IMPACT OF GLOBALIZATION ON POVERTY IN PAKISTAN

BY

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There may be differences on the precise measurement of poverty but it is widely believed that the incidence of poverty in Pakistan has increased during the decade of 1990s. According to some studies, the caloric-based poverty has in fact doubled from 17.4% in 1987-88 to 32.6% in 1998-99. Similar results are obtained on approaches based on basic needs and poverty of opportunity trends. Social indicators such as literacy rate, infant mortality rate, population growth rate, access to water, nutritional intake etc., all corroborate the above findings that poverty and weak social and human development are not only at an unacceptable level in absolute terms but also have worsened over the last decade.

What are the factors responsible for this outcome?

First and foremost, economic growth rate has declined from the historical level of 6 per cent to 4 per cent and with population growth rate of almost 2.5 per cent and more, the increase in per capita incomes has been insignificant.

Second, the poor performance on economic growth is accompanied by rising income inequality and high open unemployment rates. Overall unemployment is estimated at well over 10 per cent and underemployment even higher. The Gini coefficient has risen.

Third, the high fiscal deficits of public sector inherited from the 1980 have not allowed much space for undertaking redistributive policies and poverty oriented

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programs. On the other hand, the ratio of development expenditure has consistently declined from 8 per cent of GDP to the current level of 3.2 per cent. Even considering the leakages, waste and inefficiency of public expenditures this curtailment has led to severe imbalances in the demand and supply of public goods which benefit the poor.

Fourth, the poor governance of public sector institutions and cornering of public goods by the well-to-do segments of the society in a general environment of congestion and shortages have led to reduced access to these services by the poor. The worrisome aspect of this poor governance is that opportunities for human capital formation for those below the poverty line have diminished considerably both for the current cohorts and the future additions to the labour force.

Fifth, in an era of growing globalisation, financial integration and technological revolution of the 1990s Pakistan has not benefited very much. While the world exports were growing at 5 per cent annually during the last five years Pakistan's exports have remained stagnant. Foreign direct investment flows to Pakistan have remained modest in relation to the size of its economy and spurt in information technology has by passed the shores of Pakistan so far. On the other hand, we have expanded our external debt burden to a level that is beyond our full servicing capacity.

It is this particular area of liberalisation of trade and investment regime, financial integration and technological revolution which together constitute the key elements of globalisation that I will focus today.

What are the transmission channels for globalisation to poverty reduction? These channels are at two levels. At the first level globalisation aids economic growth. At the second level, rapid economic growth of the right pattern does help alleviate poverty. Chart I depicts a schematic representation of the relationship between globalisation and poverty reduction.

This transmission at the first level takes place through four distinct channels: (a) through international trade, (b) through international capital flows, (c) through international labour flows and (d) technological change particularly in information technology (IT) and telecommunications.

(a) International trade

- In the medium – to long term, trade will help the poor, since labour is the primary asset of the poor which is used in the exportables of developing countries.
- Increased trade will result in gains for relatively abundant factors (labour in most low-income countries).
- Consumers get cheaper products (nearer world prices), at least in the medium-to long-term.
- Short-term lay offs and retrenchment of labour in inefficient industries.

(b) International Capital Flows

- Long-term capital inflows (FDI) are beneficial for labour in the developing countries if these are destined towards labour-intensive sectors.
- Short-term flows reward economic discipline and punish policy failures.
- Management of exchange rate becomes critical as external financial flows lead to an appreciation of exchange rate.

(c) International labour flows

- In both the long and short-run, international migration generally helps the poor.
- With more trade and capital flows, the need for labour to move is, however, lower.
- ‘Race to bottom’ in the developed world.

(d) Technological Change.

- Assimilation and adoption of technology improves efficiency in resource use.
- New products and new processes broaden the choice of consumers
- Solutions are found for gains in productivity.

These effects and channels are not always unambiguous and clear, and a number of caveats should be kept in mind.

(i) Economic growth is the main transmission channel. The effects of globalisation and liberalisation often work on poverty through higher growth, and only then through the above transmission channels. International and regional institutions and arrangements such as WTO and the policies of developed countries and governments can facilitate or hamper these flows.

(ii) High economic growth does not automatically result in poverty reduction. Complementary domestic policies, good governance and institutions delivering public services do make a big difference.

(iii) Poverty and inequality are not synonymous. We must always distinguish between the effects on inequality (relative income levels) and the effects on poverty (usually absolute income levels). absolute income levels). Recent work by the World Bank shows that poverty declines with growth, but the effect of growth on inequality varies across countries.

(iv) The effects differ over the long and short term. We must also keep in mind that economic analysis can provide a better guidance for long-term effects but the short-term transitional effects, and dislocations caused by globalisation and liberalisation can be adverse. It should also be recognised that there will be both winners and losers.

(v) There are both partial and general equilibrium effects. The first order responses by economic actors to various liberalisation measures are incomplete and do not necessarily capture the full effects, particularly any second and third order effects. A look at three exogenous stimuli – import liberalisation (domestic trade policy), global agricultural liberalisation, and the elimination of the Multifibre Arrangement (Uruguay Round) – helps to illustrate this point. In each case, it is possible that the final and total effect may be at variance with the initial effect, depending both on the public policy response and the subsequent actions of affected economic actors – consumers, producers, etc.

The magnitude, strength and speed of transmission depend upon the mediating influence of domestic economic policies and domestic economic institutions including the nature of governance. The economic policies that facilitate unhindered flows of international trade, capital and participation in labour flows are (i) reduced tariff and removal of non-tariff barriers, (ii) removal of price distortions, (iii) flexible regulations and legislation of labour, (iv) healthy and sound financial sector and capital markets, (v) investment in skill development and technological assimilation and (vi) macroeconomic stability. How do these policies affect the rate and pattern of economic growth? The following Chart describes the process.

(a) <u>Domestic macroeconomic stability</u>

- Lower inflation helps everybody; but probably helps the poor more.
- Investor uncertainty is reduced.

(b) <u>Reduced over regulation and lower relative price distortions</u>

- The removal of price controls on agriculture helps raise the incomes of poor farmers, but higher food prices and the removal of consumer subsidies may hurt the rural landless (in the short-term) and urban consumers.
- The removal of exchange rate distortions should help agriculture (as most of the poor are in rural areas) since producer incentives are improved.
- Reduced labour regulations will likely lower the price of labour and help employment growth. (This may reduce wages in highly regulated labour markets, but the poor do not usually constitute a large proportion of the formally employed).

(c) <u>Changing public expenditure patterns</u>

- Expenditures on primary health care, education and other skill upgradation and training programs need to be protected as the revenue base falls (in some countries) over the short-term.
- Direct poverty alleviation programs should be given priority in Public Sector Development.

(d) Rural-urban migration

- Incentives, institutions and investment to promote agriculture growth will also lead to poverty reduction.
- The reduced burden on agriculture implies a slower migration to urban areas.

The above transmission mechanisms can improve the quality and pattern of growth and thus affect poverty reduction. But growth alone is not sufficient to make an inroad. Poverty targeted interventions, investment in human development and social safety nets are additional and complementary steps which will reinforce the movement towards poverty reduction. Domestic policies, institutions and governance can either accelerate or hinder the process of transmission from economic growth to poverty reduction.

Why should we believe that globalization is in our larger national interest? What is the empirical evidence connecting liberalization, financial integration and technological revolution with the improved welfare and development of poor countries? The two most populous countries in the world, China and more recently India, accounting for almost more than half the population of the developing world and one half of the world's poor have derived enormous benefits from this virtuous cycle. Since China has opened up to foreign trade and foreign direct investment and has introduced market-based incentives the results have been spectacular. China has increased its exports more than 10 times in the last 15 years; is the largest single beneficiary of Foreign Direct Investment flows (about $ 42 billion last years), has tripled its per capita income during last two decades and has reduced its incidence of poverty from one-third to one-tenth. China has a lot of problems with state-owned enterprises and State-owned banks but the mediating environment for attracting international financial flows, managerial and technical know how and participating vigorously in international trade have been positive and benign. Given its large domestic market of 1.2 billion people it would have been equally tempting to keep itself insulated from the rest of the world and produce and consume for domestic markets but its own experience of the period 1948-78 over three decades persuaded it to switch over to an outward oriented strategy. China's accession to WTO will support an open trade and investment regime and ultimately lead to further reforms in Capital markets, privatization and currency convertibility. There is little doubt that these reforms combined with a disciplined labour force, high domestic savings and investment rates will enhance the standing of China in the world league of nations.

The other glaring example of opening up its economy comes from our next door neighbour India. Until 1990, Pakistan was growing almost twice as rapidly as India and the incidence of poverty in Pakistan had declined from one-third to one-sixth while the incidence of poverty in India was edging up. Since 1991 when India decided to reduce its external barriers to both foreign trade and foreign investment and begun to dismantle controls the record of its achievements has indeed been impressive. India's exports have almost doubled; FDI flows are doubling every year; annual growth rates have exceeded 6 per cent; IT revolution has engulfed the entire South India region and the incidence of poverty has been lowered. It has been empirically estimated that 87 percent of the observed decline in poverty was accounted for by rapid growth in the country. From all accounts and looking at the bee-line of prospective investors from all over the world knocking at the doors of India, its economic prospects, despite a plethora of political and social problems, appear quite promising.

The above evidence is not only confined to China and India but also extends to East Asia and more recently to Latin America. Brazil, which used to be a highly unstable economy in the world, is beginning to show the initial results of its changed economic paradigm which incidentally was adopted by one of the founders of economic dependence theory. Our friend and former partner Bangladesh which was lagging behind us in the 1970s and 1980s has caught up with us in exports and reduced its dependence on foreign aid.

It may be argued that African economies are getting marginalized with increased globalization and are less integrated financially and technologically. There are a host of factors which explain this unfortunate episode. A number of countries are mired in civil wars, internal conflicts and cross-border tensions. Weak institutions, poor policies, inefficient public service delivery and lack of good governance are some other additional explanatory factors which have not allowed the mediation process to take roots. Natural resource based economies have found markets for their oil and primary commodities all across the world but the backward and forward linkages of these primary commodity based exports are rudimentary and yet to be developed. The benefits of participation in international trade are thus very limited and in some cases have in fact contributed to perpetuation of internal conflicts.

Pakistan has to make some hard policy choices. Do we seize the opportunities provided by globalization for the larger benefit of our economic growth and poverty reduction or we remain insulated from these forces and become marginalized in the process. Except Afghanistan, Cuba, North Korea, Iraq and Myanmar there are very few countries in the world which have made a choice in favour of insulation and deliberate withdrawal. Even North Korea is presently engaged in an active dialogue with South Korea for possible movement towards integration.

I, for one, believe that it is in our larger national interest that we should derive maximum benefits from globalization. Contrary to the popular perception this will in fact help restore our capacity to manage our economic affairs in a more autonomous way, enhance our economic sovereignty and reduce our dependence on international financial institutions. Like all public sector institutions, the IFIs are driven by the political and economic agenda of its major shareholders which are the Governments and legislatures of G-7 countries. Until there is a coherence between the agenda of these countries and our own agenda the uncertainty about assistances from IFIs will loom large on our economic horizon. On the other hand, if we increase our share of world export markets from 0.15 percent to 0.22 percent which used to be the case in the past we will receive additional $ 4 billion of export revenues annually. Export-GDP ratio has in fact declined from 13.9% in 1991-2 to 12.5% in 1998-99. If Foreign Direct investment flows to Pakistan were to reach only 0.5% of all the flows to developing countries the country will increase its flows by almost $ 400-500 million every year in addition to transfer of managerial skills and technical know-how, employment opportunities for professional classes in the country and possible linkages with new export markets. In 1995-96 Pakistan actually received more than 1% of FDI flows i.e. $ 1.3 billion. The third element of globalization is international labour flows. Pakistan has in the past, benefited considerably from the oil price boom in the Middle East and a large proportion of unskilled labour had migrated to the Gulf States. They remitted their earnings in foreign exchange through official channels, provided a market for ethnic food and other Pakistani products, invested in the upgradation of human development of their children and on return brought new skills and capital to the country. For the last five years or so, the demand for this labour has tapered off but the workers' remittances have also taken a dip particularly since May, 1998. If we are able to get these workers to remit at the same level as 1997 we should be able to have an additional $ 600-800 million of foreign exchange earnings from this particular source.

The magnitudes I have talked about are not figment of my imagination but are based on actual past indicators of performance. We have attained these ratios in the past and there is no reason that we cannot do it again provided we put in place the right enabling environment.

Look at what these additional flows can do to restore our economic sovereignty. We will be able to service all our external financial obligations without any difficulty, build up our foreign exchange reserves to provide some semblance of confidence to both domestic and foreign investors, maintain a stable exchange rate and need not enter into any arrangements with the IMF. Those who are nationalistic but are wary of globalization should examine this scenario and see whether their opposition to globalization is misplaced or not. Their agenda for promoting national interest of Pakistan will be best served if we actively participate in international trade, foreign direct investment, labour flows and technological revolution rather than abdicate this course. If we do not follow this route we have no choice but to abide by the conditionalities of the IFIs which may not be the most desirable outcome the opponents to globalization will like this country to pursue.

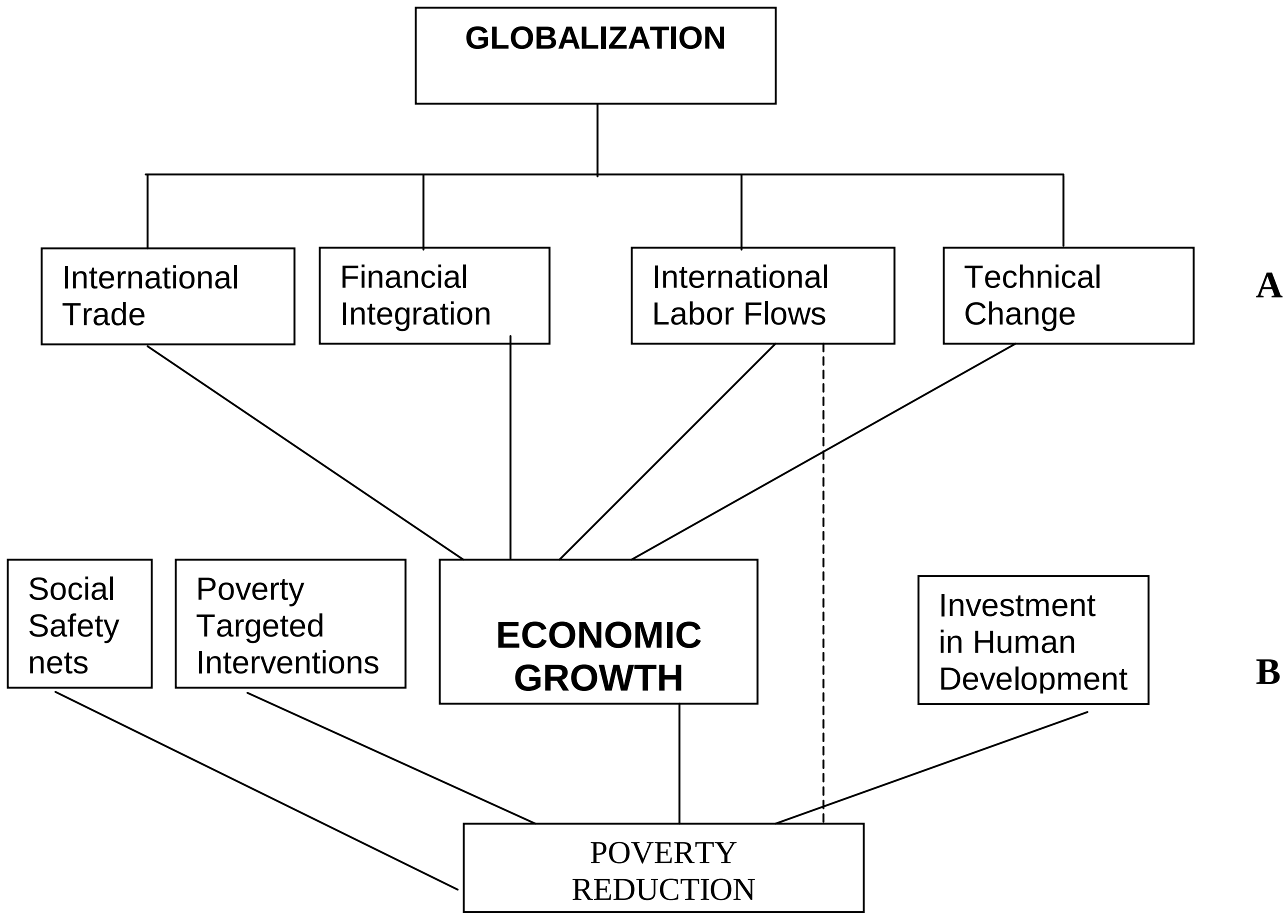
Of course, the recent East Asian experience of 1997-98 has amply demonstrated that financial integration also make the economies more vulnerable and risk-prone. Policy errors and macroeconomic mistakes can be magnified by capital market reactions and generate crises of large proportions. But then these reactions also act as a powerful deterrent for the policy makers from indulging in irresponsible policies, low return pet projects and rent seeking by their political cronies.

There is another economic reason as to why unlike the past official aid and lending is no longer a reliable source of financing. The proportion of the budgets earmarked by OECD countries is gradually declining and unlike the past commitment of devoting 0.7% of GDP for official aid the major donors are well below 0.3% of GDP. This declining pot of official assistance, growing demand for such assistance by more than 100 developing countries and a less than satisfactory record of Aid effectiveness has put pressures on donor countries to become more selective. Each country is, therefore, developing its own criteria for aid delivery. The focus of their assistance has, therefore, become narrow – from wildlife conservation to HIV and AIDS and human rights and democracy depending upon the domestic constituency in each country. It may not always be feasible for a developing country to qualify for such assistance as the particular activity for which aid is available may not necessarily be the priority for the recipient country. For example, Pakistan is today no longer eligible for assistance by these donors who value democracy as the major criteria.

The imperatives of globalisation have shifted the course from reliance on foreign aid and international financial institutions to reliance on international trade, foreign direct investment, technology and labour flows. The sooner the policy makers and opinion makers in Pakistan wake up to this new reality and participate activity to derive maximum benefits from globalisation the better off we will be.

A Schematic Representation of Globalization- Poverty Nexus

CHART-I



Mediating Environment

A- International & Regional Institutions, Policies, Governance

B - Domestic Policies, Institutions & Governance