

Keynote Speech 1

Misthinking globalisation

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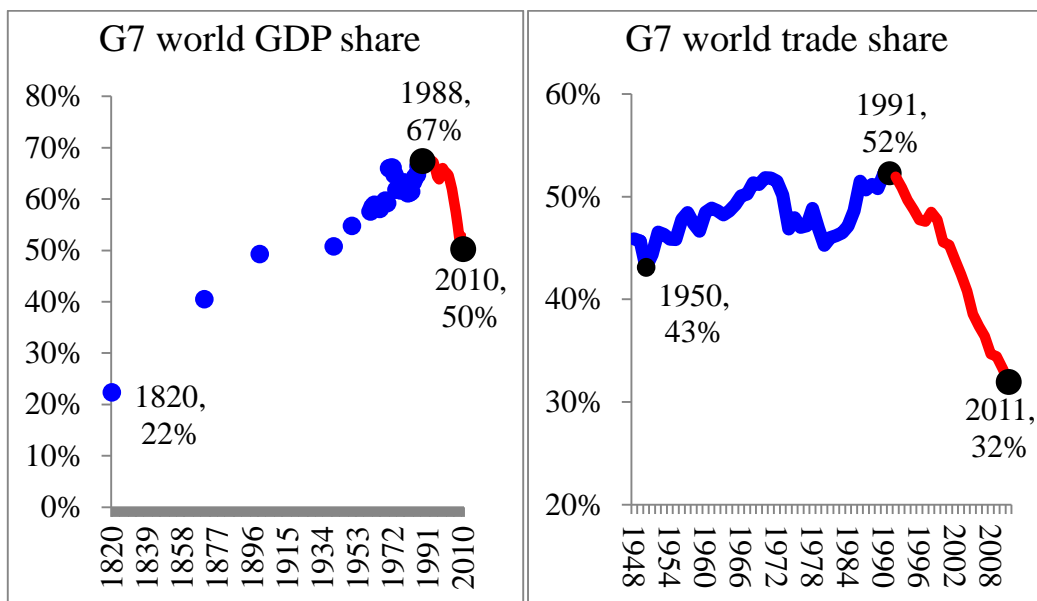
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1. INTRODUCTION

Globalisation is typically viewed as driven by the gradual lowering of natural and man-made trade costs. This is a serious mistake. Globalisation should be viewed as two processes, not one.

Globalisation leaped forward in the late 19th century when steam power slashed the costs of moving goods internationally. Globalisation made a second leap in the late 20th century when ICT radically lower the cost of moving ideas internationally. The two leaps had dramatically different effects as can be seen from Figure 1.

Figure 1: Globalisation: One paradigm or two?



The first leap – what might be called old-paradigm globalisation – fostered economic agglomeration in large industrialised nations. The G7 nations saw their share of world GDP soar from a fifth in 1820 to two-thirds in 1988. G7 world trade shares also rose steadily. The second leap – what might be called new-paradigm globalisation – reversed this. In just two decades the G7’s shares of world GDP and trade plummeted to 50% and 32% respectively.

This distinction, which I first posited in Baldwin (2006), requires some background.

2. THE 1ST UNBUNDLING

Since the dawn of human civilisation, high costs of moving goods, ideas and people forced the geographic “bundling” of production and consumption; every village made almost everything it consumed. Globalisation meant lowering the costs of moving goods across borders. This made it feasible to geographical “unbundling” production and consumption of goods. Once it was feasible, the vast international differences in efficiency made it profitable. Trade boomed.

2.1. Globalisation policy: 1st unbundling and old-paradigm thinking

The intellectual framework we use today when thinking about globalisation (mainly trade theory) was formulated during this phase. There were two key economic insights from this ‘old-paradigm’ thinking.

- A nation’s economy was connected to the world mainly via goods markets.

Further globalisation was viewed as an intensification of goods markets competition. This impacted different sectors differently. A nation’s best sectors – what could be called ‘sunrise’ sectors – gained as freer competition allowed them to win markets abroad. The nation’s worst sectors – ‘sunset’ sectors – lost.

- Sunrise and sunset sectors were associated with distinct skill groups.

For rich nations, sunrise sectors tended to hire skilled workers and employ high-

technology much more than the sunset sectors. Globalisation's winners were associated with skilled workers and high technology, the losers with unskilled workers and low-tech.

Wise government realised that globalisation created winners and losers but that the winners won more than the losers lost, so they adopted policies to share the gains and pains. Education, technology and industrial policies were designed to help sunrise sectors rise faster. Social policy, subsidies, and employment laws were crafted to lessen the pain in sunset sectors and dis-favoured skill groups. The entire European 'social market economy' model rests on this notion of fostering open markets while sharing the gains and pains.

Importantly, the pace of the 1st unbundling could be controlled in the post-war period by lowering tariffs gradually. This gave time for moving resources out of sunset sectors and into sunrise sectors.

Old-paradigm thinking taught governments to think of globalisation as a slow, predictable process whose economic effects hit sectors and skill group. This changed when the ICT revolution sparked the 2nd unbundling just as steam power sparked the 1st.

3. THE 2ND UNBUNDLING

During the 1st unbundling production dispersed internationally but, paradoxically, it clustered nationally (factories and industrial districts). The paradox is resolved with three points: i) cheap transport favoured large-scale production, ii) such production tends to be very complex, and iii) close proximity lowers the cost of coordinating complexity. In other words, relaxing the transportation constraint brought to the fore another constraint on location – the coordination constraint. Coordinating the process demands continuous flows of goods, ideas and people. Stages bundled into factories to save on coordination costs.

From the mid-1980s, the ICT revolution made it economical to separate manufacturing stages. Once it was feasible, vast international wage differences made it profitable and some stages were offshored.

3.1. How 2nd unbundling globalisation is different

The 2nd unbundling, or new-paradigm globalisation, impacts the economy with a finer degree of resolution. More intense competition is felt at the level of stages, or even occupations rather than sectors. Globalisation's effect are felt at the stages or occupations level, not at the sectors or skill groups.

The 2nd unbundling's impact is also more sudden. Unlike tariffs, ICT cannot be easily controlled or slowed. Finally, the impact is also more unpredictable. While most traded goods were affected more or less proportionally by lower trade costs, it is difficult to predict which stages become footloose as ICT progresses.

To summarise, new-paradigm globalisation more individual, more sudden and more unpredictable.

3.2. 2nd unbundling as a technological not trade phenomenon

From a more factual perspective, the radically different impact shown in the Figure 1 stems from the fact that the 2nd unbundling is really about know-how, not trade. It is a trap to even think about the 2nd unbundling as a trade phenomenon.

The 2nd unbundling means firms from high-technology nations recombine their firm-specific managerial, technical and marketing know-how with developing-nation labour. After all, the off-shored stages have to mesh seamlessly and evolve in tandem with the rest of the production network.

The firm-level motive is to leverage the value of their firm-specific know-how by combining it with low wages in developing nations. Trade and investment are merely symptoms of this phenomenon.

3.3. 21st century globalisation policy and new-paradigm thinking

Because globalisation's impact is individual, sudden, and unpredictable, wise governments should adjust policies that were developed to deal with economic consequences of the 1st unbundling. Since it is much harder to identify the sunrise sectors, education, technology and industrial policy should be more nuanced, and more nimble.

With new-paradigm globalisation the share of workers with lifetime jobs, or who spend a lifetime in one sector will diminish. Workers retraining will become more important; learning to learn may become as important to a worker's competitiveness as learning itself. Wise governments can reduce the pains from globalisation by getting children used to the idea that they will be engaged in life-long learning, and providing the right institutions and incentives for continuing education and skill retraining.

Labour market policies should also be adapted. Europe has two basic 'flavours' of labour market policies – some nations (e.g. Denmark) protect workers, other (e.g. Spain) protect jobs. When globalisation impacted economies in a gradual, predictable manner, the distinction was important but not critical. The individuality, suddenness and unpredictability of new-paradigm globalisation make flexibility far, far more important. Firms that are locked into particular workers doing particular jobs will have an incentive to move much more of the production process abroad. Offshoring provides the ultimate labour market flexibility. Nations should shift toward protecting workers, not jobs.

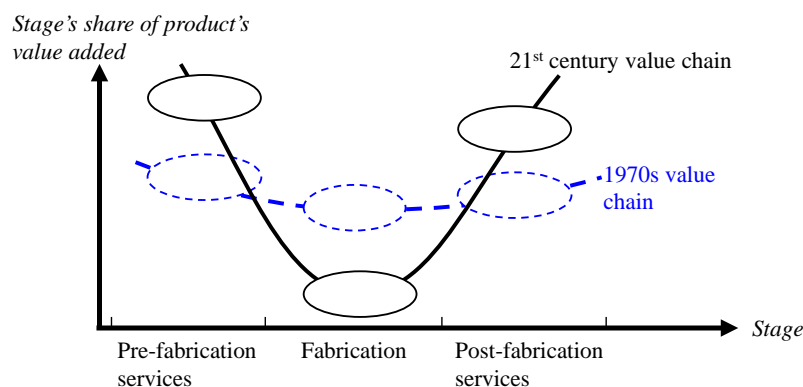
Industrial policy is also much harder in a 'landscape of work' that is fragmented, footloose, and unpredictable. Even if the policy identifies an activity worthy of being promoted, how can we be sure that the promoted production stays in nation promoting it? Wise governments must work out how internationally mobile various factors are and are likely to be. Mobile and immobile factors matter; both contribute to national income. But good jobs created locally have a local multiplier effect that good jobs created abroad do not (Moretti 2010). This suggests that an important consideration for policy should be 'stickiness' of the inputs affected by the policy.

3.4. The 'smile curve' and cities as 21st century factories

2nd unbundling created winners and losers at the stage-of-production level rather than at the sector level. As it turns out, stages related to fabrication of goods have been systemic losers in rich nations and systemic winners in emerging markets. In rich nations, the winners tend to be the pre- and post-fabrication services – things like design, marketing, managing complex supply chains, retail services, and after sales services.

Governments need to understand why value-added shares have shifted along value chain in rich nations, and how this has turned some formerly ‘good’ jobs into ‘bad’ jobs (Baldwin and Evenett 2013). The key concept is the so-called ‘smile curve’. Due to the 2nd unbundling, some stages moved abroad; others did not. Importantly, the distribution of value added along the value chain shifted away from the offshored fabrication stages. The standard assertion is that the smile curve has gone from flat (jobs all along the chain were ‘good’) to U-shaped, with fabrication stages – especially final assembly – now receiving much lower shares of value than under old-paradigm globalisation (Figure 2).

Figure 2: The smile curve, good and bad stages in the value chain.



The economics of the smile curve are simple (Baldwin 2013). Fabrication adds value in ways that are easily reproduced and easily moved. Since rich-nation firms have a wide choice of where to put offshoring production, fabrication became commoditised. The pre- and post- fabrication services, however, have not been commoditized. These services require agglomerations of talented workers interacting quickly and flexible to produce value that is difficult to copy. Mass production techniques work well for fabrication but not for pre- and post-fabrication services. In rich nations, factory jobs have become ‘bad’ jobs, pre- and post-fabrication services have become ‘good’ jobs.

Apple in the US and Nokia in Finland are good examples.

As far as policy is concerned the key point here is cities have become rich-nations' 21st century factories. Wise governments should start thinking about urban policy as part of their globalisation and industrial policy. Good factory jobs for low-skilled workers are a thing of the past in rich nations. They are competing with robots at home and China abroad. The good jobs – the ones that won't drift offshore suddenly and unpredictability – will be in cities that agglomerate broad and deep talent pools.

4. CONCLUDING REMARKS

Thinking about 21st century globalisation with 20th century intellectual frameworks is leading governments to make all sorts of policy mistakes. It's time for a rethink.

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