GLOBALIZATION AND POVERTY

This is an unlikely topic in a class on International Business Management. The reason, why it is important for us is that the "sinister forces" of a "globalized" economy are increasingly held responsible for all sorts of social ills in the world: both the third world and in the industrialized countries. Is this appropriate? Are we sacrificing our standard of living by inviting competition from low wage countries? Or are other forces at work that create circumstances of misery around the world?

A few years ago, the Nobel Prize in Economics was awarded to Amartiya Sen for his work relating to poverty. Accordingly, he was invited to write an editorial in the International Herald Tribune. His message was somewhat surprising. Famines have never occurred in democracies. Economic and political freedom provide the best protection from poverty. Is poverty a homemade problem? We remember that also the French revolution started because of mass starvation. Marie Antoinette's response was: "Let them eat cake!" Could it be that poverty in the third world is a result of leaders being out of touch with their people?

Poverty in industrialized countries takes a different form. In Europe, the overriding problem is unemployment. Across Europe, some 20 million people are out of a job, and - as it seems - permanently so. They typically live in suburban or urban ghettos, and share a hopeless predicament: marginalized in a society that seems to refuse to integrate them into their opulent lifestyle.

In North America, poverty takes a different form again: the so-called "working poor". What is meant by that term is a class of people that do have work, but earn so little that we consider them to fall below the poverty line. Like in Europe, the working poor live in urban ghettos, and lack necessities that we have come to assume as basic, such as adequate health coverage.

In Europe and North America alike, these resurgences of poverty are blamed increasingly on competition from low wage countries. Whether it is Mexican illegal immigrants in the USA or Polish workers in Germany working illegally, foreigners are ultimately to blame for our ills at home.

I will discuss three books on the subject today that have received quite some attention in the press. However, they have reached at times fundamentally opposing conclusions. The first book is by Viviane Forrester: "Der Terror der Ökonomie" (L'Horreur Economique), and had at its time occupied the bestseller list in *Der Spiegel*. It represents a wholesale indictment of our tolerance for the marginalization of the unprivileged, largely focusing on Europe's - especially France's - unemployment problem.

The second book is by Helmut Schmidt, our ex-chancellor, titled "Globalisierung". It also blames globalization for at least some of our ills, but reaches some surprising conclusions.

The third book was written by Daniel Cohen under the German title: "Fehldiagnose Globalisierung." Cohen – an economics professor at the Sorbonne and the École Normale Supérieur in Paris – argues that globalization is wrongly held responsible for our domestic problems, and that other forces are to blame for European mass poverty, among them ourselves.

I will try to make the case that Cohen’s views are the most well-founded. The reason for this ‘detour’ in our course in International Business is to convince you that studying "International Business" is not unethical. Challenges that would identify you as the villain in our society since you may export jobs to foreign shores are unfounded. As usual in these circumstances, however, the line of arguments is subtle, and the rhetoric of the enemies of globalization is appealing. Thus, I challenge you to seek the opportunity to debate these issues with whoever comes along to see if you yourself can absorb Daniel Cohen's logic, and pass it on to others, who live in a world of rather unfounded stereotypes. To give you some consolation: it also took me a long time to accept these arguments, because on the face of it, the globalization rhetoric seems to make sense. It is only the more subtle arguments based on an understanding on how the international economy works that can finally convince people.

1.) Vivane Forrester: "Der Terror der Ökonomie"

Viviane Forrester's book serves one extremely important purpose: it makes us unequivocably aware that Europe's unemployment problem is a serious social problem and thus really not tolerable. She raises a number of important issues that are just too easy to look over or "sweep under the rug". She talks about

Mass poverty in rich countries as well as the third world
Increasing inequality
Especially European mass unemployment
Unemployment as a psychological degradation of the individual
America's working poor as a cynical alternative to European unemployment
A disillusioned youth growing up in an environment of uncertainty and hopelessness
Urban and suburban ghettos as symbols of shame for our "affluent societies"
And finally, a seemingly disinterested public

These issues are all real and serious, and we need to thank her for bringing them to the forefront of the popular debate. At least, now people cannot say they didn't know about the problem, or didn't know it was that serious. Our societies have a serious problem, and that is poverty. A growing segment of the population is left out from the process of wealth accumulation. While many people participate in the affluence generated in our societies, they coexist with a growing class of marginalized people that cannot share their hope for a better future. That, we certainly need to do something about. But in order to give correct answers, we need to understand the root of the problem. Mrs. Forrester tries to do just that: to understand the problem. But has she done that? Let’s see what she has to offer as an explanation for our ills.

The villain in this theatrical play is easily identified: it is a ruthless elite of businessmen and politicians, who shamelessly use opportunities in an increasingly globalized world to maximize their profit potential: "The unemployed are victims of a global logic that mandates the disappearance of employment," and "the world that produces such system is the world of the multinationals, transnationals, absolute liberalization, globalization, and deregulation." "The commercial transnational groups are not controlled by states, but rather control the states themselves, and have an interest to create unemployment to make more profits."

In her analysis, the complaint is that the public discussion talks about the "side-effects" (e.g. unemployment), while not getting to the root of the problem, namely globalization. She increasingly uses vocabulary from class conflict to make her case: "Economic interests and their ruling classes were always capable of establishing their dominance in society." Repeatedly, we hear talk about the "international, transnational, and economic powers."

She does have one point, and that is that businessmen themselves seem not to have understood the problem, or they opportunistically use the globalization rhetoric for their own advantage. The chairman of the French employer's association was overheard to say that "it is necessary to downsize in order to adapt to the global situation." This leads Mrs. Forrester to conclude that "we acquiesce to the tyranny of an economic system, whose power basis needs to be identified."

Thus, we have all necessary elements of a conspiracy. The powerful few keep the rest of us in a situation of subjugation and exploitation for their own advantage. Haven't we heard all of this before? Indeed, it seems to be the classical Socialist explanation of the social dynamics in our societies, and Mrs. Forrester ventures on to explain that merely because Stalin failed should not be reason enough to dismiss these arguments. In summary, she identifies the following reasons for our current problems:

A religious adherence to the profit motive
Intellectual hegemony of the free market philosophy
Multinationals undermining national sovereignty
Financial speculators controlling the world
Deliberately bad education in urban ghettos keeping the poor stupid
The "powerful few" using the "lobby of globalization"

So what should we do about our malaise? Mrs. Forrester does not provide an answer, but reasons that at least she has given an adequate diagnosis of the problem, which should provide a sufficient platform for debate, eventually leading to the right policy conclusions.

Has she provided the right diagnosis? Regarding the profit motive, one may insert a qualifier: it simply expresses human desire that more is better than less. The worker's desire for higher wages is triggered by the same motive as the entrepreneur's desire for higher profits. As to the "powerful few:" Germany alone has more than two million self-employed people, many of whom are employers. Can these people really conspire against all of us in a concerted effort? History has taught us that the world tends to be too complex for conspiracy theories to have any validity.

I leave Mrs. Forrester's book with a recognition for again alerting us to serious social problems, but with some doubts that she indeed has provided the proper diagnosis of the situation.

2.) Helmut Schmidt: "Globalisierung"

Helmut Schmidt tries to answer the question, whether globalization implies any dangers or whether it mandates any adjustments in our societies. If so, he asks whether we have any remedies for the situation, or what type of cures we should employ. His book is split into three chapters. First, he provides his diagnosis of the situation. Secondly, he talks about the solutions we have to employ. And thirdly, he talks about cultural and political implications. While the third part is definitely worth reading, I am going to focus on the first two, since they deal more immediately with the problem at hand.

a) The problem

Helmut Schmidt builds up what by now is a standard argument regarding globalization. First, he mentions countries like Hong Kong, Singapore, South Korea, and Taiwan and "powerful competitors of the Western world". Generally, people in poor countries are willing to work for less, which implies that - necessarily - jobs emigrate to low wage countries. Thus, it is clear to him that European mass unemployment is a direct consequence of globalization.

He also talks about the recent revolution in financial markets. The world is witnessing a tremendous increase in speculation, leading him to conclude that we now live in an environment of "Casino Capitalism", since world financial flows far outstrip world trade flows. Is this an appropriate diagnosis? Certainly, hedge funds like that of George Soros have featured prominently in the media, but are they characteristic of world financial flows?

One counter argument is that markets do not find equilibrium by themselves: they depend on people trading on profit opportunities in order to restore equilibrium. If the Dollar/Yen forward exchange rate differs by only a few hundredth of a penny between - say - New York and Tokyo, traders spot an arbitrage opportunity and create a certain position that guarantees them a profit. However, since there are transactions costs for every deal, it is easy to show that they have to use millions of dollars to break even on miniscule price differences. In trying to exploit the arbitrage opportunity, the traders contribute to currency market equilibrium, since the volume of their trade moves the market such that prices in New York and Tokyo are aligned again. And it is that simple. Is that "Casino Capitalism?"

Helmut Schmidt also has a few other misconceptions about financial markets, when he talks about takeovers as "predatory capitalism", or when he sees the concept of "shareholder value" as a new manifestation of egoism in our societies. While every development features excesses, both takeovers and shareholder value are much more harmless than the public debate implies. But that has nothing to do with globalization. We leave Helmut Schmidt's diagnosis with the recognition that nations compete with one another, and that globalization is directly to blame for European unemployment.

But wait. Helmut Schmidt recognizes other problems that - like globalization - are responsible for European unemployment. And these problems are decisively domestic in nature. Speaking of Germany, he argues that a by now incomprehensible tax and social security system leads to business inertia. That we live in a society of total overregulation: 84000 laws, onerous licensing requirements for everything, and a system of labor interests, where legislation, contracts, and jurisdiction provide an impenetrable, and often conflicting maze through which individual entrepreneurs cannot possibly find their way through.

Helmut Schmidt also complains about the unwillingness to provide for a conducive environment to conduct high technology research in. He finds that German companies are too myopic to react to the serious global challenges (shareholder value implies - in his world - that firms only go for immediate profits and forego long-run business opportunities. An alternative viewpoint would be to argue that politicians are the truly myopic cast in our societies, since they hardly look beyond the next election, but more on that later). Finally, he thinks that people in Germany may be generally too unwilling to accept and enact change, and he may well have a point there.

b) The solution

Having identified this array of problems, what are the solutions that Helmut Schmidt has to offer. He recognizes that due to the already high level of government debt in just about any European nation, Keynesian deficit spending policies are no longer an option for the countries to reduce their unemployment problem.

More to the point, however, he recognizes that protectionism is not an option! Turning the clock of globalization back is not feasible, since too many German jobs depend on our ability to export. And now, we encounter a fundamental analytical problem. Didn't we just hear him argue that jobs are lost, because other countries compete with lower wages? And now, our high wage country is dependent on exports. As a matter of fact, Germany has among the highest export performance of all large industrialized nations, and traditionally has achieved an export surplus (which is also not necessarily good, but certainly no cause to worry about globalization induced unemployment). Indeed, Helmut Schmidt recognizes European integration (which is sort of a mini-globalization) as largely beneficial in economic terms. We leave this insight with these few remarks, and note that there is a small logical inconsistency when job-loss is attributed to globalization, but we benefit from globalization when jobs are created due to our good export performance.

So, what are the solutions that Helmut Schmidt has to offer? He makes a powerful case for purely domestic remedies, including the following points:

- Less regulation and more responsibility for the individual
- More subsidiarity, more federalization, less centralization of government
- Less government in general. The state is too big and too unproductive.
- Simpler and more comprehensible tax legislation
- Less tax loopholes
- More decentralized wage bargaining (Uh oh: what are German unions going to say about that?)
- Less dependence of politicians on powerful special interest groups
- A comprehensive reform of all social security legislation
- A more conscious effort to sponsor high tech research

AND WHAT DOES ALL THAT HAVE TO DO WITH GLOBALIZATION?

NOTHING!

We leave Helmut Schmidt's insights with a recognition that something seems to be amiss in the line of arguments. The brief reference to German export performance casts doubts over his analysis that globalization is truly to blame for the unemployment problem. His solutions are all and exclusively geared towards stimulating economic activity from within. Are we after all facing a purely domestic problem? Let’s see what Daniel Cohen has to say about that.

3.) Daniel Cohen: "Fehldiagnose Globalisierung"

Daniel Cohen builds up two lines of arguments. First, he argues that inequality between and within nations is not a consequence of globalization, and then he tries to explain what really lies at the root of the recent trend towards European mass unemployment and growing inequalities within industrialized nations. Let’s look at his main points first.

- Globalization is not the reason for mass unemployment
- Nations do not compete with each other
- We still profit from world trade
- We now live in an environment to be described as the "third industrial revolution:" production technologies rely more and more on qualification, know-how, and computers.
- Globalization merely *coincides* with this change in the economy, which is why we try to find a logical connection between the two, and hold it responsible for our ills by mistake.
- International trade does lead to internal redistribution within nations, but not between capital and labor (as also implicitly argued by Mrs. Forrester), but between qualified and unqualified labor.
- Fighting poverty could be so easy if it weren't for special interest groups that prevent a redistribution against the interests of their clienteles.

How does Professor Cohen support his argument? Let’s start with a brief history of inequalities between nations. He argues that only about two hundred years ago, there weren't so many differences in the wealth of the different nations on this globe. Only after the industrial revolution did Western countries achieve their current wealth. But this wealth was not founded on the exploitation of the third world, but mostly due to efficiently operating domestic economies.

Similarly, the so-called Tiger economies achieved their remarkable growth in the recent decades largely because of efficiently operating domestic businesses, not at our expense. The basic logic runs as follows. A country exporting goods for $100 to us will eventually import goods for $100 from us. Countries running a persistent trade deficit need to a) finance the deficit by going into debt with the rest of the world or, if the rest of the world doesn't want to invest in that country b) lower their exchange rate in order to restore domestic competitiveness. The exchange rate adjustment is actually an automatic response by the market, and the government's role is not to actively achieve a devaluation, but to allow it. Many "currency crises" were a direct result of governments violating this basic insight.

Just like Helmut Schmidt's argument that globalization contributed to the export of German jobs, US presidential candidate Ross Perot announced in 1992 that the implementation of the North American Free Trade agreement (NAFTA) would only create a "Giant Sucking Sound:" all good US jobs would be sucked down to Mexico, where cheap labor would provide more attractive investment opportunities for US businesses. In similar spirit, former CBS news anchorman Dan Rather once reported that "Another few hundred workers could say 'Adios' to their jobs when their employer relocated to Mexico." He never reported that another few hundred employees could say hello to their jobs when Thai Airways ordered a few more Boeing Aircraft.

The reality of long-run trade equilibrium has never entered the popular debate on globalization, and the symmetry of jobs imported through exports to jobs exported through imports has not yet sufficiently surfaced.

And what happened after NAFTA? The Mexican government made the notorious developing country mistake of trying to gain something by keeping its currency overvalued. In 1992 I saw a relatively simple two-bedroom apartment in the center of Mexico City for rent at $1800 a month. At the same time, taxis and restaurants were priced at New York level. A common indicator is that when everything seems too expensive, only one thing is: the currency.

When Mexico entered NAFTA with an overvalued currency, it quickly ran a trade deficit, and the adjustment pressures on the currency became overwhelming, because the international community did not feel like financing this deficit for long. In January of 1994 the currency collapsed, which sparked the so-called "Peso crisis." The crisis component was merely that the government had for too long ignored economic realities, and had made its citizens believe in a level of affluence that was objectively not enjoyed. The crisis was a crisis of expectations more than a crisis of reality.

More to the point, we learn that in an environment of adjustable exchange rates, nations do not compete with each other. Firms compete with each other, and that is why firm managers are only too eager to jump onto this metaphor, because it is true that - for example - Korean car producer entered the world market as a new competitor, and threatened market share of the previously established firms. On the whole, however, nations do not compete.

If there is any problem with trade, it can only be the **sectoral composition** of trade flows, not the absolute volume of trade!

This issue was taken up by the so-called Neo-Ricardians, who argued that the affluent North would specialize in the production of capital intensive goods, while the labor abundant South would specialize in the production of labor intensive goods. The obvious result would be that if trade balances at a monetary equivalent, then the North exports more jobs than it imports, and thus suffers unemployment consequences. Hence, we had a theory that trade was indeed responsible for our unemployment problems.

Yet, empirically, this pattern was never revealed. The first comprehensive studies to this end were conducted by Noble laureate Leontief, and thus, the phenomenon is called the "Leontief Paradox:" the Neo-Ricardian trade patterns cannot be verified empirically.

A more detailed analysis of actual trade flows revealed that what the North actually exported were jobs rich in qualified labor, and it imported jobs rich in unqualified labor. Thus, the real loser in today's industrialized countries are the unqualified workers, not workers overall.

But how much of Europe's unemployment can be blamed on this development of international trade patterns? This is again an empirical matter. Daniel Cohen argues that France's trade with poor countries amounts to merely 2-3% of GDP. Can this really explain French mass unemployment? He sais that pessimistic estimates blame about 300000 jobs lost due to international trade. Compared to about 4 million unemployed people, this is significant, but doesn't explain a lot. Coincidentally, similar empirical studies in the USA come to similar conclusions: the amount of jobs lost due to trade with low wage countries amounts to approximately 1% of the labor force.

Job losses due to foreign competition are **quantitatively insufficient** to explain European mass unemployment. This is one of the reasons why the popular debate is still hooked on stereotypes: in principle, we have a theory that predicts job losses due to international trade. In practice, the theory doesn't explain a lot. The important argument is not theoretical, but empirical in nature.

The rise of income inequalities in industrialized nations is explained by the declining importance of the unqualified worker in the productive process. What is the reason for this? US studies have examined the following three factors: the immigration of low skill workers, the deregulation of the labor market, and the reduced importance of trade unions. While all contribute to some extent to the declining wages of the low skill worker, the overall effect is dominated by a fourth reason: the growing level of education of the typical US citizen.

Like may other industrialized nations, the USA has witnessed a great leap in mass education over the last thirty years. The low demand for low skill jobs is predominantly explained by an increased supply of high skill workers that have once and for all changed the nature of our workplaces. In other words: our productive technologies have adapted to the fact that there are many more high skill workers out there, and low skill production is generally declining. The majority of jobs are not suitable for low skill workers. Today's work environment is moving towards smaller, more professional, more homogeneous "high skill teams." The "Fordian" firm with lifetime employment guarantees is losing in importance. Why is this so?

Ford's idea to pay workers above average (efficiency) wages did not result from the goodness of his heart, but because his firm experienced excessive worker migration. This was possible, because the relatively low skill work environment both at his assembly lines and elsewhere in industry made workers flexible in where they would find a job. Today, it takes a lot more training to perform a certain job effectively, workers can't switch as easily, but have a better market niche in a high skill environment. The structure of the labor market is largely a consequence of the educational shift in society.

But what explains that there is so much long-term unemployment in Europe, when there is relatively little unemployment in the USA? Economist Paul Krugman has coined the phrases of "Moneyless America" and "Jobless Europe," which contrasts mass unemployment and working poor as two sides of the same coin. But what is the reason for this?

How do unemployment rates compare between Europe and the USA? Daniel Cohen argues that one can only compare unemployment rates across similar positions over the business cycle, and makes a case that European unemployment is approximately 3% higher than US unemployment. Empirical studies have then found that the difference of three per cent is approximately decomposable as follows:

Higher minimum wages: 0.5-1%
More generous employment benefits: 0.5%
Labor Law frictions: 1%
Statistical differences: the remainder (may be 0.5-1%)

This, however, explains only a maximum of one third of total unemployment. Together with the 7% or so of unemployment due to international trade with low wage countries, we still have to account for over 60% of total unemployment. What explains the bulk of unemployment?

Daniel Cohen argues that it is misleading to talk about an unemployment *rate*. The rate is determined through a) how many people lose their jobs in a given amount of time, and b) how quickly they can find a new one. And here lies a crucial difference between the USA and Europe:

In France, 0.4% of all workers lose their job every month, but it takes more than a year to find a new one. In the USA, about 2% of all workers lose their job every month, but it takes on average less than three months to find a new one.

Thus, unemployment is much more common in the USA, and - as the flipside of the coin - it is much more stigmatized in Europe.

Moreover, Cohen cites statistics that argue that in France, every year more than 4 million jobs are both created and destroyed, which is comparable to job market shifts in the USA. Yet, the difference is that most jobs in France are filled by people that have a job elsewhere and merely shift positions, while in the USA the jobs tend to filled by the people that were temporarily unemployed. Again, the growing consensus seems to be that European unemployment is a result of a stigmatization of the unemployed: a pattern that feeds on itself.

If you compare the stock of 300000 unemployed due to international trade patterns to the yearly dynamics of 4 million jobs created and destroyed, it finally becomes clear that globalization cannot be the reason for our ills.

So what about poverty? Why do our countries tolerate the level of poverty that our long-term unemployed represent? One example illustrates the difficulties our societies experience at the moment. While economic output in France grew at an average 2% per annum between 1980 and 1995, the total income of retired people grew by about 4%. Due to the funding mechanisms of our retirement systems, this represents a huge redistribution of wealth, and the income of those paying into the retirement system in France only grew at an average 0.5% over the same period.

To blame the internal problems of redistribution due to demographic shifts on globalization is simple demagoguery! Is there a solution?

In Western Europe, the State - being the principle agency to enact redistribution - accounts for approximately 50% of the economy: every second Euro passes through the redistributive hands of the government. Shouldn't it be possible to alleviate poverty since those are the people that need redistribution the most?

Daniel Cohen's answer is that the redistributive potential of the State is severely curtailed by the special interest groups that try to influence the State to redistribute in *their* favor, and not anybody else's. Retired people are just one example. Many others can be named. Farmers, coal and steel workers, students, various industrial lobby's and so on and so on.

In particular, large companies are often successful these days to coerce governments into giving them tax brakes. In return, they promise domestic investments and job creation. Politicians defend such (and other) subsidies with the need to "maintain employment" in the face of international competition. If politicians - like the rest of us - would internalize the concept of long-run balanced trade via adjusting exchange rates, they would understand that these subsidies have - at best - a short-run effect.

Thus, as I mentioned earlier, politicians may be more myopic (short-sighted) than businesses. Businesses, like any other group in society, have certain rent-seeking interests, i.e. redistributing wealth in their own favor. Politicians have the not so enviable task of seeking out those groups of society that are deserving of "special allocations." Caving in to a faulty globalization rhetoric of businesses to gain subsidies is true myopia on the side of politicians anxiously awaiting the next election.

Looking at redistributing activities in the context of political elections also identifies the true problem with poverty in Europe. It is not seriously an election topic. True, we need to reduce poverty, but please, not from my pocket!

In the final analysis, the poor are poor because we don't care! And that is something Viviane Forrester complained about. If the trend continues, it may be just a matter of time until there is a political party representing the unemployed.

Cohen continues to offer solution concepts to help without further stigmatizing the poor, such as negative taxes as implemented with the American "Earned Income Tax Credit," but we are only beginning to understand what really lies ahead in challenges to combat mass poverty in Europe.

As a consequence of the preceding discussion, we can come to some powerful conclusions: a lot of globalization talk is "Globaloney." Globalization is not a problem, but largely (for most of us) a challenge and an opportunity.

This course is designed to help you understand the international business environment to be able to face the challenges you'll encounter abroad, and make use of the opportunities that a globally integrated marketplace has to offer.

By studying international business, you are not to blame for domestic unemployment and poverty, but you will - on balance - contribute to an improvement by contributing to world economic growth.

Possibly at the end, a little argument on ethics. It is easy in public debate to brand those people that relocate jobs to other countries ‘unethical’. If you would be in the position to relocate jobs from Germany to Romania, obviously there would be lots of opposition in Germany. On the other side, a lot of people in Romania may be very happy with your decision. Do they not count? Clearly, the malaise of one individual is pitted against the fortune of another. Do workers from rich countries have an innate right to keep workers from poorer countries from competing with them? Clearly, our immigration and labor laws try to do just that. Interestingly, our trade and investment laws DO NOT limit international competition, because for the longest time we thought we were benefitting from international trade. Now that we seem to be confronted with its costs, we want to turn the clock back?

Clearly, ethics is the wrong framework to lead this debate. To help people in poorer countries is a thing normally considered ethical. Does it become unethical if you do it for personal gain? At the end, no religion, and no charter of human rights defines the individual as a citizen or a national. They are always defined as humans, irrespective of their nationality.

If you like arguments, you can actually have a lot of fun with people trying to lead a globalization debate on ethical grounds, because more often than not, you will be able to demonstrate to them that their intellectual views imply that humanity ends at (their) national – or EU – border.

And that’s clearly unethical.