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D. Fragmentation (continued from last lecture)

- Outsourcing: have (usually) intermediate inputs produced by another company or subsidiary.
- Subcontracting: have another company do some of the production

<u>Examples</u>:

- Data entry in South America, unskilled labor with lower wages than the United States.
- Computer Programming in India, lower wages for very skilled workers. Why India? English is widely spoken (especially by those who can program computers) and the time difference is just right (approx. 12 hours) so that people in India can work on the computers during the night in the US when US workers are not at work.

E. Non-traded Goods & Factors

Things that don't readily cross borders:

- Labor
- Services
- Land
- Government

Perceived Dangers of Globalization

1. Perception that globalization drives down living standards in:
    - Rich Countries: makes rich richer, poor poorer (from H-O theory and Stolper-Samuelson result where the real wage of the scarce factor will be reduced. More on this later.
    - Poor Countries: Globalization as a process of exploiting people.
2. Loss of National Sovereignty
    - Reduces the flexibility of a nation to conduct its own policies because of treaties, agreements, etc.
3. Increased Power of Big Business

    Is this a concern?

    Companies are competing against each other and this dampens their power.

    Are MNCs stronger than governments?

    Well, governments can tax and raise armies, so probably not.

    Does it mean anything if corporate revenue for companies is larger than GDP? Not really, GDP is a value added measure, revenue is not, so the two are not comparable.
4. Increased Leverage of Mobile Factors & Firms Compared to Immobile
    - Capital vs. Labor

        Firm negotiating with works (firm is mobile): "If you don't accept the wage we will move to another country, etc"
    - Different Kinds of Labor

Workers with more human capital tend to be more mobile than those without, or with much less, and therefore are able to get a better deal.

Skill Premium:
Ratio of Skilled wage to unskilled wage

- Constant in 1950s, 60s, 70s (all wages generally rose and fell together)
- Risen since 1980 (skilled wages have increased, real wages for unskilled have fallen

See graph: index of real wages for three groups
Next graph shows ratio
1980: college wage = 2x HS dropout wage
1995: college wage = 2.75x HS dropout wage
This is the rising skill premium and is a sign of increasing inequality.

<u>Possible Explanations</u>:

- Supply Side:
  Argument needs: scarcity of skilled workers and an abundance of unskilled workers, to make the price of workers behave like the data.
  See graph for evidence: Share of total weeks worked, 1963-1995
  1965: 40% of labor force is HS dropouts
  10% college grads
  1995: 10% HS dropouts
  30% college grads
  So, the evidence does not match this explanation. The data suggest that following a supply side argument wages for unskilled workers would increase because of their reduced supply, but of course, this has not been true.
  Is there another supply side explanation?
  -Immigration: increased supply of unskilled labor. The majority of evidence says that this has not happened to a great enough extent to account for much change in wages..
- Unions:
  Unions raise the wages of their members and usually represent unskilled labor. If unions become less powerful than they used to be or have less membership, this could cause the wage to go down. The unions have in fact lost power and membership, but the majority of the evidence says that this too has not been an important factor in changing wages.

Big Two Explanations:

- **Globalization**: Stolper-Samuelson predicts this wage change if there is freer trade.
  <u>DC Trade liberalization</u> (lowering of barriers): DCs tariffs reductions since 1980 (yes). But, tariffs had been lowered much more dramatically before 1980 when there was not a rise in the skill premium. So increased DC liberalization cannot account of the rising skill premium.

LDC tariff reductions: After WWII LDCs had high tariffs with their import substitution policies, etc. In 1980s they start to liberalize much more than they had before. Later examples were NAFTA, etc.

Growth in Poor Countries: This put more and more labor labor-intensive goods onto world markets and NIE (newly industrialized economies) grew and produced more. There was also increased FDI by DCs in LDCs and this too put more labor-intensive goods on world markets.

Population growth in LDC > Population growth in DC, thus increasing the relative supply of unskilled labor in the world and cheapening unskilled labor.

Transfer of Technology DC → LDC, to produce even more labor-intensive products, outsourcing, etc.

All of these imply that there will be lower unskilled wages in the US. So, the lower wages could be due to these facets of globalization.
Economists Say: measured effect that approximately 30% of the actual increased skill premium was due to globalization.

Thus a significant portion of the increasing premium is due to globalization, but it is not the largest portion. Something else was going on

- **Technology:** (More on this next time).