The Winners and Losers of Globalization
全球化下的贏家與輸家

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Introduction

- Economic theory tells us that whenever a new economy joins the world economy, aggregate economic welfare of the world should increase. Moreover, the aggregate economic welfare of each country should also increase.
- The basic idea is a simple one: international trade is voluntary. If there are no gains to any one of the trading partner countries, there will be no trade. In any trade, both partner countries must gain. And the gains are sufficient to compensate the potential losers in each trading partner country.
- When a new economy joins, international trade can only increase, and not decrease.
- However, the introduction of new international trade transactions will necessitate adjustments in each of the trading partner countries, as some industries will expand while other industries will contract, in each of them.

The Meaning of Economic Globalization

- The growth of international trade and investment
- Economic globalization is not new—The Silk Road, the East India Company, the China Clippers
- The World is Flat (Thomas Friedman)—globalization now reaches every corner of the Earth
- The benefits and costs of globalization

The Growth of International Trade

- The growth of international trade
  - Economic communities, unions and free trade areas and agreements
  - Global supply chains—international division and sub-division of labor
  - The entry of new players (China, India, Russia, Eastern Europe and countries from the former Soviet Union)
  - The consolidation of dispersed production at a single location, e.g, within the European Union (but the need for diversification of supply through dual or multiple sourcing)
- The growth of international capital flows (direct and portfolio investment and hot money)
- The globalization of markets for goods, services and factors (capital—tangible and intangible--and skilled labor)

The Growth in International Trade and Investment

- The volume of world trade had been growing at double-digit annual rates until 2008, which was between 3 and 4 times higher than the average annual rate of growth of world GDP, estimated at between 3 and 4 percent. (It is important to distinguish between gross output and value-added. The gross value of exports is frequently much higher than the value-added in the exporting country.)
- World direct investment has also grown significantly. Annual global direct investment may be estimated at approximately US$400 billion prior to the current global financial crisis.

The Causes of Growth in World Trade and Capital Flows

- The falling costs of transportation and communication—resulting from the declines in the costs of information technology and real telecommunication costs and shipping costs, coupled with the logistics technology revolution, and facilitated by the worldwide use of English as the medium of business communication.
- The reduction of tariffs and other barriers to international trade in goods and services and to international capital movements through the agreements on World Trade Organization (WTO) and various free trade areas (FTAs).
- De-verticalization or fragmentation of production—finer and finer intra-firm as well as inter-firm division and sub-division of labor around the world, through out-sourcing and specialization by enterprises in niches of core competence—internationalization of supply chains. A product may have gone through several different countries from start to finish.

The Causes of Growth in World Trade and Capital Flows

- The emergence of the Chinese economy on the global market—as both a supplier of exports and demander of imports—was the one important new development during the past quarter of a century. The entry of other new players—Brazil, India, Russia, Eastern Europe, also increased significantly the value and volume of world trade.
- There has also been rapidly rising volume of trade in services such as tourism, financial services and professional services as well as previously non-tradable services (software-outsourcing, data processing, call centers, back offices).
- Tourism is one of the few non-tradable services left because it is location-specific.

The Implications of Economic Globalization

- Major re-alignment of comparative advantages
  - Both existing and new players can benefit
  - Comparative advantages will change, for example, a lower-cost producer of shoes may emerge
  - Adjustments will be necessary
  - There should be sufficient gain for everyone to more than compensate all the losers
- Intensification of global competition

International Trade Permits Economies of Scale and Specialization to be Realized

- International trade enlarges the market and permits greater specialization and the exploitation and realization of economies of scale and learning-by-doing by the individual enterprises. And with the growth of markets, their integration as well as segmentation become possible.
- A rise in the rate of return to intangible capital (investment in innovation, R&D capital, intellectual property and brand names) as the size of market expands
- International trade also facilitates the exchange and transfer of new concepts, ideas, business models, methods and technology.

The Complementarity of De-Verticalization and Globalization

- Specialization in tasks rather than products by firms—finding a niche in the global supply chain that maximizes value-added based on "core competence"; higher-value-added parts of the supply chain have much less competition (Intel, Microsoft, TSMC)
- Specialization in tasks enables the realization of economies of scale and learning by doing effects—It is more efficient for firms to expand horizontally (to supply multiple customers around the globe) rather than to integrate vertically

Globalization: Growth of Foreign Direct Investment

- Falling barriers to as well as incentives for foreign direct investment. National treatment for foreign direct investment is becoming increasing standard under the World Trade Organization (WTO) and similar agreements.
- Foreign direct investments (FDI) often follow trade—e.g., to secure long-term supply of raw materials and natural resources; and trade often follows foreign direct investments—e.g., production by captive subsidiaries. A large proportion of world trade consists of intra-industry and intra-firm trade.
- Foreign direct investments are also motivated by the desire to provide cross-border services, e.g. AIG, McDonald.

Globalization: Foreign Direct Investment Leverages Intangible Capital

- FDI (and exports) permit the leveraging of intangible capital (patents, technology, knowhow, goodwill, brand name, reputation, business methods) over a much larger market. Intangible capital has several characteristics:
  - It is much more industry-specific than location-specific. It is much easier for an existing firm to enter the same industry in a different geographical market than to enter a different industry in the same geographical market.
  - The creation of intangible capital (e.g., a patented product or process) often requires a high fixed cost of development, but once created, the expanded application of such intangible capital has low marginal cost (e.g., Coca-Cola, an already worldwide brand, expanding into a new market; introduction of existing drugs into a new market) and hence high marginal profit.
  - The protection of the intangible capital in the new market often requires direct supervision, management and control and hence direct investment. Franchising without active monitoring does not work in many economies.

Globalization is Facilitated by the ICT Revolution, Use of English, and Hedging

- The information and communication technology revolution:
  - Caused large reductions in the costs of information transmission and analysis, information storage and retrieval, and communication;
  - Increased significantly the timeliness and reliability of information—information is now available and transmitted accurately in real time;
  - Greatly facilitated inter-firm and intra-firm co-ordination by reducing the costs of communication, monitoring, and control (geographical distance is no longer a barrier), and thereby lowering the explicit and implicit transactions costs of fragmentation of production and out-sourcing.
- The worldwide use of English as the language of business.
- De-verticalization or fragmentation, and hence globalization, is also facilitated by the possibility of hedging of risks. What must at one time be internalized in order to reduce risks can now be separated because of the availability of separate risk markets.

Opportunities and Challenges of Globalization

- Globalization of the world economy presents tremendous opportunities and great challenges.
- Opportunities arise because:
  - The entire world population have now become potential customers; the entire world is the potential market;
  - Firms everywhere are scouring the globe for potential suppliers and sub-contractors to source and to out-source;
  - The huge potential of economies of scale can be realized through expansions, mergers, acquisitions, consolidations, and formation of strategic alliances and partnerships;
  - Investors everywhere are moving their capital around the world to seek the highest rates of return;
  - The possibility of global cooperation and coordination (e.g., on the prevention of global warming).

Challenges from Globalization

- Intensification of competition from both domestic and foreign firms for market shares and for capital, human resources and other resources (e.g., oil, iron ore, rubber);
- Increased unpredictability (footlooseness of suppliers, customers and investors; external shocks) and decreased ability for risk diversification because of rising synchronization of business cycles around the world;
- The social costs of job displacements and disruptions can be high;
- The possibility of monopolization and cartelization of world markets; (Monopolization and cartelization are the natural outcomes of a completely free and unregulated (global) market economy. They tend to result in higher prices and poorer qualities for goods and services and inputs and less innovation.)
- The renewed rise of protectionism and isolationism as a reaction to globalization;
- For smaller economies, greater vulnerability to external disturbances.

Globalization of Labor Markets

- The labor force has become increasingly mobile. Foreign labor is very common in many countries, e.g., in Taiwan, in Hong Kong, in Germany, in the Middle East. And human capital in the form of skilled labor and professionals has become very mobile. There is now a world market in professionals such as accountants, engineers, scientists and managers.

Globalization as a Source of Economic Disturbances

- Global competition can cause temporary as well as permanent disruptions in employment and economic growth.
- Technological obsolescence, whether domestic or imported, can also cause similar disruptions (e.g., Amazon.com wipes out mom-and-pop bookstores in the U.S.).
- In order to survive these disruptions and disturbances, the comparative advantages of an economy have to be continually created, maintained, preserved and renewed.
- The East Asian economic development experience provides an example of created as opposed to natural comparative advantage (human capital and R&D capital can substitute for natural resources).

Rising Synchronization of Global Economies

- Rising globalization of the markets for goods, services and factors (capital and labor) implies that the world economies tend to move up and down more or less simultaneously. There is therefore increasing synchronization of business cycles, resulting in higher correlation of real rates of growth, rates of inflation, and rates of increase in the prices of assets among economies. It is no longer possible for small economies to rely solely on diversification to reduce the impact of external disturbances and shocks.
- However, it also implies that economic recovery is also likely to be more simultaneous, and hence more rapid and robust, with the aggregate demands of each of the economies feeding into one another (as was experienced during the 1997-1998 East Asian currency crisis).
- There is, however, also evidence of partial de-coupling of East Asian economies from the rest of the World.

The Benefits of International Trade

- Voluntary trade between two countries is always advantageous to both trading partners. Both country gains from trade.
- The truth is obvious if one country is more efficient in the production one good (in terms of requiring less resources per unit of output) and the other country is more efficient in the production of the other.
- Specialization and trade can then make both countries better off.
- But if one country is more efficient than another country in the production of every good, can both countries still gain from trading with each other?

The Benefits of International Trade

- The answer is yes! Consider a World with two countries and two goods

	Country A	Country B
Natural Endowments of Labor	10	10
Labor Required per Unit of Good I	1	2
Labor Required per Unit of Good II	2	5

- Country A is therefore more efficient then Country B in the production of every good (less labor required per unit of each good produced).
- **Question: Is there any gain for Country A to trade with Country B?**

The Concept of Comparative Advantage

- We note, however, that Country A is more efficient in the production of Good II in terms of the number of units of Good I that has to be foregone (2) in order to produce one unit of Good II than Country B (2.5).
- Similarly, Country B is more efficient in the production of Good I in terms of the number of units of Good II that has to be foregone (0.4) in order to produce one unit of Good II than Country A (0.5).
- This illustrates the concept of "Comparative Advantage." We shall show that it is the existence of comparative or relative efficiency that enables countries to gain from trade with one another.

Production and Consumption Patterns in the Absence of International Trade

- Let us suppose that in the absence of international trade, the pattern of production (and consumption) is given by:

	Country A	Country B	World
Units of Good I	6	2.5	8.5
Units of Good II	2	1	3

- Labor employed in Country A = 6 x 1 + 2 x 2 = 10
- Labor employed in Country B = 2.5 x 2 + 1 x 5 = 10
- Thus, in both countries labor is fully employed.

A Possible Production Pattern with International Trade

- With international trade, a possible pattern of production is given by:

	Country A	Country B	World
Units of Good I	4	5	9
Units of Good II	3	0	3

- Note that total World production of Good I is now 9 compared to only 8.5 in the absence of international trade and total World production of Good II remains at 3 as before.
- It may also be verified that labor is fully employed in both countries (4 x 1 + 3 x 2 = 10; 5 x 2 =10)
- Thus, the World can be better off with international trade in the sense that the total availability of goods is enhanced.

A Possible Production Pattern with International Trade

- International trade expands the production/consumption possibilities of the World--when international trade is first introduced, total World GDP is always increased (a one-time effect). When a previously completely autarkic economy joins the World trading system, total World GDP is also increased (a one-time effect).
- In this particular example Country B is completely specialized in the production of Good I.

A Possible Consumption Pattern with International Trade

- With international trade and the above pattern of production, a possible pattern of consumption is given by:

	Country A	Country B	World
Units of Good I	6.25	2.75	9
Units of Good II	2	1	3

- It may be verified that total World consumption of each good is equal to total World production of each good.

A Possible Consumption Pattern with International Trade

- In this case, country A trades 1 unit of good II with country B for 2.25 units of good I. <u>Both</u> countries gain with trade.
- In general, no country should lose with the introduction of international trade. (One way to think about it is as follows: since total World GDP is increased with trade, there should be sufficient increase in real output to make everyone better off than before.)

Another Possible Consumption Pattern with International Trade

- With international trade and the above pattern of production, another possible pattern of consumption is given by:

	Country A	Country B	World
Units of Good I	6.01	2.99	9
Units of Good II	2	1	3

- In this case, country A trades 1 unit of good II with country B for 2.01 units of good I. Both countries are still better off with trade than without trade.
- But note that the distribution of the gains from trade is changed. Country A does not gain as much under this alternative scenario as under the previous scenario.
- It may be verified that total World consumption of each good is again equal to total World production of each good.

A Third Possible Consumption Pattern with International Trade

- It is also possible to have most of the gains appropriated by Country A--such a possible pattern of consumption is given by:

	Country A	Country B	World
Units of Good I	6.49	2.51	9
Units of Good II	2	1	3

- In this case, country A trades 1 unit of good II with country B for 2.49 units of good I. Both countries are still better off with trade than without trade.

The Distribution of Gains from Voluntary International Trade is Indeterminate

- What these examples illustrate is that while voluntary international trade <u>always</u> brings gains to all trading partner countries, the distribution of gains from trade, or the terms of trade, is not uniquely determined by the principles of comparative advantage alone but depends on the relative bargaining power of the trading partner countries.

Is Free Trade Always Good?

- Yes, but see exception below.
- However, there may be distributional issues within each country. The shareholders and the workers of the contracting industry in a country may be worse off. Transitional assistance may be required (re-training, unemployment insurance).
- It is possible to devise schemes that will allow the "winners" to compensate the "losers" (e.g., internalization, auctioning of import permits, taxing out-sourced service payments as income).

The Problem of Distribution of Gains and Losses

- The problem lies in the domestic internal distribution of the gains within each partner country and depends on whether part of the gains from trade are used to compensate the actual losers.
- The challenge for all governments is to find, insofar as possible, win-win strategies that allow the respective countries to benefit from the increased trade and at the same time provide compensation for the displaced workers in the contracting industries.

Providing Employment for the Displaced Workers

- In the long run, globalization should create winners everywhere. However, in the short run, there will be both winners and losers. The gains will exceed the losses, so that in principle it is possible to compensate the losers. In practice, compensating the losers requires specific policy measures.
- The possibility of internalization of the costs of adjustment (e.g., exporting textile machinery in exchange for increased imports of textiles; firms in exporting country assuming the responsibility for the displaced workers in the importing country).
- The government should provide temporary support for displaced workers.

Providing Employment for the Unskilled

- Given globalization, any job that can be moved to a lower-cost region has been or will be moved.
- The only unskilled jobs that cannot be moved away are tourism-related—hotels, restaurants, retail, and local transportation.
- In the short term, retraining and re-employment of unskilled labor.
- In the medium term, providing new employment opportunities, e.g., in the tourism industry.
- In the long term, investment in human capital.
- The problem will be solved in one generation.

Can Protectionism be Justified?

- Temporary protection can be justified under the “infant industry argument”
  - Economies of scale
  - Learning by doing
  - Predatory competition
  - Sunset provision

Promoting Social Harmony

- Short-term redistribution can be implemented through direct transfer payments.
- Intermediate-term redistribution depends on the establishment of a **credible** social safety net, the institution of a progressive comprehensive individual income tax, and the full implementation of the rule of law in the economic sphere—protection of labor and land rights as well as other tangible and intellectual property rights.

Promoting Social Harmony

- Long-term redistribution can be done through the investment in education and human capital especially in the poor areas of the country. It is the proven most effective means for alleviating poverty and reducing income inequality permanently.
  - Universal secondary education as a goal
  - Central government back-stop of educational expenditures for provinces/municipalities/regions with low per capita GDP
  - Ensuring equal opportunities of access for all

Promoting Social Harmony

- A well-functioning society must strike a balance between efficiency and equity. Redistribution, in particular, lumpsum redistribution, is actually not incompatible with efficiency. Efficiency only requires that economic agents face identical prices **on the margin**. Different inframarginal prices (and taxes) do not affect efficiency.
- Perceived equity and fairness and potential social mobility are fundamental to long-term social harmony and stability.

Promoting Social Harmony

- Investment in education enables citizens to support themselves eventually by greatly improving their employability and re-trainability in the long run.
- It thus helps to narrow the inequality in the income distribution and reduces long-term social costs, enhances social harmony and strengthens long-term sustainability of economic growth.
- Investment in infrastructure is also a form of redistribution, e.g., mass transit system financed from taxes on gasoline; schools, parks, hospitals and other public facilities built with general revenue.
- Universal basic social insurance can also be financed through general tax revenue.
- Bringing capital and jobs to labour rather than labour to capital and jobs—industrialization and urbanization in situ.

The “Smile Curve”

- The “Smile” Curve basically captures the empirical fact that most of the profits from a product accrue to either the discoverer/innovator/inventor (at the beginning of the supply chain) or the marketer/distributor (at the end of the supply chain) and very little to the actual manufacturer (in the middle of the supply chain).
- The discoverer/innovator/inventor owns the patents, knowhow and designs, and profits from the royalties and license fees. The marketer/distributor owns the brand name and the distribution organization and profits from the brand recognition and distribution margins. The profit margin of the manufacturer is usually very thin.
- Nike and Apple provide such examples. Original Equipment Manufacturing (OEM) captures very little of the profits; Original Development and Manufacturing (ODM) is slightly better. But ultimately, patents and brand names are the real sources of profits.

The Example of Taiwan

- Taiwan used to be a large exporter of bananas, pineapples as well as cane sugar, but no more. Banana and pineapple and sugar farmers have all since moved on to other occupations and professors and are better off than before. No one wishes to go back to growing bananas or pineapples or sugar cane.
- The economic success of Taiwan is due to the expansion of the non-agricultural sector and the transfer of the labor force from agriculture to non-agriculture.
- Taiwan also used to be the world’s largest exporter of shoes, but no more. Taiwan continues to prosper through the expansion of its high-technology industries.
- Made by Taiwan instead of Made in Taiwan
- Comparative advantage can be changed and enhanced through investment in human capital and in Research and Development (R&D).
- Taiwan’s most successful corporations make huge investments in R&D to maintain their competitive and comparative advantage.

The Coffee Growers of Ethiopia

- While our sympathy lies with the coffee growers of Ethiopia, we need to realize that low value added is common in international trade. It is the rule rather than the exception that exporters of goods can only capture a very small fraction of the price paid by the final consumers in developed countries. This is true of the coffee growers around the world. It is also true of the much of the "processing and assembly" exports in Mainland China, including, for example, the manufacturing of notebook computers and the i-phone.

The Alternatives to Growing Coffee

- The alternatives to growing coffee are most likely worse—that is why many farmers in Ethiopia have chosen to grow coffee.
- Taiwan used to be a major exporter of bananas, pineapples as well as cane sugar, but not any more. Banana and pineapple and sugar cane farmers have all since moved on to other occupations and professions and are better off than before. No one wishes to go back to growing bananas or pineapples or sugar cane.
- The future of the existing coffee growers in Ethiopia lies in finding new alternatives to growing coffee. It can be forward integration into better quality control, further grading, sorting and processing (roasting, packaging and grinding) of coffee beans. It can be the creation of job opportunities for workers in non-agricultural activities—e.g., low-technology, labor-intensive, light industrial products—following the footsteps of other economies such as Taiwan and South Korea.

Who are the Real Winners and Losers?

- Ethiopia has been a coffee-exporting country for more than fifty years. Globalization has actually increased, rather than decreased the demand for Ethiopian coffee over time.
- Of course, globalization also intensifies competition in the global coffee market. The collapse of the International Coffee Agreement in 1985 is one reason for the sharp decline in the price of coffee on the world market since.
- It is not globalization per se, but the collapse of the International Coffee Agreement, that has resulted in the low world price of coffee. The losers are the existing coffee growers in the coffee-producing countries.
- In addition, coffee faces the competition of substitutes: for example, tea of various kinds, cocoa, and other non-alcoholic drinks.
- Consumers of coffee, as well as all those involved in the supply chain of coffee consumption—the bean processors, packagers, ground and instant coffee manufacturers and marketers, cafes, are all likely to benefit, but to varying degrees.

What Can Producers of Primary Products Do?

- Throwing part of the output into the sea—Brazil has actually done that before.
- An export tax? But for an export tax to work in a World with many producers, coordination is required.
- A producers' cartel (e.g., The Organisation of Petroleum Exporting Countries (OPEC))—a revival of the International Coffee Agreement?—is a possibility, but it does not always work.
- Coffee-growing countries can undertake forward integration, e.g., sorting of coffee beans and roasting, to retain more value-added and to generate more employment within the country. This requires investment, technology and possibly brand-building, and marketing.
- The real long-term solution is to find alternative, non-agricultural employment for the existing coffee growers.

The Role of Forward Markets

- Growers can sell part of their output forward, thus ensuring an income floor for themselves. However, forward markets are not long enough to cover the initial production cycle of four years.
- But once the coffee tree is planted, coffee beans can be harvested beginning in the fourth year, and the coffee growers can sell part of their annual output forward every year.
- The Government can also provide a guaranteed price floor for a guaranteed fixed quantity for each producing household.
- Production loans provided by potential customers can be structured so that they are repaid in kind.
- The governments can provide insurance against the weather and other serious natural calamities.
- The price of coffee on the spot commodity market is too volatile for the average coffee grower. Coffee growers should not speculate in the coffee market.
- Farm subsidies in developed countries have little impact on the coffee market since very little coffee is grown in developed countries.

Concluding Remarks

- Economic globalization has the potential of bringing benefits to the poorest people in the World and has actually done so (e.g., in Mainland China).
- The potential aggregate global benefits are always positive, provided that the markets are competitive, that is, not monopolized by one buyer or monopsonized by one seller, and the transactions are voluntary.
- The principal problem is one of internal distribution of the gains from globalization.
- It is the government's responsibility to provide transitional support to the displaced workers during the adjustment period, to provide re-training and re-employment assistance, and to create and facilitate alternative employment opportunities and to try to redistribute part of the gains from the winners to the losers.