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8.
The Social Impact of Globalization in the Developing Countries

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1. Introduction

This paper is one of the outcomes of a four-years economic research programme (2001- 2005), funded by the Department for International Development (DFID) of the UK and developed at the International Labour Office (International Policy Group). The general aim of the project is to fill a gap in understanding - both theoretical and empirical – the impact of globalization. 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.

2. 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 . Since the debate appears quite confused and the issues overlapping, one of the aims of this contribution is to select some precisely-defined topics and to give an account of 3 theories and applied approaches which have really contributed to the understanding of the social impact of globalization in developing countries (DCs). With this purpose in mind, it is therefore important to clarify the limitations of the discussion put forward in the following sections. Definition. An ex-post measurable and objective definition of globalization has been used, namely increasing trade openness and FDI.

3. 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 (Grossman and Helpman, 1991), or for quite differentiated employment trends in the evolutionary "catching-up" models (Fagerberg, 5 1988 and 1994; Dosi et al., 1990; Cimoli and Dosi, 1995; Verspagen and Wakelin, 1997; Targetti and Foti, 1997; Montobbio and Rampa, 2005). 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 technologies (see Haddad and Harrison, 1993; Coe et al., 1997; Aitken and Harrison, 1999; Kathuria, 2001). 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 (see Fosu, 2004 and Reddy, 2004). 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 (see Lall, 2004). 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 (especially formerly protected nascent industries; think, for instance, to the 6 case of large urban state-owned firms in China, see Rawski, 2002; see also Aitken and Harrison,1999).

4. 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 (see Stolper and Samuelson, 1941; for a recent 8 reappraisal of the possible equalizing effect of trade in newly industrialized countries, see Wood, 1994 and 1997; for a critical view, see Milanovic, 2002a). 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" (see Davis, 1996, a cone of diversification being a group of countries characterised by similar endowment proportions, very similar production functions and supplying the same range of goods)? 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; see also Wood, 1997 and Wood and Ridao-Cano, 1999).

5. Globalization and poverty alleviation

As far as poverty reduction is concerned, trade and FDI are supposed to be beneficial to a DC's economic growth (see Collier and Dollar, 2002; for a much more critical point of view, see Rodriguez and Rodrik, 1999) and so – given the expected overall neutrality in terms of their impact on income distribution (see Section 4) – globalization should be a way to achieve poverty reduction. Indeed, most DCs experienced a significant reduction in the proportion of their population living below the poverty line, including fast globalizing countries like China, India, Vietnam. 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 (with a possible redundancy of low skilled people concentrated below the poverty line, see also previous Section 4); the need for macroeconomic stability (since stability implies low inflation, trade should affect the poor positively because the poor tend to be hardest hit by increasing inflation, see Bhagwati and Srinivasan, 2002; however, liberalization may 12 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 liberalization (see Lee, 1998; Cornia, 2004; Taylor, 2004).

6. Conclusions and policy implications

In Section 2, we posed some general questions to which the following discussion aimed to give analytical and empirical answers.

1) 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.

2) Which are the channels through which trade and FDI affect employment, withincountry 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.

3) 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.

4) Given the results from the previous points, what policy suggestions can be made to a globalizing DC? Needless to say, here we cannot go into a deep analysis of possible national and international policy options; however, we can briefly highlight from the previous discussion four main avenues for policies devoted to amplifying the positive impacts of globalization in terms of a DC's domestic employment and within-country income distribution. 17

a) Market failures and disparities in the initial levels of economic and human development, technological "absorptive capacity" and "social capabilities" call for "controlled liberalization" as the best way to foster globalization. Indeed cautious globalizers seem to be characterised by the best employment performances, while faster globalization may imply a wider income inequality trough increasing import.

b) Given the crucial role of the specific institutional, structural and technological characteristics and the uneven distribution of the positive employment effects of globalization (both in terms of countries and in terms of economic sectors), a possible new role emerges for regional, industrial and innovation policies at the national level.

c) Given the possible adverse distributional effect of importing pervasive SBTC, a crucial role has to be attributed to national and local education and training policies, in order to increase the supply of skills. Conversely, skill shortage implies an output constraint and an increasing wage dispersion with negative effects both in terms of domestic employment and within-country income inequality.

d) Heterogeneous and country-specific impacts in terms of employment and income distribution call for preventive intervention (for instance through insurance schemes and/or social safety nets) at the international level by means of adequate social, labour and income multilateral policies.

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