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Globalization and the benefits of trade

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Globalization involves increasing integration of economies around the world, from the national to the most local levels, thereby promoting international trade in goods and services and cross-border movement of information, technology, people, and investments. This article examines the benefits and costs to the U.S. and other countries.

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Since the conclusion of World War II in 1945, international trade has been greatly facilitated by agreement among trading countries on a set of rules for international trade, known as the General Agreement on Tariffs and Trade (GATT). These rules were developed through a series of eight "rounds" of international trade negotiations between 1947 and 1994. Through these negotiations, export subsidies were banned on everything but agricultural products, and import tariffs on manufactured goods were reduced to inconsequential levels. As a result, trade in manufactured goods has grown rapidly, achieving an unprecedented level of specialization and exchange among countries.

Developments in ocean shipping have also facilitated the latest wave of globalization, e.g., larger and faster vessels and containerization of their cargoes. These developments, combined with state-of-the-art logistics, have significantly lowered the cost of international transactions. Multinational firms now engage in just-in-time sourcing through global supply chains. Deregulation and increasing competition have further reduced costs of international transportation and telecommunications. Overbuilding of fiber optics capacity among countries during the dot-com boom in the 1990s also contributed to today's historically low prices of international telecommunications.

At the end of World War II, most countries imposed barriers to free movement of capital across their international borders. These barriers have been largely eliminated among high-income countries and have been significantly lowered in middle-income countries, too. Billions of dollars of funds can move instantaneously among countries at the touch of a computer key.

Why trade?

Why do countries engage in international trade anyway? The U.S., for instance, engages in such trade to obtain goods and services that some other countries can produce at relatively lower cost than it can in exchange for goods and services that the U.S. can produce at lower cost than the other countries can. If everything cost the same to make in every country, there would be no basis for international trade.

When a country engages in international trade, its households' real purchasing power rises. Their incomes stretch further because they can obtain at lower cost the goods and services they have been buying. The country as a whole benefits, too. When a country engages in international trade, it can produce more gross domestic product (GDP) from its land, labor, and capital because it is not using them to produce things that other countries can produce at lower resource cost. When a country opens its borders to free movement in and out of goods and services, the market then provides the incentive to move the country's resources into their highest-value uses, thereby facilitating economic growth.

Globalization has created the environment in which export-led economic growth can reduce poverty by bidding up wages in low-income countries. As poor people's incomes rise, they gain purchasing power and become better markets for the products that others produce more efficiently. This has happened over and over again, particularly in Asia.

At the end of World War II, Japan, Korea, Taiwan, and most other East Asian countries were very poor and their wage rates were very low. Japan's early post-war manufacturing exports were cheap in both price and quality; however, Japan's manufacturing industries developed and matured over time. Japan's wage rates were bid up by this export-led growth to the point that it could no longer compete in the production of the low-end labor-intensive products, and their manufacture moved to South Korea and Taiwan to take advantage of cheaper labor there. As South Korea's and Taiwan's wage rates were bid up, the jobs moved to Southeast Asia and, more recently, the coastal provinces of China.

Now we are reading press reports of labor shortages in coastal China, which mean that employers in labor-intensive industries there are having to pay higher wages to get labor. Jobs in labor-intensive industries are starting to move into the interior of China and on to India, where wage rates are lower. As each place loses competitiveness in labor-intensive industries, it moves up to more sophisticated and higher quality manufactured products. As the labor-intensive sectors move to take advantage of cheaper labor elsewhere, they leave behind a significant reduction in poverty in each country they depart.

As wages and incomes have risen in each country in succession, that country has become a better market for products in which the United States is competitive. For example, Japan, South Korea, and Taiwan became the best markets for midwestern corn and soybean products as people there gained the purchasing power to include more animal protein in their diets. Globalization made it possible for them to experience the broad-based, export-led economic growth that increased their purchasing power. While Asia has a huge population, parts of which are still growing rapidly, high numbers of people alone do not create market opportunities. It takes purchasing power along with large populations to translate need into effective market demand.

> One of the great benefits of globalization is the manner in which it increases wage rates and purchasing power in previously low-income countries.

The current Doha Round of the World Trade Organization's (WTO) negotiations is putting special emphasis on using trade to accelerate economic development in presently low-income countries. Out of the world's 6.5 billion inhabitants, about half live on less than $2 per day, and 1.25 billion live on less than $1 per day. People with so little purchasing power do not represent market opportunities. The objective of the Doha Round is to create a trading environment in which broad-based economic growth can occur in the presently low-income countries. Those countries confront the highest barriers to their exports in the very products for which they have a comparative advantage. These products include those made by labor-intensive manufacturers, such as textiles, apparel, and footwear, as well as crops that do well in the tropics, such as sugar, rice, and cotton.

Opponents of globalization often assert that opening up international trade will drag our standard of living down to that of low-wage developing countries. They have it exactly backwards. The objective is to accelerate broad-based economic development that brings wage rates in low-income countries up closer to ours. In the process, this will provide people in those developing countries with the purchasing power that will create better markets for products we produce more efficiently, and the development of better markets will, in turn, create more jobs here in the sectors in which we have a comparative advantage.

Dynamic change in competitiveness

Countries' competitive positions change all the time. No economy stands still. New mineral deposits are found, and others are depleted. Some countries' populations grow, while those of others decline. Research may find new technologies that provide a greater advantage to one country than another. New technologies can completely wipe out previous industries. How many buggy whip manufacturers can you find in the U.S. today?

It is normal for a new, high-tech product, e.g., the silicon chip or the personal computer, to go through a life cycle. When first introduced, production of a new product takes a lot of skilled labor. However, once the product's launch has been successful and a large market develops, its production can be mechanized and carried out by much less skilled labor than was required at the outset. It is not unusual for manufacturing to move at this stage to another country with abundant supplies of less skilled, and therefore lower-wage, labor. This can happen in a relatively short span of time. As such "commoditization" occurs, whoever can produce the product at lowest cost, while meeting the quality standards and delivery schedule of the buyer, will get the sale.

Today, industries rise and fall and rise again in other countries at a very rapid rate. What is clear, however, is that one of the great benefits of globalization is the manner in which it increases wage rates and purchasing power in previously low-income countries. This has happened over and over again in the past half century.

Any time an employer closes up shop in a community—large or small—it is traumatic to the community and to the individuals involved. Plant closings get high-profile coverage in the media. It is reported that 55,000 American jobs are moving overseas each quarter. One could easily get the impression from the media that all of our jobs are moving offshore. Not to understate the traumatic impact on the individuals and communities concerned, when put in perspective, the problem is not nearly as large as it appears in the media.

The United States has a well-functioning labor market and a very mobile work force. No one expects any longer to stay in a single job throughout a career. Every three months about 7 million Americans change jobs, and over 400,000 new jobs are created in the United States. The U.S. unemployment rate is very low by international standards, and there are large numbers of undocumented workers in jobs that most Americans don't want.

Economic theory tells us that when trade liberalization occurs, the gains of the gainers exceed the losses of the losers, and the country as a whole ends up better off. It does not say there are no losers, but it does say that because the gains of the gainers exceed the losses of the losers, it should be possible to compensate the losers for their losses and still end up with a net gain to society as a whole.

If a country is to reap the potential benefits from globalization—increases in both consumer purchasing power and potential GDP—adjustment must be allowed to occur. The market must be allowed to reallocate resources (land, labor, and capital) from the sectors that have lost competitiveness to sectors that can compete. However, such adjustment is neither costless nor painless. It hurts people who have specialized skills that are salable only in the sectors that are in decline. It also hurts people who have made investments in specialized machinery and factories that are not useful in producing other things than those they were designed to produce.

A well-functioning labor market, such as that of the United States, is essential to facilitate adjustment as smoothly and painlessly as possible. However, even with a well-functioning labor market, change can be costly in both monetary and emotional terms. Changing one's line of work often requires retraining, which may involve significant expenditure. There is also the matter of providing income for the family during the period of training. Changing jobs may require a physical relocation, which involves both the financial cost and the emotional cost of leaving family and friends behind and starting over in a new community. Older people may simply not feel they have enough working years left to incur the costs associated with starting over in another line of work or place.

Firms that lose their competitiveness are likely to have undepreciated specialized capital equipment that still has productive life left in it and must be written off as a loss. Investors in the business suffer capital losses. In the farm sector, a loss in competitiveness can also precipitate a drop in land values.

It is natural that people who are comfortable in their present situation—workers and investors alike—try to avoid adjustment. People in this situation often see themselves as being singled out for unfair treatment, being asked to accept losses in the value of their skills or investments. In our democratic system, it is also normal for politicians to do everything they can to "protect" jobs in communities that they represent, especially just before elections. As former Congressman Tip O'Neill said many years ago, "All politics is local." Further, no politician wants to see the number of voters in his or her district decline.

The cost of protectionism

When barriers to imports from lower-cost suppliers are erected, all of the country's consumers of that product are forced to pay more. In effect, they are taxed on their consumption of that good or service. The country's residents are asked to accept a lower per capita gross national product as a result of wasting some of the country's resources producing things that another country can produce at lower resource cost. Each job "saved" may end up costing consumers hundreds of thousands of dollars per year. The cost of providing the protection is diffused across all consumers of the products, while the benefits accrue to a relatively small group.

Great creativity is shown in the protectionist arguments used by leaders and advocates of industries that have lost their competitiveness. As a last resort, many petitioners for protection from lower-cost imports make the case that we need to protect a given industry because in a time of war it would be essential to have production capacity in that sector inside our country.

Labor groups often argue that it is unfair for them to have to compete with "cheap labor" in less developed countries. But that is exactly the point. In industries that are inherently labor-intensive, there is no way we can be competitive, and bidding up wages (reducing poverty) in presently low-income countries is what economic development is all

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about. Unless they can sell us the products that use their most abundant, and therefore lowest-cost, resource—their labor—their wages will never rise. And they will never become good markets for the products in which we have a comparative advantage.

Sometimes an industry that has lost its competitiveness is granted “temporary” protection from lower-cost imports to give it time to update its technology or modernize its facilities. However, one has great difficulty finding examples of industries ever willingly giving up this protection. More often than not, the assistance is used as a subsidy to keep producing in the same manner as always, with no adjustment occurring. Delaying adjustment in this way usually makes it more costly later on. This appears to be the case in many parts of the U.S. textiles and steel industries. This is also the situation in some parts of the agricultural sector, e.g., sugar, rice, and cotton, which have received the largest production subsidies and/or highest import protection.

It is not uncommon for industry leaders to argue that the cost per American consumer of protecting domestic production of a certain good is small. This may be true for a single product; however, if protection is provided to one industry, others will demand it. If a country provides protection across a broad range of goods and services, its citizens lose twice. Their incomes are lower because the country forgoes potential GDP when it allocates its resources inefficiently. And what income they receive has smaller purchasing power because they have to pay more for the protected goods and services that they could have obtained at lower cost.

Trade Adjustment Assistance

Recognizing that the gains of the gainers exceed the losses of the losers from trade liberalization, the U.S. Congress has institutionalized Trade Adjustment Assistance as a means of compensating the losers. Compensation to losers from trade liberalization is granted out of a sense of equity or fairness to facilitate adjustment of labor or investment out of a declining industry. This may involve retraining workers who lose their jobs and buying out the undepreciated value of investments in specialized machinery and facilities that cannot be used for other purposes.

Compensation may also be justified if imports of cheaper goods had not occurred previously because an otherwise uncompetitive industry had used its political connections to secure government subsidies and protection from imports. In this case, a buyout or some other form of compensation may be necessary to neutralize that industry’s political opposition, which might prevent trade liberalization from occurring and block the rest of a country’s residents from reaping the benefits of freer trade.

Conclusion

Overall, the world has benefited enormously from globalization. However, because the adjustment required to attain the benefits of increased globalization can be costly to individuals, it is appropriate that society as a whole, which stands to benefit, shares in the costs of those who lose as a result of globalization through such means as Trade Adjustment Assistance. The current round of WTO trade negotiations, the Doha “Development” Round, provides an opportunity to exploit trade liberalization to bid up wages and reduce poverty in low-income countries. This would make the world a safer and more just place, while creating larger potential markets. I will look at the implications of globalization for rural America in an upcoming issue of this publication.