

The benefits and costs of globalisation

When Marco Polo reached China in the 13th century via the Silk Road, he found a prosperous land where agriculture and industry were flourishing thanks to trade, supported in turn by a vast network of roads, bridges and canals. The per capita wealth of the Chinese far exceeded that of the Europeans, as illustrated by the fact that steel production in China was five times higher than in Europe. However, in the early 15th century, at the peak of its prosperity, the Ming dynasty made a radical change to the country's economic policy, isolating it from the outside and, in doing so, oppressing its capacity for innovation. Four centuries later, China had been left behind, while Europe, which was more open, powerful and richer, began its colonialist phase in the Asian country.

In times like those we are living in today, in which voices have arisen in favour of greater protectionism, it is more necessary than ever to understand the benefits and costs of globalisation.

The benefits of globalisation on economic growth

The economic literature identifies several channels through which the phenomenon of globalisation affects economic growth and, therefore, our well-being. The first channel is known as knowledge spillover and refers to the benefits generated by the fact that knowledge gained in one country can be used in other countries.¹ Flows which contribute to globalisation (such as trade transactions or migratory movements) allow the dissemination of new ideas. These ideas, in turn, facilitate improvements in productivity in the countries which receive these flows, as well as in other countries, leading to improvements in the overall well-being of the population. One feature that makes this channel particularly relevant is the fact that knowledge is a factor of production that can be used simultaneously by different people in different countries (it is a non-rival factor, in economic terms).

Secondly, we have the «scale effect», which is derived from the larger market which is intrinsic to a more globalised world. In particular, globalisation gives companies a bigger playing field in which to exploit their ideas. Thus, they are able to earn profits from sales abroad, in addition to those from local sales. This increased market size encourages firms to grow and to acquire greater knowledge, which increases the country's productivity and, therefore, economic growth. This effect, however, has a direct counterpart at the local level, which is that the greater profit which companies can earn in this more globalised economy due to increased demand can be offset by the loss of market share in the face of competition from foreign companies. This gives rise to the «competition effect» of globalisation, which, contrary to the scale effect, can discourage some companies from acquiring greater knowledge. This occurs when, for example, upon losing market share and thus earning lower profits, local companies have fewer funds to invest in R&D. Similarly, at the global level, increased globalisation can also end up leading to a greater concentration of companies and, therefore, lower rates of investment.

On the other hand, a more global environment increases the variety of products available for consumers, since they now have access to foreign products, which increases their well-being («gains in variety»). Finally, economists have identified a last channel, known as «technological dissemination». The link between globalisation, technology and growth is as follows: in a globalised economy, companies are forced to use technology that is equal to or greater than that of their global competitors. Therefore, the greater competition means that only those companies that employ cutting-edge technology survive. The confluence of these elements means that new players entering a more globalised market are more technologically advanced than those in one with only local competition, resulting in better well-being in a globalised world.

Although we have identified the various channels that link globalisation and economic growth, we cannot assure that the former's impact on the latter will always be positive. This is because, although the majority of effects are beneficial for growth, the «competition effect» is detrimental to improvements in the population's well-being. Furthermore, the importance of this relationship must be tested: it could be the case that there is a positive and statistically significant relationship, but it is not economically significant.

Indeed, numerous empirical studies that take into account the different channels we have spelled out demonstrate that the aggregate effect on economic growth is positive and quite significant. In particular, in a baseline study using information from 150 countries, Frankel and Romer demonstrated how increases in an economy's trade flows lead to significant increases in its real per capita income. Specifically, an increase in international trade as a percentage of GDP of 1 pp translates into a 0.9% increase in per capita income. Such an increase in Spain would represent a boost of 225 euros to GDP per capita, while in Portugal it would represent an increase of 170 euros.²

1. See Grossman, G.M. and Helpman, E. (1990), «Trade, innovation, and Growth», *The American Economic Review* 80, n° 2: 86-91; and also Grossman, G.M. and Helpman, E. (1991), «Trade, Knowledge Spillovers, and Growth», *European Economic Review* 35, n° 2-3: 517-526.

2. International trade can be estimated using the ratio of imports plus exports over GDP. See Frankel, J.A. and Romer, D.H. (1999), «Does Trade Cause Growth», *American Economic Review* 89, n° 3: 379-399.

Weinstein and Broda, meanwhile, identify that the variety of imports in the US increased fourfold between 1972 and 2001, and that this greater variety led to a significant improvement in the well-being of the American people.³

The losers of globalisation in advanced countries

Despite the proven positive effects which globalisation can have on people's well-being, it can be the case – and, in fact, it is – that this better well-being is not equitably distributed among all individuals: some not only do not benefit but actually come out worse-off. They are the losers of globalisation.

Numerous studies have analysed the harmful effects of this phenomenon. In particular, the effects of globalisation on the labour market have been the subject of extensive research, especially in relation to the adverse effects it has on certain groups of workers in developed countries.

In this case, we can also identify different channels through which they are affected. The main one is related to the increase in direct competition suffered by certain groups of workers (generally, low-skilled workers) when faced with the possibility for companies in developed countries to relocate part of their production to emerging countries (with much lower labour costs). This can result in a reduction in the demand for local workers and, therefore, their salary.

There is, however, an effect that counteracts this unfavourable situation: companies opting to offshore part of their production (either by relocating or outsourcing) are able to lower their costs and thereby increase their productivity. In this situation, the company will have greater incentives to expand, which can increase the demand for workers (both qualified and non-qualified) in the country of origin and, with it, their remuneration. Finally, this decrease in the costs borne by companies opting to offshore their production leads to a decrease in the prices of the final goods and services they produce, leading to an increase in the real wages of all local workers.

At this point, and to assess the relevance of such costs, we once again turn to what the empirical analyses show us, including those conducted by the MIT economist David Autor. In one of his most notorious articles, «The China Syndrome», he warns of a significant negative impact on some groups of American workers caused by the strong rise in imports from the Asian country following its entry into the World Trade Organization in 2001.⁴ As such, workers in regions of the US which produced a high percentage of goods directly exposed to Chinese competition (such as electronic goods or textiles) suffered significant declines in wages and an increase in unemployment. As an example, manufacturing jobs (as a percentage of the total population) fell by 5 pp between 1991 and 2007, and their estimates indicate that greater exposure to Chinese imports was responsible for half of this deterioration. Similarly, other studies show real wage reductions of up to 12% in the face of greater exposure to international trade in the US.⁵

Besides labour costs, some studies have focused on the negative consequences for workers' health. The loss of employment or a reduction of wages can lead to depression. In addition, for those workers who have not lost their jobs and have even been able to keep their remuneration intact, the new scenario of greater competition which their employers face can have a substantial impact on their working day (both in terms of tasks and in terms of timetables), leading to greater occupational stress.⁶

In short, globalisation is capable of improving countries' well-being through improvements in productivity, lower prices and greater variety in the products that are available. However, it generates significant adjustment costs for those workers who suffer the most from the direct competition posed by the new flows arising in a globalised world.

Its staunch detractors have focused on highlighting these costs, while its outright defenders have sometimes only emphasised its benefits. None of them are lying, but neither are they telling the whole truth. Partial truths are of little use when faced with a phenomenon that has not stopped growing in recent decades and that affects us directly. Knowing the benefits and the costs brought about by globalisation is essential for deciding what form of globalisation we want to see from today onwards.

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3. See Broda, C. and Weinstein, D.E. (2006), «Globalization and the Gains from variety», *The Quarterly Journal of Economics* 121.2: 541-585.

4. See Autor, D.H., Dorn, D. and Hanson, G.H. (2013), «The China Syndrome: Local Labor Market Effects of import Competition in the United States», *American Economic Review* 103, nº 6: 2121-68.

5. See Ebenstein, A., Harrison, A., McMillan, M. and Phillips, S. (2014), «Estimating the impact of Trade and Offshoring on American Workers using the Current Population Surveys», *The Review of Economics and Statistics* 96(4).

6. See Italo, C., Crinó, R. and Ogliari, L. (2015), «The Hidden Cost of Globalization: import Competition and Mental Distress»; as well as Autor *et al.* (2013), referenced in note 4.