GLOBALIZATION'S CHALLENGES FOR THE DEVELOPED COUNTRIES

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INTRODUCTION

By the end of the World War II, US and Europe, having experienced the disastrous consequences of protectionist policies, had realized that a country's future prosperity depended upon having other equally prosperous countries in the world as its partners engaged in friendly relationships and free trade. Therefore, during the second half of the 20th century, initially US and Europe, and eventually Japan played a leadership role in convincing the world country governments of the dangers of protectionism and the great promise of free trade. It is a historical fact now that these efforts have been very successful in creating a global economy in which specialization combined with free trade is spreading prosperity among numerous small and big countries across the world.

While on the one hand, free trade has benefited both businesses and consumers in the developed countries enormously, on the other hand, it has resulted in a major restructuring of their economies and caused massive outsourcing of a wide range of manufacturing and service jobs to low wage developing economies. Unless dealt with effectively, these changes can threaten their citizens' sources of income which are the foundations of their very prosperity.

This paper will briefly trace the history of the developed countries' efforts to promote global free trade, and analyze how their success in doing so may have, ironically, created the next biggest challenges to their future prosperity. Finally, the paper will discuss the prognosis for the world's developed economies if the present trends continue, and alternative strategies for them to deal with the challenges.

CREATION OF MAJOR GLOBAL TRADE INSTITUTIONS

The historical United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire, USA from July 1-22, 1944—popularly known as the "Bretton Woods Conference"—laid the foundations of a new world economic order. The conference created three important institutions open to all countries of the world—International Bank for Reconstruction and Development (IBRD) to speed post-war reconstruction and development, International Monetary Fund (IMF) to stabilize world currencies, and General Agreements for Tariffs & Trade (GATT) to establish free trade among all nations—as the three pillars supporting a prosperous and stable world economy of the future (World Bank, IMF, GATT, WTO 2009).

Through the years, these institutions have continued to evolve and play an important role in leading the world to peace and prosperity. The IBRD was the premier of the five institutions that became the World

Bank Group—a group of financial institutions. Created initially to insure rapid post-war reconstruction of the devastated economies in Europe and Japan, its mission has evolved into providing developmental assistance to emerging economies, and short and long term commercial loans to country governments and businesses for large investment projects.

The IMF came into existence in 1947 with the goal of providing large short-term loans to country governments to support their currencies when necessary, and ensure stable exchange rates, that would create a risk-free financial environment and freely convertible currencies in which international trade could flourish. This role has become only more important with globalization.

Beginning in 1947, the GATT went through eight rounds of negotiations spread over half a century before finally evolving into what it was originally meant to create—the World Trade Organization (WTO)—in 1995.

THE ACCEPTANCE OF A FREE MARKET SYSTEM BY WORLD GOVERNMENTS

Until the middle of the 20th century, most countries pursued the goal of self-sufficiency in agriculture and in basic industries providing inputs to the country's infrastructure and national defense, in order to ensure the country's political independence through military strength, and to attain sustained economic wellbeing, prosperity, and affluence.

However, US and Europe had realized that their strength and future prosperity could be expanded beyond the limits of their own economies by building up and supporting a world-wide network of prosperous trading partners engaged in free exchange of goods, services, and ideas with them. In time, US, Europe, and Japan became the shining examples of creating economic stability and prosperity through free trade.

Increasingly, more and more countries realized and joined the free trade movement. By the mid 1990s, virtually all large and populous developing countries too gave up their historical policies of self-sufficiency, removed the protectionist barriers they had built around themselves, and embraced the free market system.

Thus, the 20th century saw the world economy becoming free of various trade and investment restrictions and embracing free trade with confidence. In a way, this was a de facto acceptance by most country governments of Adam Smith and David Ricardo's assertion that specialization combined with free trade would pave the way to prosperity for all nations (Adam Smith 1776; David Ricardo 1817).

CONGRUENCE OF OTHER FACILITATING FACTORS

The simultaneous congruence of a few other factors gave enormous momentum to the spread of free trade around the world (Joag 2009)

1. Formation of Regional Cooperation and Integration Groups

While the international trade institutions such as the World Bank, IMF, and WTO continued their slow progress toward their very ambitious goal of promoting free trade across the world, smaller groups of countries that were eager to forge ahead with free trade, joined together to form regional cooperation and integration groups, free trade areas, common markets, and even economic and political unions.

Western Europe took the lead in such economic integration, and due to its unprecedented success in creating peace and prosperity, the EU became the inspiration and a model for economic cooperation and integration to all countries of the world. Subsequently, many other free trading groups formed in different parts of the world. They pursued similar objectives and have had varying degrees of success.

2. Rapid advances in information and telecommunications technology

Information and telecommunications technology made rapid advances toward the end of the 20th century, brought down the variable costs of communication close to zero, made possible instant communication and information transfer to any part of the world, and effectively changed the world.

3. Easy, rapid, reliable, and relatively inexpensive transportation across the world

Almost equally revolutionary changes occurred in transportation. Costs came down drastically, and reliability rose to levels where transportation delays are no more a serious concern in supply chain management.

4. The Silent Education Revolution

As the country governments were slowly adopting free market policies, another silent revolution was taking place in many populous, poor countries of the world—the Education Revolution. Many third world countries continued to educate their populations from minimum functional literacy to the highest levels of knowledge, skills, and technology. Thus, by the end of the 20th century, these low-wage developing countries had available large pools of technically trained and highly skilled workers for hire. And in the new global economy, these countries offered the manufacturers from high wage advanced countries ideal destinations to transfer their manufacturing operations to, and produce their products at the lowest possible production costs.

GLOBALIZATION COMES AS A MIXED BLESSING FOR DEVELOPED COUNTRIES

Globalization's Benefits to Consumers in Developed Countries

Globalization has brought great benefits to the developed countries. Clearly, all consumers in the world, but especially those in the high-income developed countries, are the greatest beneficiaries of global free trade. Now they can choose the best products and services that are available at the lowest possible prices in the world's unified marketplace due to global competition, and, in effect, enjoy the highest standard of living possible at this time.

Globalization's Benefits to Businesses in Developed Countries

Similarly, businesses and marketers in developed countries have been the second major group of beneficiaries under globalization.

As a result of these changes, raw materials, finished goods, and capital can move across national borders quickly and inexpensively. Even though, labor still continues to have the most limited and restricted mobility, inexpensive labor with high levels of education, technical training, and experience is abundantly available in many third world countries. As such, marketers can and do move manufacturing of even the most advanced products to where the educated and skilled labor is available at the lowest cost.

Thus, free trade has made it possible for leading manufacturer-marketers to bring together, the best of input materials, capital, technology, and skilled and unskilled labor in a win-win combination. Now, they can combine the capital and technology from the developed countries with the best materials and cheapest labor in the world, produce their finished products at the lowest possible cost, and use their unhindered access to the world markets to sell them to the global consumers under free competition. In fact, in addition to manufacturing of products, developed countries are now using highly skilled employees in low wage countries to produce and deliver services such as medical diagnostics and research and development (R&D) in many technical fields.

As a result, many manufacturing and service businesses from developed countries have been able to reduce their costs, expand globally at an unprecedented pace, and produce spectacular results.

GLOBALIZATION'S CHALLENGES FOR THE DEVELOPED COUNTRIES

In spite of all these benefits globalization has brought about, it has posed many challenges before the developed countries of the world. Some of these challenges could have been foreseen while others are totally unexpected.

Two factors have combined together to create an enormous wage disparity between the developed and developing countries.

1. High and Uncompetitive Wage Rates Make Developed Countries' Labor Prohibitively Expensive Even for their Own Industries

The highest standard of living enjoyed by the developed countries has also made their workforce the most expensive in the world, just when equally—if not better—skilled and educated, much cheaper and abundant supply of workforce is now accessible to them in many parts of the world. In effect, the very high and uncompetitive wage rates in developed countries have made their labor prohibitively expensive even for their own industries.

2. Undervalued Currencies of Developing Countries Further Magnify the Wage Disparity between Developed v Developing Countries

As if the lower wage rates in developing countries were not enough of a threat, lack of demand has undervalued their currencies in the world markets making their effective wage rates even lower than what they actually would be had their currencies' exchange rates reflected their true buying power.

Exhibit 1 presents supporting data for these phenomena.

Exhibit X1

Indexes of Hourly Compensation Costs for Production Workers in Manufacturing: 2006
Source: Statistical Abstract of US 2009

	Indexes Based on Currency Exchange Rates against US Dollar	Country's Currency Over(+) or Under(-) Valued By	Indexes Adjusted for Purchasing Power Parity of Currencies
US	100	0%	100
France	105		91
Germany	144	+15%	125
UK	114	+24%	92
Asia NICs	42		Not Available
Brazil	21		Not Available
HK	24	-28%	33
Taiwan	27		Not Available
China		-56%	
Japan	85	+9%	78

Reading the table across for Hong Kong, it can be seen that Hong Kong wages are only 24% of US wages. And even after correcting for the fact that Hong Kong currency is undervalued by 28% in terms of US dollar, Hong Kong wages are still only 33% of US wages. If this is the state of wages in one of the most advanced Asian Tiger economies, the wages would be far lower in China, India, and Russia.

Clearly, wage differences in developed and developing countries are so huge that the attractiveness of the developing country labor is not at all diminished even after accounting for their undervalued currencies. In other words, correct valuation of Asian currencies will not be sufficient to stem the wave of outsourcing from developing countries; only the cost of such outsourcing will go up which will be even worse for the developed countries.

Developed countries are in fact experiencing massive outsourcing, to cheaper destinations in the world, of labor intensive manufacturing, service, and even high tech research jobs in fields such as health care and space research. However, this has brought to the fore a new anomaly that did not exist before. While such outsourcing to reduce costs is good for the business profitability, it is a bad news for the workers in the developed countries whose jobs are shipped overseas. Thus, the old rules and words of wisdom such as: "What is good for the business is good for its employees," and "What is good for the industry is good for the country," are no longer true. For the first time, outsourcing of jobs is good for the business profitability, but is a disaster for the employees. Further, the unemployment resulting from such job losses becomes a huge economic and social problem for the country as well.

Most worrisome is the fact that paying only internationally competitive wages at home is not the solution to this problem. If the developed countries are to maintain their high standard of living, their labor must be paid high wages. However, from business point of view, high wage rates make the labor expensive. And since cheaper and equally competent labor is available elsewhere in the world, high labor costs at home would mean only one thing: all jobs at home could be threatened by overseas competition, and all jobs that could possibly be outsourced may in fact be outsourced to low wage destinations. Thus, unexpectedly, maintaining high standard of living at home could mean high levels of underemployment if not unemployment.

While raising the standards of living of the poorer countries, globalization is thus also putting downward pressure on the wages and living standards of the rich countries, and in effect, threatening the high living standards and the very affluence of the developed countries.

In summary, developed countries are faced with the following challenges.

1. They must create new jobs in sufficient numbers to replace the outsourced manufacturing jobs so as to provide continued employment to their displaced workforce.

2. These jobs must be able to pay equally high wages as the outsourced jobs so that the countries are able to maintain their past high standards of living.

3. Finally, developed countries' high standards of living depend on continued imports of cheap manufactured goods from less developed economies. Therefore, as more and more manufactured products are outsourced, they must replace them with new goods and services that can be produced at home, and even after paying high wages to local labor, can still be exported at competitive prices to the world markets in order to earn sufficient foreign exchange to pay for the imports.

CONCLUSION

The challenges faced by the developed countries are formidable and the solutions are not simple. Further, doing nothing is not an option. One aggressive alternative out of this situation is to continue to innovate new technologies and produce new products at a rapid pace that support high domestic wages and still are competitive in the international markets. Another option always open to resource rich countries is to export more natural resources that the world needs in exchange for imports. And finally, the least preferred and defensive alternative is to maintain full employment at any cost for social peace, using protectionist measures where necessary, and pay the price for it by letting the standards of living stagnate.

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