Gains and Risks of Financial and Economic Globalization for Developing Countries, Particularly on a Unique Poor Country as a Case Study

Naji Maseeho Odel
Soran University- Soran-Erbil
Kurdistan Region of Iraq

Abstract

The aim of this paper is to examine and assess the importance of globalization impact on poverty reduction. This paper will further look at the possible incentives and drawbacks of economic globalization on poor countries.
As the global economy has significantly intensified since 1990s, a question has raised that how globalization could affect different aspects of developing countries and specific on poor societies the first wave of globalization ended in twentieth century and afterward the second wave started more powerfully. Economic or financial globalization is a complex and broad issue which similar to any other phenomena in the world has both positive and negative effects. Over the recent decades, countries across the world have become more financially integrated as a result of potential gains of financial globalization. The potential benefits of financial globalization are much more than its risks.regarding the benefits of financial globalization which has been reviewed in this report, it is highly recommend that as a poor country should in any way possible try to engage with globalisation given that the benefits of such engagement is far greater than the risk. The main gain of this engagement is that it would also help toward poverty reduction.

Keywords: Globalization, financial globalization, economic globalization, liberalization

1. Introduction

The aim of this paper is to examine and assess the importance of globalization impact on poverty reduction. This paper will further look at the possible incentives and drawbacks of economic globalization on poor countries.
In this report, using the results and recommendations of preceding studies, the incentives and gains of financial and economic globalization will be reviewed and analysed. Furthermore, the pains and risks of this phenomenon especially for developing countries will be reported. Finally, will receive the answer of this question: whether the poor countries should indeed engage with globalization or not?

As the global economy has significantly intensified since 1990s, a question has raised that how globalization could affect different aspects of developing countries and specific on poor societies (Nissanke, 2011). A report of World Bank (2002) considers "Integration" as an equal for "Globalization" and defines "Globalization" as integration of various societies and economies over the world (World Bank Research Report, 2002). This is also widely believed that Globalization and Development are strongly related. Development causes change as from an economic angle it enhances the economic situation from a lower stage to a higher stage (Hameed and Nazir, 2009).

Historically, globalization could be traced back to the time when Asia, Africa, and America were colonized by the European economic (Guttal, 2007). The first wave of globalization ended in twentieth century and afterward the second wave started more powerfully (Yusuf, 2001). So, globalization is a recent phenomenon which at last comes back to less than three decades ago. Although many groups of political and economic organizations have investigated this issue and conducted some research on, there are lots of debates about this issue and its related phenomena (Santarelli and Figini, 2004; Guttal, 2007).This new phenomenon has powerfully influenced different parts of societies especially financial and economic aspects (Stukalo, 2006). Economic or financial globalization is a complex and broad issue which similar to any other phenomena in the world has both positive and negative effects. Nowadays, taking some actions toward globalization is strongly suggesting by different economic authorities like The World Bank to low income and poor countries to reduce their poverty and strength their economic power.

2. Literature review

Globalization and growth gather many different phenomena together and there is an association between growth particularly economic growth and poverty reduction. The results of some case studies in some globalized countries such as China and India report a positive association between growth and poverty reduction. Deaton (2001) reports a reduction in poverty in India from the years 1987-1988 to the years 1999-2000 as a result of economic growth. Park and Wang (2001) also report a significant fall in poverty from 31% in 1979 to 10% in 1990 in rural areas in China. In theory, the globalization-growth and poverty reduction is widely accepted and many studies emphasize on the positive effect of globalization on poverty reduction over a country in general (Srinivasan and Wallack, 2004; Weede, 2008) and in rural areas in particular (Nissanke, 2011). Bhalla (2002, p.170) warns about the poverty increasing situation in Africa and forecasts a 54% increase in poverty in this continent until 2015. As he believes, this country has not been affected by positive wave of globalization.

As mentioned before, globalization and development are on the same track. Development aims to decrease the rate of poverty, inequality and unemployment (Hameed and Nazir, 2009). So, they could be presumed as the goals of globalization as well. The other developments of financial globalization for developing countries are the increase in capital flows and "the internationalization of financial services" (Schmukler, 2008). According to Schmukler (2003, p. 31) the development of financial sector in developing countries which leads to more comprehensive, deeper, more organized and stable financial markets could be of benefit to financial globalization and as Levin (2001) observes, a stable and well-functioned financial system is a key to economic growth. Furthermore, Schmukler (2008) continues that the potential advantages of financial globalization will lead to "a more financially interconnected world" and higher rate of integration with international financial markets in developing countries (Schmukler, 2008).

On the other hand, financial liberalization is one of the main results of financial globalization. As Schmukler (2003) declares financial system of developing countries can significantly benefit from financial liberalization. When liberalization appears in a society, it enhances the economic opportunities, declines the cost of capital, and extends investment (Schmukler, 2008).

Trade promotion is another main result of financial globalization which has a positive impact on the share of exports through a country.As reported by IDRC (2010) rising exports will increase productivity and introduce new firms to the society which can then create new jobs. Furthermore, financial globalization and liberalization create trade links between countries through the process of internationalizationand as mentioned byEichengreen et al. (1996), Glick and Rose (1999), and Forbes (2000) trade links are really important to the markets in developing countries.A widely held belief in economics is that a liberal international trade breeds development (Dollar and Kraay, 2001). An evidence of recent globalizers in the world like China, India, and some other globalized countries shows that trade openness has caused a fast-growing economy in these countries. Many studies have confirmed the fact that trade openness contributes to a fast growth (Dollar, 1992; Edwards, 1992; Sachs and Warner, 1995).An upsurge in trade volume in these globalizing countries has been seen over the past two decades (Dollar and Kraay, 2001). Trade openness expands exporting through countries. Indeed, as reported in an IMF working paper by Jaumotte, Lall, and Papageorgiou (2008) an increase in export-to-GDP ratio is a positive effect of financial globalization on financial systems.

All in all, economic globalization breeds trade liberalization and trade liberalization increases trade flows and all result in economic growth which will decrease poverty across less developed countries (UNDP, 2007).Weede (2008) mentions that globalization widens the size of the market which results in higher productivity. He continues that globalization leads to an equalization of income between individuals and as Goklany (2007) states, equal income distribution has many positive effects on less developed societies as it increases life expectancy, maximizes healthier lifestyles, and decreases childlabour.

Although financial globalization has many benefits, it also carries some risks. The potential risk of financial globalization reported by preceding studies is at the beginning when the country starts opening up (Schmukler, 2008). One well-known drawback of globalization isthat it can be pertinent to financial crises. When a country steps toward globalization, it should liberalize its financial system and a liberalized system is subject to both domestic and foreign investors. So, such an open financial market may cause financial crises (Schmukler).

But fortunately, these types of crises rarely happen and usually those countries with a sick financial system will get involved. If the government could strongly monitor its financial system, it does not need to be worry about the financial crises.

Some studies imply financial inequality to be a disadvantage of globalization. Wei (2002) implies the impacts of globalization in China and declares that over the recent years due to economic openness in Chinese markets, the rate of income inequality has dramatically climbed.Dollar and Kraay (2001) emphasize on the impact of globalization on inequality and mentions that globalization causes divergence between rich and poor nations. Jaumotte, Lall, and Papageorgiou (2008) through an IMF working paper, discuss about the negative effect of financial globalization on equally distributing of income across countries. However, they conclude that some aspects of globalization can positively affect inequality i.e. the increasing of the exports across countries which is a result of trade openness.

On comparison between urban and rural regions, the World Bank (1997) has estimated that 75% of the overall inequality is seen between these two regions in the period 1984–95. The same result was reported by Lin, Zhuang, Yarcia and Lin (2008) for the period 1985-2004 for China. Then the highest rate of inequality was seen in rural counties. Figure 2 is clearly visualizing this difference.

3. Discussion

3.1 The benefits of financial globalization/ financial globalization and economic growth, development and poverty reduction

As mentioned the financial globalization and economic growth, development and poverty reduction are the most benefits from the globalization on the developing countries. The result shows that application of these benefits for developing countries is as follows:

1. The main advantage of financial globalization for developing countries would be a significant reduction in poverty and as a result reduction in unemployment and an increase in income.
2. As Dollar and kraay (2001) claimed financial globalization leads to an increase in the growth rate of per capita GDP and as the rate of per capita GDP is so low in developing countries, involving financial system of this country with globalization could significantly benefit it.
3. Having high rate of population in some poor countries is one of the main issues on the way of development. Nissanke (2011) warns about the poverty explosion in rural areas of sub-Saharan Africa; he recommended engaging in economic globalization for these areas to overcome the high rate of poverty. Farrington and Mitchell (2006) also strongly emphasized on the significance of globalization on reducing poverty in rural areas over the world. So, if the government of those countries that has a high rate of population accepts engaging with globalization, the rural areas which constitute the main part of the country will benefit in terms ofreducing the poverty.

3.2. Financial globalization and liberalization, trade and export growth

Applying the Financial globalization and liberalization, trade and export growthadvantages for poor countries recommend that:

1. As mentioned, financial globalization leads to trade openness and liberalization which this openness benefits financial system of a country significantly and promotes trade widely. The main advantage of trade promotion and openness is the increase in export rate which it will also cause an increase in export-to-GDP ratio. So, if the government tries to involve in globalization process, using the advantages of trade liberalization and also trade internationalization, they can expand their export services and cooperate with many nations all around the world. Furthermore, cooperating with the countries of the world which is one of the results of internationalization will be really helpful for the country.
2. Although IDRC's report (2010) notifies that not all types of exporting leads to foundation of new careers and jobs, good exporting goods like oil and efficient strategies will highly promote trade.
3. Financial globalization will improve financial system in these countries and organize it to a high level and as clear, an organized financial market will benefit the economic situation of the country significantly.

Dollar and Kraay (2001) claim that the growth rate of income of the poor is closely related to the growth rate of per capita GDP. According to data samples they gathered for their study, the percentage per Capita GDP in globalizing countries has increased from 1980s to 1990s while it is a small rate for non-globalizing countries (See Figure 1).

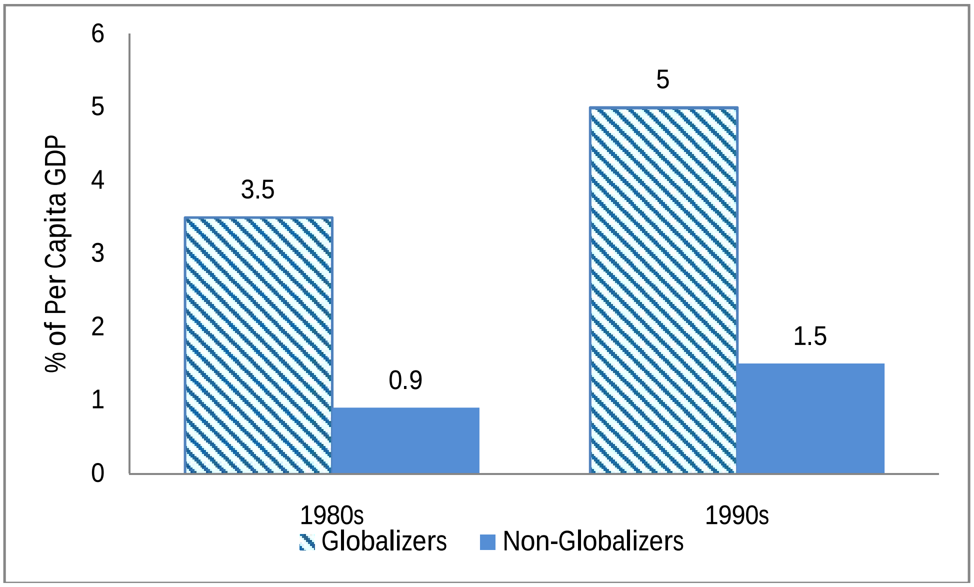

Figure 1: Per Capita GDP Growth across globalizing and non-globalizing countries through two decades (The data for this curve was extracted from Dollar and Kraay (2001))

3.3. The risks of financial globalization: Financial globalization and financial crises

As mentioned before, although financial globalization has many benefits, it also carries some risks. Furthermore some studies imply financial inequality to be a disadvantage of globalization.So, applying these risks to developing countries suggest that:

The only debate that remains is about the rural areas in these countries and that is the possibility of higher rate of inequality in these areas rather than urban areas. As found by Lin, Zhuang, Yarcia and Lin (2008) the rate of inequality is going to be higher in rural areas. However as Jaumotte, Lall, and Papageorgiou (2008) claimed the increasing rate of exports across countries which is a result of trade openness can positively affect inequality. So, if government could reach a high level of exporting, the negative effect of inequality will reduce.

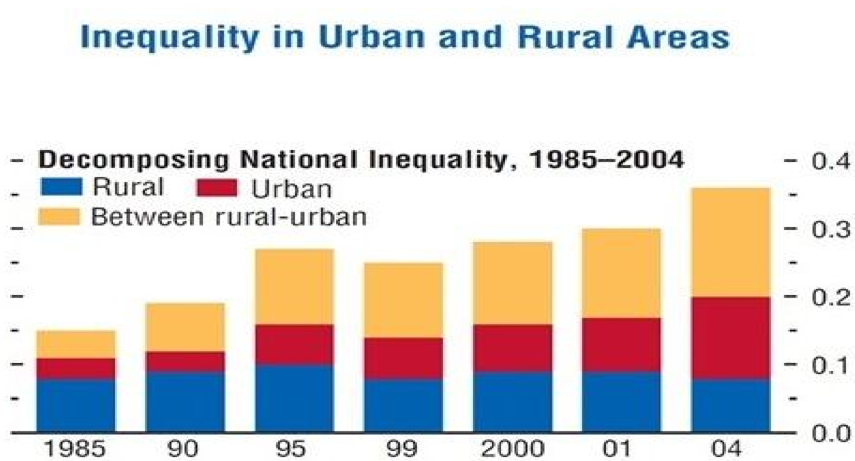

Figure 2: Rate of inequality in Urban and Rural areas in China (Source: Lin, Zhuang, Yarcia and Lin, 2008)

4. Conclusion and recommendations

Over the recent decades, countries across the world have become more financially integrated as a result of potential gains of financial globalization. The potential benefits of financial globalization are much more than its risks. As reported, many researchers and theorists working on financial globalization have got a widely-held belief that this issue positively affects different aspects of poor societies particularly their financial systems and services. Developing countries are economically considered a poor country which after all mentioned potential benefits financial globalization could bring for this country, the results of this paper strongly believes that the developing countries and particular a poor country can largely benefits from globalization. So, considering the problems that government faces and also regarding the benefits of financial globalization which has been reviewed in this report, it is highly recommend that as a poor country should in any way possible try to engage with globalisation given that the benefits of such engagement is far greater than the risk. The main gain of this engagement is that it would also help toward poverty reduction.

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