GLOBALIZATION, POVERTY, AND INEQUALITY IN THE 21ST CENTURY

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Abstract

The problems of equality and poverty have now taken the center-stage in discourse on globalization. While the critics and supporters of globalization are engaged in heated debates on the extent of changes in equality and poverty worldwide, between North-South and within countries, and argue over the data and techniques of measurement, there is general agreement that the current level of inequality and poverty, especially in poorer countries is unacceptable.

The paper addressees this issue and attempts to provide a conceptual framework for redirecting the process of globalization so that economic growth can take place with reduced inequality and poverty. The position taken in this paper is that the "golden age" of capitalism (1950-70) was disrupted and replaced by the Neo-liberal theoretical framework developed in The Washington Consensus in the 1970's, and this policy package of re-structuring the economies of indebted countries have been the primary cause of increased poverty and inequality sine then.

The old causes of inequality such as lack of access to land and education are aggravating the problems. Replacing the policy package by a post-Washington consensus policy and substantial reduction in causes of ***rural poverty and inequality, as already followed by many countries with successes, is also recommended.***

Introduction

Globalization has created wealth and prosperity, generated higher economic growth rates, higher human development index (representing life expectancy at birth, literary rate, and infant mortality rates) for countries that have been able to integrate in the global economy. But globalization has also worsened poverty and inequality according to the opponents of globalization. The problems of equality and poverty as such have now taken the center stage in discourse on globalization. While economists do not agree about the changes in inequality and poverty world wide, between North-South and within countries,

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and argue over the data and techniques of measurement, there is general agreement that the current countries today must be reduced and the process of globalization must be re-directed to make it fairer in the new century.

The purpose of the paper is to provide a conceptual framework for making globalization not only to increase economic growth rates, but to reduce poverty and inequality simultaneously. The analyses are based on the premise that globalization is a recent and stronger phase of capitalism, fostered by the new orthodox theories of economic growth, supported by the so called Washington Consensus, implemented by the IMF, and is the primary sources of inequality and poverty increase in many countries. Hence, causes must be identified, and remedies found within that framework, although the old causes of inequality and poverty must also be rectified.

Section I, provides a brief historical background of the current phase of globalization, with a focus on the "Washington Consensus" and analyze the impact thereof on Income, Equality and Poverty during the 1970 – 2005 period.

Section II looks at the old (e.g. pre-Washington Consensus) nature and causes of economic growth, poverty and inequality and suggests policies for rectifying them.

In Section III the new (e.g. Washington Consensus period) causes are identified followed by conclusion and policy recommendations in Section IV.

Section I – Historical Background Of Globalization

The view taken in this paper is that the crucial period for understanding the nature of the most recent phase of globalization is the period in between 1914–1971. In the first phase 1914–1945, capitalism de-globalized at first and went through a crisis phase with the Great Depression, the challenge of Bolshevism and the rise of Fascism. In economic terms, the pre-war global system broke up into individual, somewhat insulated capitalism in few industrialized countries protected from free trade, controlling their own money supply (after the abandonment of the gold standard) and with disrupted capital movements. (Desai 2001).

The period also saw two further developments. The First War led to the rise of the territorial social state (Harris 1995). This was the state which would actively promote the welfare of its citizens. It had fixed borders and created barriers to entry (passport/visa). It was also the state which believed it had the capacity via fiscal and monetary instruments to do so. The departure from the nineteenth century liberal order was to continue and be strengthened in the 1930's with FDR's New Deal, Hitler's economic planning and the Soviet Five Year Plan.

The twenty-five years after 1945 saw full employment, steady income growth and surge of mass consumerism. The Keynesian revolution discovered the *secret of controlling the economic machine*. He had provided an international framework of control over capital movements and exchange rate fluctuations which made “Capitalism in one country” safe. For the first time in its 200 year history, Capitalism seemed to be tamed, almost benevolent. Welfare capitalism, the Keynes- Beverage New Deal seemed to be permanent. If there were problems, there were policy tools available to solve them. (Desai 2001).

The period ended abruptly and the period 1971–1989 saw the Crisis of Keynesianism. Following the steep rise in oil prices in 1973, the economies of the industrialized countries experienced stagflation: low output high unemployment, and high inflation. With another rise in oil prices, to limit inflation, these countries’ monetary policies shifted in 1979, ushering in a period of sustained high interest-rates.

The Keynesian economic theories seemed to be unable to provide a solution to this complicated global situation. In this theoretical vacuum, the New Orthodox or Neo-liberal group came up with policy prescriptions through the IMF’s power to set conditions (IMF Conditionality) for countries to receive funding. This school is often part of a total economic strategy designed to move the economy in a laissez-faire direction. The program attempts to improve the potential scope of conventional demand-management instruments, especially the monetary instruments. Monetary policy, rather than fiscal policy is emphasized in the short-run, and in the long-run, this program recommends reduction of the size of the public sector, increase the efficiency of product and factor markets, and open the economy to foreign capital and trade. Instruments such as price control, rationing, and trade and foreign exchange controls are to be excluded. Public Sector investment is also excluded, because of the conviction that a free-market economy is more efficient than an interventionist economy. Privatization of industries, abolition of all forms of subsidies, including food subsidies were to be excluded as conditions for IMF loans.

This liberal policy package, known as the Washington Consensus strongly advocated policies since the mid 1970’s to remove barriers to international trade, opening up of foreign direct investment and liberalization of short-term capital flows – which helped accelerate the pace of globalization of the world economy. This approach, under IMF conditionality, strongly influenced the policy-making in developed, developing and transitional countries. These policies, it is claimed by proponents of globalization improved economic growth in developing countries, promoted convergence of the living standards of poorer countries with those of the advanced nations, and reduced the incidence of poverty world-wide. Proponents of globalization also claim that the within-country distributive impact of these policies in general is neutral, the long-term income distribution is stable, and there is no clear association between inequality and growth. Opponents of globalization challenge most of these claims. They argue that during the last decades (especially since the 1980’s), no or limited convergence has taken place at a global level. Their findings suggest that (i) during the late 1990's, the income-gap between North-South and East-West was larger than in 1960's or 1980. Critics also argue that growing polarization has been combined with a surge in inequality within most countries. They point out that in most of these countries, growth and poverty alleviation have suffered significantly, primarily caused by the Washington Consensus.

There are elements of truth on both sides. The fact remains that despite the higher economic growth rates, higher human development index, etc. an unacceptable level of poverty and inequality in the distribution of benefits of growth remain. The UNDP 2005 Report states:

"Debates about trends in global income distribution continue to rage. Less open to debate is the sheer scale of inequality. The world's richest 500 individuals have a combined income greater that that of the poorest 416 million. Beyond these extremes the 2.5 billion people living on less that $2 a day – 40% of the world's population – account for 5% of global income. The richest 10%, almost all of whom live in high-income countries, account for 54%". The Report continues, "One-fifth of humanity live in countries where many people think nothing of spending $2 a day on cappuccino. Another fifth of humanity survive on less than $1 a day." As such, it is important to alleviate or eliminate poverty in the coming decades as the Millennium Development Goals advocate.

Section II – old causes of economic growth, poverty and inequality

The old sources of poverty and inequality have been well investigated and documented. It is generally agreed that inequality in the distribution of assets in a society gives rise to income inequality and poverty. The two most important assets in this respect undoubtedly are land in a predominantly agrarian economies, and education. The most important factor affecting development, poverty and inequality is the concentrated pattern of land ownership and/or operation. At the end of World War II, extreme concentration of land ownership was a basic characteristic in most Asian and Latin American countries. Most of them introduced legislation eliminating or reducing this concentration. China, Japan, Taiwan, S. Korea for example, introduced drastic land reform measures with meaningful land-redistribution combined with government support for credit, extension, input subsidy, etc. The immediate effect was increased out-put per acre, increased farm family income, consumption and investment in land improvement. The governments of these countries also opted for massive spending on universal education. The government thus followed what I have termed "dispersal strategy." Land was distributed to families based on the family labor available. Cultivation was thus family-based as contrasted to wage-based farming on large holdings. In the absence of wage-based capitalist farming, intensity of cultivation and multiple cropping increased output, income and standard of living in the short-run. In the long-run, these reforms formed the foundation of an increased economic growth rates, egalitarian income distribution and reduced poverty. I called this strategy as the Uniformly Small Farms Strategy (USF) – (Mukhoti).

In contrast, Latin American countries developed their agriculture and the economy, with a very high concentration of land ownership, devoted much of public resources on a small number of large holders, co-existent with vast majority of rural families without access to land. This system is characterized by a "focus strategy" where the public resources have been focused on the benefits of a few large holders. In addition, this strategy did not provide access to the second important asset to the poor, e.g. education. This strategy has been termed by me as the "Dual-Size Structures" (DSS) model of development. In between, there are countries like India and Pakistan, where land reform legislation and implementation were done in a half-hearted way, as is possible in a democracy in peace time. This strategy is called the Mixed System (Mukhoti 1983).

Experience during the age of globalization suggests that countries that started with a "dispersal strategy" have succeeded in achieving high economic growth rates with equality and prosperity for all (except some regional issues). The countries with a DSS model and a focus strategy, as in most of Latin America, failed to do so (Mukhoti 1997).

As such, there is a compelling reason for the poor, agrarian economies to eliminate or at least to reduce the concentration of land ownership and develop agriculture on a USF model using a "dispersal strategy".

Education being another important asset, special attention needs to be given to the education of the poor, thereby, eliminating, the lack of access to this vital asset. More public spending on education is one of the most important instruments for achieving growth with equality.

It is important to note that in recent years the center of gravity in most countries has shifted from agriculture to manufacturing, trade and service sectors both in terms of the proportion of GDP originating in agriculture and the percentage of total population employed in this sector. As such, access to land ownership, while still important in many countries, access to education, especially universal access to a high quality education to meet the challenges of a globalized, highly technological society, would by far be the most important instrument for reducing poverty and inequality in the near future.

Section III – new causes of poverty and inequality

The most important causes of inequality and poverty since the 1970's no doubt are the neo-liberal polices of the "structural reform" and "stabilization" as developed by The Washington Consensus in the theoretical vacuum to fight "stagflation" as already explained. After the "oil shock" of 1973, re-cycled oil money was borrowed by developing countries through encouragement by investment bankers at adjustable interest rates, denominated in dollars. Subsequently, a second "oil shock" and inflation in the industrialized countries led to higher interest rates, increased debt-burden of emerging economies, particularly in Latin American Countries, and a "debt-crisis" developed when Mexico defaulted. The IMF, backed by the US Treasury and The World Bank, entered and threatened to restore the financial stability of these countries by providing financial aid on conditions of "restructuring" their economies and stabilization program, mostly through demand management.

Demand contrition on the other hand has been achieved through a reduction in money supply, wage repression, cuts in public expenditures and revenue increasing policies. While giving rise to quick results in terms of macroeconomic balance, this approach of demand management gave rise to avoidable recessions of varying duration (Mukhoti 1987). Unlike in industrialized economies, inequality in developing countries rises during recessions and adjustment, and falls during recoveries. In industrialized countries, recessions have a greater impact on profits than wages, because of stickiness of wages, social safety nets that cushion wage income loss, and firms do not discharge labor during recession for avoiding recruitment and training cost when recovery begins. In contrast, in developing countries, wages are downward flexible, social safety nets practically non-existent and labor retention is not common. Hence, wages of unskilled workers decline faster than GDP per capita and profits, the wage share falls and the inequality of the size distribution of income increases (Addison & Cornia 2003).

Research also suggests that countries experiencing a high inflation rates and incomplete stabilization (Bolivia in the 1980's Ukraine in the 1990's) generally experience a worsening of income distribution. The reasons are that the poor are not able to index their incomes and maintain the real value of their assets, and unskilled workers are more vulnerable to be laid off in recessions caused by inappropriate stabilization programs (Chossudovsky 1997).

These stabilization programs aim to achieve results through budget cuts and high interest rates. Both have negative distribution effect. In addition, the monetary approach to inflation control has called for serious austerity programs for an extended period of time inflicting more hardship on the poorer sector of society. Elimination of food subsidy, cutback on government spending on education, health, and housing programs are some examples (Mukhoti 1987).

With regard to the trade liberalization policies advocated by the Washington Consensus, many developing countries have prospered through increased exports of global goods and services. On the other hand, global markets in primary commodities have, on the whole, given the poor countries, which mostly depend on export of such commodities, declining terms of trade since the 1970's. (Coote, 1996) Indeed, world prices of primary commodities in the mid 1990's stood at their lowest level since the 1930's (Ul Hag et al, 1995). According to the United Nations Conference on Trade and Development (UNCTAD) the world's 48 poorest countries would collectively lose $300 – 600 million per year because of reduced exports and increased food imports under the Uruguay Round Agreements. In addition, trade liberalization has deprived many poor states of one of their chief sources of tax revenue, e.g. customs duties, which in turn increased the squeeze on public-sector programs for poverty reduction.

To accelerate poverty reduction therefore, the Post-Washingtonian Consensus must explore alternative adjustment and structural reform program. Such a strategy for poverty and inequality reduction must focus on minimizing unemployment and avoiding sharp recession induced rises in inequality.

Privatization, as advocated and imposed by the IMF in the name of improving efficiency has in most cases, especially in the transition economies, given rise to unemployment, a highly regressive asset distribution, and failed to increase efficiency. Although privatization is a "done deal" in these countries, the Post-Washington Consensus must consider strict regulation of the privatized industries to ensure efficiency and supply from the equity point of view in industries like utilities.

Free flow of "short term capital" advocated by the IMF and the consequent financial crisis increased poverty and inequality in the affected countries in Asia, Latin America and several transitional economies. Some measures must be adopted to control and regulate such uncontrolled flows of hot money in pursuit of highest returns around the globe. Such a control could curb destabilizing short-term capital flows and could reduce out put volatility and recession induced increases in inequality and poverty. A reversion to capital control is essential if growth is to be achieved through fiscal and monetary policy. A Tobin tax is one of the possibilities.

The Chilean government has placed a reserve requirement on short-term capital inflows, thereby discouraging international short-term "hot money", and encouraging long-term investments not subject to any reserve requirement. China and India retain significant restrictions on foreign exchange transactions and foreign ownership of assets, and now Malaysia has imposed restriction. However, in the absence of a lender of last resort, individual countries would have to accept enormous responsibilities. Whether the IMF and World Bank could transform themselves from "stabilizers" to assume such a role, and aim at being the lender of last resort combined with a role of providing guidelines for growth with equality and poverty elimination is debatable. In any way, substantial modification of the Bretton Woods Institutions' roles must be instituted to protect the poor of the developing countries.

Section IV – conclusions

The above analysis suggest that the Pre-Washington Consensus causes of inequality and poverty has been the lack of access to land and education in predominantly agrarian economies, and must be rectified by sustained efforts by country governments.

It is also apparent that the primary causes of inequality and poverty since the 1980s have been the IMF conditionalities imposed on indebted countries for receiving IMF loans, which required stabilization and re-structuring of their economies. These policies caused recessions and financial crises, and the "Austerity" policies imposed hardship on the poor. As such, replacing the Washington Consensus policy-package by a Neo-Keynesian one consisting of macroeconomic stabilization through fiscal and monetary policies, prevention of recession, changing the terms of trade in favor of agricultural products, prevention of financial crisis through control of free flow of capital is imperative. These policies, combined with provision of safety nets to those hurt by the implementation of IMF conditionality should go a long way to make globalization fairer in the 21st Century. Obviously, the roles of the Bretton Woods Institutions must also be modified significantly.

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