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Trade, Growth and Poverty Reduction¹

‘Globalisation’ is now the widely-used word to describe the process over time of the integration of individual economies with the world economy, through international trade in goods and services, international flows of capital, finance and knowledge (including technology). It is widely, though not universally agreed, that there were two waves of globalisation, “the first ended with World War I and the second started at the end of World War II, while the years in between were ones of anti-global backlash” (Williamson, 2002).

The achievement of the first wave, before it ended with the outbreak of the First World War in August 1914, was eloquently described by John Maynard Keynes (albeit from the perspective of an upper-class Londoner).² Keynes was referring not only to freedom to trade in goods, but also to engage in foreign investment in equities and bonds, and freedom of travel (both for pleasure and work, temporarily and permanently, although he did not explicitly mention this aspect). Keynes’ emphasis that those freedoms were deemed “normal, certain and permanent”, and expected

1. This chapter draws heavily on Srinivasan and Wallack (2004).

2. “What an extraordinary episode in the economic progress of man that age was which came to an end in August 1914! ...The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; or he could decide to couple the security of his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend. He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could dispatch his servant to the neighbouring office of a bank for such supply of the precious metals as might seem convenient, and could then proceed abroad to foreign quarters, without knowledge of their religion, language or customs, bearing coined wealth upon his person, and would consider himself greatly aggrieved and much surprised at the least interference. But, most important of all, he regarded this state of affairs as normal, certain and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous and avoidable” (Keynes, 1919).

to improve, underscores the fact that the abrupt end to these freedoms during the inter-war period was not at all anticipated. The attempts after the Second World War to restore them succeeded only partially, with migration, for example, not yet free and unlikely to be free in the near future. However, it is also important to note that, for example, two of the world's largest developing countries (in terms of population and the number of poor), China and India, have succeeded in raising millions of people above their modest poverty lines *only since* both began taking advantage of available opportunities by integrating themselves with world markets. Their experience and that of other countries—that globalisation has been associated with acceleration in their growth and with poverty reduction—does not necessarily imply that there is a causal link between globalisation, growth and poverty reduction. It is no surprise, therefore, that distinguished economists (e.g., Jagdish Bhagwati and Joseph Stiglitz) as well as policy-makers could be found asserting or questioning the link.

Distinguishing mere association from deeper causation requires an appropriate theoretical and empirical framework or model for several reasons. Several plausible links in the globalisation-growth-poverty reduction chain can be postulated in theory, yet the reality is far more complicated and many links could be absent in some countries at some points in time. Agènor (2003), for example, finds that globalisation may have a U-shaped effect on poverty: while extensive integration reduces poverty, small amounts of globalisation may hurt the poor.³ Even in theory, not all links need be unidirectional—thus, it is possible that in some links, globalisation influences growth positively, but the character of that growth increases poverty. This being the case, it is easy enough to blame the process of globalisation for any observed or imagined deterioration in the condition of the poor, rather than look for the missing links or for other factors that could have muted or outweighed the beneficial effects of globalisation. It is equally easy to argue that observed outcomes deviate from globalisation's predicted contributions to poverty reduction only because globalisation has not gone far enough. By focusing selectively on some aspects of globalisation, while ignoring that other processes besides

3. The paper presents a variety of theoretical reasons for this finding. The composite index of 'globalisation'—a weighted average of trade and financial openness—is difficult to interpret, however, in the context of his cross-country study.

globalisation could explain the observed outcomes, it is possible to assert or deny the role of globalisation.⁴

In theory, greater international integration should play an important part in reducing poverty around the world. In practice, it has had mixed effects due to domestic policy shortcomings, continued industrial country protectionism and limited labour-market integration across countries. Many of the ways in which globalisation is perceived as harmful to the poor are not intrinsic aspects of global integration. They reflect, rather, domestic policy failures such as segmented and distorted internal markets, as well as industrial country protectionism and limited labour-market integration across countries.

To sort out the issues in a systematic fashion, the following discussion is divided into four subsections: (i) globalisation and growth; (ii) growth and poverty reduction; (iii) globalisation and poverty reduction; and (iv) globalisation for the poor. The first subsection summarises the underlying theory and empirical evidence for the globalisation-growth linkage, while the second discusses empirical evidence for the connection between growth and the poverty reduction sequence. While there are many mechanisms in theory for expecting greater integration to increase growth and reduce poverty, the theory is not without caveats and the empirical evidence is not conclusive. The effect of globalisation on inequality, in particular, is ambiguous. The third subsection provides a conceptual analysis of how globalisation could be expected to reduce poverty by reducing market distortions that disproportionately affect the poor. It is argued in the last section that remaining industrial country protectionism, particularly in agriculture, as well as continued restrictions on international labour mobility are key areas for reform.

This division simplifies the discussion of the effects predicted by economic theory and the policy changes needed to achieve these effects. There are clearly additional links among the three phenomena, and all three are endogenous outcomes of the varying economic and social processes in the countries analysed.

4. Deardorff (2003) goes so far as to suggest that globalisation's critics are motivated by a different understanding of how the world works as compared to the understanding globalisation's supporters have.

For most of this book, the author defines the “poor” as those whose income or standard of living is below what the society in which they live deems a minimum that all its members ought to have.⁵ These standards vary widely across nations and the poorest in a rich country may be well-off from the perspective of an average person in lower-income countries. The author focuses on those whose resources are below country-specific poverty lines, rather than those below a global poverty line (such as \$1 a day), because the latter poverty line suffers from serious conceptual and measurement problems.

The author also distinguishes here between absolute poverty and relative deprivation, or inequality. Inequality can rise, even as the numbers in absolute poverty decline. Understanding globalisation’s effects on relative deprivation is important for understanding some of the obstacles to further integration, but the focus here is on how globalisation affects national poverty.⁶

2.1 GLOBALISATION AND GROWTH

The terms ‘globalisation’ and ‘growth’ lump together several different phenomena. Globalisation in its comprehensive sense includes capital market integration, goods and services market integration, migration agreements and cultural interchange, or some combination of all of these. This book refers to these separately. It similarly distinguishes between forms of growth in the discussion of theory, though the empirical section does not distinguish between steady state (long-run) growth, and growth during transitions to a steady state.

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5. Operationally, this social minimum is often identified with the value of a specific bundle of goods and services that can be obtained through home production, market purchases and public provisions. Defining a poverty bundle for individuals is difficult enough, but extending the definition to households with many members and differing age-sex compositions is fraught with additional difficulties. Valuation is also difficult: Deaton (2001), for example, shows that using a price index based on prices actually paid by households rather than an official consumer price index, ‘reduces’ the number of the poor (as measured by the proportion of the population consuming less than the poverty line) in urban India in 1999-2000 from around 254 million to 181 million.
 6. More generally, however, the effects of poverty on human well-being include peoples’ feelings of deprivation relative to those around them. Sen (1981, Chapter 2) discusses these and other concepts of poverty. Tinbergen (1971) long ago suggested that the intensity of peoples’ feelings about what others around them are consuming as compared to their own consumption could affect their welfare.

2.1.1 Theory

There are essentially three sources of economic growth: growth in inputs of production; improvements in the efficiency of allocation of inputs across economic activities; and innovation that creates new products, new uses for existing products or brings about more efficient use of inputs. The combination of changes in these three dimensions that brings about higher long-run growth (as opposed to short-run transition effects) depends on the economy's characteristics. Whether or not a change in rate of accumulation of a factor of production or the efficiency of factor allocation, for example, has long-run or only transitional effects on growth depends in part on the technology of production. An exogenous change in the rate of investment or opening the economy to foreign trade has only a transitional effect on growth in a two-factor (capital and labour) constant-returns-to-scale growth model if the marginal product of capital declines to zero as capital increases indefinitely relative to labour. On the other hand, if the technology is such that the marginal product of capital is bounded away from zero, transitional as well as steady-state growth effects could arise from an exogenous change in investment or foreign trade policy (Srinivasan, 1995).

Being open to trade and investment contributes to each of the three sources of growth. Domestic resources are allocated more efficiently when the economy can specialise in those activities in which it has comparative advantage. By being open to capital, labour and other resource flows, an economy is able to augment relatively scarce domestic resources and use part of its abundant resources elsewhere, where they earn a higher return. Clearly, efficiency of resource use in each nation and across the world is enhanced by the freedom of movement of resources. Finally, the fruits of innovation anywhere in the world become available everywhere in such an open world. Empirical studies (e.g., Coe *et al.*, 1998) suggest total factor productivity (TFP) in poor countries, which do not have domestic R&D capacities, is higher when their trade with industrialised countries (who account for the bulk of R&D in the world) is greater.

Theory also suggests that globalisation and growth have a self-reinforcing relationship, in that higher growth spurs a larger volume of trade flows. While the decision to alter policies to further integration

is a policy change that harnesses trade as an “engine of growth”, trade also serves as the “handmaiden of growth” once policies support freer interchange of goods and services.⁷

Dysfunctional domestic institutions, however, can offset the contributions of liberalisation to growth by limiting labour flexibility, segmenting internal markets and failing to provide the social infrastructure for education. The traditional argument about static factor price effects and gains from trade, for example, assumes that resources move smoothly and costlessly from import-competing to exporting activities. Obviously, if resources cannot or do not move (as is arguably the case in LDCs), exporting industries would not expand, while import-competing industries would still contract because of increased competition from imports after trade liberalisation, thus creating unemployment. This somewhat extreme but elementary argument has been raised by Stiglitz (2002: 59) against trade liberalisation, when he says that: “It is easy to destroy jobs, and this is often the immediate impact of trade liberalisation, as the inefficient industries [those created under protectionist walls] close down under pressure from international competition.” Since he assumes that no new, more-efficient jobs would be created, he concludes that “moving resources from low-productivity uses [in inefficient industries] to zero productivity (to unemployment) does not enrich any country....” True, but neither does keeping factors in less productive uses forever.

A case can be made for developing countries credibly committing to phase in trade liberalisation over a period of time, while at the same time removing impediments to mobility of labour and other resources; such a case can certainly not be made for postponing liberalisation indefinitely, as is sometimes argued. Credibility of commitment of developing country members of the WTO would be considerably enhanced if they, instead of asking for a waiver from or for lower levels of commitment to reductions in trade barriers as compared to other members, commit themselves to the same levels of reduction, but ask for a longer, though definite, period for reaching these levels.

Globalisation’s effect on short-term growth also depends upon the exact forms of globalisation and pre-existing market distortions. Removing

7. The phrases “engine of growth” and “handmaiden of growth” are associated with Dennis Robertson (1940) and Irwin Kravang (1970), respectively.

barriers and controls on financial capital flows, for example, may improve resource allocation and give more people access to better-functioning credit markets in the long run. In the short term, on the other hand, it can lead to crisis and lower growth in countries with fragile domestic financial sectors. Capital controls have been advocated by many in the wake of the Asian financial crisis, and some have found that controls were useful in helping some countries recover from adverse shocks faster than those that had freer capital movements.⁸ The ongoing global crisis in financial and credit markets has reinforced these views. On the other hand, it could be argued that financial crises often arise not from free capital movements *per se*, but from such freedom co-existing with domestic institutional (particularly regulatory) failures. Capital controls, if they are effective and not evaded, could at best help in providing time for eliminating institutional failures through reforms.

To sum up, there is no reason to presume that the effects of globalisation on growth have to be the same everywhere and at all times, or even if they are similar, that they operate with the same intensity. This variation in country experiences is as important as the expected positive effect of globalisation on growth.

2.1.2 Empirical Evidence: Cross-Country Analyses⁹

Theoretical formulations of a trade-growth linkage are the foundations of the globalisation-growth links. Empirical demonstrations of the linkage go back to the careful and nuanced cross-country studies in the late 1960s and 1970s sponsored by the Organisation for Economic Co-operation and Development (OECD) (Little *et al.*, 1970), and the National Bureau of Economic Research (NBER) (Bhagwati, 1978; Krueger, 1978). More recent studies based on simple cross-country regressions such as Sachs and Warner (1995) and many, many more since then asserting the same linkage

8. Mussa (2000). See Kaplan and Rodrik (2001) on the second point.

9. The author will not discuss analysis of effects of trade liberalisation using simulations from partial and general equilibrium models. Hess and Cramon-Taubadel (2008) mention 1,200 studies of which they could include only 110 for their meta-analysis for various reasons. They are able to explain the enormous variation in simulated welfare changes from trade liberalisation through a meta-regression using variables that describe the liberalisation experiment, the characteristics of the model used and the database employed. They find that their estimates of quantitative impacts of liberalisation to be significant and to have plausible signs of magnitude.

have been controversial for good reasons (Rodrik, 2008), though often, though not always, the questions are more about the magnitude than the existence of the linkage between trade and growth.¹⁰ Wacziarg and Welch (2002) find that Sachs and Warner's cross-sectional results are somewhat weaker when the sample period is extended through the 1990s. However, their estimates show that openness has positive effects on growth and investment rates within countries.

Nevertheless, the positive effect of trade and growth emerging from the earlier studies appears to be robust when carefully evaluated using more recent data. Dollar and Kraay (2000a) attempt to respond to some, though not all, of Rodriguez and Rodrik's econometric criticisms in evaluating the trade-growth linkage for countries—mostly developing countries—that liberalised after 1980.¹¹ They relate decadal changes in trade volumes (which they see as a better—though not perfect—proxy for changes in trade policy) and decadal changes in growth. Their focus on changes mitigates the effect of geography on growth (and trade) through channels other than trade policy, while their inclusion of 'time dummies' controls for shocks common to all countries included in their analysis. By focusing on within country changes in trade and growth, they find a strong positive relationship between the two, and no systematic relationship between changes in trade and changes in household income inequality.

Individual country experiences bear out these cross-country trends. China and India have enjoyed historically unprecedented average annual rates of growth of GDP since 1981, as the two countries engaged in opening their economies to foreign trade and investment. To be sure, the effect is not entirely attributable to 'globalisation,' as both countries also engaged in domestic economic reforms to varying degrees, allowing a greater role for markets and the private sector in the economy, but integration

10. Rodriguez and Rodrik (2000) are the most trenchant critics, though Warner (2002) refutes their critique. He essentially argues that their finding, that the effect of trade openness on growth is not statistically robust, is due to the fact that the forms of protectionism vary across countries, so that any single indicator of openness will not describe the effective level of integration for all countries.

11. Whether or not a country is defined as a 'globaliser' is based on the decline in trade-weighted average tariffs and the increase in constant price value of trade (exports plus imports) relative to real GDP. Among the top 40 countries, according to each of these two criteria, 16 (including Brazil, China and India) appear on top in both. Unsurprisingly, none of the African countries is among them, though Ghana and Uganda, two African economies that came closest to their threshold, were included in the analysis.

no doubt played a large role. Growth rates not only accelerated, but the proportion of their populations below national poverty lines declined with the acceleration. Their growth rates and poverty ratios since 1980 are shown in Tables 2.1 and 2.2.

Table 2.1
Growth Rates for China and India

	<i>China</i>	<i>India</i>
1980-1990	10.3	6.1
1990-2000	10.6	5.9
2000-2006	9.8	7.4

Source: World Bank (2005, 2008, Table 4.1).

Table 2.2
Poverty Ratios for China and India (per cent)

	<i>China (rural)</i>		<i>India</i>	
1978	30.7		1977-78	51.3
1990	9.5		1983	44.5
1998	5.0		1987- 88	38.9
			2004- 05	27.5

Source: China: Park and Wang (2001); India: Datt (1998, 1999), Government of India (2007).

2.2 GROWTH AND POVERTY REDUCTION

Aggregate growth is undoubtedly an instrument for poverty reduction, and it is associated with improvements in the minimum standard of living over some time horizon. The estimates of Besley and Burgess (2003) for the elasticity of poverty¹² with respect to income per capita vary widely across country samples, but all are negative, implying that growth reduces poverty. This association between growth and poverty reduction, however, could take a long time to be seen.

Inequality, which is different conceptually and empirically and measured in different ways, need not necessarily decline with faster growth. Although the poor may be becoming better off over time, the rich

12. There are analytical and empirical problems in estimating and using the elasticity of poverty—see Subsection 2.4.

could gain even more. There are many possible mechanisms through which aggregate growth could affect, positively or negatively, poverty at national or sub-national levels on the one hand, and on the other, how levels and trends in poverty could influence growth, again in either direction. The basic mechanisms behind growth and poverty reduction do not fully overlap, and some policies meant to encourage growth will have little or a negative effect on the poor in the short run. These lags can affect the political feasibility of reforms.

It is clear, however, that poverty reduction requires growth, particularly in lower-income countries. The available resources may not, in some cases, provide adequately for all, no matter how the country's income is distributed. An early blueprint for development in India, put together in the late 1930s by a National Planning Committee of the Indian National Congress under the chairmanship of the future Prime Minister Jawaharlal Nehru, for example, clearly recognised the instrumental role of growth for poverty reduction and specifically estimated the extent of growth necessary to meet a minimum standard of living for all. Indian policy-makers were by no means unique in seeing rapid income growth as the major instrument for poverty reduction—statements similar to those of the Indians could be found in development plans of many other countries.

A positive association between growth and reduction in poverty is seen in several large countries with a high incidence of income poverty, such as China, India, Indonesia (until the financial crisis) and the Philippines. Angus Deaton (2001) estimated the proportion of poor in India's rural (urban) population in 1987-88 to have been 39 per cent (25 per cent). Annual data for earlier years suggests that the rural and urban poverty proportion fluctuated with no downward trend until 1977-78, when it was 51 per cent. It is no coincidence that significant reductions in poverty since 1980 were associated with a near tripling of per capita GDP growth to an average of around 4 per cent per year during 1980-1990, as compared to 1.25 per cent during 1950-1980, and even higher since 2000. Latest official estimates of poverty in 2004-05 are 28 per cent in rural and 26 per cent in urban India. According to Park and Wang (2001), official data for China show that rural poverty has been virtually eliminated in China—falling from 31 per cent of rural population in 1979 to 10 per cent in 1990, and further to 5 per cent in 1998.

A few small sub-Saharan African countries, such as Botswana, Lesotho and Mauritius, also enjoyed high growth resulting in a reduction in those nations' poverty. The association with income growth of non-income facets of poverty (caution: association should not be confused with causation) is also evident (Table 2.3): there has been a general improvement of life expectancy, rates of infant and child mortality, educational attainments and so on, although some of the gains achieved are being threatened by the AIDS epidemic in some countries of sub-Saharan Africa and Asia. Also, developing countries experienced significant growth only during the 1990s, a time period too short to see significant reductions in poverty.

Table 2.3
*Development Outcomes in the 1980s and 1990s,
by Growth Class (Unweighted Means)*

			<i>High Growth</i>	<i>Moderate or Improved Growth</i>	<i>Low Growth</i>
Poverty	Per cent with less than \$1 a day	1990s	24.1	31.4	36.9
		1980s	31.0	32.1	30.2
Infant mortality	Per thousand	1990s	29.2	54.3	60.7
		1980s	41.0	66.6	71.0
Illiteracy	Per cent	1990s	17.2	31.2	31.4
		1980s	22.9	37.6	38.8
Life expectancy	Years	1990s	70.0	62.9	59.8
		1980s	66.8	60.6	58.4
Carbon dioxide emissions	Tonnes per capita	1990s	2.4	2.3	1.7
		1980s	1.5	2.3	1.8
Deforestation	Per cent per year	1990-95	0.83	1.05	1.11
		1980-85	1.08	0.65	1.15
Water pollution	Kilograms per day per worker	1990s	0.16	0.21	0.21
		1980s	0.18	0.21	0.21
GDP growth	Per cent per year	1990s	5.3	4.2	0.3
		1980s	6.5	2.3	2.1
Number of countries			13	53	39

Source: World Bank (2000, Table 1.2).

While these specific cases suggest that growth reduces poverty, systematic statistical results are limited.¹³ Dollar and Kraay (2000b) is

13. Since there are too few observations to do an econometric analysis of the growth-poverty-reduction experience over time of individual countries, cross-country regressions are the only option.

perhaps the most careful (econometrically) study.¹⁴ They define the poor as “the bottom one fifth of the population” so that poverty goes down from their perspective if and only if the mean real income of the bottom 20 per cent goes up.¹⁵ Their data on incomes of the poor and mean incomes relate to 80 countries covering four decades, providing 236 episodes for evaluating the link between aggregate income growth and poverty reduction. They estimate variants of a basic regression of the logarithm of per capita income of the poor on the logarithm of average per capita income, control variables and a country fixed effect.¹⁶

Their results suggest that, notwithstanding the variation around the estimated relationship, the positive effect of growth on incomes of the poor is the same in rich and poor countries. Other findings include that: the incomes of the poor do not fall more than proportionately during economic crises; the poverty-growth relationship has been stable in recent years; policies that promote overall growth also benefit the poor; good rule of law and fiscal discipline benefit the poor as much as the rest of the population; and inflation is more harmful to the poor than for others. Finally, they find no evidence that formal democratic institutions, as well as public spending on health and education, have systemic effects on the poor.

2.3 GROWTH AND INEQUALITY

The lags between sustained acceleration in growth and poverty reduction can create political problems, for the reason that horizons of politicians are almost surely shorter than the lags. Policy-makers in India, for example, a country whose development plans explicitly stated that efforts to increase growth were essential instruments for its goals of reducing poverty, debated the extent to which the poor benefited from growth. As early as in 1960, at the end of the Second Five-Year Plan, the question of whether growth

14. They allow for measurement errors and endogenously of control variables as well as for the omission of possibly relevant control variables. They also test for over-identifying restrictions.

15. This relative definition of poverty precludes any simple comparison of their results with those of other studies using an absolute definition based on national or international (e.g., \$1 a day) poverty lines.

16. Their control variables include proxies for openness, capital account restrictions, rule of law, democratic institutions, inflation rate, government consumption and expenditures on social sectors as a proportion of total government spending, and primary school enrolment.

of the previous decade had improved the lives of the poor was raised by a skeptical socialist member in the parliament.¹⁷

Rising inequality can also accompany periods of growth. In contrast to trends in indicators of absolute poverty, those relating to measures of inequality are ambiguous. The data from China and India, for example, suggest that, although poverty at the national level decreased during the period of their globalisation and growth, not all of the regions or groups grew at the same rate, nor did they experience poverty reduction to the same extent. This is not surprising, since a change that raises everyone's income and reduces the proportion of the poor in a population, could nonetheless increase inequality if the rise in income accrues first to those with the higher skills and resource bases, which allow them to take advantage of the change.

There is some evidence that regional disparities widened in China and India as these nations liberalised their foreign trade and introduced other reforms. To a certain extent this is natural: those regions (and individuals) that are better placed initially to take advantage of the opportunities opened up by reforms or, for that matter, by any other factor, such as, for example, the information-technology revolution, are likely to grow faster (and richer). For example, India's phenomenal success in software was, until recently, confined to a few cities in the south and west. The real issue is not one of increasing regional disparities and even disparities between households and individuals, but whether the socio-economic system would enable the initially disadvantaged regions and individuals to catch up. If it does not, the social and political consequences could be serious and could lead to serious domestic conflicts. A participatory democratic political system and a transparent governance structure free from corruption will contribute to a peaceful resolution of emerging disparities.

17. Prime Minister Nehru responded to this question in introducing the Third Five-Year Plan in Parliament and said:

Again it is said that the national incomes over the First and Second Plans have gone up by 42 per cent and per capita income by 20 per cent. Now a legitimate query is made—where has this gone? To some extent, of course, you can see where it has gone. I sometimes do address a large gathering in the villages, and I can see that they are better fed and better clothed, they build brick houses and they are generally better off. Nevertheless, that does not apply to everybody in India (Government of India, 1964, p.1).

Nehru followed up his response by appointing a committee to enquire into the distribution of income and standards of living.

Whether widening disparities are temporary and would be reversed, or are permanent and entrenched is an interesting and important issue. At the aggregate level, one approach to this issue is to ask: do regions converge over time to the same level and rate of growth per capita income in the long run, without conditioning on any characteristics of the regions other than their initially different levels of income? This is the so-called 'absolute' convergence hypothesis. It is to be contrasted with the 'conditional' convergence hypothesis, which suggests that each region converges to its own steady state or long-run level and growth of per capita income, which, in turn, depends on the region's characteristics such as its savings rate, rate of labour-force growth and the rate of exogenous technical progress and initial levels of human capital. Under either hypothesis, a region further from its steady state grows faster than when it is closer to that state.

There is a growing literature on testing the hypotheses of absolute and conditional convergence in both China and India. Demurger *et al.* (2002) and Dayal-Gulati and Husain (2002) find support only for conditional convergence in China. In India, Cashin and Sahay (1996, 1997) found evidence of absolute convergence. Rao and Sen (1997) suggest that, in fact, the findings of Cashin and Sahay should be interpreted as supporting conditional convergence. Clearly, a finding of conditional convergence, since it is consistent with regions growing at different rates in the long run, could mean growing disparities across regions. Coupled with the fact that the incidence of poverty is higher and the share of the country's population larger in the latter states, there has been legitimate concern that if sustained in the future, these growth disparities will threaten the stability of India's federal democracy.

2.4 GLOBALISATION AND POVERTY REDUCTION

Some individuals or groups in a society may be poor and remain poor because they are disadvantaged in the social and political processes of their society. Social institutions such as the caste system in India or forms of racism elsewhere have denied equal access to socio-political processes to lower castes and racial minorities. Using economic policy instruments for addressing social and political problems is unlikely to be efficient and in cases where the instruments conflict with incentives at the level of individuals or social groups, could even be counterproductive. The economic

mechanisms for alleviating poverty could be divided into two broad categories: increasing the resources held by the poor through redistribution, and affecting the economic environment that perpetuates poverty. This book focuses primarily on several ways in which globalisation affects the latter category, as these economic changes have far deeper impacts on reducing poverty over the long run.¹⁸ While critics focus on globalisation's sometimes negative effects on redistribution, they overlook its potential to reduce economic constraints that continue to limit the prospects of the poor.¹⁹ Market integration and increased migration could limit the extent of poverty-alleviating redistribution in several ways, but their effect on removing the market distortions that perpetuate poverty over the long run far outweighs the consequences (that market integration and migration may have). Their advantage as mechanisms for poverty reduction is that they do not disrupt, but rather shift the existing equilibrium.

In the developing world, market distortions are ubiquitous, and their impact on the extent and depth of poverty is often serious. Whether an individual (or a household) has adequate resources to purchase the poverty bundle of goods and services at the relevant prices at a point in time depends, of course, on what she or he (or her/his household) can earn from her/his assets (land, financial and physical capital) and most importantly from her/his (allowing for skills and educational attainments) labour. The functioning of asset and labour markets, as well as product markets for goods and services bought or sold, obviously influences the earnings from assets and their purchasing power.²⁰ From this perspective, the central issue is not simply to alleviate poverty with transfers, but to eradicate it by tackling the more difficult issue of lifting the poor above poverty permanently—that is, by removing obstacles the poor face in trading, saving and investing in their assets for a higher standard of living.

Critics of globalisation point to some forms of exploitation of workers in developing countries, such as the frequent use of child

18. Besley and Burgess (2003) discuss the poverty-reduction benefits of a similar set of policies, though they do not address the link with globalisation.

19. Critics often associate globalisation with a reduction in the state's ability to redistribute income. This point is discussed further in the next subsection.

20. Clearly, if there are no distortions in all these markets and all individuals and households face the same prices, the extent of poverty would be determined by the distribution of assets and labour in the economy.

labour, the damage that a rapid exposure to global agricultural markets can cause for developing-country farmers and other aspects of the increasingly-integrated global economy. However, these are not intrinsic or permanent consequences of globalisation. They often reflect, rather, domestic institutional policy failures in poor and rich countries and continued industrial-country protectionism with the respect to imports of labour-intensive manufactures from developing countries and, above all, in agriculture. A backlash against off-shoring to developing countries is another major political obstacle. Even in the absence of policy failures, the fact is that the most powerful forces for alleviation of poverty take time to work.

2.4.1 Country Studies

A very recent study of 13 (8 Asian and 5 African) individual country experiences with trade-development-poverty linkages is that of the Consumer Unity & Trust Society (CUTS, 2008). The introductory chapter of the study states that the project “was intended to study the country cases closely to understand the nature and dynamics involving trade and poverty linkages... The project has examined the overall country experiences as well as experiences associated with two chosen sectors within each country” (p.1). Interestingly, the countries included large ones (China and India), small ones (Sri Lanka, Nepal and Zambia), landlocked ones (Nepal, Uganda and Zambia) and an island country (Sri Lanka). Six of them were least-developed countries (Bangladesh, Cambodia, Nepal, Tanzania, Uganda and Zambia). The remaining seven were China, India, Kenya, Pakistan, South Africa, Sri Lanka and Vietnam. The whole of South Asia (except Bhutan and Maldives), accounting for an overwhelming majority of the world’s poor, was covered. South Asia is the region in the developing world that is least integrated with the world economy. Thus, the range of countries covered included some of the most relevant ones for studying trade and poverty linkages.

The introductory chapter of the CUTS study also reports some cross-country regressions relating to developing countries in general, and also to the 13 project countries. Since the author is skeptical of the usefulness of such regressions for drawing policy lessons, he will not comment on them. The study estimates what it calls the ‘growth elasticity of poverty’

in the 13 countries and found it ranged from negative values for Kenya and Pakistan (i.e., the poverty situation has deteriorated in these countries, even though there was positive rate of GDP growth in the 1990s), zero in South Africa (no change in the poverty situation) and positive values for the rest, with India estimated to have the highest elasticity 0.8, implying that a 1 per cent annual growth in GDP is associated with a 0.8 per cent decline in poverty ratio. The data for India covered the decade ending in 1990-2000. As pointed out earlier, the relatively low poverty ratio for 1999-2000 is not comparable to that of other years and could have influenced the high elasticity estimate.

Leaving aside the measurement biases and errors in both poverty and growth data, there is an analytical and empirical problem with the use of growth elasticities. Simply put, both the observed growth and poverty outcomes are endogenous joint outcomes of exogenous and endogenous determinants, most importantly policies (including, in particular, trade, investment, labour-market and other policies). Relating one endogenous outcome, namely, poverty ratio to another endogenous outcome, namely, growth, to derive the elasticity of one with respect to the other is conceptually flawed. Its empirical magnitude tells us nothing about the operation of the relevant policies that influence both variables. This dubious elasticity concept is widely used, including in Besley and Burgess (2003), discussed in Subsection 2.2.

The main lessons learned from the project are reported to be:

- (i) Countries (e.g., China and Vietnam) that have undertaken domestic reforms have succeeded most in poverty reduction. It is arguable, however, whether adoption of domestic reforms and the effectiveness of their implementation can be equated, as the study does, with 'country ownership' of policy regimes, an amorphous catch-all phrase that is bandied about in the literature. In any case, it does not follow directly from the analysis. However, the study is almost surely right in concluding that poverty reduction strategies that "in the first place were developed to secure financial support from the donors, greatly undermine the point of any home-grown initiative". This conclusion is particularly relevant, given that Poverty Reduction Strategy Papers (PRSPs) are now being pushed as prerequisites for funding from the IMF and the World Bank.

- (ii) There is overwhelming evidence to suggest that export response to trade liberalisation is weak. This should not surprise anyone. Obviously, the exports of a country represent the difference between its domestic supply and domestic demand. For most of the products exported by the project countries, their exports constitute a very small fraction of world imports and, as such, lack of world import demand at world prices is most unlikely to be a constraint on exports. Trade liberalisation, by reducing distortions in the prices realised by exporters at the country's border, to the extent it raises domestic prices of exportables, influences their domestic supply and domestic demand. However, if either changes in border prices are not passed through to domestic prices, or the non-price factors that influence domestic supply are dominant, or both, then the supply response to price increases will be limited, at least in the short term when the non-price supply constraints cannot be relaxed significantly. This is a well-known phenomenon. Nonetheless, the lesson from it is not that trade liberalisation is ineffective, but only that non-price domestic supply constraints have to be addressed for its full effectiveness to operate.
- (iii) A predictable and altogether unsurprising finding is that countries which had less unequal distribution of the relevant resource endowments (e.g., land, and human and physical capital) also did better in reducing poverty. In some project countries (e.g., China and Vietnam), the better endowment distribution was achieved through domestic reforms: the abolition of collectives and the introduction of the household-responsibility system in China, and property rights reforms in agriculture in Vietnam. It could be argued that these two countries, with authoritarian communist parties in charge, are exceptions and that it is rare to find drastic redistribution of land and other assets through the non-revolutionary peaceful means of enacting laws and implementing them effectively. Be that as it may, almost surely the potential for reform of access to, if not ownership of, relevant endowments is substantial in other project countries, such as Bangladesh, India and South Africa.
- (iv) The study characterises trade-reform measures, such as tariff reductions and simplification of tariff structures, removal of

quantitative restrictions, liberalisation of exchange-rate regimes and export-promotion measures, as 'easy' reforms. The reform of domestic institutions needed to reap the full benefits from 'easy' reforms are deemed 'difficult'. Perhaps a more useful and general characterisation would distinguish between 'enabling policy reforms' and 'institutional reforms', to highlight the fact that the former enable beneficial outcomes to be realised, while the latter ensure that they are in fact realised. However, why some, if not all, of the latter are more difficult to implement than the former cannot be understood without analysing the domestic political economy. The study does not go into political economy issues in any depth.

- (v) The finding that there is no systematic relation between the level of tariff protection and growth is not at all surprising. In general, tariff is one, and not the only, measure for protection of domestic production. When more than one protection measure, such as tariff and an import quota, is being used simultaneously, the tariff level need not be the binding constraint on the quantity of imports. As the choice of protectionism measures used could and often does vary across countries and over time, there is no reason to presume any systematic relationship between tariffs, imports and growth in the first place.
- (vi) The last, again unsurprising, finding is on the role of the agricultural sector in poverty reduction. In many of the project countries, a large majority of the poor happen to be rural residents, dependent on agriculture and primary activities for their earnings, either as wage-workers or as self-employed. It is a fact that the import-substituting industrialisation strategy, implemented in South Asia for example, by insulating producers from domestic and import competition through trade and domestic policies until the 1980s, discriminated against agriculture in general and agricultural exports in particular. Trade liberalisation, by removing one source of discrimination, could be expected to contribute towards raising agricultural output and exports. However, if the reform of other relevant domestic policies, as well as of institutions relating to land and labour markets, is either not undertaken at all or does not go far enough if undertaken, the effects of trade liberalisation would be clearly limited. This is

what the study finds. In particular, the reform of labour-market and other policies that favour capital-intensive industries are slow to be implemented. The traditional mechanism for lifting millions of poor employed in agriculture and other primary activities in rural areas out of poverty and into gainful employment in more productive off-farm employment, operates through expansion of labour-intensive manufacturing for supplying domestic and foreign markets. This mechanism was prevented from operating by domestic policies of encouraging urban capital-intensive industries. This is what happened in most of the project countries, except for in China and Vietnam.

It seems evident that the 13 country case studies confirm that the constraints on acceleration of growth and reduction of poverty are primarily domestic and involve domestic political enomy. This is not to minimise in any way the importance of a development-friendly regime for external trade, finance, capital and technology flows and migration. The proposals in the CUTS (2008) study on priorities for further domestic reforms (particularly institutional reforms) and reforms of the global trading and financial system in a development-friendly direction are appropriate.

2.4.2 Redistribution

Critics of globalisation generally point to a decline in state spending on price supports and services for the poor as countries become more internationally integrated. Clearly in a globalised economy subject to the discipline of international capital markets, fiscal deficits are not sustainable, and taxation of mobile factors will induce their flight. On the other hand, the fact that in most developing countries the tax base is often narrow and the tax structure is likely to be dominated by taxes that are easier to collect, such as import tariffs, not only makes trade liberalisation but also fiscal correction, difficult political issues. Again, if the growth-accelerating effects of globalisation are strong, the revenue expansion (with a buoyant fiscal system) from growth would enable financing of the necessary services for the poor and avoidance of taxing mobile factors. However, buoyancy of the fiscal system depends in large part on domestic factors including, importantly, tax compliance.

Increased flow of immigrants is often thought to reduce domestic demand for redistribution, as the original non-immigrant population may not want to finance services for new immigrants to their country. The rise of nationalist parties, as well as anti-immigrant violence in several industrial countries, reinforces this perception. Razin (2002) shows that immigration generally moves the political voting equilibrium toward less redistribution, unless the new migrants join forces with existing low-income voters in their destination country. Be that as it may, the fact remains that trade in services through temporary migration (or the movement of 'natural persons' in the terminology of the General Agreement on Trade in Services [GATS] of the Uruguay Round), is still not liberal. Whether the Doha Round, if it resumes, will liberalise such migration significantly remains to be seen. From the perspective of developing countries, further liberalisation is absolutely essential.

The ramifications of less redistribution for poverty, however, are small relative to potential gains in other areas. Government-led redistribution is one of the more direct, but generally less effective, means of reducing poverty in the long run. It has limited effectiveness as a means of affecting the resources that poor households command. It will reduce poverty in the short-run if individuals are poor, because the assets they own are meagre. Unless redistribution of income is sustained indefinitely, its poverty-reduction effect will be temporary if the conventional belief that the marginal propensity to consume of the poor is close to unity is correct. On the other hand, if credit markets are absent so that investment is constrained by resources owned and marginal returns to investment diminish, the rich would have a lower marginal return to investment than the poor if assets are unequally distributed. A redistribution of resources to the poor from the rich would raise the average rate of return to investment, and hence the rate of growth of the economy.²¹

Subsidy policies may not even achieve the short-term goals of providing more resources to the poor, as subsidies are seldom targeted at the poor and there is hijacking of subsidies intended for the poor by the non-poor. The cost of transferring a dollar to the poor through subsidy schemes (particularly poorly-targeted ones) often exceeds that dollar by a

21. For surveys of relevant analytical and policy issues, see Aghion *et al.* (1999) and Bénabou (1996).

substantial margin. The Indian public distribution system (PDS), through which fixed amounts per person of foodgrains and a few other essential commodities are sold at subsidised prices, for example, has a negligible impact on rural poverty and the Central government alone spends four rupees to transfer one rupee worth of resources to the poor.²²

2.4.3 Raising the Productivity of the Poor

Lessening market distortions, in contrast, has a dynamic effect in that it not only increases the value of present resources, but encourages greater investment and future accumulation. The chief asset of the poor is their labour. Raising productivity to create a sustained increase in real returns to labour in wage and self-employment would contribute significantly to poverty alleviation. Domestic public policy has a large role to play: increasing the human capital endowments of the poor—perhaps by providing incentives for private investment in human capital or through public expenditure on, and improving the access of the poor to, public education and health-care programmes—raises the productivity of their labour.

Globalisation also contributes to this goal in several ways. First, the growth associated with globalisation will generally create an outward shift in the domestic demand for wage labour and for goods and services produced by the self-employed. Second, returns to the abundant factor, which in most poor countries is unskilled labour, will rise with trade liberalisation, both in developing and developed countries.²³ Multinational companies naturally take advantage of a less-developed country's abundance of unskilled workers at a wage less than what they would have to pay similar workers in their home countries. However, the more relevant comparison is that these wages are often higher than the wages paid by domestic companies in the host countries. Third, more integrated labour markets are important to ensure that workers receive the best return for

22. Rao and Radhakrishna (1997) analysed India's PDS from the national and international perspective. They found that in 1986-87, PDS and other consumer-subsidy programmes accounted for only about 3 per cent of the per capita expenditure of the poor, and their impact on poverty and the nutritional status of the poor was minimal.

23. There are, empirically, important exceptions to this general theoretical expectation: Harrison and Hanson (1999) present evidence that trade openness in several Latin American and Asian countries has been associated with an increased return to skilled labour relative to unskilled labour.

their work.²⁴ This last aspect of globalisation has not yet been realised, in fact, leaving aside global integration, even national integration of markets for goods, services and labour is still limited by poor infrastructure, explicit restriction on labour movement (as in China) and dysfunctional labour laws, as well as by linguistic differences across regions in India. Unlike commodities, the cost of whose movement within and between countries is primarily determined by costs of transportation and insurance, the cost of mobility of labour involves difficult-to-remove social and legal barriers, as well as economic ones.

2.4.4 Opportunities for and Returns from Accumulation of Physical and Human Capital

Globalisation can also benefit the poor by creating strong competitive pressures for improved financial intermediation. More efficient financial intermediation would have large and long-term benefits for the poor, by facilitating their investment in both physical and human capital. Although this is again partly a matter for domestic policy-makers, international capital market integration may provide an added incentive to move financial sector reforms faster. Banks facing international competition in their traditional markets may be faster to move into micro-lending or services for small depositors. Similarly, the competition for investment under globalisation encourages governments to focus more closely on providing better opportunities for investment in human capital.

The share of savings used to finance direct investment in physical assets depends in large part on the functioning of the financial system and access to it, which together influence the cost of financial intermediation. The costs faced by the poor are high, and a large share of savings and investment by households in developing countries is currently in the form of physical assets, which they finance on their own without involving formal financial intermediaries. This share could be as high as 80 per cent, as in Ghana, or around 50 per cent, as in India. These assets include

24. Wage labour market policies are obviously not a solution for all poverty. Only a small part of the labour force in many developing countries (less than 20 per cent in India and South Asia, for example) is in formal wage and salary employment. An overwhelming majority of the labour force is in self-employment (often in subsistence farming, in handicraft activities and household-based production for local markets). For them, it is not so much the functioning of labour markets, but that of product and credit markets that could be more relevant.

mostly those related to their production activities and also dual-use (i.e., production and consumption) assets.

Even though the poor do not save enough to invest in financial markets (particularly in equity markets), they do invest their meagre financial savings in the form of deposits in commercial banks, purchase of life insurance policies and also lending in informal credit markets. Clearly, the returns they realise on such investments depend on the functioning of the financial sector, including the banking system.

The more important effect of improved financial intermediation—via domestic policy changes or spurred by international competition—would be in providing greater opportunities for financing education. Just as labour is the major asset owned by the poor, it is investment in accumulation of human capital that is likely to be the major component of their investment. Although poverty limits the poor's saving and investment in any form, it is particularly limiting when it comes to human capital accumulation. Indeed, a major reason that the incidence of child labour is so high in many poor countries of South Asia and sub-Saharan Africa is the poverty of the parents of working children. Such parents cannot afford to forego the income from the work of a child (directly from paid work or indirectly in terms of unpaid contributions to the household's farm or non-farm enterprise). The out-of-pocket costs to the parents of sending their children to school are often substantial.²⁵

Lack of investment in education has three serious consequences. First, the earning prospects of uneducated (or less-educated) children in their adult working life would be less compared to their competitors in labour markets. Second, unless labour-market conditions improve in their adult life as compared to those that prevailed in their childhood, they are likely to end up as poor as their parents were and, as such, unlikely to educate their own children. The prospect of perpetuation of poverty across generations in such circumstances cannot be ruled out. Third, since some minimal education is often needed for an individual to participate effectively in political and social processes that make decisions affecting

25. National and international attempts to eradicate child labour, through restrictions on imports or consumer boycotts of goods produced by children, are not likely to succeed unless the basic cause of child labour, namely the poverty of parents, is addressed.

his/her social and economic prospects, these individuals may be in effect unable to exercise their right to participate.

Some of the serious constraints on the accumulation of human capital through education, as well as job experience, are domestic. As the evidence from South Asia and also other countries amply demonstrates, the delivery of educational as well as health services through the public sector has been both inadequate and deficient in quality. The ailments of the system have been well documented in the literature. Yet the response has often been to attempt to raise public expenditures on education and health, rather than address deeper problems of delivery. In addition, the allocation of resources within the education sector among primary, secondary and tertiary levels, and in the health sector between curative and preventative, is unbalanced. Meanwhile, in some of the larger countries discouragement of labour-intensive manufacturing through domestic and trade policies (at least until the 1980s) has precluded growth of productivity through on-the-job learning.

Apart from its beneficial effect on investment in human capital through improved financial intermediation, globalisation has a direct effect on the demand for skilled labour in poor countries through off-shoring by industrialised countries of manufacturing activities (a practice that has been going on for a long time), and of some service activities more recently. Already, China and India have benefited from this. However, there is a protectionist backlash in the United States against off-shoring. The ongoing presidential campaign in the US is discouraging in that, no matter who wins, the new president appears most likely to cave in to opposition to further trade liberalisation, as well as off-shoring. One glimmer of hope is a recent statement attributed to Mr. Barack Obama, the nominee of the Democratic Party for the office of the president, that "Revolutions in communications and technology have sent jobs wherever there's an Internet connection, that have forced children in Raleigh and Boston to compete for those jobs with children in Bangalore and Beijing... We live in a more competitive world, and that is a fact that cannot be reversed." He concluded that America's challenges on the economic front cannot be overcome by building "protectionist walls", and the country needed to focus on improving the situation of the middle class and investing in education.

(See: <http://www.thehindu.com/2008/06/12/stories/2008061260791300.htm>, accessed 29 July 2008).

2.4.5 Product Market Efficiency

Product market efficiency, affected by domestic policies as well as international integration, determines the 'terms of trade' the poor face in attempting to exchange their production for consumption and investment. Needless to say, the extent of integration of national markets and also the competitiveness of exports in world markets depends in large part on whether or not transport and communications infrastructure exists, and functions efficiently, to minimise costs of transportation and of acquiring market intelligence. Insufficient integration would mean the existence of price differentials across markets that cannot be arbitrated away. Also, given the uncertainties, not only about harvests, but also about the prices that will rule at harvest time or at any time thereafter when the harvested output is to be sold, it is important whether national markets for forward transactions exist and how costly it is to store commodities for later sale.

Globalisation could have a particularly significant impact on poverty by affecting the prices farmers in developing countries receive for their products and pay for inputs. There are currently two obstacles: lack of competition among intermediaries who aggregate primary products for international trading; and continued industrial-country subsidies and protection for their farmers.²⁶

2.4.6 Economic Institutions

Globalisation can be helpful in mitigating, or even overcoming, the institutional and market failures that affect the poor adversely. Below are a few examples.

Governance quality. Tackling corruption is a major challenge of governance in developing countries, as processes of adoption, enforcement and effectiveness of policy interventions are often distorted by endemic corruption. Inefficient and corrupt bureaucracies raise transactions costs in asset markets that are important for the poor. Land and tenancy markets, for example, have higher transactions costs than other asset markets,

26. See McMillan *et al.* (2002) on how domestic-market imperfections limited farmers' benefits from liberalisation of the cashew sector in Mozambique.

because of the difficulty in establishing a claim of ownership in land when records are poorly maintained and officials with authority to certify ownership are corrupt. This is a phenomenon that has been around for ages. The *Arthashastra*, a Sanskrit treatise on statecraft dated to fourth century BC, India (Kangle, 1972), not only lists more than 50 ways in which officials could be corrupt, but also advises the King to pay officials adequately for inducing them to be less corrupt.²⁷

Any extra impetus that globalisation provides toward more transparent institutions will contribute to poverty reduction. The prospect of losing out in the race to attract international capital flows, for example, can act as an important impetus to curb corruption. Wei (2000a) finds that corruption's effects on international investment are as if governments were imposing a tax—investors are significantly less likely to invest in more corrupt countries. The direction of causation between corruption and globalisation, however, is likely to go in the opposite direction for trade: corrupt bureaucrats' bribes act as tariffs limiting imports and exports (Wei, 2000b).

Insurance and credit. Limited access to domestic credit and insurance markets exposes the poor to substantial uncertainty and potentially to consumption volatility. Domestic financial markets in many developing countries are simply not efficient enough to find it worthwhile to extend services to the poor, because it is costly relative to returns to provide small loans to many poor people in contrast to providing large loans to a few rich ones. As mentioned previously, globalisation can create an impetus to improve financial markets and offer such credit and insurance opportunities to the poor.

In addition to being dependent on agriculture, the rural poor also have to cope with uncertainties, some of which relate to the environment for production and consumption (e.g., weather or disease vectors) and others that are idiosyncratic (e.g., health and mortality shocks to humans and livestock). Further, the agricultural production process is one in which inputs have to be committed in advance of the realisation of an uncertain

27. On the other hand, China, a country in which corruption is thriving, has attracted large flows of investment, particularly from overseas Chinese, who apparently are better at operating in a corrupt system! Corrupt practices by trans-national enterprises, often with the connivance of the governments in countries of their origin, have received attention in the literature.

harvest, while the process of consumption is more certain and evenly paced over time. In an economy that is closed to international agricultural commodity markets, particularly to futures markets, (domestic and international) shocks to domestic output and demand have to be absorbed through price changes in spot markets, thus making prices more volatile. To the extent such shocks are not highly correlated across economies, world output and consumption would be more stable than their domestic counterparts, thus making world prices less volatile than domestic prices. Thus, integration with world markets, leaving aside concerns (often ill-informed and exaggerated) about speculation, would in effect provide insurance against the price effects of domestic shocks, though not necessarily against their income effects.

It is clear that, even if production and consumption processes were to be free of any risk and uncertainty, still the lack of synchronisation between the two would require some means for smoothing consumption over time. It is also clear that achieving such smoothing would be less expensive, compared to each individual holding inventories of inputs and consumption goods, if access to smoothly and efficiently functioning credit markets is available. The need for credit is enhanced also if purchased inputs (e.g., fertilisers and pesticides, energy and fuels, hired labour, etc.) account for a large share of production costs, as in the case of the cultivation of the so-called 'Green Revolution' varieties of crops. With well-functioning insurance markets, insurable risks would be addressed. However, uninsurable (or, more precisely, insurable only at a high cost) risks are also significant in rural areas of poor countries.

For well-known and well-understood reasons of moral hazard, absence of collateralisable assets, and poorly-functioning legal systems for enforcement of contracts and the seizing and sale of whatever collateral that has been pledged, formal credit and insurance markets in poor countries are either virtually absent or costly, if not altogether out of reach, of the poor. On the other hand, informal arrangements substitute in part for transactions in formal markets (Townsend, 1994; Udry, 1993). However, the cost of informal transactions is not necessarily low and, in any case, informal arrangements are nowhere near adequate to substitute fully for the incomplete and imperfect functioning of credit and insurance markets. The growth of micro-finance institutions, following

the pioneering Grameen Bank in Bangladesh established by the visionary Nobel Laureate, Muhammad Yunus, and their role in providing access to credit for the poor, particularly women, and other self-help groups through innovative lending, has helped fill the absence of credit from commercial banks and other formal institutions. However, whether micro-credit is cost-effective is yet to be settled.

Providing insurance against damages from natural disasters and catastrophies is a challenging task for several reasons. Some or all the catastrophies are very low probability events, but with severe damages when they do occur. Others are of greater significance for a few countries with small populations such as many small island developing states, so that the market for such insurance is likely to be small. Recently, in his address to a meeting of Pacific Island developing states in Bangkok on 23 April 2008, the UN High Representative for LDCs, LLDCs and SIDS, Mr. Cheick Sidi Diarra, called for an insurance scheme to aid SIDS in times of a natural catastrophe. Mr. Diarra did not himself offer any specific proposals. Whether or not a cost-effective and feasible scheme could be developed and, if developed, whether a large enough market would emerge for such a scheme, are open questions.

2.5 GLOBALISATION FOR THE POOR

The globalisation discussed in the last section looks substantially different to the partially-integrated goods, capital and factor markets that we have today. The most notable departures, and those with the largest negative effects on the poor, are continued industrial-country protection of agricultural and other markets and restrictions on legal migration. For example, Porto (2003) estimates that tariff reforms in industrial countries leading to a 15 per cent price increase in world prices of Argentina's agricultural exports would lead to a 2.5 percentage point decrease in the proportion of Argentines in poverty.²⁸ The impact domestic subsidisation of a few cotton growers in the US on the livelihoods of thousands of cotton growers in Mali and elsewhere in Africa is well known. The recently-passed Farm Bill by the Congress of the United States is an egregious example of

28. The paper points out that although domestic trade reforms in Argentina have larger marginal poverty-reduction effects, the scope for lowering foreign tariffs is much greater and therefore, the overall poverty reduction possible from industrial-country trade reform is greater than that achievable from domestic reforms.

not only continued farm protection, but also of the utter disregard by the US lawmakers of the adverse impact of such protection on the prospects of resuming and concluding the Doha Round. President George W Bush's veto of this bill has been easily over-ridden by the US Congress.

Industrial-country protectionism has been a constant part of this most recent wave of globalisation. The fiasco at the ministerial meeting of the World Trade Organization at Cancún, Mexico, in 2003, driven in part by the refusal of the US and the EU to engage the developing countries on agriculture (particularly on subsidies to cotton growers in the US), and the continuing stalemate in the Doha Round, is a testimony to industrial-country protectionist attitudes still persisting. This is not to say, of course, that protectionism in developing countries, particularly on imports from other developing countries, is either absent or unimportant, but only to say that given their vast power in the global economy, rich countries have an obligation to move away decisively from their protectionism.

The industrial countries' practice of protecting vulnerable markets may be thought of as politically difficult to change, but that does not justify its acceptance. The answer may be to devote more attention to monitoring the practice of trade protection as an instrument to address the vulnerability problem, and devise less-distortionary means of addressing that problem through international institutions such as the WTO, IMF and others having some responsibility for policy-making and setting standards in relevant markets.

Labour-market integration has been similarly under-emphasised in the current wave of globalisation. Freer migration is an effective tool for achieving the goal of reducing disparities in wage levels across the world, but the issue has not even been on the agenda in most international trade talks. The cost of providing an adequate standard of living to a few people in remote islands while keeping them there could be far higher than the cost, if any, to host countries of allowing them to immigrate permanently. Rodrik (2002) argues that this is the area with the most significant consequences for developing countries. He estimates that a temporary visa scheme that allowed migration from developing to developed countries of up to 3 per cent of rich countries' labour force would "easily yield" \$200 billion annually for developing-country citizens.

As if these two changes were not substantial enough, it is also important to emphasise that globalisation alone will not bring about the reforms in the economic and institutional environment that are most effective for reducing poverty. It creates additional pressure for such reforms, but these are ultimately domestic decisions.

