BRIEFING PAPER

CUTS International

TDP 4/2007

Globalisation and Inequality

The Development Rationale

Prashmita Ghosh*

Background

The process of globalisation constitutes social, cultural and economic transfers across borders. The last two decades have seen major economic policy changes in most of the world economies, driving the globalisation process. The 1980's was marked by severe economic crises faced by a number of developing countries, brought on by economic mismanagement and global economic downturn, caused by the oil crises during that period. These economies, especially the countries discussed in this paper, i.e., Bangladesh, India, Nepal, Pakistan, and Sri Lanka, were closed economies, following the import substitution policies in 70's and 80's.

The economic crises made these countries adopt policies similar to what international organisations, like the World Bank (WB), the International Monetary Fund (IMF) were advocating for. The adoption of such policies marked the beginning of the liberalisation, or the economic reforms process, in these countries.

Growth rates in the five South Asian countries, Bangladesh, India, Nepal, Pakistan and Sri Lanka, have been averaging five percent in the last few years. Despite this performance, South Asia is the home for a majority (40 percent) of the world's poor. Income inequality has been traditionally high in this region. Unequal access to education and other public services, selective access to credit, emphasis on industries in the urban sector and unequal access to agricultural land have further aggravated the income inequality in these countries, post-reforms.

This paper gives a brief sector-specific economic overview of five South Asian countries and analyses the possible causes of the increasing inequality in South Asia. The discussion on inequality becomes restricted because of inadequate availability of supporting data in some cases.

Bangladesh

Bangladesh was primarily a foreign aid-dependent nation. Following serious macroeconomic imbalances in the early 1980's, Bangladesh adopted a set of policy reforms and the Structural Adjustment Programme was undertaken, under the guidelines of the IMF and WB. These reforms were undertaken to steer the economy from being an import-substitution one to an export-oriented economy. The reforms reposed faith in the role of market forces. The instability of the 80's was corrected by the growth of manufacturing industries, especially the Readymade Garments (RMG) industry, and increased foreign remittances by migrant labour.

Export-oriented RMG primarily drove the manufacturing sector's growth. The establishment of the RMG sector in Bangladesh was because of relocation of businesses by East Asian exporters. This was to avoid the quota restrictions imposed under Multi Fibre Agreement (MFA). Preferential access to US, EU and Japan markets and abundant labour supply, which work at a minimum wage, led to this industry's growth in Bangladesh. In 1985, 0.1 million people were employed in the RMG sector, which grew to about 1.9 million in 2005, accounting for 35 percent of all the manufacturing employment in the country, 80 percent of whom were women (Rahman, 2004).

Though the RMG sector provides large-scale employment, Bangladesh is known to be a country with one of the lowest wage rates in the world (Abernathy et al, 2004). While the low wage rate reflects abundant labour supply, the legal minimum wage has not increased in this sector in the last 10 years. The minimum monthly wage for the workers was fixed 12 years ago, in 1994. However, it is often argued that the actual minimum wage rate has increased, with increased standard of living. The growth of RMG in Bangladesh is highlighted, but, because of the abysmally low wage income, inequality persists, despite a rise in employment.

The export boom in RMG sector has not resulted in substantial improvement of the economic conditions of the workers in RMG sector. This is because of abysmally low wages that the RMG workers received. The growth in RMG saw increased export revenues, increased employment but low wages for the workers. Therefore, just increasing employment is not enough for reducing poverty and inequality. Commensurate support to the RMG sector, like establishment of technical and educational institutions, availability of capital, technological progress, etc., will enhance the quality of human capital.

Between 1991-92 and 2000, the proportion of the people living below poverty line has declined, on an average, by one percentage point per annum. It has also been found that poverty incidence, in recent years, has fallen by 0.3-0.5 percentage points, along with rising inequality. Economic reforms has not been able to suitably address the rural economic problems and with increasing export revenues, there is a trend of increasing inequality in Bangladesh.

* *Programme Officer, CUTS International*

With the support of
MINBUZA Ministry of Foreign Affairs, The Netherlands & DFID Department for International Development, UK

Box 1: Nepal's Garment and Tea Sector: Contrasting Policy Mix

Readymade Garments

RMG has occupied an important position in the exports of Nepal. The share of garments in total exports was 17.7 per cent in 2003-04.

RMG industry in Nepal had some particular features:

- US was the most important market for garment exports;
- Export was limited to a few products;
- High production cost; and
- Outdated technology.

After 2000, Nepalese garment exports started to decline. Because of:

- Preferential market access granted to the Sub-Saharan African countries by the US, under the African Growth and Opportunity Act (AGOA);
- Abolition of quota system in 2004 led to the decline of total exports;
- Lack of initiative from the government and business; and
- No up gradation of technology.

In the last two years, there has been a drastic rise in unemployment in the garment sector, following the end of the quota phase, in January 2005. Frequent political disturbances within the country have probably led to the destruction of the infrastructure, labour displacements, and disruption of development work.

Tea Industry

Despite, the internal conflict situation, the tea industry in Nepal has been able to reduce rural poverty.

Following are some characteristics of the tea industry:

- Tea industry consists of large-scale firms and small farmers.
- Post reforms, state monopoly in tea production has lessened.
- Increased private sector participation led to increase in size of the sector.

In 2000, the Government of Nepal framed the National Tea policy that provided financial incentives, availability of land for plantation purposes, etc. The policy also aimed to establish training centres, to enable small farmers to participate in growing tea. The large firms cultivated 70 percent of the land, while the small farmers cultivate the remaining 30 percent, in the hilly tracts of Nepal.

Small farmers' participation in tea cultivation has increased from 20 percent in 1994-95 to 41 percent in 2003-04. The small farmers are now specialising in the production of this cash crop and using the profits to buy food grains. Tea farming has given the small farmers a commercial crop and a way out of poverty. Moreover, the growth of small farmers substantiates that tea trade benefits are no more restricted to large farmers, but are spread to all farmers, with little or no access to capital.

Nepal

In the mid-1980's, Nepal initiated her economic liberalisation process. The gross domestic product (GDP) growth rates averaged less than five percent per annum during the 1980's and 1990's. The overall economic growth in the 90's decelerated, owing to the slow agricultural growth. The reform process was at its full peak in the early 90's, to keep pace with the India reform era. Nepalese economy is driven by two external agents, India and the foreign donors, since Nepal is also an aid-dependent country.

The incidence of poverty is very high in Nepal, with one-third of the population below the absolute poverty line, especially in remote areas and excluded communities. Only 10 percent of the people are in absolute poverty in urban areas of Nepal, while, in rural areas, it is 34 percent. Land constitutes as the single most productive asset for the rural Nepalese. But, the high population growth rate and inheritance laws have led to land fragmentation and the decline in farm sizes, over the years. Small farm holdings give less income.

Moreover, the backward regions in Nepal, i.e., the mid-western and the far-western hill and mountain regions suffer from low literacy, gender discrimination in education, high labour intensity in small farms, inadequate infrastructure and is also the place for political conflicts. All these factors have resulted in low economic productivity from these areas.

The positive impact of the economic reforms is visible in the non-agricultural sectors, with an increase in the number of business enterprises in the urban areas. The urban centre in Nepal has developed in and around the capital, Kathmandu. Inequality in Nepal has widened in recent decades, with the economic growth, led by market forces, not doing distributive justice. Rural inequality in income distribution has increased faster, compared with the urban income inequality for the decade 1996-2004. Further analysis reveals that economic growth has contributed to a 24.1-percent decline in poverty, whereas the redistribution of income exacerbated poverty by 13.2 percent, thereby net poverty declined by 11 percent. This is because there has been less growth of the poor people, compared to the rich class.

Sri Lanka

Sri Lanka was the first economy in South Asia to open up her market and initiate the reform process in 1977. The reform measures constituted of trade liberalisation policies, decontrol of prices and interest rates, private sector development, financial sector reforms and foreign investment promotion. The economic reforms transformed Sri Lanka into an industrial economy, from an agricultural one. Privatisation led to the closure of inefficient textile mills that were state-owned enterprises (SoE's), which provided employment to a large number of people. The rapidly expanding manufacturing sector was not able to absorb the huge number of rural labour displaced, due to the closure of the SoE's.

The curtailment of formal employment opportunities in the organised sector caused workers to be employed in unstable wage employments, with poor working conditions. Almost all the workers employed in the small industry and in large public sector mills belonged to the low income segments in the country that had less resources and lacked dynamic working skills to adjust to the new employment opportunities of the export-oriented RMG sector.

During 1990-91 to 2002, the poverty gap between the urban sector and the rest of the country widened and there was a significant increase in poverty in the tea plantation export sector, of 50 percent, because of declining tea exports. At the same time, urban poverty halved and rural poverty declined by five percent. The mid-90's saw a decline in rural poverty, because of the recovery in the agricultural sector.

Inequality increased by almost 24 percent for the country, as a whole, between 1990-91 and 2002. The analysis of the links between poverty reduction, growth and inequality suggest that, had inequality not increased during the decade, Sri Lanka would have experienced a significantly greater reduction in poverty. In Sri Lanka, the areas surrounding the capital city of Colombo in the Western province have a high growth rate and less poverty. The western province has 30 percent of the total population, but contributes 47 percent to the GDP. Also,

Box 2: Pakistan's Unequal Growth Pattern – Cutlery and Other Sectors

The cutlery sector is based in the Punjab province and is a traditional industry of Pakistan. Being a Small and Medium Enterprise, this industry provides employment opportunities for people in the semi-urban areas, who are semi-skilled. Tough competition from China and the lack of technological progress are the factors hindering development of this traditional industry. The reduction of the customs duty led to massive Chinese cutlery imports that have affected the local production.

In Punjab province, other manufacturing industries such as textiles, sports goods and electrical appliances are posting higher growth rates. So, on one hand, cutlery industry's performance is declining and, on the other, manufacturing sector is growing . This aspect of unbalanced growth increases inequality among people.

poverty is 11 percent, which is less than the national poverty rate of 23 percent.

Pakistan

Pakistan's economic growth had been quite impressive between the 60's and 80's, with the economy growing at six percent per annum. However, in the 90's, the growth rate declined to four percent.

Despite the accelerated economic growth rates, poverty levels in Pakistan have stayed high. Between 1990-91 and 2000-01, the overall poverty increased from 26.1 percent to 32.1 percent. Rural poverty increased, from 24.6 percent to 35 percent, in the same period and urban poverty fell from 30.3 percent to 20.9 percent. There are regional disparities within Pakistan. Like, in the Punjab province (the most industrialised province in Pakistan), the districts with better infrastructure and higher education standards have a high level of development. Hence, the northern districts of the Punjab province are more developed than the southern districts.

While the manufacturing and services sectors grew at 8.6 percent and 8.8 percent, respectively, agriculture, the mainstay of Pakistan's economy, grew at only 2.5 percent in 2005-06. Pakistan's growth is driven by high growth rates of the manufacturing and services sectors. But, agriculture, on which majority of people are dependent, is lagging behind, because of low growth rates, compared to the number of people dependent on the sector.

India

Like her other South Asian neighbours, India had an inward-looking economic policy, post- Independence. With the economic crisis of 1991, the Indian Government undertook major macroeconomic policy reforms. The reforms addressed the restrictive controls of state monopoly and promotion of private enterprise. However, the agricultural sector was not liberalised in 1991.

The economic reforms of the last two decades did bring positive results, in terms of higher economic growth; expansion in exports, increase in the GDP growth rate, from 3.5 percent to 5-6 percent in 80's and 90's, touching an all-time high of 8.2 percent in 2003-04.

However, the agricultural growth, post-1991, has been disappointing, with the growth rates struggling to climb above 2–3 percent, compared to an average growth rate of 3.8 percent during the 1980s.

The following section outlines the inequality aspects in these five South Asian countries and tries to understand the possible reasons behind increasing inequality, despite a high rate of economic growth, after economic reforms.

The Inequality Dimension

The experiences in the South Asian countries have been similar. Traditionally, these economies had high levels of rural, uneducated poor people, with little or no assets. Over the last two decades, these economies are struggling to accelerate the growth rates. Internal conflicts, wars across borders and traditional problem of a massive rural populace are slowing down the growth process.

The distribution of the benefits of the rising economic growth rate has been extremely skewed. As had been pointed out in the World Bank Report on Economic Growth in South Asia, "Poverty is not just endemic, but increasingly concentrated in particular, lagging regions. Not only are these regions poorer, but their growth rates are substantially slower than the better-off regions".

In India, over the years, the increasing income and regional inequality is becoming more acute. Inequality poses social and political instability. It is difficult to pinpoint the reasons for this inequality. Though employment generation avenues have increased, like in Bangladesh employment has increased and so have export revenues, wages remained constant, though, presently, the wages have been revised. This shows that, though increased revenues have led to increased employment opportunities, they have not been able to distribute income equitably.

It is difficult to address the income inequality issue simultaneously with the poverty alleviation drive. The shifts in the labour market and the demographic effects could have been responsible for the recent rise in inequality. Over the years, in the five countries there has been a decrease in the labour share in the total income *vis-à-vis* the capital share. This is evident from the declining share of agriculture, upon which a majority of the South Asian population is dependent. The share of

Box 3: Oilseed Sector in India

India followed the policy of import substitution in oilseeds sector till 1994-95. India became self sufficient in oilseeds production in mid 90's. This policy, along with doubling the output and stabilising the oilseed production in the country, led to crop diversification. New crops such as soyabean, sunflower were cultivated.

Because of limitations such as restrictions on interstate movement, low capital base, production inefficiencies, etc., the industry could not take full benefit from the import substitution policy. Hence, the Government, in 1994-95, reformed the agricultural policy. The oilseed sector was impacted upon negatively, after markets were opened up. Though the consumers were benefited from cheap imports of palm oil, the small inefficient producers could not withstand the inflow of cheap oil imports and went out of business.

From being self-sufficient in oilseed production and also a major exporter in the 90's, India became the largest importer of oilseeds in the world. The policy measures that are taken at national level, to keep in tune with international agreements, led to a gain and loss situation. To keep up with the commitment of farm reforms, made by India in 1995, Indian consumers gained by getting cheaper oil. Prices have declined in the market, but the farmers have lost.

agriculture in the GDP is declining over the years, as manufacturing industries and services are gaining prominence. In India, for example, around 60 percent of the people are dependent on agriculture, where agriculture currently contributes around 20 percent to the GDP.

What are the possible reasons for this increasing inequality? A major reason for the rising inequality is the unbalanced growth in these economies. The growth pattern in these economies can be described as pocketed growth where specific areas are benefiting from the rapid economic activities. Economic activities are concentrated in and around the urban areas, where educated people are benefiting from the gains in incomes.

The disadvantaged people have some common characteristics in this part of the world: lack of access to land, capital, equipments, education, timely information on market opportunities, etc. This traditional socio-economic deprivation leads these people more towards economic vulnerability. The South Asian population has different kinds of inequalities that are inter-related. The income inequality exists because of the difference in employment activities, i.e., an educated person in a skilled manufacturing job will get paid more than an unskilled labourer in an agricultural farm. This qualitative difference is because of the educational difference and the difference in skill sets, different policy orientation. Also, to this is added the productivity of each sector. As was mentioned earlier, agriculture is seeing a declining share in country's GDP, though population-dependency on agriculture is still quite high.

It is opined that, as growth takes place, because of adjustment costs, such as labour displacements, there will, initially, be a temporary rise in inequality. Such as with the increase in the manufacturing industries and the service sector and the ever-increasing demand for land, there will be land transfers to give space to the upcoming industries. These transfers for development might lead to labour displacements, if farmlands are taken away. The temporary labour displacement is an adjustment that becomes inevitable in the economic development process. This adjustment might bring in more inequality in the society, as the displaced labour may not be able to find jobs in the interim period. This can be addressed through government intervention in developing skills of the unskilled labourers, developing educational and vocational institutions, etc. Governments announce schemes for employment generation, vocational training, food for work programme and other developmental schemes to bring the deprived and vulnerable societies some economic benefit. In most cases, the benefits of the schemes, if implemented, are not being availed by the needy, because of lack of information flow.

Conclusion

South Asian countries attained a high growth level in the past decade. To continue at a steady pace, certain common initiatives have to be undertaken by the countries. Tea sector in Nepal or the RMG sector in Bangladesh, could grow because of sustained government initiative in framing growth-promoting policies and developing supporting institutions.

The growth of any sector is dependent on a number of supporting institutions, starting from the basic raw material stage to the time it reaches its destination-consumer or the importing country. In this regard, lack of any input, be it in the form of foreign exchange restriction or poor and stringent labour laws or the unavailability of electricity, will hinder the growth process.

Income inequality is difficult to drive out from these economies immediately, given the vast poor population. However, an effort has to be made to ensure that the increasing income inequality does not become a counter to the pro-growth initiatives. Massive investments have to be made by the respective governments and private entrepreneurs in the areas of education, health services and infrastructure, so that the vast resource of labour can be transformed into valuable human capital, for ushering in development and addressing the rising inequality problem of the region.

References

Ministry of Finance, Government of Bangladesh, (2006, 2004). *Bangladesh Economic Review*, Bangladesh.

Devarajan, S. and Ijaz Nabi, (2006). *Economic Growth in South Asia: Promising, Un-equalising…Sustainable?*, South Asia Region, World Bank Washington DC.

Jha R. (Ed), (2005). *Economic Growth, Economic Performance and Welfare in South Asia*, Palgrave Macmillan.

Khatiwada Y., (2005). *Linkages between Trade, Development and Poverty Reduction, A Study on Short Term Impact of Trade Liberalisation on Poverty in Nepal*, SAWTEE, Nepal for CUTS International.

Kumar P., (2005). *Trade, Liberalisation and Its Impact on Poverty Reduction, An Indian Experience*, CUTS CITEE.

Mahmood A., (2006). *Linkages between Trade, Development and Poverty Reduction: Pakistan*, Asian Institute of Trade and Development, Pakistan, for CUTS International.

Pahariya N.C., (2006). *Impact Assessment of Trade Liberalisation in Oilseeds Sector: A Case Study of Rajasthan*, CUTS International.

Government of Pakistan, (2004-05). *Pakistan Economic Survey*, Pakistan.

Razzaque A., (2006). *Trade, Development and Poverty Reduction: The Bangladesh Perspective*, Unnayan Shammanay, Bangladesh, for CUTS International.

Weerakoon, D. and J. Thennakoon (2006). *Linkages between Trade, Development and Poverty: Sri Lanka*, IPS, Sri Lanka, for CUTS International.

The paper is written by Prashmita Ghosh, Programme Officer, CUTS International. The views expressed are personal. This is an abridged version of the paper presented at the 7th Annual Symposium on Poverty Research in Sri Lanka, on December 06-07, 2006, organised by Centre for Poverty Analysis, Colombo, Sri Lanka. Examples used in writing this paper are derived mainly from the CUTS CITEE's project entitled "Linkages between Trade, Development & Poverty Reduction", supported by the Ministry of Foreign Affairs, The Netherlands and the Department for International Development, UK.