

K.G. Persson: The Political Economy of Globalisation.

A note on the recent literature.

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

Quite a few politicians, journalists and literati say that Globalisation is a new event. It is a mistake and they have not done their economic history courses properly.

Question: What is Globalisation?

Answer: A high degree of international interdependence of national economies.

More precisely there are high scores on:

1. International capital mobility, which can be measured by the absolute value of the current account balance. Recall that a current account deficit (surplus) implies capital imports (exports).
2. International labour mobility, that is international migration.
3. Free trade and increasing trade/income ratios.

Let me propose a rough ordering of these characteristics according to A for high (and /or unconstrained, free) and C for low and regulated and B for an intermediate position. The last 150 years can be subdivided in periods, that will get the following marks

	1850- 80	1880-1914 (30)	1931- 45	1947- 80	1980 -
1	A	A	C	B	A
2	B	A	C	B	C
3	A	B	C	CB	CA

A few comments are needed. (i) The CB and CA marks on trade for the post WWII periods are motivated by the fact that trade in agricultural goods is extremely regulated despite recent efforts to liberalize and deregulate the international food markets by WTO. Only trade in manufacturing and some services have been radically liberalized since the first GATT-round in 1947. The European Union is moving very slowly and reluctantly towards less distortions in food trade. (ii) The 1880-1914 period seems to be the most globalised period.

Table 1**Ratios of Merchandise Trade to GDP (percent)**

Country	1890	1913	1960	1970	1980	1990
Australia	15.7	21.0	13.0	11.5	13.6	13.4
Canada	12.8	17.0	14.5	18.0	24.1	22.0
Denmark	24.0	30.7	26.9	23.3	26.8	24.3
France	14.2	15.5	9.9	11.9	16.7	17.1
Germany	15.9	19.9	14.5	16.5	21.6	24.0
Italy	9.7	14.4	10.0	12.8	19.3	15.9
Japan ^a	5.1	12.5	8.8	8.3	11.8	8.4
Norway	21.8	25.5	24.9	27.6	30.8	28.8
Sweden	23.6	21.2	18.8	19.7	25.0	23.5
United Kingdom	27.3	29.8	15.3	16.5	20.3	20.6
United States ^b	5.6	6.1	3.4	4.1	8.8	8.0

Notes: Merchandise trade is measured as the average of imports and exports, except as noted below.

^a Data for 1890–1950 uses three-year averages.

^b Data recorded under 1890 is for 1889, and along with that in 1913, measures the ratio of merchandise exports to GNP.

Sources:

1960–1990: Data for the United States are taken from *Economic Report of the President, 1997*, Tables B-10 and B-101; data for other countries are calculated from *World Tables of Economic and Social Indicators, 1950–1992*, The World Bank, 1993.

1890–1913: Data for the United States from Irwin (1996, Table 1); data for Japan from Bairoch and Kozul-Wright (1996); data for other countries from Williamson (1996, Table 1).

Source: Robert C. Feenstra, Integration of Trade and Disintegration of Production in the Global Economy, *Journal of Economic Perspectives*, 12,4,1998,31-50.

Table 1 above suggests that trade income ratios were as high, or almost as high, at the end of the 19th century as today, but that fact conceals that the non-trading sectors (the public sector and some services) have grown as a proportion of total GDP in modern economies. The trade income ratio for the manufacturing sector is much higher today. Table 2 below measures merchandise trade (average of exports and imports of manufacturing, mining, agriculture and utilities) to merchandise value added and indicates an increase, in some cases sharp, in trade dependency of those sectors. As a consequence the immediate effect of global forces are now concentrated on a proportionally smaller group of producers.

Table 2**Ratios of Merchandise Trade to Merchandise Value-Added (percent)**

<i>Country</i>	<i>1890</i>	<i>1913</i>	<i>1960^a</i>	<i>1970</i>	<i>1980</i>	<i>1990^b</i>
Australia	27.2	35.6	24.4	25.6	32.4	38.7
Canada	29.7	39.4	37.6	50.5	65.6	69.8
Denmark	47.4	66.2	60.2	65.9	90.0	85.9
France	18.5	23.3	16.8	25.7	44.0	53.5
Germany	22.7	29.2	24.6	31.3	48.5	57.8
Italy	14.4	21.9	19.2	26.0	43.1	43.9
Japan	10.2	23.9	15.3	15.7	25.8	18.9
Norway	46.2	55.2	60.0	73.2	70.9	74.8
Sweden	42.5	37.5	39.7	48.8	72.9	73.1
United Kingdom	61.5	76.3	33.8	40.7	52.6	62.8
United States ^c	14.3	13.2	9.6	13.7	30.9	35.8

Notes: Merchandise trade is measured as the average of imports and exports, except as noted below. Merchandise value-added combines agriculture, mining and manufacturing for the U.S., and these sectors plus construction and public utilities for most other countries.

^a Value for Australia refers to 1962, and for Canada refers to 1961.

^b Value for Canada refers to 1988, for Germany to 1989, and for the U.K. to 1987.

^c Data recorded under 1890 is for 1889, and along with that in 1913, measures the ratio of merchandise exports to industry value-added.

Sources:

1960–1990: Data for the United States are taken from *Economic Report of the President, 1997*, Tables B-10 and B-101; data for other countries are calculated from *World Tables of Economic and Social Indicators, 1950–1992*, The World Bank, 1993, except as noted below.

1890–1913: Data for the United States from Irwin (1996, Table 1). Data for other countries are computed from Table 1, making use of the proportion of national income accounted for by agriculture, mining, manufacturing, construction and public utilities from Mitchell (1992, 1993, 1995). These values are also used in computing the trade ratios for Denmark and Italy in 1960, and for France and Sweden in 1960 and 1970. For Canada, the industry share of GDP in 1890 and 1913 is assumed to equal that in 1926–29, the earliest years for which data is available.

Source: Same as for Table 1.

(iii) International capital mobility measured, as suggested above, as net capital flows is not much different today from the 1880-1914 period. Table 3 below does not provide information on developing countries, but the fact is that most of them have net capital inflows similar to Australia, Canada and Sweden, rather than Argentina., before 1913.

Table 3

Size of Net Capital Flows since 1870 (mean absolute value of current account as percentage of GDP, annual data)

<i>Period</i>	<i>Argentina</i>	<i>Australia</i>	<i>Canada</i>	<i>Denmark</i>	<i>France</i>	<i>Germany</i>	<i>Italy</i>
1870–89	18.7	8.2	7.0	1.9	2.4	1.7	1.2
1890–1913	6.2	4.1	7.0	2.9	1.3	1.5	1.8
1914–18	2.7	3.4	3.6	5.1	—	—	11.6
1919–26	4.9	4.2	2.5	1.2	2.8	2.4	4.2
1927–31	3.7	5.9	2.7	0.7	1.4	2.0	1.5
1932–39	1.6	1.7	2.6	0.8	1.0	0.6	0.7
1940–46	4.8	3.5	3.3	2.3	—	—	3.4
1947–59	3.1	3.4	2.3	1.4	1.5	2.0	1.4
1960–73	1.0	2.3	1.2	1.9	0.6	1.0	2.1
1974–89	1.9	3.6	1.7	3.2	0.8	2.1	1.3
1990–96	2.2	4.0	4.1	2.0	0.7	1.9	1.8

<i>Period</i>	<i>Japan</i>	<i>Norway</i>	<i>Sweden</i>	<i>U.K.</i>	<i>U.S.</i>	<i>All</i>
1870–89	0.6	1.6	3.2	4.6	0.7	3.7
1890–1913	2.4	4.2	2.3	4.6	1.0	3.3
1914–18	6.8	3.8	6.5	3.1	4.1	5.1 ^a
1919–26	2.1	4.9	2.0	2.7	1.7	3.1
1927–31	0.6	2.0	1.8	1.9	0.7	2.1
1932–39	1.0	1.1	1.5	1.1	0.4	1.2
1940–46	1.0	4.9	2.0	7.2	1.1	3.2 ^a
1947–59	1.3	3.1	1.1	1.2	0.6	1.9
1960–73	1.0	2.4	0.7	0.8	0.5	1.3
1974–89	1.8	5.2	1.5	1.5	1.4	2.2
1990–96	2.2	3.7	2.1	2.0	1.0	2.3

Source: Obstfeld and Taylor (1998) data.

^a Denotes average with some countries missing.

Source: M.Obstfeld, The Global Capital Market: Benefactor or Menace, *Journal of Economic Perspectives*, 12, 4, 9-30, 1998.

It is likely that the more or less constant net flow of capital as a percentage of GDP conceals much larger gross flows today.

(iv) The inter-war period stands out as exceptional and a period of ‘de-globalisation’. It is clear from Table 2 that the 1913 trade pattern had not fully recovered in 1960, and net capital

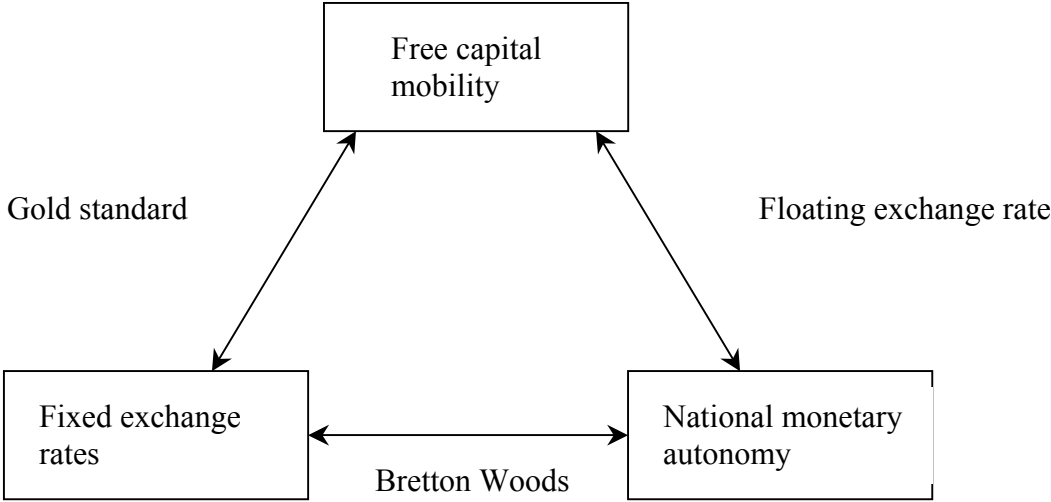
flows were at their lowest in 1932-39, see Table 3.

The realization of *the law of one price* is a possible fourth criteria for globalisation. But note that the law of one price does not apply in the literal sense of the word, because transport costs and tariffs will make price of a given good different at two geographically separated locations. To the extent that the price differential between two markets that trade are exactly equal the *transport cost adjusted* law of one price applies. However, *the law of one price*, transport cost adjusted or not, is rarely perfectly fulfilled. One should interpret the law of one price as an ‘attractor’ equilibrium. Markets are subject to asymmetric shocks and the speed at which prices adjust back to the ‘attractor’ equilibrium is an indicator of the degree of market integration and hence globalisation. The important change in market performance is related to the introduction of modern means of information transmission. By the early 1870s the whole world was ‘wired’ by a network of telegraphs which speeded up the adjustment process. Prices adjusted back to equilibrium within days, or at most a couple of weeks. In the early 19th century adjustments could take months, sometimes even years. The politically important aspect is of course that international shocks were transmitted much faster than before. And that domestic shocks necessarily became less persistent. In the current critical debate on globalisation you get the impression that international shocks and dependence are necessarily more difficult to handle than domestic shocks. This is not obvious. An isolated economy can suffer from a domestic decline in demand if it cannot redirect production for exports. A domestic price-shock is necessarily more persistent in a non-global economy. Globalisation, on the other hand, certainly imposes the need for quick domestic adjustments, which can be painful for many, but advantageous for others. There are winners and losers.

Open and globalised capital markets bring the advantage for nations in that domestic investments need not be constrained by domestic savings. Scandinavia exploited that advantage during its early phase of industrialisation. However, channelling large amounts of capital imports to sound investments requires a robust and sophisticated financial system. Open capital markets seem to be difficult to reconcile with exchange rate stability in many countries today and in the past. It highlights a general globalisation problem known as the *open market trilemma* (Obstfeld and Taylor): an economy cannot simultaneously maintain fixed exchange rates, an open capital market and monetary autonomy. If a government uses monetary policy to attain domestic goals it has to scrap either fixed exchange rates or open

capital markets.

Figure 1. The Obstfeld-Taylor Open Market Trilemma, “Pick two, just two, any two” according to Dani Rodrik.



The changing fortunes of globalisation instruments such as free trade and labour mobility can be seen as the political response to the effects of globalisation, and the relative strength of winners and losers. Differing reactions to globalisation will typically reflect how mobile the owner of a particular resource is (or how mobile the resource is). Not surprisingly land owners seem to be the group whose behaviour is most easily explained when faced with an adverse shock in prices and income: they tend to go protectionist. However it might be misleading to look only at how mobile a factor is - land is not very mobile of course- but how flexible land (owners) is (are) to alternative uses (of their resources). An adverse shock to, for example, grain prices need not always trigger a protectionist reaction if there are alternative uses of land. The Danish reaction towards the late 19th century ‘grain invasion’ was not protectionist, as was the case in France and Germany. Instead land was converted from arable to livestock and dairy production. A non-mobile resource can be flexible in its use.

Labour also seems to react differently in different parts of the world. The Stolper-Samuelson prediction that owners of abundant resources gain from trade, while owners of scarce resources lose is consistent with the late 19th century evidence that workers in labour abundant Europe were free traders while US labour was protectionist. Currently protectionist sentiments are more pronounced in US trade unions despite the fact that the US economy has quite a low trade/income ratio. In Europe it seems as if export oriented industrial unions are more favourable to globalisation compared to home market industrial unions, which is not

surprising.

Dani Rodrik's work, see reference in first paragraph of this note, reflects the attention that globalisation has got in the US debate. He highlights three social and moral issues that arise from globalisation in the *rich* world:

1. Globalisation accentuates the asymmetry between groups which can cross international borders, such as skilled labour and professionals, and owners of capital (employers), and on the other hand those which cannot, such as unskilled labour and landowners. (To cross a border should not be interpreted literally here. Apart from the fact that capital as a *flow* is mobile a factory-owner of capital as a *stock* can easily cross the border through so-called *outsourcing*, that is subcontracting production to an external supplier). Expressed in economic jargon the demand for the immobile factors, such as labour, will become more elastic in a global economy, which restricts labour's bargaining power. Wage increases will have large negative effects on employment. (The employer says: if you demand higher wages I know of workers in Korea willing to work for the going wage and we will out-source production to Korea).

2. Globalisation, and trade in particular, is raising serious moral issues. Competitive advantages of poor countries do not only arise because of low wage costs, but also from non-wage standards of work, such as working conditions, hours of work, health and safety of workers, etc, and most controversially, from the high incidence of child labour. The increased international competition threatens groups with high *non-wage* costs in the rich nations. This aspect is probably more accentuated now compared to 19th century globalisation when job-safety legislation, hours of work etc did not differ that much across nations. There is a fear in nations with high safety standards that globalisation implies 'a race towards the bottom'. That is, competitors with the worst standards will *set* the standards. Economic historian Michael Huberman showed, however, that the pre WWI period (1870-1914) witnessed a 'race towards the top'. That is the working conditions, hours of work, insurance etc. converged to the level of the best performers at that time, for example UK and Germany.

3. Rodrik advances the interesting hypothesis that economies which have high trade/income ratios have higher incidence of income shocks and therefore develop advanced (social) insurance system as a compensation against job and income insecurity. But there seems to be an inherent inconsistency in these policies. Globalisation seems to limit the ability of governments to finance such schemes, since they have to compete with low-taxation nations

for their mobile resources. Only non-mobile resources (non-mobile labour) and consumption can be differently taxed in a global economy.

There are three important consequences for the rich world of globalisation if labour demand is becoming more elastic as a consequence of the fact that international commodity markets are becoming increasingly 'governed' by the law of one price.

(i) Isolated domestic improvements in job-safety in the rich world will have larger negative effects on employment, if such measures are paid by firms. However, in a global economy with elastic demand for labour, employers can more easily shift the burden of non-wage cost on labour. As a consequence not only employment falls more but also take-home wages fall more than in the less globalised economy. (I will demonstrate that point with a diagram).

Labour in rich nations therefore has an interest in helping trade unions in the poor countries to improve their members' working conditions. (Workers of the world, UNITE! as Karl Marx put it some 150 years ago).

(ii) Domestic shocks to prices or wages will have larger effect on employment and income variance. That will call for higher welfare spending, see above.

(iii) Bargaining power of non-mobile labour falls and we will expect the wage between unskilled and skilled labour to increase. If, as suggested above, taxation must be redirected to non-mobile factors of production, that is to unskilled labour, and consumption, then the unskilled in the rich world will not have much to cheer about in the future. However, the expectation is that at least unskilled wages will converge in the world economy.

job standards, reads the hopeful message

A paradox: The claim that globalisation is primarily hurting low and unskilled workers in the rich countries is sometimes countered by the argument that most unskilled low paid workers in the rich world are in non-traded goods sectors such as services.

A digression on the moral issue: Public concern for low-wage imports - a small fraction of world trade - rests on the fear that the comparative advantage which generates this trade might have to do with abundant supply of child labour. Rich countries have erected legal restrictions – as a response to trade union agitation - on the use of child labour but poor countries have abundant supply of child labour simply because there are no legal

restrictions. There are two (incompatible?) ways of looking at this problem. One draws a conclusion from moral principles and highlights the following problem: We would not accept child labour flying in to work in, say, Sweden, and then travelling back home after the working day because such a practice, apart from being impractical, violates legal restrictions on child labour. A commodity produced by child labour can fly in, however, and be traded. It cannot be discriminated against according to World Trade Organization (WTO) rules. Is this dualism or ambiguity reasonable? One defence would be to say that you should not interfere in other nation's self-determination as regards its labour laws. But would we accept trade in products by slave labour? Certainly not. (In fact WTO rules permits trade restrictions in goods produced by prisoners of war.) Having conceded that, we have to stop and ask what the consequences would be if only goods were accepted for trade which were produced under job standards similar to the ones in the developed world? The answer is that it would lead to severe restrictions in trade between the rich and poor worlds. But could we not agree on some *minimum* standard that should apply. In principle yes, BUT.... If we are not careful protectionist forces will hijack that minimum standard and use it as a pretext to restrict trade in own interest. The (much too?) pragmatic solution (aired by *The Economist*) takes this view: child labour is better than its alternative, say, child prostitution or starvation. There might also be some ground for hope that child labour is only a transitory phase, as it was during the Industrial Revolution. School absentee-ism was rather pronounced in 19th century Denmark among the children of the poor peasantry. Part of the competitive strength of, say, 19th century Scandinavia relied on poor working conditions and low wages. With economic growth comes improved