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# Policy Brief

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## **A Labor Perspective on Globalization**

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# **A Labor Perspective on Globalization**

## **Abstract**

A labor perspective on globalization sees the current structure of globalization as problematic. The main features of a labor perspective are: (1) Globalization is hurting many working families and increasing social divisions by raising income inequality; (2) The debate over the size of net gains or losses from globalization misses the point. Nor is it an issue of stopping globalization. Instead, the issue is that globalization is being wrongly constructed. (3) Globalization alone does not explain what has been happening to growth and income distribution, and globalization should not be looked at in isolation. Instead, globalization should be seen as a core element in the neo-liberal economic paradigm that has been implemented post-1980. That means the debate over globalization is ultimately about changing the economic paradigm.

Keywords: globalization, labor perspective, neo-liberalism, economic paradigm.

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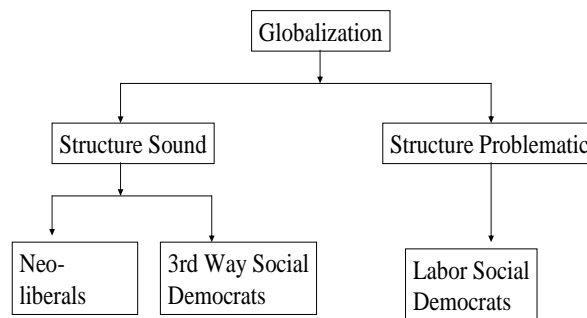
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## I The debate over globalization

Globalization is an enormously controversial subject that is usually presented in terms of technical economic arguments. Aside from being difficult to grasp, conventional economic arguments tend to misrepresent the issue by painting it as a simple pro- versus anti-globalization debate, when the reality is more complex.

For these reasons, the debate over globalization is better approached through a political lens in which different political camps emphasize different economic concerns. Viewed through such a lens there are three major perspectives, as illustrated in Figure 1. At the most fundamental level there is a divide between those who see the current structure of globalization as “sound” and those who see it as “problematic”.

Figure 1. The Debate Over Globalization



Those viewing globalization as sound can then be sub-divided into “neo-liberals” and “third way social democrats”. Neo-liberals believe that globalization is delivering its promised

benefits, that in general all benefit both within and between countries, and that globalization should continue full steam ahead in its current form.<sup>1</sup>

Third way social democrats also believe globalization is fundamentally sound and delivers positive net benefits to all countries.<sup>2</sup> However, within countries there are some losers, although total losses are less than total gains. For third way social democrats the policy implication is globalization should continue as is, subject to making compassionate “helping hand” policy adjustments that target help to those who lose.<sup>3</sup>

Balanced against these two perspectives is a “labor social democrat” perspective that maintains the current structure of globalization is fundamentally problematic and therefore needs deeper architectural change. The main features of a labor social democrat perspective are:

(1) Globalization is hurting many working families and increasing social divisions by raising income inequality.

(2) The debate over the size of net gains or losses from globalization misses the point. Nor is it an issue of stopping globalization. Instead, the issue is that globalization is being wrongly constructed.

(3) Globalization alone does not explain adverse changes in growth and income distribution, and globalization should not be looked at in isolation. Instead, globalization should be seen as a core

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<sup>1</sup> The neo-liberal perspective is exemplified by the U.S. Chamber of Commerce.

<sup>2</sup> The third way social democrat perspective is exemplified by the Brookings Institute in Washington, DC.

<sup>3</sup> An example of “helping-hand” policy is the U.S. proposal for wage insurance, whereby workers who lose jobs due to trade and suffer wage losses would be compensated by government (Kletzer and Rosen, 2005). The argument is that the costs of such programs can be paid for by taxes levied on those who have benefited from globalization. That way everyone can win since the overall gains exceed losses.

element in a new neo-liberal economic paradigm that has been implemented post-1980. That means the debate over globalization is ultimately about changing the larger economic paradigm.

The analytical split among social democrats regarding globalization creates major political difficulties for labor because it internally splits the parties that have traditionally represented labor's interests. This holds for the Social Democratic Party in Germany, the Labor Party in the United Kingdom, and the Democratic Party in the United States.<sup>4</sup>

As a result, social democrats have been placed in a position of structural weakness versus neo-liberal political parties, and this split confronts labor with a major political conundrum. For labor, the political choices are: a) have social democrats stick together in fractious unison and face the likelihood of steady erosion of historic social democratic aspirations; b) split and risk full-blown neo-liberal political triumph; or c) recapture social democratic parties by establishing a new economic consensus.

## **II Economic trends in the era of globalization**

Talking meaningfully about the global economy is a difficult task because of its diversity. One fact (see Tables 1 and 2) is that average annual global economic growth has been slower post-1973 than in the period 1950 – 73 (Madison, 2001). With regard to income distribution the consensus is there has been widening income inequality within countries (Anand and Segal, 2008, p.86) and widening inequality across most countries (Milanovic, 2005).<sup>5</sup>

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<sup>4</sup> This split emerged with the political triumphs between 1979 and 1982 of Margaret Thatcher, Ronald Reagan, and Helmut Kohl. That triumph initiated a two decade long political dominance of conservative economic ideology, and some social democrats made the decision to embrace part of that ideology. Their argument was it provided a needed modernization of social democratic thinking, and it also provided a tactical avenue for regaining political power. The Third Way conversation of Prime Minister Blair, President Clinton, and Chancellor Schroeder can be viewed as an attempt to permanently seal this tactical decision by making it the official social democratic creed.

<sup>5</sup> China and India complicate discussion of global economic developments. That is because these two enormous countries have grown very rapidly since 1980. Their large size increases the overall weighted average global growth

Table 1.

Growth of GDP: world and major regions, 1950 – 98. Source: Madison, 2001, p.126 and 138.

	<b>1950 - 73</b>	<b>1973 - 98</b>
<b>U.S</b>	3.96%	2.90%
<b>Western Europe</b>	4.81	2.11
<b>Japan</b>	9.29	2.97
<b>Asia ex-Japan</b>	5.18	5.46
<b>Latin America</b>	5.33	3.02
<b>Africa</b>	4.45	2.74
<b>World</b>	4.91	3.01

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rate, and it also reduces inequality between countries. However, both countries have had large increases in inequality within their borders. The reason China and India complicate the discussion is they grew fast without adopting neo-liberal policies but they did adopt market reforms and they also joined the global economy. Their strong performance raises questions whether their growth has been due to adopting market economy principles, due to the particular combination of state planning plus market forces, or due to globalization.

Table 2.

Growth of per capita GDP: world and major regions, 1950 – 98. Source: Madison, 2001, p.126 and 132.

	<b>1950 - 73</b>	<b>1973 - 98</b>
<b>U.S</b>	2.50%	2.00%
<b>Western Europe</b>	4.08	1.78
<b>Japan</b>	8.05	2.34
<b>Asia ex-Japan</b>	2.92	3.54
<b>Latin America</b>	2.52	0.99
<b>Africa</b>	2.07	0.01
<b>World</b>	2.93	1.33

Africa has had special political and governance difficulties related to corruption and civil strife, and it has suffered especially sharp deterioration in economic performance despite international economic opening. This shows that openness and global integration do not reduce corruption. Instead, opting for global integration may even worsen corruption by increasing the financial stakes and thereby aggravating the “natural resource curse” problem.

With regard to regional income inequality, that has increased almost everywhere. Table 3 shows how income shares for the fifth and tenth (top) deciles of the income distribution evolved between 1980 and 2000 in the OECD, Latin America and the Caribbean, East Asia and the Pacific, Africa, and East and Central Europe. In all regions the income share of the fifth decile decreased between 1980 and 2000, while the income share of the tenth decile increased. This pattern resulted in further increased income inequality measured by the ratio of the incomes of

the fifth to tenth deciles. Africa has the highest income inequality, followed by Latin America and the Caribbean. The OECD has the lowest income inequality, but inequality has been increasing.

Table 3.

Evolution of fifth and tenth (top) decile income shares, 1980 - 2000 (LAC = Latin America & Caribbean, EAP = East Asia & Pacific, AFR = Africa, ECE = East & Central Europe).

Source: Dikhanov (2005) and author's calculations.

	<b>OECD</b>	<b>LAC</b>	<b>EAP</b>	<b>AFR</b>	<b>ECE</b>
<b>Decile 5 -1980</b>	7.6%	4.9%	5.6%	4.0%	8.1%
<b>Decile 5 - 2000</b>	7.2%	4.7%	5.4%	3.1%	6.5%
<b>Ratio 2000/1980</b>	0.95	0.96	0.96	0.77	0.80
<b>Decile 10 – 1980</b>	25.7%	41.6%	41.2%	51.6%	22.7%
<b>Decile 10 – 2000</b>	28.3%	43.6%	41.3%	54.4%	30.9%
<b>Ratio 2000/1980</b>	1.10	1.05	1.00	1.05	1.36
<b>5/10 ratio – 1980</b>	0.30	0.12	0.14	0.08	0.36
<b>5/10 ratio – 2000</b>	0.25	0.11	0.14	0.06	0.21

In many regards the U.S. exemplifies the problematic trends of the last three decades. Figure 2 shows how U.S. median family income has evolved relative to an index of productivity over the period 1947 – 2005. Until the late 1970s the two series moved together, but since then median family income has become detached from productivity.<sup>6</sup>

Figure 3 shows how average hourly compensation of production and non-supervisory workers evolved relative to productivity between 1959 and 2005. Such workers represent 80 percent of employment, and total compensation includes all benefits including health insurance. Once again, compensation and productivity tracked closely until the late 1970s, but thereafter compensation stagnated while productivity continued growing.

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<sup>6</sup> Figures 2, 3, and 4 are from the Economic Policy Institute, Washington DC.

Lastly, Figure 4 shows the evolution of low-family income (20<sup>th</sup> percentile) and high-family income (95<sup>th</sup> percentile) for the period 1947 – 2005. Again, the two tracked together until the late 1970s, but since then low-family income has stagnated while high-family income has grown rapidly. The result of this divergence has been widening income inequality.

The core problem afflicting the U.S. economy is the disconnection of worker wages from productivity post-1980. That disconnect explains wage stagnation and rising income inequality, and a similar disconnect likely affects many other industrialized countries. Restoring the knot between wages and productivity growth represents labor’s central challenge in the era of globalization.

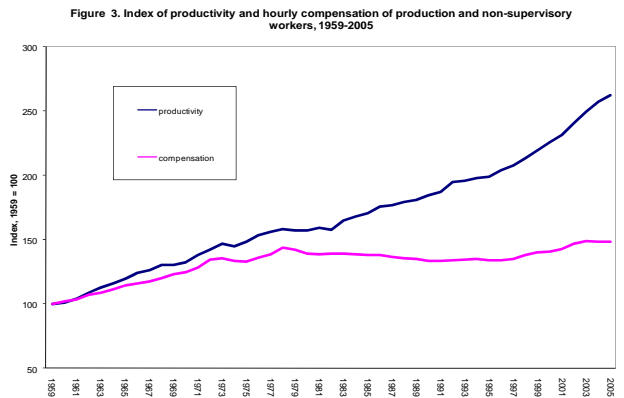
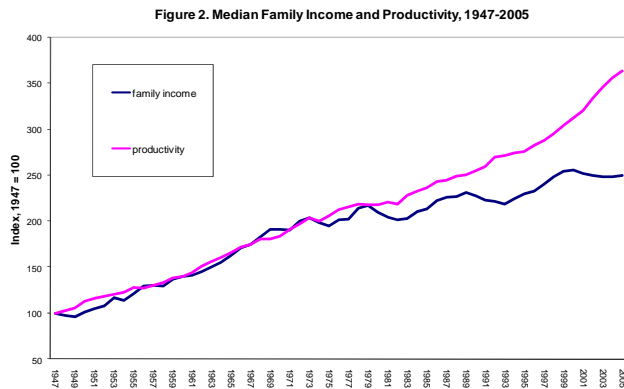
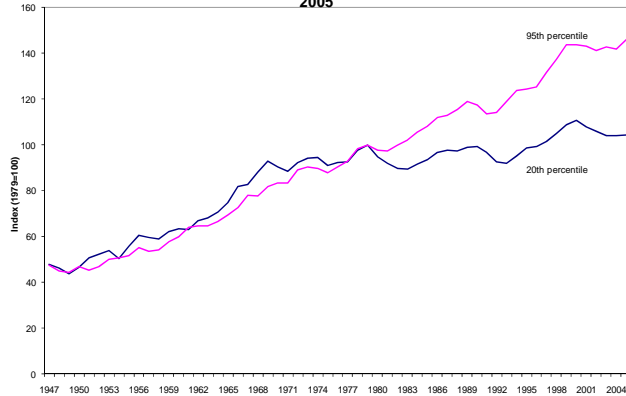


Figure 4. Index of Low-family income & high-family income, 1947-2005



Source: Mishel et al, The State of Working America 2006/2007. An Economic Policy Institute Book. Ithaca, N.Y.: Cornell University Press, 2007.

### III The new economics of globalization

Globalization is widely believed to be a contributing factor behind these adverse wage and income inequality developments, and implementing appropriate policy remedies therefore requires understanding the economics of globalization.

Unfortunately, the economics of globalization is not well understood and globalization is frequently conflated with trade. Whereas trade has been a long-standing part of the global economy, globalization is a qualitatively new phenomenon involving the creation of globally flexible production networks in which production can be readily shifted between countries. Globalization could not proceed without trade, but globalization is far more than trade. Treating globalization as if it was simply trade explains why policy has come up short and failed to address the challenges of globalization.

The new global production networks created by globalization involve three building blocks:

(1) Changed technological and organizational conditions that have created a new world of “barge economics” in which capital and technology are globally mobile;

(2) Changed competitive conditions brought about by the adoption of a new global sourcing business model;

(3) Neo-liberal trade and financial policies that have removed barriers to international movements of goods and money.

The effects of these systemic changes have then been amplified by the addition of two billion workers to the global labor supply owing to the end of economic isolationism in China, India, and the former Soviet bloc.

### *III.a) Barge economics: the new model of production<sup>7</sup>*

According to classical theory the pattern of trade is explained by the principle of comparative advantage, which asserts that all can benefit when countries specialize in producing those things in which they have comparative advantage. A key assumption is that the means of production (capital and technology) are internationally immobile (i.e. fixed in each country).

Globalization challenges this assumption, thereby deconstructing classical trade theory's foundation. Jack Welch, former CEO of General Electric, captured the new reality when he talked of ideally having "every plant you own on a barge". Welch envisioned factories floating between countries to take advantage of lowest costs, be they due to under-valued exchange rates, low taxes, subsidies, or low wages.

Globalization has made Welch's barge a reality, creating a new world of "barge economics". In this new world, capital mobility determines the pattern of trade rather than comparative advantage, with factories moving to wherever costs are lowest. As a result, so-called "free trade" increasingly trades jobs, which move with the barge.

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<sup>7</sup> This section draws on Palley 2008a, 2008d.

Additionally, barge economics also promotes downward equalization of wages and standards by fundamentally changing the balance of bargaining power between workers and corporations, and by changing the margins of competition between countries. Think of two swimming pools with different levels of water. Barge economics joins the pools together, causing the water to equalize at a lower level.

*III.b) Global sourcing: the new model for buying*<sup>8</sup>

Global sourcing is a second critical element of globalization. Barge economics represents a new model of global production (the supply side). Global sourcing represents a new model of buying (the demand side). Together they leverage each other and fundamentally change the nature of global competition.

Global sourcing has evolved gradually over the past sixty years, beginning with the growth of multinational corporations in the 1950s and 1960s. The role of multinationals has received much attention, but less noticed and equally important is the “retail revolution” based on so-called “big box” discount stores exemplified by Wal-Mart. These stores have been a key driver of globalization.

Wal-Mart was established in 1962, and it immediately created a “national buying” model whereby it bought goods from manufacturers all around the U.S., thereby placing manufacturers in a nationally competitive market. In the 1980s big box discounters like Wal-Mart shifted to a global buying model, changing the scale of the phenomenon. This global buying model has big box discount retailers scour the world for the lowest price (the so-called “China Price”), which puts countries in competition. This creates north-north competition, north-south competition, and south-south competition, and puts each country’s entire manufacturing sector in international

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<sup>8</sup> This section draws on Palley, 2008c.

competition. As a result, the global buying model erodes manufacturing jobs and wages, and its commercial success forces all retailers to adopt it or face elimination.

Offshore outsourcing represents an application of retailers' global sourcing model to manufacturing. It is exemplified by recent developments in the U.S. auto-parts industry that have affected companies such as Delphi and Visteon. These companies were originally subsidiaries of General Motors and Ford. In the 1990s they were spun-off and placed in national competition with other U.S. parts makers, but still retained some preferential supply-standing with their former corporate parents. That standing has now been abandoned and Delphi and Visteon have been placed in international competition, with General Motors and Ford asking their former in-house parts suppliers to meet the "China Price" or lose the business.

The same process is occurring in aerospace, with Boeing's new 787 Dreamliner being sourced on a global basis. Peering into the future, trade in services looks like being the next area of application of the global sourcing model, and the Internet means even retail can potentially be out-sourced.

### *III.c) The role of international economic policy*

The third critical element in the creation of the new global economic system is trade and international financial policy. Trade policy has worked to remove barriers to cross-country movement of goods, while financial policy has worked to remove barriers to cross-country movement of finance. Trade policy has also worked to secure property rights and investor rights.

These policy developments have been essential for globalization, and they have leveraged and multiplied the effects of barge economics and global sourcing. Absent these policy changes, global production networks would be far less viable owing to costs of moving goods, lack of investor confidence, and inability to finance these arrangements.

### *III.d) Two billion additional workers*

By themselves the above economic cocktail would have produced downward pressure on wages and income distribution. However, these structural changes have been accompanied by the addition of two billion additional workers resulting from the end of economic isolationism in India, China, and the former Soviet bloc, making their effect even greater. Moreover, this labor supply impact can be expected to continue for years as the process of absorbing so many workers will take decades.

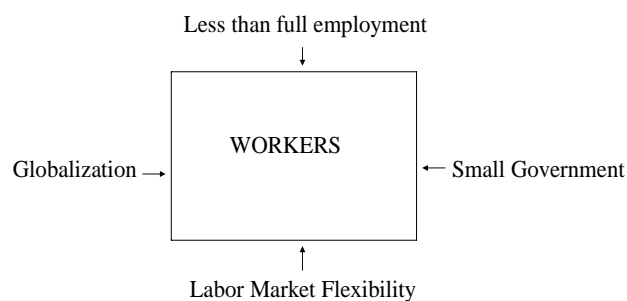
China has played an especially significant role as it alone has approximately 750 million active workers and is a preferred location for MNC production. That has resulted in a flood of capital and technology into China, which has made it the global low price supplier for big box retailers and increasingly for manufacturing outsourcing. This impact is exacerbated by China's specific economic policies that encourage export-led growth and inflows of foreign investment through an under-valued exchange rate, wage suppression, and unfair trading practices such as subsidies, domestic content requirements, and production offsets.

Lastly, China's impact afflicts both north and south. With regard to the north, China competes with large segments of northern manufacturing, causing job losses and reduced investment. With regard to the south, China attracts foreign investment that might otherwise have gone to other developing countries, while its policies of export-led growth lower the price of low-end manufactured goods that are also produced by other developing countries. China's huge labor surplus pulls down wages in the north, while preventing them from rising in the south.

#### IV Globalization as part of neo-liberalism

Globalization is often talked of as if it were a natural phenomenon. Such talk distorts understanding and diminishes political space for alternatives. Not only is globalization significantly a creation of policy, it should also be understood as an integral part of a larger neo-liberal policy agenda. Thus, globalization fits into a larger economic policy program developed by corporate elites and aimed at advantaging business. That makes globalization as much a product of corporate planning as it is a product of the invisible hand.

Figure 5. The “Neo-liberal” Policy Box



The neo-liberal policy program can be described as boxing in workers, as illustrated in Figure 5.<sup>9</sup> Workers are placed within the box and are then pressured on all four sides. The left side of the box has globalization pressuring workers through international competition. The right side has workers pressured by the push for small government which aims to shrink the size of the public sector, lower public sector wages, and reduce public sector provision of services. The upper edge has workers pressured by a retreat from commitment to full employment, which is replaced by a focus on low inflation that is ideologically justified on the grounds of a “natural

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<sup>9</sup> The notion of the neo-liberal box is attributable to Ron Blackwell of the AFL-CIO.

rate of unemployment”. Lastly, the lower edge of the box pushes for labor market flexibility that principally aims to weaken unions and labor market protections, thereby increasing the threat effect of unemployment and weakening worker bargaining power.

Workers cannot outrun the consequences of box, and both private and public sector workers are boxed in. All workers feel the pressure of labor market flexibility and the retreat from full employment, while private sector workers are pressured by globalization and public sector workers are pressured by the push for small government. Southern workers are also pressured because the neo-liberal agenda has also been applied in developing countries, and globalization (i.e. barge economics and global sourcing) also puts southern workers in competition with each other as described earlier.

Governments are also boxed-in. Mobility of investment and production creates fears of employment losses, while mobility of finance creates vulnerability to financial disruption. These conditions deter progressive policies (such as fair taxation and unionization) by raising their “political cost”. Moreover, it also creates “lock-in” whereby the longer a policy is in place the harder it is to reverse.

### **V Some comments on Germany: the problem of export-led growth**

The neo-liberal box provides a generic description of the neo-liberal paradigm, but there are also country specific differences. Among industrial countries Germany represents a special situation – that may also be shared to some degree by Japan. In particular, Germany has remained a manufacturing powerhouse and is also a heavily export-oriented economy, which makes it look as if Germany benefits from neo-liberal globalization. However, closer inspection shows globalization is problematic for Germany too.

First, like other countries, Germany has been subject to wage competition from less developed economies – especially those in Central Europe. Thus, even Germany’s famed auto and engineering sectors have felt the threat effects of manufacturing re-location to Poland, Hungary, and the Czech and Slovak Republics.

Second, Germany’s export-led paradigm poses problems for the global economy that ricochet back to impact Germany. This is because one country’s exports are another’s imports, which means all countries cannot rely on export-led growth. If all try to run trade surpluses the result must be a global shortage of buyers that produces global unemployment and deflation. Moreover, even if a few try it, those few inflict a negative externality on other countries by poaching their demand.<sup>10</sup> Thus, Germany, which relied on the global economy to provide demand, may have weakened growth in other countries and contributed to the global financial imbalances that are behind the current financial crisis.

With global growth now weakening, Germany is feeling two significant negative effects. First, its reliance on exports and neglect of German domestic demand mean that it is vulnerable to the global economic slowdown. Second, Germany’s trade surplus has made it vulnerable to financial contagion. This is because its trade surpluses were invested in U.S. financial assets, thereby providing a corridor of contagion into the German financial system.

Ironically, Germany’s trade surplus required giving up consumption, yet Germany now finds itself afflicted by financial instability and the financial assets it received for its exports are considerably reduced in value. That suggests a better outcome for Germany would have been to

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<sup>10</sup> This fundamental problem was identified long ago by the economist Joan Robinson (1966) who characterized it as “beggar-thy-neighbor” economics whereby countries rely on other countries for growth. Export-led growth also poses a problem for developing economies as they crowd-out each other as they try to gain market share in industrialized economies (Palley, 2003).

export less and consume more – but that requires dismantling the neo-liberal policy box so that German workers can bargain the higher wages needed to support higher consumption.

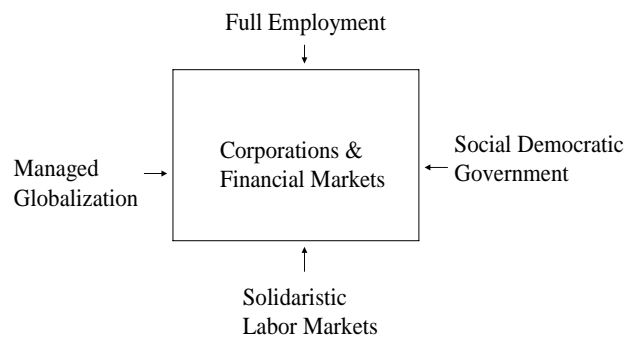
## VI How should labor respond?

The neo-liberal box is built upon economic policy, which means changing economic policy is critical. Social Policy, in the form of helping hand policies for displaced workers, is always welcome but it cannot substitute for changing economic policy.

### *(VI.a) Repacking the box*

For labor the goal must be replacing the neo-liberal policy agenda with a social democratic agenda that re-packs the box, taking workers out of the box and putting corporations and financial markets in. Such an alternative box is illustrated in Figure 6. It involves globalization with standards and restrictions on adverse forms of competition; full employment policy; restoring worker bargaining power; and restoring a social democratic vision of government that generously provides for education, social and health insurance, public goods and public infrastructure.

Figure 6. Repacking the Box



*(VI.b) Financialization*

The neo-liberal policy box represents the face of neo-liberalism, and it is tempting to immediately jump to standard policy recommendations. However, that would be a mistake. Instead, it is necessary to understand the deeper foundations of the box, what holds it together, and then to address those foundations.

Figure 7. Lifting the lid & unpacking the box.

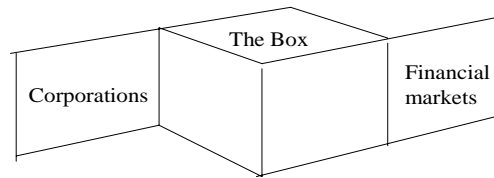


Figure 7 shows how the neo-liberal box rests on the power of corporations and financial markets, which combine in a new phenomenon that has been labeled “financialization” (Epstein, 2001; Palley, 2008b). Absent these side-supports the box would fold.

Figure 8. Dynamics of Financialiaztion

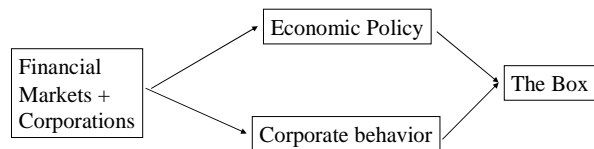


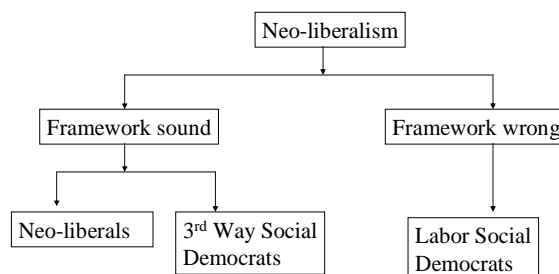
Figure 8 shows how financialization operates. Financial market interests have captured control of corporations, and the combination of the two drives neo-liberal policy in the political arena and short-term financially oriented behavior in the corporate arena.

The implication is reversing the neo-liberal paradigm also requires a novel policy agenda addressing financial markets and corporations. That agenda must serve to re-align the behaviors of both financial markets and corporations so that they incorporate a greater public interest.

*(VI.c) Changing the climate of economic opinion*

Politics is critical to repacking the box as political power is needed to change the direction of policy. However, this raises the same political problem as afflicts the debate over globalization. Once again, social democrats are split on the issue of neo-liberalism, as illustrated in Figure 9. Thus, Third Way Social Democrats think the neo-liberal policy paradigm is basically sound, but is in need of some compassionate “helping hand” policies to assist the “invisible hand”. Conversely, labor social democrats think the neo-liberal paradigm is fundamentally misguided and the box needs re-packing.

Figure 9. The Political Dilemma of Neo-liberalism



This split means that electing social democratic governments in the current environment is at best a holding strategy. More likely, neo-liberalism will continue to entrench itself inch by

inch even when social democrats are in government.

That points to the fact that standard electoral politics are insufficient. Rather, there is need to fundamentally change the national economic policy debate. Such change requires transforming the ideas that frame economic thinking – what Milton Friedman (2002, p.vii) called the “climate of opinion”.

To use a sports metaphor, for the past thirty years neo-liberals and market fundamentalists have controlled the political playing field by setting the national economic conversation. That control has given neo-liberals an enormous advantage, placing labor persistently on the policy defensive. It compares with the thirty years from 1945 to 1975 when the ideas of Keynes and Franklin Roosevelt’s New Deal dominated thinking. During that earlier period social democrats defined the policy playing field and neo-liberals were on the defensive.

Labor’s challenge is to redraw the political and policy playing field by recapturing the national economic conversation. That is a deeper and broader task than conventional economic policy analysis. It involves constructing a compelling economic vision supported by economic logic that justifies the policies labor advocates.

The experience of the past twenty years shows that technically good policy alone is unconvincing. Policy also needs to be connected to a logically compelling economic vision that has widespread public understanding and support. Labor has to promote and communicate that vision. History shows that if labor persuades people about how the economy works, political support will quickly be forthcoming for its policies.

The current moment of crisis and accumulated discontents open a window for political change. However, change will only be deep and long lasting if labor regains control of the climate of opinion. Absent change in deep economic understanding, political victory is likely to

prove fragile and temporary, and easily swept away by everyday political misfortunes or sudden bad economic news. Bringing about such a change calls for a new intensive engagement with economics and economic policy by labor. That engagement has been missing the past thirty years.

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