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Share gains with globalisation's losers

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Globalisation remains the great economic story of our era. It is also the great political story. The big question remains how likely is a reversal of our era's move towards a more integrated global economy. History suggests, alas, that the onward march towards integration is not inevitable: economics may propose, but politics dispose.

This was the issue raised by Ben Bernanke, chairman of the Federal Reserve, in his address to this year's annual economic symposium organised by the Federal Reserve bank of Kansas City at Jackson Hole, Wyoming.* At the end of a brief overview of the history of economic integration, Mr Bernanke argued that "the social and political opposition to openness can be strong. Although this opposition has many sources... much of it arises because changes in the patterns of production are likely to threaten the livelihoods of some workers and the profits of some firms, even when these changes lead to greater productivity and output overall". The need, he suggests, is to ensure that the benefits of integration are sufficiently widely shared.

Mr Bernanke concentrates, implicitly, on the politics of the high-income countries; and, second, he devotes attention to trade in goods and services. He is right to do so. The US and Europe remain the core of the global economy. Equally, nothing is more politically sensitive than trade.

What, then, is likely to be the impact of the current wave of globalisation on trade and production in the high-income countries? Mr Bernanke notes three relevant novelties of today's globalisation.

The first is the scale and pace of integration, with global merchandise exports now above 20 per cent of world gross product, compared with 8 per cent in 1913 (the end of the last era of globalisation) and 15 per cent as recently as 1990. More fundamentally, "the emergence of China, India and the former communist-bloc countries implies that the greater part of the earth's population is now engaged, at least potentially, in the global economy".

The second is the transformation of the international division of labour. High-income countries used to export manufactures in return for commodities. Now developing countries are able to produce and export things the high-income countries make.

The third novelty, as Princeton University's Gene Grossman and Esteban Rossi-Hansberg also noted at the Jackson Hole conference, is the growth of trade in tasks within manufacturing and services.** The digital revolution allows the unbundling of production to an unprecedented extent. The old assumption that services were non-tradeable is obsolete. Those that can be turned into "bits" are potentially more tradeable than goods.

What does all this mean? A frequent answer is that a tide of irresistible competition from cheap Asian labour will sweep the economies of the high-income countries into oblivion. Alternatively, those who are slightly less alarmist suggest that wages and salaries in the rich countries will collapse, as Asian pauper labour succeeds in setting the global wage.

Two of the papers at the symposium shed useful light on these anxieties. The first, by Tony Venables of the London School of Economics, noted the entrenched advantages of agglomerations of economic activity.*** Indeed, among the most striking features of economic activity are the gains from proximity. The dominance of a few cities in international finance – at first glance, the world's most easily tradeable activity – is a superlative demonstration. Prof Venables notes copious research on the gains from proximity: other things being equal, moving from a city of 100,000 to one of 10m raises the productivity of all factors of production by 40 per cent.

The conclusion of this line of analysis is that production will shift only where the benefits of agglomeration are relatively small or the benefits of moving activities are large. Moving back-office functions is an example of the former. Shifting production of clothing to poorer countries is an example of the latter. But the advantages of established centres of expertise are enduring, provided some effort is put into maintaining them: London has been a world-class financial centre for almost three centuries. The relocation of activity will, suggests Prof Venables, prove both difficult and “lumpy”.

More important, trade is no zero-sum game. Profs Grossman and Rossi-Hansberg show this in analysing how the cost-advantages of trade may play out in our brave new world of “trade in tasks” within the production chain. Again, the conclusion is that the impact on the high-income countries is more complex than popular discussion suggests. Trade in tasks has three potential effects: productivity improving, as companies outsource activities that can be done more cheaply abroad; relative price or terms of trade altering, as prices of exports rise relative to those of the now cheaper imports from new suppliers; and labour-supply enhancing, as labour is released from its prior activities. The net effects are unpredictable, but the most important point is that offshoring of tasks is equivalent to technological progress. Being opposed to trade is no more reasonable than being opposed to other sources of higher productivity.

What do these analyses tell us? A first conclusion is that developing countries have more reason to fear the entrenched advantages of the high-income countries than the other way round. A second is that there are big gains from the new entrants in world trade: between 1993 and 2004, for example, the prices of US exports rose by 16 per cent relative to those of its imports of manufactures from developing countries. A third is that relatively low-skilled workers may not lose from offshoring, after all. The last is that the rise in trade opportunities is equivalent to a boost in productivity and should be welcomed for exactly the same reason.

The pain of the losers is the reverse side of the overall gains. But it is pain all the same. The need is to find a way of ensuring a broad sharing of the gains. This can be done by subsidising retraining, subsidising the wages of the unskilled or subsidising goods and services that are particularly important for the futures of the unskilled (health and education services being obvious examples).

The political challenge is to secure consent to changes that should benefit almost everyone in the long run. The answers will be different in different countries. But answers must be found. Globalisation offers big potential benefits. Policy must ensure that this potential is realised. July’s failure of the Doha trade negotiations suggests that policymakers still fail to recognise its urgency.

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