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China, India and the Doubling of the Global Labor Force: who pays the price of globalization?

By Richard Freeman

[*In this concise article, Harvard Economist Richard Freeman shows us that a spectre is haunting the industrialized societies, and above all the workers of these countries. Though little recognized in Japan and elsewhere, there has been an effective doubling of the global labour force (that is workers producing for international markets) over the past decade and a half, through the entry of Chinese, Indian, Russian and other workers into the global economy. The effective supply of capital, on the other hand, has virtually remained unchanged. With such a massive increase in the supply of labour, its relative share of the returns from production inevitably decline. One important dimension of this decline is the ability of increasingly footloose capital to find cheaper labour to employ. Morgan Stanley's Chief Economist Stephen Roach has long referred to a "global labour arbitrage" wherein high-wage jobs in the developed world are eliminated in favor of low-wage jobs in the developing world. He has argued that this is not limited to manufacturing, but also extends to such service industries as banking. But capital does not have to move to keep pressure on wages and salaries. Even work that is not at present outsourced may experience this pressure if the cost of labour becomes excessive relative to global benchmarks (including premiums for developed world levels of political stability and infrastructure).*

Small wonder, then, that the labour share of compensation in Japan, the US and the EU countries is almost flat (indeed, incomes are declining for much of the workforce), while corporate profits are robust. What is more than a little strange is the general lack of recognition of this labour supply shock and its sobering implications. The public debate on globalization is largely dominated by pressure to open markets in order to attract more capital or at least keep what one has, while progressive taxes, regulations, unions and the other means of collective provision and action are either ignored or dismissed as "socialistic" impediments to growth. But Freeman rightly argues that capital can take care of itself and that it is time for domestic and international politics and policy to shore up the woefully eroded position of workers, a proposition that applies no less in the periphery than in the core. Japan Focus]

The global economic community, and economic policymakers in governments and global institutions alike, has yet to fully understand the most fundamental economic development in this era of globalization — the doubling of the global labor force.

I estimate that the entry of China, India and the former Soviet bloc into the global economy cut the global capital/labor ratio by just 55% to 60% what it otherwise would have been.

The doubling I am referring to is the increased number of persons in the global economy that results from China, India and the ex-Soviet Union embracing market capitalism.

1. Chinese workers assemble computers in Fuzhou, Fujian

In 1980, the global workforce consisted of workers in the advanced countries, parts of Africa and most of Latin America. Approximately 960 million persons worked in these economies.

Population growth — largely in poorer countries — increased the number employed in these economies to about 1.46 billion workers by 2000.

New players enter the scene

But in the 1980s and 1990s, workers from China, India and the former Soviet bloc entered the global labor pool. Of course, these workers had existed before then. The difference, though, was that their economies suddenly joined the global system of production and consumption.

2. Indian programmers

In 2000, those countries contributed 1.47 billion workers to the global labor pool — effectively doubling the size of the world's now connected workforce.

Competing globally

These new entrants to the global economy brought little capital with them. Either because they were poor or because the capital they had was of little economic value.A decline in the global capital/labor ratio shifts the balance of power in markets away from wages paid to workers and toward capital, as more workers compete for working with that capital.
Using figures from the Penn World Tables, I estimate that the entry of China, India and the former Soviet bloc into the global economy cut the global capital/labor ratio by just 55% to 60% what it otherwise would have been.

The capital/labor ratio is a critical determinant of the wages paid to workers and of the rewards to capital. The more capital each worker has, the higher will be

their productivity and pay. A decline in the global capital/labor ratio shifts the balance of power in markets toward capital, as more workers compete for working with that capital.

Even considering the high savings rate in the new entrants — the World Bank estimates that China has a savings rate of 40% of GDP — it will take 30 or so years for the world to re-attain the capital/labor ratio among the countries that had previously made up the global economy.

Pressure to compete

Having twice as many workers and nearly the same amount of capital places great pressure on labor markets throughout the world. This pressure will affect workers in the developing countries who had traditionally participated in the global economy, as well as workers in advanced countries.

Countries that had hoped to grow through exports of low-wage goods must look for new sectors in which to advance — if they are to make it in the global economy.

The effect on advanced countries
Mexico, Columbia or South Africa cannot compete with China in manufacturing, as long as Chinese wages are one-quarter or so of theirs — especially since Chinese labor is roughly as productive as theirs.

The entry of China, India and the former Soviet bloc to the global capitalist economy is a turning point in economic history.

The ending of the apparel quotas in January 2005 has brought this point home to many countries, which are now rethinking their growth strategy.

But the advent of 1.47 billion new workers also pressures labor in advanced countries. The traditional trade story has been that most workers in advanced countries benefit from trade with developing countries because advanced country workers are skilled, while developing country workers are unskilled.

But this analysis has become increasingly obsolete due to the massive investments that the large populous developing countries are making in human capital. China and India are producing millions of college graduates capable of doing the same work as the college graduates of the United States, Japan or Europe — at much lower pay.

A shifting monopoly

By 2010, China will graduate more PhDs in science and engineering than the United States. The huge number of highly educated workers in India and China threatens to undo the traditional pattern of trade between advanced and less developed countries.

Historically, advanced countries have innovated high-tech products that require high-wage educated workers and extensive R&D, while developing countries specialize in old manufacturing products. The reason for this was that the advanced countries had a near monopoly on scientists and engineers and other highly educated workers.

Job migration

As China, India and other developing countries have increased their number of university graduates, this monopoly on high-tech innovative capacity has diminished. Today, most major multinationals have R&D centers in China or India, so that the locus of technological advance may shift.The world needs to abandon the Washington Consensus model of globalization that was designed, not all that successfully, for an utterly different global economy.

Certainly, the rate of technological catch-up will grow, reducing the lead of advanced countries over the lower wage developing countries.

Business experts report that if the work is digital — which covers perhaps 10% of employment in the United States — it can and eventually will be off-shored to low-wage highly educated workers in developing countries.

If and when Russia gets its economic act together, labor market pressures on educated and skilled workers will grow.

Transitioning to global market capitalism

The entry of China, India and the former Soviet bloc to the global capitalist economy is a turning point in economic history. For the first time, the vast majority of humans will operate under market capitalism, with access to the most modern technology.

3. Kunshan development zone: the epicenter of Taiwan high tech investment in the Shanghai-Suzhou corridor

The workers in these new entrants to the global capitalist system should make great gains, reducing rates of poverty, as indeed has occurred in China and India over the past 10-15 years.

A difficult change

But there will be a long and difficult transition for workers throughout the world to this change — a more formidable transition than that associated with the recovery of Europe and Japan after World War II.Countries that hoped to grow through exports of low-wage goods must look for new sectors if they are to make it in the global economy.

In advanced countries, real wages and/or employment are likely to grow more slowly than in years past. In developing countries that have traditionally been part of the global economy, manufacturing jobs are at risk.

They are likely to see a shift in labor to the informal sector with rising poverty, as indeed has occurred in many countries. China and India themselves are likely to face problems. Inequality in China and the former Soviet bloc has risen at rates unprecedented in economic history. Inequality has historically been high in India.

Large numbers of rural workers in China and India could lose from globalization, creating dangers of social unrest, particularly in non-democratic China.

Responsibility of policymakers

What does all this mean for economic policymakers and officials like Paul Wolfowitz at the World Bank and his counterparts at the International Monetary

Fund?

So far, the World Bank and the IMF have tended to blame economic problems on insufficient labor flexibility, or fiscally irresponsible governments with excessive expenditures on social safety nets, as well as on government interventions in markets.

The role of the IMF and World Bank

The IMF, in particular, has sought to protect capital, particularly foreign capital, as its actions in Argentina make clear. But with a doubled workforce, capital should be quite capable of taking care of itself.The huge number of highly educated workers in India and China threatens to undo the traditional pattern of trade between advanced and less developed countries.

Instead of seeking to protect capital, the World Bank and the IMF need to help countries develop policies to minimize the costs of adjustment to workers during what is likely to be a long transition.

The global community needs to make sure that the gains of globalization are spread widely, to avoid backlashes and instability. And the world needs to increase savings as rapidly as possible to build up the global capital stock.
For its part, the United States has to shift from being the world's greatest debtor to becoming a giant creditor to the global economy.

A new consensus

In short, the world needs to abandon the Washington Consensus model of globalization that was designed, not all that successfully, for an utterly different global economy.

The world needs a new model of globalization and new policies that put upfront the well-being of workers around the world. They will be on the short end of the stick for a long time to come.

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