

Is Globalization Reducing Absolute Poverty?

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Summary. — Using data from 114 countries (1983–2007), we examine the relationship between globalization and World Bank absolute poverty estimates. We find a significant negative correlation between globalization and poverty, robust to several econometric specifications, including a fixed-effect panel—a “long run” first difference—and a pooled OLS-regression. Introducing two instruments for globalization we also show that results are robust to correction for potential endogeneity. We motivate and test the instruments in several ways. In particular information flows and more liberal trade restrictions robustly correlate with lower absolute poverty.
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1. INTRODUCTION

Is globalization good or bad for the poor? Despite lots of indicative evidence (Collins & Graham, 2004; Noguez & Siscart, 2005; Wacziarg & Welch, 2008; Yanikkaya, 2003), two paramount problems still linger. First, previous research typically studies economic growth rather than absolute poverty (Bhagwati & Srinivasan, 2002; Dollar & Kraay, 2004).¹ Second, studies inevitably suffer from the endogeneity problem: Globalization may well be both a cause and an effect of rising incomes.

This paper contributes in both these areas. Recent improvements in data availability allow a meaningful analysis of panel data where the dependent variable is head count measures of absolute poverty collected from the World Bank’s household surveys. Our regressions include more than 100 countries, with poverty data averaged over four five-year periods, the first one being 1988–92.

We also introduce two instruments for globalization in order to examine whether the estimated relationships are causal: preceding average economic globalization of neighboring countries, and the number of years with the presence of McDonalds in a country. We examine both instruments carefully, showing that they are powerful, directly uncorrelated with poverty, and theoretically meaningful in the sense of capturing globalization the way it actually happens.

Using the KOF Index of Globalization, (Dreher 2006a, 2006b; Dreher & Gaston, 2008) we find evidence of a negative relationship between different types of globalization and absolute poverty. The effect appears in a fixed-effect panel, a long first difference estimation, in a pooled OLS regression and when instrumenting for globalization. In particular, information flows and more liberal trade restrictions seem to reduce poverty.

Section 2 provides an analytical framework discussing the possible links from globalization to absolute poverty. Section 3 describes our data and empirical strategy, and presents baseline panel regression results, with a number of robustness tests. Section 4 introduces our instrumental variable strategy and presents results when instrumenting for globalization. The article closes with some concluding remarks on the implications of the findings.

2. BACKGROUND

(a) *Related literature on the relationship between globalization and poverty*

Wade (2004) describes what he calls the neoliberal argument, which holds that world poverty and income inequality showed signs of falling around 1990 thanks to increasing economic integration. He questions the empirical basis of the neoliberal argument by noting (among other things) that the small decline in population-weighted between-country world PPP-income inequality that has occurred since around 1980 is driven entirely by China.

Our aim is not to say something about the global income distribution, but rather to analyze if countries with higher levels of globalization fare differently in terms of absolute poverty. For this question, the standard approach in the literature (illustrated in Figure 1a) is to focus on the country level relationship between economic globalization and economic growth. For example, the often cited study by Dollar and Kraay (2004) argues that trade is good for growth, and that there is no systematic relationship between changes in trade volumes and changes in the income distribution within countries. Thus, they conclude, if trade increases growth rates, this translates into proportionate increases in the income of the poor.²

At least in the short run, globalization can affect absolute poverty regardless of its effect on growth. Growth occurs when average real income increases, but absolute poverty depends only on the real incomes of the poor. Noting this is not merely a theoretical oddity: As shown by Kalwij and Verschoor (2007), the capacity of growth to reduce absolute poverty exhibits large regional variations.³

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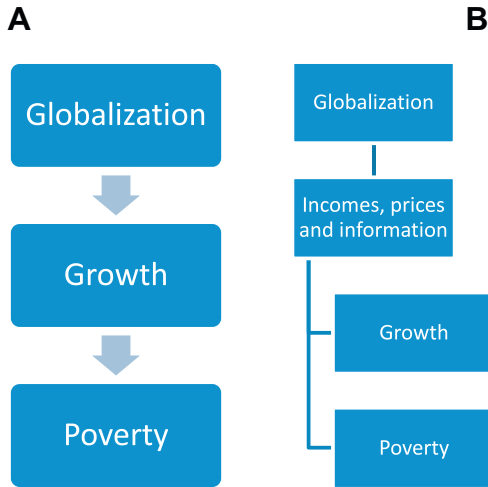


Figure 1. Two views on the relations between globalization, growth and poverty.

Another problem with the standard approach is that recent findings suggest that globalization in addition to causing growth also causes higher income dispersion within countries (Bergh & Nilsson, 2010; Lundberg & Squire, 2003; Milanovic & Squire, 2006). In this case the effect on absolute poverty is ambiguous.

Contrasting the standard approach, our preferred approach (illustrated in Figure 1b) assumes that globalization affects prices, incomes and information flows, which in turn may or may not lead to economic growth and/or poverty reduction.

The paper most closely related to ours Aisbett *et al.* (2008), who share our critique of the standard approach and present evidence on the relationship between trade openness (measured as trade shares and tariffs), GDP growth, and poverty. Results suggest a negative effect of (both measures of) trade openness on poverty that disappears when adding country-fixed effects, and also cannot be confirmed in a IV-regression where trade shares are instrumented using its own three-year lag. We improve on these results by having access to more data (allowing country dummies to be included), a broader multi-dimensional measure of globalization, and by using two different external instruments to examine causality.

(b) Measuring poverty and globalization

Measuring poverty involves a number of methodological choices. For example, there is a large discrepancy between

national accounts and survey data estimates of consumption. For recent overviews of the debate and choices involved see Anand, Segal, and Stiglitz (2010) and Deaton (2001, 2010). Our preferred measure of absolute poverty is the headcount index calculated for a poverty line of one PPP dollar per day from the World Bank (2010), which is based on household surveys. While subject to debate, Ravallion (2010) argues that the World Bank estimates remain the best projections available for studying absolute poverty worldwide.

Our measure of globalization is the so-called KOF Index developed by Dreher (2006a, 2006b) and updated in Dreher, Gaston, and Martens (2008). The index quantifies economic, social, and political globalization, using principal components analysis, to construct an aggregate index that is comparable over time and between countries from 1970 and onward. The index also allows for a separation between different dimensions of globalization, is updated every year, and is available on the web. Tables 1 and 11 and in the Appendix presents the details of the index.⁴

As with poverty, the question of how to measure globalization is a debated topic. One of the most widely used measures of economic openness is the index introduced by Sachs and Warner (1995). This index, however, is binary and questions have been raised by, among others, Rodriguez and Rodrik (2000) with regard to what it actually measures.⁵ An important point brought up by these scholars is the distinction between trade flows (such as imports and exports) and trade policies (such as tariffs, taxes, and regulations). Studies finding that trade flows are linked to growth are not sufficient to conclude that policies of economic openness lead to growth. More liberal trade restrictions need not necessarily lead to higher trade flows. An advantage of using the KOF-index is that it allows a separate analysis of economic flows and trade policies. Similarly, social globalization can be further broken down into information flows, personal contact, and cultural proximity, allowing for a deeper understanding of the globalization-poverty relationship.

(c) Possible links from globalization to poverty

Agénor (2004) describes several reasons for expecting economic globalization to foster growth and decrease poverty in the long run. Many mechanisms are straightforward applications of mainstream economic theory: specialization, scale economies, competition, incentives for macro-economic stability, and innovation are all likely to be important mechanisms. Higher integration in the global economy may also increase the returns to higher education in poor countries, as described by Stark (2004), negatively affecting poverty in the long run.

Table 1. Indicators of economic and social globalization: expected effects on poverty

Type of globalization	Economic	Social
Measure	Flows: Trade, investments and international transfers (% of GDP) Policies: Mean tariff rates, taxes, import barriers, and capital account restrictions	Information flows: Internet hosts, Internet users, cable television, and radios (all measured per capita), trade in newspapers (% of GDP) Personal contacts: Outgoing telephone traffic, transfers, tourism, and foreign population in percent of total population Cultural proximity: McDonald's and IKEA per capita, trade in books (% of GDP)
Short-run effects on	Prices and wages via changes in supply and demand	Available information. Supply and demand
Possible long-run effects on	Growth, innovation, and human capital	Social norms and lifestyle
Expected effect on absolute poverty	Ambiguous in the short run, negative in the long run	Ambiguous both in the short and long run

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