



National responses to make globalization work for human development

Markets can go too far and squeeze the non-market activities so critical for human development

Globalization has swung open the door to opportunities in the world's markets. But markets can go too far and squeeze the non-market activities so critical for human development. Because of a *fiscal squeeze*, the public provision of social services is being constrained. Because of a *time squeeze*, the personal provision of (unpaid) caring services is being reduced. And because of a perverse *incentive squeeze*, the environmental resources so essential for human development are being degraded.

The markets in today's global system are creating wonderful opportunities, but distributing them unevenly—and the volatility of markets is creating new vulnerabilities. What's worse, the success of the global markets has marginalized many non-market activities for human development, making human well-being even more vulnerable.

What can countries do to make globalization work for human development?

- Capture global opportunities in trade, capital flows and migration.
- Protect people against the vulnerabilities that globalization creates.
- Overcome the resource squeeze from the shrinking fiscal autonomy of the state.

For national action to succeed in these areas, countries have to generate pro-poor growth that reduces inequalities and enhances human capabilities. They also have to create effective alliances of all actors. And they have to formulate strategies for better managing their needs and interests in today's globalizing world. None of these tasks is easy. With deeper integration of economies in the global system, the demand for convergence of policies is high. But without strong national governance, neither the opportunities nor the threats of global-

ization can be effectively managed for human development.

CAPTURING GLOBAL OPPORTUNITIES

Comparative disadvantage in markets and resources need not be a constraint. With appropriate policies, countries can capture global opportunities in trade, finance and employment and translate them into more human development.

ENHANCING TRADE

The standard policy prescription for the developing world has been to liberalize trade and provide incentives to produce for export. Many developing countries have reduced their tariffs, removed distortions in exchange rates and trimmed fiscal deficits. The CFA countries have devalued the CFA franc. Eritrea, Ethiopia and Mozambique have achieved current account convertibility for their currencies. Several South Asian countries have removed import restrictions. Transition economies in Eastern Europe and the CIS have made tax incentives a key part of their strategies. And several Arab states are liberalizing financial services.

Has this helped growth? Yes, in many countries. Botswana, Chile, China, India, the Republic of Korea and Mauritius had a burst of exports—and a boost in per capita income. The lessons are clear: countries can accelerate growth through trade liberalization if they have sound macroeconomic management, good infrastructure and social services, and strong governance with an appropriate institutional framework. Critical in all this is human development. Just look at Botswana and Mali. Both opened their economies. But Botswana's per

capita income grew at nearly 6% a year in 1980–96, while Mali's shrank 0.8% a year. In the mid-1980s Botswana was far ahead of Mali in human development (figure 4.1).

Translating trade and growth into human development. Even though there is a strong link between trade and growth, there is no automatic link with human development (table 4.1). Egypt and Pakistan achieved annual export growth of more than 5% and per capita income growth of more than 3% in 1985–97, yet both still have far to go in human development. At the other extreme, countries can open their economies, but generate neither growth nor human development. Russia generated trade and attracted private capital flows by opening in the 1990s, yet economic stagnation and human deprivation are serious (box 4.1).

By contrast, the Republic of Korea managed trade and growth to improve its human development. Since 1960 life expectancy has risen from 54 years to 74. Infant mortality has come down from 85 per 1,000 live births to 6. More than 96% of its people are expected to survive beyond age 40, and 98% of adults are literate.

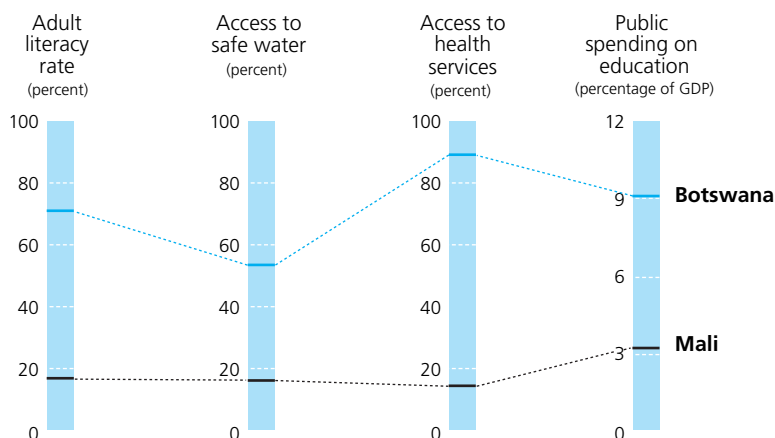
The main elements of the Republic of Korea's success:

- A pro-growth strategy, with a commitment to poverty reduction.
- Bold economic reforms, with sound macro-economic policies and a focus on price reforms.
- Institutions oriented to the market, with a restructuring of banking and financial institutions.
- An emphasis on rural areas and agriculture, with widespread land reform.
- Extensive public provision of social services.
- Redistributive income policies, creating more labour-intensive employment and instituting measures for social protection.

Similar policies in Botswana, Chile, Malaysia and Thailand have also translated good performance in trade into economic growth—and into the well-being of their people.

A major lesson is that capturing global opportunities in trade requires a comprehensive package, evident when contrasting Russia with Poland. From the beginning of its transition to the market, Poland opened its economy,

FIGURE 4.1
Differences in human development—Botswana and Mali, mid-1980s



Source: UNDP 1990.

TABLE 4.1
Trade, economic growth and human development—no automatic link (percent)

Country	Annual growth of exports 1985–97	Per capita income growth 1985–97	Reduction in human development index (HDI) shortfall 1985–97
Stronger links			
Singapore	12.9	6.2	45
Mauritius	7.9	3.7	38
Hong Kong, China (SAR)	13.0	4.8	33
Weaker links			
Pakistan	9.0	3.0	17
Uganda	8.0	2.4	5

Source: Human Development Report Office.

BOX 4.1

More trade, more capital, more human deprivation—Russia

In 1997 Russia's exports to the rest of the world were \$56 billion—and its inflows of foreign direct investment \$6 billion, 30% of the total to the region. But its economic growth was a meagre 0.4%. In 1989–96 its Gini coefficient deteriorated from 0.24 to 0.48, a doubling of inequality. Wages fell 48%, with the share of wage income down from 74% to 55% and that of rent and other income up almost fourfold, from 5% to 23%.

There are also serious human deprivations. Between 1989 and 1996 male life expectancy declined by more than four years to 60, two years less than the average

for developing countries. The under-five mortality rate is 25 per 1,000 live births, compared with 14 in Poland. Homicides and illegal drug trafficking have increased.

What went wrong? Sometimes Russia's problems are seen as only a financial crisis—partly due to the East Asian crisis, unfavourable external conditions and a lack of progress in building market institutions. A broader view sees deeper causes: bad governance, no rule of law, a criminal society, concentrated power, an imperfect market economy.

Source: Ruminska-Zimny 1999.

built up institutions, put in place democratic and participatory processes and ensured transparency and accountability (box 4.2).

Maintaining labour and environmental standards. Capturing trade opportunities is complicated by labour and environmental standards, for violating them hurts human development.

When wages less than the minimum are imposed on female garment workers in Bangladesh, that is a violation of the minimum wage law. When the workplace is put under lock and key with workers inside, that is a violation of human rights. When hundreds of these women die in a fire because they cannot get out, that is a human tragedy. When 27 million workers in the world's 845 export processing zones are not allowed to organize in unions, that is a violation of workers' rights as well as human rights. And continuing degradation of the environment for economic gain increases the vulnerability of current generations—and deprives future generations of the opportunities that are their due.

BOX 4.2

Opening the Polish economy with institutional reforms

In the late 1980s, when Poland embarked on opening its economy, it took a "shock therapy" approach to macroeconomic management. In the first few years of transition income and consumption dropped by some 20% and unemployment and poverty increased. But in 1994 human development trends started improving and economic growth took off. Consumption increased, and unemployment fell from more than 16% in 1993 to less than 10% in 1997.

What made the difference? Poland shifted in the mid-1990s from a piecemeal to a comprehensive approach. The building blocks of the programme were institutional reforms, policy consistency and popular participation.

At the beginning of the transition Poland established a democratic system with market institutions, including property rights and a transparent financial sector. There was strong political will to advance reforms and a consensus on the transition strategy. Policies aimed at building the market system with a comprehen-

sive approach towards privatization and the modernization of the industrial base. This differed from the rushed and uncontrolled privatization in Russia, from the market option in Hungary and from the equity option in the Czech Republic. By negotiating with banks and other partners, and in some cases undertaking debt swaps, Poland solved the debt problems of state enterprises.

Openness policies remained consistent despite changes in government, and there was a consensus on opening to the world economy, joining the OECD, European Union and North Atlantic Treaty Organization (NATO) and adopting internal policies related to privatization, economic restructuring and decentralization. All policies balanced market and equity considerations.

And all policies were the subject of public debate—in parliament and the media. This gave a sense of transparency and ownership, facilitating consensus. Compare that with Russia, where a narrow group of people made decisions whenever policies were subject to internal conflict.

Source: Ruminska-Zimny 1999.

Does lowering labour and environmental standards give developing countries a competitive edge in capturing trade opportunities? No. Are developed countries using these standards as grounds for unfairly restricting trade? Possibly. And do developing countries lose if they improve their labour and environmental standards? Again, no.

Empirical evidence suggests that lowering labour standards does not make a country more competitive, especially if the country does nothing to improve productivity. It is not so much cheap labour as low per-unit labour cost that attracts investment. The irony is that developed countries themselves take advantage of lower labour standards by outsourcing production, \$585 billion worth (in 1994 prices) and more than two-fifths of the exports from developing countries. Enhancing labour standards will not harm developing countries if they can improve productivity.

In labour standards there is a strong movement among trade unions and NGOs to ensure workers' welfare in the developing world. But there is no substitute for government action on legal and regulatory frameworks, on codes of conduct for business and on monitoring and punishing violations of labour standards.

On the whole, developing countries will be better served, in trade and in human development, if they maintain appropriate environmental standards. Repeated tests of the pollution haven hypothesis—that investment and production migrate from countries with high environmental standards to those with low standards—have failed to find systematic evidence in its favour. Moreover, trade liberalization affects the environment through many routes—some positive, some negative. The net result can be anything, and thus does not justify lowering environmental standards a priori. Consumers in developed countries can help if they are willing to pay for such standards through social labelling and ecolabelling. And developing countries, through regional collective action, can set regional environmental standards that provide them with better bargaining tools in trade negotiations.

In environmental standards country experience offers specific policy recommendations:

- Abolish policies that distort trade and have negative environmental impacts. In the 1990s,

a decade in which Indonesia cut pesticide subsidies from \$128 million to zero, the country's exports grew 7% a year.

- Correct market failures with good incentive systems. In Norway energy taxes have helped cut carbon dioxide emissions in some sectors by more than a fifth since 1991.
- Provide more incentives for transferring “clean” technologies to help developing countries follow environment-friendly growth paths. In Lithuania 35% of companies started cleaner production in the 1990s.
- Create the legal and institutional framework to comply with environmental standards. In 1997 Brazil passed an environmental law to protect natural resources, imposing fines of up to \$44 million or prison terms of up to four years for illegal logging or killing wild animals.
- Improve the effectiveness of environmental policies through an alliance of communities, NGOs and other institutions of civil society.

One last point. Developed countries should realize that using trade restrictions in the name of environmental standards is protectionist and, for domestic environmental problems, inefficient. For transboundary problems, it is both inefficient and inequitable.

*ATTRACTING CAPITAL —
CONTROLLING ITS VOLATILITY*

Private capital flows, particularly foreign direct investment, have helped developing countries to grow and to enhance human development. But again, the link between foreign direct investment, growth and human development is not automatic (table 4.2). And empirical evidence suggests that short-term speculative capital makes for financial volatility and little long-term contribution to an economy.

Attracting long-term capital flows. To attract foreign direct investment, the traditional macroeconomic package calls for liberalizing capital, providing incentives, formulating a conducive industrial policy and implementing pragmatic technology and labour policies.

- Countries thus need a comprehensive policy package, not ad hoc measures. Consider India, which liberalized its investment rules,

offered investment incentives and promoted foreign investment opportunities (box 4.3).

- National governance conditions the domestic policy and economic framework, affecting attitudes towards foreign direct investment and operational efficiency and profits. Important in all this is political openness—ensuring a democratic system, promoting transparency and accountability, unleashing the press and civil society and maintaining political stability through the work of democratic political institutions. That is perhaps why Poland, with a GDP a fifth of Russia's, received \$18 billion of foreign direct investment in 1991–97, while Russia received only \$13 billion. In Latin America, too,

TABLE 4.2
Foreign direct investment, economic growth and human development—no automatic link

Country	Foreign direct investment flows (US\$ billions)		Per capita income growth rate (%) 1985–97	Reduction in human development index (HDI) shortfall (%) 1985–97
	1985	1997		
Stronger links				
Chile	0.2	5.2	3.7	47
China	2.3	43.5	8.3	45
Korea, Rep. of	0.3	2.2	6.5	35
Weaker links				
India	0.1	3.1	3.7	13
Romania	0.0	1.1	–0.6	–2

Source: Human Development Report Office.

BOX 4.3

Liberalizing foreign investment in India

Foreign direct investment flows to India in the 1980s were insignificant, not much more than \$1 billion. But in the early 1990s India removed restrictions on ownership, loosened regulations on currency transactions, expedited the review and approval process for foreign investment through “one-stop” coordination and encouraged imports of new technology.

The outcome: new opportunities for foreign investment. In 1988 the stock of foreign direct investment in India was \$1.2 billion—in 1994, \$2.5 billion. Inflows rose from \$91 million in 1988 to \$300 million in 1994 to \$3 billion in 1997.

India developed seven export processing zones, where foreign investors

receive tax incentives and can bring in duty-free imports. India also promoted private foreign investment in the country and identified enterprises for joint ventures. The government advertised broadly in newspapers and other media in foreign countries. It arranged international fairs. It sent trade delegations to countries. It cranked up its missions abroad.

What helped in this? Good human capital, enhanced technological power, market size, democratic traditions and stable politics. But they are not new. What made the breakthrough possible was the liberalization of foreign investment and a new set of strong incentives.

Source: Lim and Siddall 1997.

the democratization of politics explains higher inflows of foreign direct investment in the 1990s. Increasingly, there are demands for government insurance against political risks for foreign direct investment. In many cases foreign investors are willing to undertake commercial risks, but require protection against political risks.

- Educating people and moving their skills up the ladder are essential for raising productivity—and for attracting foreign direct

investment. The quality of labour and its skill level are an important element in capturing global opportunities. For the workers, skill ensures better pay. Education and training are essential to build the necessary human capital.

- Countries need to complement liberalization policies with technology policies, as Brazil, China, India and Malaysia have done. Look at the results in India, which has been providing incentives for research and development and working with foreign multinationals in high-tech areas.

That's what is needed to have foreign direct investment. But what does it take for foreign direct investment and growth to contribute to human development? First, investments in infrastructure and services should have a direct impact on human development. Second, foreign direct investment must be tailored to national priorities, in activities that have spillovers—in creating more employment, bringing in high technology, building future human capital (box 4.4). Third, countries need to minimize the adverse impacts of foreign direct investment (such as creating inequalities), provide domestic enterprises with necessary incentives and protect their interests.

National action on multinational corporations should focus on:

- *Providing appropriate incentives.* Countries might give economic incentives to multinational corporations, but these should not come at a cost to domestic enterprises (box 4.5).
- *Bringing the operations of multinationals under national rules.* While keeping the incentive structures for multinationals intact, their operations should be subject to all national rules and regulations—ranging from general laws to economic regulations.
- *Ensuring social responsibility.* In the absence of an enforceable international framework governing the operations of multinational corporations, pressing companies to adopt voluntary codes of conduct guaranteeing minimum labour standards for all their international operations has become a key strategy for enforcing labour standards—an issue discussed in chapter 5.

Managing the volatility of short-term capital. The recent financial crisis in East Asia has renewed the debate on the effectiveness of

BOX 4.4

Foreign direct investment for human development in Malaysia

In 1993 foreign direct investment accounted for nearly 25% of gross fixed capital formation in Malaysia, which has used it to generate growth and enhance human well-being. With per capita income growth of more than 4% a year in 1980–95, Malaysia reduced income poverty from 29% to 13% and lowered its Gini coefficient from 0.49 in 1980 to 0.45 in 1993. The income of the poorest 20% has increased from \$431 in 1970 to \$1,030 (1985 PPP\$). Wage employment grew at more than 8% a year in 1970–92, and unemployment has fallen from 8% to 4%.

Look at what that has done for human development. Life expectancy is 72 years. Adult literacy is 85%. Primary enrolments are 91%. Infant mortality has come down in the past 20 years from 30 per 1,000 live births to 11. And more than 88% of Malaysians have access to safe water and health services.

Foreign direct investment played a big part in these achievements. The Malaysian approach has been to use foreign direct investment for economic growth and human development, with

economic measures backed by social and structural measures. An active affirmative action policy for Malays reduced social and economic disparities. Technocratic governance ensured efficiency, and institutional reforms supported the policy measures.

The recent financial crisis spotlights four principles:

- A high priority on policies friendly to human development and good governance helps a country take advantage of globalization's opportunities.
- Human and physical capital cannot insulate a country from the harm of globalization—and can indeed attract much more short-term capital than a country can cope with.
- Rapid access to larger amounts of capital, labour and natural resources can distort the development process, leaving it unsustainable.
- A slower, more sustainable pace of growth—with a strong emphasis on human development—may be a better way to take advantage of the opportunities and minimize the vulnerabilities.

Source: Jomo 1999.

BOX 4.5

Incentives to multinationals—and nationals—in Mauritius

Mauritius gave incentives to multinational corporations in export processing zones, simultaneously protecting domestic industries. Enterprises in the zones had tariff-free access to imports of machinery and inputs, free repatriation of profits, a 10-year tax holiday and implicit assurance that wage increases would be moderate. But domestic firms also got tax holidays and protection from imports. In the mid-1980s the average effective tariff

for manufactured imports was 89%.

The combination fuelled an export boom in garments to European markets, generating new opportunities for women. And because incentives went to all industries, the boom didn't drive up wages in the rest of the economy. New profit opportunities were created at the margin, leaving old opportunities undisturbed. There were no identifiable losers, only winners.

Source: Rodrik 1999.

capital controls to inhibit volatile, short-term flows. Earlier the focus was on capital controls to limit capital flight. Now it's on controls to alter the volume and composition of capital flows (box 4.6).

To avoid the speculative movement of hot money, the Republic of Korea favoured a gradual opening of its financial markets, even though there were pressures to fully liberalize its capital markets to become an OECD member. Rather than opening capital markets directly to foreign investors, the government chose to do it indirectly, allowing domestic financial institutions to borrow from abroad and distribute the borrowed funds in domestic markets.

Malaysia approached crisis management and recovery with a multipronged strategy of fiscal austerity, caps on bank lending, bank recapitalization and capital controls. Its ban on foreigners taking money out of the stock market for a year has attracted much attention. Although new foreign direct investment commitments fell by 12% in 1998, that is not bad given the regional slump. And in recent months Malaysia has eased capital controls, allowing investors to repatriate capital by paying an exit tax equal to 30% of the principal. The impact is not yet clear, but the experience shows that tight fiscal policy alone cannot calm panic and restore the capital flows essential for fast recovery. In addition to relaxing capital controls, Malaysia has recently increased public spending to spur demand and avoid a recession.

GETTING THE MOST FROM MIGRATION— BOTH WAYS

To aid the migration of unskilled workers, labour-sending countries such as Jordan, Pakistan and the Philippines have set up overseas employment units to capture opportunities for employment and protect workers' well-being. Policies for opening accounts with banks and financial institutions also helped migrant workers—and were good for remittances back home. Egypt managed to get \$4.7 billion in remittances in 1995—close to the \$6 billion it earned from Suez Canal receipts, oil exports and tourism combined. The Philippines received \$7 billion in remittances in 1996, and Mexico \$4 billion. Albania received three times as much

from the 600,000 Albanians working abroad in 1993 as it did from foreign investment.

Countries also need stronger legal frameworks and tougher laws to punish those involved in human trafficking. NGOs and other institutions of civil society can play an important part in uncovering the story of human trafficking (box 4.7).

When developing countries open their economies and develop a strong private sector, they can reverse their brain drains. In Taiwan (province of China) this is called *rencai huiiliu*—the “return flow of human talent”. A survey of US multinational corporations in Taiwan

BOX 4.6

Short-term capital controls in Chile

In the early 1990s Chile experienced a surge in capital inflows that created a conflict between maintaining a tight monetary policy and spurring export competitiveness. In 1991 the Central Bank attempted to resolve this by imposing a one-year unremunerated reserve requirement on foreign loans, primarily designed to discourage short-term borrowing without affecting foreign direct investment. Between 1991 and 1997 the rate of reserve requirement was increased and its coverage extended in several steps to cover most forms of foreign financing except foreign direct investment.

The empirical evidence on the effectiveness of the Chilean controls in reducing short-term capital flows is ambiguous. It is difficult to be conclusive in the absence of a counterfactual, but national

data for Chile's external debt suggest that the controls affected the maturity composition of net capital inflows only after 1995, when they were strengthened. Data from the Bank for International Settlements present a somewhat different picture. The figures for short-term external borrowing substantially exceed those reported in Chilean sources, and the maturity structure of foreign bank borrowing appears quite different from what the national data imply.

Analysts, too, are divided on the effectiveness of the Chilean approach. Some suggest that the controls were effective, but only for a short while. Others suggest that they were not effective before 1995. And still others argue that they were always ineffective.

Source: IMF 1998b.

BOX 4.7

Revealing the human trafficking in Eastern Europe and the CIS

An estimated 500,000 women are trafficked each year from Eastern Europe and the CIS to Western Europe. An estimated 15,000 Russians and Eastern Europeans work in Germany's red-light districts. In the Netherlands 57% of the trafficked women are under 21.

The Global Survival Network played a big part in exposing this slave trade, after studying it between 1995 and 1997. The researchers interviewed police and government officials, NGOs, and women traf-

ficked overseas. It also went undercover to get information from companies dealing with trafficking and traffickers.

The outcome: *Crime and Servitude: An Exposé of the Traffic in Women for Prostitution from the Newly Independent States*. This very useful report showed the size and depth of the problem, heightened awareness of the trafficking in people and made concrete recommendations for actions to rein in the traffickers and assist the victims.

Source: Global Survival Network 1997.

Evidence does not show that flexible labour markets contribute to competitiveness, and the trade-off between worker protection and competitiveness may be illusory

(province of China) found that no fewer than 35% of expatriate staff were of Chinese extraction. In both Hong Kong (China, SAR) and mainland China there is a high demand for ABCs (American-born Chinese). The brain drain may also have reversed in India and the Republic of Korea. Would that it could in Africa.

There is also a need to protect unskilled workers who return home. Return migration can occur for several reasons. There could be a slowdown of the economy in receiving countries (oil-producing countries in the 1980s). Countries might want to speed the climb up the skills ladder by importing cheap foreign labour (the Republic of Korea and Singapore). Or there could be political or social problems (some 2.7 million people returned to Russia after having emigrated to other republics, finding it infeasible to stay if they could not speak the national language).

Return migration can cause political, social and cultural disruption in the home countries, as it did for many Asian and Arab countries after the Gulf War in 1991 and as it is doing today in many countries in Eastern Europe and the CIS. Bangladesh, the Philippines and Thailand have long had in place measures to integrate returnees in the economy and society with little disruption.

PROTECTING PEOPLE AGAINST VULNERABILITIES

People everywhere are more vulnerable. Changing labour markets are making people insecure in their jobs and livelihoods. The erosion of the welfare state removes safety nets. And the financial crisis is now a social crisis. All

this is happening as globalization erodes the fiscal base of countries, particularly developing countries, shrinking the public resources and institutions to protect people (box 4.8).

COPING WITH CHANGING LABOUR MARKETS

The structure and composition of labour markets in both developing and developed countries are changing rapidly. Some are moving towards jobs that are highly skilled and highly productive. But there are also pressures to be more flexible, as emphasized in chapter 1—and that can mean throwing out the protection of workers' incomes, rights and working conditions. Yet evidence does not show that flexible labour markets contribute to competitiveness, and the trade-off between worker protection and competitiveness may be illusory. Belgium, France, Germany and the United Kingdom weakened labour laws, but with little effect on unemployment. Spain and the Netherlands decentralized wage bargaining and Italy eliminated automatic wage indexation, but also failed to reduce unemployment.

Developing countries have responded to the changing labour markets in different ways—sometimes successfully, sometimes not. Malaysia and the Republic of Korea used price policies to ensure an affordable food supply for workers. By fixing the domestic price of rice above the export price, they maintained the domestic supply. And through subsidies, they ensured that workers could afford it. That allowed them to devalue their currencies to capture trade opportunities while protecting workers.

Countries in Latin America attempted to deal with changing labour markets through wage flexibility, allowing a widening gap between formal and informal sector wages. But that did not increase trade or foreign direct investment. So, they are now trying to make their informal sectors more productive, more vibrant and more sensitive to workers' rights. The lesson: making labour markets flexible by abandoning conditions that protect labour does not help in dealing with changing labour markets and capturing global opportunities.

The new vulnerabilities in labour markets in developing countries call for:

BOX 4.8

Social protection for Tunisia's poor

Under the pressure of globalization Tunisia cut public spending, but without hurting the poor. Food subsidies fell less in Tunisia than in some other Arab countries, going from 3% to 2% of GDP in recent years, compared with a fall in Morocco from 5.5% of GDP to 0.5% between 1981 and 1993. Also important:

Tunisia has reduced its ratio of military to social spending in the past 30 years from 45% to 31%, one of the smallest in the Arab States.

Tunisian labour unions, though not large, were instrumental in setting a minimum wage and in maintaining food subsidies for the poor.

Source: Amin 1999.

- Expanding employment, with a focus on creating reasonably productive jobs.
- Constantly upgrading the skills of workers, particularly the unskilled, through training, on-the-job dissemination of technical know-how and building the flexibility in skills needed to move around.
- Maintaining reasonable compensation, the minimum wage and accepted labour standards and rights.
- Increasing the productivity of the informal sector—through tax holidays, duty exemptions, lower interest rates and access to credit.

The transition economies of Eastern Europe and the CIS swiftly transformed labour policies. Wage setting by the state was replaced by income policies, now being abandoned. The region has the old tripartite commissions bringing together unions, employers and governments. But in many countries economic and social conditions have deteriorated so much that unemployment is high and real wages are low. Many enterprises, particularly those in the public sector, cannot pay workers. Workers can be protected only if an adequate legal system, sound institutions and good governance are put in place. Only if macroeconomic policies are undertaken to reverse economic stagnation and enhance human development. Only if social policies are pursued for the protection of people.

In the developed world deindustrialization and declines in manufacturing employment are due mainly to slow growth, outmoded patterns of growth and the expansion of high-skilled, high-productivity jobs. Finance, insurance, real estate, health care and business services have become the most dynamic sectors in job creation, with a doubling in their share of employment. But there are large disparities in skills and wages between service sectors. And part-time and precarious, low-productivity, low-wage jobs are the norm for low-skilled workers in the formal sector. The labour market is also changing because of growing links with developing countries—more imports, outsourcing of investments and immigration. But no more than a tenth of the unemployment in industrial countries can be attributed to these links.

How to overcome the vulnerabilities in labour markets? With political commitment

and strong will, as in Ireland (box 4.9). What specific actions are needed? More growth, particularly pro-labour growth. How can this be achieved through expansionary monetary policy as well as other measures? That is explained later on. Addressing the vulnerabilities of workers in labour markets calls for:

- *Providing education and training.* Unskilled workers need training to upgrade skills and be flexible in adapting to different situations. Training by governments, direct or indirect, could be supported by an employers' training tax. Employers should also provide training to their employees, encouraged by tax refunds. Just look at the way Sweden has taken

BOX 4.9

Ireland's social partnership agreements

Since 1988 Ireland has used social partnership agreements to help the Irish act together to pursue strategic goals and recognize the actions of each part of the community. The idea is to have a national strategy against poverty and inequality.

One essential agreement is for moderate wage increases—to ensure work for everybody. It has kept society together through continuous increases in real take-home pay and employment growth without neglecting competitiveness.

The results are impressive. Since 1994 Ireland's GDP growth has been more

than 7% a year, twice the developed world average. Since 1992 Ireland has created nearly 220,000 jobs, more than the rest of the European Union could manage. It cut unemployment in half between 1986 and 1998, and has raised real wages for the average industrial worker about 10% a year since 1990. Inflation remains at 2%, and the national debt is down from 122% of GDP in 1986 to 55% in 1998.

The challenge in all this progress is to reduce poverty and inequality. About 10% of the Irish are not expected to survive age 60, 23% are functionally illiterate, and nearly a fifth are income-poor.

Source: National Economic and Social Forum 1997; Ireland 1998.

BOX 4.10

Upgrading skills and achieving worker flexibility in Sweden

Globalization has brought changes in Swedish firms' organization, increased capital-intensive production and raised the requirements for knowledge. The results for workers: greater demand for vocational education, skills, broad competence and flexibility.

Sweden has helped workers meet these challenges through programmes to build their skills and increase their flexibility. Its active labour market policy absorbs 7% of the government's budget, \$5 billion for a workforce of 4.4 million. More than 70% goes to training and placement programmes. In contrast to the Netherlands,

the Swedish government does not support job creation at the low-wage, low-productivity end of the market. Its labour market policy has always been part of a policy of full employment that emphasizes equitable wage policies and promoting labour mobility.

Unemployment is lower in Sweden than in Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy and Spain. Although problems of structural unemployment remain, skills formation and training have contributed to equity and helped prevent long-term unemployment.

Source: Bakker 1999.

workers' training seriously in dealing with changing labour markets (box 4.10).

- *Supporting the unemployed in finding jobs.* Job search assistance complements training for the unemployed. And public employment may be a real possibility for targeting such disadvantaged workers as the long-term unemployed or workers with disabilities.

- *Maintaining workers' benefits and rights.* Setting minimum wages at moderate levels does not hurt employment, and it can reduce wage gaps between men and women. Health insurance, maternity benefits, parental leave and unemployment insurance are all important for workers' welfare. And prior notice of dismissal and rights of association and collective bargaining are workers' rights.

- *Managing transitional labour markets.* Policies should support change in the gender roles in households—to value caring activities differently—and encourage the use of information technology.

MANAGING THE SOCIAL COSTS OF FINANCIAL CRISIS

Financial volatility brings huge social costs, as evidenced by the debt debacle in Latin America in the 1980s, the financial collapse in Eastern Europe and the CIS in the early 1990s and the recent East Asian crisis. The costs go beyond job losses, food insecurity and reduced social services. Weak social insurance systems and sudden unemployment also cause serious psychological and social stress, pushing up circulatory disease and suicide. Some households may even turn to prostitution and crime, leading to the spread of disease, family breakdown, increased violence and ethnic hatred. So, with restoring economic stability, one of the big issues national governments face in a crisis is minimizing the social costs and protecting people.

The financial crises of the 1980s and 1990s show that countries need to:

- Target poor people through public works programmes and food subsidies.
- Protect public spending for basic social services for poor people.
- Put in place such formal protections as unemployment insurance.
- Avoid excessive fiscal restraint.

- Align macroeconomic policies to ensure their compatibility with poverty reduction.

Besides public works programmes, countries can rely on private job placement services to ensure job and income security for poor people, as Thailand did. Income transfers for the needy are also important. To maintain food security, countries have targeted low-cost food supply to poor people. Allowing poor people to cultivate unused land can help to alleviate hunger and absorb some of the urban unemployed.

Social services for poor people are crucial. Indonesia has kept children in school by reducing or waiving school fees and providing more scholarships to poor students. And it has targeted 18 million families in a program to protect basic health services in 1998–2000, ensuring basic health services in health centres, nutritional improvements, midwife services and a health guarantee scheme at the district level. In any kind of transition—whether a financial crisis or trade volatility or economic transition—how people fare depends largely on the kind of social protection. When countries cushion people's living standards against economic declines through social transfers, they minimize the rise in inequality (table 4.3).

OVERCOMING THE RESOURCE SQUEEZE

The fiscal resource base of developing countries is being squeezed in four ways:

- *Trade liberalization.* Efficiency objectives, as well as multilateral commitments, have led many developing countries to reduce trade taxes, particularly import taxes. Trade taxes have always been a revenue-raising device for developing countries, where they account for an average of a third of tax revenue (table 4.4). Losing that base has hurt revenue generation in these countries (figure 4.2).

- *Globalization of the tax base.* With most tax systems designed when economies were primarily domestic, it is difficult to tax operations that are transnational. A typical US company may earn up to 50% of its profit outside the country. Through transfer pricing, multinational corporations can make it even more difficult for national governments to tax them. And the rise in electronic com-

TABLE 4.3

Adjustment and greater income inequality, 1987–88 to 1993–95

Country by type of adjustment	Increase in income inequality ^a
Non-compensatory	
Russian Federation	0.24
Ukraine	0.24
Estonia	0.12
Compensatory	
Bulgaria	0.11
Latvia	0.08
Belarus	0.05
Populist	
Slovenia	0.03
Poland	0.02
Hungary	0.02

a. The increase in income inequality refers to the increase in the Gini coefficient. A Gini coefficient of zero means perfect equality, a coefficient of one perfect inequality.

Source: Rodas-Martini 1999.

TABLE 4.4

Major and minor collectors of trade taxes, 1990–96

Country	Taxes on international trade as % of total government revenue
Major collectors	
Lesotho	54.8
Madagascar	47.2
Mauritius	40.6
Dominican Republic	40.4
Lebanon	40.2
Minor collectors	
Lithuania	3.6
South Africa	2.6
Brazil	1.6
Singapore	1.3
Estonia	1.2

Source: Human Development Report Office.

merce is posing a fresh challenge to revenue collection.

- *Tax competition.* With capital tending to prefer low-tax situations, countries compete in lowering their corporate and capital gains taxes, reducing tax receipts. Of 35 Commonwealth countries that had an individual income tax before 1990, 29 reduced their rates by 1990, and none increased them. And tax-exempt export processing zones compete with one another and with the domestic economy. Tax competition led all OECD countries except Switzerland and Turkey to reduce the rate in their top tax bracket in 1985–90, from an average of 52% to 42%.

- *Growth of the underground economy.* The growth of the “black”, or “underground”, economy has also reduced tax revenue in many countries. India’s underground economy is estimated at 20% of GDP, comparable in size to Chile, Colombia, Kenya and Nigeria. In the European Union the untaxed economy is estimated to be 25% of GDP. Russia estimates that its tax revenue is less than half of what it would be if tax laws were implemented, and that organized crime generates \$900 million a year. The global drug business generates \$400 billion a year—8% of all international trade.

As the resource base in developing countries shrinks, the demand for public resources grows—a double jeopardy. All the structural changes of globalization increase the demand for public resources—but in the face of reduced revenues, governments are pulling back. Public spending on health and education in countries with low human development declined from 2.0% of GDP in 1986–90 to 1.8% in 1991–96. Capital spending fell in the same period from 6.5% of public expenditure to 6.1%.

Economic and industrial change increases calls on public authorities to offset the effects of stronger competition by subsidizing ailing firms—or helping exporting firms in their struggle for global competitiveness. And seeking to boost growth, public authorities are luring investment capital with various incentives, all with a price.

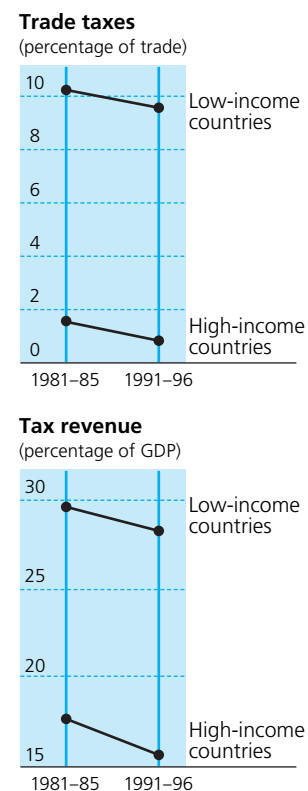
Governments also have to put up public funds to stabilize their exchange rates. Where capital inflows are sterilized to avoid currency appreciation, open market operations usually lead to losses for the central bank—up to 1% of

GDP in some Latin America countries. In Jamaica central bank losses from exchange rate guarantees exceeded 5% of GDP in the early 1990s. Thailand spent \$23.4 billion, or three-fourths of its foreign exchange holdings, in the first half of 1997 to resist devaluation and shore up financial institutions.

Governments differ in their wishes and capacities to provide social protection. In industrial countries government expenditure increased from just under 30% of GDP in 1960 to nearly 50% in 1995. More than half this increase was due to higher social transfers, up from 9% of GDP to 20%. A recent OECD report recorded an increase in member countries’ national costs of subsidies from \$39 billion in 1989 to \$49 billion in 1993. Meanwhile, many countries have cut social spending to balance their books. Confronted by the challenges to welfare states posed by globalization, new thinking has emerged in the discourse within and among supranational organizations about the future of welfare (box 4.11).

Two conflicting models are emerging. One is a modified version of liberalism—liberalism with a safety net, the US model of welfare but more

FIGURE 4.2
Reduced revenue generation—
loss of fiscal strength



Source: Mohan J. Rao 1999a.

BOX 4.11

Responses to the eroding welfare state

With the erosion of the welfare state, people in the developed world are even less secure and even more vulnerable—smashed or marginalized by market forces, their survival endangered, with much of the burden falling on women.

- *The neoliberal response.* Britain, New Zealand, the United States and to less degree Australia and Canada believe that the market should supplement a very basic social safety net. But market decay—typified by wage deregulation and low pay—is accompanying welfare decay, eroding both public and private coverage in health and pensions among young and low-wage workers. Welfare gaps will therefore widen, and costs will shift to families and individuals. A double jeopardy: the low-wage labour market requires higher income maintenance transfers and creates a disincentive to work.
- *The Scandinavian response.* With declining fiscal resources in recent years, there is now more emphasis on workfare,

and benefits are tied more closely to contributions. High unemployment means more reliance on private sector jobs and services, putting pressure on a “social investment” approach.

- *The continental European response.* Continental Europe is subsidizing unskilled workers’ exit from the labour market, mainly through early retirement. This creates a dual problem of mass retirement and mass unemployment, pushing up financial requirements and social contributions. The strong incentive to participate in the informal sector or to pursue self-employment further undermines the welfare state’s tax base.

Built-in labour market rigidities stem from most families’ dependence on the male earner’s pay and social rights. So, it is argued, welfare states need to be scaled down. Dutch social policy suggests the possibility of updating policies without abandoning job growth and social solidarity.

Source: Deacon 1999.

committed to targeting benefits to poor people. The second, based more on the European welfare system, is more universalist. It argues that the middle class should be brought into the welfare system—to ensure political support, and thus a sustainable tax base, for the system. This approach maintains that without support from the middle class, services for poor people become poor services. This point is borne out in the evidence showing that more targeted programmes result in more inequality (table 4.5).

To cope with the shrinking fiscal autonomy of the state, particularly in developing countries, national governments might focus on:

- *Generating more revenue from direct taxes*, such as income and property taxes. Direct taxes are often extremely low. In many South Asian countries agriculture accounts for more than 33% of GDP, but contributes less than 6% to total tax revenue. Imposing property taxes on big landholdings would generate significant resources in the region.
- *Introducing a value added tax*. A broad-based value added tax can be more effective in generating resources than an income tax. But it may be more regressive, requiring a choice between efficiency and equity, a choice that can be tackled only through a full analysis of the impact of both taxes in a country.

- *Making tax laws simple*, easy and transparent and making tax administration efficient. Countries may need to formulate new institutional arrangements and mechanisms for tax administration.

- *Restructuring expenditures* by taking resources away from the military and redirecting them to health and education. Countries in Eastern Europe and the CIS have recently done this.

GENERATING PRO-POOR GROWTH—REDUCING INEQUALITIES AND ENHANCING HUMAN CAPABILITIES

To generate growth the main policy components are ensuring sound macroeconomic management and macroeconomic stability, boosting domestic demand by appropriately adjusting real interest rates, adopting fiscal discipline, accelerating industrial production, reforming financial sector institutions and promoting good governance. But economic growth alone is not enough. It must be pro-poor growth—expanding the capabilities, opportunities and life choices of poor people (figure 4.3). To ensure the generation of pro-poor growth, national action should:

- Restore full employment and expansion of opportunities as a high priority of economic policy.
- Remove antipoor biases in the macroeconomic framework.
- Invest in the capabilities of poor people by restructuring public expenditure and taxation.
- Ensure access of poor people to productive resources, including credit.
- Increase the productivity of small-scale agriculture.
- Promote microenterprises and the informal sector.
- Emphasize labour-intensive industrialization to expand employment opportunities.

Reducing inequality in the developing world requires the following additional actions, through alliances of governments, firms and NGOs:

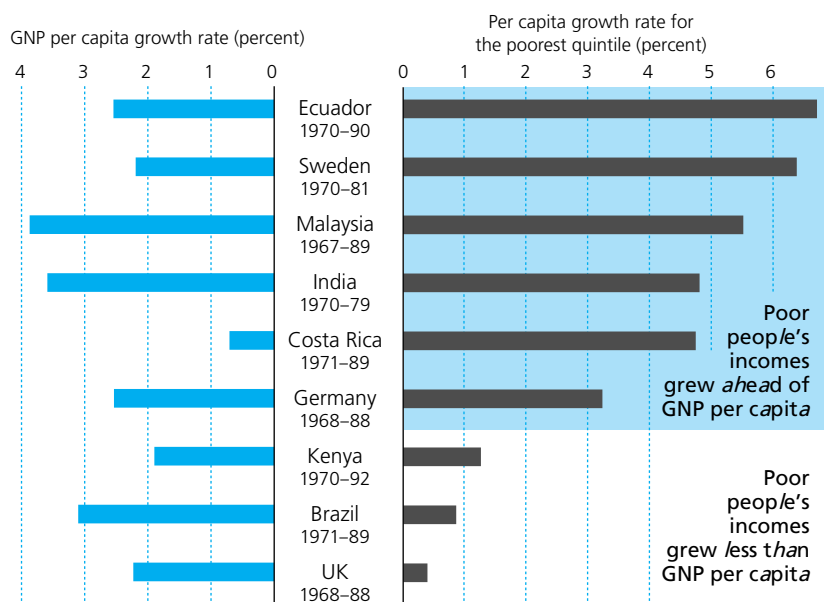
- Build human capabilities through education and ensure access of poor people to education. Education has been found to be the most important asset in explaining income disparities, and wage dispersion among skill levels has become significant.

TABLE 4.5
Social welfare systems and income inequality, 1998

Country by type of social welfare system	Income inequality (Gini coefficient) ^a
Non-targeted	
<i>Encompassing—based on contribution</i>	
Norway	0.23
Finland	0.23
Sweden	0.22
<i>Corporatist—compulsory membership, but separate social programme</i>	
France	0.29
Germany	0.24
Basic security and targeted	
United States	0.33
Australia	0.31
United Kingdom	0.29

a. A Gini coefficient of zero means perfect equality, a coefficient of one perfect inequality.
Source: Rodas-Martini 1999.

FIGURE 4.3
Growth—pro-poor or pro-rich?



Source: UNDP 1997a.

- Make public provision of safe water, health services and housing accessible to poor people.
- Make more financial assets and productive resources available to poor people and create productive and remunerative jobs for them.
- Reduce inequality through progressive income taxation and other redistributive policies.
- Provide income transfers and other social protection during adjustment and crisis—and pursue antipoverty programmes for the poorest.

Both redistributive policies and social protection are important means for reducing inequality. But in many developing countries redistributive tools, such as subsidies, favour the rich (figure 4.4). This is particularly true in urban health facilities and universities. Of course, national action to generate pro-poor growth and reduce inequality may be constrained by measures at the international level—a point discussed in chapter 5.

CREATING EFFECTIVE ALLIANCES OF NATIONAL ACTORS

An alliance among the government, NGOs, local firms and multinational corporations can go far to foster cooperation towards common goals. An alliance does not mean submission by any one actor to the others. The work of each actor can complement that of others, under such universal guidelines as respecting the rule of law, not violating human rights, and being fair, transparent and accountable. A strong, democratically elected government is especially important, allowing representatives of the people to express their aspirations and be accountable to them. All this is easier said than done, for elite groups and other interest groups benefit from the present nature and structure of globalization. They also share power with global elites.

NGOs have emerged as major actors—both in size and in impact. In the United States employment in the NGO sector is nearly 9 million, in the European Union nearly 6 million and in Japan more than 2 million—and in Brazil 1 million, in Argentina 350,000 and in Colombia 270,000. The share of resources accruing to NGOs has steadily increased, even though official aid transfers have been steadily declining. NGO revenues in the United States total \$566

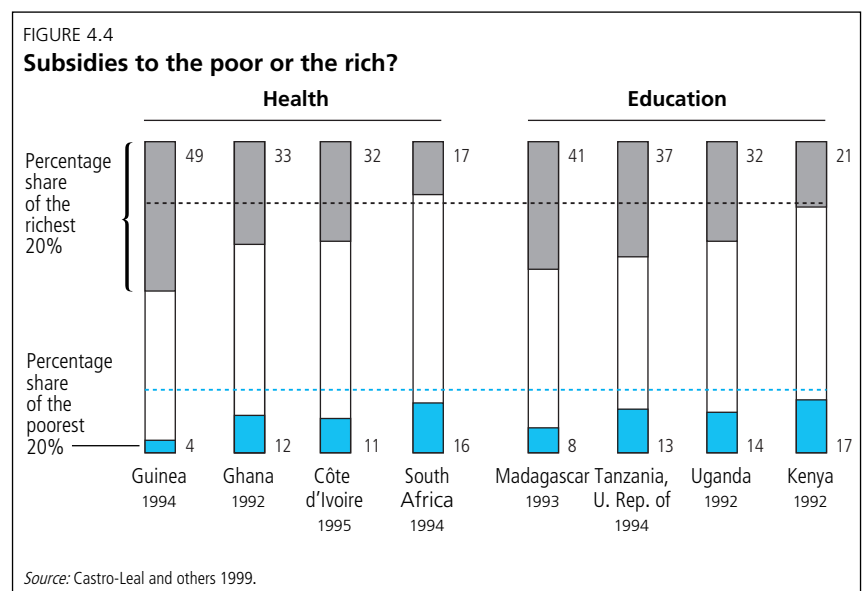
billion, in Japan \$264 billion and in the United Kingdom \$78 billion. In the developing world NGO budgets are nearly \$1.2 billion, more than \$200 million in Mexico alone. And among the transition economies their budgets are more than \$1.4 billion in Hungary and nearly \$900 million in the Czech Republic. The point: NGOs are a strong force—both as advocates and as providers of services.

NGOs can often do more than developing country governments in meeting the basic needs of citizens—using fewer resources. NGOs also create opportunities for people and protect them against the new vulnerabilities of globalization. And they have become important pressure groups, protecting people’s rights and watching over other actors. The 1998 Birmingham Declaration for Debt Relief to the poorest countries is an important achievement. During the 1998 election in Germany more than 80 NGOs came together to get a commitment from national political parties to increase aid funding to 0.7% of the country’s GDP.

For a long time governments and NGOs were adversarial, each suspicious of the other, but that is changing. NGOs’ relationships with local firms and with multinational corporations are also improving steadily. And the donor community is coming to recognize NGOs as development partners (box 4.12).

How can the private sector be pulled in? By allowing it to work creatively, and by encouraging its innovativeness. This requires complemen-

An alliance among the government, NGOs, local firms and multinational corporations can go far to foster cooperation towards common goals



BOX 4.12

NGOs as a powerhouse in national alliances

In the outcry against child labour—with threats of boycotts and other trade restrictions—NGOs in South Asia have often joined with local manufacturers and the government to lobby against the arbitrary imposition of social clauses within the World Trade Organization. In 1998 a group of NGOs lobbied the World Bank and other international donors to fund detailed research on the human impact of structural adjustment policies.

NGOs everywhere are making bigger contributions to national development

Source: Human Development Report Office.

efforts. In Uganda NGOs are collaborating with the government, private sector and communities in a project on nutrition and early childhood development funded by a \$34 million credit from the International Development Association, using their expertise to give primary care providers better access to infrastructure. Proshika MUK, an NGO in Bangladesh, does participatory rural appraisals of the national budget to encourage the government to examine how spending decisions affect the poor and to adopt a pro-poor budget.

BOX 4.13

Meeting the challenges of globalization—Fundación Chile

Fundación Chile, a joint initiative by the Chilean government and the private sector, combines research and development with a creative vision for market opportunities and a commitment to sustainable development.

The first step is to identify a product that Chile may not yet produce but for which there could be a significant market. Next, Fundación Chile masters the technology through long experimentation. If the product can be adapted to local conditions, a

company is created for commercial production. When production is exported, the process is complete and Fundación Chile sells the company—30 so far—to Chilean interests.

Take salmon, which did not exist in Chile. Given the high price of salmon in the world market and the demand in Japan, Fundación Chile introduced salmon in Chile's rivers in the early 1990s. By 1995 salmon exports amounted to almost \$500 million, creating thousands of jobs.

Source: Human Development Report Office.

BOX 4.14

Using national human development reports to outline impacts and priorities

National and local human development reports—expected to number 260 by the end of 1999—provide a great opportunity to outline how a country or community is affected by globalization. Some possible elements:

- An analysis of how people have been affected by globalization in the past 5–10 years, with a balance sheet of gains and losses, quantified as much as possible. It should cover which groups of people gained or lost, what enabled the gains and what caused the losses.
- An analysis of gains and losses in the different elements of human security.

Source: Human Development Report Office.

- Priorities for action by local communities, by urban and rural groups and by the national government.
- Indicators for monitoring the impact of globalization and the effectiveness of national policy to manage it.
- A common position on globalization for the different sectors of government—covering finance, planning, trade, agriculture, health and so on.

Globalization should be the topic of one chapter or the theme for an entire national human development report. The chapter or report might set out key priorities in national policy for managing globalization to enhance human development.

tary domestic and trade policies to guarantee a competitive market environment, regulating any monopoly or oligopoly, particularly if it provides essential services. In many cases the private sector has demanded subsidies, protection and infrastructure from government to benefit from global markets. But in other cases local firms have accepted the challenge of tackling globalization for the good of the country (box 4.13).

Bringing multinational corporations into these alliances is the most difficult. Not only outsiders, they are empires—with money, power, affiliates, subsidiaries and the support of the international system. They are often seen as creating enclaves in national economies, and it is extremely difficult to bring them under national rules and regulations. To make them partners in the development process, they require support, but they also need to respect national rules and be accountable, transparent and sensitive to social responsibilities.

FORMULATING STRATEGIES FOR EMERGING NEW ISSUES IN THE GLOBAL SYSTEM

National action is essential to capture global opportunities in trade, capital flows and migration—and to protect people against the uncertainties and vulnerabilities of globalization (box 4.14). But the success of national action hinges on how effectively countries can negotiate at the global level.

Globalization's many facets require a focus, but efforts today are divided among different ministries and departments. Some are led by the ministry of trade, some by the ministry of finance and some by the ministry of planning. This fragmentation not only weakens the capacity of developing country governments to develop a powerful and consolidated strategy at global forums. It also limits their ability to capture global opportunities. That is why each developing country should set up a coordinated mechanism for dealing with globalization. And whatever the mechanism chosen—presidential task force, global planning commission, special interministerial unit—it must be given the visibility, power and flexibility as well as the technical expertise and political clout to handle the complexities of globalization.