

# Developing Countries in a Globalizing World

**2005 World Fellows Seminar**

Irene Brambilla

The session will deal with different aspects of globalization and its effects on the welfare of developing countries, namely increased openness and growth, wages and labor conditions and intellectual property rights.

Feenstra, Robert, "Integration of Trade and Disintegration of Production in the Global Economy," *Journal of Economic Perspectives*, Vol. 12, No. 4, Autumn 1998, pp. 31-50.

Irwin, Douglas, "Retrospectives: Challenges to Free Trade," *Journal of Economic Perspectives*, Vol. 5, No. 2, Spring 1991, pp. 201-208.

Rodrik, Dani, "Symposium on Globalization in Perspective: An Introduction," *Journal of Economic Perspectives*, Vol. 12, No. 4, Autumn 1998, pp. 3-8.

Drusilla K. Brown, "Labor Standards: Where Do They Belong on the International Trade Agenda?," *The Journal of Economic Perspectives*, Vol. 15, No. 3. (Summer, 2001), pp. 89-112.

Nina Pavcnik and Eric Edmonds, "Child Labor in the Global Economy," *The Journal of Economic Perspectives*, Vol. 18, No. 1. (Winter 2005), pp. 199-220.

World Trade Organization, "Understanding the WTO," Ch. 2, pp. 39-45 (Intellectual Property: Protection and Enforcement).

Jean O. Lanjouw, "Beyond TRIPS: A New Global Patent Regime," Brief no. 3. The Center for Global Development. August, 2002.

*When we buy manufactured goods abroad, we get the goods and the foreigner gets the money. When we buy the manufactured goods at home, we get both the goods and the money*

– Abraham Lincoln (allegedly)

Discuss here what is wrong with the argument above. What is the fallacy in Lincoln's argument?

## The principle of comparative advantage

Resources are scarce and have alternative uses. There is an *opportunity cost* of production.

United States	200 Shirts	10 Computers
Dominican Republic	200 Shirts	3 Computers

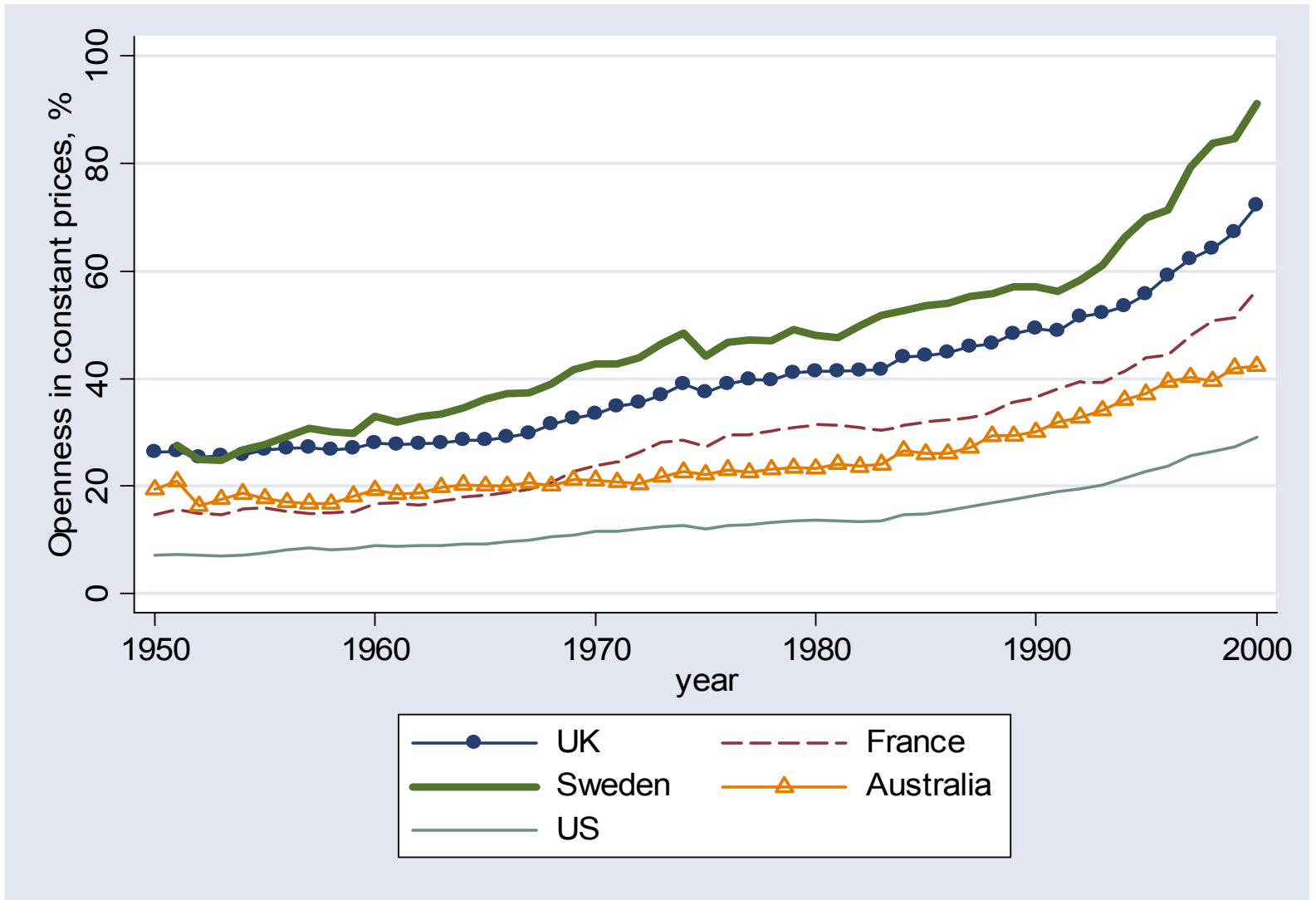
Absolute advantage does not matter

United States	200 Shirts	10 Computers	1000 dollars
Dominican Republic	200 Shirts	3 Computers	2000 dollars

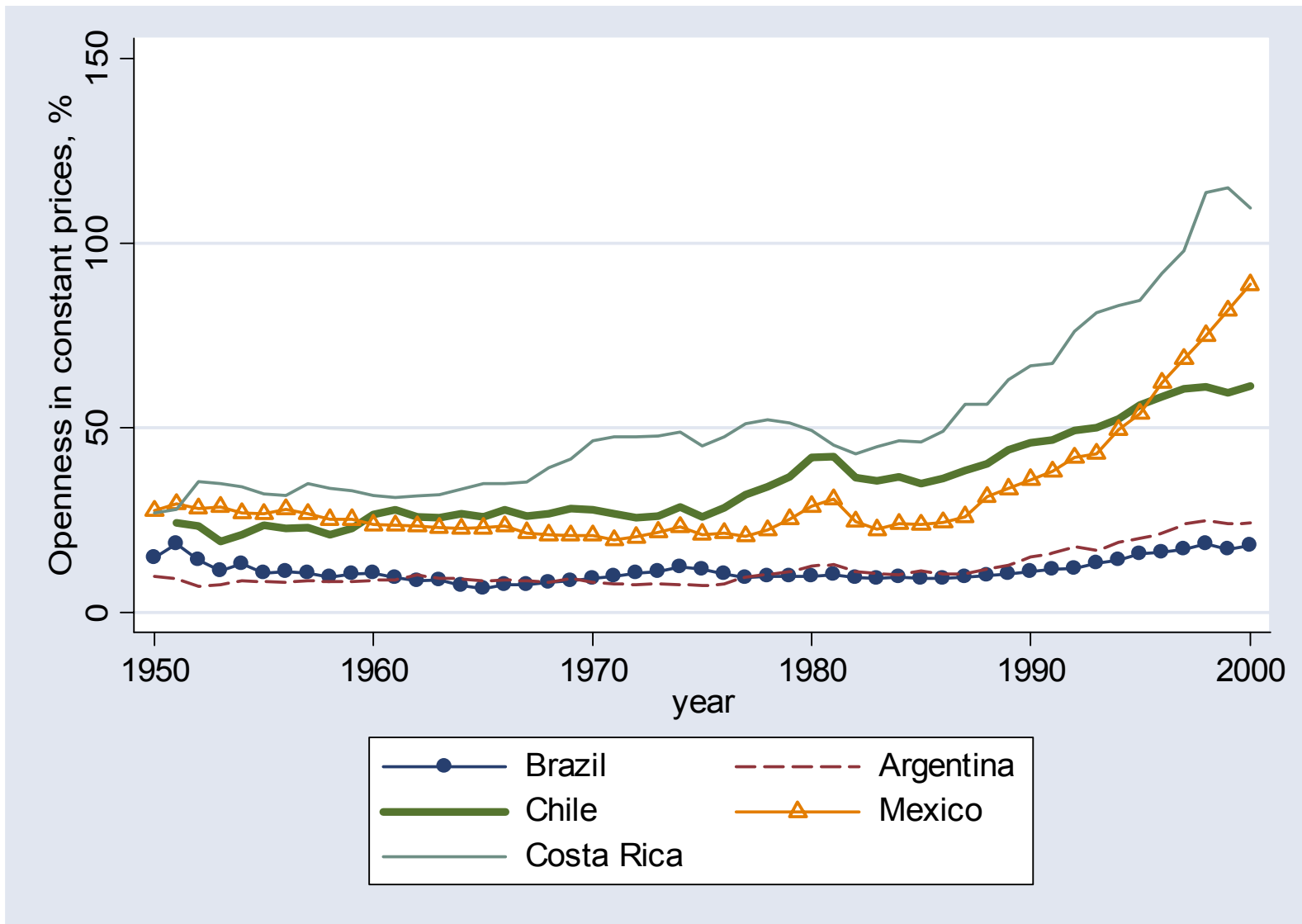
## Gains from trade

- ① Differences in technology (David Ricardo)
- ② Differences in factor endowments (Heckscher & Ohlin)
- ③ Scale economies
- ④ Access to a larger number of varieties of goods
- ⑤ Increase in efficiency through more competition (not in classical models)

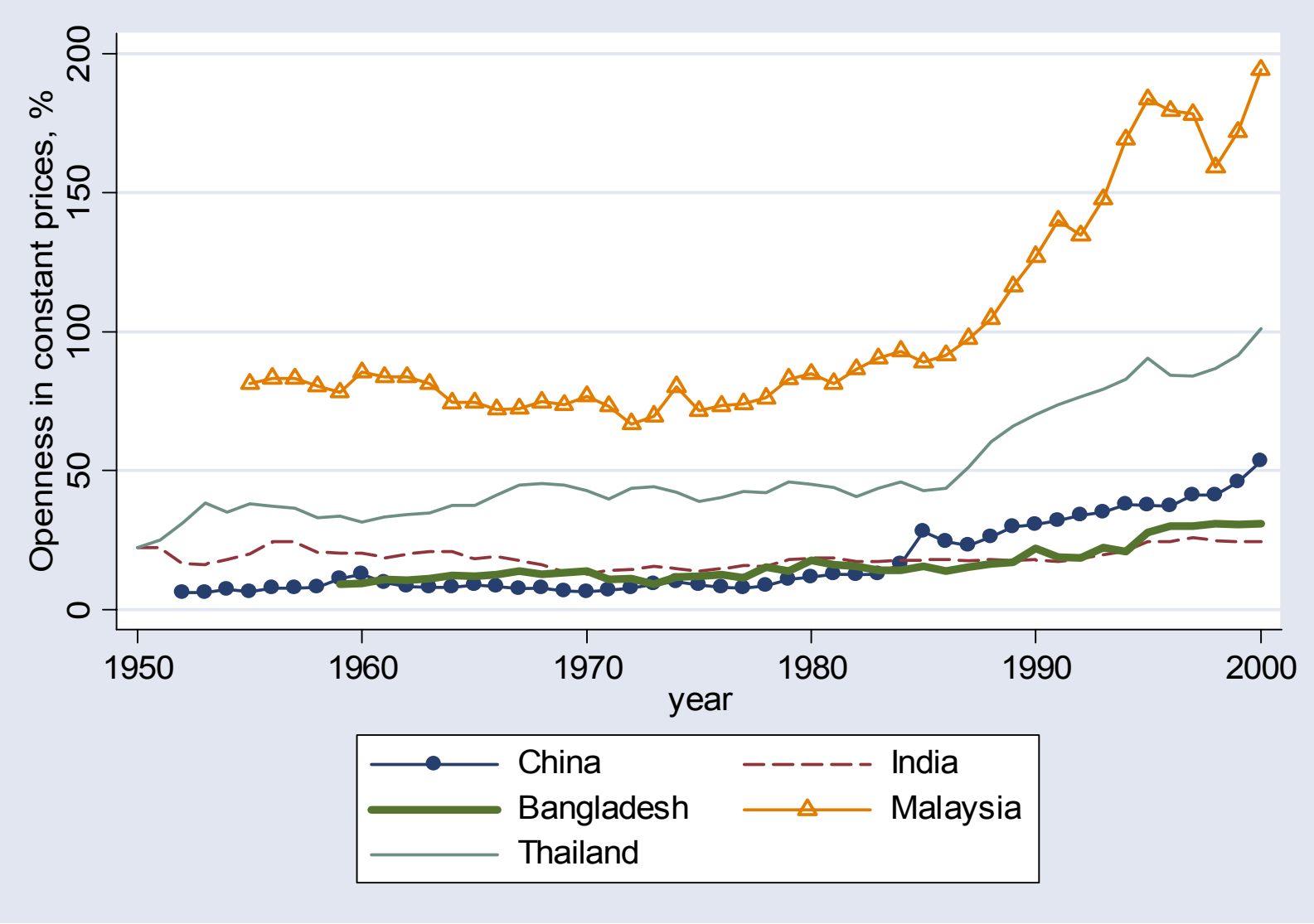
# Trends in Developed Countries



# Trends in Latin America



# Trends in South and South-East Asia



## **Reasons for huge increase in trade?**

- Decrease in transport costs
- Decrease in protection

## More on Trends

### Ratios of Merchandise Trade to GDP (*percent*)

<i>Country</i>	<i>1890</i>	<i>1913</i>	<i>1960</i>	<i>1970</i>	<i>1980</i>	<i>1990</i>
Australia	15.7	21.0	13.0	11.5	13.6	13.4
Canada	12.8	17.0	14.5	18.0	24.1	22.0
Denmark	24.0	30.7	26.9	23.3	26.8	24.3
France	14.2	15.5	9.9	11.9	16.7	17.1
Germany	15.9	19.9	14.5	16.5	21.6	24.0
Italy	9.7	14.4	10.0	12.8	19.3	15.9
Japan <sup>a</sup>	5.1	12.5	8.8	8.3	11.8	8.4
Norway	21.8	25.5	24.9	27.6	30.8	28.8
Sweden	23.6	21.2	18.8	19.7	25.0	23.5
United Kingdom	27.3	29.8	15.3	16.5	20.3	20.6
United States <sup>b</sup>	5.6	6.1	3.4	4.1	8.8	8.0

*Notes:* Merchandise trade is measured as the average of imports and exports, except as noted below.

Feenstra, "Integration of Trade and Disintegration of Production in the Global Economy", Journal of Economic Perspectives, 1998

## Why protect?

- ① Infant industry argument (import substitution regimes)
- ② Terms of trade (large countries)
- ③ Distributional issues (protect unskilled labor)
- ④ Political economy reasons (lobbies)
- ⑤ International politics (example: embargoes)

A great fraction of the increase in trade is due to trade liberalization.

Infant industry (Irwin, JEPersp 1991): Very old debate. One of the earliest reasons to protect. Adam Smith (The Wealth of Nations) and many classical economists did not accept the infant industry argument. Early advocates of the infant industry doctrine, such as Alexander Hamilton, Friedrich List, and mercantilist writers, were usually dismissed as ill-informed, nationalist, or just crudely protectionist. The doctrine gained formal acceptance into international trade theory in 1848 when John Stuart Mill published the first edition of his Principles of Political Economy. "The superiority of one country over another in a branch of production often arises only from having begun it sooner. There may be no inherent advantage on one part, or disadvantage on the other, but only a present superiority of acquired skill and experience." Mill's standing and reputation in economics gave intellectual credibility to the infant industry argument for the first time. Complaints soon reached Mill about how his statement was being distorted by protectionists to justify high tariffs in the US, Canada and Australia. He proposed giving an annual grant instead of a tariff. This early discussions appear to be very dogmatic, people were in favor of free trade or purely protectionists.

Distributional issues: consumers vs. producers; workers vs. capital; skilled vs.

unskilled labor

There are both domestic and foreign lobbies

## Multilateral negotiations

- GATT (General Agreement on Tariffs and Trade). 1947.
- Rounds of negotiations.
- First rounds were about reducing tariffs. Setting *bindings*.
- Principles:
  - Reciprocity.
  - Most favored nation (MFN). Differentiation.

## Next rounds

Kennedy Round	1964-1967	Anti-dumping measures
Tokyo Round	1973-1979	Valuation of goods Quantitative restrictions
Uruguay Round	1986-1994	Agriculture (export subsidies) Textiles (MFA) Intellectual property rights (TRIPS) Labor and environmental standards WTO was created

## Questions

Are trade and globalization good for developing countries?  
What should be the role of the WTO?

Focus on two aspects

- Labor standards
- Intellectual property rights

## **Labor standards**

- Sweatshop conditions (long hours, low wages, poor conditions)
- Child labor
- Fair trade

## Proposed Solution

- Resort to consumer's demand for goods produced in fair conditions
- Don't buy products that are produced and traded under unfair conditions (sweatshops, slave labor, child labor, unfair prices)

## Fair Trade



Omanhene Cocoa Bean Company  
<http://www.omanhene.com/slavery.php>

*The only way to assure a chocolate bar is made without slave labor is to make sure the chocolate is not made from cocoa beans grown in countries such as the Ivory Coast where slave labor has been documented in the harvesting of cocoa beans.*

*Omanhene dark milk chocolate is made with cocoa beans grown exclusively in Ghana.  
There is no use of slave labor on Ghanaian cocoa farms*

## Demand for labor standards

<b>Marymount University Center for Ethical Concerns</b>	<b>1995</b>	<b>1996</b>	<b>1999</b>
Would avoid shopping at retailer that sold garments made in sweatshop	78 %	79 %	75 %
More inclined to shop at stores working to prevent sweatshops	66	63	65
Willing to pay \$1 more for \$20 garment guaranteed made in legitimate shop	84	83	86
Most responsible for preventing sweatshops			
Manufacturers	76	70	65
Retailers	7	10	11
Both	10	15	19
What would most help you avoid buying sweatshop clothes			
Fair-Labor label		56	
Sweat-Shop List		33	

Source: survey run by Marymount University's Center for Ethical Concerns. Table extracted from Elliot and Freeman, NBER Working Paper 8102.

## Questions

- What do you think of this solution?
- What is the alternative for these workers?
- Is there a risk of less investment and less trade?
- How about consumers in developing countries?
- Why are low labor standards associated with trade and/or multinationals?
- What about income effects?

- What do you think of this solution? –¿ Is this something that goes beyond NOT consuming a product manufactured under unfair conditions? Consumers want to share in the costs? They are willing to pay more. Can that be a solution? To what extent are consumers willing to pay more? How about consumers in developing countries?
- Negative publicity could deter trade and investment and reduce the number of jobs available in countries with already high levels of unemployment and under-employment (Elliot and Freeman). They don't think this is a reality, though.
- What is the alternative for these workers? –¿ Are they better off without trade? What happens to the Ivory Coast coffee workers?
- Elliot and Freeman: some authors argue that sweatshop jobs are better than jobs in rural agriculture or the informal sector. Studies show that foreign owned and export oriented factories offer higher pay and better conditions on average than domestic firms producing for the local market. Wages in footwear and apparel may be at the bottom of manufacturing, but they are generally higher than the minimum wage level and better than in agriculture.

- Why are low labor standards associated with trade and/or multinationals?  $-\zeta$   
higher demand, need more workers. Why are domestic employers better?
- What about income effects?  $-\zeta$  positive

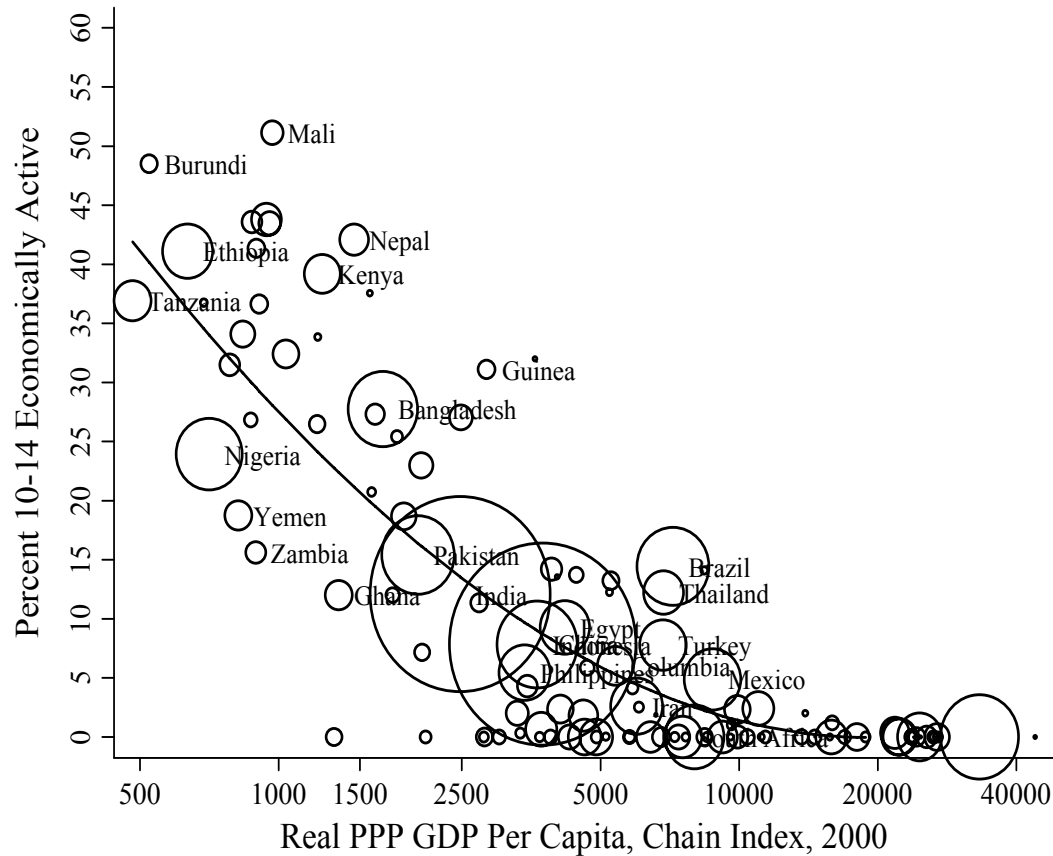
## Some facts about child labor (Edmonds and Pavcnik)

- ① Child labor defined for children between 5 and 14.
- ② Most working children are in low-income countries. 60 percent of working children are in Asia.
- ③ Contrary to popular belief, most working children are employed by their parents in agriculture or house work. Although other occupations are harder to find in the data (mostly household surveys).
- ④ Example: in Bangladesh, only 1.2 percent of children work as paid employees (despite bad reputation of Bangladesh's garment industry).

- ⑤ Most children that work attend school. Attendance rates:

Work	80.6%
Not Work	82.2%

**Figure 1: The Relationship between Economic Status and Economic Activity, 2000**



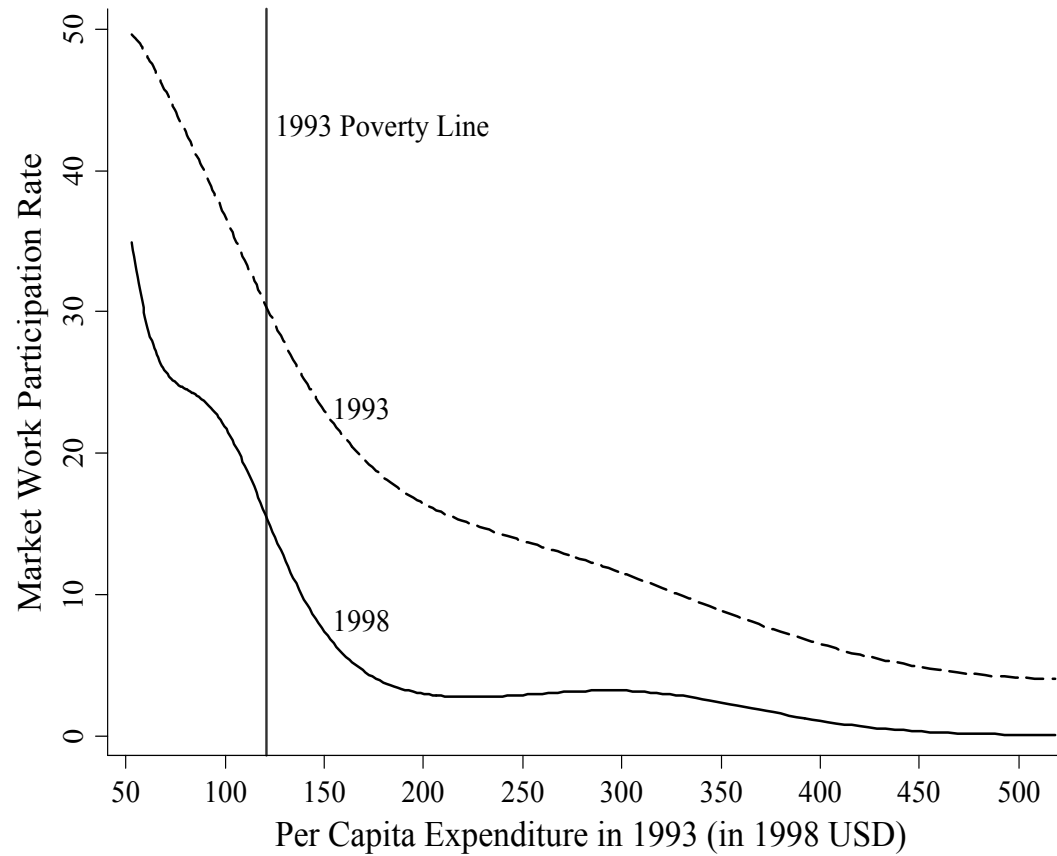
Source: Economic Activity for 2000 from LABORSTA (<http://laborsta.ilo.org>), GDP per capita from Penn World Tables 6.1, and Population aged 10-14 weights from UNStat.

Source: Edmonds and Pavcnik, Child Labor in the Global Economy, Journal of Economic Perspectives.

## The Role of Income

- Low income is the driving force. Greater demand for adult labor raises income and may reduce child labor. Families are quick to move children out of work when their economic status is improved. Examples:
  - ① Beegle et al., 2003. Tanzania. Children tend to work when households experience unexpectedly poor harvests.
  - ② Yang, 2004. Philippines during 1997 financial crisis. Children in households that received remittances from abroad devoted less time to work.
  - ③ Edmonds and Pavcnik, 2004. Vietnam between 1993 and 1998. Liberalization. Price of rice went up and can account for 45 percent of the decline in child labor in rural areas.
- Development is the best overall cure for child labor.

**Figure 2: Living Standard Improvements and Child Labor in Vietnam in the 1990s**



Source: General Statistical Office (1994, 1999): Vietnam Living Standards Survey, Rural Panel, 1993 & 1998

Source: Edmonds and Pavcnik, Child Labor in the Global Economy, Journal of Economic Perspectives.

## Role of the WTO

Should the WTO impose labor standards? Or should this be an issue for the ILO (International Labour Organization)?

Two issues:

- Exploitation. Anti-globalization groups, consumers.
- Protectionism. Governments do not have incentives to improve labor standards because lower wages make them more competitive.

## Issues in WTO setting labor standards

- Developed countries demand labor standards to protect their own low-skilled workers. Low labor standards are considered an unfair advantage. Does this grant intervention by the WTO?
- Is involvement of the WTO paternalistic? Concerns for national autonomy.
- Which standards could be set? Lack of universal agreement about standards beyond basic rights.

Rodrik 1996. Labor costs are overwhelmingly determined by labor productivity. Doesn't find a strong link between low labor standard in developing countries and wages of unskilled workers in industrialized countries.

# TRIPS

Trade-Related Aspects of Intellectual Property Rights. More homogeneous property rights among trade partners; minimum level of property rights protection.

“Creators can be given the right to prevent others from using their inventions, designs or other creations – and to use that right to negotiate payment in return for others using them.”

- Patents. (Capable of industrial application. 20 years+).
- Copyright (literary and artistic work – death + 50 years; computer programs; rental rights).
- Trademarks (counterfeit) & Geographical indications (Champagne, Roquefort).
- Trade secrets (undisclosed information).
- Industrial designs and Integrated circuits. (10 years +).

Patents, industrial designs, integrated circuit designs, geographical indications and trademarks have to be registered in order to receive protection. The registration includes a description of what is being protected. Copyright and trade secrets are protected automatically according to specified conditions. They do not have to be registered, and therefore there is no need to disclose, for example, how copyrighted computer software is constructed.

## Some comments

- Piracy increasing rapidly because of the proliferation of low-cost means of copying.
- Most property rights belong to firms with base in the US, Japan and a few other countries in Western Europe. Other countries don't have incentives to protect property rights.
- Violations occur at the individual level. Offenders can be prosecuted, but need to do so in the country where the violation occurred. Countries need to modify their laws. In the 1990's many countries strengthened their property rights laws under the pressure of the U.S. Degree of enforcement varies.
- Concern: poorer countries will lose ability to imitate foreign products and technologies.
- More FDI where property rights are well established
- Transition period from January 1995 (WTO) until Jan. 1996, 2000 or 2005 depending on country (high income, middle income, low income).

# Patents

- Pharmaceutical products & Plant varieties.
- Patent owner needs to supply product (local production, imports).
- Voluntary vs. compulsory licences.
- Issue: Dynamic gains (incentives for innovation) vs. Static losses (public good).
- Government involvement to prevent anti-competitive behavior (monopoly prices, abusive licensing conditions).
- Demands are different. Most revenue comes from developed countries. Prozac vs. Malaria.
- Products or Processes.

## Questions

What should be the degree of protection for pharmaceuticals in developing countries?

What should it depend on?

Should developing countries produce AIDS anti-retrovirals?