Douglas A. Irwin

THE TWO FACES OF GLOBALIZATION

ABSTRACT: *Fears about economic globalization overlook the fact that the growing international division of labor can be beneficial to all participants—as may be seen in the spectacular strides that have been made recently by once-impoverished developing countries. Free trade does threaten some, but the negative effects of international trade even on developed countries such as the United States have been vastly overstated. Western workers are rich because of their high productivity, not (primarily) because of their insulation from competition. Ignorance of these facts, however, fuels support not only for specific trade barriers, but for Seattle-style activism that threatens to harm the very people it is intended to benefit.*

If "competitiveness" was the international economics buzzword of the 1980s, "globalization" clearly replaced it in the 1990s. Though "globalization" has become a stock phrase—any term that signifies a very broad phenomenon faces the danger of losing precise definition and becoming vague and ineffable—serious international and domestic economic issues lie behind it. If "globalization" is nothing more than shorthand for the increasing economic integration of nations, it is abundantly clear why the fin-de-siècle public latched onto it. Public awareness, if not understanding, of the global economy has been high in recent years, starting perhaps with the hotly debated North American Free Trade Agreement (NAFTA) and continuing with the protests surrounding the Seattle meeting of the World Trade Organization. And concern about globalization encompasses a multitude of other issues,

Critical Review 14 (2000), no. 1. ISSN 0891-3811.

Douglas A. Irwin is Professor of Economics, Dartmouth College, Hanover, NH 03755.

ranging from the outsourcing of employment by American multinationals, to congressional funding for the International Monetary Fund, to worries about the global fallout of the Asian economic crisis.

Both *Globaphobia: Confronting Fears about Open Trade* (Washington, D.C.: Brookings Institution, 1998), by Gary Burtless, Robert Z. Lawrence, Robert E. Litan, and Robert J. Shapiro, and *Has Globalization Gone Too Far?* (Washington, D.C.: Institute for International Economics, 1997), by Dani Rodrik, provide excellent introductions to the broad economic issues—mainly regarding international trade rather than international finance—that fall under the rubric of "globalization." Although they deal with similar issues, however, the books differ markedly in tone and emphasis.

Globaphobia is a spirited rejection of the idea that globalization is responsible for any of the economic ills afflicting the United States. Burtless et al. first set out the simple facts about U.S. trade with the rest of the world and a context in which to view those facts. They then seek to dispel popular fears about U.S. participation in the global economy and to strongly defend the American commitment to an open world trading system.

Rodrik's book has some common ground with *Globaphobia*, but it is also a penetrating, controversial critique of the way in which economists (such as Burtless and his colleagues) have traditionally analyzed globalization. As its title suggests, *Has Globalization Gone Too Far?* is much less sanguine about globalization and raises potentially more disturbing issues than *Globaphobia*. Rodrik's views, however, cannot be understood if one is unfamilar with arguments of the sort that are presented in *Globaphobia*.

Old Myths About Globalization

The explicit purpose of *Globaphobia* is "to demonstrate that the fear of globalization . . . rests on very weak foundations." To persuade the reader of this conclusion, the authors—an impressive team of economists from several Washington think tanks (dominated by the Brookings Institution)—explain why international trade is a positive-sum activity from which all participants benefit. Trade between regions within a country allows those regions to be better off because they are able to specialize in the production of certain goods and need not produce everything for themselves. So it is with trade between countries, even if labor cannot move between countries as easily as it can between regions within a country. The division of labor enables output to be larger than it would be in the absence of specialization; countries share this larger output through international trade. This reasoning is standard economics, but it is oft forgotten and cannot be repeated too frequently for noneconomists.

After setting forth the classic case for free trade, *Globaphobia* attacks many popular American perceptions about the costs of globalization. First and foremost is the claim that trade destroys jobs—which is true, but only in a very limited sense. Employment in the Maine shoe industry and in the South Carolina textile industry is lower to the extent that consumers forego their products in favor of imported goods. But, as *Globaphobia's* authors show, trade-induced job loss is an extremely small proportion of overall labor turnover. For example, they ask, did NAFTA reduce U.S. employment by liberalizing trade with Mexico? Their answer:

> By any reasonable measure, even the gross job turnover induced by the agreement has been slight. According to the Department of Labor, over the nearly four years from January 1994 through mid-August 1997, 220,000 workers had petitioned for adjustment assistance (cash and training allowances) under the legislation enacted when the trade deal was signed. Of this total, 136,000—an average of about 40,000 workers per year—were certified as eligible for assistance (under both the more general trade adjustment assistance program and that created as part of NAFTA). Even this figure overstates NAFTA's true impact, because to be eligible under both programs workers only need to show that "imports" have contributed to their losses, but not specifically as a result of NAFTA. By way of comparison, the gross monthly turnover of jobs in the United States exceeds 2 million. Since NAFTA, overall employment in the United States has risen by more than 10 million. (57)

So much for the "great sucking sound" that Ross Perot and others had predicted.

Even if NAFTA had produced more job loss than it did, however, more trade cannot result in lower employment. Imports—for example, imports into the United States—are not free. They must be paid for in one of two ways: through exports of U.S. goods and services, or through foreign investment in the United States. All of the dollars U.S. consumers hand over to other countries to buy their imports will return either to purchase U.S. goods exported abroad or U.S. assets created by foreign investment. Both exports and investment create new jobs.

How can we be sure that the number of jobs destroyed by imports are at least matched by the number of jobs created by exports and foreign investment? If the unemployment rate began to rise, then the Federal Reserve Board would probably reduce interest rates in an effort to head off a recession. This would not only stimulate the economy, but would also tend to depreciate the dollar, thereby encouraging more exports and discouraging imports. The simplistic claim that globalization destroys jobs is erroneous. It is conceivable, however, that globalization could be bad for other reasons, such as the "quality" of the jobs that remain.

Thus, it is feared that, for instance, trade is "deindustrializing" the United States. Imports and foreign investment outflows by U.S. companies, it is said, have destroyed good manufacturing jobs and have hollowed out America's economy. This mantra of the early 1980s is less fashionable these days, but the fear of multinational outsourcing still lingers close to the surface of trade-policy debates. *Globaphobia*'s colorful charts, however, show that the shift from manufacturing toward services is a trend common to all developed countries. In fact, this shift has proceeded even more in other developing countries, which is to some degree reassuring because ruin has not befallen them. The authors demonstrate that higher productivity growth in manufacturing compared to service industries—not the trade deficit or unfair trade practices—is the root cause of deindustrialization. Simply put, developed countries have been able to produce more manufactured goods with fewer people. In service industries, this productivity performance has been difficult to achieve.

The authors then turn to the link between trade and wages, a controversial topic that, in recent years, has been the subject of considerable economic research. One of their charts illustrates that the course of average U.S. wages over time has virtually nothing to do with international trade flows (60). The same chart shows that worker compensation tracks nonfarm business productivity in an extraordinarily direct way. Real wage growth is inextricably and inexorably tied to productivity growth. As productivity growth slowed after the early 1970s, so did real wage growth. (This raises the question of whether trade had any detrimental effects on productivity, but some evidence suggests that international competition has actually spurred productivity improvements in import-competing sectors.)

If trade has little impact on average wages, has it affected the distribution of income, exacerbating the gap between rich and poor? There has been no significant change in labor's share of total national income for many decades. But economic theory provides clear support for the notion that trade can increase the rewards of skilled workers while reducing those of unskilled workers (or the other way around, depending on the conditions) in a country facing international competition, as imports tend to displace unskilled workers and exports tend to embody skilled labor.

There is no debate that U.S. wage inequality has risen since the 1980s: the wages paid to skilled workers have risen while those of unskilled workers have stagnated or fallen. To what degree has trade contributed to this development? Grappling with this question has proven difficult and complicated. Most empirical research indicates that trade has had a small effect on wage inequality. Burtless et al. add that the decline in pay and in the use of workers with little education has proceeded apace in both trade-sensitive industries and in industries insulated from trade. They therefore contend that trade cannot be a major part of the "problem." The authors instead proffer the widely held notion (among economists, at any rate) that technological change has raised the demand for skilled workers and is therefore the principal cause of growing wage inequality.

New Fears about Globalization

Dani Rodrik's *Has Globalization Gone Too Far?* is far more critical of globalization. The fundamental question Rodrik poses is whether social disintegration is the price of economic integration. Globalization, he writes, "is exposing a deep fault line between groups who have the skills and mobility to flourish in global markets and those who either don't have these advantages or perceive the expansion of unregulated markets as inimical to social stability and deeply held norms" (2). He concludes that "globalization delivers a double blow to social cohesion—first by exacerbating conflict over fundamental beliefs regarding social organization and second by weakening the forces that would normally militate for the resolution of these conflicts through national debate and deliberation" (29). Rodrik fears that those who can adjust to economic change—capital owners, skilled labor, and professionals—will be increasingly pitted against those who cannot—unskilled and semiskilled workers. This conflict, he contends, could undermine the postwar "social bargain" in which steady pay increases were exchanged for labor peace.

Such a social bargain, though often referred to, strikes me as the imaginary construct of academic social scientists. In the United States, at least, "capital," "labor," and "the state" are abstractions that never actually sit down at real tables to strike corporatist deals. As *Globaphobia* illustrates, rising living standards have everything to do with advancing productivity, not with bargains brokered by the state or pressure exerted by labor unions.

Still, the potential for conflict is real and Rodrik is creative in searching, where others have failed to look, for sources of that conflict. In doing so, he is sometimes critical of his fellow economists. For example, while many economists, such as Burtless et al., have been investigating the role of trade in the widening wage premium for skilled workers, Rodrik argues that trade may instead be responsible for increased labor market instability and insecurity, most of which is borne by unskilled workers. Because these issues have been left unexamined, there is precious little evidence to which we can turn in order to evaluate their actual importance.

Rodrik's own analysis is a start, but not a completely persuasive one. For example, he makes the somewhat plausible claim (for which, however, we have no evidence) that "in an integrated world economy, higher labor standards cost workers more in terms of both wages and jobs" (17). The reason, he posits, is that globalization (specifically the ability of firms to locate abroad) has made the demand for domestic labor more elastic, since more international substitution possibilities are available. He then uses a simple supply-and-demand framework to illustrate that, as the demand for labor becomes more elastic, more of the cost of labor standards is borne by workers rather than firms.

Aside from the assumption that labor demand has in fact become more elastic, Rodrik's argument hinges on workers reducing the labor they supply if wages fall. Yet labor economists typically view labor supply as not being very responsive to wages. If this is the case, the elasticity of the demand for labor is irrelevant: workers have and always will bear the lower wages that are the price of higher labor standards in terms of lower wages, and globalization has changed nothing.

Rodrik also worries that globalization will adversely affect the bargaining power of organized labor. He notes that de-unionization could potentially be a good thing, freeing the economy of such inefficiencies as wages high enough to price less-skilled workers out of the market, but he cautions that "efficiency benefits are reaped only to the extent that employment *expands* in industries in which artificially high wages previously kept employment below efficient levels" and that "it is difficult to make a prima facie case that expanding trade has in fact led to more hiring in sectors such as steel and autos in the United States" (25). Yet such a case may not be that difficult to make. According to the 1996 *Statistical Abstract of the United States*, the number of production workers in the motor vehicle industry expanded from 575,000 in 1980 to 617,000 in 1990 and 759,000 in 1995.

Rodrik next contends that globalization raises the "social cost of maintaining divergent social arrangements" (29). This proposition is, again, plausible, but Rodrik does not really demonstrate it. After making several uncontroversial claims, such as that trade can have distributional effects that conflict with common notions of fair play; that there is a perceived difference between comparative advantage shaped by relative factor endowments and that shaped by different institutional arrangements; and that trade can impinge on long-standing implicit social contracts, Rodrik concludes that we cannot "treat trade liberalization as an end in itself, without regard to how it affects broadly shared values at home." But democratic governments seem to be rather well insulated from any pressure exerted by global competition to undermine such values. In Japan, the government has refused to sacrifice the important social position of Japanese rice farmers on the altar of the global economy. Agriculture in Japan, and to a lesser extent in Europe and America, has been exempt from postwar trade liberalization (which has occurred only recently, and then only in a limited way). Moreover, where such values are sacrificed, it is not for the sake of trade liberalization as an end in itself; it is for the economic benefits that liberalization brings.

Rodrik then turns to globalization and the demand for social insurance. He presents data that show a positive and striking relationship between government spending and openness to international trade. Rodrik concludes that this correlation is not a coincidence. "Societies that expose themselves to greater amounts of external risk demand (and receive) a larger government role as shelter from the vicissitudes of global markets. . . . The social welfare state is the flip side of the open economy!" (53).

But is it true that more "open" economies are subject to greater amounts of external risk? Rodrik is careful to point out that economies that are relatively closed to foreign trade are also subject to economic shocks, and that openness to trade can be thought of as a way of spreading risk (due to crop failures and other local calamities). Moreover, there is a tendency for countries that have liberalized their trade policies to see their portfolio of exports become much more diversified. Chile, for example, moved away from being a raw commodities exporter to producing a variety of processed goods. The reason for such diversification could be that lifting import restrictions has the effect of eliminating an indirect tax on exports, enabling a country to export not just a larger volume of the goods in which it had specialized before, but also to export other goods. This diversification reduces economic risk. Rodrik's point is that openness to trade forces a country to specialize in certain goods, which suggests more exposure to risk. Yet that openness might also generate higher incomes and promote a variety of specialized domestic industries, which may counteract this risk.

* * *

The multiplying protests against globalization suggest that doubts of the sort expressed in sophisticated form by Rodrik can mobilize many thousands who are entirely innocent of economics. One drawback of *Globaphobia* is that, like many of the protestors, it is rather narrowly focused on fears that increased international integration could have negative effects on domestic employment or wages in the developed world, underplaying the huge benefits of globalization for the desperately poor of the Third World. But such are the political realities. The continued willingness of developed countries to keep their markets open to imports from developing countries will probably hinge on whether domestic misconceptions, such as those so effectively dispelled by Burtless and his colleagues, gain new adherents in coming years.

REFERENCES

Burtless, Gary, Robert Z. Lawrence, Robert E. Litan, and Robert J. Shapiro. 1998. *Globaphobia: Confronting Fears about Open Trade*. Washington, D.C.: Brookings Institution, Progressive Policy Institute and Twentieth Century Fund.

Rodrik, Dani. 1997. *Has Globalization Gone Too Far?* Washington, D.C.: Institute for International Economics.