Globalization and the Poor

Ian Vásquez

The economic crises in Asia, Russia, and Latin America in recent years serve as a reminder that nothing is inevitable about the process of globalization. In a number of countries, liberalism has suffered a setback, temporary or not. Even so, the liberal cause still appears to have the long-term advantage in the struggle for global capitalism as much of the world continues to advance in that direction. Still, proponents of globalization cannot afford to be smug. The world has returned to a global economy only recently, and we should not forget that that first era of global capitalism ended in the cataclysms of the twentieth century.

The present era of globalization thus poses challenges to liberals (in the classical sense). It requires us to counter the critics of globalization with a forceful advocacy of the moral case for capitalism. It also requires a clear articulation of the long list of market reforms still left on the agendas of every developing country. In too many countries that have begun opening their economies, flawed policies, the lack of reform, and other manifestations of the statist past have led to crisis and to disillusionment with the free market. Globalization has indeed brought many blessings, but, as my colleague Brink Lindsey says, "It is much earlier than the triumphalists think." Finally, liberals should be wary of constructivist approaches to promoting global capitalism, especially through multilateral government agencies. Because of unintended consequences and capture by protectionist forces, attempts to promote globalization from the top down can result too easily in a globalization backlash.

In this article, I attempt to follow through on this advice in a focused discussion of how globalization favors the poor. First, however, a brief comparison of the two eras of globalization may be useful.

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The Recent Return to a Global Economy

The recent return to a global economy by most measures has made the world more integrated than in the past. Trade as a share of world economic output reached the pre–World War I level only in the 1970s, and it has now at least doubled (International Monetary Fund 1997, 112). Gross capital flows are far larger, international lending and investing more diversified, and global production more complex. The current era of global capitalism, moreover, encompasses far more countries and people than did the previous era.

Other measures suggest, however, that in some ways the world is less globalized than in the past. A look at net capital flows, for example, reveals greater financial integration during the Victorian era. The outflow of capital from Great Britain reached 9 percent of its gross domestic product (GDP) during that time, and figures for Germany, France, and the Netherlands were similar. No country today comes even close to those rates. In the 1990s, the average capital outflow for leading economies was slightly above 2 percent of GDP (International Monetary Fund 1997, 114). Wider differences in domestic saving and investment rates during Victorian times, moreover, imply that capital markets were integrated more closely then (C. Wolf 2001, 5). That difference may reflect to a large extent the gold standard's replacement by a system of central banks, fiat currencies, and a variety of exchange rate regimes.

Another area in which the world is clearly less liberal than under the Pax Britannica is that of immigration, in that rich countries now impose extensive controls. As economist Deepak Lal convincingly argues, such restrictions on the movement of people exist today because citizenship concedes rights to the services of the welfare state (2000, 29). This observation suggests another major difference between the two eras of globalization: the growth of government in developed countries during the twentieth century has not been reversed by the current advance of capitalism. Governments of the Organization for Economic Cooperation and Development (OECD) countries are receiving more in taxes—both in absolute terms and as a share of the economy—than they were ten years ago ("Is Government Disappearing?" 2001, 14). In most of those countries, total government spending as a percentage of GDP also has increased or stayed approximately the same. Even developing countries that have introduced market reforms have managed to maintain or even increase the size of government. Total government spending as a percentage of output is 29 percent in Bolivia, 36 percent in Brazil, and more than 30 percent in Argentina. Those figures indicate governments that are four to six times larger than the governments of rich countries when the rich countries were at similar stages of development.

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Clearly, globalization is not characterized by minimal, "night-watchman" states, nor has it led to laissez-faire. There is also little evidence of job loss or of a "race to the bottom" either in wages or in labor standards owing to increased trade openness. Those concerns, expressed for the most part in rich countries, have been discussed more effectively elsewhere (Burtless et al. 1998; Griswold 2001; Krugman 1996), and, at least in the United States, they have subsided with the prosperity of the 1990s.

Globalization holds the most promise for developing countries with respect to economic growth, poverty reduction, and the reversal of global inequality. Most important, globalization is helping parts of the developing world to replicate the experience that Western countries went through beginning around 1820, when they broke with the historical norm of low growth and initiated an era of dramatic advances in material well-being. Living standards tripled in Europe and quadrupled in the United States in the nineteenth century, and they improved at an even faster pace in the twentieth century. Economic growth thus eliminated mass poverty in what is today considered the developed world.

The West's escape from poverty did not occur by chance. Sustained growth over long periods of time took place in an environment that generally encouraged free enterprise and the protection of private property. Today, developing countries have an advantage. By adopting liberal economic policies, they can achieve within one generation the kind of economic progress that rich countries took a hundred years to achieve. Rapid growth is possible because poor countries will be catching up to rich countries rather than breaking a new path.

The most comprehensive empirical study of the relationship between economic policies and prosperity is the Fraser Institute's annual report *Economic Freedom of the World* (Gwartney and Lawson 2001), copublished by the Cato Institute. It examines more than twenty components of economic freedom, ranging from size of government to monetary and trade policy, in 123 countries over a twenty-five-year period. The study finds a strong relationship between economic freedom and prosperity. With the countries divided by quintiles, the freest economies have an average income per capita of $19,800 compared with $2,210 in the least-free quintile. Freer economies also grow faster than less-free economies. Annual growth of output per capita in the 1990s was 2.27 percent in the freest quintile, but –1.45 percent in the least-free countries.

The Fraser study also found that economic freedom is strongly related to poverty reduction. The United Nations Human Poverty Index, for example, is negatively correlated with the Fraser index of economic freedom. The recent acceleration of growth in many developing countries indeed has reduced poverty, measured as those living on less than one dollar a day. In the past ten years in the developing world, the percentage of people who are poor fell from 29 to 24 percent (World Bank 2001, 21). Despite that progress, however, the number of poor people has remained stubbornly high at approximately 1.2 billion, and reductions in poverty have been uneven geographically.

This mixed performance has prompted many observers (for example, Wolfensohn and Stiglitz 1999) to ask what factors other than growth reduce poverty and whether growth is enough to accomplish that goal. Market reforms themselves have been questioned as a way of helping the poor. After all, many developing countries have liberalized their economies to varying degrees in the past decade.

The pattern of poverty reduction we see around the world should not be surprising. It generally follows the relationship found by a recent World Bank study that considered growth in sixty-five developing countries during the 1980s and 1990s (Easterly 2001, 13). The share of people in poverty, defined as those living on less than one dollar per day, almost always declined in countries that experienced growth and increased in countries that experienced economic contractions. The faster the growth, the study found, the faster the poverty reduction and vice versa. For example, an increase in income per capita of 8.2 percent translated into a 6.1 reduction in the poverty rate. A contraction of 1.9 percent in output led to an increase of 1.5 percent in the poverty rate.

That relationship explains why some countries and regions have done better than others. "Between 1987 and 1998, there was only one region of the world that saw a dramatic fall in both the number of people and the proportion of the population living on less than a dollar a day. That region was East Asia," observes economist Martin Wolf. "But this was also the only region to see consistent and rapid growth in real incomes per head" (1999, 23).

During this period, high growth allowed East Asia to reduce the share of its poor from 26 to 15 percent and the number of poor from 417 million to 278 million people. With annual growth rates of nearly 9 percent since 1979, when it began introducing market reforms, China alone has pulled more than 100 million people out of poverty. That rate and scope of poverty reduction is unprecedented in world history. The more modest but increasing growth rate in India during the past decade means that the outlook of the poor in the two countries that make up half of the developing world's population is noticeably improving.

Elsewhere the performance is less encouraging, but it follows the same pattern. Poverty rates rose in eastern Europe and Central Asia, where economic activity declined sharply, and stayed the same in Latin America and sub-Saharan Africa, where growth was low or negligible.

Even within regions there are variations. Thus, Mexico's growth rate of output per capita of 1.5 percent in the 1990s did not affect the share of people living in destitution, whereas Chile's average growth rate of 7 percent from 1987 to 1998 reduced the poverty rate from 45 to 22 percent, according to the Institute for Liberty and Development in Santiago (Camhi 2000, 5).

Likewise, Vietnam stands out in Southeast Asia. According to the World Bank, with that country's growth rates of output per capita averaging approximately 6 percent in the 1990s, those living under the poverty line declined from 58 to 37 percent between 1993 and 1998. Uganda's growth of output per capita of more than 4 percent in the 1990s reduced the share of people living below a minimum poverty line from 56 percent to 44 percent between 1992 and 1997. The Centre for the Study of African Economies at Oxford University concluded that "general growth accounts for most of the fall in poverty" (Appleton et al. 1999, 1).

The growth induced by globalization does not just reduce poverty. The Fraser Institute study (Gwartney and Lawson 2001) found that economic freedom is related strongly to other indicators of progress. For example, people living in the top 20 percent of countries in terms of economic freedom tend to live approximately two decades longer than people in the bottom 20 percent. Lower infant mortality, higher literacy rates, less corruption, and greater access to safe drinking water are also associated with increases in economic liberty. Indeed, the United Nations Human Development Index, which measures various aspects of standards of living, correlates positively with greater economic freedom.

The empirical evidence also shows that critics of globalization are wrong about the effects of global capitalism on inequality, both within and among countries. A recent World Bank study, for example, compared the performance of globalizing and nonglobalizing developing countries (Dollar and Kraay 2001). It found that globalizing countries had higher growth rates (approximately 5 percent in the 1990s) than other countries, rich or poor. Countries participating in globalization thus are catching up with rich countries. Because the high-growth countries include China and India, which contain half of the developing world's poor, the growth in global inequality that had occurred for some two hundred years is now ending, and perhaps global inequality has begun to decline.

Consistent with other studies (for example, Lal and Myint 1996), the World Bank report also found that globalization has not increased inequality within nations. In some countries, inequality has risen, in others it has not, but liberalization has had no general effect on changes in income shares. In general, the incomes of the poorest 20 percent of the population in liberalizing countries have risen proportionately with the average rise in income. Because many countries are making the transition from socialism to the market, moreover, the increase in inequality should not be surprising or alarming. Anders Aslund (2002) shows, for example, that in the fast-reforming countries of the former Soviet bloc, inequality has risen to western European levels, whereas among the gradual reformers inequality has grown to U.S. levels.

The Neglected Agenda

Although the collapse of central planning forced many countries to abandon inward-looking economic policies in the 1990s, most of the developing world is still far from adopting a coherent set of policies consistent with economic freedom. Russia may have dumped communism, but in terms of economic freedom the Fraser Institute ranks it 117 out of 123 nations (Gwartney and Lawson 2001, 9). Even countries such as Argentina and Mexico that have done much to liberalize their economies have clung to policy remnants of the past, with devastating consequences for the poor. Mexico's peso crisis of 1994–95, for example, resulted from monetary and fiscal policies during an election year that were thoroughly inconsistent with market economics.

Attention to market-oriented macroeconomic policies is well founded, particularly because they benefit the poor. This point applies especially to two such policies that disproportionately favor the poor—reducing inflation and reducing government spending. Much less attention, however, has been paid to institutional reforms and the microeconomic environment. Although the reform agenda in most countries is quite long, three areas stand out: the rule of law, the extent of bureaucratic regulation, and the private-property rights of the poor.

A legal system capable of enforcing contracts and protecting persons and their property rights in an evenhanded manner is central to both economic freedom and progress. Indeed, the sustainability of a market economy—and of market reforms themselves—rests in large part on the application of the rule of law. Yet the rule of law is conspicuously missing in much of the developing world. The 2001 *Economic Freedom of the World* report (Gwartney and Lawson 2001), which includes a more comprehensive index of economic freedom for fifty-eight countries, takes this measure into account. It finds that Latin American countries rank especially low in this area. Also at the bottom of the list are transition countries such as Russia and Ukraine. Were reliable data available for African countries, they would no doubt receive low ratings as well.

The absence of the rule of law is especially unfortunate for the poor, not only because they have fewer private resources to protect their rights, but also because the rule of law in itself is related to economic growth. Robert Barro (1998) created an index that measures the rule of law on a scale of 0 to 6, and he found that a country's growth rate increases by half a percentage point with each increment in his index. Because the rule of law provides essential protections for the poor, sustains a market-exchange system, and promotes growth, it may well be the most important ingredient of economic prosperity.

Another much-neglected area in need of reform is regulation. Here again the Fraser Institute's comprehensive index shows that the freedom to operate a business and to compete in the market is circumscribed in much of the developing world. The same countries that rank low in the rule of law also rank low in this area. To have an idea of the bureaucratic burden with which people in the developing world must contend, consider the cases of Canada, Bolivia, and Hungary. According to a study by the National Bureau of Economic Research, it takes two days, two bureaucratic procedures, and \$280 to open a business in Canada (Djanok et al. 2000). In contrast, an entrepreneur in Bolivia must wait eighty-two business days, go through twenty procedures, and pay \$2,696 in fees. In Hungary, the same operation takes fifty-three business days, ten procedures, and \$3,647. Such costly barriers favor big firms at the expense of small enterprises, where most jobs are created, and push a large proportion of the developing world's population into the informal economy.

The informal economy in the developing world is large because of another major factor: the private-property rights of the poor are not recognized legally. Peruvian economist Hernando de Soto (2000) has documented how poor people around the world have no security in their assets because they lack legal title to their property. In rural Peru, for example, 90 percent of poor people's property is not recognized by the state. The lack of such legal protection severely limits the wealth-creating potential that the poor would otherwise have were they allowed to participate within the legal framework of the market. Without secure private-property rights, the poor cannot use collateral to get a loan, cannot take out insurance, and find it difficult to plan for the long term.

Ending what amounts to legal discrimination would permit poor people to benefit fully from the market system and allow the poor to use their considerable assets to create wealth. Indeed, as de Soto has shown, the poor are already asset rich—their assets being worth 40 times the value of all foreign aid since 1945. The wealth of Haiti's poor, for example, is more than 150 times greater than all foreign investment in that country since its independence in 1804. In the limited places that poor people's property has been registered, the results have been impressive. Where registration was carried out in Peru, new businesses were created, production increased, asset values rose 200 percent, and credit became available.

Extending the system of property-rights protection to include the property of poor people is the most important social reform that developing countries can undertake. It is a reform that has been ignored almost completely around the world, yet it would affect the poor directly and produce dramatic results for literally billions of people.

Globalization as a Bottom-Up Process

Both the enemies and the proponents of globalization often attribute the implementation of market policies to the guidance of international institutions such as the International Monetary Fund (IMF), the World Bank, or the United Nations, and both groups often recommend that further global developments be managed by international bodies.

Those views are unfortunate because they give the false impression that globalization is somehow imposed from above. In truth, the world economy has evolved as a result of changes coming from the national level rather than changes directed at the international level—what German liberal Wilhelm Röpke called an international order "from within and beneath" rather than the "false internationalism" that characterizes supranational organizations (Sally 1998, 133, 134). Moreover, the constructivist approach to achieving a liberal economic world order is fraught with peril because it can have unintended consequences and may lead to discretionary and arbitrary use of power. Razeen Sally of the London School of Economics describes some of those hazards:

> Neoliberal institutionalists do not portray international policy coordination in the frame of limiting general rules at the international level that proscribe discretionary government action; rather, they think of it as an apparatus of complicated negotiations on particularistic policies intended to achieve spe-

> cific results. This is the hallmark not of limited government under the Rule of Law, but of unlimited and discretionary government in an international public policy cartel, avoiding both domestic political accountability and market disciplines. In this context, international regimes are manifestations of government failure transplanted to the international level. Intergovernmental cooperation and international agreements, far removed from public scrutiny and the control of national legislatures and judiciaries, supply extra room for arbitrary activity by politicians and bureaucrats. They exacerbate the malaise of Big Government and political markets within nation-states. (1998, 196–97)

Multilateral aid intended to reduce poverty and to promote market reforms, for example, in practice has reduced prosperity and slowed the move to world capitalism. IMF bailouts have created both moral hazard and the impression that capitalism somehow has failed. Official international organizations also have been used to pressure poor countries to adopt labor and environmental regulations that are inimical to growth and contrary to the wishes of developing countries and the vast majority of consumers in rich countries. Deepak Lal notes that the West's efforts to promote labor, environmental, and other standards in the developing world are reminiscent of nineteenth-century imperialism and its attempts to legislate its "habits of the heart" worldwide, which did so much to undermine that era's liberal economic order. "If the West ties its moral crusade too closely to the emerging process of globalization," he warns, "there is a danger that there will also be a backlash against the process of globalization" (2000, 40).

Conclusion

Globalization is proving the antiglobalization movement wrong in the area that is perhaps its central feature: the spread of capitalism is reducing poverty and global inequality. This reduction is not enough, however, for liberals to dismiss as misinformed the claims of the antiglobalists in this area or in others. Liberals must take the offensive and occupy the moral high ground in the globalization debate rather than play a defensive role when crises break out (John Micklethwait and Adrian Wooldridge [2000] make much the same point). The task ahead is to show how all developing countries, including those that have done much to liberalize their economies, are still a long way from establishing free markets based on private-property rights and the rule of law. Indeed, Argentina is only the most recent example of how the growth of big government in the twentieth century has made the return to a global economy cumbersome and tumultuous.[1] Our challenge is enormous because we can expect the ongoing process of globalization to be uneven and rough, nor is its outcome inevitable.

1. For a review of the causes of Argentina's crisis and for policy recommendations, see Hanke 2001; Lindsey 2002b; Schuler 2002; and Vásquez 2001a.

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