

Globalize, Globa–lize, Global Lies* :
Myths of the World
Economy in the 1990s

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* The title of this chapter originates from Rob Davies of the University of Zimbabwe.

Globalize, Globalize, Global Lies^{*}: Myths of the World Economy in the 1990s

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Introduction

Major changes occurred in the world economy during the last twenty years of the twentieth century, but there was considerable disagreement as to what those changes were and who gained and who lost from them. In the opinion of the business establishment in the developed countries, the changes created an integrated international economy that benefited all. This sanguine view was summarized in the *US Economic Report of the President of 1999*:

Economies that are open to international trade and investment are more likely to experience a rising standard of living than are economies with significant barriers to cross-border economic activities. Consumers in open economies benefit from a wider variety of goods at lower prices than do consumers in economies that resist competition from foreign suppliers. The economy as a whole benefits from an increased ability to devote its scarce resources to economic activities that it performs relatively efficiently. Over time, through both international trade and international investment, open economies benefit from higher rates of productivity growth and innovation that result from increased participation in international markets. (CEA 1999, p. 260)

The foregoing statement, typical of the eulogies to 'free markets', incorporates a number of theoretical and empirical assertions. It epitomizes what we call '*the globalization hypothesis*': over some clearly defined period at the end of twentieth century, the world economy underwent a dramatic change. The quantitative aspect of this change was a substantial increase in the importance of trade and foreign investment at both the international and national levels. The qualitative aspect was that the quantitative changes ushered in a new era, in which the only viable national economic policy involved liberalization of trade, deregulation of capital flows, and orthodox fiscal and monetary policy. The globalization policy package can be briefly

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stated. Liberalization of trade would be necessary to achieve domestic efficiency and capture welfare gains for consumers. ‘Investor-friendly’ policies would be required to attract capital that would embody growth-stimulating technical change and managerial skills. Low budget deficits and tight monetary policy would be the macroeconomic prerequisites for maintaining the ‘confidence’ of international financial markets.

This chapter deals with these assertions, summarized so confidently in the *Economic Report*, and demonstrates that they are in each case either false or half-truths. First, there is the theoretical allegation that international trade is based upon the so-called comparative advantage of countries (‘benefits from...[specialization in] activities it performs relatively efficiently’). Second, there is the empirical assertion that more ‘open’ markets have increased international trade more than would have been the case in its absence (‘open’ economies trade more). Third, and closely related to the second, is the contention that foreign investment has increased beyond what would have been the case had market liberalization not been followed. The corollary of this contention is that countries with fewer regulations on trade and foreign investment can expect to receive a disproportionate amount of said investment.

In a rather different category, and a stronger assertion, is that deregulating trade and capital flows increases the standard of living (‘economies...[more] open to international trade and investment are more likely to experience a rising standard of living...’). This allegation has two aspects: a dynamic one (open economies grow faster); and a static one (‘consumers...benefit from a variety of goods at lower prices...’). Not found in the CEA eulogy to open markets, but asserted with regularity (e.g. World Bank 1995), is the proposition that in more open economies unemployment is lower and wages higher than in less open economies.

Prior to considering each of these propositions of deregulation, it is necessary to clarify a few fundamental theoretical points, namely what is ‘openness’ and how might it be measured, and what is the basis of the trade among countries. Analysis of these two issues reveals that the international deregulation assertions rest upon extremely unstable theoretical foundations.

Myth 1: Orthodox Trade Theory is Sound

The globalization hypothesis that less regulated trade is inherently good rests on neoclassical trade theory, frequently called Heckscher-Ohlin-Samuelson trade theory after its principal theorists. Under extremely restrictive assumptions, this theory reaches the conclusion that free trade, in the sense of trade in the absence all barriers private and public to competition, is optimal. Of course, trade is never ‘free’ in this sense. Prior to the ideologically-laden 1980s and 1990s, the theory concluded that in the absence of free trade, ‘some trade is better than no trade’, conclusion that could hardly be faulted.

The most frequent defense of unrelated trade is that it increases competition and, therefore, raises the efficiency of production and brings lower prices to consumers. This is not based upon H-O-S theory; indeed, the argument typically invokes no theory at all, or the most primitive partial equilibrium analysis. In the orthodox analysis, all producers in all countries are assumed to operate at maximum efficiency by both the technical and economic definitions.¹ In this, the standard framework, trade increases efficiency through altering the allocation of resources; i.e. the efficiency gains from trade refer to economy-wide allocative efficiency, not firm-level production efficiency. To be precise, H-O-S theory concludes that moving from ‘autarky’ to ‘free trade’ results in a reallocation of productive inputs, such that each country *specializes*, with specialization based upon the so-called factor endowments of each country. To put it simply for the case of two inputs, labor and ‘capital’, in a country which is ‘abundant’ in labor, free trade will shift resources to ‘labor-intensive’ product lines (see Evans 1989, chaps 4 & 5). As a result, the country will export these ‘labor-intensive’ products and import ‘capital-intensive’ products. This is the famous principle of ‘comparative advantage’.²

¹ Production is technically efficient if a producer achieves a level of output with the minimum inputs. Production is economically efficient if, given technical efficiency, the producer choice of the level of output results in producing that output at the lowest unit cost. The latter implies, under the typical assumption of perfect competition, that the price of output is equal to the marginal cost of output, and (implied by $P = MC$) that each input is employed in a quantity such that the ‘marginal’ unit’s contribution to output is equal in value to that input’s market price.

² In the Economic Report of the President, one reads:

The primary source of static gains from trade is specialization...Such trade can be beneficial even in cases where one country could produce both goods more efficiently. This notion, commonly referred to as comparative advantage, is straight forward when applied to individuals – each of us sometimes purchases from others some goods or services that we could make or perform even better ourselves, because we realize that our time is most

The frequent use of quotation marks in the foregoing paragraph is necessary because of the problematical nature of the concepts of standard theory. For consistency, a theory whose argument is based upon the concept of input abundance and scarcity must, at the minimum, specify a theoretically consistent method of measurement of those inputs. To put this another way, a theory which predicts that the trade of countries will reflect the relative supply of labor and capital (in the two input case) must have a measure of the supplies of labor and capital which is independent of composition of trade. This proves possible only under extremely restrictive assumptions. The problem arises because, in general, the 'supply of capital' is not independent of the rate of return on capital. Only in a special case, an output uses a capital input which is the same as that output, are the relative supplies of capital and labor unambiguously defined (Weeks 1989, chapter 10).

An example can demonstrate the seriousness of the problem for orthodox trade theory. Let there be two countries with closed economies (no trade). When trade barriers are reduced, commodities will be exchanged. As a result, the prices of the commodities will change in each country, gravitating towards a common price for each (net of transport costs). As a result of changes in prices, wage rates and profit rates in each country will change. If the traded commodities are each produced with a capital input different from the output, the change in the wage-profit rate can result in a change in the ordering of the commodities in terms of the capital-labor ratio. In other words, a commodity which before trade opened was relatively labor intensive can become relatively capital intensive after trade occurs. As a result, the country which before trade was measured as 'labor abundant' could, after trade, export commodities which are measured as 'capital-intensive' and import commodities measured as 'labor intensive'. Empirical evidence indicates that this outcome is not merely a theoretical possibility (Helmut & Balance 1990). Given the theoretical and methodological problems in the application of orthodox trade theory to actual trade, it should not be a surprise that empirical studies show that its explanatory powers are extremely weak. For example, two studies by Yeats, a World Bank economist, conclude that the observed pattern of developing country exports differs substantially from what H-O-S theory would predict (Yates 1989 and 1992, see also White 1978).

profitably spent doing those things we do best. But the principle applies equally well to countries. (CEA 1998, p. 236)
Shaikh (1979) demonstrated that this principle *cannot* be applied to countries.

Orthodox theory claims to explain not only the pattern of trade among countries, but also the macroeconomic aspects of trade, determination of the exchange rate and the aggregate balance of trade. These were central issues in the defense of globalization, because they related to the stabilizing or destabilizing nature of unregulated trade. In the orthodox approach, unregulated trade should reduce the instability of the real exchange rate, and foster a sustainable trade balance. On these issues, the orthodox theory is even less successful than in its attempts to explain the pattern of trade. In a review of the literature on exchange rates, Harvey concludes,

...[N]eoclassical economists have expressed increasing frustration over their failure to explain exchange rate movements...Despite the fact that this is one of the most well-research fields in the discipline, not a single model or theory has tested well. The results have been so dismal that mainstream economists readily admit their failure. (Harvey 1996, p. 567)

In the same vein, Stein refers to 'why economists have been so disappointed in their ability to explain the determination of...capital flows' (Stein 1995, p. 182). Indeed, the most successful attempt to explain the movement of exchange rates has been within a Marxian theoretical framework, in the work of Shaikh (e.g. Shaikh 1998). The globalization advocates would have one believe that a grand corpus of high theory provides support for the conclusions that 1) unregulated trade fosters an efficient allocation of resources; 2) unregulated trade ensures less exchange rate volatility; and 3) unregulated trade will promote equilibrium of the balance of payments. These are myths of globalization. The theoretical support for the first is weak at best; empirical evidence provides little support for any of the three.

Myth 2: Globalization has increased international trade & investment

Central to the globalization hypothesis was the allegation that trade and foreign investment increased dramatically towards the end of the twentieth century. The hypothesis maintains that this increase represented an inevitable and irreversible process, to which governments throughout the world had to adjust. And, further, that failure to adjust to the globalization of markets would exclude countries from the benefits of this process. Prior to assessing alleged benefits, we consider the empirical

question: did foreign investment and trade grow dramatically over some period one might justifiably define as the era of globalization? The globalization hypothesis is not necessarily supported by evidence that either of these indicators increased towards the end of the century. Since World War II, both foreign investment and trade showed an upward trend. What must be demonstrated is that for a specifically defined 'globalization period' there was a significant upward shift in these indicators.

Table 1 inspects the fundamental quantitative assertions of the globalization hypothesis, the trends in foreign direct investment and trade. It is based upon the following test. To take investment, for each major region of the world foreign direct investment was calculated as a portion of gross domestic product. The trend in this indicator was calculated, using regression analysis (ordinary least squares). Within this trend analysis, it was tested whether over various years that might be defined as 'globalization periods' the share of foreign investment differed significantly from its longer-term trend. The cells in the table report whether for the period in question, the values of the indicator were significantly above the longer-term trend, significantly below, or not significantly different. The test is then repeated for the share of exports in gross national product. Because there is no consensus as to when 'globalization' began, four periods are tested: 1985-1997, and the sub-periods 1985-1989, 1990-95, and 1990-1997.

For foreign direct investment, the results are mixed, with limited support for the allegation that the importance of the variable increased. For all groups except the developed ('high income' OECD) countries, there was a long term positive trend in the percentage over 1970-1997. For two of the six groups, the Middle East and North Africa, and South Asia, no period that might be defined as globalization shows a significant increase. For the developed countries, there was a significant increase for 1985-1997. However, when the period is disaggregated, one finds that the increase was significant for the second half of the 1980s, but not for the 1990s; i.e. the increase was not sustained. East Asia and the Pacific did show a significant increase for the 1990s (both 1990-1995 and through 1997), but this was almost entirely explained by foreign investment flows to China, which rose from .5 percent of GDP in 1985, to five percent in 1997. For the other important economies in the region, the share of foreign investment flow in GDP did not deviate significantly from the longer

term trend.³ For the sub-Saharan countries, foreign investment flows were significantly above trend for 1990-1997, but this disappears if 1996 and 1997 are excluded, as is the case for Latin America and the Caribbean.

Overall, there is little compelling evidence that levels foreign direct investment in the late 1980s and 1990s represented anything other than a continuation of previous trends. In other words, the shift of policy in developed and underdeveloped countries to be more accommodating of the interests of international business seems to have had no significant impact on aggregate flows. It is possible that competition among countries for foreign investment, for example *via* the lowering of labor and environmental standards, shifted flows among countries. If so, this probably reduced the host country's benefits, such that the positive impact of foreign investment was less in the 1990s than previously.

If globalization increased the importance of trade in the world economy, one would expect this to be manifest in an increase in the share of exports across countries. Part B of Table 1 tests this issue. After World War II, world trade grew consistently faster than world output, so, again, the question is whether in the 1980s and 1990s the share of exports in gross domestic product shifted above its long term. The table reveals that this was not the case. For the high income countries, export shares were significantly *below* their trend value in the late 1980s and 1990s. That is, for the world's largest trading countries, the period of globalization was associated with significantly *lower* export shares than would have been the case had previous trends continued. For Latin American and the Caribbean, the export share rose above its trend in the 1980s, but fell below it in the 1990s (though the decline is non-significant if 1996 and 1997 are included). The significant increase in the export share in the late 1980s resulted from that region's stagnation of output, not rapid export growth.

There was an increase above the trend for East Asia and the Pacific, but its significance was dependent upon the inclusion of 1996 and 1997. If these two years are excluded, the deviation is non-significant. It may be that subsequent years will confirm that these two regions have shifted to a significantly larger export share, but this cannot be concluded on the basis of data through 1997.

³ We refer to Indonesia, Malaysia, the Republic of Korea, the Philippines, and Thailand. The foreign investment share across these countries was .9 in 1980, 2.0 in 1990, and 2.4 in 1997.

At the end of the century the evidence for a more ‘globalized’ world economy was extremely weak. For most groups of countries, the levels of direct foreign investment and exports were close to what one would have predicted on the basis of long term trends. The allegation that the world economy experienced a dramatic change in the degree of integration in trade and investment was another myth of globalization.

Table 1: Foreign Investment and International Trade in the Era of ‘Globalization’, 1970-1997

A. Foreign Direct Investment as a Percentage of GDP

	Trend	Period Shifts:			
		1985-97	1985-1989	1990-95	1990-97
High income: OECD	pos, nsgn	pos, sgn	pos, sgn	neg, nsgn	neg, nsgn
Latin America & Caribbean	pos, sgn	neg, nsgn	neg, sgn	neg, nsgn	pos, sgn
Middle East & North Africa	pos, sgn	pos, nsgn	pos, nsgn	pos, nsgn	neg, nsgn
East Asia & Pacific	pos, sgn	neg, nsgn	neg, sgn	pos, sign	pos, sign
South Asia	pos, sgn	neg, nsgn	neg, sgn	neg, nsgn	pos, nsgn
Sub-Saharan Africa	neg, sgn	neg, nsgn	neg, sgn	pos, nsgn	pos, sgn

B. Exports as percentage of GDP

	Trend	Period shifts:			
		1985-97	1985-1989	1990-95	1990-97
High income: OECD	pos, sgn	neg, sgn	neg, sgn	neg, sgn	neg, sgn
Latin America & Caribbean	pos, sgn	neg, nsgn	pos, sgn	neg, sgn	neg, nsgn
Middle East & North Africa	no data	no data	no data	no data	no data
East Asia & Pacific	pos, sgn	neg, nsgn	neg, sgn	pos, nsgn	pos, sgn
South Asia	pos, sgn	neg, nsgn	neg, sgn	pos, nsgn	pos, sgn
Sub-Saharan Africa	pos, sgn	neg, nsgn	pos, nsgn	neg, sgn	neg, nsgn

Notes: The trends in all cases are for 1970-1997.

Source: World Bank, *World Development Indicators* 1999 (CD-ROM)

Myth 3: Globalization has improved growth performance

The allegation that there was a dramatic increase in foreign investment and trade toward the end of the century (which we have shown to be unconfirmed) was accompanied by the normative judgement that this was a good thing, because it fostered faster growth of countries that adopted the globalization policy framework. This judgement had little theoretical support. In as far as increased trade and investment flows would foster allocative efficiency of labor and capital, there is no theoretical reason to think that this would increase growth. Orthodox theory

concludes that such efficiency gains, if they are realized, provide one-and-for-all increases in welfare, and need have no impact on growth (see Weeks 1998).

The arguments that globalization would increase growth were *ad hoc*: by facilitating the transfer of technology, stimulating innovation under competitive pressure, and making economies more 'flexible' in adapting to external 'shocks'. Thus, the hypothesized pro-growth effect of globalization was an empirical issue that would rise or fall on the evidence. Figures 1-5 show the growth rates of the world's major groupings of countries. In each figure, the growth rate for the 1960s through to 1980 is calculated, along with the rate for 1985-1998. The years 1980-1984 were excluded, because they covered a world-wide recession, affecting most regions severely. Their inclusion, they would seriously distort and bias the calculations. For the OECD (developed) countries, the evidence is clear. The average growth rate was 2.3 percent per annum after 1984, compared to 3.8 percent for 1961-1980. While both periods show pronounced cyclical movements, the level of growth rates shifts *downwards* from 1985 onwards. This downward shift can be seen clearly by inspecting the derivations from the long term average, which were negative for only four years out of twenty before 1980, and negative for eight years out of fourteen, 1985 through 1998. The result is similar for the Latin American countries (Figure 2), an average of 5.1 percent per annum for 1961-1980, and 3.2 percent for 1985-1998. For these two groups the slower growth after 1984 is particularly significant, for they included the countries that adopted neoliberal policies most fervently. This is especially the case for the Latin American countries. In the 1960s and 1970s, these countries, with few exceptions (Chile after 1973) pursued protectionist trade regimes, with strong capital controls. After 1985, all the Latin American countries, with the exception of Cuba, deregulated markets, liberalized trade, and abandoned capital controls. Growth rates were significantly higher in the earlier period.

Declining growth rates after 1985 also afflicted the countries of the sub-Saharan region (Figure 3). In the second half of the 1980s and in the 1990s a great wave of deregulation, trade liberalization and decontrol of capital accounts swept the region, fostered by stabilization and structural adjustment programs in virtually all of the forty-odd continental sub-Saharan countries (World Bank 1994). Whatever the achievements of these dubious programs, improved growth rates was not among them. From 1965 through 1980, the sub-Saharan countries grew at 4.2 percent, and at half that rate after 1984. Though a rise in growth rates occurred during 1992-1996,

reaching a rather modest peak of four percent, the data for 1997 and 1998 suggest that this was merely part of a cyclical movement, not to be sustained.

East Asia and the Pacific show a more complex pattern (Figure 4). This group includes the famous ‘miracles’ of growth (World Bank 1993), as well as China, one of the fastest growing countries in the world in the 1980s and 1990s, as well as one that had tight capital controls. For these countries, growth rates were higher on average after 1984 than before 1980 (7.5 compared to 6.8). However, beginning in 1992, the cross-country growth rate declined in every year, falling below zero in 1998. It would appear that after having weathered the instability of the world economy in the 1980s, the East and Southeast Asian countries fell victim to those instabilities in the 1990s. Their crisis of the late 1990s reflected many of the problems that afflicted the Latin American countries in the previous decade, exacerbated by the capital account liberalization that was central to the policy agenda of the globalizationists.⁴

Of the five charts, perhaps the most instructive is that for the South Asian countries. Of all the groups reviewed, this is the one whose countries adhered least and most tardily to the globalization policy agenda. This is especially the case for India and Pakistan, the two largest economies in the region. Taken as a group, the South Asian countries grew substantially faster in the ‘globalization’ period than before 1980, 5.6 percent per annum compared to 3.6 percent.

Looking back over the five groups of countries, one can summarize as follows: the country groups that introduced the globalization policies to the greatest degree fared least well in the 1990s relatively to previous decades (the OECD, the Latin American, and the sub-Saharan countries); the best performing group since 1960, East and the Pacific, entered into a severe recession in the 1990s; and the group whose growth improved in the 1990s without recession, South Asia, was that which least adopted policies of deregulation, trade liberalization, and decontrol of the capital account. The hypothesis that those policies foster growth is unconfirmed; i.e. it is a myth of globalization.

It should not be surprising that it is a myth. Were it the case that freer trade fostered growth, one would expect to find a positive correlation between growth rates and the share of trade in gross domestic product: if liberalization stimulates trade, then the trade share should rise; if trade stimulates growth, then the rise in the trade

⁴ For a comparison of the growth performances of the Latin American countries and the so-called High Performing Asian Economies, see Weeks (1999).

share should be associated with faster growth. Inspection of the statistics reveals quite the opposite, as Table 2 shows. For the five country groups, the simple correlation between the export share and the rate of growth was estimated,⁵ for 1965-1997. For none of the groups of countries was the relationship positive and significant, and for two groups (the OECD and Latin American groups) the relationship was significant and *negative*; a rise in the export share was associated with a slower rate of growth.

Notwithstanding the negative or non-significant relationship between the trade share and growth, a number of studies purport to demonstrate a positive interaction between ‘openness’ of an economy and growth performance. These studies do not use a direct and commonsense measure of openness (the trade share), but rather some esoteric proxy which allegedly measures the degree of liberalization of the trade and capital accounts.⁶ In addition to the interpretation of these statistical exercises suffering from serious ambiguities, Pritchett showed that the various measures of openness are not correlated with trade performance.

Figures 1-5 go here

⁵ The export share is used because the other obvious measure of the importance of trade would give theoretically ambiguous results. The import share might be positively related to growth because an economy is import-constrained. That is, growth may be dependent upon imported inputs in the short run, and imported machinery in the medium term. This would not indicate that trade stimulates growth in the sense of the globalization hypothesis, which refers to the alleged benefits of *liberalized* trade. If an economy were import-constrained, an appropriate policy response might be protection of domestic producers, to stimulate domestic production (so-called import substitution policies). The rate of growth of exports is also ambiguous, since a positive correlation could reflect that the economy is demand constrained. If this were the case, the appropriate policy might be export subsidies, which are judged as inefficient by the globalizationists.

⁶ For example, Sachs and Warner (1997), in an exercise in cross-country regression analysis, use an index of open-ness which includes tariff levels, impact of quotas, and whether or not a country had a ‘socialist’ economic system. Collier and Gunning (1999) measure open-ness by the difference between a country’s official exchange rate and the black market or ‘parallel’ market rate. It is unclear what either set of authors is measuring.

Table 2: Simple Correlations Between the Export share in GDP and the GDP Growth Rate, 1965-1997

<u>Region</u>	<u>Export Share</u>	<u>Shift (1985)</u>
OECD, high income	Negative, <u>significant</u>	nonsignificant
Latin America & the Caribbean	Negative, <u>significant</u>	nonsignificant
Africa, South of the Sahara	Positive, nonsignificant	Negative <u>Significant</u>
South Asia	Positive, nonsignificant	nonsignificant
East Asia & Pacific	Positive, nonsignificant	nonsignificant

Myth 3: Consumers have gained from trade liberalization

Of all the myths of globalization, perhaps the most ideologically potent is the argument that freer trade brings lower prices for consumers. Therefore, it is in the general interest of society, while trade protection reflects special interests. This argument is so powerful that opponents of trade liberalization frequently concede it, and argue that costs associated with freer trade, such as the environmental impact, outweigh the gain from lower prices. The argument need not be conceded, for it is essentially ideological with little empirical support.

In trade theory, all members of society are treated as utility maximizers, and they are all consumers. Thus, the desire of agents to improve the conditions of consumption is a *general interest* of society. On the other hand, as producers, people work in different sectors and occupations, and their desire to improve their conditions of work is a *special interest*. The trade policy debate is presented as a tension between the general interest of society as consumer and the special interest of producers. It is on the basis of this interpretation of society that free trade is viewed as beneficial to all, and any restraint on private trading, domestic or international, as a manifestation of anti-social special interests. In the context, it can be asserted that ‘international trade brings immediate gains through cheaper imports’ (World Bank 1995, p. 10).

However, the functioning of society is considerably more complex than this. It ignores the possibility that unequal bargaining power among people as producers

can reduce the incomes of some and increase the incomes of others, such that gains from consumption (lower prices) are rendered trivial by the gains and losses of income from production. Treating all agents primarily as consumers also ignores the welfare effect of working conditions. In the short run, the ‘working conditions of capital’ are improved by a deterioration of the working conditions of labor, because longer hours, more intense work, and reduction of workplace safety and hygiene tend, in general, to reduce operating costs.

Once the ideological nature of the ‘lower prices’ argument is recognized, it must be defended on purely empirical grounds: do the lower prices off-set the welfare losses from trade liberalization? The necessary condition for price gains to off-set other welfare losses is that it be demonstrated that price gains occur. To demonstrate that trade liberalization has given consumers lower prices is not straight-forward. Inflation during the 1990s was lower throughout the world than during the 1990s, but this could neither be attributed to globalization nor did it imply that ‘prices are lower’. Since prices are the source of money incomes, a lower price level implies lower purchasing power in an economy as a whole.

If the freer trade associated with globalization benefited consumers, this would be manifest in a change in *relative* prices. If one divides products between traded goods and services and non-traded goods and services (a standard analytical division), then one would expect prices of the former to fall or rise slower than prices of the latter. A comparison of import and export prices to the prices of domestic goods and services not exported, when such data are available, does not accurately capture the price ratio of tradables to non-tradables. The great majority of domestic goods and services would be products which to some degree substitute for imports, and, therefore, their prices would be correlated with import prices. A standard measure to avoid this is to compare a country’s consumer price index (CPI) with the producer price index (PPI). The former includes a range of non-trade inputs, principally transport and marketing services. In algebra, for an economy with two traded commodities, a consumer commodity (1) and an input to the consumer commodity (2),

$$p_1 = \{[p_2m + wn][1 + \pi]\}[1 + \beta]$$

Where p is price, m is the unit materials requirement, w is the wage, n is the unit labor requirement, π is the manufacturer’s profit margin, and β is proportion of all retailing costs in the price of the consumer commodity; and

$$p_1 = \text{CPI}$$

$$p^*_1 = [p_2m + wn][1 + \pi] = \text{PPI}$$

For computation purposes, one could set both indices to 100 in some base year. We can now consider the impact of trade liberalization. If less regulated trade resulted in cheaper imports of consumer goods and material inputs, then p_1 and p_2 would fall. If both prices fell by an equal amount, there would be a fall manufacturer's profit margin. If retailing costs remained the same, or fell less than import prices, the CPI would fall less than the PPI. The PPI can also fall as a result of an increase in labor productivity (the parameter n), which may be independent of the change in trade policy. Thus, the necessary condition for evidence of gains to consumers from trade deregulation is that the CPI fall less (rise more) than the PPI falls (rises). The sufficient condition is either 1) that the fall in the PPI not be the result of faster productivity growth in the production of goods and services than in distribution, or 2) that this faster productivity growth be demonstrated to be the result of the trade liberalization itself.

For the United States, the globalization prediction would appear confirmed: after moving virtually in step for 1960-1984, from 1985 onwards the consumer price index rose faster than the producer price index (Figure 6). However, this is only the *necessary* condition for trade to bring lower prices, not a sufficient condition. Figure 7 shows the relationship between the US producer price index and an index of nominal wage costs in manufacturing. Inspection of the chart shows that the two were highly correlated, as one would expect. Figure 6 showed that the CPI and the PPI diverged after 1985. If this reflects that globalization tended to bring lower prices to consumers, one would expect to find that producer markups were lower after 1985. That is, one would expect to find that the divergence was not merely the result of productivity change (lower increases in nominal wage costs), but also the result of lower profit margins, due to import competition. As a simple test for this, we regressed changes in nominal unit labor costs against changes in the producer price index, with a shift variable for various periods after 1985. No series of years with 1997 as the last (the last year for which there were data on costs) was significant. Two earlier time periods did yield significant negative shift coefficients, 1967-1972 and 1981-1987. The implied downward shift in manufacturing mark-ups during these periods could probably be explained a cyclical phenomenon.

If there is no evidence that greater openness to trade benefited consumers by reducing profit margins, is it possible that the import pressure stimulated faster growth of productivity, such that labor costs rose less than would have been the case in a less ‘globalized’ environment? The evidence is quite the contrary, as Table 3 shows. Over thirty-eight years, there was a statistically significant long-term decline in the rate of productivity increase,⁷ and the rates for the 1990s did not differ significantly from this trend. We can conclude that the rise in the consumer price index relatively to the producer price index is apparently explained by a faster rate of productivity change in production compared to distribution, rather than to competitive pressures associated with trade liberalization. And the faster rate of growth of productivity increase *was relative*: in absolute terms, production productivity grew slower in the 1990s than in any previous decade after 1960. There is no evidence that consumers in the United States gained from trade liberalization via lower prices.

Table 3: Annual Percent Change in Non-farm Labor Productivity, United States, 1960-1997

<u>Time periods:</u>	<u>Non-farm Productivity</u>
1960-64	3.3
1965-69	2.3
1970-74	2.1
1975-79	1.7
1980-84	1.2
1985-89	1.0
1990-94	1.0
1995-97	0.9

Source: CEA 1998

Figures 8-10 present the consumer and producer price indices for three other countries generally recognized as ‘trade liberalizers’’: the United Kingdom, Canada, and Mexico. For Mexico, the rate of change of the two indices is shown, to accommodate the country’s high rate of inflation during 1981-1989 on the chart. For these countries no further investigation is required, for none shows any significant or systematic divergence between the producer and consumer price indices. While we have presented evidence from only four countries, these four are the ones that would be expected to show evidence of consumer gains were the gains there to be shown. In

⁷ The fall from an average rate of change of about three percent in the 1960s to less than one percent in

the absence of other evidence, one can conclude that the assertion that consumers gain from liberalization of trade is yet another myth of globalization.

Figures 6-10 go here

Myth 7: Workers gain from globalization

Of all the myths of globalization, perhaps the least convincing is the allegation that increased trade and investment flows stimulated higher real wage growth. Even the *Economic Report of the President* floundered on this issue:

Throughout the first half of the postwar era, real average hourly wages for US production and nonsupervisory workers increased at an average rate of about 2 percent per year. Between 1974 and 1996, however, this measure of real wages fell by roughly 10 percent, retreating to 1965 levels...the coincidence of increasing trade and falling real average hourly earnings suggested to many that international forces were the source of this decline. (CEA 1998, p. 239)

The reader is assured that ‘this inference is *probably* wrong’ (emphasis added). In the view of the report the probability of falsehood derives from several considerations. First, ‘it is more appropriate to focus on the level of total compensation’, which included ‘health care benefits, pension costs, and other fringe benefits’. When these were included, the reader is told that ‘total real compensation has increased by almost 8 percent since 1974’. A quick calculation shows that an increase of eight percent over twenty-two years implies an annual rate of increase of 0.4 percent, *one-fifth* of the rate for the post-war years before 1974. Perhaps in recognition of the lameness of the ‘total compensation’ argument, the Report asserts, ‘this slowdown is more appropriately explained by factors other than international trade’.⁸

The principal ‘other factor’ offered in explanation is ‘a slowdown in productivity growth’. This is a rather strange defense of the trade impact on real wages, for two pages previously one read, ‘by encouraging continuous productivity

the 1990s implies a long term trend is about minus nine percent per year.

⁸ An expert in textual analysis might wish to pursue the implications of the phrase ‘more appropriately explained’, rather than ‘more correctly explained’, which would seem more precise if an empirical argument is being made. All the quotations in this paragraph are from page 239 of the *Report*.

improvements, international trade can increase an economy's growth rate' (p. 237). Thus, a *non sequitor* seems to be lurking here:

- 1) trade encourages 'continuous productivity improvements';
- 2) 'growth in trade exceeded growth in output by approximately 3.5 percentage points per year following 1974' (p. 239);
- 3) there was a 'coincidence of increasing trade and falling real hourly earnings' (p. 239); and
- 4) the fall in real earnings is explained 'by a slowdown in productivity growth' (p. 239).

In other words, increased trade *did not* encourage productivity growth, and real wages fell. It would seem safe to conclude that if an 'appropriate' (much less convincing) argument for a positive link between real wages and trade cannot be made by the advisors to an enthusiastically pro-trade president it did not exist.

A rigorous analysis of the impact of globalization on wages in the other developed countries is beyond the scope of this chapter.⁹ There is evidence for the Latin American countries (Weeks 1999a). During the globalizing 1990s, real urban wages rose in most Latin American countries. This was to be expected after the severe depression of the 1980s, when per capita income fell in virtually every country. The defenders of globalization argued that an important gain from greater openness to trade would be increased employment generation for any rate of growth. This would occur because 'comparative advantage' would induce use of more labor intensive techniques (see Myth 1, above). Evidence shows the contrary, that in the 1990s, growth was less employment generating (Weeks 1999b, pp. 160-62). Further, neither for the 1990s nor the two previous decades were real wage changes correlated with measures of openness to trade (*ibid.*). These results are particularly damaging to the globalization advocates, because of the dramatic shift in Latin America from import substitution to trade liberalization in the 1980s and 1990s.

It may have been that some workers in some countries gained from the deregulation of trade, but this remained conjecture. The lack of evidence for labor's gain was hardly surprising, given the strong bias in favor of capital in the globalization policy agenda. Especially damaging to the welfare of workers was the

⁹ For example, it would require a relevant measure of policy changes, to compare with the movement in wages.

growth of job insecurity (Standing 1999, chapters 5-8). The assertion that workers gained from increased trade was another myth of globalization.

Conclusion

The so-called globalization process at the end of the twentieth century was not inevitable. It resulted from a set of clear and purposeful policies, motivated by the interests of capital, with little regard to its impact on the welfare of the vast majority of the world's population. Clearly, it could not be presented as such, so the advocates of globalization produced a set of myths to induce the belief that the allegedly inevitable was also desirable. One central purpose of the myths was to convince people that they had little choice but to be passive observers of the process, but could look forward to the spread of its benefits.

The myths were exactly that: myths of globalization, fairy tales of welfare gains constructed upon weak theoretical arguments with little empirical support. As part of the construction of the mythology, public reaction against the costs of globalization policies was treated as irrational fears generated by special interest groups bent upon denying 'consumers' the gains from trade and countries the benefits of specialization. This argument, that fears about the negative impact of trade and investment flows are irrational,¹⁰ is particularly ironic coming from the globalizationists, for their supporting theory treats economic agents as rational decision makers who are rationally informed. It would appear that people throughout the world are rational: they can distinguish between the myths and realities of globalization.

¹⁰ From the *Economic Report of the President*:

...[P]ublic opinion polls continue to reveal a low sense of job security among American workers. This is surprising...*Rightly or wrongly*, workers may associate much of their concern about job security with the expansion of trade. (CEA 19998, p. 244, emphasis added)

Data Sources:

Table or Figure	Source
Table 1	<i>World Development Indicators 1999</i>
Table 2	<i>World Development Indicators 1999</i>
Table 3	<i>Council of Economic Advisors 1999</i>
Figure 1	<i>World Development Indicators 1999</i>
Figure 2	<i>World Development Indicators 1999</i>
Figure 3	<i>World Development Indicators 1999</i>
Figure 4	<i>World Development Indicators 1999</i>
Figure 5	<i>World Development Indicators 1999</i>
Figure 6	<i>Council of Economic Advisors 1999</i>
Figure 7	<i>Council of Economic Advisors 1999</i>
Figure 8	<i>International Financial Statistics 2, 1998</i>
Figure 9	<i>International Financial Statistics 2, 1998</i>
Figure 10	<i>International Financial Statistics 2, 1998</i>

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Figure 1
 OECD Countries: Annual Growth Rate and
 Deviations from the Period Average, 1961-1998

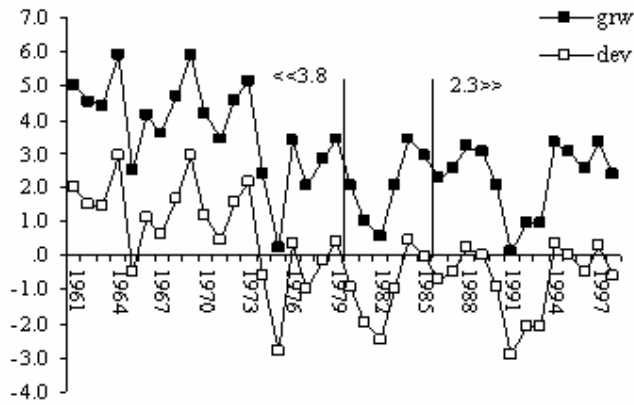


Figure 2
 Latin American Countries: Annual Growth Rate & Deviations
 from the Period Average, 1961-1998

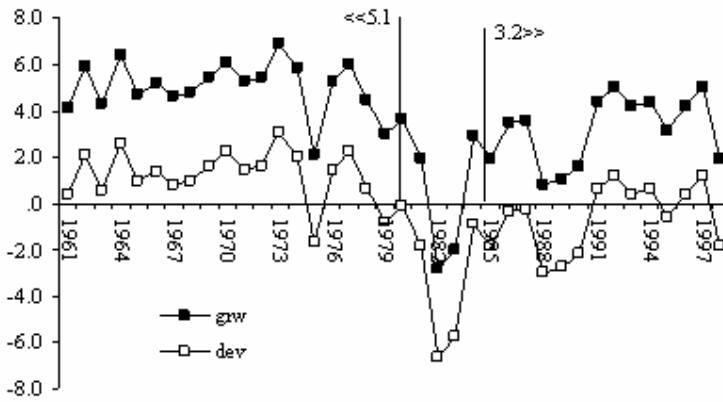


Figure 3
 The sub-Saharan Countries: Annual Growth Rates and
 Deviations from the Period Average, 1965-1998

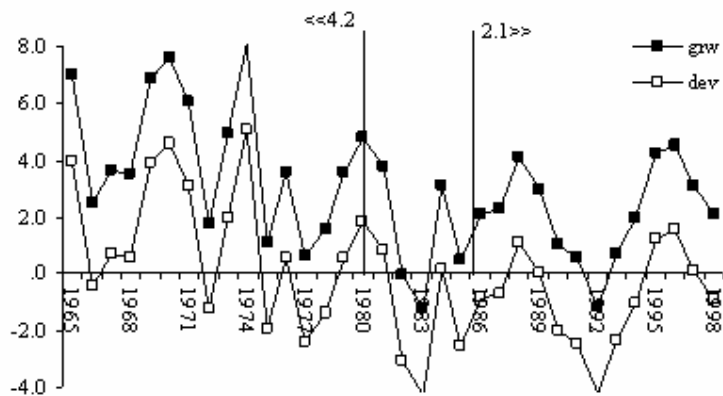


Figure 4
 East and Southeast Asia: Annual Growth Rates and
 Deviations from the Period Average, 1965-1998

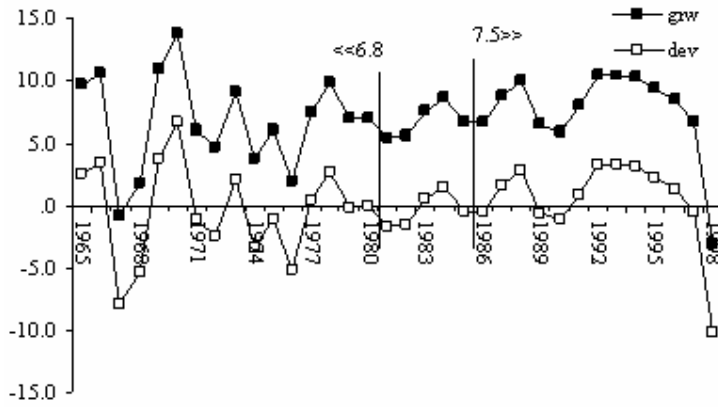


Figure 5
 South Asia: Annual Growth Rates and Deviations from the
 Period Average, 1965-1998

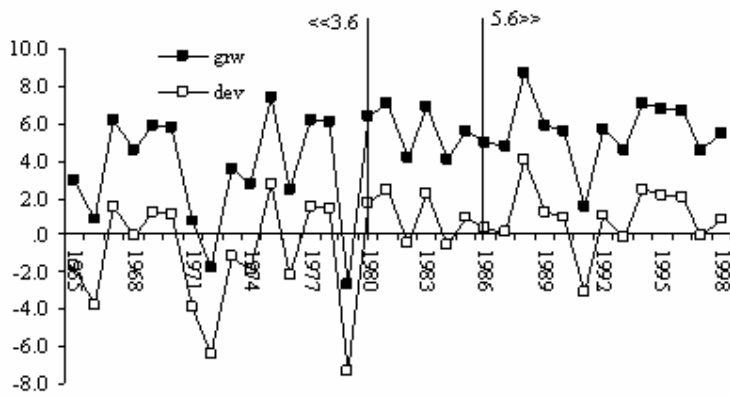


Figure 6
 United States: Consumer Price Index & Producer Price
 Index, 1960-1998

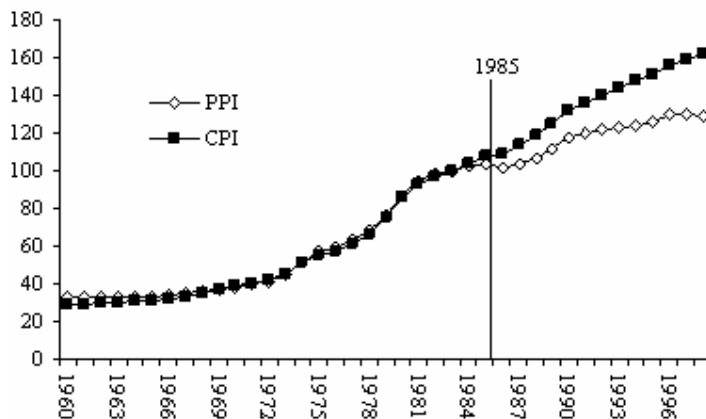


Figure 7
 United States: Changes in Nominal Unit Labour Costs
 and the Producer Price Index, 1960-1997

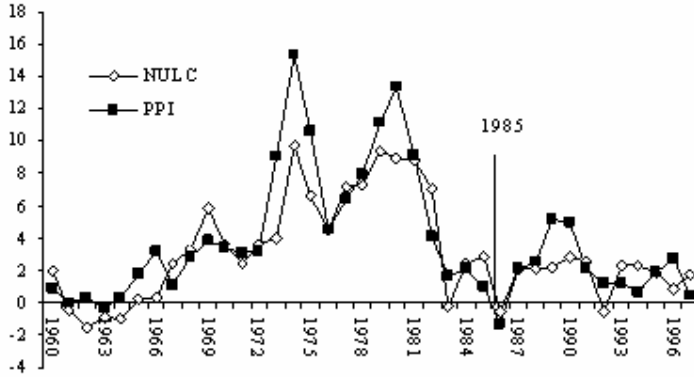


Figure 8
 United Kingdom: Consumer Price Index and
 Producer Price Index, 1960-1997

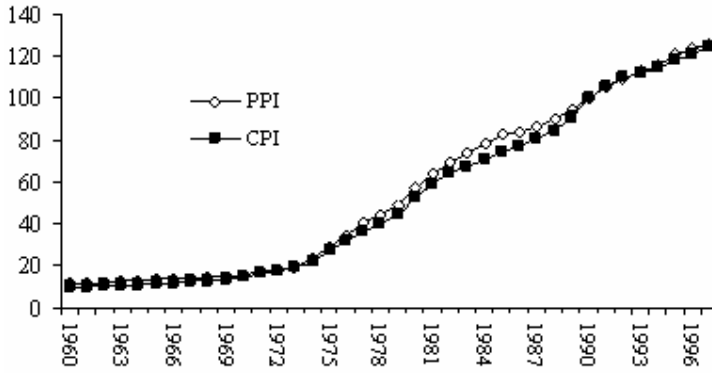


Figure 9
 Canada: Consumer Price Index and
 Producer Price Index, 1960-1997

