



Globalization: It Doesn't Just Happen

BY DEAN BAKER*

Progressives will not be able to tackle the problems associated with globalization until they first understand some basic facts about the process. First and foremost, they must recognize that globalization is not just something that happens like the changing of the seasons, it is a process that is consciously directed to advance certain ends. Thus far it has been a process that has been consciously directed by business and highly educated professionals in order to benefit themselves at the expense of other groups within society. But there is no reason that it need take this form. It is just as easy to design a path of globalization that benefits the rest of society at the expense of these groups. The obstacle is the power held by business and highly educated professionals, not the inherent logic of globalization.

In my remarks I will focus on the impact of globalization on the United States, recognizing that some of these comments may apply less to the Netherlands or the European Union as a whole. I think it is better to focus on a country and economy that I know well, and risk being overly narrow, than discuss a broader group of countries and risk not knowing what I am talking about.

The United States has seen a huge upward redistribution of income over the last 30 years. This redistribution has been primarily due to the failure of real wages to keep pace with productivity growth. While usable productivity has risen by 48 percent since 1973, real hourly compensation for the typical worker has increased by just 20 percent.¹ The real median wage grew by just 7.1 percent as a growing share of compensation went to cover employer provided health care benefits. Part of the productivity-compensation gap has gone to an increased profit share, but most of the gap has been due to the growth in wages for the most highly paid workers at the expense of those in the middle and bottom.

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It is worth emphasizing that, in the United States at least, the upward redistribution has mostly gone to high-end workers and not profits. The profit share of GDP rose from 18.5 percent of GDP at the profit peak of the 70s business cycle to 20.1 percent of GDP in 1997, the profit peak of the 90s cycle. This increase in the profit share explains less than 2 percentage points of the gap between productivity growth and compensation growth, or less than 10 percent of the total gap.

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¹ "Usable productivity" is productivity that can be directly passed on in compensation growth. It is adjusted for the gap between the growth in gross and net output and also for the gap between the consumer price index that is used to deflate wages and the GDP deflator that is used to deflate output. This is discussed in Baker (2007) "The Productivity to Paycheck Gap: What the Data Show," Washington, D.C.: Center for Economic and Policy Research [http://www.cepr.net/documents/publications/growth_failure_04_2007.pdf]. The wage and compensation data are taken from Mishel, L., J. Bernstein, S. Allegretto, 2007, *The State of Working America, 2006-2007*, Ithaca, NY: Cornell University Press.

The profit share in 2006, which appears to be the profit peak of the current cycle, will almost certainly be lower than the profit peak in 1997, which raises questions about the extent to which globalization has been a major force behind the increase in profit shares in the United States.² There was an enormous increase in trade and the trade deficit between 1997 and 2006. The trade share of GDP rose by 3.8 percentage points from 24.2 percent in 1997 to 28.0 percent in 2006. The trade deficit rose by 4.6 percentage points of GDP over this period. If such a large increase in trade and the trade deficit did not increase the profit share, then a rising profit share is clearly not a direct result of current trade patterns. It appears as though the lower price of imports was entirely passed through in lower prices to consumers, with competition having the desired effect of restraining profit margins. The upward redistribution away from typical wage earners in this decade has gone to higher-end wage earners, not corporate profits.

Globalization has played an important role in this upward redistribution. Globalization has placed U.S. manufacturing workers in direct competition with low wage workers in the developing world. This has had the predictable effect of eliminating manufacturing jobs in the United States and depressing the wages for those that remain employed in the sector. In 1973, manufacturing employment accounted for 24.2 percent of total employment in the United States. It now accounts for just over 10 percent of employment. Since manufacturing has historically been a source of relatively high-paying employment for those without college degrees (still 70 percent of the workforce in the United States), the loss of such a large portion of the jobs in this sector put downward pressure on the wages of non-college educated workers more generally.

Immigration has also played a role in reducing the wages of less-educated workers. Immigration rates increased substantially over this period, rising from less than 300,000 a year in the 70s to more than 1.3 million in the peak years in the late 90s. Most of this increase in immigration consisted of less-educated workers who competed first and foremost with workers without high school degrees. However, some relatively good-paying jobs, such as jobs in food processing plants and construction work are now disproportionately done by immigrant workers. The pay and working conditions in these jobs have deteriorated substantially.

Of course globalization has not been the only source of downward pressure on the wages of these workers. Several major sectors of the economy have been deregulated in the last three decades, such as transportation, telecommunications, and utilities. This deregulation has placed substantial downward pressure on the wages of workers in these sectors. In addition, the federal minimum wage has not only failed to track productivity growth, it has fallen far behind inflation. The real value of the current minimum wage is more than 30 percent less than the value of the minimum wage in 1973. In addition, unionization rates have plummeted over the last three decades, with the unionization rate in the private sector falling from more than 20 percent in 1973 to just over 7 percent today, although globalization also was a factor in this decline. The unionization rate fell most rapidly in manufacturing, from close to 40 percent at the beginning of this period to just over 12 percent at present. Foreign competition was certainly a factor in this drop.

² There are two measurement issues that complicate a direct comparison of profit shares between 1997 and 2006. First, the profit data for 2006 are unrevised. Revisions generally push profits lower, primarily because of the way stock options are treated in the initial reporting. The revisions tend to be especially large after stock market rallies. In 2000, the downward revision was equal to 15 percent of the profits that were originally reported.

The other complicating factor is that write-downs due to bad debts are not deducted from profits in the National Income and Product Accounts (NIPA). This means that if financial companies initially reported large profits from issuing loans, but the loans subsequently went bad, the losses from bad loans would not be deducted from reported profits. The write-offs will show up as lower profits in subsequent years. With the wave of bad debt associated with the collapse of the housing bubble almost certainly exceeding \$100 billion, profit in the National Accounts may be overstated by an additional 5-10 percent in 2006.

While other factors have contributed to the upward redistribution of income over the last three decades, globalization has played a central role. And, this is not an accident. The pattern of globalization that the United States has followed over the last thirty years was designed to put downward pressure on the wages of less educated workers, while protecting the most highly educated workers.

The basic story is very simple. From the standpoint of rich countries like the United States, the developing world can be seen as a gigantic menu. The menu includes items like cheap textile workers and autoworkers. Through the path of immigration it also contains cheap farm labor, cheap construction workers, and cheap nannies. The United States has ordered extensively from this portion of the menu, benefiting from low cost labor in the developing world.

This menu has exactly the benefits that trade economics predicts. The low-cost labor from the developing world reduces the prices of the goods and services it produces. This keeps down inflation and raises output and living standards overall. However it reduces the wages and living standards of the workers in the United States who must directly or indirectly compete with low-wage labor in the developing world: in this case, the 70 percent of the workforce who lack a college degree.

But this is only part of the menu. The menu also includes items like cheap doctors and lawyers, cheap accountants and economists. It even includes cheap investment bankers. The United States has not been ordering from this portion of the menu. In fact, most people don't even know this portion of the menu exists, but it is possible to get highly educated workers at a much lower cost in the developing world than in the United States.

The basic story is that it is far cheaper to educate doctors, lawyers, and investment bankers in the developing world, just as it is much cheaper to produce textiles and toys. The developing world already educates an enormous number of professionals, although generally not to the standard that would be expected in the United States. This is due to the fact that a wide variety of professional and immigration barriers make it difficult for foreign educated professionals to work in the United States.³

In order to get educational institutions in the developing world to train students to U.S. standards, and to get students interested in being educated to these standards, it will be necessary to reduce these barriers. This would require setting rules about trade in professional services in the same way that recent trade agreements set rules for trade in manufactured goods. Hospitals, law firms, and banks would have to describe the obstacles that prevent them from hiring more doctors, lawyers, and investment bankers from the developing world. The immigration and licensing barriers could then be adjusted to facilitate free trade in these services, while still preserving legitimate quality requirements.⁴

A large inflow of foreign educated workers would reduce the wages of the most highly paid workers in the United States, but more importantly it would reduce the prices of the goods and services they provide. The cost of medical care, college education, and a wide range of legal and financial services would be reduced as a result of the freeing of trade at the top end of the labor market. This would both increase economic

³ Note that its "difficult," but not impossible, for foreign-born professionals to work in the United States. Many economists seem to believe that they can prove that barriers do not exist by virtue of the fact that their co-worker was born in India or their doctor was born in China. By this logic, the United States has free trade in agriculture because it is possible to buy Mexican avocados in supermarkets.

⁴ To ensure that developing countries benefit from the outflow of highly educated workers, the agreements should include some tax on the earnings of foreign-educated professionals in the United States, with the money used to reimburse their home country for their educational expenses. In principle, this tax could be set at a level that would allow for two or three professionals to be educated for everyone that comes to work in the United States. This would guarantee that developing countries gain from this arrangement as well.

growth and increase the real wages of everyone except workers in this narrow group of professions. This is exactly the argument that economists always make for liberalizing trade except that this type of trade liberalization leads to more equal distribution of income rather than less equal distribution.

Unfortunately, trade liberalization in highly paid professional services has generally not been on the agenda in the United States, even for progressives. While the neo-liberal agenda is quite explicitly focused on using cheap labor in the developing world to depress the wages of those at the middle and bottom, progressives have been reluctant to adopt the same weapon to depress the wages of those at the top. This has left progressives in the United States taking a largely defensive position against trade, arguing for policies that limit the extent that less educated workers are forced to compete with workers in the developing world.

This is especially unfortunate, since most of the major battles on this issue have already been lost anyhow. With the huge pools of low-cost labor in countries like China, Vietnam and India already available to produce goods to export to the U.S., the removal of the remaining trade barriers in manufactured goods will have little additional impact on the labor market in the United States.

On the other hand, workers in the United States could potentially see enormous gains from the liberalization of trade in highly paid professional services. This is a far more promising path both economically and politically than fighting to preserve the few remaining barriers that still provide some protection to less educated workers.

So, rather than trying to obstruct the next so-called free trade agreement, progressives in the United States should work to ensure that it liberalizes trade as much as possible in the most highly paid professional services. In fact, we can even look to initiate our own free-trade agreements that start by removing the barriers that obstruct businesses, pension funds, and state and local governments from taking full advantage of low cost investment banking and financial services in Mumbai. Just as the authors of NAFTA sought to remove all the legal and institutional barriers that discouraged U.S. firms from investing in Mexico, a progressive trade agenda should seek to eliminate any legal or institutional barriers that prevent start-up corporations from using Mumbai based investment banks to have lower cost initial public offerings, or discourage pension funds from using financial firms in India that charge lower management fees, or obstruct state and local governments from using Indian firms as bond underwriters.

Trade theory suggests that the elimination of these barriers would save start-up companies, pension funds, and state and local governments tens of billions of dollars annually, increasing economic efficiency and leading to more rapid growth. At the same time it would lead to a more equal distribution of income in the United States, as investment bankers and other highly paid financial professionals suddenly had to compete in global economy without their current protective barriers. Our policy should be to have trade do for Wall Street what it has already done for Detroit.

There is one other very important item that should be front and center in any progressive globalization program. The United States and other rich countries should not seek to impose intellectual property rules, such as copyrights and patents, on developing countries. These rules lead to enormous economic distortions. In the case of copyrights, this government granted monopoly allows items like software, recorded music and videos to sell for far more than their marginal cost. In fact, the marginal cost of these items would generally be zero, since they can be transferred at zero cost over the Internet. There are far

more efficient mechanisms for financing the creation of software and artistic products. We should pursue these alternatives, requiring appropriate contributions from poorer countries.⁵

Even more importantly, we should not allow the pharmaceutical industry to impose patent monopolies on prescription drugs in the developing world, making life-saving drugs unaffordable to the world's poor. We can find more efficient mechanisms to finance prescription drug research that will not lead to the same sort of endemic corruption as the patent system.⁶

Workers in rich countries have no interest in the grabbing rents from poor countries through copyrights and patents. These antiquated relics of the guild system would have long ago been replaced by more modern mechanisms, if it had not been for the political power of the industries that profit from them. Workers have no interest in sustaining such anachronisms which become ever more inefficient in an increasingly globalized economy.

In conclusion, progressives must attempt to redefine the process of globalization. There is nothing inherent to the process of globalization that leads to greater inequality in rich countries. It is only when the wealthy are allowed to define and control the process that globalization leads to inequality. If we chose to subject the most highly educated workers to competition with developing countries instead of less educated workers, then globalization would both lead to more growth and more equality.

Thus far, the most highly educated workers have been allowed to keep their protections primarily because no one has ever attacked them. The right has long known that the income of construction workers, autoworkers and textile workers are costs to them. They have therefore used globalization to depress the wages of these workers through trade and immigration. If progressives can ever master basic arithmetic, we will understand that the incomes of doctors, lawyers, and investment bankers are costs to middle and lower income workers. The question is then whether we want to pursue futile efforts to protect less educated workers from global competition or whether to make the most highly educated workers enjoy the full effects of global competition that less educated workers have long been forced to experience. If we choose the latter route, the globalization debate and trade policy are likely to undergo serious changes for the better.

⁵ See for example Baker, D. 2005, "Opening Doors and Smashing Windows: Alternative Measures for Funding Software Development," Washington, D.C.: Center for Economic and Policy Research [http://www.cepr.net/index.php?option=com_content&task=view&id=122] and Baker, D. 2004, "The Artistic Freedom Voucher: Internet Age Alternative to Copyright," Washington, D.C.: Center for Economic and Policy Research [http://www.cepr.net/index.php?option=com_content&task=view&id=161].

⁶ See Baker, D. 2004, "Financing Drug Research: What Are the Issues?," Washington, D.C.: Center for Economic and Policy Research [http://www.cepr.net/index.php?option=com_content&task=view&id=149]