Social Effect of Globalisation on Developing Countries

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***Abstract*- In this paper we are going to through light on the topic Globalisation definition of globalization has been used, namely increasing trade openness and FDI. A general result is that the optimistic Heckscher-Ohlin/Stolper-Samuelson predictions do not apply, that is neither employment creation nor the decrease in within-country inequality are automatically assured by increasing trade and FDI.**

The other main findings of the paper are that:

1) the employment effect can be very diverse in different areas of the world, giving raise to concentration and marginalisation phenomena

2) increasing trade and FDI do not emerge as the main culprits of increasing within-country income inequality in DCs, although some evidence emerges that import of capital goods may imply an increase in inequality via skill-biased technological change;

3)increasing trade seems to foster economic growth and absolute poverty alleviation, although some important counter-examples emerge.

I. INTRODUCTION

Since the '80s, the world economy has become increasingly "connected" and "integrated"; on the one hand the decreasing transportation costs and the diffusion of Information and Communication Technologies have implied a fast downgrading of the concept of "distance", while – on the other hand – gross trade, Foreign Direct Investment (FDI), capital flows and technology transfers have risen significantly. In most countries, the current wave of "globalization" has been accompanied by increasing concern about its impact in terms of employment and income distribution. Whatever definitions and indicators are chosen the current debate is characterized by an acrimonious dispute between advocates and critics of globalization. While this is true even as regards the employment and income distribution effects within the developed world, positions diverge even more sharply over the impact on Developing Countries (DCs). For instance, the optimists underline the link between increasing trade and economic growth and then they conclude that trade is good for growth and growth is good for the poor (both in terms of job creation and poverty alleviation). In contrast, the pessimists show that globalization is quite uneven in its impact and gives rise to negative counter-effects on the previously protected sectors, the marginalisation of entire regions of the world economy and possible increases in within- country income inequality (WCII). Another example of this kind of diversity of opinions is the debate about poverty indicators: supporters of globalization underline the fact that worldwide absolute poverty has decreased over the last two decades, while critics of globalization show that this result is almost entirely due to statistical artefacts and to the fast growth of China, while absolute poverty has increased in many DCs and relative poverty has increased in the majority of countries.

The following sections will try to go deeper into these topics and provide some theoretical and empirical answers to the question of whether globalization is good for employment, poverty alleviation and income redistribution within the DCs.

II. DEFINITION AND METHODOLOGY

"Globalization" is currently a popular and controversial issue, though often remaining a loose and poorly-defined concept. Sometimes too comprehensively, the term is used to encompass increases in trade and liberalization policies as well as reductions in transportation costs and technology transfer. As far as its impact is concerned, discussion of globalization tends to consider simultaneously its effects on economic growth, employment and income distribution - often without distinguishing between-countries and within-country inequalities – and other social impacts such as opportunities for poverty alleviation, human and labour rights, environmental consequences and so on. Moreover, the debate is often confused from a methodological point of view by the interactions between history, economics, political science and other social sciences. Partially as a consequence of the lack of clear definitions and methodological choices, the current debate is characterized by an harsh divide between the supporters and the opponents of globalization, where both groups appear to be ideologically committed and tend to exploit anecdotes (successfully or unsuccessfully respectively), rather than sound, comprehensive empirical evidence to support their cause . An ex-post measurable and objective definition of globalization has been used, namely increasing trade openness and FDI. The purpose is to discuss whether the actual increase in trade and FDI inflows is favouring or damaging DCs engaging in globalization. In this context, we will not address liberalization policies; these are ex-ante proposals which may be announced and not implemented or implemented but not effective.

III. GLOBALIZATION AND EMPLOYMENT

According to the theory of the relative comparative advantages, both trade and FDI should take advantage of the abundance of labour in DCs and so trigger a trend of specialization in domestic labour-intensive activities and so involve an expansion in local employment. However, contrary to this Heckscher-Ohlin (HO) prediction, the analysis of the recent literature supports the conclusion that the employment impact of increasing trade is not necessarily positive for a developing country. In particular, a relaxation of the hypothesis of homogeneous production functions across different countries allows for either the possibility of multiple equilibria In fact, when “total factor productivity” increases in the DCs as a consequence of globalization, the employment enhancing competitive effect has to be compared with the direct labour-saving effect of the imported technology

In other words, in a developing country, the final employment impact of increasing trade depends on the interaction between productivity growth and output growth both in traded goods sectors and in non-traded sectors. The final outcome cannot be assessed a priori for different reasons. On the one hand, export may involve a demand-led economic and employment growth, but - on the other hand – import may displace previously protected domestic firms, inducing labour redundancy. Moreover, in the presence of supply constraints (lack of infrastructures, scarcity of skilled labour, under investment, inefficient labour market), even in the exporting sectors productivity growth may exceed output growth, to the detriment of job creation. Finally, domestic sheltered sectors (such as agriculture, public administration, construction, non-traded service) may act as labour sinks, often implying hidden unemployment and underemployment in the informal labour market Shifting our focus from trade to FDI inflows, when a developing country opens its borders to foreign capital, FDIs generate positive employment impacts both directly and indirectly through job creation within suppliers and retailers and also a tertiary employment effect through generating additional incomes and so increasing aggregate demand Yet, all these positive employment effects of “greenfield” FDI have to be compared with the possible crowding-out of non-competitive and previously sheltered domestic firms (implying bankruptcies and job losses); with the possible labour-saving effects of the new technologies brought about by multinational firms; and with the possible reduction in employment associated with FDI operating through Mergers and Acquisitions (M&A). In fact, both imports and inward FDI may imply a “crowding out” of domestic production

IV. GLOBALIZATION AND WITHIN-COUNTRY INCOME INEQUALITY

On the one hand, the Stolper-Samuelson (SS) theorem predicts that both trade and FDI should take advantage of the abundance of low-skilled labour in DCs and so imply an increasing demand for domestic low skilled labour and hence decreasing within-country wage dispersion and income inequality Some important theoretical critiques can be addressed to the SS theorem . First, is the theorem valid in a global sense or in relation to the so-called “cones of diversification If SS theorem is valid not in relation to the world economy but in relation to a specific cone of diversification, it could be the case that countries abundant in unskilled labour in a global context are abundant in capital and skilled labour in comparison with some other country in the same cone; if such is the case, the SS theorem might have very different distributional consequences from those one would anticipate on the basis of a simplistic North-South interpretation of the theorem (for instance, in Mexico the equalizing effect of trade and FDI with the USA may be more than compensated by the dis-equalizing effect of competition by China and other newly industrialized Asian countries model points out that what is unskill- intensive in a developed country may be skill-intensive in terms of the labour market of the recipient DC; accordingly, shifting production from developed towards developing countries (both through FDI and import/export trade relationships) may imply increasing inequality both in the former and in the latter. For instance, outsourcing of production through FDI from the U.S. to Mexico implies that plants which were relatively intensive in unskilled labour in the U.S. would be relatively skill-intensive in Mexico (with a higher ratio of skilled/unskilled labour than domestic plants), thus raising relative wages and income inequality in both countries Third, the latter increasing inequality effect may be amplified by a possible "skill- biased" nature and in importation of capital goods. Indeed, capital equipment and intermediate goods constitute the majority of increasing imports by DCs following Liberalization For sake of clarity, we can look separately at FDI and importation. If we think about FDI as a vehicle of new technologies, in addition to the direct effect, there are different channels through which skilled-biased innovation spill over from foreign to local firms: the demonstration effect labour turnover and spin-offs and the competition More than other imports, imports of capital goods, - embodying technological innovations - are important both because of the role they play in contributing to capital upgrading and more generally to economic growth of DCs In fact, even without necessarily assuming that developed countries transfer their "best" technologies to the DCs, it is quite reasonable to expect that transferred technologies are relatively skill-intensive, i.e. more skill-intensive than those in use domestically before trade and FDI liberalization. If such is the case, openness – via technology – should imply a counter-effect to the SS theorem prediction, namely an increase in the demand for skilled labour, an increase in wage dispersion and so an increase in income inequality. Finally, globalization is often coupled with market-oriented policy reforms within the globalizing Hence, on the theoretical side, relaxing the HO hypothesis of technological homogeneity, and allowing for capital deepening and skill-biased technological change (SBTC), opens the way to an important possible counter-effect in terms of the distributional impact of globalization, and so the theoretical prediction ceases to be univocal and becomes open to different outcomes depending on the relative importance of the determinants discussed so far. On the empirical side and starting from simple correlation analyses, both Bowles (2001) and Dollar and Kraay (2001b) do not find any significant correlation between changes in openness and changes in inequality. Turning the attention to more sophisticated econometric analyses, Edwards (1997) does not find any evidence linking trade liberalization to increases in inequality; Higgins and Williamson (1999) – using a framework based on the unconditional Kuznets' curve - fail to find any significant relationship between economic openness and inequality; Spilimbergo et al. (1999) find that trade openness has a positive impact on income inequality in skill-abundant countries, but when they limit the analysis to DCs, they fail to find any significant relationship between trade and inequality; Ravallion (2001) finds no significant effect of exports as a share of GDP on Gini index changes across 50 countries (both developed and developing countries). However, Birchenall (2001) concludes that, in the case of Colombia, liberalization interpreted as a skill-biased technological change induced wage inequality, polarization and higher labour mobility. Pavcnik et al. (2003) show that trade reform in Brazil has contributed to the growing skill-premium through SBTC instigated by increased foreign competition (even though the overall effect on wage differentials is relatively small). Finally, Vivarelli (2004) does not find any significant distributional effect of trade openness and FDI inflows; however, in his study some evidence emerges that, in the early stages of openness to trade, importation may imply an increase in WCII (possibly via SBTC).

V. GLOBALIZATION AND POVERTY ALLEVIATION

As far as poverty reduction is concerned, trade and FDI are supposed to be beneficial to a DC's economic Conversely, many slow globalizers in the Sub-Saharan Africa registered an opposite trend. While the apologists of globalization support the view that current trends clearly indicate a decreasing global inequality (Sala-i-Martin, 2002), the critics show that this result mainly depend on the exceptional growth of China, while absolute poverty has increased in SSA and relative poverty (inequality) has increased in the majority of countries (Milanovic 2002b; Reddy and Pogge, 2002). On the theoretical side, economic growth is not the only vehicle through which globalization can affect poverty levels, as broadly discussed by Winters et al. (2004). In fact, globalization deeply influences labour productivity (and this may imply higher wages on the one hand but job losses on the other hand); the demand for skills however, liberalization may also involve cautious and restrictive macroeconomic policies with an opposite effect, see Langmore, 2004); relative prices (with possible adverse or positive effects in terms of purchasing power of poor households depending on the basket of tariffs reductions and on the changes in the terms of trade); relative competitiveness of domestic firms (possibly crowded-out by more efficient multinationals), government revenues and expenditures, etc. On the whole, it is true that globalization aids economic growth and that economic growth aids poverty reduction, but not unconditionally: the final outcome in terms of poverty reduction can be actually either amplified or diminished (even cancelled) by the complementary economic factors and policies which are part of the game. To better understand the issue, it is also important to distinguish between trade and FDI on the one hand and financial liberalization on the other hand. While increasing trade and FDIs seem to be associated with increasing economic growth and absolute poverty alleviation (although conditional on the occurrence of many complementary events), poverty can rise rapidly in the wake of increased vulnerability, occurrence of generalised economic crises and contagion of "innocent victims" which can all be related to fast financial

To conclude, nothing can assure that the relationship between globalization and poverty alleviation has a 1 to 1 nature as implied - for instance, - by the optimistic slogan by Dollar and Kray (2001a and 2001b) when they state that "trade is good for growth, growth is good for the poor and so trade is good for the poor". Focusing on the empirical studies, the above mentioned Dollar and Kraay (2001a and 2001b) classify countries into globalizers and non-globalizers according to their performance in raising their trade openness (export + import over GDP) and show that the former group has experienced higher growth rates during the period 1977-97 they show that the incomes of the poor rise proportionally with average incomes and that globalization does not have any systematic effect on domestic income distribution. They therefore conclude that growth is good for the poor. A summary of the most pertinent criticisms of these papers can be found in Rodrik (2000): the author does not agree with Dollar and Kraay's exogenous definition of globalizers and challenges Dollar and Kraay's arbitrary exclusion of some derived by Ravallion (2001) who points out that microeconomic and country-specific researches are needed to understand why some poor people are able to take up the opportunities offered by a globalizing developing economy while others not. Finally, UNCTAD (2002) report on low-income developing countries stresses that the current conventional wisdom that persistent poverty in LDCs is mainly due to their low level of trade integration is too simplistic; indeed the characteristics of trade integration are more important than its intensity. In particular, it is underlined that completely different paths in poverty are exhibited by non-oil primary commodity exporters (in which poverty has increased) and by manufacturer exporters, which generally display a trend towards poverty alleviation. Thus, the overall conclusion by Winters (2000) sounds particularly wise: while trade liberalization is generally found to increase economic opportunities and potentialities for DCs, it is absurd to think that globalization never pushes anyone into poverty, if any because the poor are so heterogeneous within a country and because poor countries differ so much among themselves

VI. CONCLUSIONS

What is likely to happen to local employment and income distribution when a DC chooses to open (or becomes exposed) to globalization? As is obvious from the discussion in the previous sections, both the theory and the empirical evidence did not give us black and white, clear-cut results, but rather nuanced research outcomes. If one is to be found, a general result is that the optimistic by increasing trade and FDI. In contrast, the employment effect can be very diverse in different areas of the world, giving raise to concentration and marginalisation phenomena, with the scope for enhancing the "absorptive capacity" of a given socio-institutional system which is quite large. In more detail, the employment impact depends on the initial labour-intensity, the output effect and the productivity effect characterizing traded goods and non traded goods sectors. According to the values of these three parameters and to the magnitude of possible constraints in the supply of capital, infrastructure and skilled labour, very different results in terms of job creation can emerge. Very similar arguments apply to the employment effects of FDI inflow Finally, increasing trade seems to foster growth and absolute poverty alleviation, although some important counter-examples emerge, especially in Sub-Saharan Africa. While FDIs seem to be neutral in terms of their impact on income distribution and poverty, financial liberalization seems to have adverse effects on relative poverty.

Which are the channels through which trade and FDI affect employment, within- country income distribution and poverty reduction? The positive outcome of increasing trade on poverty reduction is mediated by increasing economic growth. Since overall trade (import+export) is neutral in terms of income distribution and fosters economic growth, the final outcome is an overall reduction in poverty. As far as employment and income distribution are concerned, a clear message emerging from many studies is that technology matters. If trade (especially through importation of machinery) and FDI are characterized by labour-saving and skilled-biased technologies, globalization implies consequences which are opposite to the HO/SS predictions, i.e. decreasing employment and increasing within-country income inequality of the social consequences of increasing trade and FDI is the institutional organization of the labour market (including the informal sector). The presence of labour market flexibility and extensive use of informal labour may increase the positive employment impact, in quantitative terms, of globalization.

However, possible counter-effects are quite serious and negative, and they entail increasing income-inequality and social dumping (a sort of "race to the bottom" and "beggar thy neighbour" race induced by globalization). In the end, this regressive race may imply a substantial reduction in the socio-economic capabilities of a given DC, finally affecting the "absorptive capacity" of that country in terms of political institutions, social cohesion and technological opportunities.

What is the role of the level of development and of the institutional framework of a given DC? On the whole, the level of economic and human development does matter in shaping the direction and the impact of the current wave of globalization. For instance, the role of the physical and human infrastructures within a DC is crucial in maximizing the positive employment and distributional effects of increasing trade and FDI. Conversely, bottlenecks in the supply of educated and skilled labour and in public and private investments (including R&D) may condemn a country to marginalisation, exploitation and high levels of domestic unemployment and income inequality. Examples and policy implications are quite straightforward and concern: the role of education and training; the institutions regulating the labour and the capital markets; the modes of "governance" at the local, regional and national levels products; the construction of a welfare system able to create safety nets for possible victims of the globalization process.