Ec320 Lecture 25
Globalization and Poverty

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Introduction

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- What are its effects on growth?
- On poverty and inequality?
- Readings: UPP, Chapters 6,7; Winters et al (2004) for review of empirical evidence

What do we mean by Globalization?

- Trade liberalization: goods and services
- Increases in short term (portfolio) capital movements across countries
- Increases in direct foreign investment (DFI) by MNCs in LDCs
- Increased migration flows of workers
- Trade Related Intellectual Property Rights (TRIPs), esp in pharma products
- Threats to indigeneous cultures, values, environment

Polar Views

- One view: globalization is good for growth and for the poor in LDCs (hurts poor in DCs): mechanism of catch-up (e.g., East Asia, China, Vietnam)
- Other extreme view: growth benefits are negligible, poor and vulnerable groups lose out while the rich gain (e.g., Latin America)
- Shall argue: matters are more complicated, results likely to be context-dependent
- Shall focus on globalization defined as trade liberalization and DFI

Growth Effects

- Generally trade liberalization is expected to give rise to higher growth in LDCs through a number of channels:
    - specialization and benefits of comparative advantage & scale economies
    - Greater competitive pressure on firms
    - Superior access to modern technology imports
- Many empirical studies confirm this: growth effects may be negligible in some instances, but almost never negative
- Extent of trickle down to the poor? Depends on what happens to inequality

Inequality: Price Effects

- Can be very complicated and context dependent
- Example: effects of NAFTA on distribution of income among Mexican farmers (Prina (2011))
- US had comparative advantage in corn, Mexico in fruits and vegetables
- Corn is grown by large farmers, fruits and vegetables by small farmers
- Hence NAFTA reduced inequality among Mexican farmers
- If instead corn were grown by smaller farmers and fruits by large farmers, the result would have been reversed

Inequality: Income Effects

- Robust result in neoclassical trade theory: the *Stolper-Samuelson (SS) Theorem*
- Northern countries (DCs) have comparative advantage in capital and skill intensive goods, Southern countries (LDCs) in labor and low-skill-intensive goods
- Trade liberalization: should cause LDCs to specialize in labor and low skill-intensive goods, raises unskilled wages relative to skilled wages and returns to capital
- Hence trade liberalization (and DFI) should reduce inequality and poverty within LDCs (opposite effects in DCs): convergence mechanism

Evidence regarding Effects of Trade Liberalization on Relative Wages of Unskilled Workers

- SS Theorem convergence predictions borne out in 19th century, also in East Asia, China, Vietnam, Bangladesh in last two decades (Banerjee, Ch 6 in UPP)
- But not in most Latin American countries: Winters et al report evidence for Mexico, Colombia, Argentina as well as SSA where
  - skill premium in wages went up, or remained the same
  - employment effects for poor workers zero or negative

Possible Reasons why SS Predictions were not upheld in LA and SSA

- *More than 2 countries:* Latin American countries joined WTO around the same time that China did, and were more like Northern countries vis-a-vis Asia
- *More than 2 factors:* Mexican exports of shoes/cars to the US were more skill-intensive than other products produced in Mexico (Feenstra-Hanson 1996, Verhoogen 2003))

Possible Reasons why SS Predictions were not upheld in LA and SSA, contd.

- Argentina had protected low skill-labor intensive industries before lowering tariffs in 90s, which hurt workers in these industries
- Imported machinery imports were capital and skill-intensive: trade as a channel for skill-biased technical change in LDCs

Other Reasons: Marketing Intermediaries and Margins

- Export sectors of many primary products out of SSA (e.g., coffee, cocoa) or even China (e.g. Barbie dolls) involve marketing intermediaries/MNCs
- These intermediaries earn high margins, owing to their role in quality control, marketing, brand names, credit provision to producers

Other Reasons: Marketing Intermediaries and Margins, contd.

- Benefits of export growth can accrue mainly to the intermediaries, depending on elasticity of supply (e.g. Uganda coffee (Fafchamps-Hill (2008), cashews in Mozambique (Rodrik et al 2004))
- Intermediaries can also be government marketing boards (e.g., Zambia, Mali) who do not pass on increases in export prices to producers

Other Reasons: Skills and Infrastructure

- To be internationally competitive, exporters from Third World countries need to have appropriate skills, credit access and infrastructure
- In the absence of suitable education, credit, infrastructure, trade liberalization can give rise to loss of competitiveness in critical industries: differences between East Asia and SSA

Summary of Effects

- *Growth: Size of the Pie*: positive effects, generally
- *Effects on Inequality/Poverty*: very complicated (e.g., price effects of NAFTA, pro-anti-SS Theorem results)
- Bardhan (Ch 7 in UPP) argues governments should pay more attention to deeper sources of poverty and inequality (land reform, education, credit, infrastructure) rather than anti-globalization tirades
- DCs could open up their markets to imports from LDCs, and to immigration inflows, but this is politically difficult