The Economics of Globalization: A Labor View[1]

Thomas Palley, Assistant Director of Public Policy, AFL-CIO

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Introduction

My purpose this morning is to provide you with a labor view of globalization. Globalization is a process that is impacting profoundly the lives of workers everywhere, and the AFL-CIO is therefore deeply committed to ensuring that it is made to work for the benefit of working people. In particular, our goal is to see that the benefits of globalization are fairly shared, and that any economic and social dislocations are properly addressed.

Regrettably, all too often the debate over globalization is cast in terms of a conflict between trade openness and protectionism. This characterization completely misses the mark. It is not a matter of openness versus protection; rather, it is one of how we deal with the problems that are unleashed by globalization while preserving its benefits.

If we are going to manage successfully the process of globalization, we must recognize three things. First, globalization brings problems as well as benefits, and these problems run deeper than just the fact that there are winners and losers. Yes, those who lose through no fault of their own need to be made whole. But beyond this, there is a deeper problem whereby globalization is changing the very structure of our economy, and in doing so it is establishing patterns of incentives that can have negative societal effects long into the future.

Second, we must realize that globalization is not a natural process over which we have no control. Instead, it is being driven by the choices of business, governments, and international policymakers.

Third, given that globalization is not a natural process, we must recognize that we have choices and the way in which we exercise those choices will determine the pattern of outcomes. Whether

[1] Thomas Palley is the Assistant Director of Public Policy at the AFL-CIO in Washington, DC. This article is based on remarks delivered at the 24th Annual AAAS Colloquium on Science and Technology Policy, held April 14-16, 1999, in Washington, DC.

globalization produces a world in which prosperity is shared and stable, or whether it produces one in which prosperity is unstable and unequally distributed, depends on the choices we make. This, rather than protectionism versus openness, is the essence of the debate.

The economics of globalization

Globalization refers to a process of international integration of national goods, financial, and labor markets. It is a process that is being driven by firms through their competitive search for profits, and it is also being driven by the process of market arbitrage which works to ensure that the same goods sell for the same price no matter where they are traded. In a sense, none of this is new, and globalization is just the logical extension to the international economy of processes that have long operated within our own domestic economy for over one hundred years. Thus, the creation of a unified national economy in the second half of the 19th century, through the fusing together of the different regional economies, involved the same processes. Similarly, the competition between the Rust Belt and the Sun Belt in the 1970s also involved these processes. However, in earlier times these processes operated within the confines of the national economy. Today, they are operating at the global level, and this is both the source of the benefits and the source of the costs. Just as national economic integration produced benefits, so too can global economic integration. But national economic integration also brought problems, and we addressed those problems through the creation of modern government. Addressing the problems raised by global economic integration is more difficult because of the deeper political problems, and because of the lack of proper structures of international economic governance.

Market forces are one source of impetus to globalization. Technical innovation is another. Such innovation has increased the mobility of both physical and financial capital. If we have any doubts about this, think of the history of the factory. At the beginning of the 19th century, production took place on the factory floor while management sat above in overlooking offices. Today, companies can be headquartered in New York while production takes place thousands of miles away in China, and yet the production process remains intimately controlled via electronic communication and integrated computer systems that ensure production to specification.

Finally, globalization is also being driven by economic policies which have sought to remove barriers to the flow of goods and capital between countries, and in doing so have increased the international integration of national economies.

Without doubt globalization brings significant economic benefits. These benefits include increased goods market competition that has contributed to lower prices and improvements in quality. It has also contributed to improvements in production efficiency with domestic firms forced to go head-to-head with their foreign rivals. There have also been improvements in the provision of financing which has helped developing countries acquire the capital necessary for their own development.

But side-by-side, there have been serious negative effects with globalization creating new forms of wage and workplace competition that have twisted the distribution of income in favor of the most well to do. It has also twisted the economic structure such that policy makers now face a pattern of incentives that has them increasingly compelled to run economic policy for the benefit of those corporate interests which have been empowered by the globalized economy.

If we are to achieve our goal of ensuring that the benefits of globalization are fairly shared and the costs properly dealt with, we need an economic understanding of how globalization is impacting our economic world. A framework that I have found useful is to see globalization as having created "leaky" national economies. There are three forms of leakiness.

The first is what I call *"macroeconomic leakiness"* whereby there is a tendency for demand to leak out of the national economy owing to an increased propensity to import goods. Today, in the U.S. we see this leakiness in the form of larger and larger trade deficits that result from our spending more on imported goods. This increase in macroeconomic leakiness is true for almost all industrialized countries, with trade (i.e. imports and exports) as a share of GDP having increased by more than fifty percent over the last 30 years have. In the 1960s, exports and imports constituted 10 percent of GDP in the U.S. economy. Today they constitute almost 25 percent, and in the European economies that proportion is even larger.

A second form of leakiness is *"microeconomic leakiness"* whereby there is a tendency for jobs to leak out of an economy if labor markets aren't sufficiently flexible, or if profit taxes are relatively unfavorable compared to conditions elsewhere. Microeconomic leakiness has been promoted very much by technological developments that have lowered costs of transportation and costs of coordinating production. For example, the first container ship crossed the Atlantic in May 1966, a mere 33 years ago. Back then, transportation costs used to be about 10 percent of final sales costs; now they've fallen to less than 1 percent. Economic policy has also contributed to increased microeconomic leakiness by bringing down trade barriers and making it cheaper and more economically feasible to shift production between countries.

A third form of leakiness is “financial leakiness” whereby money flows between countries. Today, more than $1.5 trillion is traded in foreign exchange markets every day, whereas the actual value of international trade is less than 3 percent of this amount. Financing of trade is therefore no longer the main purpose of international financial markets. Once again, this change has been driven by technological innovation in the form of lowered costs of electronic communication and transacting, and once again it has also been driven by policy which has removed controls on the international movement of money.

These different forms of leakiness have significant economic effects. Macroeconomic leakiness has tended to promote an increased reliance on exports, which means that countries are more exposed to shocks originating abroad. This exposure is evidenced by the recession in U.S. manufacturing which was badly hit by the collapse in exports to East Asia. Macroeconomic leakiness also means that countries rely more heavily on imports so that demand leaks out of the economy when policy makers try to expand economic activity. This in turn has made it more difficult to pursue the economic stabilization policies that were used so successfully in the 1950s and 1960s. When faced by recession, policy makers used to be able to use monetary and fiscal policy to stimulate demand and restore employment. Now such policies also produce large trade deficits. This feature explains why European policy makers have been unwilling to pursue expansionary policies, and this has contributed to Europe getting stuck in recession. In the U.S. the problem is not one of recession, but rather one of a burgeoning trade deficit caused by an economic boom, but this deficit could eventually contribute to financial instability that undermines the boom.

Microeconomic leakiness poses a different set of problems. In particular, it has increased the bargaining power of business vis-à-vis both labor and government. Business now knows that it has alternative sources of labor elsewhere, and it has used this option to put pressure on labor to win wage concessions and to reduce benefits. This is clearly visible in the NAFTA experience. Thus, a recent study out of the Cornell Industrial Labor Relation School found that after NAFTA was implemented there was a 33 percent increase in business use of threats to relocate production during wage bargaining rounds.

However, it is not just labor that loses as a result of increased microeconomic leakiness. Government has also been put under pressure through the use of threats to move to win tax concessions. If tax conditions are deemed relatively less favorable than elsewhere, business now threatens to invest only in those places where conditions are more favorable. An example of this is the Mercedes Benz plant that was built in Alabama. Mercedes Benz set up a competition between Alabama and North Carolina that involved an auction regarding the tax concessions each was willing to give to attract the new plant. At the end of the day, Alabama won, but it is estimated that this cost the state $250,000 per job in terms of tax concessions. The point is that there was always going to be one Mercedes Benz plant, and it was going to be in either North Carolina or Alabama. The tax auction effectively stripped the public purse of huge amounts of revenue that were transferred to Mercedes. The incentive to engage in such auctions poses real problems because states are either going to have to make up the shortfall by raising taxes elsewhere (which is why the burden of taxation has increasingly shifted away from capital incomes and onto labor incomes), or states will have to cut public spending on education, public services, and public infrastructure. Shifting tax burdens is bad for fairness, while cuts in such spending are bad for both fairness and future economic growth.

The Alabama – North Carolina tax auction is not an isolated example. Exactly the same form of tax competition has been played out in Europe, where there has been competition for Japanese plants between France, Spain, and Britain. The European Community is now trying to deal with this problem by introducing tax harmonization rules that prevent such forms of tax competition. Similar rules are needed both domestically in the U.S., as well as internationally.

Responding to globalization

So much for the economic problems posed by globalization. What can be done about them? Dealing with the problem of macroeconomic leakiness requires the establishment of a new global economic development agenda. This agenda must encourage countries to shift away from exclusive reliance on export-led growth to a more balanced policy in which growth is also driven by expansion of domestic markets. It is impossible for all countries to rely on export-led growth because one country's exports are another's imports so that all cannot run trade surpluses. Moreover, export-led growth also fosters wage competition, deteriorated work place conditions, degraded environments, and weakened systems of governmental social support. This is because countries and business have an incentive to try and gain international competitive advantage by any means possible. This is the infamous "race to the bottom."

However, getting countries to grow their domestic markets requires rising wages, and this in turn requires a leveling of the playing field between business and labor. The global enforcement of core International Labor Organization (ILO) labor standards that give workers the rights of free association and collective bargaining is key. These standards do not set quantitative wage rates. Instead, they are qualitative and give workers rights. Trade unions are not a market distortion as is so often asserted. Instead, they are a private sector solution to massive market failure, namely the huge imbalance of power between business and labor.

Core labor standards are also good for national economic governance, and we all now recognize that good governance is good for growth. A major problem in many developing economies is corruption and economic cronyism. Simply opening economies to the global market will not eliminate this problem because it is political in nature. However, enforcement of human rights and labor standards can contribute to the development of the counter-veiling political powers that are needed to block such behaviors.

Core labor standards also contribute to solving the problem of microeconomic leakiness by establishing global standards that cannot be avoided by shifting production between countries. In doing so, they block off the inappropriate forms of competition that constitute the race to the bottom. With the low road blocked off, companies will then have an incentive to follow the high road that focuses on growing productivity rather than exploiting workers and the environment.

In similar vein, there is a need for new rules to prevent international tax competition. Labor standards can prevent the race to the bottom in labor markets. Tax harmonization rules can prevent a race to the bottom in tax fairness and the funding of government.

Finally, with regard to financial leakiness, there is a need to make changes to the international financial architecture. The weakness and instability of the existing architecture was clearly evident in the global financial crisis of 1998, and the world economy flirted dangerously close with economic catastrophe. The existing structure is unstable, and it also gives financial interests too much sway over domestic and international economic policy. We need a new structure that reduces speculation, that gets investors to invest with proper regard to risk and return, and that creates the space for domestic economic policy autonomy.

If we do these things, globalization can be made to work for all working people. Its benefits can be widely shared, and the prosperity it creates can be firmly rooted.