on the poor include “Impacts of the Indonesian Economic Crisis: Price Changes and the Poor” by James Levinsohn, Steven Berry, and Jed Friedman, NBER working paper No. 7194 and available at www.nber.org as well as a series of papers by Elizabeth Frankenberg and Duncan Thomas including “The Indonesian Crisis: Early Results from the IFLS2 and IFLS2+” and “The Real Costs of Indonesia’s Economic Crisis: Preliminary Findings from the Indonesia Family Life Surveys” available at <http://www.rand.org/FLS/IFLS/papers.html>. Work in progress by Lant Pritchett at the World Bank (www.worldbank.org) including “Social Impacts of the Indonesian Crisis: New Data and Policy Implications” also addresses these issues. Evidence from South Africa is researched in “Implications of Trade Policy Reform Given Income Distribution and Expenditure Patterns in South Africa” by Prof. Anne Case and available at <http://www.wws.princeton.edu/~rpds/working.htm>.

This paper was written for the September 14-15, 2000 meeting of the G-24 technical Group in Geneva, Switzerland. Correspondence should be sent to: Prof. James Levinsohn, Ford School of Public Policy, University of Michigan, Ann Arbor, MI 48109, USA or to jamesL@umich.edu.