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New ECIPE Policy Brief:

GLOBALIZATION, EARNINGS AND CONSUMER PRICES: Taking stock of the benefits from globalization

Globalization has been accused of “stealing jobs” and depressing wages in the developed part of the world. China’s entry into the world economy, in particular, has sparked fears about a “middle-class squeeze”. These fears resemble the anxiety in previous eras over the rise of new emerging markets. As recent as twenty years ago, Japanese firms were by some considered to be far too competitive for American or European firms to survive. Now, as then, most of these fears are based on erroneous facts and wild exaggerations. In this new Policy Brief, Fredrik Erixon analyses data on wages, prices and income to estimate the benefits from globalization. He finds a strong link between disinflation and rising real income.

Globalization has surged in the last decades. Average tariffs on manufactures have come down significantly and trade has increased sharply. Trade has consistently grown faster than output, and the size of most countries’ trade sectors have increased. The U S trade sector has increased from 11 percent in the 1970s to 27 percent in 2005. The trade sector in the Euro area has moved from 43 to 74 percent in the same period. The global FDI stock tenfolded between 1980 and 2000, and in 2006 global FDI flows amounted to 1,3 trillion US dollars.

Critics of this development have accused globalization of stealing jobs and depressing wages. Both propositions might be true, and there is a certain logic to the argument: low-cost countries attract production from Europe and the U S, and when production moves to other countries demand for labour will fall, which will put a downward pressure on wages. Honest critics will say that globalization also creates job in the developed part of the world, but the net result, however, is on the minus side.

There is only one problem with this view: it is not supported by evidence and real developments. Nominal earnings growth in the developed world has slowed down since the 1980s, but that is due to falling inflation. Real earnings growth has increased in some countries, and slowed down in others, such as the United States. Yet the slowdown is not substantial if non-wage compensations and distributional effects of disinflation are taken into account. In some European countries, real earnings also for blue-collar workers have increased faster in the last decade than in previous decades. In other countries growth has been low for people in manufacturing, while it has overall been high for white-collar workers. Little evidence, however, supports the claim that trade liberalization is behind the slowdown of earnings growth for blue-collar workers in countries with slower earnings growth. The claim that globalization is stealing jobs is also false. Trade affects the composition of jobs, but not the volume of jobs.

To better understand the development of real earnings or real income it is crucial to look at price developments. Real income is not only a function of the wage level, but also of prices and what a consumer gets for her income. The remarkable period of disinflation between 1980 and today has fed into higher real income. Global annual variations in consumer prices have come down from 30 percent in the 1980s to far below ten percent today. In the OECD area, inflation has fallen further.

Globalization has been instrumental to falling inflation. Increased competition has slowed down price increases and the exploitation of comparative advantages has led to falling prices in some highly tradable sectors. Disinflation has also affected equality. Lower-income households tend to spend a higher share of their income on non-durable goods, which typically are highly tradable, and higher-income spend more on services.

What would have happened if globalization had freezed at its levels in 1970 or 1980? This paper presents a number of counterfactual calculations which aim at assessing the effect of globalization. If globalization had freezed at its 1980 level, real earnings in France, Germany, Sweden and the United Kingdom would have been approximately 10–22 percent lower than its actual level in 2005. This could also be presented in another way. In Sweden, one has to work 10 percent more time to afford the same transport services in 2007 as in 1997. However, the average Swede can work 43 percent less time to cover the same room with a carpet. In the UK, one can afford only 92 percent of a haircut in 2007 with the same amount of work than in 1997, but nearly 3 pair of trousers instead of only one. The same goes for France, where a night at the restaurants costs 7 percent less work time, while a shirt costs 27 percent less work time. In Germany, while a night at the restaurant cost nearly the same number of work hours as ten years ago, the telecommunication services can be afforded with 40 percent less work.

Individual goods—especially tradable goods—would have been much more expensive if globalization had freezed at its 1970 level. The price of a vacuum cleaner would have been 67 percent higher in Germany and 53 percent higher in the UK. The price of a refrigerator would have been 48 percent higher in Sweden and 26 percent higher in France. Price developments such as these have had a remarkable effect on consumers and real income. Consumers today get more for their money.

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By Fredrik Erixon

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Fredrik Erixon, fredrik.erixon@ecipe.org, is a Director and co-founder of ECIPE. He can be reached at 0032 (0)499 053 107.

Press information:

Anna Wilson, anna.wilson@ecipe.org, Mobile: 0046 709 263 177.

The paper can be downloaded at www.ecipe.org