

ECONOMICS AND SOCIETY – U52005

Globalization Coursework

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Question:

'I believe that globalisation – the removal of barriers to free trade and the closer integration of national economies – can be a force for good and that it has the *potential* to enrich everyone in the world, particularly the poor. But I also believe that if this is to be the case, the way globalisation has been managed, including the international trade agreements that have played such a large role in removing those barriers and the policies that have been imposed on developing countries in the process of globalisation, need to be radically rethought.' (Joseph Stiglitz, Winner of the Nobel Prize for Economics 2001)

The following assignment gives you the opportunity to examine some of the issues raised in the above quotation, namely why most economists are in favour of free trade and economic integration and why, despite this, the world is still some way from achieving this outcome.

1. Explain, using appropriate economic concepts, why most economists believe that free trade and the abolition of protectionist measures are welfare enhancing. (30 marks)
2. Explain why, despite the arguments presented in 1. above, the most recent round of trade talks (The Doha Development Round) ended in failure with many trade barriers continuing to proliferate. (30 marks)
3. One of the major criticisms of globalisation is that growth in trade is bad for the environment. Using appropriate economic concepts, evaluate this argument. Is there any evidence to support it? (40 marks)

Globalization, free trade and the removal of protectionist barriers are three economic concepts that come hand in hand. The definition of globalization is 'the development of the world into one market place' (Grant 2003) and the way this could be achieved would be by the removal of protectionist measures such as quotas and tariffs, to create free trade between all countries. In this assignment I will look at why globalization is in economic theory a fantastic idea, but in the real world fails to deliver the benefits for all anticipated by economists.

The fact that in theory globalization would be a good thing is one of the least contested economic arguments of our time. In theory if the barriers to free trade are removed and the world moves towards becoming a global economy there should be many benefits. One of the first ways these would occur would be from the increased competition between firms. If firms are operating in a global market then there will be more alternatives from consumers to purchase. This in theory should mean that unproductive and wasteful firms are forced out of business, while the firms who remain are made to increase their productivity. The end result of this process ought to be lower prices for better quality goods as the market becomes more streamlined. Coupled with this point is the supposed increase in technology that operating in a global market ought to lead to. As there are no barriers and hopefully much more information sharing the rises in productivity should come quickly to all the markets without the threat of increased competition.

Another major benefit that globalization should bring to global welfare would come from the idea of comparative advantage. Comparative advantage is one of the main economic concepts linked to globalization and is defined as; the ability to produce a product or service at a lower opportunity cost than other regions or countries. (Sloman 2006) One of the main ways the use of this comparative advantage has been affected by globalization is that Newly Industrialised Economies (NEI's) are gaining a comparative advantage in manufacturing industries, as they take advantage of the increased technology mentioned above. As these countries have large supplies of low skilled labour their wage rates are lower and so they can produce the goods cheaper. This change in where goods are being produced has been very prominent in the textiles industries, where big multi-national companies such as Nike are shifting much of their production to the Far East Countries like Thailand and Cambodia, where the costs of production are much lower. Although some commentators have expressed worry that this shift in production will lead to more un-employment and a fall in wages in the industrialised world I do not think this is the case. In fact I believe that although industrialised countries will lose market share in manufactured goods this will be countered by increases demand for more highly skilled labourers. The UK is a prime example of this as although the number of jobs requiring low skilled workers is falling, the number of jobs for high skilled workers (such as financial advisors and business services) is actually rising. So instead of the total demand for British goods falling I think in fact it will just shift toward more tertiary industries. The end result of this double edged process should be that the total output of the world economy will rise and this in turn will cause standards of living to increase across the globe.

The last important way that globalization ought to increase welfare across the globe is linked to the first point and is that consumers will get higher quality products for lower prices as productivity rises. This should mean that people will spend their income on products and so with use of the multiplier effect, more people will have more money and in theory aggregate demand and thus standards of living should rise across the

globe. Although the theory stated above makes it sound like there are no faults with Globalization and the removal of trade barriers, protectionism still occurs for a number of reasons. The real reason behind this is that if everyone across the globe was to remove trade barriers then everyone should benefit, for an individual state however, if they remove trade barriers and other states don't follow cue then they will be left in a weakened economic position, whereas if other countries remove their trade barriers and a state keeps its own it will gain some major economic advantages.

The reasons why countries use quotas, tariffs and other protectionist measures even when there seems to be such strong arguments for their removal can be split into two parts, protecting specific industries and protecting the whole industrial base. One of the main reasons that countries use to justify keeping import restrictions across the whole economy is that it will protect domestic employment. The idea behind this is that if a government restricted imports then people in the country would buy more of the relatively cheaper domestic products and thus raise domestic employment. Although this sounds sensible it is a short term policy as if imposing import restrictions is likely to lessen other countries abilities to purchase exports. This may well mean that the raise in employment from the domestic market is offset by the fall in employment from exports. Pursuing this kind of policy could even lead to rising levels of un-employment, if it causes other countries to retaliate by raising their tariffs and thus creates a trade war, in which case both countries will lose out.

Another reason why governments might try to protect their whole industrial base would be to help with their balance of payments position. If there is a situation where expenditure of imports is more than expenditure on exports, then a government might try to stop this by restricting the imports a country, in an attempt to divert domestic expenditure from imports to domestic products. This policy however has all the same disadvantages as the argument for protecting domestic employment, and is also short term. Another problem that pursuing these kinds of policies could create is a loss of welfare, caused by the loss of comparative advantage that comes from being able to specialise in the products that can be produced with low opportunity costs.

As well as protecting the domestic economy as a whole by using import restrictions, governments use similar protectionist measures to protect specific industries for a number of reasons. The first of these is to enable infant industries to grow. Infant industries are newly established industries that have not grown to the size where they can benefit from economies of scale. If they were left on their own then they would probably find it difficult to develop as average costs are likely to start higher than foreign competitors. The idea is that by protecting the industry in its early years a government will allow it to grow and so take advantage of economies of scale, lower its average costs of production and find a comparative advantage, at which point the trade restrictions will be removed. Although this can be a very useful way of starting up new industries it can lead to a lack of competitiveness and the industry becoming dependent on protection from foreign competitors.

There are a number of other reasons why governments choose to protect specific industries from foreign competition. They may want to allow declining industries to go out of business gradually (like, for example, in the UK car manufacturing industry today) so as not to create a sudden and large increase in un-employment in localised areas. To protect strategic industries that the government feels it should maintain some degree of self-sufficiency in, or even as a short-term measure to allow a firm that has lost its comparative advantage due to a lack of investment to not go out of business while additional investment is found. Overall I think that the main reason that trade barriers,

tariffs and quotas do continue to exist is that no one country trust other countries around the globe enough to put themselves into a position of vulnerability by removing their own barriers.

The debate about whether globalization has detrimental affects for the environment is fiercely contested, and spills over into debate about the whole economic system in place across the world at this time. One of the most strongly expressed arguments against globalization is that it gives too much power to global bureaucracies like the WTO, IMF, World Bank and the large multi-national corporations. Many people believe that this power leaves government and even individuals in the service of global corporate priorities, where making a profit is the most important thing and other social issues are abandoned. If this truly is the case then it is likely to have a large negative effect on the environment no companies are going to be willing to lose profit for the sake of trying to protect the planets future. On the other hand many OECD experts say that there is no clear empirical evidence that high environmental standards will reduce the competitiveness, on either a micro or a macro-economic level, if this is the case then it becomes possible for corporate mentality to come hand in hand with the increased environmental protection that is needed in today's world.

This leads neatly into the second criticism of Globalization when it comes to protecting the environment, that it is very short-term. As we are now living in what is being described as "the era of corporate rule" (Mander 4/2/03) there is no planning for the future. There is an argument that to occur, globalization indefinitely it needs a never ending, always expanding supply of cheap recourses, and cheap labour. As more and more of the planets recourses are used (especially oil), and less and less cheap labour is available, the corporate system has to work much harder to maintain economic growth. This in turn means that the big global bureaucracies and corporations cant afford to spend money on helping the environment. One of the ways this has really manifested itself is through a shift in production to the east, where cost of production are cheaper, due in part to more relaxed environmental legislation. This idea known as the 'pollution havens' hypothesis seems to be occurring on a large scale, with economies like India and China growing quickly through increased foreign direct investment, and increases their pollution levels in tandem with this. However, although this seems like a clear cut argument, proponents of globalization state that evidence shows companies investing abroad are actually more likely to meet environmental standards than domestic competition. Although this is a good point, if the environmental standards in the NIE are much lower than they would be in the 'West' this will still had adverse effects on the environment.

Overall I think that globalization is always going to be placed against the environment because the key to globalization is free markets with as little government intervention as possible. It is clear that in a free market system pollution and damage to the world's recourses is a negative externality and so is not taken into account by the market prices. For the environmental issues we face to be tackled in any consequential way the whole world needs to start trying to incorporate environmental damage into costs of production on microeconomic scale, and with its emphasise on profit maximisation and increased productivity I don't think that globalization, in the form that's being put forwards today will be beneficial to this process. A great example of this conflict comes from the Kyoto agreement in 1997. There 110 nations came together to try and start making steps to reducing greenhouse emissions. One of the only countries who refused to sign was the USA, who are the largest polluter in the world by far, and also one of the foremost proponents of capitalism and globalization as the way for all

states in the future. The reason that the US gave for not signing the treaty was that it was "too costly, and would damage the US economy." I consider that this almost perfectly demonstrates the underlying choice that has to be made between pure, short-term economic thinking or a more balanced social approach.

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