

Carol Graham

## Stemming the Backlash Against Globalization

There is much speculation about a new round of protests at the upcoming meetings of the World Bank and the International Monetary Fund (IMF). The protestors contend that globalization is bad for poor people in poor countries. But the evidence suggests the opposite: that globalization provides the poor in developing countries with new opportunities for upward mobility. Yet it also introduces new vulnerabilities, particularly for those in the middle income strata, which cause even the upwardly mobile in these strata to negatively assess their economic progress. We propose three sets of policies for poor countries—increasing access to higher levels and better quality education, eliminating market distortions that block the upward mobility of the poor (including excessive levels of inequality), and providing more broadly available safety nets for people without steady incomes—that could help prevent these negative sentiments from growing into a broader backlash against globalization, which would ultimately hurt the poor in these countries the most.

With the spring meetings of the World Bank and the IMF taking place this month in Washington, D.C., there is much speculation about a possible repetition of the protests that plagued the recent World Trade Organization (WTO) meetings in Seattle and the World Bank/IMF meetings in Prague and D.C. Beyond the logistical nuisances posed by the protestors, a more fundamental question is the extent to which they represent more widely-held sentiments against globalization and market policies. Is there a looming backlash against globalization? In the United States and most industrialized economies, the main opposition to globalization and free trade stems from fears about job displacement. What do people in developing countries think?

The protestors claim that globalization is bad for poor people in poor countries. A wide body of evidence suggests the opposite. Why the discrepancy? In developing countries, market reforms, which are essential to countries' effective integration in the global economy and for poverty reduction, are part and parcel of globalization. Globalization is thus a convenient sounding board when particular policies result in dislocation for certain economic or social sectors.

My research on income mobility with Nancy Birdsall of the Carnegie Endowment for International Peace and Stefano Pettinato of Brookings suggests that globalization has brought substantial benefits and opportunities for upward mobility for large numbers of low-income individuals in the emerging economies. Yet these opportunities have been accompanied by new vulnerabilities and new risks of falling into poverty for others in both low-and middle-income brackets.



Carol Graham is a senior fellow in Economic Studies and the co-director of the Brookings Center for Social and Economic Dynamics.

## Addressing Insecurity and

These trends have also affected public perceptions. While the protestors bemoan the harm that globalization has caused the poor, the most dissatisfied respondents in the developing countries for which we have data tend to be in the middle-income levels, rather than at the lowest. This does not mean that there is an inevitable backlash against globalization in these countries. Yet the strong negative perceptions of those in the middle and lower middle income brackets suggest that policymakers should pay attention to the insecurities of these groups in addition to those of the poor.

### The Reform Record

A genuine backlash against globalization would not manifest itself in the form of angry teenagers on the streets of D.C. or Seattle, but instead through electoral outcomes in countries from Poland to Peru. In Latin America, the region that has led the world in implementing market reforms, a number of countries that were seemingly model performers are facing economic and political uncertainty. Argentines are bracing for the possible spillover effects of the Turkey crisis as they simultaneously contend with debilitating internal political squabbles. Bolivia is in its second year of political crisis and social unrest. Will voters in these countries throw out the baby with the bathwater and turn against markets and integration with the world economy?

The answer is probably not. In Latin America, there is widespread debate about how to make the market model more equitable and efficient, but, thus far, only one candidate has been elected to office promising to reverse integration into global markets—Hugo Chavez in Venezuela, where reform was not fully implemented. Still, there are some worrisome trends. In Peru, one of the countries that has gone furthest in implementing market reforms, a main contender in the June run-off election is former president Alan Garcia, notorious for his rejection of market principles in the late 1980s.

The Garcia experiment in Peru resulted in hyper-inflation, economic collapse, social unrest, and unprecedented increases in the incidence of poverty. Venezuelans today live in economic chaos. In the end, the turn to the market is much better for developing countries—and for their poor—than the alternative scenario of self-imposed isolation. Yet if the turn to the market has been so good for these countries, why is there so much debate about it?

In Latin America, reforms have delivered substantial benefits for a region that was plagued with inflation, economic instability, and daunting levels of external debt. Those countries that have fully implemented reforms have stabilized inflation, reestablished stable if not high levels of growth, liberalized trading regimes and expanded their level and diversity, and privatized public enterprises and social security systems that were draining fiscal coffers.

# Inequality in the Emerging Markets

A common assumption, meanwhile, is that market reforms are bad for the poor. While the effects of these reforms on inequality are unclear at best, the positive effects of such reforms for the poor are quite clear. Eliminating high levels of inflation has important and positive effects for the poor, who are least able to protect themselves from its costs. And in many countries, part of the reform package was a reorienting of public expenditures to the poor, who were often excluded from the benefits of the expenditures prior to reforms.

In addition, by merely removing distortions that block the productive potential of the poor in a number of sectors, market reforms can increase equity—and already have in some countries. In many developing economies, market and government failures either introduce perverse incentives or block the ability of poor people to accumulate productive assets such as education. Reforms that remove such distortions—such as rationed credit due to negative real interest rates, and rigid and over-protective labor market regulations that discourage legally registered firms from employing new workers—have had positive effects for the poor in a number of countries.

Removing market distortions is a first step toward creating new opportunities for the poor to move out of poverty. It is not, however, a sufficient one. While reforms have provided new opportunities for many poor people to move up the income ladder, reforms have also created new vulnerabilities for other groups—particularly those that were previously middle-class and had secure public sector jobs—and many of them have fallen to at or near poverty levels. Aggregate inequality measures like the Gini coefficient, which are static snapshots of countries' income distributions, mask a great deal of movement up and down the income ladder. If one compares relative mobility trends in a country like Peru, for example, with those in the United States over a 10-year period, one sees many more people moving up—and down—several income quintiles in Peru. [Table 1]

## Reforms and Inequality

The record on reforms and inequality as measured by the Gini coefficient is mixed. Inequality has gone down in some countries and increased slightly in others. Part of the inequality has been driven by increasing disparities in rewards to skilled and educated labor versus their unskilled counterparts. Contrary to what the theory predicted—that trade would reward unskilled labor, which is in much greater supply in Latin America—the rewards from the opening to trade have been to skilled labor, which is scarce.

Over the last several years, returns to higher education in Latin America have risen dramatically relative to returns to secondary and primary education. Although in the 1960s and 1970s a secondary education was sufficient to attain a stable job and a “middle-class”—and

**Table 1. Relative Mobility**

Peru, 1991-2000

Quintile 2000						
Quintile	1	2	3	4	5	Total
1991						
1	<b>45</b>	25	19	6	5	100
2	25	<b>25</b>	23	14	13	100
3	16	23	<b>22</b>	20	19	100
4	11	18	18	<b>32</b>	21	100
5	3	9	18	28	<b>42</b>	100
Total	100	100	100	100	100	100

Note: quintiles are calculated using equivalence expenditure

United States, 1979-1989

Quintile 1989						
Quintile	1	2	3	4	5	Total
1979						
1	<b>61</b>	24	9	5	1	100
2	23	<b>33</b>	28	14	3	100
3	8	25	<b>30</b>	26	11	100
4	5	13	23	<b>33</b>	26	100
5	3	5	11	23	<b>59</b>	100
Total	100	100	100	100	100	100

Note: quintiles are calculated using family income. The figures in bold along the diagonal indicate the percentage of those in the quintile that ended up where they began.

Source: *Happiness and Hardship: Opportunity and Insecurity in New Market Economies*, Carol Graham and Stefano Pettinato. (Brookings, forthcoming).

indeed fairly privileged—standard of living, by the 1990s it guaranteed neither a well-paying job nor protection from falling into poverty. Many of those who completed secondary schooling (rather than higher levels) were public sector workers; in 1990, there were far fewer public sector jobs, and they were also less desirable.

An important and related trend is top-driven inequality: high levels of wealth at the top of the distribution compared to the rest of society, where income is not as unequally distributed. In Latin America, where inequality levels are especially top-heavy, the trend is driven primarily by gaps between the top decile and the rest of the distribution, including the ninth decile. According to Miguel Székely and Marianne Hilgert of the Inter-American Development Bank, although in many Latin American countries the richest 10 percent earn three times what the next richest 10 percent earn, this difference does not exceed 1.6 in the United States, the United Kingdom, and Canada.

Top-driven inequality is driven in part by the rising wage premium to educated workers. It may also be driven by a possible increase in wealth at the top, as more open capital markets enhance opportunities for high returns. In addition, taxes on mobile capital (to the extent they were effective) are probably declining, while in developing countries, shallow financial sectors and underdeveloped capital markets may be limiting investment opportunities for small savers and borrowers. Finally, it is difficult to measure top-driven inequality. As noted by Vito Tanzi and Howell Zee of the International Monetary Fund, labor income is poorly measured at the top, and there is substantial underreporting in less developed countries, often through legal exemptions. Second, in all countries, income from wealth is undercounted.

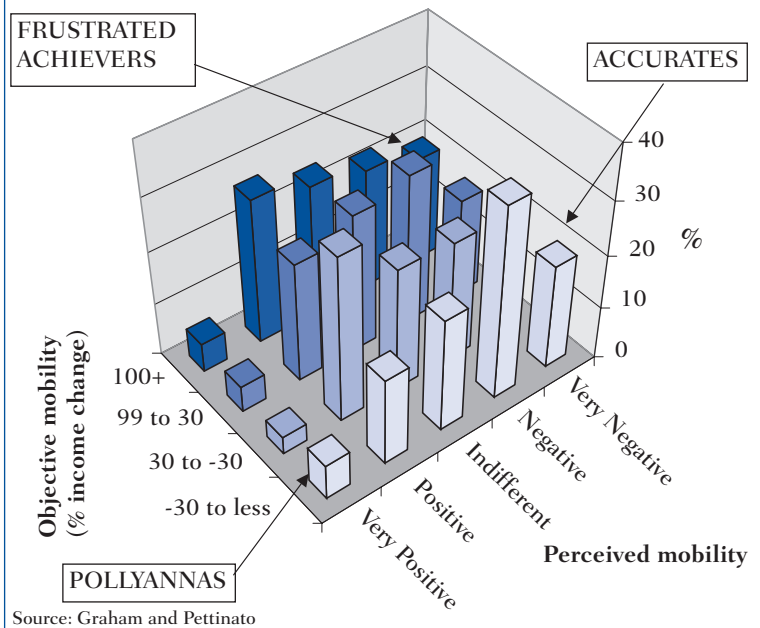
The uneven manner in which people have shared in the benefits of globalization and market reforms, as well as the new insecurities that have accompanied new opportunities, are surely part of the reason why public opinion is so mixed. Those that perceive themselves as losers are not necessarily the poor, but rather those in the middle of the income distribution who are vulnerable to falling into poverty. At the same time, those in the middle are acutely aware of the extent to which gains from the market process have been very high for those at the top of the income distribution.

### Frustrated Achievers in New Market Economies

Most of the literature on subjective well-being finds that after a certain level of absolute income, individuals' satisfaction or happiness is determined by relative rather than absolute income levels. These findings hold across countries, regions, and development levels, other than for the very poorest countries. My research with Pettinato generally supports

**Figure 2A**

**Perceived Mobility v. 1991-00 Income Mobility, Peru 2000**



Source: Graham and Pettinato

these findings, with very clear implications for the debate on public support for globalization.

In repeated household surveys in Peru during a 10-year period of market reforms, we found that of the respondents with the most upward income mobility (gains of 30 percent or more), 44 percent reported that they were worse off. Household surveys conducted in Russia during a period of market change yield more negative results, with 71 percent of upwardly mobile respondents reporting that they were worse off. (See Figures 2A and 2B)

What explains the frustrations and misperceptions of our achievers? We found that in Peru they had average income levels, but were more urban and

older than non-frustrated upwardly mobile respondents. In Russia, we found that the frustrated respondents had slightly lower than average income levels and had also experienced more income volatility (as measured by the coefficient of variation) than had the upwardly mobile respondents who were not frustrated. For the most part, then, these respondents were NOT the poorest in the sample, but rather tended towards the middle of the distribution. In Peru, while poorer respondents were much more likely to answer that their economic condition was the same as it had been before, those in the middle were much more likely to say that it was worse.

What do these frustrations imply? In a Latin American public opinion survey, the Latinobarometro, we found that respondents who were more satisfied with their lives were more likely to favor the market and to be satisfied with democracy. The surveys in Russia yield similar results. In both Russia and Peru, the frustrated achievers were less satisfied with their jobs and more critical about their economic situation as compared to others in their country.

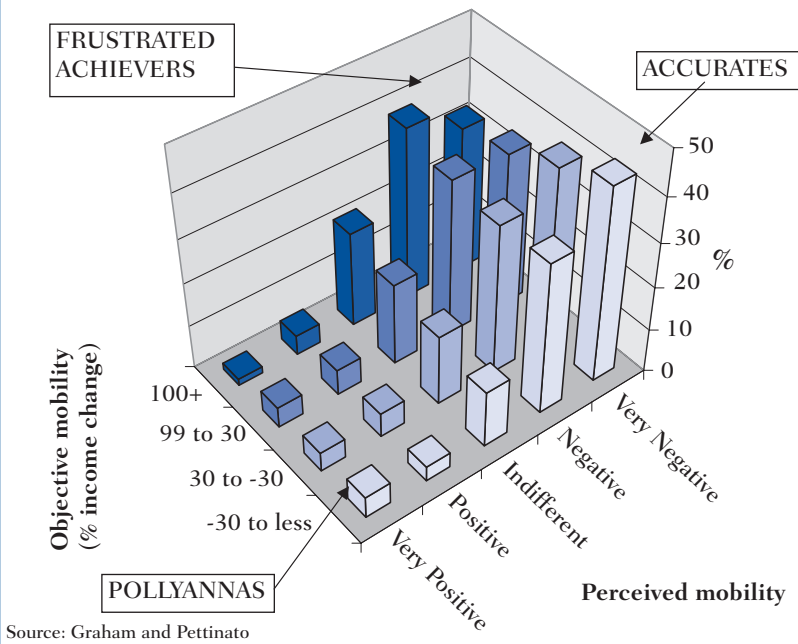
Given that these people participate economically and politically, their frustrations should give policymakers some cause for concern. We posit that the frustrations of achievers are driven by reference norms (which are clearly affected by top-driven inequality), and insecurity (such as fear of unemployment), as well as by differences in individuals' psychological make-up, which policy can do nothing about. Therefore, at least part of the solution lies in creating more widely shared opportunities for upward mobility, and part lies in reducing or managing macroeconomic volatility and reforming labor markets and social insurance systems.

### **Policies to Enhance Opportunity and Reduce Insecurity**

There are three sets of policies which could reduce insecurity and enhance the upward mobility of both the middle strata and the poor in the emerging market economies. The first

**Figure 2B**

**Perceived Mobility v. 1995–98 Income Mobility, Russia 1998**



Source: Graham and Pettinato

and most obvious way to enhance the mobility and opportunity of both poor and middle-income people is to improve access to better quality and higher levels of education (beyond secondary). While the long-term benefits of such a policy shift are evident, it will take a long time before it yields results, as well as sustained political commitment, institutional development, and substantial resources to implement and sustain it.

A more comprehensive social contract for the delivery of essential social services is fundamental to delivering better education. There is widespread debate about the merits of targeted versus more widely available social welfare

policies in the advanced economies, for example, with those in favor of the latter arguing that tightly targeted policies cannot sustain the political support necessary to preserve their public funding.

In the developing economies, the increased targeting of public social expenditures that accompanied the turn to the market in many countries has been very effective at reducing absolute poverty, particularly at times of fiscal austerity. At the same time, globalization-related shifts in the rewards to different education and skill cohorts, coupled with the shrinking size and scope of public services, has led to a perception and often a reality of increased insecurity for middle and lower income groups. At least some targeting is desirable in most contexts where public resources are limited. Policy must aim towards crafting a broader and more politically sustainable social contract that includes middle income groups as well as the poor.

In addition to supply-side policies, there must be an effort to address demand. A wide body of literature—including articles by Steven Durlauf of the University of Wisconsin and George Akerlof of UC Berkeley and Brookings—addresses the perpetuation of inequality by persistent social norms, identity, and low expectations. In some societies, where the poor lack a tradition of attaining higher education, there is a role for policies to educate and encourage low-income people to make new kinds of investments in their children's future. My earlier works suggests that the poorest are the least likely to participate in reforms such as vouchers in education and privatized social security due to transaction costs, the opportunity costs of their time, and low expectations.

The second set of policies must address existing distortions in markets and failures in government policies. Many countries in the developing world, particularly in Latin America, have made major strides in improving their macroeconomic frameworks. Yet, as in the case

of improving education systems, removing distortions alone is not enough. If, as in some countries, poorly performing public monopolies are merely replaced with private ones, the outcome is likely to be persistent or even increased inequality, and few, if any, new opportunities for the poor or near poor. Adequate regulatory policies, which level the economic playing field for all participants, are essential. The same policy package should also address the issue of inequality. The high costs of excessive concentration of income and assets for economic growth have been well-documented elsewhere. Our results suggest that high levels of inequality have additional costs in that they create an unachievable reference bar which frustrates even the most upwardly mobile individuals. These frustrations, in turn, may erode political support for the kinds of market-enhancing policies that deliver sustained growth and poverty reduction.

A third proposal that is essential to enhancing both opportunities and public perceptions of the existence of those opportunities is providing adequate safety nets, both for those who take risks to get ahead and run into trouble, and for those that fall behind because they are unable to take up new opportunities. The absence of adequate insurance mechanisms can result in market distortions, as those who are employed seek to minimize risk and guarantee employment security through whatever mechanisms are available, even though they may be extremely inefficient (such as excessively rigid labor laws). In addition, insecurity caused by weak insurance mechanisms in the face of volatility is certainly one of the factors that drives our achievers' frustrations.

Two kinds of safety nets are necessary. One is unemployment insurance, which allows workers to take risks by protecting them from unexpected income changes due to macroeconomic volatility and other exogenous shocks. The second safety net must address the needs of those who fall behind, either because of low skills or other barriers to their participation in the low-skilled sector of the economy. Past attention to this issue, such as my own earlier work, has focused on fiscal adjustments. More recently, Nora Lustig has emphasized the need for more permanent safety nets that can expand and contract as needed, and provide a buffer at times of cyclical fluctuations and/or during downturns. Finally, policymakers must explore new and better ways of managing macroeconomic volatility.

Our findings suggest that public opinion in the developing world about the market and global integration is surprisingly mixed. While the rhetoric of the protestors implies that globalization has been bad for the poor, the evidence suggests otherwise. Rather ironically, it is those in the middle strata, who in many countries had more secure positions prior to global integration, that are now very vulnerable and also the most negative in their assessments of their progress with the turn to the market.

The existence of such negative perceptions does not mean that a backlash against globalization is inevitable. At this juncture, the broader public in most emerging market countries seems to be aware that the alternative—self-imposed isolation—has high costs. Yet developing

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*This policy brief draws heavily on work with Nancy Birdsall and Stefano Pettinato. See "Stuck in the Tunnel: Has Globalization Muddled the Middle Class?" (Brookings Center on Social and Economic Dynamics Working Paper #14, Aug. 2000) and Happiness and Hardship: Opportunity and Insecurity in New Market Economies (Brookings, forthcoming).*

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policies to address the causes of these frustrations is essential—precisely so that they do not become the source of a backlash.

Reducing insecurity and addressing large differences in the distribution of the benefits of reform—thereby creating a more broadly held perception and a reality of equality of opportunity—could go a long way towards building a broader and more sustainable base of support for continuing market policies. At the same time, if poor people in poor countries perceive that the playing field is level and that opportunities exist, they will be much more likely to invest in their children's education and therefore their ability to take up those opportunities in the future.

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