NINE FALLACIOUS ARGUMENTS ABOUT GLOBALIZATION AND COMPETITIVENESS

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Recent arguments about competitiveness and globalization from international media, which I consider to be partially or totally fallacious, have encouraged me to write this short piece. They come from the protectionist reactions to further trade liberalization by politicians, businessmen and trade unions in developed countries when confronted with the end of textile quotas, already agreed at the Uruguay Round, and with a necessary reduction in their protection of agriculture and labour-intensive manufactures, in order to achieve a meaningful agreement at the present Doha Round of trade negotiations. They come as well of blaming some developing countries for the present global imbalances and asking them to reduce their current account surpluses. In the next pages, I will try to show why these arguments have little theoretical base as well as empirical evidence. But nothing of what I am going to say is new, since it has been said and demonstrated before by some eminent economists, so my aim is jus to offer a comprehensive reminder to the non specialized reader.

"Competitiveness depends exclusively on relative costs and prices"

The first argument is to believe that economic competitiveness (that is, the capacity of an economy to compete internationally while, at the same time, maintaining increasing and sustainable standards of living) is

exclusively based on relative costs and prices. This argument is only partially true. It is based on the neoclassical models of perfect competition in international trade and it is still valid in the case of basic commodities (oil and gas, gold, metals, soybeans, coffee, maize, wheat etc.) and some perfectly homogeneous products (some iron and steel products, basic chemicals and some textiles and clothing) which many of them are quoted at international or local exchanges. In these basic homogeneous products, the relative levels of production costs and exchange rates are the key determinants of their competitiveness.

Nevertheless, many decades ago, Kaldor (1978) did show already that there was not a clear correlation between the reductions in relative costs and prices of an economy and its market share or competitiveness in international markets (the so-called “Kaldor Paradox”). Later, in the seventies and eighties, new theories and models of international trade, developed by Krugman (1980), Helpman and Krugman (1985), Dixit and Stiglitz (1977), Dixit and Norman (1980) and Ethier (1982), have shown that international trade and competitiveness were mainly based on the existence of increasing returns to scale in production and distribution, as well as on product differentiation and on the level of quality, design, innovation, embedded technology and brand recognition. That is, there are today other forms and ways to compete in international markets, even more efficient than costs and prices, by developed countries, for heterogeneous goods and services.

Today, most heterogeneous manufactures compete internationally based mainly on these new parameters and not so much on their relative cost or price. This form of “imperfect or monopolistic” competition is extremely important among very similar economies in terms of income levels, tastes and revealed comparative advantages and even more between these type of countries when they have a single currency or a peg to a major international reserve currency, where each competing economy cannot have recourse to competitive nominal exchange rate depreciations which can give them a temporary cost advantage. It is also very important in the case of “intra-industry” or “intra-firm trade”, where foreign trade flows are exchanged among different companies within the same sector of production or among subsidiaries or companies within the same company or group, respectively. By contrast, it is somehow less important in trade of heterogeneous products between developed and developing countries because of their large differences in wage costs.

Finally, there is increasingly today a clear distinction between a country “external competitiveness”, based exclusively in its short term trade results or export market shares and its “long term global competitiveness”, mainly based on its relative levels of productivity. Any country’s productivity level is the one that determines, in the long term and in the last instance, not only its relative level of competitiveness but also its potential GDP growth, its real wage levels and its wellbeing. This concept is basically used by the World Economic Forum or by IMD to make their annual Global Competitiveness rankings. In these rankings, China, for example, is not considered a highly competitive country, given that it is only very competitive in labor-intensive manufactured products, given that it has lower wages (because of its lower relative productivity), a medium level of technology (but growing fast) and an artificially depreciated currency. By contrast, Germany and Japan are ranked as very competitive countries, because they are able to compete internationally in spite of their very often appreciated currencies and higher costs and wages, showing that their productivity, technology and innovation levels are higher than in most other developed countries.

Technically, the only way that productivity and competitiveness may differ is when a country’s purchasing power grows at a slower rate than its output or, what amounts to be the same, when its terms of trade deteriorate, that is, when the average price of its imports becomes higher than the average price of its exports, which means that its purchasing power and its standard of living are deteriorating. Nevertheless, this has not been the trend in developed countries until now since their terms of trade have followed an improving long term trend, in spite of their temporary short term falls, due mainly to energy shocks. By contrast, developing countries have suffered, much more often, a fall in their terms of trade, even today, where, they are exporting manufactures at falling prices and importing commodities at rising prices.

Finally, until now we have only spoken about trade and competitiveness in complete goods or services, but today competition is increasingly becoming more important not among complete goods, but among different parts of the production process or even among different tasks within them. Globalization is the result of increasing technological advance and therefore of falling transport costs of goods, services, people and ideas, each of them has been affecting to more refined layers of the production process, from sectors to firms, from firms to factories and offices

and finally from factories and offices to different stages of production and different tasks performed in then, which makes even more difficult to find out where in the production process competitive advantages are to be found.

“Competitiveness should be measured by export performance”

The second argument is to think that the only real way of measuring a country level of competitiveness is through its export performance in foreign markets, so that export competitiveness should be a key target of economic policy. This view of competitiveness can be as Krugman warned “a dangerous obsession” (1994) and the argument is not based on any serious evidence (Posen, 2006):

First, historically, those countries which have engaged in such a type of policy have ended, in most cases, eroding their living standards. The reason being that most of them have depreciated their currency at the expense of deteriorating the purchasing power of their population; or have depress wages in export sectors, either directly or through a relative deflation versus their trading partners (that is, cutting down real incomes and domestic demand) or have subsidize and protected exporting companies, at the cost of discretionary wasting of public money and distorting investment decisions, or have promoted national champions through large discretionary subsidies, protection against foreign “take-over” bids or even forcing domestic mergers among large national companies, at the expense of other smaller and competitive business and the taxpayers.

Second, large empirical evidence shows that although engagement in international trade and openness is highly correlated to faster economic growth, this is not the case with export performance. The reason being that, the main benefits of openness to growth are the following: Be able to import goods and services at lower prices and with a greater variety than domestic ones; creating efficiency gains from increasing competition in the domestic market; and give a signal to business that there is a clear engagement of government in promoting openness and market oriented policies instead of a framework of discretionary intervention which maintains incumbents

protected and avoids new entrants which today tend to be the key to innovation and competition.

Again, as it was said earlier, the key to competitiveness for any country is being able to increase its average productivity and achieve increasing terms of trade when opening to the rest of the world. For that it is necessary to be able to be permanently producing new and more diversified, differentiated and more expensive goods and services ahead of other countries and to exploit efficiently the economies of scale and scope. Only in this way the country can be competitive, it can keep moving up in the value added chain and its citizens can prosper in the long term.

"**Competitiveness is mainly a static concept"**

The third argument is to believe that competitiveness is essentially a static concept, when it is truly dynamic. Since the first globalization in the late nineteenth century until today, countries, in order to keep being competitive, have had to improve progressively their level of productivity and innovation, all along a kind of "value chain" that never seems to end. It should not be forgotten that all presently developed countries were, much before, also underdeveloped and they started to compete, a long time ago, by exploiting their comparative advantages based on their relatively low labor costs or their abundant natural resources, the same as they do today many developing countries to catch up with developed ones.

Later, after the Industrial Revolution, they were able to increase their technological levels and their productivity by improving the education and human capital levels of their labor force, by using their physical capital more effectively, by investing heavily in R&D, innovation and by introducing incremental discoveries, to be able to start producing more diversified and differentiated products with higher prices and margins, while abandoning other manufactures not compatible with their higher wages and productivity. To get up that "value chain" is increasingly difficult for developed countries, which need to develop new technologies and new productive innovations, than for developing ones. Now that the costs of transporting goods are much lower, due to improvement in air shipping and the costs of transporting ideas have falling to almost zero, through the improvement in telecommunications, developing countries can grow faster just by imitating

and adopting technologies and innovations from developed countries, thus, increasing total factor productivity and catching up.

The first globalization wave (1870-1913) produced the industrialization of the North at the expense of the deindustrialization of the South. Since the start of the second globalization wave (1950-today) the contrary has happened. At the end of the XIX century, employment in agriculture, cattle-raising and fishing represented an average of 68 per cent of total employment in Japan, 46 per cent in today's EU 15 and 44 per cent in the US. By contrast, today their respective percentages of total employment are only 4.4 per cent, 3.4 per cent and 1.2 per cent. Industrial employment achieved 40 per cent, on average, of total employment in present OECD countries and today, is only 27 per cent in Japan, 26 per cent in the EU 15 and 20 per cent in the US, respectively, of their total employment and it may go down much further (to 10 per cent?) in the next four decades.

Does it mean that these OECD countries have been forced to reduce their employment rate levels? Not at all, they have increased both their employment rates and their wage levels very substantially due to having achieved a higher level of productivity in their new production mix. As a result they are now many times wealthier than a hundred years ago. Their labour forces have shifted slowly towards the construction and mainly services sectors, which today represent around 70 per cent on average of their total employment.

The same is happening now with emerging countries, which, although agricultural employment still accounts for the largest part of total employment, 50 per cent on average, their industrial employment has reached already levels close to those in developed countries one hundred years ago, that is, around 35 per cent of the total, (only the poorest countries have still 80 per cent of their total labour force in subsistence agriculture, this is the reason why they are so poor). At the same time, emerging countries have also moved up their productivity levels, the value added of their exports and their terms of trade. For instance, only three decades ago, most American and European imports of textiles, apparel and shoes were coming from China, Taiwan, Hong Kong, Korea, Brazil and Mexico. Today, these countries have reduced the relative weight of these cheap labour-intensive manufactures exports and now they are also exporters of chips, PC's, cell-phones and automobiles, while Bangladesh,

Vietnam, Indonesia or Philippines are the countries exporting most of these high labor-intensive manufactures.

But this change does not mean that, for instance, the US and the EU 15 are not competitive in textiles, apparel and shoes. As a matter of fact, Italy, France and Spain still export these products competitively but of a much higher quality, price and margin, thanks to their better fashion, design, finishing, quality and brand recognition than before. Therefore, they have been able to make better and more differentiated products and, at the same time, they can now manufacture a large part of these more labour-intensive products or their productive parts and processes in those countries with a lower cost of their labour force.

"Developing countries are doing "social dumping""

The fourth argument is based on the idea that developing countries, where their workers do not have the same level of trade union representation, the same level of wages, the same working regulations and conditions and the same political and social rights than in developed countries, are doing "social dumping" through their cheap exports to developed countries by exploiting badly paid workers under very hard working conditions, so they should be subject to an antidumping duty to eliminate such an "unfair" competition. This idea is totally wrong for several reasons:

First, according to basic international trade theory, each country should specialize in what it can produce more competitively exploiting its revealed comparative advantages in its relative unit labour costs (including productivity), as well as its level of physical capital and human capital accumulation. Developing countries, to compensate fro their lower productivity levels, will tend to specialize in their cheaper labor force, cheaper land or their abundant natural and energy resources, while developed countries will tend to specialize in their higher level of education and human capital, in the more abundant physical capital, technology and innovation and, as a result, in their higher level of productivity. When their lower wage levels weighted by the transport costs, more than compensate the higher similarly weighted productivity of developed countries they can be competitive.

Second, “social dumping” cannot even be called dumping. This word means that the country in question is exporting a service or a good to another country at a price below its domestic market price. This is exactly the contrary of what it is happening in developing country exports to developed countries. In developing countries, wages in labor intensive industries producing for exports are much higher than in those firms producing only for their domestic market and, as a consequence, their export products have a higher price than their domestic products. Moreover, many if not most exporting firms in developing countries are owned by developed country multinationals or they have outsourcing or off-shoring contracts with them and massive empirical evidence available shows that foreign owned companies pay higher wages than domestic companies both in developing as well as developed countries. Thus, only in the case that these domestic companies’ exports were clearly subsidized by governments then protests would be justified and an antidumping procedure should be initiated.

Third, there are also protests in developed countries about the very low level of social security contributions that exporting companies in developing countries have to pay, so they have another advantage to compete with those in developed countries. Nevertheless, these contributions are also very low in some developed countries such as the US or Denmark and nobody dares to say that these two countries are doing social dumping to the rest. Moreover, universal services of social security and health are, in many developed countries with a long democratic tradition, a social conquest achieved no a long time ago and it should be seen as shocking to try to impose them now on to poorer countries, with low income and budget revenue.

Fourth, “child labour” is also criticized not only for moral and ethic motives, which are fully understandable, but also because it is considered to be another factor contributing to “social dumping” and some business associations, trade unions and even some NGOs are demanding an import ban on all manufactures produced using, fully or partially, child labor. One the one side, contrary to this view, most empirical evidence shows a positive correlation between more international trade and less child labour. (Edmonds and Pavcnik, 2002 and 2004) On the other, only 12 per cent of children in developing countries are employed in exporting companies and they have higher wages than those 88 per cent involved in domestic productions. Finally, banning child labor in those countries would only have

a positive effect if all of the following conditions would apply simultaneously: if the reduction in the supply of working children would imply a similar increase in the demand for adult workers (which are natural substitutes); if this larger demand of adult workers would increase their wage levels compensating totally the loss of children wages and, finally, if the adult workers now employed would use their higher wages to send their children to school (Basu and Van, 1998) (Brown, Deardoff and Stern, 2001).

In these four conditions are not fulfilled, such a prohibition would make working children worse-off and total welfare would deteriorate. The main factor behind child labour in those countries is extreme poverty, where a low paid job is better than no job at all (Krugman, 1996), and their parents need for their children wage to complement their total income in order to survive. The solution to this problem is not banning manufactures produced by children, but to reduce drastically the scandalous protectionists laws and practices by developed countries (and some emerging countries) against agricultural and labor-intensive manufactures produced by developing countries, which are exactly those they can export more competitively to the rest of the world and which impedes parents to find a reasonable job in the export business and, therefore, to send their children to the school instead of forcing them to take a job.

“China and India will keep being very competitive for many decades”

The fifth fallacious idea is to think that China in manufactures and India in services will dominate these two sectors forever because they have much lower relative wages and a reasonable and increasingly higher level of productivity and technology. The available empirical evidence does not avail this thought.

First, today the US is still the world’s largest producer of manufactures and services followed by Germany and Japan in manufactures and by the UK in services. Germany is still the largest exporter of manufactures in spite of having an average cost per hour 40 times higher than China and a strong Euro versus the rest of the world’s currencies.

Second, as Krugman (1996) has pointed out: “to say that a country can be able to combine developing country wages with developed country productivity is an oxymoron”. By definition if China average wage levels are so low is because its average productivity levels are also very low. Thus, as its productivity goes up so will its average wage until reaching a level of income, purchasing power and prosperity in which it will not be so competitive in intensive labor manufactures and it will have to outsource some of them to (or import them from) other cheaper labor and lower productivity level countries. In the meantime, China will be moving its production to other manufactures with higher level of productivity, technology, price and value added per worker, compatible with its higher average wages as it has already happened in most developed countries.

It is important to remind, in the case of China and India, that countries grow richer on the back of appreciating currencies. Currencies tend to appreciate as higher productivity leads economies to converge on Purchasing Power Parity (PPP) exchange rates. There is a clear tendency for countries with higher income per capita to have exchange rates closer to PPP. Those developing countries which are far from the PPP exchange rates tend to have a much lower levels of productivity, so as their productivity levels rise, there will be a tendency for their currencies to appreciate towards PPP. This was already found at the same time and independently by Balassa (1964) and Samuelson (1964), so it is called the Balassa-Samuelson effect, by which, prices in the non tradable sector grow faster than in the tradable sector, being the prices of latter set at the international level and the former at the local level, so the larger is the difference the higher tends to be the real appreciation of their exchange rate. This process will continue until productivities in both sectors tend to converge.

Third, today, China is more the largest final assembler than a very large exporter, given that almost two thirds of the value of Chinese exports of manufactures to Europe and the US are imported and a similar percentage comes from EU and US multinationals established in these two and other developing countries (“intra-firm trade”). The same can be said of Indian exports of services which are in a large extent produced by American and European firms established there or contracted out to local suppliers. This increasing multinational presence allows both countries to benefit from large foreign direct investment flows, from increasing exports, employment, education, training and technology levels and, at the same

time, allows those multinationals to be more competitive and to increase their higher and more skilled domestic employment.

Moreover, cheap imports from these developing countries are benefiting all citizens in developed countries, given that their low prices moderate their rate of inflation or compensate for the inflation pressures originating from the hike in commodities and energy prices, so as to maintain their purchasing power. They also tend to impede central banks raising further short term interest rates, helping to maintain a moderate and stable cost of capital and level of debt for households and companies. That is, most people in the world become winners. Even those workers, who lose as producers because their may become unemployed or see their real wages fall because of the increasing competition from these cheap imports, may see as consumers, some compensation in terms of increasing purchasing power.

This process of increased globalization of capital and intra-firm trade by multinationals is very important. Using an extreme example can help to understand it in all its strength. Today, foreign trade is conventionally defined as flows of goods and services between residents in one country and residents in the rest of the world. If instead of using the “country of residence” criteria of the exporting or importing firm or person as the key to accounting system for foreign trade, it could be used the “country of ownership” of the exporting and importing company, then, the US, which has a huge trade and current account deficit would turn it into a surplus and the Euro Area current account surplus would be much larger than at present, because most trade in manufactures and services today is done within the same company or group of companies, (either between their parent company at home and their own subsidiaries abroad or among their own subsidiaries located in different countries). By contrast, many developing countries, now showing a foreign trade surplus, will turn into it into deficit (except some energy and commodity exporters) because they do not own many of their producing and exporting firms at home and abroad, even if they benefit greatly from their presence, their investment flows, their technology transfer, their employment and their exports.

This type of trade is called “intra-firm trade” which today accounts for more than 40 per cent of world’s total trade in manufactures, given that there are today more than 70,000 multinationals with more than 700,000 affiliates around the world (more than 50 per cent of them located in developing countries) which have annual sales of $19.0 trillion and total

assets of $37.0 trillion. That is, sales by US affiliates alone are nearly four times larger than total US exports and European Union multinational's affiliate sales are two times larger than EU 15 total exports. Total sales by multinational affiliates account for 10 per cent of total world sales and their exports account for 33 per cent of total world exports.

Fourth, nevertheless, let's suppose, against all empirical evidence, that China, having an autocratic political system which imposes limits to the movement of people domestically, is still going to be able to maintain for many years part of its poor population in rural and interior areas, as a reservoir of cheap labor, while it accumulates more capital and develops new technologies in its coastal provinces with the end result that it can eventually produce all manufactures cheaper than in the developed countries. That means that China is going to be able to achieve an "absolute advantage" in the production of all manufactures. In that case, we should go back to Ricardo (1817), who already explained, almost two centuries ago, that even if a country has an absolute advantage in all products, it will tend to specialize its exports in those products in which its "comparative advantage" (and thus, its margins and net export proceeds) will be larger, leaving its "absolute advantage" in other products to be exploited by other countries with similar comparative advantages and import them.

"All jobs in an economy compete globally"

The sixth is the increasingly popular idea that all jobs have to compete globally and are subject to a competitive risk. Again this argument is only partially true. Every economy, even the most open one, has two clearly differentiated productive sectors: first, one which produces goods and services which are exported, competing with those of other exporters in foreign markets or with imports from other countries in its own domestic market, this sector is called the "tradable sector" and it is composed mainly of manufactures, some agricultural goods, commodities, oil and gas and some services. Second, another and usually larger, productive sector, which does not produce goods and services which are tradable, and, therefore, its domestic producers only compete among themselves and not with foreign ones, unless the latter are established locally. This sector is

composed mainly of services, of construction and of some very heavy products with very high transport costs (as cement) and it is called “non tradable sector”.

Within the service sector there are some jobs which can be offshored easily to other countries with lower wage costs (accountancy and back-office jobs, computer processing, call centers etc.) as well as some more sophisticated ones (architecture, construction and engineering services, medical diagnosis and treatment etc.). A recent study by McKinsey Global Institute shows that, as of today, only the 11 per cent of total services can be supplied from a distant location whether in the country itself or abroad but this percentage can go up in the future through the deployment of new technologies. Some basic service jobs, which are not tradable, may compete locally with those provided by new low skilled immigrants (but if these are reasonably controlled, they will mostly compete for jobs that locals do not supply because their hard working conditions or their low pay) or, at the other extreme, highly sophisticated jobs may compete with high qualified immigrants when there is not enough local supply to meet their demand or there is a need for more competition given their increasing costs.

In sum, as of today, a relative small part of the productive jobs in the primary and secondary sectors and most of the service and construction jobs do not compete with imports locally or are exported and compete with other exports in other markets. In the developed countries these “non tradable sector jobs” represent, on average, close to 60 per cent of total employment (close to 70 per cent in the US) while in the developing countries they represent less than 50 percent. Therefore, it is paradoxical to see why protests against trade and globalization are mainly concentrated in developed countries, which are more protected against them, rather than in developing ones, which are less protected. The fact is that most outsourcing of manufacturing jobs to developing countries has been already exhausted, while the off-shoring of services is still growing. Maybe, the main reason for the present level of protest in developed countries could be that civil societies tend to be more developed and better organized in rich countries than in poor ones.

“Competitiveness is about large numbers of graduates in science and engineering”

The seventh idea, related to the former, is to think that the only way that developed countries can compete globally is by getting most of their labour force achieving PHD university degrees, mainly doctorates in sciences (math, physics, chemistry, biology and engineering). This argument is only partially true. It seems very clear that it is an essential condition, for any country to grow faster and catch up, to have a high level of human capital and thus to have an increasing proportion of its labor force with high university education in order to create and develop more science, research, technological development, innovation and ideas which are the key to improve their "total factor productivity" and potential growth. Nevertheless, the reality shows that, in most developed countries, this kind of university graduates is only a very small proportion of their total labour force and for a very important reason: their need to match job supply with job demand.

Today, in the large majority of developed countries, most of the demands for employment by government, institutions, companies and households are concentrated on jobs which do not compete globally and this trend is going probably to increase in the future. Nevertheless, to work in non tradable sector does not mean that workers do not need to a have a deep knowledge of the new general purpose technologies, as the computer, internet and telecommunications in general and know well how to use them in order to be productive and to earn higher wages. A non tradable sector can be as productive as a tradable one depending on the quality of its labour composition as well as its physical capital and technology content.

In developed countries most employment demands are concentrated today in the following specialties: social services (education, health, long term care to the elderly, social assistants) administration (government and company employees) accountancy, sales and marketing, information and communication, retail and wholesale trade and finance, hotel and restaurant services, leisure, tourist services, transport, household services, maintenance and cleaning, after sales services, security, construction and real estate, art and culture and application and diffusion of new technologies. Most of these jobs are in the non research and science sectors and in the non tradable sectors showing the large increase in services employment and the large decrease in agricultural, industrial and manufacturing employment in developed countries. As Krugman (1996) puts it: "there is a need for well paid occupations such as gardening, house

cleaning and other services which will receive an ever-growing share of our expenditure, as consumer goods become steadily cheaper"

One potential reason for the fast increasing jobs in the "non tradable sector" is the changing nature of globalization. In the last 50 years globalization has produced two great "unbundling processes" (Baldwin, 2006) (Blinder, 2006) and (Grossman and Rossi-Hansberg, 2006a and 2006b). In the beginning, the high cost of moving goods, people and ideas forced the geographic clustering of production and workers. The first unbundling was due to a large fall in transport costs, which allow for ending the need to produce goods close to the point of consumption. The second one have been the result of a large fall not only in the transport of goods but also the fall in the cost of transporting information and ideas, due to a very large fall in the price of communications and coordination costs, which have allowed for ending the need to perform most manufacturing stages of production of goods and services in close proximity. At the beginning was behind a large process of outsourcing of production stages to developing countries, and, more recently, this second unbundling has also spread from factories to offices, allowing for the large present off-shoring of service-sector tasks to developing countries. That is, the first one allowed the spatial separation of factories and consumers, the second has allowed for the geographical separation of factories and of offices themselves.

Before the second unbundling, firms and sectors were the level at which globalization was really felt. Since most firms in a sector stood or fell together, the type of labour used most intensively in the sector shared the fortune of the sector firms, so sectoral labour groups were a useful aggregate for analytical purposes. In the US and Europe the first unbundling adversely affected the fortunes of unskilled labour-intensive sectors, so unskilled workers were affected negatively while skilled workers were net gainers. As the second unbundling opened up firms (viewed before as a black box package of different tasks), global competition came directly into factories and offices and the different tasks performed by both.

Thus, competition today occurs on a task by task basis rather than o a firm-by firm or sector-by sector basis. This trade-in-tasks versus trade-in-goods has an important implication for employment policy. The old competition-at-the-sector level paradigm could allow to predict which sectors would be expanding and which would be contracting and thus which skills would be in growing demand and which in falling demand, so that "the information society" was considered as a fast expanding sector in

developed countries and that upgrading education and skills could lower adjustment costs. But from the new unbundling paradigm it may be not the case. Competition now is at the level of tasks rather than sectors so globalization may help one high skilled worker because his task is maintained but may hurt another because his task is off-shored to a cheaper labour and similar skills country, even if they are working in an expanding sector. So, the previous correlation between skill-education and winner status may not hold in the new unbundling. Krugman (1996) already warned about this fact showing that the key distinction lies in the tradability of goods and services more than in the level of education.

If these ideas and trends turn out to be right, policy makers in developed countries will be pushing workers into jobs that only seem to be good jobs since they do not yet face international competition and governments should also be cautious about spending too much resources to push workers into specific “information society” jobs which up today look like high valued added but maybe off-shored later.

Nevertheless, other economists, such as Venables (2006) think that agglomeration forces are still huge. For instance, other things being equal, moving from a city of 100,000 people to another of 10 million raises productivity of all factors of production by 40 per cent. That is, production will only be off-shored when the potential benefits of agglomeration are relatively small or the actual benefits of off-shoring are very large. Therefore, the relocation of activity may prove uncertain, difficult and lumpy, given that, for instance, London has been able to remain a world-class financial centre for about three centuries, in spite of fierce competition from other newcomers.

Both arguments show that the outcomes of globalization may be more complex than expected because developing countries may have more reason to fear the entrenched advantages of the high income countries than the other way round or because there may be big gains for new entrants in world trade or because low skilled workers may not lose much from off-shoring as predicted.

Under any alternative potential outcome, educational policy in these developed countries needs to aim mainly at providing those jobs which are most demanded to avoid a mismatching between supply and demand and to try mainly to achieve a higher employment and productivity growth rates. At the same time, it is extremely important to develop, at every level of

educational skill levels, a culture of entrepreneurship, in order to foster the creation of new firms and ventures, which are a key to the future growth of jobs in the economy, as well as a culture of risk taking to foster innovation to be able to develop new products and processes and compete both domestically and globally.

But it is also a fact to take into consideration that most scientists and engineers study, live and work in developed countries, mostly in the US, the country which represents still today the “world’s science and technology frontier” and which because of that receives huge benefits for its economy, coming out of its scientists ideas and discoveries, even if they represent a very small proportion of their total labour force.

“Competitiveness is a “zero sum game”

The eighth is to think that international competitiveness among countries is a “zero sum game” as it is often the case between two firms which compete in the same sector and the same market producing very similar or totally homogeneous products or services. In theses cases, if one of them gains market share is mostly at the expense of the other, and, if this trend goes on, eventually the losing or less competitive firm closes down or is bought by its competitor, which achieves cost reductions (euphemistically called “synergies”) by reducing all redundant jobs and closing some of its less productive plants. This is what many businessmen still think today about competition among both firms and countries (although Ricardo did proved the contrary as early as in 1817) maybe because it is what some of them have experienced in the firm where they work, in very special competitive circumstances, but it is false in the case of countries, for the following reasons:

First, while those producing companies in the tradable sector, which are not able to compete in their own domestic or in foreign markets with their product or service, are eventually deemed to go broke, closed or be sold to a competitor, by contrast, uncompetitive countries, even after defaulting on their debt, never close down, disappear or are taken over by another country. There are several causes for this striking difference: On the one side, as it was shown earlier, a large part of its productive economy (the non-tradable sector) does not compete with that of other countries. On

the other, for a no competitive country to survive it needs to continue exporting in order to be able to import essential goods and services which does not produce or not in the volume demanded. As a consequence, its exchange rate starts to depreciate against most other currencies (at the cost of increasing temporarily its inflation rate and of reducing the purchasing power and the real income of its citizens in terms of foreign currency) until it regains again enough competitiveness and export proceeds to pay for its imports.

Second, by contrast to individual firms, countries not only compete in the international market with other countries, but also, each country is the export market of the other, so they need each other. If, for example, the European Union increases its exports to the US does not mean that it achieves that success at the expense of the US GDP or income, because, on the one side, the EU is exporting goods and services to the US, competitively and at a reasonable price, because they are demanded and bought by US companies and households to increase their utility and wellbeing and, on the other, by exporting more to the US, EU employment and income growth will be higher and it will eventually increase its internal demand and part of it will filter to imports from the US.

Thus, international trade is not a zero sum game. When the US increases its productivity, its real wages improve and its employees spend part of their higher wages in the consumption of goods and services from other countries, allowing for real wages to increase in the rest of the world as well. For instance, in the period of ten years from 1995 to 2004, the fast expansion of US domestic demand of consumption and investment, fuelled by an increase at the same time of productivity, innovation and employment, did contributed to close to 55 per cent of the world’s growth over the period, even when the weight of the US GDP in the world’s total was only 33 per cent (at current exchange rates) and its imports of goods and services from the rest of the world were only the 11.4 per cent of its GDP. By contrast, EU contribution to total world’s growth, over the same period, was only 10 per cent, while its relative GDP weight represented 28 per cent of the world’s total (at current exchange rates) and Japan reduced almost 10 per cent world’s output growth while its GDP weight was 11 per cent of the world’s total.

Now that the US will be forced, most probably, to reduce its domestic demand and its imports rates of growth and to save more (given its large trade and current account deficit) its currency will have a higher pressure to

depreciate against the euro and the yen, the Euro Area and Japan, which have been growing very slowly for some years and its growth rate has been based, almost exclusively, on the contribution of its external sector, (thanks in part to the US fast growth of its internal demand and to a strong dollar) will now, most probably, reduce the growth of its exports to the US, due to an appreciation of their currencies versus the dollar, and start to increase slowly its internal demand and its imports, reducing its surplus for current account and helping the US to reduce its large current account deficit.

Nevertheless, as explained by Woodall (2006) the most recent important shift in world's growth contribution has been the re-emergence of the emerging countries which now represent 50 per cent of the world's GDP versus 22 per cent of the US, 7 per cent of Japan and 18 per cent of the EU 15 (all at PPP weighted exchange rates) and more than 20 per cent of world's GDP (at current exchange rates). Moreover, their share of world's exports has jumped from 20 per cent in 1970 to 43 per cent in 2005 and their share of world imports is also increasing a fast rate absorbing almost 50 per cent of total OECD exports. This major shift has been the result of largest emerging countries opening to world trade and globalization and it is also a demonstration that trade is not a zero sum game, given that rising exports from emerging to developed countries give the former more resources in foreign currency to spend on imports from developed countries and other developing ones and the more they export and import the higher their income and the larger and more attractive their market. It is expected that a billion new consumers may join the world markets in the next ten years.

Third, the size of the international market of a totally homogeneous product not only is not fixed but it follows and increasing trend, as shown by the historical trade statistics (except of course in some short periods of negative growth, as during the Great Depression). Only when a new discovery or technology appears (which is usually produced in a developed country) it may rend a product redundant and the market for the latter may decline, but slowly, since new technologies take a long time to be diffused worldwide (as it was the case, for example, with synthetic rubber).

By contrast, the market for differentiated products or services is almost infinite, given that consumer tastes are very diverse and continuously changing and that the product and process innovations are increasingly faster to meet those changes in tastes and preferences or even to create new ones. Moreover, every year, since globalization

accelerated after 1980, both developed and developing countries are opening further their economies to international competition, so global markets are, for any product or service, expanding faster than ever before.

Fourth, if emerging and developing countries are now increasing their production and exports to developed countries, their income will grow accordingly (except if their terms of trade are deteriorating) thus, they will spend more in consumption and investment and part of it will filter to increasing imports from the rest of the world. That means that it is impossible for any developing country to maintain a permanent or even long term surplus in its trade or current account balance. If a developing country is successful exporting to the rest of the world, it will receive larger flows of foreign direct and portfolio investment (to exploit its faster growth in purchasing power and the increasingly larger size of its market) which will allow it to invest more than what it saves and it will eventually end with a current account deficit (given that the current account balance is defined by the difference between national saving and investment). Moreover, as by an accounting convention, the final result of a balance of payments account needs to be zero (except errors and omissions), a large inflow of foreign investment, which generates a large surplus in its capital account, will have to be matched by a deficit in its current account, in order to achieve zero in the ending balance.

It is nevertheless true that China exhibits today, paradoxically, a surplus in its current account while attracting large sums of foreign direct investment. The temporary reason for that is twofold: On the one side, there is not a clear distinction between which part of the current account surplus is due to Hong Kong and what part is due to China. On the other side, China does not invest domestically all the net foreign direct investment inflows it gets, for several reasons: first, China is a very important outsourcer and off-shorer to other countries in Asia with even lower labour costs; second, China is also a major investor in other developing countries and some developed ones, in order to assure an stable long term supply of energy and basic commodities of which it has a short supply or its supply is very cyclical; third, it also invest heavily abroad to build and maintain large networks to distribute part of its exports in other countries and, finally, it holds close to $900 billion of foreign exchange reserves and with them it has been buying massive amounts of US Treasury debt (to both finance the US current account and make room for

more Chinese imports) and now is also investing in euro and yen government bonds, to diversify its financial and exchange rate risks.

All these arguments mean that: first, if developed countries continue maintaining their present large protectionism against imports from developing countries, just to preserve some jobs in an inefficient and uncompetitive agricultural production (instead of employing them to preserve the rural environment which has been vastly deteriorated by agricultural exploitation) or to maintain other low skilled jobs in a fast decreasing labor intensive local manufacturing production; second if they try to stop or reduce outsourcing and off-shoring of labor intensive production processes to developing countries, just to keep some local inefficient jobs, then, most world's citizens will end being losers (de la Dehesa, 2006a):

The first losers of this protectionist policies are, paradoxically, the large majority of citizens in developed countries and mainly the poorest ones, who have to pay an extra tax when they consume imports of food and labour intensive manufactures (given that consumption represents a higher proportion of their disposable income) due, not only to the very high tariffs charged at EU level on the imported foreign agricultural produce, foodstuffs and labour intensive manufactures that they buy bur also due to the high indirect VAT rates that they have to pay to finance their huge agricultural subsidies. Thus, these low income households suffer a loss of their disposable income, only to maintain the protection of a rather small minority of jobs (which can be compensated by subsidizing their employment at a much cheaper cost) and to maintain huge agricultural subsidies benefiting mainly rich European agricultural land-owners (de la Dehesa, 2007).

The second losers are most citizens of developing countries, who, by not being able to export to the developed ones (which are still their larger potential markets) what they can produce competitively, because of the latter high protectionism, are forced to have a lower employment rate and a lower level of income.

The third losers are many competitive firms in developed countries, which, because governments are keeping protected their domestic and declining markets, (when they really do not need it) are going to lose their future and booming largest export markets with a higher growth potential (Wolf, 2006). The facts provide large supporting evidence: According to the

UN most probable medium forecast, in the next 45 years, world population is going to increase by around 2.6 billion people, of which, 99 per cent will be born in developing countries. The population of developed countries not only has been shrinking from 25.8 per cent of the world's total, in 1975, to 18.7 per cent, in 2005, but also it will go down further to 13.6 per cent in 2050. If these increasingly larger markets in developing countries grow at a slower growth rate because of protectionist policies in developed countries, companies and households in developed countries will earn less from exporting and importing from them as well from investing in them and, as a result, world's growth will be much lower.

Finally, if these developing countries, with a much higher population growth rate, are not able to export enough to developed countries or are not receiving enough FDI flows to meet their larger growth potential or some of them do not even get larger amounts of development aid to prepare its social, legal and political institutions to be able to opening up their economies and join globalization, they will be doomed to be out of it and remain poor with a low growth and employment rates, a high rate of unemployment, and, therefore, may be forced to migrate massively to developed countries, legally and illegally. These migration flows will be very difficult to stop and may result eventually in situations of conflict, violence and maybe war.

"Globalization threatens the survival of the welfare state in developed countries"

The ninth and last fallacious argument, which is an implied consequence of the previous ones, is to think that, on the one side, the present low wage competition from developing countries is going to produce an increasing erosion of developed countries welfare states, and, on the other and conversely, that developed countries' large and generous welfare states reduce their competitiveness and growth. Thus, globalization and a generous welfare state are considered incompatible in the medium and long run. Its two main theses are:

First, as a consequence of globalization, many workers in developed countries are going to lose their jobs or to reduce their wages, either because of low wage countries competition, new immigration flows or the

outsourcing and off-shoring of their jobs to developing countries. On the one side, these losing out workers are going to reduce or stop paying their social security contributions and, at the same time, are going to demand higher social security service subsidies as unemployed or as retired if they are older. On the other side, governments are not going to be able to increase debt or raise taxes, as they were used to do before globalization, because they will be punished by the markets with higher debt spreads and because most of its tax base, that is, their richer citizens and companies, may move to other countries with lower taxation and debt levels. In the end, globalization may threaten the survival of the welfare states, which are considered to be one of the great conquests of the working classes in the twentieth century.

Second, generous welfare states in some European countries absorb a huge amount of governmental budgetary resources, which need to be financed by a very high level of taxes on the private sector, which in turn, finds itself “crowd out” to allocate those resources extracted as budgetary revenue to productive investment and therefore, these countries become less and less competitive and have to cut down their welfare state to be able to regain competitiveness.

Available empirical evidence does not give any support to these two arguments: The main evidence against the first argument is that, developing countries increasing competition with cheap exports has had, at least until now, a moderate impact on real wage reductions and even a smaller impact on job loses and unemployment increases. On the one side, cheap imports from developing countries have cause a wide wage dispersion among the employees wages and also some unemployment, but at the same time, they have maintain inflation at low levels, allowing for their workers to increase their purchasing power. On the other side, outsourcing and off-shoring of production to developing countries has been rather small in terms of total production and jobs. According to the McKinsey Institute, services off-shoring has affected to a total of 1.5 million workers up to 2004 although it is following an increasing trend. According to Forrester Research, it is expected that, by 2015, the number of jobs off-shored may reach 3.4 million. These figures are small if one considers that around 30 million jobs are destroyed and created every year both in the US and in the EU 15.

Even more, on the one side, firms which have delocalized to developing countries have been able not only to survive and to avoid

closing most of their labor intensive production, but also they have become more competitive avoiding further reductions or even increasing their total headcount, and, on the other, those workers which have lost their jobs, mainly because of their lower skills, have engaged in training to improve them or have been able to found other jobs, on average, one year later at the same or slightly lower wage (except older workers, which many of them have found ways to get an early retirement).

Finally, a considerable part of the wage reduction and job losses by workers in developed countries, attributed to globalization and foreign competition, is the result of the implementation in the productive sectors of new information and communication technologies (created and diffused by the developed countries themselves), which have produced a comparatively similar impact on their labour force than imports from developing countries and job delocalization to them. They have also contributed to wage dispersion according to skill and to some unemployment, but, at the same time, they have also helped to increase average productivity and wages in developed countries. It is also true that the combination of more foreign competition due to globalization and the increasing trade-off between labour and technology have helped companies to achieve wage moderation because of the fear by trade unions in developed countries to have more unemployment.

Nevertheless, it must also be recognized that there is a clear increase in inequality in many developed countries, mainly in those which have very flexible labour markets (US, the UK), where, as expected, low skill jobs have suffered a drop in real wages and only in a few cases in nominal wages, while in countries with very rigid and regulated labour markets there has been a lower wage reduction and dispersion at the expense of a temporary increase in unemployment.

There are also some economists that think that inequality is originating from globalization. The huge increase in the world's labour force has benefited more capitalists than workers in developed countries producing a shift in the distribution of income from labour to capital, (exactly the contrary effect to what has happened in emerging countries). According to this line of thinking, globalization is helping to lifting more company's profits (benefiting shareholders) than headcount wages (penalizing workers). Profits have gone up through large cost reductions due to off-shoring and outsourcing to developing countries as well as to cheaper imports. Wages have deteriorate through unions accepting wage

moderation due to their fear to lose jobs through production shifting to cheap labour countries and through larger domestic competition coming from more immigrants (Woodall, 2006).

This argument can be counter argued as well. On the one side, this trend is going to be only temporary, since higher competition will eventually reduce profit margins and distribute benefits back to consumers and workers through lower prices of goods and services. On the other, in some countries where inequality has increased faster (the US) there is another important factor for the increase in inequality: that is, the strong tax reductions introduced by the US government on high incomes and on dividends, which has made rich people, at the top of the earnings spectrum, even richer, while maintaining the poorer put. Thus, it could be said that inequality has increased mainly between the top five per cent of rich capitalists and the bottom twenty per cent of low skilled workers.

The evidence against the second argument is that, in the EU 15, where welfare states are more generous, there is no evidence whatsoever of any loss of competitiveness or any correlation between the volume of cheap imports or delocalization and the size of the welfare states. For example, countries such as Ireland, Sweden, Finland, Norway or Denmark, which are amongst the most open to international trade, are also within the top ten most competitive countries in the world, according to most rankings, and, at the same time, they have been able to keep their welfare states still healthy (which are among the most generous in the world), and to keep being competitive in spite of collecting a tax revenue close to 50 per cent of GDP, as it happens in the four Nordic countries, the highest in the world.

The main problem with this fallacious argument is that some people in developed countries prefer to blame globalization for the future uncertain solvency of their welfare states, than trying to face and solve their own domestic real problem for their future outcomes: i.e. change their own demographic trends, which show a dramatic increase in the ageing of their populations, mainly in the EU 15 and Japan. Both show today, on average and at the same time, very low fertility rates, (1.3 children per fertile woman, when the replacement rate is 2.1 children) very high life expectancy rates at birth (around 80 years) and very early retirement rates (around 60 years) This combination is explosive in the long term for the finances and the solvency of their welfare states. (de la Dehesa, 2006b)

Moreover, contrary to the main argument, globalization can indeed be an important part of the solution to the progressive population ageing in most developed countries. If these demographic trends continue over the next four decades, their total labor force (people between 15 and 59 years of age) will shrink by almost one third on average, from 70 per cent of the total today to 50 per cent of it by 2050, and their retired population will increase accordingly since the mean age will go up to close to 50 years and the old rate of dependency, that is, the number of retired people (aged 65 and more) as a percentage of the population at working age (15-64) who is employed will represent, on average, 140 per cent.

Therefore, there are only four ways, or a combination of them, that these countries may try to rejuvenate their ageing populations: either by increasing the age of retirement in accordance with the increases in their life expectancy, by increasing the productivity of their labour force, by trying to give very large incentives for many years to their own families to encourage them to have more children or by allowing increasing inflows of young immigrants from developing countries, who not only can fill and compensate for their shrinking labor force but also who tend to have more children than the nationals (as it has happened in the US, Canada and Australia).

If for security or identity reasons some developed countries do not want to accept many more immigrants, the other available alternative is to delocalize most of their labor intensive production to developing countries and keep the most sophisticated or skilled jobs for their own decreasing labor force. But this final alternative, unlike the previous ones, does not solve (at least temporarily, because immigrants need also to retire) the problem of how to avoid the future insolvency of their welfare states.

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