THE GLOBALISATION DEBATE : Our Ideas and Critique

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ABSTRACT

This paper looks closely at the currently ongoing debate on globalization, and shall be especially examining its effects on the growth of nations and global poverty and income inequality. Here, the primary focus shall be on the seminal Dollar and Kraay paper and this paper shall also seek to provide expositions on the critique provided and refutations made towards this paper by certain noted economists. The final part of the paper shall contain our ideas on the debate.

Key words **: Globalisation, growth, poverty, income inequality, institutions, corruption.**

Of late, globalization has become an oft-used term, used to depict any phenomenon that involves any interaction between multiple nation states. And, the idea that the world is increasingly becoming a "global village", where distances have shrunk immensely, has firmly gripped the imagination of people worldwide. Of course, like any new and emerging idea, globalization, too, has its advocates, the Globaphilics, and critics, the Globaphobics, who vigorously debate on the effects of the phenomenon, and, in fact, even on the phenomenon itself ! And, in this paper, we are going to mainly focus on this debate. Here, not only are we going to review the opinions of the noted advocates and critics, but, we are also going to intertwine the review with our opinions and ideas on the debate and on the phenomenon itself. But, before we delve into the intricacies of the debate, we shall first briefly define the very phenomenon that we are about to examine, and broadly outline some of its most important effects.

Formally, globalization is the increasing interdependence, integration and interaction among people and corporations in disparate locations around the world. This term basically encompasses a complex combination of global economic, trade, social, technological, cultural and political relationships. And, it has significant impacts on a large number of important areas in an economy, ranging from the economic, financial, social, political and legal / ethical sectors to the informational, technical and ecological sectors. It also has important impacts on immigration and emigration, culture and language. For our purposes, we would concentrate only on the effects on the economic and allied sectors in this paper.

Globalisation creates a global common market based on freedom of exchange of goods and capital and provides access to foreign goods for both consumers and producers. One result of this increased access is increased competition, which in turn, results in increased productivity, It, further, provides added access to external financing for borrowers in the financial market. Data shows that in early 21st century, more than \$1.5 trillion in national currencies were traded daily to support expanded trade and investment. Globalisation also encourages migration. IOM estimates show that there were about 200 million migrants globally in 2008, and, the amount of remittances to LDCs was estimated at around \$328 billion. Moreover, it raises global awareness against crime and corruption and helps to strengthen cooperation among nations in fighting them.

Now, in this paper, we shall mainly focus on the debate centering on the effects of globalisation, that is, increased integration of individual nation states with the global economy, on the growth performance of these globalising economies and other non-globalising economies, along with their position with respect to change in income inequality, both inter-country and intra-country, and alleviation of poverty. And, we shall build our paper around the seminal paper "Trade, Growth and Poverty" by David Dollar and Aart Kraay. The main reason for us concentrating on this particular paper is that it has heavily influenced the conditions on trade

liberalisation attached to IMF and World Bank loans and the advice of Northern governments as given to Southern governments.

In the second section, we shall discuss, at considerable length, the results derived in the Dollar and Kraay paper along with the methodology used by them to arrive at the results. Then, we are going to dive head first into the actual debate by explaining, in some details, the main refutations and critiques put forward on the results and methodologies of this paper by certain noted economists, namely, Dani Rodrik, Howard Nye, Sanjay Reddy, Kevin Watkins and Stanley Fischer, while attempting to intertwine their opinions with ours. In the third section of the paper, we shall attempt to put forward our opinions and ideas on this debate.

SECTION II : REVIEWING THE LITERATURE

In their paper titled "Trade, Growth and Poverty", David Dollar and Aart Kraay have reached three important results that have been at the centre of the whole globalization debate. First, they have contended that the experience of post 1980 globalisers, who are known as late globalisers, shows that greater involvement in trade is related to, that is, helps in the process of faster growth of developing countries. Secondly, they have stated that there is no evidence that countries that trade more, or are integrated along other dimensions, display rising income inequality in general. In fact, globalizing LDCs grow faster than the richer countries and thus the gap between rich and poor countries is bridged to a certain extent. And, finally, they have claimed that the existence of growth benefits of greater trade coupled with the fact that there is no evidence on the systematic effect of trade volumes on income inequality show that globalization is indeed a force for reduction in poverty. Thus, in a nutshell, this paper states that globalization leads to faster growth and poverty reduction in developing and underdeveloped countries.

Now, this paper by Dollar and Kraay is a fully empirical work where each of the results have been derived through rigorous econometric modeling. And, they have mainly taken inspiration from Srinivasan and Bhagwati (1999), where a detailed analysis of country experiences, considering many country-specific factors, in major OECD, NBER and IBRD projects during 1960s and 1970s have yielded the result that trade creates and even sustains higher growth. But, Dollar and Kraay have used a very different methodology.

Here, first they have identified the post 1980 globalisers. For that, they have used two measures, namely, growth in trade relative to GDP (prices kept constant) and reduction in average tariff rates. The first group of globalisers is the top one-third developing economies that have the highest growth in trade relative to GDP. The second group of globalisers is the top one-third tariff-cutters. And, finally, those countries that are common to both lists have been selected to form the third group of globalisers. This group, satisfying both criteria, contain nine countries that are, China, India, Brazil, Thailand, Argentina, Bangladesh, Uruguay, Nicaragua and Dominican Republic. Here, perhaps Colombia has been inadvertently left out, as has been pointed out later by Dani Rodrik in his critique on this paper.

Next, taking the data for these nine countries, Dollar and Kraay have run the following regression :

$$y_{ct} - y_{c,t-k} = \beta_1 (y_{c,t-k} - y_{c,t-2k}) + \beta_2` (X_{ct} - X_{c,t-k}) + (y_t - y_{t-k}) + (v_{ct} - v_{c,t-k})$$

where, $y_{ct} - y_{c,t-k}$ = log(difference in per capita GDP in country c in decade t-k to t)

$y_{c,t-k} - y_{c,t-2k}$ = log(difference in per capita GDP in country c in decade t-2k to t-k) = bringing in country's trade history.

$X_{ct} - X_{c,t-k}$ = difference in control variable measured over decade t-k to t & t-2k to t-k.

$y_t - y_{t-k}$ = difference in unobserved period effect that is common across countries.

$v_{ct} - v_{c,t-k}$ = error term.

Unobserved country effect, η, is eliminated through taking the first difference.

Running OLS and IV on this equation, it has been seen that as trade rises by 100%, income rises by around 50%. Thus, this has led to the first result that greater involvement in trade leads to faster growth in developing economies.

Next, they have regressed the following equation :

$$y_{ct}^{P} = \alpha_0 + \alpha_1 y_{ct} + \alpha_2` X_{ct} + \mu_c + \varepsilon_{ct}$$

where, y_{ct}^{P} = log(per capita GDP of poor in country c at time t)

y_{ct} = log(per capita GDP in country c at time t)

X_{ct} = vector of other determinants of mean income of poor

$\mu_c + \varepsilon_{ct}$ = error term.

Here, the poor have been defined as the bottom 20% of income distribution.

Estimating this equation using GMM estimator, has given the second result that there is no significant correlation between changes in inequality and changes in trade volumes.

And, finally, matching this result with the data collected on the post 1980 globalisers have shown that growth rate of income of the poor is similar to growth rate of per capita GDP, that is, growth rate of the economy as a whole. This has led to the final result of the paper that globalization is indeed an important force in poverty reduction in developing and underdeveloped economies.

Perhaps the most important critique to this paper has been put forward by Dani Rodrik. He has refuted Dollar and Kraay mainly on four grounds, namely, arbitrary selection of globalisers, examining the case of India and China, using tariff data as proxy for trade barriers and using trade relative to GDP as the regressor.

Rodrik's main objections with the method of selection of the globalisers are that an outcome variable cannot be combined with a policy variable and that the two groups cannot be selected using two different base years. In fact, Rodrik

selected the third group of globalisers consisting of 17 countries, only four of which overlapped with Dollar and Kraay's selection, using their rule and showed that those countries have actually shown an undistinguished growth performance. Further, he has also mentioned that since the policy variable is only under the control of the policy-maker, it is more appropriate to take that into account only.

Then, Rodrik has shown that on studying the economies of India and China in details, it can be seen that they have started displaying a rising trend growth rate even before they have actually had trade liberalization. And, thus, he has concluded that globalization is not the cause of rising growth rate in these two emerging economies. Next, he has argued that tariff data is actually a good proxy of trade restrictions, as although they form a small part of trade barriers, they accurately reflect the level of restrictiveness of the trade regime of the country. And, finally, he had constructed a simple causal model and has shown that even when there is no direct impact of trade policy or volume over growth, still trade and growth are correlated. Therefore, there is no plausible reason to use trade volume as a proxy for trade policy while running the regression.

Therefore, Rodrik's contention is that Dollar and Kraay's analysis of late globalisers is extremely misleading and that there is no evidence that globalisers did better than non-globalisers. Also, he states that the statements made on poverty is based more on faith than on evidence. And, he importantly states that the quality of institutions is the actual key element.

Another important critique of the paper is made by Howard Nye, Sanjay Reddy and Kevin Watkins. They too take up the case of selection of the globalisers. They, unlike Rodrik, rightly point out that many factors, like, domestic institutions, geography, attitudes of trading partners, etc., other than trade policy only affect the volume of trade of a country. Further, they support Rodrik's argument of using different base years for selection of the two groups being an incorrect method. They have, in turn, shown that the globalisers identified by Dollar and Kraay actually

undergo a very diverse experience when the percentage reduction of tariffs of these countries during 1990s is compared to the IMF Trade Restrictive Index. Next, they contend that country specific factors do change over time and affect growth of the country. Thus, it is incorrect to eliminate that from the regression equation. They also state that using trade volume as a proxy for trade policy is incorrect as certain non-trade-policy factors may have a direct effect on trade policy which in turn might affect growth. And, finally, they show through empirical evidence that the conclusion that globalization does not have any systematic effect on income inequality is actually incorrect.

Branko Milanovic also shows, in his 1999 World Bank report, that there is no proper empirical evidence that the incomes of rich and poor countries are actually starting to converge. This debate has even made Joseph Stiglitz remark, "Today, few -- apart from those with vested interests who benefit from keeping out the goods produced by the poor countries -- defend the hypocrisy of pretending to help developing countries by forcing them to open up their markets to the goods of the advanced industrial countries while keeping their own markets protected, policies that make the rich richer and the poor more impoverished -- and increasingly angry."

Finally, Stanley Fischer chalks out certain challenges that the global community faces in making the benefits of globalization effectively reach the poor. First, he advocates implementing the right policies and especially emphasizes on the outward-oriented policies of the 1990 Washington Consensus. Secondly, he emphasizes that Northern economies should deliver on their commitment on trade and aid. Thirdly, the international community has to work to make the international financial system less crisis-prone. Fourthly, governments of both the North and the South should try to effectively deal with migration of labour and human capital. Finally, governance has to be improved and corruption has to be tackled effectively.

SECTION III : OUR IDEAS

Dollar and Kraay's basic contention is that globalization, or increased integration of a country with the global economy, leads to the country experiencing a faster growth rate. And, if it is a developing economy, then it grows at a faster rate than a rich economy resulting in a fall in inter-country income inequality. Also, due to the growth benefits of globalization and the lack of evidence on the existence of an inverse relationship between trade volumes and income inequality, globalization also helps to reduce poverty. Thus, economies should reduce trade barriers and increasingly engage in international trade. And, this is especially required for poor economies.

We agree completely that growth is indeed required in a developing economy as only economic growth has the potential to reduce income inequality, both inter-country and intra-country, and alleviate poverty. But, Rodrik shows that in India and China growth started picking up even before trade liberalization started. Therefore, we cannot agree with Dollar and Kraay when they say that globalization is a necessary condition for the initiation of a rise in the growth rate of an economy.

Further, we would like to contend that the idea that benefits of growth of a country would have a trickle-down effect and would ultimately reach the poor who are at the base of the income pyramid has been seen to not really hold in practice. In reality, it has been found that the benefits of growth mostly accrue to the few income groups that are at the top of the income pyramid, and that leads to a rise in intra-country income inequality. This also results in aggravating the poverty situation in the country by making the poor even more vulnerable to extreme poverty and deprivation. Several papers have addressed this issue, among which Basu and Bandyopadhyay (2005) has shown that economic growth is not always beneficial for developing and underdeveloped economies. A good example of the benefits of growth not really trickling down in reality can be seen in our country. India has been experiencing a very good growth rate over a sustained period of time now. But,

inspite of that, empirical evidence shows that, in 2010, eight Indian states, namely, Bihar, Chattisgarh, Jharkhand, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh, and West Bengal, have more number of poor than the 26 poorest African countries combined !

The fact that, benefits of economic growth does not display trickle-down effects is perhaps one of the main reasons behind the recent emergence of the concept of inclusive growth. It does not believe that economic growth will automatically take care of income inequality and poverty problems in the country, but, rather that active measures, along with economic growth, are needed to raise the share of poor in the framework of market-based growth. This school of thought advocates adoption of strategies that would enable redistribution of land in favour of the poor, allow for greater investment in building of proper infrastructure, provide better access to education and healthcare facilities, especially to the poor, ensure basic labour rights, provide basic minimum wage protection and tackle corruption. And, in our opinion, a rise in inclusive growth is perhaps more important than a simple rise in the growth rate, at least from the perspective of a developing country like that of ours. Thus, we feel that a process of globalization that encourages the rate of inclusive growth shall be more beneficial to Southern economies than the process of globalization supported by Dollar and Kraay.

Next, a fall in income inequality is obviously a desirable effect of globalization. But, if we take the case of a Northern economy, we can see a school of thought, that had John Rawls as one of its noted advocates, that states that in rich economies, where the incidence of poverty is negligible, persistence of a certain degree of inequality in income is actually beneficial for the country. The idea, here, is that if income inequality is present, in accordance to the level of skill possessed by an individual, then that will act as an incentive to less skilled individuals to acquire more skills so as to qualify for the higher income level. Also, it would make high skilled workers maintain their skill levels or to get even better so as to maintain their high level of income. As a result of this, the overall productivity of the economy

rises that leads to a rise in output level, which in turn raises the growth rate of the economy. Thus, here persistence of income inequality is boosting the growth rate.

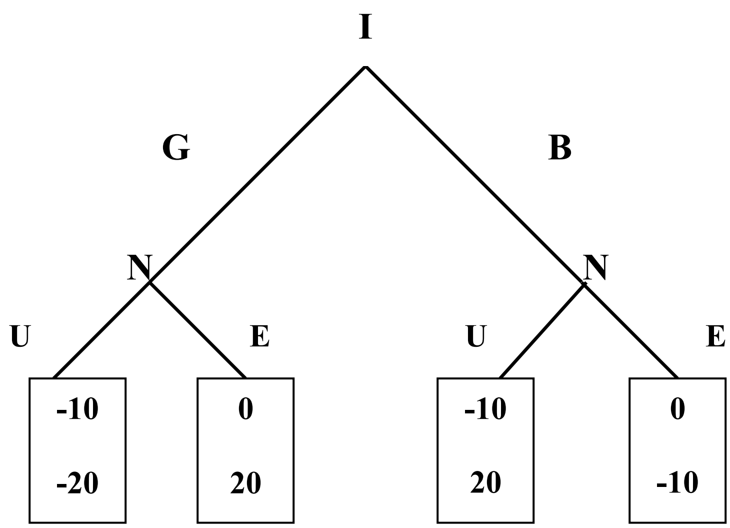
Now, analyzing this phenomenon, following the above mentioned school of thought, we see that globalization that reduces inequality actually reduces the rate of economic growth in a Northern economy. Now, Dollar and Kraay have stated that globalization induces faster growth of the globaliser. They have stated that a Southern economy grows faster than a Northern economy, but, still the Northern economy does grow. Thus, here, this idea of Dollar and Kraay stands refuted.

Rodrik and Fischer have hinted that quality of institutions and certain international political factors are really the key behind trade and growth. The phenomenon of selective openness in trade between the North and the South bear testimony to the fact that perhaps international politics is indeed at play here. It is observed that while the North advocates trade openness to the South, it itself generally imposes huge import tariffs specially on agricultural goods and labour-intensive manufactured goods, that is, goods that the South has a comparative advantage in producing. In fact, the North is estimated to spend $1 billion on subsidizing over-production and export dumping. As a result, the South is estimated to lose $50 billion a year. Actually, the South loses through the avenue of welfare loss as well as it is unable to export the goods that it has a comparative advantage in producing and the amount of overproduction of the North is forcefully dumped onto the South.

Such uneven liberalization enables the North to capture most of the benefits of globalisaton, and, the pattern in which it is done showcase that there indeed are certain underlying political factors. Notably, the politically influential large-scale farmers, like, the grain barons of Paris Basin, the peanut magnates of Georgia, etc. receive the highest amount of subsidy, and, IMF and World Bank loan conditionality also supports such uneven liberalization. This also proves that had

the quality of institutions been better, such political factors would never have been able to affect the process of trade liberalization in the world.

We may take the help of a highly simplistic sequential game of complete information to show that the trade pattern followed by the North shall depend on the quality of institutions. We are considering a complete information game as generally countries have an idea about the quality of institutions. Here, the two players are the Institutions (I) and the North (N). Strategies of Institutions are Good (G) and Bad (B), i.e., institutions can either be of good quality, i.e., North cannot influence them politically, or of bad quality, i.e., North can influence them politically. Strategies of North are follow Uneven liberalization (U) and follow Even liberalization (E). Pay-offs are taken in multiples of 10 and the structure is arbitrary. The game is depicted below :



When institution is good, and N plays U, then I will put sanction on N. So, I loses as it has to put sanction, but N loses both in terms of sanction and lack of subsidy. If N plays E, I incurs no loss, and N gains in terms of no sanction and gaind through legitimate trade. When institution is bad, and N plays U, I loses as it has to subsidise and N gains both in terms of subsidy and lack of sanction. If N plays, I

incurs no cost, and N loses out on subsidy as institution will not sunsidise when trade liberalisation is proper and even.

Here, the Sub-Game Perfect Nash Equilibrium is { G, (E, U) }. That is, when institution is good, North will go in for even liberalization, otherwise it will go in for uneven liberalization.

Globalization may lead to a rise in the growth rate of the economy. But, literature on Economics of Corruption shows that corruption and growth rate are inversely related (Mauro (1995), Shleifer & Vishny (1993) and Li, Xu & Zou (2000)). Thus, if the level of corruption in an economy is very high, then most of the benefit of globalization will be undone as high corruption levels will pull down the growth rate. Also, it has been proved in Li, Xu & Zou (2000), that corruption and income inequality are related in an inverted U-shaped way, that is, in countries with intermediate levels of corruption, inequality is higher than in countries with little or excessive corruption (Table 1). Thus, we can say that the position of income inequality will depend to a great extent on the level of corruption in the economy, rather than on the extent of globalization. Now, corruption is a reality that Dollar and Kraay did not take into account. But, it is one factor that can completely refute their findings and observations.

In fact, corruption is one problem that none of the critics of Dollar and Kraay talked about. But, it has very far-reaching effects on globalization and its resultant growth, reduction in income inequality and poverty. And, we would like to conduct a detailed investigation into the problem.

Another aspect the current debate has ignored are the non-economic dimensions of poverty, like, security, health and self-respect. The effects of these dimensions are particularly visible in the case of women and children. Globalisation has provided employment to millions of women. And, although incomes have risen, the tendency of fierce competition associated with it has deprived women of basic

rights and security, as firms seek to operate under increasingly competitive conditions so as to maximize their profits. It has also been observed that globalisaton has caused a rise in demand of certain goods produced in industries that use a good amount of child labour. In response to increased demand, industries have raised supply as well. And, thus, incidence of child labour has gone up. Therefore, globalization has encouraged child labour, in certain instances.

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Table 1 :

Relationship Between Corruption & Unequal Income Distribution, 2006[1]		
Country	**Gini Index**	**Corruption Perceptions Index (CPI)**
Argentina	48.8	2.9
Armenia	40.0	2.9
Austria	25.0	8.6
Belarus	27.9	2.1
Belgium	28.0	7.3
Bulgaria	31.0	4.0
Colombia	58.5	3.9
Costa Rica	49.2	4.1
Cyprus	29.0	5.6
Czech Republic	25.0	4.8
Denmark	24.0	9.5
Dominican Republic	51.9	2.8
Ecuador	53.4	2.3
Estonia	33.0	6.7
Finland	26.0	9.6
France	27.0	7.4
Germany	27.0	8.0
Greece	34.0	4.4
Guatemala	53.7	2.6
Honduras	55.3	2.5
Hungary	33.0	5.2
Iceland	26.0	9.6
Ireland	32.0	7.4

Italy	32.0	4.9
Jordan	37.7	5.3
Kazakhstan	41.4	2.6
Kyrgyzstan	46.0	2.2
Latvia	39.0	4.7
Lithuania	35.0	4.8
Luxembourg	28.0	8.6
Macedonia FYR	39.4	2.7
Mali	39.0	2.8
Malta	28.0	6.4
Mexico	48.1	3.3
Moldova	32.7	3.2
Netherlands	26.0	8.7
Norway	30.0	8.8
Panama	54.9	3.1
Peru	49.6	3.3
Philippines	44.0	2.5
Poland	33.0	3.7
Portugal	38.0	6.6
Romania	36.4	3.1
Russia	45.1	2.5
Serbia	38.8	3.0
Slovakia	28.0	4.7
Slovenia	24.0	6.4
Spain	31.0	6.8
Sweden	24.0	9.2
Togo	34.4	2.4
Ukraine	41.0	2.8
United Kingdom	32.0	8.6
Venezuela	43.4	2.3
Viet Nam	37.8	2.6
[1] The 54 selected nations are those for which both CPI and Gini data are available for 2006.		
Average	36.6	4.94
Median	34.21	4.25
Mode	28	2.5

Source : Transparency International; World Bank; United Nations University – World Income Inequality Database.