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Globalization, Labour Markets and Social Outcomes in Developing Countries

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10.1 The problem

In this chapter we seek to examine the relationship between globalization in its current form and social outcomes (in particular, poverty and inequality) in developing countries (DCs) with special reference to channels of causation that involve the effects of globalization on labour markets. In particular, we focus on the effect of the current form of globalization on employment, wages, and working conditions, and thereby on poverty and inequality.

For purposes of this study, we take the current form of globalization to be defined by a set of policy changes that has reduced barriers to the integration of national economies, and thereby induced such integration. In practice, the most important policy modifications fostering the integration of national economies are those that have reduced barriers to trade and to capital flows. The context of the study is the well-documented observation that in the last two decades a 'worldwide wave' of market-oriented reforms featuring policy modifications of these types has swept the DCs.[2]

10.2 Relevant specificities of DC labour markets

It has long been observed that the labour markets of DCs have distinguishing structural features. This view for example is embodied most famously in the 'Lewisian' model of the less developed economy, which stressed that poor countries typically possess a small 'modern' sector and a large 'traditional' sector in which employment and wages are determined by principles that accord with convention and that are at variance with those determining employment and wages in the modern sector.[3] Another (comparatively recent) 'dual economy' view centres on the distinction between the 'formal' and 'informal' economy (see also section 5.3.3 in this volume). This distinction, which may be traced to Hart (1973), and ILO (1972) emphasizes that some economic activities and enterprises are formal in the sense that they take place in the context of official legal structures and recognitions that make them susceptible to regulation, whereas others 'take place beyond effective state regulation' (Hart, 2001). It has frequently been supposed that formal sector enterprises are likely to be larger and more capital-intensive and to possess greater access to credit and other resources than do informal sector enterprises. It has also been supposed that workers in the formal sector are likely to be more skilled, better paid, and more likely to be provided with non-wage benefits such as the protection offered by formal pension and social insurance systems. It has frequently been emphasized that the mass of workers (particularly in the poorer DCs) are likely to belong to the informal sector, because the most accessible and prevalent livelihoods involving agriculture, petty commerce, manufacturing and services are likely to be outside of the ambit of direct state regulation.[4] The concept of 'informal sector' is of course inadequately precise. An important distinction, for instance, is that between informality of enterprise and informality of employment. Formal sector enterprises can, for instance, employ workers informally. Workers who are informally employed are unlikely to benefit from the protections of those who are employed formally, whether or not they are employed in informal enterprises.

These distinctions have been powerfully employed in characterizing and analysing the specificities of DC labour markets. However, they have been qualified from at least two standpoints. First, it has been noted that developed countries also possess the 'structural dualism' that DCs are characterized by, if to a smaller degree.[5] Second, it has been noted that the distinction between sectors is more muted than generally presumed. For example, there are typically significant and vital practical inter-linkages (involving, for example, employment and commercial tie) between formal and informal sectors. Moreover, the extent to which enterprises are subject to state regulation is typically a matter of degree rather than kind. Further, it cannot be supposed that formal sector enterprises and workers are always more privileged, although they most often are.[6]

The presence of a significant informal sector in DCs may limit the ability of the state to foster improved conditions for workers through direct intervention, and may require more creative approaches to this goal. Institutional provisions such as minimum wages may reach only a small share of workers who are 'covered' by these provisions, and changes to such provisions may have complex general equilibrium effects as a result (see e.g. Harrison and Leamer, 1997, and the discussion later in this chapter). Forms of universal social protection that reach all workers, regardless of the nature of the enterprises in which they work and their employment contracts, are attractive alternatives in such contexts.

An important feature of labour markets in the poorer DCs is that wage–productivity relationships are likely to be important. The presence of a relationship between nutrition and productivity (as identified for instance by Leibenstein, 1963 and Smith, 1776) is one such relationship that can have important labour market consequences. As demonstrated by Dasgupta and Ray (1986), in the presence of such a relationship self-reinforcing involuntary unemployment equilibria may arise. Those who were once shut out of employment opportunities may find that they remain shut out, because of the impact of their past history on their current productivity. Other mechanisms of this type are related to the role of social networks in facilitating access to employment and the role of skills generated through employment in making workers more likely to be employed, or more employable. When past employment makes a worker more employable, then the chronically unemployed may find it difficult to gain access to remunerative work.

Much previous literature in development economics has emphasized the role of interlinkages between the labour market and other important markets (e.g. those for land and credit) that result from asymmetries of information and lacunae in contract enforcement. The emphasis of this literature has been on noting the widespread existence of long-term labour contracts whose terms are linked to those governing the provision of other resources. These long-term contracts may impede the mobility of labour as well as of other factors of production and influence the way in which wages and employment respond to changes in economic conditions.

It is important to note that internal labour migration may take complex forms in DCs. For instance, Breman (1991, 1996) has documented the existence of complex social-network based regional and inter-regional flows of migration on the part of unskilled workers. These flows abide by seasonal patterns and tie rural to urban areas in concrete but shifting relationships. In such a setting, the assessment of the employment and distributional consequences of policies must be undertaken with consideration to what is known about these labour market dynamics.

The gendered nature of responsibilities for work, within the labour market, and within the larger world of production, also requires consideration. As noted by Cagatai (1998a, 1998b and 2001), the disproportionate presence of women in particular segments of the DC labour market (particularly those involving export-oriented production) implies that policies such as trade liberalization can have gender-specific effects. Moreover, the recourse to household production as a substitute for market incomes makes women's labour an important absorber of shocks experienced in the formal labour market. These facts require recognition in an adequate distributional analysis.

Finally, it is important to note that the role that labour market outcomes play in determining the distribution of income will depend on the importance of non-wage incomes. The historical process of proletarianization is one in which wage incomes gain nearly exclusive significance as a source of livelihood for increasing numbers of people. In some DCs, in which self-employment in agriculture, home production and petty commerce is common, this process has not as yet advanced far.[7]

The relevant specificities of DC labour markets pointed to here are regrettably not adequately taken into account in much of the survey which follows, which focuses disproportionately, by necessity of the fact that much of the existing economic literature does so, on evidence concerning the level and distribution of wages in formal sector non-agricultural employment. This blindness of the recent literature is one of the major lacunae that must be overcome by future studies. In the absence of such studies, the tendency to draw broad conclusions concerning the effects of globalization on labour markets in DCs must be firmly resisted.

10.3 Globalization: pathways and consequences

We focus in this section on current theory and evidence concerning the impact that the package of policy reforms that we have referred to as globalization may have on employment, wages and working conditions and thereby on poverty and inequality. We focus in succession on revisions to policies concerning trade, policies concerning capital markets, and policies concerning labour markets (which are of concern insofar as they have been adopted in order to complement other policies aimed at fostering international integration).

10.3.1 Trade policy reforms

It has frequently been supposed that trade liberalization in DCs would be likely to reduce poverty and inequality. A variety of reasons have been adduced for this conclusion. One reason is the belief, derived from the Stolper–Samuelson (S–S) theorem of Heckscher–Ohlin (H–O) trade theory, that trade liberalization is likely to raise the real rate of return to the factor of production that is relatively abundant in poor countries – labour – and lower the real rate of return to the factor of production that is relatively scarce in poor countries – capital (see also sections 4.3, 6.2, 6.3 and 8.2 in this volume). Insofar as the primary asset of the poor is labour, trade liberalization is likely to raise the incomes of the poor and reduce poverty. Insofar as the primary asset of the wealthy is capital, trade liberalization is also likely to lower inequality. This conclusion has been extremely influential in the literature on international trade and development, notwithstanding the fact that it is dependent on a number of premises of questionable empirical validity (as noted for instance by Bhagwati and Dehejia, 1994). For example, it has provided the basis of the belief (advocated, for instance, by Krueger *et al.*, 1991) that trade liberalization in poor countries possessing a significant agricultural sector would be likely to benefit the mass of small farmers and landless labourers, as trade barriers suppressed the prices of the agricultural goods that they produced and raised the prices of the non-agricultural goods that they consumed. Another reason for the belief that trade liberalization in DCs would be likely to reduce poverty and inequality has been the view that past protectionism has tended to benefit a small and politically powerful 'aristocracy of labour', present primarily in cities, and representing those privileged enough to gain access to formal sector employment in manufacturing enterprises. The costs of protecting this aristocracy of labour, it has been argued, have fallen disproportionately on those consumers and workers (especially the unskilled) who pay higher prices as a result of protection and face more limited employment opportunities due to the bias that protectionism has created toward employing resources in sectors that intensively employ capital and skilled labour. It has been argued accordingly that trade liberalization is likely to have raised the earnings of the large mass of unskilled workers while lowering those of a small group of relatively privileged workers in DCs. Both of these arguments concern the static distributional consequences of trade liberalization. They identify a 'one-time' impact of trade liberalization on the pattern of earnings.

In addition to these static arguments, there exist dynamic arguments (see e.g. Romer, 1986; Romer and Rivera-Batiz, 1991; and complementary empirical literature by Frankel and Romer, 1999) that assert the role of trade liberalization in providing a basis for sustainable growth in aggregate incomes, and thereby in employment and wages. Followers of these arguments emphasize that sustained increases in aggregate income generated by trade are likely ultimately to cause a decrease in poverty, although their impact on inequality is ambiguous. The focus of such arguments is on the role of the enlarged markets and increased competitive pressures created by trade in fostering ongoing technological improvements that facilitate sustained growth. The tradition of making such arguments is lengthy (see, e.g. Smith, 1776). However, the mechanisms by which trade liberalization can be expected to have a sustained impact on growth remain surprisingly obscure.

These powerful arguments have provided the intellectual underpinning for trade liberalization in DCs. Are they right? The empirical record concerning the impact of recent trade liberalization in DCs appears to be mixed. This chapter will not consider further the general impact of trade liberalization on aggregate income and growth, but rather will focus on the recent evidence concerning the direct impact of trade liberalization on labour market outcomes. A number of careful recent studies offer insights. Many of the studies, based on labour market surveys, focus on the wage premium accorded to more skilled labour. Studies of this kind are informative, but can offer only limited insight concerning the impact of trade liberalization on the distribution of overall incomes, comprising non-wage as well as wage income (see also Chapter 7 in this volume).

Harrison and Hanson (1999) note that wage inequality in Mexico (between skilled and unskilled workers) has been increasing after trade liberalization, which is puzzling in a H–O context if Mexico has a comparative advantage in producing low-skill-intensive goods. Noting that Mexico 'experienced a substantial rise in the skill premium and overall wage inequality following the trade reform of the mid-1980s', Attanasio *et al.* (2002, p.2) go on to state that 'while the causal link between the Mexican trade liberalization and inequality was never established beyond dispute, the chronological coincidence of the increase in wage dispersion with the trade reforms was nevertheless a disappointment to those who hoped that globalization would benefit the poor in developing countries'. Indeed, Slaughter (2002) notes that in Mexico the skill premium began rising sharply the year of liberalization, after 20 years of steady declines. Attanasio *et al.* (2002) find that an increase in the wage premium to skilled workers was also experienced in Colombia in the aftermath of 'drastic tariff reductions' in the 1980s and 1990s. Similarly, Pavcnik *et al.* (2002) find that increases in the wage premium to skilled workers have accompanied trade liberalization in Brazil. Building on the work of Robbins (1995 and 1996), Slaughter (2002) reports that substantial increases in overall income-inequality were experienced in a range of Latin American countries in the aftermath of trade liberalization. This finding is consistent with the general observation of a pattern of rising inequality in DCs during the recent period of policy reforms. There does not also appear to have been any substantial reduction in poverty in Latin American countries in this period. The DCs in which notable increases in inequality have been experienced during periods of policy reform include India and China (see Slaughter, 2002). Within both of these countries, differences in the extent to which specific regions have gained from international trade appear to have played an important role in widening inter-regional inequalities. The picture in regard to poverty appears more promising. Substantial poverty reduction appears to have been experienced over the past twenty years both in India and in China. However, in both cases the increases in growth and poverty reduction experienced in the last two decades appear to have preceded the onset of significant trade liberalization, suggesting that factors other than trade may have played the central role (see also section 9.5.2 in this volume).

The casual evidence seems to suggest that trade liberalization need not be linked (at least over the time horizons studied) to reductions in either inequality or poverty. How can this conclusion be satisfactorily reconciled with existing theory?

A first possibility is that the simplest version of the theory is wrong. The possibility that the simplest S–S picture of the consequences of trade liberalization may be far too simple is suggested by the fact that many of the observed increases in skill premia have taken place in middle-income DCs, such as those in Latin America. The S–S conclusion emerges most unambiguously within a two-commodity, two-good, two-factor model. In a real-world context, the presence of multiple countries, factors and goods complicates the applicability of this conclusion. In principle, the implications of trade liberalization for factor prices in middle-income countries may be indeterminate in a more general setting. For instance, the impact of trade liberalization on the wages of the unskilled in Mexico may be influenced by the necessity to compete with (relatively more abundant) unskilled labour in China more than it is by its ability to compete with (relatively less abundant) unskilled labour in the United States. Furthermore, as Davis (1996) points out, if countries' factor endowments are sufficiently dissimilar that they do not inhabit a common 'cone of diversification' then the impact of trade liberalization on the return to a particular factor of production may depend not on whether or not it is abundant in a global sense but rather on whether or not it is abundant in a local sense (see also section 8.2 in this volume). In particular, the effect of trade liberalization on the rate of return to a factor of production may depend on whether or not that factor is relatively more abundant in the country in question than it is in other countries whose factor endowments belong within the same cone of diversification. This reasoning implies that trade liberalization will have diverse and difficult-to-predict effects on countries when there exist multiple cones of diversification and multiple countries associated with each.

An important factor in middle-income DCs and in the urban-industrial sector in poor countries is that wage determination involves an element of rent-sharing. Increased competition induced by international trade can lower firm-level rents and increase firm-level elasticities of product demand, which in this case will cause a lowering of bargained wages (see Reddy, 2000). If tariffs fall most in those sectors in which unskilled workers are disproportionately represented (as found in the case of Mexico by Harrison and Hanson, 1999), then wage-bargaining associated reductions in wage can lead to the increases in skill premia that have been widely observed. Moreover, reductions in wages associated with trade liberalization (see Revenga, 1997, for evidence concerning the magnitude of such effects in Mexico) can be a major cause of overall increases in income inequality.

A factor of considerable importance in certain poor countries is the presence of labour surplus, along the lines specified by Lewis (1954). In the context of labour surplus, unlike that of full employment supposed in the standard theoretic setting, trade liberalization induced increases in demand for unskilled labour need not give rise to significant increases in wages of the unskilled, although they must give rise to increases in employment.[8] However, decreases in protection for the commodities produced by scarce skilled workers ought still to give rise to decreases in the relative wages and employment of skilled workers. However, as already noted, there is little evidence of this kind.

A second possibility is that the observed increases in inequality are due to factors other than trade liberalization. After all, the theory predicts that trade liberalization will have particular effects only when other features of the environment are unchanging. Needless to say, in practice, other features of the environment change alongside changes in the trade regime. Evidence that would permit the role of distinct factors to be identified convincingly is scarce, but that which is available is suggestive. For example, Haouas *et al.* (2002) find that in Tunisia increases in labour supply (especially due to women's entry into the labour market) dampened increases in wages that would otherwise have occurred due to trade liberalization. A causal factor that has been extensively mentioned in the developed country literature on rising wage inequality is 'skill biased technological change' (see Chapter 3 in this volume). Has technological change in DCs taken a form that has made skills more valuable and increased the wage premium associated with them? It cannot be readily established that technological change rather than trade is responsible for observed increases in wage inequalities, since as Slaughter (2002) points out, it is quite possible that 'liberalization induces technological change'.[9] Pavcnik *et al.* (2002, p.4) find evidence of increasing use of skilled labour in the aftermath of trade liberalization in Brazil. They interpret the evidence that 'firms do not substitute away from skilled labour given the higher relative price of hiring skilled workers' to suggest that the 'economy wide skill premium cannot be attributed to H–O adjustments to trade' (which would lower the demand for skilled labour), but rather that 'the evidence is however consistent with skill biased technological change'. On the other hand, the authors state that 'skill biased technological change ... was concentrated in sectors that experienced larger increase[s] in import penetration. These results suggest that skill-biased technological change could have been partially induced by changes in foreign competition, so that trade liberalization may have had an indirect effect on the rise of the skill premium.' If skill-biased technological change was merely accelerated by trade liberalization, then the rise in inequalities associated with it may have been difficult to avoid through alternative trade policies alone. Rising wage inequality is in principle wholly consistent with rising wages for all. The impact of trade on the level of wages of unskilled workers in DCs is a subject that deserves further investigation.

Is trade liberalization a determinant of the level of informality in the labour market? This hypothesis has gained currency as a result of the rise in informality in many DCs' labour markets in the last two decades, contemporaneous with trade liberalization. However, there seems to be little systematic data concerning the extent of these relations.[10] However, anecdotal evidence suggests that subcontracting chains that ultimately involve informal sector workers play an important role in North–South trade.

A fair conclusion is that the picture remains muddy, and that microeconomic evidence concerning labour market outcomes does not suggest any grounds for complacency concerning the effects of trade liberalization on either poverty or inequality in DCs.

10.3.2 Capital market reforms

What are the effects of policies opening the way to increased Foreign Direct Investment (FDI) on labour market conditions in DCs? This question has been understudied and is difficult definitively to address. At the macroeconomic level, FDI offers potential additional resources with which to undertake investment and create employment. Moreover, to the extent that it brings about improvements in skills and productivity, this may have a positive influence on wages. However, it is controversial both to what extent FDI in fact provides net investment resources, and to what extent it is associated with improvements in skills and productivity (Haddad and Harrison, 1993; Singh, 2003). In any event, net FDI inflows made up only 1 per cent of GDP in low-income countries in 2000 (as compared with 4 per cent in high-income countries and 3 per cent in middle-income countries). Similarly, net FDI flows made up only 2 per cent of gross capital formation in low-income countries in 2000 (as compared with 19 per cent in high-income countries and 13 per cent in middle-income countries).[11]

In section 4.4 in this volume, Lall points out that the vast majority of FDI in DCs goes to a small number of recipients. There is also considerable evidence that a large and increasing share of FDI is motivated by the desire for cross-border Mergers and Acquisitions rather than fresh investment (Andersen and Hainaut, 1998; Singh, 2003). For these reasons, the role of FDI in generating employment in the DCs should not be exaggerated.

Conventional theory emphasizes that capital flows to poor countries are likely to raise wages and increase employment (especially in the sectors employing capital intensively). There is some evidence that higher wages are associated with foreign investment in enterprises (see Aitken *et al.*, 1995). On the other hand, it is likely that the poorest and least skilled workers have limited access to such employment. The work of Feenstra and Hanson (1996 and 1997) emphasizes the role of FDI and trade (outsourcing) in bringing about a worldwide relocation of marginal activities. The key result is that this relocation

> reduces the relative demand for unskilled labour, and this result applies both to the more developed economy that is shedding production activities, and to the developing economy that is receiving them. The reason is that the outsourced activities are unskilled labour-intensive relative to those done in the developed economy, but skilled labour-intensive relative to those done in the less developed economy. Moving these activities from one country to the other raises the average skill-intensity of production in both locations. (Feenstra, 1998, p.42)

As a result, FDI and trade can cause increases in wage inequalities in DCs, just as they may do in developed countries.

Finally, when wages incorporate a rent-sharing component, the possibility of relocating production activities to lower-wage locations can create opportunities for employers to achieve reductions in the wages they bargain with their workers, even if they do not ever actually take advantage of these opportunities for relocation. Reddy (2000) demonstrates the possibility that such wage reductions through threat effects may arise, and shows that they are likely to be concentrated in industries that have an intermediate level of capital intensity. Reductions in bargained wages of this kind, associated with outward capital mobility, may be of some importance in middle-income DCs, as they may be in developed countries.

It has been well documented that in the last two decades the share of inward capital flows to DCs that can be attributed to portfolio investment rather than to FDI has substantially increased. As is widely known, various concerns have been attached to portfolio investment, especially relating to its volatility and the potential macroeconomic consequences of that volatility. Information concerning the labour market consequences of financial crises generated by reversals of capital flows is limited. We therefore confine ourselves to a brief account of recent evidence concerning the distributional impact of financial crises (see also Chapter 2 in this volume).

Das and Mohapatra (2002) show that financial market liberalization (especially capital account liberalization) appears to be associated in a sample of DCs with increasing inequality in the distribution of income. In particular, they find a pattern in which relative income gains are experienced by the top quintile of the income distribution at the expense of the middle three quintiles of the income distribution. They find that the share of income commanded by the lowest-income quintile remained unchanged. However, the small size of the sample makes it necessary to view these conclusions as far from definitive. Diwan (2001) found, using a dataset incorporating 67 financial crises (51 of which took place outside the OECD), that financial crises are associated with a 'sharp' fall in the share of labour income in national income. Galbraith and Lu (1999) find similarly, using a dataset involving 34 financial crises, that there is a significant association between the occurrence of financial crisis and increases in inequality in wage earnings, and that these increases are very large. A more microeconomic view is provided by Levinsohn *et al.* (1999), who demonstrate clearly on the basis of a study of differences in the detailed consumption pattern of individuals inhabiting different income groups and regions, that in the aftermath of financial crisis in Indonesia, the poor faced substantially higher increases in cost-of-living than did others. The authors declare that 'what is clear is that the notion that the very poor are so poor as to be insulated from international shocks is simply wrong. Rather, in the Indonesian case, the very poor appear the most vulnerable' (p.20). This conclusion is based simply on price effects, and does not incorporate the effect of the financial crisis on employment and wages.

It may be concluded that the evidence concerning capital market reforms does not suggest any grounds for complacency concerning their effects either on poverty or inequality in DCs.

10.3.3 Labour market reforms

We address labour market reforms because of their connection to globalization in two respects. First, many labour market reforms in DCs have been introduced as an element of a larger package of reforms that has included liberalization of trade policies and capital markets. In many instances they have been introduced specifically in order to support the success of those elements of the policy reform aimed at greater external integration.[12] As such, they are an integral part of the thrust toward globalization. Second, the impact of globalization is greatly dependent on the specific features of labour markets. For this reason, it is necessary to study the implications of labour market reforms when investigating the impact of globalization.

Policy reforms aimed at attracting foreign capital, and at enabling the domestic economy to adjust maximally so as to take advantage of opportunities for trade, have often included an element of labour market liberalization. In particular, it has often been advocated that restrictions on hiring and firing and on plant closures should be removed as an aspect of the thrust for external market integration.[13] Although there is plentiful anecdotal information on the consequences of such reforms, there is less by way of concrete documentation. The arguments in favour of 'labour market flexibility' in the context of international integration are well-known. However, labour market flexibility may have had more complicated implications then generally foreseen. Some recent studies show that those who have lost formal sector employment as a result of policy reforms in DCs have often faced extended unemployment or downward mobility, rather than being rapidly absorbed into the expanding sectors of a dynamic post-liberalization economy, as hoped. These findings raise questions concerning the nature of the employment impact of conventionally recommended labour market reforms in DCs. McMillan *et al.* (2002) demonstrate that workers displaced as a result of privatization and reform in the cashew sector in Mozambique were thrown into a large pool of the already unemployed, and mostly remained so. They also point out that a substantial share of the displaced employees were women, and reject the idea that employees in the factories in which dislocation took place were 'politically powerful urban constituents' belonging to an aristocracy of labour. Similarly, Breman (2003) has demonstrated that workers displaced due to the closure of textile mills in Ahmedabad, India, over time often suffered severe downward mobility. They typically replaced their moderately well-paid formal sector employment with low-income informal sector labour possessing little security.

The role of minimum wages in DCs is controversial. It has been widely proposed that minimum wages act inadvertently to increase unemployment.

Although the logic of this conventional prediction is well-known, it may be less widely applicable than generally thought. Further, even if present, the employment-reducing effect of minimum wages may offer less cause for concern than at first appearance. Even within the textbook model of wage determination, the damaging effect of minimum wages on employment is accompanied by its effect of increasing the wage of those who find work. In DCs, where intra-family and intra-community transfers of income are common, it may well be the case that the net income of individuals is increased by the application of a minimum wage. A recent World Bank study on Indonesia, for example, finds that a recent doubling of the real value of Indonesia's minimum wage led to a 10 per cent increase in average wages and at 2 per cent decrease in wage employment (Rama, 1996. See also Alatas and Cameron, 2003).[14] With even moderate redistribution from the employed to the unemployed within communities or kinship groups, these elasticities would imply that a minimum wage would increase the value of workers' individual as well as collective income. Another finding of the study is that the minimum wage appears to have actually caused an increase in employment in large firms. One interpretation as to why this is so, which is in keeping with the developed country literature on minimum wages (Card and Krueger, 1994), is that large firms behave like monopsonists in the labour market, as a result of which increases in the minimum wage cause increases in wages and increases in employment. This theory is consistent with the perception that there is widespread job queuing in DCs such as Indonesia. The study also finds that the elasticity of investment with respect to the minimum wage is negative. On the other hand, the presence of positive wage-productivity relationships in DCs may cause increases in wages to give rise to increases in productivity and output. These wage-productivity relationships may be related to effort extraction (as suggested by Harrison and Leamer, 1997), nutrition or health.[15]

A central factor that differentiates the DC experience of minimum wages from the developed country experience is that rates of compliance with minimum wage requirements are typically very low. Harrison and Leamer (1997) ask the interesting question of what is the implication of these low coverage rates on the effect of minimum wages. They point out that the possibility for production to take place in the 'uncovered' segment of a production sector implies that increases in the minimum wage that displace workers may cause a decrease in the wage in the uncovered segment and a corresponding increase in employment and production in the production sector as a whole. Whether increases in minimum wages are a desirable policy will then be dependent on what weights are attached to the loss in employment and gain in wages in the covered segment as against the gain in employment and decrease in wages in the uncovered segment.

The role of institutional factors, such as the capacity to form into workplace collectives and engage in collective bargaining is of considerable

importance in determining the labour market impact of globalization. Suggestions that these act as deterrents to FDI, and as impediments to the competitiveness of international trade, may often be misplaced. International trade can be based on the capabilities of an enterprise and its workers rather than on labour cost advantages (as suggested by Lazonick, 1990; Lall, 1992). Collective organization in the workplace may foster technological learning and thereby competitive advantage in the global marketplace. Whether or not collective organization plays this role is not determined by the presence of collective organization as such, but rather by its nature. Cooperative forms of workplace organization that facilitate problem solving can aid in the acquisition of competitive advantage. Similarly, in the presence of wage productivity relationships associated with nutrition and health, individual employers may not find it in their interest to invest in the productivity of workers due to the difficulty of ensuring that these investments will not be lost to other employers. In such circumstances, widespread improvements in wages and working conditions brought about by workers' organizations may generate gains for employers and workers alike.

As demonstrated by Reddy (2000), the extent of workplace organization can be a critical factor in determining the response of bargained wages and employment conditions to competitive pressures arising from trade liberalization and capital market liberalization. Reductions in bargained wages arising as a result of such competitive pressure will generally be lower when coordination between workers across firms is greater. The literature on institutions and labour market outcomes in developed countries also demonstrates that labour unions have been a key factor in dampening wage inequalities (see Abowd and Lemieux, 1993; Fortin and Lemieux, 1997; Card *et al.*, 2003). They have also played a historically important role in shaping the 'democratic trajectories' that have given rise to egalitarian outcomes in specific developed societies, including some that have been relatively open to trade, such as those of Scandinavia (Moene and Wallerstein, 2002). The question for the future concerns to what extent forms of worker organization can be found that overcome a prevalent 'corporatist' model in DCs in which labour unions act as representatives of a small and privileged segment of the workforce, and act as a sclerotic force that can cement inequalities and generate resistance to technological change.

10.4 Future research priorities and implications for public action

The existing literature on globalization and its social consequences in DCs has been based on a paucity of information. The literature attempting to correlate aggregate-level social outcomes with macroeconomic and trade policy choices is much better developed than that concentrating on how particular policy choices have influenced microeconomic dynamics in the labour market and thereby individual well-being. A major reason for the over-reliance on aggregate-level data has been the lack of adequate micro-level data suitable for the tracing of the pathways by which the current form of globalization affects social outcomes. Investment in the collection of appropriate data concerning the reaction of firms and individuals to changes in the policy environment is essential if the gap in understanding is to be addressed. It is reassuring that even with the limited data currently available, there has been substantial progress in understanding the relations between globalization and social outcomes, with a more realistic and nuanced picture of these relationships having emerged in recent years. It has become increasingly clear that ideological nostrums of any kind relating to the impact of the current form of globalization on social outcomes are unhelpful. Existing research has demonstrated that the actual record has been mixed at best. Future research can lead to a better understanding of the diverse pathways that have given rise to this mixed record, and thereby make possible better collective choices.

Dogmas concerning the role of trade liberalization or capital market liberalization in reducing inequality or poverty have little justification on the basis either of recent microeconomic evidence, or of *a priori* reasoning. Detailed study of labour market experience in DCs suggests reason for worry that the thrust toward external market integration may in certain instances have contributed to increases in inequality, and failed to contribute to poverty reduction. The state of knowledge suggests caution in pursuing any one prescription, and recommends attention to complementary measures. In particular, there is considerable room to pursue the improvement of levels of employment, conditions of work and wages, as goals in themselves to be directly promoted through appropriate policies and institutions.

Notes

1. I would like to thank Martha Chen and Marco Vivarelli for their invaluable comments.
2. See, for instance, Chapter 7 by Cornia in this volume.
3. See Lewis (1954).
4. For a compelling statistical portrait of the scale and nature of informal sector employment in DCs, see ILO (2002).
5. See Gordon (1972). Note, however, that much of this literature appears to emphasize the segmentation of labour markets into two types without emphasizing the segmentation of production into two forms.
6. Formal sector entrepreneurs and enterprises may at times be unprivileged in their access to capital and social networks, where informal sector entrepreneurs and enterprises may be privileged in their access to the same resources. Similarly, workers in formal sector enterprises may not always possess conditions of employment or pay that are superior to those of comparable workers in informal sector enterprises, although this is usually the case. Some, such as Maloney (1997, p.2), have gone so far as to state that in many respects 'the informal sector behaves as an unregulated entrepreneurial sector, rather than the disadvantaged sector of a dual economy'. This claim appears, however, to be based on analysis of a narrow segment of the informal sector (relatively privileged entrepreneurial small enterprises), and not on the broader category of the self-employed and informal sector workers.

7. See Unger (2002) for example, for the argument that proletarianization is by no means a necessary consequence of modernization.
8. See Marglin (1976).
9. Many researchers have argued that exports and imports transfer technology across countries; others have argued that greater product-market competition spurs innovation in firms. That said, it has proved difficult to find clear support for this liberalization–technology link (Slaughter, 2002). See also Wood (1995) and Acemoglu (2000).
10. Goldberg and Pavcnik (2002) report that they find no evidence of such a relationship in Brazil, and limited evidence of such a relationship in Colombia.
11. World Development Indicators online, June 2003.
12. See, for instance, Zagha (2000) and Rama (2003) for typical examples of the appeal for labour market reforms as a complement to external market liberalization.
13. Ibid.
14. A study for Colombia suggests that a 10 per cent rise in the real value of the minimum wage reduced employment of low-skilled workers by between 2 per cent and 12 per cent. In Mexico, a 45 per cent change in the minimum wage was not associated with any change in the level of employment (Harrison and Leamer, 1997).
15. The existence of such relationships has long been a central tenet of development economics. See, for example, Leibenstein (1963) and Dasgupta and Ray (1986).

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11

The Social Impact of Globalization: The Scope for National Policies

Augustin Kwasi Fosu

11.1 Introduction

The world has become increasingly integrated in terms of flows in information, technology, trade, and Foreign Direct Investment (FDI), *inter alia*. This process of 'globalization' has engendered both positive and negative implications for developing economies. The nature and extent of such consequences have varied across countries. For example, while East Asian countries have experienced substantial increases in trade shares over the last four decades, most countries in Sub-Saharan Africa (SSA) have stagnated in their participation in world trade.

Much of the existing analysis of the effects of globalization has concentrated on growth effects, with relatively little attention accorded social impacts, such as the effects on employment and poverty. Adequately analyzing the social impacts requires an understanding of distributional as well as growth consequences of globalization. The former include both size and functional distributions of income. In this regard, the mediating role of the labour market becomes particularly salient.

The objective of this chapter is to discuss the scope for national policies in enhancing the positive effects of globalization as well as mitigating its negative impacts on social variables. Consistent with the objectives of the present project of the International Labour Organization (ILO), the scope of the current analysis will be limited to defining 'globalization' as the augmentation of international trade and FDI; 'social impacts' refers to employment, income inequality and poverty within developing countries (DCs).

11.2 Trade liberalization and labour market adjustment

The neoclassical prediction of the beneficial effects of international trade on employment in DCs, *a là* Heckscher–Ohlin–Samuelson (H–O–S), is based on