Globalization, Development and Integration

A European Perspective

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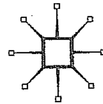

Editorial matter, selection and introduction © Pompeo Della Posta, Milica Uvalic and Amy Verdun 2009

Preface © Stefano Zamagni 2009

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First published 2009 by
PALGRAVE MACMILLAN

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Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

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ISBN-13: 978–0–230–55401–6 hardback
ISBN-10: 0–230–55401–6 hardback

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication Data

Globalization, development, and integration : a European perspective / edited by Pompeo Della Posta, Milica Uvalic, and Amy Verdun.
p. cm.
Includes bibliographical references and index.
ISBN 978–0–230–55401–6
1. Globalization. 2. Globalization—Economic aspects—Developing countries. 3. International economic integration—Social aspects. 4. European Union. I. Della Posta, Pompeo, 1960–. II. Uvalic, Milica, 1952–. III. Verdun, Amy, 1968–
JZ1318.G566 2008
306.3—dc22

2008020803

10 9 8 7 6 5 4 3 2 1

Some Notes on Globalization

Paul De Grauwe

Introduction

I will briefly discuss challenges of globalization in three areas:

- Poverty and inequality
- Social model
- Environment

Globalization, poverty and inequality

The evidence produced by the World Bank shows that the total number of extreme poor in the world (that is those living below $1 a day) has declined by close to 400 million (Table RT.1), and so has the poverty *rate* (that is the percentage of population living below this level) since 1981. These global numbers, however, conceal large differences between continents. In particular, while the decline in the number of extreme poor was spectacular in Asia, this number increased significantly in Africa since 1981.

This evidence suggests that if globalization has influenced poverty in the world, its effects have been very different. One must analyse the question of why in Asian countries globalization and a decline in poverty are observed together, while in African countries the opposite is true. Theories that make sweeping generalizations about how globalization always leads to poverty (or the reverse) are therefore suspect.

The evidence about inequality is less clear-cut. Given the dynamics of globalization, it is almost inevitable that the level of inequality will increase. This can be shown using the following stylized figure representing the evolution of per capita income of different nations since 1800 (Figure RT.1). We see that these nations have taken off at different times. Typically during the catch-up phase these countries have been growing faster than those who started earlier. As time went by, the growth rates of the 'catch-uppers' have increased. For example, China now grows much faster than did either Germany or the

Table RT.1 Millions of people below $1 a day

Region	1981	1990	1999	2001
China	634	375	223	212
India	382	357	352	359
Rest of SE Asia	254	202	135	132
Eastern Europe and Central Asia	3.1	2.3	30	17
Latin America and Caribbean	36	49	54	50
Middle East and North Africa	9.1	5.5	7.8	7.1
Sub-Saharan Africa	164	227	294	313
World	1,482	1,219	1,096	1,089

Source: World Bank.

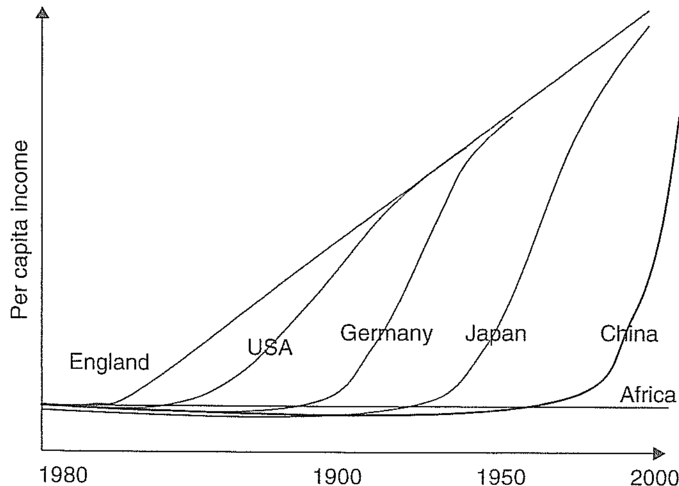

Figure RT.1 Stylized representation of the evolution of per capita incomes

USA in the nineteenth century. The reason is that as the distance between the developed countries and the poor stagnating countries increases, it is much easier to grow because one can copy so much more (technologies, products) than in previous times.

Africa continues to stagnate. It is therefore inevitable that the inequality between the top (the richest countries) and the bottom (Africa) increases. Is this evidence that globalization is to blame for increasing inequality? Yes, in the sense that not all countries integrate themselves in the world economy at the same time.

Globalization and social security

There is a widespread perception, especially in Southern EU countries, that globalization endangers Europe's social security system. This view is often formulated as follows. Social security is expensive as it raises the cost of labour. As a result, profit-maximizing firms tend to curtail their activities in countries with high labour costs and move to places where the cost of labour is low and where the social security system is less extensive. As rich countries open their markets to imports from countries with lower labour standards and lower wages, employers and governments in rich countries are forced to adopt similarly low standards in order to remain competitive. These phenomena create pressures on the countries with well-developed social security systems to scale back on them. A 'race to the bottom' is set in motion, whereby the competitive pressures arising from globalization slowly erode social security. If not controlled, this dynamics may destroy one of the great social achievements of European countries – their capacity to guarantee a reasonable income to all citizens hit by unfavourable conditions.

How serious is this 'race-to-the-bottom' scenario? Let us first consider some of the facts. Figure RT.2 shows social expenditure in the OECD countries in 1980 and 1995 as a percentage of GDP. We observe that, if anything, social spending has increased in almost all OECD countries since 1980. In a second step we relate social spending to measures of competitiveness. The 'race to the bottom' hypothesis suggests that countries which spend a lot on social security pay a price in terms of competitiveness which will ultimately force them to scale down their social security systems.

In order to test for this hypothesis we relate the OECD social expenditure data to two indices of competitiveness as constructed by the World Economic Forum and by the IMD of Lausanne. These indices synthesize the different dimensions of the competitiveness of nations (cost and price competitiveness, capacity to innovate, quality of human capital, efficiency of government sector, and other indicators). (For more detail about how these indices are constructed, see De Grauwe and Polan, 2005.) Social spending includes spending on unemployment, disability, health care, pension, family services (including child benefits) and housing.

Scatter diagrams and regression lines in RT.3 and RT.4 show the relation between the competitiveness indices and social spending. The regression results themselves are shown in RT.2 and RT.3.

The results suggest that there is a negative relation between the competitiveness ranking and social spending. This means that the countries that spend larger proportions of their GDP on social needs also score best on the competitiveness scale (they have a low number in the ranking).[1] Note that we relate the average competitiveness during 1998–2002 (IMD) or 1999–2001 (WEF) to the social spending in 1997 (this is the last available observation that is comparable across OECD countries). In doing so, we minimize the

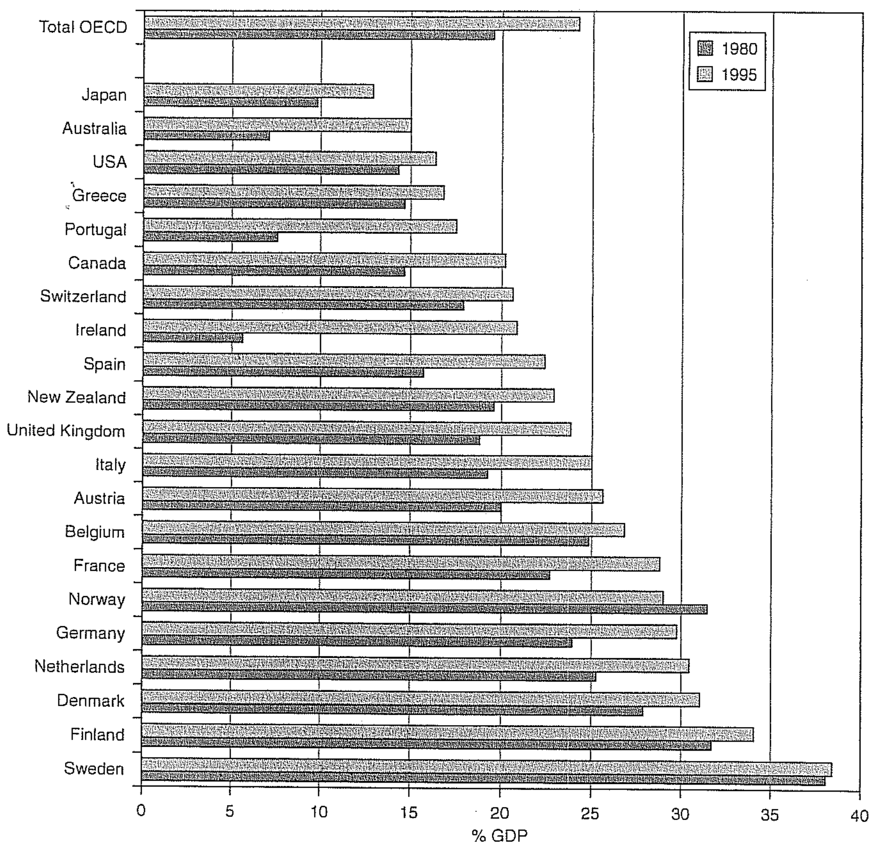

Figure RT.2 Social spending as a percentage of GDP in OECD countries
Source: De Grauwe and Polan (2005).

potential for a reverse causality. Reverse causality would occur if the countries with a high competitiveness rank created more domestic value added (their domestic product would be higher) and that, in turn, allowed them to spend more on social needs. By regressing competitiveness on past values of social spending we eliminate reverse causality as a possible explanation of the negative relations between social spending and competitiveness rankings.[2]

The previous results suggest that there is no contradiction between high social security expenditure and the maintenance of high levels of competitiveness. Scandinavian countries stand out in terms of both superior levels of competitiveness and high social spending, testifying to the view that there does not have to be a contradiction between the high levels of social security and competitiveness.

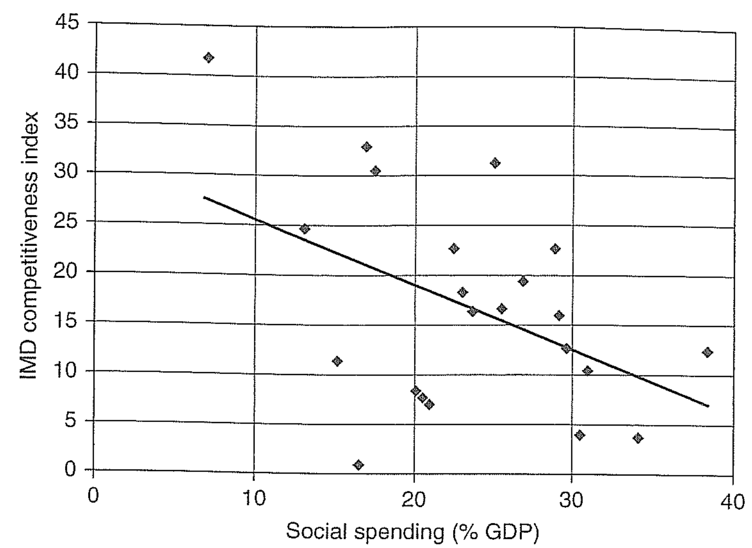

Figure RT.3 Social spending and IMD competitiveness index

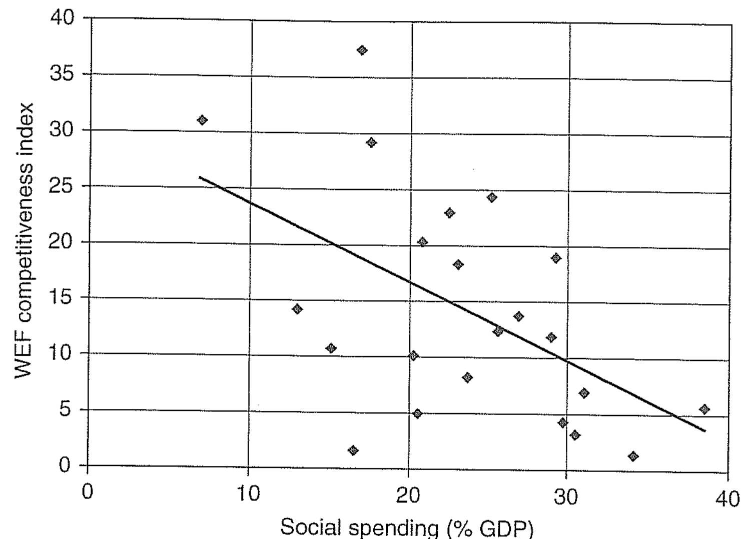

Figure RT.4 Social spending and WEF competitiveness index
Source: De Grauwe and Polan (2005).

Globalization and the environment

The evidence suggests that 'local' pollution has declined in rich countries (for example, small particle pollution, SO_2, lead, and so on).[3] This has

Table RT.2 IMD (average of 1998–2002) on social spending

Included observations: 21

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	24.912	7.6617	3.2514	0.0042
social spending	**−0.3725**	0.3057	−1.2186	**0.2379**
R-squared	0.0725	Mean dependent var		15.895

Table RT.3 WEF (average of 1999–2001) on social spending

Included observations: 21

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	27.980	7.4879	3.7367	0.0014
social spending	**−0.6025**	0.2987	−2.0167	**0.0581**
R-squared	0.1763	Mean dependent var		13.396

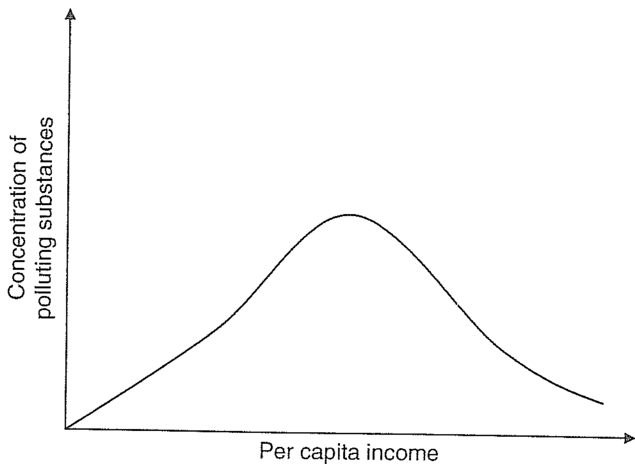

Figure RT.5 Environmental Kuznets curve

not happened in the poor countries, where local pollution has tended to increase. The case in point is China where this kind of pollution has increased dramatically.

The existence of an environmental Kuznets curve (see figure RT.5) suggests that policies aimed at reducing poverty also help to reduce this kind of pollution.

The main problem of globalization has to do with border-crossing pollution (for example, CO_2, oceans). The absence of a world government (or a sufficient degree of cooperation between national governments) leads to the 'Tragedy of the Commons'. Nations have too few incentives to curtail the pollution that crosses their border. As a result, nobody is responsible for the deterioration of the global environment.

Solving the 'Tragedy of the Commons' is the most important challenge we face. If we do not manage to solve it, globalization will have to be turned back.

Notes

1. Note that the USA is the most notorious exception to this rule; it is ranked first (according to IMD) and second (according to WEF) in terms of competitiveness during the period 1997–2001 and spends relatively little on social security, i.e. only 17 per cent, compared to about 30 per cent in most Northern European countries. Figures make it clear that the USA is the exception to the rule. Nevertheless, the experience of the USA has very much influenced the perception of the critics, who now claim that the US experience of high competitiveness and low social spending is a strong indicator of what globalization will do in Europe.
2. In De Grauwe and Polan (2005) the reverse causality is tested further by the introduction of instrumental variable methods.
3. See Lomborg (2001).

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An Overview of Current Globalization: Opportunities and Threats

Giorgia Giovannetti

Globalization has accelerated rapidly over the last 20 years, with global trade and cross-border capital flows both rising substantially relative to GDP. Trade in goods and services has expanded continuously and in most countries:[1] the ratio of world exports to world GDP, to a large extent driven by developments in emerging economies, has more than doubled between 1980 and 2005 (see ICE, 2006). Financial integration has also proceeded rapidly. The sum of stocks of foreign assets and liabilities over GDP for industrial countries has increased fivefold since the early 1980s, with an impressive rise in cross-border financial flows especially during the past decade: the share of assets and liabilities in GDP rose by more than 130 percentage points between 1995 and 2005.

Trade integration and financial integration have reinforced each other in various ways.[2] For example, larger trade flows increase the demand for financial instruments for risk hedging. Similarly, greenfield foreign direct investment is normally associated with increased imports of capital goods in the phase of construction of a plant and, possibly, increased exports afterwards (if investment and exports are complementary, which is likely when investments are horizontal). Furthermore, the production of (many) goods and services has (recently) become increasingly fragmented into components, that are dispersed over different countries via international outsourcing and offshoring. This also has represented a stimulus to raising international trade and also to cross-border foreign direct investment (FDI): a strong growth in exchanges of 'parts and components' or 'semi-finished goods' has reflected the reorganization of the productive process on a global (sometimes regional) basis and is the mirror-image of FDI growth. Outsourcing is also increasingly spreading to services, thanks to the emergence of information and communication technology (ICT), notably the internet. Hence, not only the amount of trade and investments, but also their structure is influenced by offshoring and outsourcing.

The growing interdependence, which can be observed by looking at data on trade, production and financial market linkages but also at maps,[3] was

driven by a number of different factors, including the boom in the use of information and communication technology (ICT), the opening up to international trade of some large emerging countries, rising income and (even more) income per capita levels and the ongoing liberalization of trade policies and capital controls in many countries. The ICT revolution, in particular, via lower costs of transporting goods, services and information across the globe has resulted in increasingly internationalized production processes, as firms have established affiliates abroad to gain access to foreign markets and reduce input costs. Improvements in ICT have also fostered cross-border financial flows by facilitating the development of new financial instruments as a result of declining transaction costs.

In the last ten years, the increasing interdependence has also been accompanied by robust economic growth, especially in emerging economies, and rising income per capita. Between 1995 and 2005, world GDP growth averaged 4 per cent per year, compared with a 3 per cent yearly average during the period 1980 to 1994. Developments in emerging economies have steadily become more important, reflecting their strong growth and rising share in world GDP. Economic growth was particularly strong in Asia (especially in China, but also in India and in the NICs); in addition, GDP per capita rose more rapidly in the emerging economies than in industrial ones. In particular, there was a marked improvement in per capita output in China, where it rose from 14 per cent of the OECD average in 1995 to 25 per cent by 2005 (see ICE, 2006). Russia and Eastern Europe also saw their income per capita double in the last ten years and there was a similar increase in the oil-producing countries of North Africa. The opening-up of emerging countries – namely emerging Asia and Central and Eastern Europe – to international trade and production has meant much larger destination markets. Expanding markets, in turn, allowed firms to exploit scale economies in production of manufactured goods.

Despite rising concern about the process of 'creative destruction' induced by globalization while allocating resources more efficiently among sectors and regions, there is indeed mounting evidence that inequalities in global income and poverty are decreasing and that globalization has contributed to this turnaround. Empirical evidence, in fact, suggests that developing countries which experienced substantial poverty reduction are, at the same time, the most integrated into the global economy through trade and FDI channels. Within the same country, globalization may induce possible increases of income inequality as competition from emerging economies put pressure on wages of low-skill workers in developed countries. Economic theory predicts that, depending on labour market functioning, they could face either a decrease of their real wage (in relative terms) or a higher possibility of being unemployed. Particular concern is raised about workers employed in exposed sectors. The prevailing view is that, while globalization creates aggregate gains, it also entails adjustments and, at the end of the adjustment,

there will be winners and losers. In the world that we briefly outlined above, the main determinant of the net gain is, however, no longer the skill level but, as pointed out by Baldwin (2006) and Grossmann and Rossi-Hansberg (2006a,b), the extent to which 'tasks' can be traded or offshored, where the ease of trading (offshoring) a particular task is not matter of kind but of degree and, more importantly, is a variable and not a constant (something that is not traded/offshored or even tradable today, can be so tomorrow). Some information society jobs are therefore likely to be subject to rapid changes in trade costs, in other words, they are, in principle, offshorable. With this respect, I find the example of the taxi driver (freely adapted from Baldwin, 2006) very clear: a taxi driver in Florence (despite some attempts at liberalization) is paid much more than a taxi driver, say, in India. But driving a cab is a truly nontradable job and there is no way that a taxi driver in India can compete with those in Florence. A service that can be delivered down a fibre optic cable, like X-rays for instance is, on the other hand, subject to competition from a country like India. Hence, for X-rays, either wages in industrial and emerging countries tend to be similar or, alternatively, jobs will be offshored while taxi drivers are somehow 'protected' by their own location.

There are plenty of gains to be reaped in the global (enlarging) world, but there are also threats. The gains from trade for newly tradable tasks are exactly the same as for trade in goods. Therefore, the gains are known to everyone and there is no need to discuss them. 'Pain from trade', on the other hand, may be less correlated with skill level and job experience and even with specialization (sectors) than they were in the past, before the ICT revolution, when there was no transmission by cable or optic fibre.

I am convinced that structural reforms may help in spreading out globalization opportunities. A new 'flexibility' may be the key condition to fully reap the benefits of globalization. Increasing integration among labour market, social and education policies might reduce transition costs on the adjustment path. Lifelong training and investment in human capital, in particular, may integrate, if not substitute, for traditional instruments of social protection, with the aim of maximizing workers' employability. It is essential that labour markets can adjust to the variation in countries' production structures in order to fully exploit their changing comparative advantages. This requires the right incentives for mobility of workers, between jobs and regions, but also from unemployment to employment.

I would like to refer to Italy. The upsurge of globalization, with the resulting improvement of technological content of traded goods and the reduction of their price, has benefited consumers exactly (hopefully, given some product market rigidities) as in all other industrial countries. On the supply side, however, the Italian productive sector was adversely affected owing to the similarity of its trade specialization to that found in emerging countries. Italy's adjustment to globalization presents a very distinctive feature in that Italy has recently become even more specialized in the traditional sectors

(see Giovannetti and Quintieri, 2007). Therefore, the adjustment is being mostly made *within sectors* rather than *between sectors*. In the long term, this does not necessarily represent a negative aspect as an increasing demand of high-quality consumer goods from emerging countries, whose income per capita has increased and are therefore changing the basket of consumption goods, is expected. The successful Italian firms undertook the mix of strategies usually adopted: they cut redundant costs, delocalized low value added productions, made innovation (mostly product quality upgrade), intensively searched for new export markets and adopted new marketing strategies. Interestingly enough, in relative terms, they lost less employment and they hired a proportionally larger amount of the qualified labour force.[4] This adds to the international general evidence that globalization does not necessarily harm labour markets of developed countries. Nonetheless in the short term Italy is likely to be more adversely hit than other developed countries.

With regard to the issue of income inequality, the evidence gathered about Italy suggests that sectors that face the highest competition are increasing the average skill of workers they employ. As a result of higher average wages, the labour share in most sectors that produce traditional goods is increasing rather than falling (see Guscina, 2006). Despite stagnation, moreover, the Italian economy was able to produce a relevant number of new jobs over the last decade. This perhaps helped to make more sustainable the adjustment costs to globalization. There is not yet clear evidence, however, on to what extent workers laid out in sectors exposed to competition were 'absorbed' by the tertiary sector. Personal costs of adjustment could be quite high, as skills and competence that are embedded into the specialized tasks undertaken in one sector might be of no value in other sectors. This could possibly imply a reduction of income perspective even if the worker was able to find a new position and point to the fact that in the new globalized world the individual is increasingly central and the standard categories used to assess gains and losses are too 'large'.

Let me conclude by saying that, as globalization has advanced, it has become easier to move some 'tasks' offshore. For the workers who once carried them out, this has three possible consequences – two bad, one good. The good news, which I want to emphasize, is that offshoring makes firms more productive. The tasks that are best kept close to home remain onshore; other tasks can be taken care of in cheaper places abroad. Everyone benefits from this gain in productivity, including those workers who have fewer tasks to perform. For example, Baldwin (2006) claims that Japanese electronics companies continue to flourish in American markets precisely because they have moved their assembly lines to China. I could add more examples even on traditional sectors for Italy (firms in textiles, furniture, shoes and leather which have increased employment and value added in the toughest years). Hence, the true challenge is to be ready. I agree with Baldwin when he says that what is really crucial is 'learning to learn'. Only by being flexible enough to keep

globalization. Also the policies then have to be adapted: the Lisbon strategy and upgrading skills may not be enough.

Notes

1. Only some countries in Africa have been kept out of the globalization process of the last 50 years, as illustrated by the maps shown at the conference roundtable. See also OECD (2005a).
2. Lane and Milesi-Ferretti (2003), among others, show that trade flows are correlated with financial flows and that the size of the induced financial flows is generally a positive multiple of size of the original trade flows.
3. In the roundtable at the conference, several maps were shown.
4. Baldwin (2006) finds a similar result for Japan: 'Offshoring, in other words, was a source of Japan's comparative advantage in US and EU markets' (p. 22).

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Globalization: Beneficial for Whom?

Jürgen Kröger

The debate about outsourcing, offshoring, relocating and related issues has become a hot political subject on both sides of the Atlantic. Increasingly alarmist sound-bites suggest that more and more of our jobs are in danger of moving to overseas locations such as India or China, but also to somewhat nearer shores in Central and Eastern Europe. In this short contribution I would like to address some of the myths and realities with respect to the issue of outsourcing to other countries, in particular as far as the old EU member states are concerned. Note that concerns in this respect are not by any means confined to the old EU member states – even in the new member states concerns are growing that as wages rise jobs will be outsourced further east – say to Romania or the Ukraine. Of course, outsourcing (or offshoring) has been going on for centuries, but at present there appear to be two somewhat new variants on an old theme.

First, there is the issue of relocating production facilities to the new member states including the now candidate countries, and perhaps further east, with the process being driven by cost arbitrage. This relocation process is related mainly to labour-cost differentials, but taxation, social and environmental standards and the like also clearly enter the picture.

The second somewhat new phenomenon is the increased outsourcing of services, in particular information technology (IT) activities, to Asia, but mainly to India and more and more also to China. This means that a number of jobs – including some highly skilled ones – in previously nontradable sectors have now become vulnerable to foreign competition. While the first issue can be considered to be an EU integration phenomenon, the outsourcing of services is clearly part of what we call 'globalization'.

1 What are the questions to be raised?

First, of course, there may be a negative impact of outsourcing on the availability of jobs in the 'outsourcing' countries, at least at first glance. Politicians

and trade unions are expressing a fear that outsourcing would lead to job losses and aggravate our unemployment problem.

Secondly, and perhaps more importantly in the medium term, there are concerns about how outsourcing would impact on the income distribution between and within countries and sectors. Since, in particular, low-productivity jobs are outsourced, fears are being expressed that the lower part of the wage scale would be shifted further down. In the case of the offshoring of services, rather elementary activities such as data input and processing, call centres and help desks are mostly involved. However, more ambitious tasks such as medical analysis are also increasingly being subjected to outsourcing. Thus, with trade in services potentially affecting a much larger proportion of the workforce, the potential downward pressure on wages could be much greater as well. Richard Freeman has put it succinctly in the question, 'whether our wages will be determined in Beijing?'

2 What are the evidence and reasons for outsourcing offshore?

Although the data situation is rather bleak, it is evident that the outsourcing of services is a dynamic phenomenon. Estimates of employment in the IT software industry in India suggest that an increase in employment is currently taking place – the numbers employed rose from 250,000 people employed in 2000 to 900,000 in 2005. Such outsourcing activities are not new. In the 1960s–1970s, Japan was the target for manufacturing outsourcing while, in the 1980s–1990s, in particular following the 1986 Single European Act, India benefited from foreign direct investment (FDI) from Europe and the USA. The new element is that advances in IT have made the outsourcing of services activities possible.

Previously, the provision and consumption of services were constrained to take place at the same place and at the same time. The share of 'disembodied' services has, however, increased and, in principle, the respective value added can be produced at any place in the world.

However, to put the so-called Indian threat into perspective, how big is it really? The best-known report, by the consultancy Forrester Research (2002), estimates that 3.3 million US service industry jobs will have gone overseas by 2015 – quite impressive, yet a tiny number when you consider the 7–8 million jobs lost every quarter through the normal process of job turnover in the US economy.

The main factor driving outsourcing is cost savings. While hourly labour cost in software IT production exceeds €50 in Europe and €45 in the USA, it is only €7$\frac{1}{2}$ in India or the Czech Republic. However, impressive as these differences are, other cost factors have to be considered: lower productivity, different working habits, the need to establish an enterprise, which involves search and transition costs abroad, and to provide overhead capacities (coordination costs), all of which render production more expensive.

Moreover, offshore production may also be more risky. There may be greater proprietary risks, reputation risks and specific asset risks. Thus, the estimated cost reduction is much lower than wage differences would suggest. The literature assumes that cost reductions from outsourcing amount to around 30–50 per cent of total costs. Another reason for outsourcing is the availability of qualified workers. While Germany has around 5,000 IT university graduates (compared to the US's 25,000), India produces 120,000 IT experts annually (and China 250,000).

A further reason is that markets which are attractive for outsourcing are normally very dynamic markets. Being present in an emerging economy provides an opportunity of benefiting from catching-up and exploiting local market opportunities. Indeed, one should note in this context, that a recent study on German FDI in Central and Eastern Europe (Deutsche Bank 2006) found that three-quarters of the companies investing in the region did so for market-access reasons rather than because of labour-cost arbitrage.

Finally, labour market regulations are normally less tight in emerging economies, thus increasing the flexibility of the corporation as a whole.

3 Job creation: beneficial for whom?

As already mentioned, countries such as India and China evidently gain from outsourcing and services offshoring in terms of employment creation. In particular, the creation of clusters of dynamic regions could lead to benefits beyond the direct impact of outsourced activities. Central and Eastern European countries will most likely not challenge India or China in terms of size and number of IT professionals. However, they do have a part to play in Europe for near-shore outsourcing: they have distance, time zone, cultural and language connections in their favour so that contacts are facilitated.

Let me provide an illustration of the potential benefits. By putting 10 million people in India to work at $26,000 a year providing white-collar services, you would boost India's standard of living by 50 per cent. These 10 million jobs represent some 4 per cent of the 240 million service sector workers in the First World.

But what about the countries from which outsourcing takes place? In principle, the initial job losses can be seen in the light of a 'creative destruction process' in the Schumpeterian sense. Obviously, companies that are reducing their costs by outsourcing would increase their profits, which could lead to higher investment in high value-added jobs. Higher profits could lead, through a fall in prices, to higher real wages. Because of these effects, growth and employment creation does not need to suffer. Indeed, in a recent study Mann (2002) shows that growth in the USA would have been 0.3 per cent lower per year (1995–2002) if there had been no outsourcing. Also, the

recovery of the IT sector after 2001 is partly explained by the buoyancy of outsourcing activities.

In general, little attention is paid to the benefits of consumers resulting from lower prices. It is not difficult to convince well-educated economists that these benefits typically far outweigh the costs attached to relocations and offshoring. The public debate, however, tends to get distorted and biased, simply because potential and real losers in the process are fairly easy to identify, while the gains are perceived as accruing to 'ruthless capitalist traitors', or they are not seen at all.

But will all of the world's regions benefit equally from outsourcing? Indeed, one has to admit that Europe might suffer relative to the USA. There are few global players in IT production. Moreover, culture and language favour the Anglo-Saxon countries. But internal factors also suggest that more jobs might be in jeopardy in Europe. The lack of IT managers is a constraint to the management of outsourcing. Finally, enterprises are more reluctant to create additional jobs because of rigidities in the labour market. From a US point of view, it is also an advantage that many of the outsourced activities are carried out by companies which are owned by US legal identities. A recent study by the Deutsche Bank (2006) cites that for each dollar invested for outsourcing, Europe loses $0.2 while the US gains $1.13.

4 Impact on income distribution

Even if a country is in a position to gain from outsourcing, the question of who gains arises. Evidently, in the first round, companies that are able to outsource activities successfully would be able to increase their profits. Secondly, those firms that are providing the investment goods needed in the countries in which outsourcing has been taking place would also gain. In the case of IT outsourcing, these are information and communication technologies (ICT) producing companies and the large software houses. However, since standard, low educational jobs are outsourced in particular, there will be a stronger competition for these jobs. In a competitive labour market, wages for these jobs would decline. In the USA, wages for workers with elementary appliance IT work fell by 17 per cent over the last two years while salaries for IT managers increased by 14 per cent.

As regards the distribution of the respective gains stemming from offshoring, a McKinsey study (McKinsey, 2005) estimates that for every dollar of US activities offshored, there is a global gain of $1.45. In their analysis, India captures 33 cents of the total, leaving the US with the remaining $1.12. How is this $1.12 distributed between domestic sectors? 'Re-employed' workers get 45 cents – a substantial reduction – additional exports account for a modest 5 cents and shareholders of the firms doing the offshoring gain the other 62 cents. US shareholders, it appears, win while US workers lose. But this new allocation may be only temporary. Over the longer run, competition among firms should drive down profits and consumers should benefit from lower prices.

5 Policy issues

To the extent that structural change always includes losers and winners, the political pressure to prevent such change is evident. However, protectionist measures would prevent our economies from benefiting from worldwide integration.

In the longer run, our economies would become less competitive and the standard of living would fall. In contrast, outsourcing could be one helpful channel to arrest our declining trend in productivity. For example, foreign outsourcing may accelerate the introduction of innovative products and services – an effect that has thus far remained unmeasured but may be important. Some new and young firms, especially those reliant on information technology, are using highly trained foreign technicians to build prototypes of new products and services. Obviously, this could be done at far lower costs and perhaps more quickly abroad than at home.

In view of demographic changes in Europe, if Europe does not take advantage of the human resources available elsewhere in the world, this challenge will certainly be bigger. Therefore, politics should have a positive attitude towards activities that will cause an eventual rise in our standard of living. However, in order to ensure that offshoring is truly a win–win game, some of the gains have to be transferred from winners to losers. This may involve support for specific regions, but in particular investment in education/training for those who have lost their job. Indeed, jobs held by people who are not accustomed to layoffs have now become 'tradable'. In sum, outsourcing, if accompanied by an appropriate policy response, can be a catalyst for growth rather than a motivation for protectionist policies.

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Globalization Today: Incomplete, Distorted and Unfair

Domenico Mario Nuti

Globalization – understood as increasing worldwide economic integration – is today equally as spectacular in its progress as in its incompleteness. Globalization is incomplete because of the maintenance of forms, often intense, of protectionism, tariff and non-tariff; the proliferation of commercial blocks (200 regional agreements at the latest count, for the 150 World Trade Organization (WTO) members; only Mongolia is not part of a block); the lack of a single world currency in place of 105 currencies, the conspicuous lack of global governance institutions.

Globalization is also *asymmetric* – as Pompeo Della Posta has argued rightly in his contribution to this volume – or, I would say, *distorted*, for it favours the international mobility of capital rather than labour; it finances global imbalances instead of investment and growth in poorer countries; it causes turbulences, crises and contagion; it promotes trade opening to the industrial exports of advanced countries that protect their domestic markets against the agricultural and labour-intensive exports of poorer countries; and so on. This very asymmetry/distortion is a form of incompleteness (complete globalization would have to be symmetric, though the converse is not true, for in principle incompleteness could be symmetric).

Economic theory provides hardly any support for the efficiency of an incomplete and distorted globalization; on the contrary, it favours *second-best* type arguments that cast strong doubts on its efficiency. Clearly the advantages expected of globalization – comparative advantages, static and dynamic; acceleration of growth due to foreign direct investment and financial capital mobility; technology diffusion – have been grossly exaggerated.

But the costs of globalization have also been much exaggerated. All of the objections raised by the opposers of globalization have substantial grounds but – with the exception of distributive considerations – there are mitigating factors or qualifications that reduce the strength of their arguments. True, multinational companies have a dominant weight in domestic economies, avoid taxation, manipulate consumers with their trademarks, contribute to environmental pollution, and exploit cheap (especially female and child)

labour, while international organizations have restrictive policies and non-democratic procedures.

But states have powers that are much greater than those of multinationals, governments are at fault if those powers are not used, against offending national as well as multinational companies. Tax avoidance is facilitated by globalization but also takes place domestically; the demise of the welfare state is due more to the victory of hyper-liberalism and the loss of government policy instruments than to trends in globalization.

Corporate governance is a general problem regardless of multinational status. Labour exploitation existed before globalization; it may be a condition better than unemployment and is certainly better than destitution. Boycotting the products of exploited labour by advanced countries' consumers or by the WTO is an inappropriate and perverse response. Trademarks reduce competition and manipulate tastes but make producers identifiable which also benefits consumers; moreover, *caveat emptor*. Let those who object to advertising and trademarks boycott the offending goods and services.

Multinational companies raise pollution by concentrating polluting activities in the countries of least resistance, but they cannot be blamed for the pollution generated by the additional growth that they generate; the type of growth is at fault and could and should be changed for less-polluting growth patterns.

International organizations are lacking in transparency and democracy and often impose inappropriate policies, but they have improved over time; this also requires qualification. In transition economies some of the shock therapy was inappropriate (for instance, premature capital markets liberalization, or recessionary monetary policies), but some was inescapable (instant price rises to market-clearing levels; ending the state monopoly of foreign trade; establishing exchange rate convertibility on the current account; and legalizing private ownership and enterprises). The residual costs of globalization of this kind can and should be reduced if not eliminated by means of specific measures not only at the global level, but also at that of nation-states and commercial blocks – for instance, with measures on corporate governance, fiscal harmonization, minimum wage and labour conditions, environmental protection; the transparency and democracy of international organizations.

While in some areas, such as capital markets liberalization or the arms trade, the costs are large and greater than benefits, the net effect of overall globalization is undoubtedly positive. Markets – including global markets – are the foundation of the vitality of any economic system, of its capacity to evolve and innovate. Around 1990 it was precisely the inability to deploy this vitality that caused the collapse of the centrally planned economies. Moreover, globalization is a form of technical progress, as it raises the productivity of resources. And an export-led growth is more readily sustainable than one based on internal demand. In many respects, there is not enough globalization in the world. Suffice to think of agricultural protectionism of the

EU, the USA and Japan; so-called contingent protection, with anti-dumping measures, so-called 'voluntary' export restraints, unreasonable standards; the reciprocal protectionism practiced by developing countries against each other; the restrictions to the circulation of technologies and ideas imposed by the WTO – of all people; the restrictions on labour migrations.

The overwhelming problem is the distribution of the gross costs and benefits of globalization, its resulting impact upon absolute poverty and upon world income inequality, and the difficulties of tapping into worldwide gains to compensate worldwide losers. Income distribution at the national or global level depends upon the operation of markets for goods and factors – for a given endowment of resources, technology and given economic policies and institutions. If nothing else can be changed, naturally the opposition to existing distribution turns against the operation of domestic and global markets.

The reduction of absolute poverty that accompanies globalization *per se* is not sufficient to redeem globalization, if there is consensus that poverty is excessive and is not being reduced fast enough. Even the modest Millennium Development Goals 1990–2015 in terms of reducing poverty and under-nourishment, and raising the levels of access to health, education, water and sanitation, already appear to be beyond reach. The acceptability of the conventional threshold of absolute poverty (US$2 per head per day for 'ordinary' poverty, which afflicts half the world population, US$1 per head for 'extreme' poverty), in turn depends on trends in average income.

Global inequality, usually measured by the Gini coefficient, can be referred to: (i) the average income of all countries; (ii) their average income weighted by their population; or (iii) the household income of the citizens of the world, for whom there are comparable data (see B. Milanovic, *Worlds Apart*, 2006), obtained by combining the data available for advanced countries with those collected by the World Bank *household income surveys* for developing countries. The first measure has been increasing, indicating a lack of global convergence. The second has been falling slightly, if only because of the growing weight of China, and, moreover, shows a polarization between rich and poor countries. The third measure – the only accurate measure of global income inequality – gives the highest measure of inequality and has been increasing, although in terms of purchasing power parity in 2002 it has fallen back to the 1993 level: a Gini coefficient of 65.2 per cent (remembering that Gini = 0 corresponds to absolute equality, and Gini = 100 per cent to absolute inequality, or a situation in which one takes all). Again, as stated above for poverty, it is immaterial whether globalization raises or lowers global income inequality; the widespread judgement that income inequality is excessive and does not fall fast enough is sufficient to justify opposition to the operation of global markets, when the other determinants of income distributions cannot be influenced. Thus at Cancun in 2003 an alliance of 20-odd emerging countries now labelled the G20 was perfectly legitimate – morally and

legally and strategically – in opposing a trade deal within the WTO Doha Round that would have benefited them, simply because they did not accept a distribution of gains just as biased in favour of advanced countries as was the Uruguay Round (that assigned to advanced countries 70 per cent of the gains, according to Jo Stiglitz).

Globalization redistributes income from wages to profits in advanced countries, where, over the course of 25 years (1980–2005), the share of labour has fallen on average by 10 points (from about 65 per cent to about 55 per cent of their GDP, according to the IMF World Economic Outlook 2007), without a corresponding increase in the wage share in developing countries, where labour is still abundant. Globalization also redistributes income from higher to lower wages, from producers to consumers, and from the importers of non-reproducible natural resources to their exporters.

The existence of net benefits from globalization in theory would allow the redistribution of some of the winners' benefits to an extent sufficient to overcompensate all losers, in such a way as to make everybody better off. Redistribution could also reduce both absolute and relative poverty, showing the absolute superiority of globalization over all alternatives. However, it is not enough for this overcompensation – of losers, of the poor, and of the relatively less rich – to be potential; it is necessary that it should actually take place for a welfare improvement to be established. But compensation is extremely difficult in view of the lack of global agencies with powers of taxation and redistribution, the paucity of unilateral and multilateral aid, the intergovernmental nature of the little redistribution that actually happens and that therefore does not reach the intended recipients.

This is why it is essential to create and strengthen redistribution agencies at all levels, of nations and commercial blocks as well as the global economy. The problem is that very often the winners of globalization are numerous, relatively poor and operating in competitive conditions, whereas the losers are few, relatively rich and operating in monopoly conditions. This is true, for instance, of the gainers and losers from labour migrations, or from the abolition of agricultural protection. Should we really take much of the gains from poor migrants to compensate the more highly paid and protected labourers whose salaries they hold down with their competition? Should we really tax food consumers benefiting from lower food prices to compensate rich and highly protected farmers (including the Queen of England) for their loss of protection? In these cases it is necessary to limit redistribution, or to implement it at the national or commercial block level – if at all – concentrating efforts and resources instead in the reduction of poverty and inequality.

Failure to govern globalization, and to correct its impact on poverty, inequality and redistribution, will breed increasing opposition to its further progress, which may lead eventually to the possible destruction of all of its benefits, together with its costs.