

Globalization and Economic Order

August 28, 2015

Blame it on globalization!

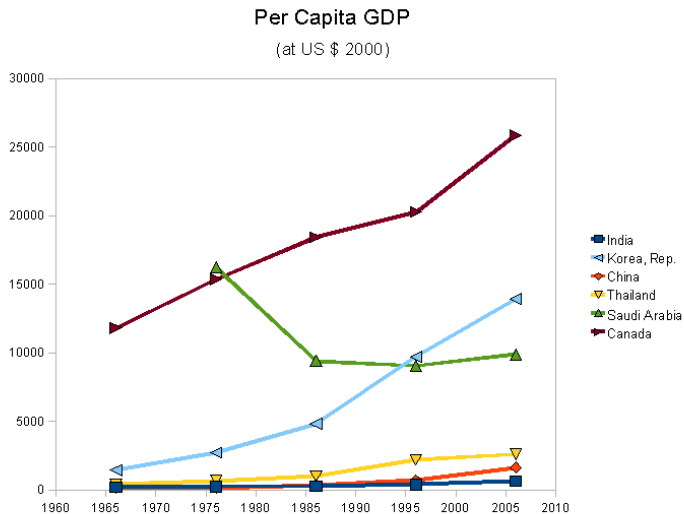
- ▶ For some time now globalization has become the bone of contention for many.
- ▶ Some people see it as tool for development while some see it as the neo-imperialist machinery.
- ▶ For almost every thing happens to a country, – events ranging from the Greek crisis to farmer suicide in India – people find globalization responsible for it.

Three cheers for globalization!

- ▶ On the other hand, supporters of globalization cites it as the main reason behind every success story.
- ▶ What is the theoretical justification behind such belief?
- ▶ There is one simplistic theory that kind of supports such belief.
- ▶ Economic development = Economic Growth = Expansion of market.
- ▶ Don't underestimate this power of this simple equation. It drives most of the policies advocated by international agencies.

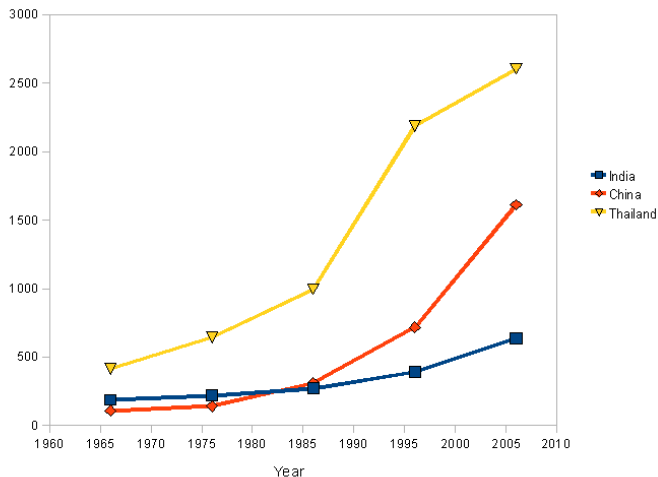
- ▶ The underlying logic of this equation says that expansion of market leads to expansion of income which leads to growth and development.
- ▶ However, in this scheme of logic globalization is not essential! This should be true for domestic expansion of market.
- ▶ A more sophisticated logic comes from trade theory.
- ▶ This tells us that trade allows a country to specialize in the line of production that can be produced at a lower cost than other countries. This leads to efficient outcome.
- ▶ In this view Globalization is nothing but more trade. So globalization leads to an efficient outcome.

Some casual empirics



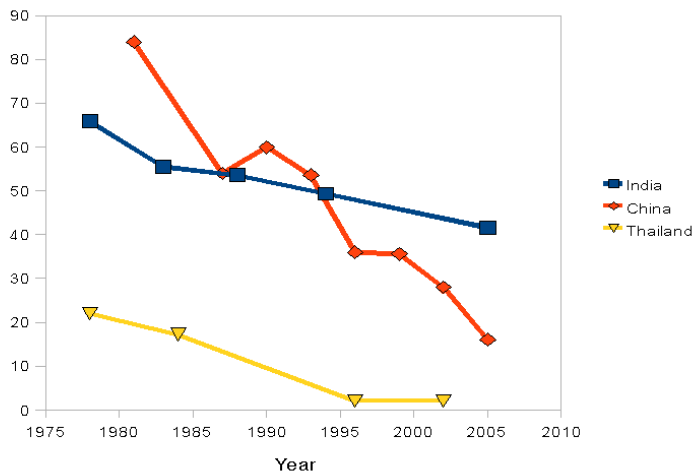
Per Capita GDP

(at US \$ 2000)

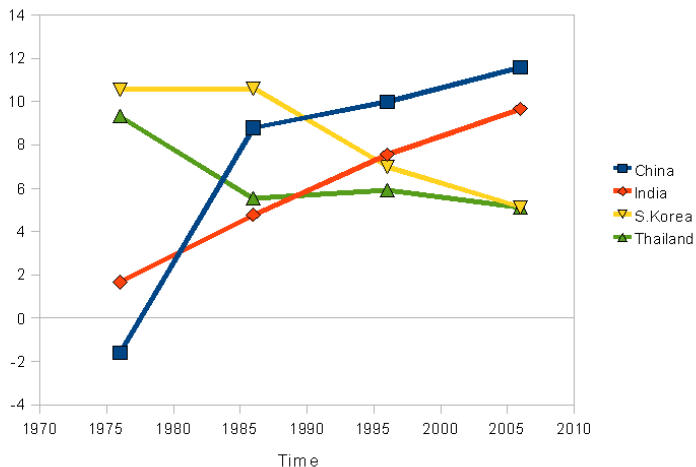


% of Population under \$1.25/day

China, India and Thailand



Growth Rates
China, India, Thailand, S.Korea



What is globalization?

1. The critical entry point of this course is to define globalization.
2. Globalization is seen from different perspectives: trade, cultural hegemony, political power, economic power and many more.
3. The most obvious way to define globalization is by defining it in terms of more trade.

Globalization as trade

- ▶ How does trade affect growth and development?
- ▶ A few models that you have studied in the undergraduate class can provide the starting point of our analysis.
- ▶ Ricardian Trade Theory
- ▶ Heckscher Ohlin Trade theory
- ▶ Stolper Samuelson Theorem

Ricardian Trade Theory

- ▶ According Ricardian theory two countries trade if they have different
(fill in the gaps)
- ▶ According to this theory if a country has comparative advantage in good X, it will gain by specializing in good X.
- ▶ However, a country may opt for incomplete specialization (what's that?) if.....

If trade is so nice, then why....



Figure: Anti WTO protest

Hecksher Ohlin Theory: Stolper Samuelson Theorem

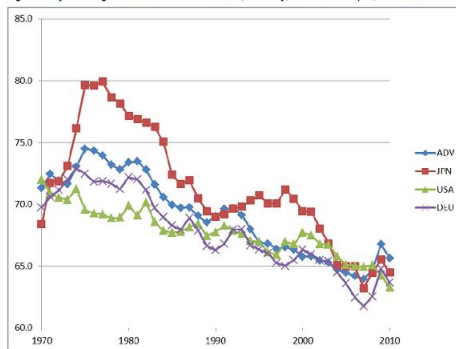
- ▶ Before understanding the position of anti-trade lobbies let us quickly review H-O theory.
- ▶ This theory suggests that a country will specialize in a labor (capital) intensive good if it is.....
- ▶ This theory has a corollary known as Stolper Samuelson theorem which says:
An increase in the price of a capital-intensive good increases the return to capital and decreases the return to the other factor (labor).

- ▶ Stolper-Samuelson theorem in its original form is very limited in its application because it is too sensitive to changes in the assumptions.
- ▶ But this emphasizes an important issue which the Ricardian trade theory glosses over.
- ▶ In Ricardian trade there is no political economy division of the country. There are no different classes owning different factors.
- ▶ However, there are producers of two different goods in the Ricardian model and moving from one production to the other may not be costless.
- ▶ But one may argue that the extra revenue generated from complete specialization can be used to cover for the transaction costs of occupational switch.

- ▶ Hence, the analysis above in a way invoke the issue of class conflict (defined in a neo classical way)
- ▶ Let us again see some loose empirics on wage share over time

What happens to wage share over time? Developed countries

Figure 1. Adjusted wage shares in advanced countries, Germany, the USA and Japan, 1970-2010



Note: ADV stands for unweighted average of high income OECD countries (without South Korea)¹

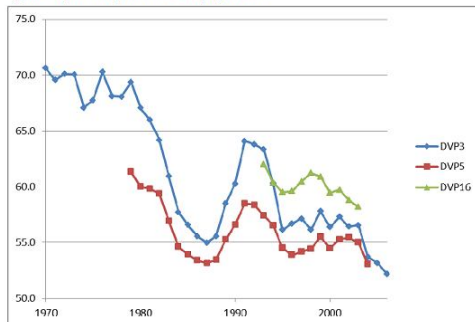
Source: AMECO

¹ We use 'advanced' economies to include all high income OECD except South Korea. See section 4.

² Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the

What happens to wage share over time? Developing countries

Figure 2. Adjusted wage share in developing countries

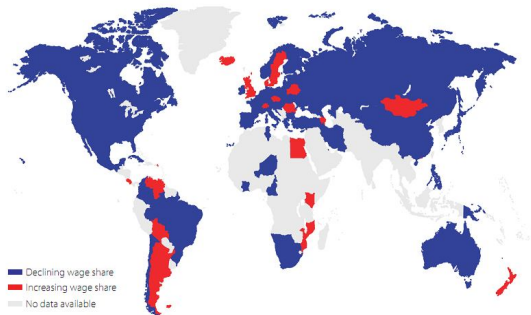


Note: DVP3: unweighted average of Mexico, South Korea, and Turkey; DVP5: unweighted average of China, Kenya, Mexico, South Korea, and Turkey; DVP16: unweighted average of Argentina, Brazil, Chile, China, Costa Rica, Kenya, Mexico, Namibia, Oman, Panama, Peru, Russia, South Africa, South Korea, Thailand, and Turkey

Source: see text

Change in wage share

Figure 8: Changes in wage share in various countries, 1995-2007



- ▶ The declining wage share hints at a political economic implication of more open trade.
- ▶ But at the same time we see declining poverty in many Asian countries (slide 12)
- ▶ Can we reconcile these two pieces of information?
- ▶ This may mean that people are getting more jobs and earning wage but the growth in wage may be less than growth in non-wage income.
- ▶ This may mean widening gap between the rich and the poor.

- ▶ The above analysis in a way focuses on the impact of trade on the relative class position.
- ▶ But what about countries? What about global power regime?
- ▶ In Heckscher Ohlin, the only way you characterize a country by its factor endowment.
- ▶ The implicit assumption is that poor countries are labor abundant and rich countries are capital abundant.

The concept of national power

- ▶ How do we understand the question of power and hierarchy in the world?
- ▶ For that, understanding the role of nation state is important which existing theories treat in a very trivial way.
- ▶ How do we define nation states in Ricardo and Hechsher Ohlin model?
- ▶ How the concepts of nation state in Ricardo and Hecksher Ohlin are any different from the concepts of individuals?

The point of departure

- ▶ Globalization is not just large scale trade!
- ▶ Even though most of the literature on globalization just show the effect of more trade on employment, environment or industrialization.
- ▶ But only looking at trade misses the bigger perspective – space and institutions.
- ▶ These are the perspectives in which country trade and individual trade are different.

- ▶ Production and consumption also require some market which is implicitly assumed by Neo-Classical economics.
- ▶ The existence of market requires contract laws.
- ▶ The difference between the sites of consumption and production, and contract enforcing institutions are ignored in Neo-Classical economics.
- ▶ This is because standard Neo-Classical economics is essentially domestic. It does not exploit the differences
- ▶ The moment we enter in the arena of global trade, the issues of space and institutions become important.

- ▶ For global trade we need global institutions – same set of rules governing all countries
- ▶ Moreover, there is a spatial distribution of industries in a globalized world.
- ▶ Both these issues lead to a need for understanding global order which is not discussed in the regular economics curriculum.
- ▶ These issues have a variety of implications for a country's welfare.

What does geography mean?

- ▶ Geography means a lot of things – some are stark and some are subtle.
- ▶ Among the starker things we have natural resource.
- ▶ More subtle is the concentration of industries.
- ▶ The issue of concentration was not discussed in detail before Krugman started new- economic geography in 1990s.
- ▶ Why?

- ▶ Mainstream economics discusses using the tools of constant returns to scale and perfect competition.
- ▶ Both these tools cannot address the issue of concentration which shows the existence of increasing return to scale.
- ▶ Globalization cannot be meaningfully discussed unless we have a theory that deals with the issue of concentration.
- ▶ Unlike the standard neo-classical theory, such theory must discuss increasing returns to scale that makes the history important in the scheme of things.

- ▶ In presence of increasing return we can have multiple equilibria and path dependence type equilibrium.
- ▶ We can also see how pattern of absolute advantage emerge.

Sameness and difference: the role of institutions

- ▶ The basis of trade is difference: in terms of technology (Ricardo) or in terms of endowment (Heckscher-Ohlin).
- ▶ However, for trade, two countries need to have an agreed upon legal framework.
- ▶ For a globalized trade this framework needs to be global.
- ▶ We find the expression of this global order in WTO.

Questions to ask

- ▶ In this course we go beyond the international trade economics perspective of globalization by raising more questions.
- ▶ Understanding the question of space and institutions thus become important.
- ▶ Can we see the world in North-South model?
- ▶ Does capital flows from North to South or is it just North-North?
- ▶ What is the pattern of trade between North and South? What about institutional differences – environmental laws, labor laws?
- ▶ Does national sovereignty exist in a globalized world?
- ▶ These are the questions that we critically examine in this course using both mainstream and heterodox approach.