

Globalization, the International Poverty Trap and Chronic Poverty in the Least Developed Countries

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¹ Senior Economic Affairs Officer, UNCTAD. This paper draws extensively on the evidence and argument of UNCTAD *The Least Developed Countries Report 2002: Escaping the Poverty Trap*, which can be downloaded from However, all the views expressed here do not necessarily correspond to those of UNCTAD.

1. Introduction

The argument of this paper is founded on an analytical perspective that can be summarized through three basic propositions. Firstly, the phenomenon of chronic poverty is best analysed through examination of the nature of poverty traps. A poverty trap is defined here as a situation in which poverty has effects which act as causes of poverty. There are thus vicious circles, processes of circular and cumulative causation, in which poverty outcomes reinforce themselves. Secondly, the causes of poverty can be identified at different levels of aggregation, running from the micro level (the characteristics of the household and community), up to the national level (characteristics of the country) and up to the global level (the nature of the international economy and the institutional structures which govern international relationships). As a corollary, it is possible to identify poverty traps at different levels of aggregation. Households can get stuck in a poverty trap; communities can get stuck in a poverty trap; countries can get stuck in a poverty trap. Thirdly, globalization, which is understood here as increasing interrelationships between countries, necessitates a shift in the framework for poverty analysis so that poverty at the household, community and national level is analysed in a global context. The co-existence of globalization with chronic poverty does not mean that the former is causing the latter. Rather, globalization implies that what is happening within countries is increasingly related to what is happening elsewhere. It is thus logically impossible to explain chronic poverty solely by reference to household characteristics, or by local and national factors alone. With globalization, the ways in which international relationships are implicated in the processes of circular causation that make poverty persist at the household, community and national level must be integrated into the analysis of chronic poverty.

The paper applies this perspective to analyze chronic poverty in the least developed countries (LDCs). It argues that \$1-a-day poverty is pervasive and persistent in most LDCs because they are caught in an international poverty trap. At the heart of this trap there are a various domestic vicious circles through which the high incidence and severity of poverty act as constraints on national economic growth, thus perpetuating all-pervasive poverty. The poverty trap can be described as international because an interrelated complex of trade and finance relationships is reinforcing the cycle of economic stagnation and generalized poverty within many LDCs, which is in turn reinforcing the negative complex of external relationships. The paper suggests that the current form of globalization is tightening rather than loosening this international poverty trap.

The argument of the paper can be situated within a larger literature on the nature of poverty traps. The idea that countries might be stuck in an underdevelopment trap was widely used by development economists in the 1950s (Nelson, 1956; Liebenstein, 1957). In the 1970s, more attention was given to the existence of poverty traps *within* countries, with the focus shifting to the question why poor people stay poor in countries which are experiencing sustained economic growth. But recently there has been a renewal of interest in the idea that poor countries can get stuck in a poverty trap. This has come from two sources: firstly, from analysis of convergence and divergence in global economy, where the concern has been to understand long-term growth failure in the poorest countries (see, for example, Ben-David, 1998; Mayer-Foulkes, 2001); and secondly from new growth theory, where theorists are increasingly interested in the existence of multiple equilibria (Azariadis and Drazen, 1990; Matsuyama, 1991; Ciccone and Masuyama, 1996; Graham and Temple, 2001). This new literature is extremely interesting, and is likely to be quite fruitful from a policy perspective in terms of the design of new development strategies for poverty reduction in poor countries (see Hoff, 2000;

Azariadis 2001). However, apart from discussion of debt traps (Sachs, 2001), there has not been much attention thus far to the way in which national and international relationships interact to leave poor countries stuck in a poverty trap. It is with this issue that the current paper is concerned.

It should be underlined that the paper does not address the issue of the ways in which international relationships influence why poor people stay poor within countries that are experiencing sustained economic growth. This is a different type of chronic poverty to that found in countries where poor people stay poor because of long-term growth failure. The former type of chronic poverty is not irrelevant to LDCs. But it only becomes important once a process of economic growth is started and sustained.

The rest of the paper is organized in five sections. Section 2 briefly describes poverty trends in the LDCs. Section 3 argues that these trends are the result of economic stagnation, by looking at growth trends in the LDCs and the nature of the long-term relationship between economic growth and extreme (\$1-a-day) poverty in lower income countries. Section 4 sets out elements of the international poverty trap, which is particularly relevant for commodity-exporting LDCs, and section 5 identifies ways in which the current form of globalization is likely to be tightening rather than loosening the international poverty trap. The conclusion draws out some general policy implications, though the treatment is brief as doing justice to the issues would deserve another paper.

2. Poverty in the LDCs

Absolute poverty is all-pervasive in most LDCs and particularly those in Africa. We have of course known this in general terms before. But data available for making international comparisons of poverty in the LDCs and estimating trends over time have hitherto been scanty. The following figures, drawn from UNCTAD's *Least Developed Countries Report 2002: Escaping the Poverty Trap*, are based on a new data set that use national accounts data on private consumption to estimate the incidence and depth of poverty for 39 LDCs.²

According to this data, in the second half of the 1990s, four out of five people in these countries were living on less than \$2 a day and half of the population live on less than \$1 a day (table 1). The number of people living on less than a dollar a day has more than doubled over the last 30 years, from 138 million in the second half of the 1960s to 307 million in the second half of the 1990.

Trends have been particularly bad in African LDCs, where we estimate the share of the population living on less than a dollar a day has risen from 56 per cent in the second half of the 1970s to 65 per cent in the second half of the 1990s. The average daily consumption of the extremely poor fell from 66 cents to 59 cents over the same period.

We also find that amongst the LDCs, the share of the population living in extreme poverty is highest in those that depend on primary commodity exports for their economic survival and development. Poverty rates are increasing in these countries. The percentage of people living on less than \$1 a day in non-oil commodity-exporting LDCs has risen from 63 per cent in 1981-83 to 69 per cent in

² For discussion of the methodology of poverty measurement, see UNCTAD (2002), Annex to chapter one.

1997-1999. Poverty rates are rising particularly in mineral-dependent economies (chart 1).

3. The Importance of Economic Growth for Poverty Reduction

Poverty is all pervasive and increasing in many LDCs, particularly in Africa and particularly in commodity-dependent economies, because they are failing to share in global economic growth. A few of the LDCs, such as Bangladesh, have managed to sustain economic growth. But most have been characterized by economic stagnation, or economic regression, or short growth spurts followed by an economic collapse of some sort, which may be triggered by a natural disaster or some kind of external shock.

The long-term growth failure is particularly marked in commodity dependent LDCs. In the non-oil commodity exporters, average real per capita income was lower in 1999 than in 1970. Over the same period, average real per capita income doubled in the world's 20 richest countries (table 2). Weighted by population and expressed in constant PPP dollars, the income per capita of the 20 richest countries was 16 times greater than that of the non-oil commodity-exporting LDCs in 1960. In 1999 it was 35 times greater (chart 2). Much less divergence can be observed between the richest countries and LDCs that have diversified into manufactures and/or services. Again weighted by population and expressed in constant PPP dollars, the average per capita income of the richest 20 countries was 8 times that of the latter group of LDCs in 1960 and 12 times greater in 1999. During the 1990s there was actually slow convergence between the weighted average income per capita in the richest countries and in the manufactures and/or services exporting LDCs, although this result is influenced particularly by the economic performance of Bangladesh.

The assertion that chronic poverty in many LDCs is due to their economic stagnation implies that poverty reduction will occur through economic growth. This remains a controversial issue in debates on the causes of poverty. But there is good reason to believe that in countries where the majority of the population live at or around basic subsistence levels of consumption, the poverty-reducing effects of economic growth are potentially very high.

The basis of this assertion is the specification of poverty curves that define the way in which \$1-a-day and \$2-a-day poverty rates normally falls as the average level of private consumption per capita rises in a country (chart 3).³ These poverty curves are *like a ski-slope* - gentle at the top, steep in the middle, and gentle again at the bottom. The \$1-a-day poverty curve is steeper than the \$2-a-day poverty curve, which means that a given amount of consumption growth will reduce the \$1-a-day poverty rate faster. Also many LDCs where \$1-a-day poverty is most pervasive are perched at the top of steep part of the slope. If average private consumption per capita doubles from \$400 to \$800 a year, the proportion of the population living on less than a dollar a day is expected to fall from around 65 per cent to less than 20 per cent.

³ The term "poverty curve" is not in general use in national and international analysis of poverty at the moment. However, Anderson (1964) uses it to refer to the curve defining the proportion of families in the United States with incomes below \$3000 as a function of the log of median income for the period 1947-60.

The \$1-a-day and \$2-a-day poverty curves shown in Chart 3 are based on 32 countries in African and Asia and include observations over three decades.⁴ They are constructed within the same tradition as economic work to identify long-run patterns of development (Chenery and Syrquin, 1975; Syrquin and Chenery, 1983). It is worth underlining that this approach to specifying the growth-poverty relationship is quite different to the approach of recent work, including the much-cited Dollar and Kray (2001) paper that proclaims that “growth is good for the poor”. In this recent work, the focus has been on the relationship between economic growth and selected indicators of poverty in “spells” defined by the periods of time spanning two successive household surveys in a given country. Such work generally examines the short-term relationship between growth and poverty, rather than the long-term relationship that is the focus of attention in the specification of poverty curves. These different foci can give different results (see Ahluwalia, 1976).

The \$1-a-day and \$2-a-day poverty curves are analogous to the famous inverted-U-shaped curve of Simon Kuznets that suggests that income inequality will increase in the early stages of development and then decrease. But instead of specifying the inequality-development relationship they show the poverty-development relationship. In my view, the discovery of the form of these poverty curves is potentially as important for the design of anti-poverty strategy as the Kuznets’ curve was for policy discussions of the relationship between economic growth and distribution.⁵

The poverty curves show that in spite of the increasing inequality which normally occurs in the early stages of development, \$1-a-day and \$2-a-day poverty rates will normally decline rapidly if average private consumption per capita rises. The strength of the relationship between average private consumption per capita and the incidence of poverty at low levels of development is apparent in the closeness of the scatter of observations around the poverty curve. In middle-income countries, even using higher poverty lines, the relationship is much more blurred. But the nature of the \$1-a-day and \$2-a-day poverty curves suggests two important qualifications to the relationship between economic growth and poverty even at low levels of development.

Firstly, once a country gets to the bottom of ski slope, further reductions in poverty must come more from specially measures targeted at the poor rather than economic growth. Ethiopia, for example, is at the top of the slope for \$1-a-day poverty, and economic growth is vital for poverty reduction. Bangladesh, for example, is at the bottom of the slope with regard to \$1-a-day poverty, and thus special programmes have become important. But economic growth remains a potent mechanism for reducing \$2-a-day poverty in Bangladesh because it is still in the steep part of the slope.

Secondly, it is also necessary to have a type of economic growth that raises average household incomes and household consumption. Increases in overall GDP per capita will not necessarily do the trick. As chart 4 shows, although average private consumption per capita generally increases as GNP per capita rises, there are variations around the normal trend. As a consequence, the relationship between increases in GNP per capita and poverty reduction is less close than the relationship

⁴ The sample includes countries for which data was available to and covers low and lower-middle-income countries with per capita private consumption levels below \$2400 a year (in 1985 PPP dollars). This is the upper limit at which it is possible to make estimates of poverty for the \$2 a day poverty line.

⁵ The discovery of the form of these curves should be attributed to the work of Massoud Karshenas – see Karshenas (2001).

between increases in private consumption per capita and poverty reduction. When one examines the relationship between increases in average GDP per capita (rather than average private consumption per capita) and poverty reduction, the growth-poverty relationship will become even more blurred. It is possible, for example, to imagine economies in which the bulk of GDP is produced in foreign-owned mining enclaves whose growth can have little effect on the population's average level of private consumption, and hence little effect on poverty.

There is also a third qualification which must be stressed. The poverty-curves do not mean inequality and social exclusion do not matter. Efficiency-enhancing redistributions of assets and income may be important for growth. There is also a high probability that as growth occurs certain regions and social groups will be left behind. This will be lessened if there is no discrimination on the basis of gender, ethnicity, etc which prevent people enjoying the benefits of assets and skills, or denies them the opportunity to acquire assets and skills.

4. The International Poverty Trap

The poverty curves indicate that the opportunity for rapid reduction in extreme poverty through a form of economic growth that raises average household incomes is large in LDCs. They reinforce the view that chronic poverty in the LDCs is due to their economic stagnation, which in a global context is expressed in their failure to share in global economic growth. Chronic poverty in these countries is thus linked with changes in the pattern of international income inequality.⁶

Some would argue that the failure to share in global growth is their own fault, and they highlight particularly the effects of poor governance and corruption. These factors cannot be ignored. But a more complete view of the problem suggests that many LDCs, particularly commodity-exporting LDCs, are stuck in an international poverty trap.

The trap stems from the fact that not only does economic growth affect the incidence of poverty, but where the majority of the population are very poor the incidence of poverty also affects economic growth. In fact, in societies where the majority of the population live at or below income levels sufficient to meet their basic needs, and the available resources even where equally distributed, are barely sufficient to meet the basic needs of the population, this all-pervasive poverty itself acts as a major constraint on economic growth.

A major mechanism through which this occurs is the negative feedback effects of generalized poverty on domestic resources available to finance investment and public goods, including governance.

Where the majority of the population earn less than \$1 or \$2 a day, a major part of GDP must be devoted to the procurement of the necessities of life. There are few domestic resources available for investment and funding vital public services including education, health, administration and law and order. Low income leads to low savings; low savings led to low investment; low investment leads to low productivity and low incomes. A telling fact in this regard is that during the period 1995–1999, the average per capita income in the LDCs when measured in terms of current prices and official exchange rates (rather than 1985 PPP dollars) was \$0.72 a day and the average per capita consumption was \$0.57 a day. This implies that on

⁶ The flip-side of “growth is good for the poor” is that national poverty trends are linked to changes in international income distribution.

average, there was only \$0.15 a day per person to spend on private capital formation, public investment in infrastructure and the running of vital public services, including health, education, administration and law and order.

Pervasive poverty leads to environmental degradation as people have to eat into the environmental capital stock simply to survive, but this in turn undermines the productivity of key assets on which livelihood depends. UNCTAD's *Least Developed Countries Report 2002* shows that the average rate of forest depletion (measured as a percentage of GDP) experienced a sharp increase in the LDCs during the 1980s and 1990s. In the late 1990s, it was equivalent to more than 2 per cent of LDC's GDP, which was over three times the rate of deforestation in other developing countries. The link between the severity of poverty and environmental degradation is particularly apparent in data which estimates "genuine" domestic savings (these estimates subtract from domestic savings the reduction in national wealth associated with the depletion of environmental resources and the depreciation of man-made capital stock). Average genuine domestic savings are negative in the LDCs with the highest incidence of poverty.

State capacities are necessarily weak where extreme poverty is all-pervasive. In terms of GDP share, government revenue and government final consumption expenditure (all government current expenditures for purchases of goods and services including compensation of employees) do not appear to be significantly different from what they are in other developing countries. But when translated into real per capita terms, available resources are extremely limited. Government final consumption expenditure was on average about \$37 per person per year over the period 1995-1999 in the LDCs with the highest incidence of poverty, and average health expenditure in these countries was about \$14 per person per year. This compares with government final consumption expenditure of \$160 per person per year in a sample of other developing countries, and health expenditure of \$84 per person per year. The low rate of per capita expenditure on essential public services such as health and education in the LDCs does not result from different expenditure priorities, but it is rather essentially due to the extremely low overall resource availability in situations of all-pervasive poverty.

The poverty trap can be described as international because international trade and finance relations are reinforcing the cycle of economic stagnation and pervasive within the LDCs. This is particularly apparent in those highly dependent on primary commodities (chart 5).

In these countries, the ability of international trade to act as an engine of growth and poverty reduction is being short-circuited by falling world commodity prices. At the end of 2001, real non-fuel commodity prices had plunged to one half of their annual average for the period 1979-1981. Large increases in export volume are not translating into large increases in export revenue and the capacity to buy imports. Associated with slow export growth, and also with large external shocks due to commodity price instability, there has been a build-up of unsustainable external debt in the non-oil commodity exporters. Finally, as debts -- which are mainly owed to official creditors -- build up, aid disbursements have increasingly been allocated, either implicitly or explicitly, to ensure that official debts are serviced. In this aid/debt service system, the developmental impact of aid has been undermined as the "debt-tail" has been wagging the "aid-dog".

5. Globalization and the International Poverty Trap

I would like to re-iterate here that in saying that there is an international poverty trap this does not necessarily mean that globalization is causing chronic poverty. Globalization, however, necessitates a shift in perspective so that the ways in which international relationships are implicated in poverty processes becomes an integral part of the analysis. Moreover, in putting chronic poverty into a global context it also becomes necessary to understand how the current form of globalization is affecting these international relationships.

This is quite a complex issue. But there are good reasons to believe that, although international economic relationships can play a key role in helping LDCs to break out of economic stagnation and generalized poverty within which they are caught, the current form of globalization is actually tightening rather than loosening the international poverty trap. The reason is that most LDCs are being bypassed by potentially beneficial aspects of globalisation of production systems, finance and markets, whilst being exposed to certain negative aspects.

In terms of access to foreign savings, a positive trend is that private capital flows to LDCs have been increasing in 1990s. But the increase has been much slower than the decrease in official capital flows. Thus LDC access to foreign savings decreased in the 1990s. Real long-term capital flows per capita declined by 21 per cent between 1990 and 2000.

In terms of access to foreign technology, another positive sign is that FDI inflows into LDCs are increasing. But in 2000 they received just 2.1 per cent of net FDI inflows to developing countries, and 0.5 per cent of global FDI flows. Also 86 per cent of FDI inflows to the LDCs were concentrated in 10 countries, with the four oil-exporting LDCs absorbing about 50 per cent. Imports of machinery and equipment are another potential channel of technology transfer, but such imports constitute just 1.2 per cent of GDP in 1996-98 compared with 3.8 per cent in other developing countries.

In terms of access to foreign markets, it is difficult for LDCs to benefit from the opening of other markets as production and supply capabilities are weak. The share of non-oil commodity exporting LDCs in world exports of goods and services fell by 60 per cent between 1980 and 1999 (chart 6).

Whilst many of the LDCs are not benefiting from these potential positive effects of globalisation, they are experiencing some negative effects. In this regard, two points are worth highlighting.

Firstly, recent changes in the structure of global commodity markets are reinforcing the cycle of economic stagnation and pervasive poverty. This is because they are leading to higher marketing margins between producers and consumers and greater commodity price instability. They are also increasing the probability of LDC commodity producers being excluded from global markets. The latter process occurs as buyers within commodity chains upgrade their volume, reliability and quality criteria for purchasing, and as more stringent requirements call for ever-larger investments to meet buyers' quality requirements and specifications.

Secondly, the inability of the more advanced developing countries to move up the ladder of development is also a key feature of the recent period of globalisation. This is contributing to the saturation of commodity markets and increasing the vulnerability of those LDCs that have sought to escape the poverty trap by

diversification out of commodities. It is difficult for LDCs to move up the ladder of development if the more advanced developing countries face a glass ceiling that blocks their development. The socioeconomic marginalization of the LDCs and the polarization of the world economy (in the sense of the weakness of the “middle class” of world States) are interrelated.

6. Conclusion

The central policy problem for the LDCs is how to break the cycle of pervasive poverty and economic stagnation and to realize the great opportunity for fast poverty reduction that can occur through sustained economic growth. A positive feature of the current situation is that, although the identification of the elements of the trap varies, there is a wide consensus that the poorest countries are caught in a poverty trap (see IMF, 2000; OECD/World Bank 2001; UN 2000). Indeed the IMF has gone as far as to describe “the persistent failure to break the cycle of stagnation and poverty in the poorest countries” as “perhaps the most striking exception to the otherwise remarkable economic achievements of the twentieth century” (IMF, 2000, p.36). The recognition of the long-term growth failure in the poorest countries has led to the adoption of a new approach to international development cooperation, which centres on PRSPs. But unfortunately it is becoming clear that the national and international policies associated with the new approach have not changed sufficiently to enable countries to escape the trap and realize the opportunity for fast poverty reduction through economic growth.

The critical issue of the moment is thus how to implement the principles of the new approach in a way that will achieve the agreed poverty reduction goals. This requires much more far-reaching policy changes at both national and international levels.

At the national level, there is a need to shift from adjustment-oriented to development-oriented poverty reduction strategies. Such strategies should seek to *double average household incomes* as quickly as is feasible. Past experience shows that this requires expansion of employment opportunities and rising output per worker. This can be achieved through more growth-oriented macro-economic policies, sectorally-focussed productive development strategies, and an export-push strategy (chart 7). Targeting the bottom 20 per cent should not be a priority of poverty reduction strategies in very poor countries, though policies are required to prevent marginalization once growth occurs, and inequality in access to assets and in their productivity is likely to be a key issue in promoting overall economic growth.

At the international level, renewed attention has to be given to relaxing the severe financial constraints that hamper development. This necessarily entails renewed debt relief which goes beyond the enhanced HIPC Initiative with top-ups, increased aid, better technical cooperation and financial assistance to re-build State capacities, revision of policy conditionality to enable genuine domestic autonomy, and attention to donor aid practices, particularly predictability and stability of aid flows, and donor coordination and alignment behind national strategies.

Finally, it is necessary to fill the two missing links in the current international approach to poverty reduction. The first is the absence of any kind of international commodity policy. There is an urgent need now to reconsider how such a policy could be re-formulated with a view to supporting poverty reduction. This does not mean a return to the old-style international commodity agreements. They did not succeed and there is little political will to return to them. Rather what is required is a pragmatic approach involving national and international efforts. This could include:

- A compensatory financing facility to offset the effects of commodity price shocks
- Exploring institutional innovations which can enable the adoption of commodity risk management instruments in poor countries
- International efforts such as the transparency initiative (“publish what you pay”) to ensure oil and natural resource companies declare what they are giving to Governments
- Linking debt repayment schedules to world commodity prices
- Speedy reduction of agricultural subsidies in the rich countries which are particularly influencing extreme poverty in the poor countries

Dealing with low commodity prices will also necessarily entail efforts to rationalize supply in saturated international commodity markets. Measures which may be explored include agreements on minimum quality standards and increased technical and financial support for horizontal and vertical diversification. The Integrated Framework of Trade-Related Technical Assistance could play an important role in the last task. Also market access issues that block diversification, including low rates of utilization of trade preferences, must be addressed.

The other missing link is the need to think about the problems and prospects of the poorest countries not simply directly but also in terms of the progress in the more advanced developing countries and their relationship with the poorest countries. One key to economic growth and poverty reduction in the poorest countries is economic growth and sustained industrialization in the more advanced developing countries. The simple reason, as argued above, is that it will be difficult for the poorest countries to get on and move up the ladder of development if the more advanced developing countries face a “glass ceiling” that blocks their development.

Under current international policy arrangements, affirmative action measures are being targeted at the poorest countries, particularly at the LDCs. But these are being undermined by a playing field for all the other countries which, although supposedly level, is actually tilted against developing countries. This is tending to make it difficult for the more advanced developing countries to deepen industrialization and move up the technological ladder and graduate out of simpler products being exported by poorer countries. It is also tending to make the relationship between the LDCs and more advanced developing countries competitive rather than complementary.

The policy challenge is to structure the relationships of both more and less advanced developing countries *with* developed countries in a way that enables the progress of both groups of developing countries and also the emergence of complementary synergies *between* the more *and* less advanced ones. The \$1-a-day poverty problem that is the target of the MDGs is not so acute in the more advanced developing countries (the relevant minimum standards are rather \$2-a-day, \$3-a-day or \$4-a-day). But in the end the eradication of extreme poverty in low-income countries will require not only differentiated treatment for them, but also international measures to reduce the polarization in the global economy.

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