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Is Trade Liberalization an Important Cause of Increasing U.S. Wage Inequality? The Interaction of Theory and Policy

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Abstract

The majority of mainstream economists believe that globalization and trade liberalization have had a minor role in increasing U.S. wage inequality. A minority argues that capital mobility and outsourcing indicate a larger effect. This paper first surveys these views, and then argues that how we understand the policy consequences of trade liberalization helps determine the character of our analysis of the issue itself. Thus, a shift in policy perspective, to consider the "equity costs" of trade liberalization in terms of eroded U.S. labor market institutions, produces a larger framework for analyzing the consequences of globalization and trade liberalization than is available in traditional comparative advantage efficiency reasoning. From this wider perspective, trade liberalization has likely had a greater impact on U.S. wage inequality than even the minority mainstream position allows.

Keywords

trade liberalization; wage inequality; outsourcing; equity costs; institutions; comparative advantage; globalization

Income distribution is perhaps the most important social policy issue for social economists (especially if poverty is seen to be a dimension of income distribution). Wage or earnings inequality in turn is perhaps the central income distribution issue, since inequality in market earnings both underlies household income inequality, and is ultimately the basis on which redistributive social policy aimed at reducing household income inequality must be formulated. Yet while adopting a critical normative stance toward increased earnings inequality in the United States since the 1980s, social economists have been relatively silent on its causes. Increasing household income inequality has been investigated as the product of the rise of neoliberalism and retrenchment in the welfare state. But there is little social economic discussion of why wages and earnings underlying household incomes are becoming more unequal. This stands in stark contrast to mainstream economics which has not only extensively documented rising earnings and income inequality, but has also advanced a widely-accepted analysis of why earnings are becoming more unequal. Thus, while mainstream economics has an analytical foundation for its policy prescriptions regarding increasing earnings inequality, social economics has a policy stance, which, in not being tied to any particular analysis of the functioning of the economy, tends to be inelastic with respect to on-going developments in the national and international economy that are currently being hotly debated. In short, social economists are at a disadvantage on a subject they feel most strongly about, and which offers them an important opportunity to influence popular thinking about the relationship between the market and society in the future.

In this paper I address a leading issue in the debate over increasing United States wage inequality, namely, whether globalization, particularly as manifested in trade liberalization, is an important cause of increasing U.S. wage inequality. In the first part of the paper I critically survey mainstream arguments on the subject, distinguishing majority and minority positions, the former concluding that trade liberalization is not a significant cause of increasing U.S. wage inequality, and the latter -- which I favor -- arguing that trade liberalization in a world of outsourcing and capital mobility is indeed a significant cause of decline in the wages of unskilled labor and consequently increasing wage inequality. But the second part of the paper attempts to show that how we understand the policy consequences of trade liberalization and increasing wage inequality helps determine the character of our analysis of the issue itself. Social economics rejects the proposition that analysis and policy are independent. I thus argue that even the minority mainstream view underestimates the ways in which trade liberalization and globalization affects wages in the United States, because it remains bound within the narrow confines of efficiency reasoning. Specifically, since efficiency reasoning excludes equity considerations, it ignores potentially significant 'equity costs' of increasing wage inequality. These "equity costs" are explained below in terms of the consequences trade liberalization and globalization may have for domestic U.S. social institutions, particularly those surrounding the labor market and affecting income distribution. Including such costs helps show that trade liberalization likely has a greater impact than even the minority mainstream position allows, and suggests a more comprehensive policy framework for assessing trade liberalization. It also demonstrates the advantages of adopting a social economics approach that recognizes the interaction of analysis and policy.

The paper is organized as follows. In section one I present the majority mainstream view that trade liberalization cannot make more than a modest contribution to increasing wage inequality. Standard trade theory argues that trade liberalization should increase wage inequality, but most mainstream economists believe that the conditions the theory requires do not hold, and/or that empirical evidence contradicts the predictions of theory. In section two I turn to the effects outsourcing and international capital mobility may have on wage inequality, and present the minority view among mainstream economists that globalization, meaning trade liberalization and international capital mobility, has a significant impact on wage inequality. In section three I comment on the

interaction of theory and policy from a social economics perspective, and then raise the issue of how we measure equity costs. In section four I advance a conception of equity, and then describe how changes in U.S. social institutions brought on by globalization have equity costs that accompany and reinforce U.S. wage inequality. Section five concludes with a second look at economic policy toward globalization and trade liberalization.

THE MAJORITY VIEW REGARDING THE IMPACT OF TRADE LIBERALIZATION ON WAGE INEQUALITY

The Facts

There is little question that the difference between the wages of more skilled and less skilled individuals in the United States has become greater since the 1970s and especially the 1980s. Recent evidence shows that between 1979 and 1994 the real earnings of college graduates increased five percent and those of high school graduates declined by 20 percent, causing the college premium to more than double (Gottschalk 1997). The standard interpretation of this is that the demand for skilled labor is rising faster than the supply (despite the fact that college graduates are a rising proportion of the labor force), and that high school workers are increasingly competing for a declining pool of jobs (despite the fact that they constitute a decreasing proportion of the labor force). Similar advantages accrue to more experienced over less experienced workers and to those better insulated from market forces by seniority or union coverage. Moreover, the rise in earnings inequality has also occurred between workers of the same race and between workers of the same gender. Between-group inequality has not increased since the mid-1970s, as reflected by the fact that the earnings of women relative to men have increased, and by the fact that the earnings gap between blacks and non-blacks has remained constant. That increased earnings inequality is within-group reinforces the conclusion that increasing inequality primarily reflects economy-wide developments in markets. Most economists consequently do not disagree either over whether earnings have become more unequal or whether the general cause of this is that the price of skills is being driven up. But debate does exist over what is causing the price of skills to rise.

The majority view is that the main cause of this development is that technological change since the 1980s has been biased against less skilled workers, while simultaneously boosting the productivity and wages of better educated workers (e.g., Lawrence and Slaughter 1993, Berman et al. 1994). At the same time, trade liberalization is generally believed to have made at most a modest contribution to increased wage inequality (e.g., Freeman 1995 and Richardson 1995). The policy implications of this double conclusion are worth stating at the outset in order to see the connection between the analysis and normative orientation of most economists on the issue: since few believe that it is possible to significantly influence the rate and direction of technological change, and since the pace of trade liberalization which can be influenced appears not to be the chief source of increased wage inequality, there appears to be nothing that can be done in the foreseeable future to either reverse or prevent further increases in earnings inequality. At best, ameliorative tax and transfer strategies might be adopted to reduce household income inequality in the short run, and retraining and education may transform the situation in the long run.

The majority view has been developed in two different ways in the standard literature, each emphasizing a different microeconomic mechanism by which trade operates on wages. One, a price approach deriving from the international trade theory literature and the factor proportions/factor price equalization model, focuses on the effects of changes in the prices of imports and exports on the wages of skilled and unskilled workers. The other, a quantity approach deriving from the labor economics literature, focuses on the effects of changes in the quantities or volume of imports and exports on the wages of unskilled and skilled workers. Both approaches

predict that increasing trade should generate increasing wage inequality for the United States and other advanced economies. However, most empirical work done within these theoretical frameworks concludes that either the conditions theory requires do not quite hold, or that the evidence does not support trade having strong effects on wages.

The Price Approach

Advanced countries which have a relative abundance of skilled workers trade with developing countries which have a relative abundance of unskilled workers, and the former export skilled labor-intensive goods while the latter export unskilled labor-intensive goods. In theory this ought to drive up the price of skilled labor-intensive goods in advanced countries, thus increasing labor demand for skilled workers, and drive down the price of unskilled labor-intensive goods (through import-competition), decreasing labor demand for unskilled workers. With fixed labor supplies of both skilled and unskilled workers, wages of skilled labor rise, and the wages of unskilled labor fall. But while theory predicts increasing wage inequality, the evidence on export and import prices does not support it. Specifically, there is little evidence that export prices for skilled-labor-intensive products have increased in advanced countries, while there is some evidence that import prices for unskilled-labor-intensive products have increased rather than fallen (Lawrence and Slaughter 1993). In addition, there are good reasons to suppose that the assumptions the theory requires do not hold. A widely held view is that the factor price equalization model makes "extraordinarily demanding" assumptions, thus casting doubt on whether changes in export and import prices should even be expected to place significant pressure on factor prices (Bhagwati and Dehejia 1994).

The Quantities Approach

The second approach to examining how trade affects wages simply focuses on changes in the volume of trade. Trade in goods is understood to effectively transfer the services of workers engaged in producing tradeable goods from one country to another. The import of unskilled-labor-intensive goods thus effectively increases the supply of unskilled labor in the importing country, while the export of skilled-labor-intensive goods effectively makes skilled labor in the exporting country more scarce. Again, with fixed labor supplies this should tend to increase wage inequality. However, it has been argued that trade is unlikely to have a significant effect in this manner, especially in regard to import-competition and the wages of unskilled labor, because the share of unskilled labor in the tradeable goods sector is too small to have produced the decline in unskilled labor wages across the entire economy that have been observed in the 1980s (Johnson 1997). Moreover, not only is the tradeable goods sector small, but the greater part of U.S. trade is with other advanced countries with similar wage structures, not with developing nations with abundant unskilled labor. Finally, it has also been argued that, since the ratio of unskilled-to-skilled workers has fallen across all sectors of the economy, trade must not be displacing unskilled workers in the tradeable sectors, since this would cause the ratio of unskilled-to-skilled workers to rise in other sectors (Berman et al. 1992). The cross-sectoral fall in the ratio of unskilled-to-skilled workers also suggests that something other than trade (which only impinges on part of the economy) causes increasing wage inequality in the United States.

Thus, whether one focuses on the prices at which goods trade internationally or the quantities of goods internationally traded, trade liberalization appears not to have a significant impact on labor market analogues of wages and labor demanded. But are these market-based, exchange-oriented approaches of sufficient scope for the problem they seek to address? A minority of mainstream economists seem to believe a wider understanding of the economy -- one that includes a role for an internationally mobile capital -- is required, and that this wider framework reveals a more significant impact of globalization on wage inequality.

THE OUTSOURCING-CAPITAL MOBILITY PERSPECTIVE

The two approaches described in the previous section take U.S. endowments of labor and capital as given. But it is increasingly being argued that it makes little sense to view capital as a fixed endowment in light of the evidence of its greater mobility in recent decades (e.g., Wood 1994). Indeed, after decades of 20th century war and depression, international capital flows have only recently re-achieved the historically high levels they were at in the early 1900s (Obstfeld and Taylor 1998). This bears directly on the issue of increasing wage inequality since capital movements and commodity trade can have identical effects on wages. If capital is exported to low wage locations, the effect is largely the same as when unskilled labor faces increased import-competition. Alternatively, if foreign capital is imported and invested in domestic high wage industries, the effect is largely the same as when industries with high proportion of skilled wage labor raise their exports. Thus the world's increasingly liberalized global capital markets are likely playing a role in increasing advanced countries' wage inequality.(n1)

Capital export is also known as outsourcing. Outsourcing involves shifting domestic production activities abroad in response to foreign low cost production opportunities. As part of the postwar break-up of the vertically-integrated, Fordist type of production system,(n2) outsourcing makes trade integration and the disintegration of production dual developments. Thus today intermediate inputs and semi-processed goods may cross borders many times before they emerge as final goods, often being sold under brand names in sophisticated marketing networks in an advanced economy with high levels of consumption expenditure. Evidence that outsourcing has become more important for the United States is suggested by the rising ratio of U.S. merchandise trade (the average of imports and exports) to merchandise value-added since the 1980s (Irwin 1996). A higher ratio of merchandise trade to value-added indicates a greater share of imported inputs in final product value. That in advanced countries final product value tends to be high relative to final product value in developing countries suggests that the higher share of imported inputs reflects inputs having a higher degree of processing. Further evidence that this higher share may reflect an increasing tendency on the part of advanced countries to outsource low wage stages of the production process associated with light assembly and manufacturing, while retaining domestically high wage portions of the production process associated with design and more complex, less standardized forms of manufacture, comes from changing shares of U.S. exports and imports by end-use categories. For the United States, the first half of the century saw higher shares of raw materials and industrial supplies in exports and imports, while since the 1980s manufactured goods, including capital goods, at increasingly advanced stages of processing, have occupied a larger share of total end-use categories (Feenstra 1998). Similar results have been found for other advanced countries, suggesting that outsourcing linked to higher capital flows is a response to domestic high unskilled labor wages on the part of economies with high per capita incomes (Campa and Goldberg 1997 and Hummels et al. 1997).

Thus capital flows may be emerging as an essential part of the overall process of trade liberalization at the century's end in what has been called a "splicing of the value chain" (Krugman 1996) or the emergence of "kaleidoscope comparative advantage" (Bhagwati and Dehejia 1994), and in which different countries specialize in different stages of the production process or value chain according to the relative sophistication of their production processes. Outsourcing and relocation of production facilities abroad in this sense depends centrally upon the liberalization of capital flows, and upon "improvements in communication technology and the speed with which product quality and design can be monitored" through computers and new robotic technologies (Feenstra 1998: 41). Yet this implies that reductions in the demand for low wage jobs that appear to result from labor-saving technological change may actually be the product of interlinked changes in technology and the international economy, and that trade and technology are complementary rather than competing explanations of changes in employment and wages. This should not be surprising, since economists generally agree that there are a variety of trade-technology linkages, such as when import-competition creates pressures for technological

change. Thus it seems shortsighted to say that technological change is independent of trade, or that changes in technology rather than trade liberalization is the cause of increasing wage inequality. Indeed, if the impact of technology change on wage inequality is strongly associated with trade liberalization, then the weight given to changes in technology in explaining wage inequality may in some considerable degree be a weight that can be ascribed to trade liberalization as well.

Yet as important as these points are, they still fail to address directly one of the most important majority view arguments advanced above, namely, that not only is the size of the tradeable goods sector too small to have a significant influence on domestic wages, but that an even smaller proportion of U.S. trade is with countries with different relative endowments of skilled and unskilled labor needed to have an impact on U.S. wages. Focusing only on the demand for unskilled labor, this argument might consequently be amended to say that, with the effects of outsourcing on the wages of unskilled labor added to the effects of import-competition, trade liberalization still cannot cause significant reductions in demand, because imports, whether as final goods or as semi-processed inputs, are a small share of GDP, while such imports from countries with dissimilar wage structures are yet an even smaller share of GDP. Empirically speaking, the 20 percent decline in wages of high school graduates from 1979 to 1994 that explains the greater part of the doubling of the wage gap is simply too large a decline to be explained by demand reductions that might be attributed to globalization. Thus, the principal cause of increased wage inequality, it still seems, must be technological change independent of trade.

To answer this argument, I turn to the analysis of trade liberalization, outsourcing, and wage inequality developed by Rodrik (1997). Rodrik argues that preoccupation with labor demand shifts in the standard trade and wage inequality literature is one of the principal reasons why many economists underestimate the effect of globalization on labor markets. He agrees that demand shifts have not been of the magnitude necessary to explain increased U.S. wage inequality, but argues that the principal effect of trade liberalization on the wages of unskilled workers in particular has not been the reduction in demand for their labor, but in making the demand for their labor more elastic. Moreover, this has primarily occurred in connection with trade between the United States and other advanced countries, not developing countries, in that the greater international mobility of capital has pitted unskilled workers in advanced countries against one another, rather than against their counterparts in developing economies. Three points lend support to this reply. First, it is true that both international financial liberalization in the advanced economies (Williamson and Mahar 1998) and actual capital flows between the advanced economies (Obstfeld 1995) have gone much further than between the advanced economies and the developing economies. Second, it makes sense to suppose that domestic firms might wish to move some operations to countries with comparable wages, rather than to developing countries with lower wages, if the labor productivity differential between these locations is comparable to the wage differential, and if there are important product distribution cost savings to doing so. Distribution cost savings, it should be added, are likely when economies of scale are associated with large, high per capita income consumer markets in advanced economies. Third, it is an implication of trade theory that trade integration increases the elasticity of demand for goods on the part of domestic consumers. Thus taking labor demand as a derived demand, trade integration should increase its demand elasticity as well.

Rodrik explains how outsourcing and capital mobility between advanced countries depresses the wages of unskilled workers in three ways:

1. through shifting a greater share of non-wage costs from employers to workers;
2. through the effects of greater instability of labor market outcomes on the average earnings of workers;
and
3. through the effect on workers' bargaining power vis-à-vis employers.

Each of these three effects may reasonably be supposed to operate more strongly in the case of unskilled workers exposed to import-competition and outsourcing. Skilled workers, whose labor is increasingly in demand, tend to be less substitutable for one another, even across advanced countries, and therefore have a more inelastic demand for their labor. Thus outsourcing mainly makes the demand for unskilled labor more elastic.

Non-Wage Labor Costs

The argument that employers are able to shift a greater share of non-wage costs to workers when labor demand is elastic is a variant on standard supply-and-demand tax-incidence analysis. Non-wage costs concern working conditions such as workplace safety. As workplace technologies change, workplace safety standards must continually be renegotiated. From the point of view of employers, the costs of workplace safety acts like a tax on employment that shifts the effective labor supply curve upward so as to include safety costs and wage costs in total labor costs. What then determines the incidence or distribution of burden-sharing of this additional cost between employers and workers is the elasticity of demand for labor. With a more elastic demand for labor, the worker's wage falls more than the wage the employer must pay increases. In addition, the equilibrium quantity of labor falls more, the more elastic the demand. Of course it might be the case that faced with the threat of job loss due to capital flight to countries with lower labor standards, domestic labor simply might acquiesce to lower standards. But were wages adjusted for working conditions, a decline in working conditions would then produce lower effective wages. Thus whether in nominal or effective terms, a more elastic demand due to outsourcing opportunities lowers the wages of unskilled labor.

Instability of Labor Market Outcomes

A more elastic labor demand produces greater instability in labor-market outcomes in the presence of labor demand "shocks." Trade liberalization tends to be associated with greater fluctuation in product prices on the grounds that competitive advantage in international markets is subject to a variety of factors, and is consequently often transitory. However, with an elastic or flat labor demand, for any labor supply, both wages and hours worked fluctuate more dramatically than when labor demand is inelastic (see Rodrik 1997: 22, Fig. 2.2). Empirically, volatility in labor-market outcomes has been shown to be associated with increased earnings inequality in the United States. Gottshalk and Moffitt (1994) show that between one-third and one-half of the increased wage inequality in the 1970s through the 1980s can be attributed to year-to-year average workers' earnings variation. In addition, it has also been shown that short-term volatility increases as worker skill levels decrease. Thus one would expect unskilled workers to be the most affected by product price fluctuation with increasing world trade.

Bargaining Power

Clearly a greater substitutability of labor also reduces labor's bargaining power vis-à-vis employers. Rodrik's discussion focuses on how this may affect less than perfectly competitive labor markets in which there is evidence of labor rents, argued to be significant by other researchers (Blanchflower et al. 1996). Essentially, a weakened bargaining power on the part of labor tends to result in a lower share of rents going to labor. But it may also be argued that changes in bargaining relationships between employers and labor in high wage sectors have changed wage-setting practices and institutions throughout the economy. Employers, emboldened by successes in renegotiating wages with unionized workers since the early 1980s have abandoned the idea that wage norms operate anywhere in the economy. From this perspective, a change in the bargaining climate in leading labor market sectors made possible by the experience of import-competition and the threat of outsourcing gets transferred throughout economy irrespective of whether other sectors are directly exposed to the effects of trade liberalization. Again, the effects of this change are likely to be strongest for workers whose skills are least in demand.

Thus, a more elastic labor demand due to increased outsourcing, added to decreases in labor demand produced by import-competition, together make a strong case for supposing that trade liberalization and globalization are an important cause of increased wage inequality in the United States. But perhaps surprisingly, this conclusion does not alter the principal policy recommendation of mainstream economics. Even with trade liberalization understood to be an important cause of increasing wage inequality, mainstream economists generally still argue that our public policy options remain the same. Specifically, most would argue that trade is efficient in always representing an improvement on a situation with less trade, implying that the benefits from increased trade always exceed the losses from trade. Thus, slowing the pace of trade liberalization, even when trade increases wage inequality, only delays future net gains. How are social economists to respond to this argument? In the following section, I show that this standard efficiency policy recommendation is more problematic than it appears, and that the ways in which it is problematic points us toward a deeper analysis of the effects of globalization on wage inequality. We begin by scrutinizing the idea that benefits from increased trade must always exceed the losses.

INTERACTION OF THEORY AND POLICY

The reason that trade is said to be efficient and that the gains from trade must exceed its losses is that trade expands an economy's more productive sectors, and contracts its less productive sectors. Strictly speaking, however, there are no losses in this conception, since the basic idea of resources being used more productively in one area than in another entirely abstracts from the question of actually transferring those resources from one sector to another. That is, the standard efficiency argument is completely static in the sense of comparing the consequences of having resources in two different locations. Consequently, when we apply this idea to the real world, in which having resources removed from one location to another is costly, it becomes clear that the standard gains from trade proposition, when taken as a necessary proposition, effectively requires that we treat resource transfer as costless. Otherwise it would be entirely possible for costs of resource transfer to sometimes exceed the gains from greater specialization, and not always the case that gains exceeded the costs. Thus it is disingenuous for economists to say that because there are gains from trade, it is possible for the gainers to compensate the losers (for example, through provision of relocation and retraining expenditures). If the issue of compensation even arises, then we have left the "world" of costless resource transfer, and it must first be shown, empirically, that there are indeed net gains available for redistribution. There is, of course, a standard reply to this criticism. If markets are competitive, then reallocations of resources will not occur unless resources are properly defined to receive "full" compensation when reallocated (say, by including an adjustment cost insurance). But buttressing efficiency in this manner is tantamount to assuming the conclusion that trade is always efficient. Moreover, it is always an empirical question whether markets are "competitive" (and often they are not).⁽ⁿ³⁾

Thus trade liberalization -- by mainstream economics' own measure -- may not always be efficient if the costs it produces in terms of the social and human dislocation outweigh the net gains in income that improved specialization makes possible. But is it even possible to determine all the costs of trade liberalization so as to guide policy by such a criterion? While net gains in income are relatively easy to determine by comparing declining and expanding sector incomes, establishing the full costs of any extension of trade that increases earnings inequality encounters an important obstacle. Adjustment costs, understood as relocation and retraining costs, can certainly be identified, and are relatively straightforward to measure, and many mainstream economists would also likely include human capital depreciation as a cost, if labor displacement is shown to permanently lower workers' lifetime income. But few mainstream economists would allow that increased earnings inequality itself constitutes a cost of trade liberalization, despite the fact that many people would be willing to say that increasing earnings inequality is harmful to society, and therefore costly. And surely increased earnings inequality does have a cost for society. But how would one go about determining this cost?

Most mainstream economists would no doubt deny that such a cost is even measurable. An important part of their argument, I think, is that increased earnings inequality is thought costly because it is perceived as inequitable. But there are so many competing views of equity, it would be argued, that equity cannot be expected to function as a principle of economic policy (however often it enters into policy discussions), and thus we cannot begin to talk about equity costs of increasing earnings inequality.

This implies, however, that either we cannot really talk about comparing the costs and gains from trade liberalization, or if we do, we must ignore what may be a potentially significant cost. No wonder that even those in the minority in the mainstream who believe trade has important effects on wage inequality still generally believe that trade is efficient. I think, however, that an equity cost of globalization can be meaningfully investigated, not perhaps one immediately associated with increased wage inequality, but one closely related to it in the form of the equity consequences of trade and globalization for how fairly labor market institutions function. Setting out to show this, however, involves a distinctively social economics type of investigation. As stated at the outset, social economics rejects the proposition that analysis and policy are independent. This disjunction seems to be clearly at issue when we talk of estimating an equity cost of free trade, since then our judgments regarding equity become part of our description. Mainstream economics, because it insists on the positivist disjunction of facts and values, analysis and policy, does not pursue this type of investigation. The result, I argue, is that it fails to explain the full consequences of globalization and trade liberalization, and its policy recommendations are biased in favor of free trade.

I want to try to be clear as possible about the social economic methodology described above before implementing it in connection with the effects of globalization. There are two ways in which values underlie the analysis at hand. On the one hand, there are the values of the analyst that define what matters are relevant when examining the effects of trade liberalization on wage inequality. Mine are basically that a market-based, exchange-oriented analysis is incomplete, and that social institutions with their more complex social relationships must also be studied in any complete economic investigation. On the other hand, there are the values of the society and economy being analyzed. Given my investigator-entry-point values and the issue here of the costs of globalization, I take these social values to be equity conceptions that may be seen as being embedded in institutions governing U.S. labor markets and existing U.S. income distribution. Thus in the following section I explain equity cost as being associated with a weakening of those institutions meant to guarantee "fair" labor market outcomes.

THE SOCIAL-INSTITUTIONAL EFFECTS OF GLOBALIZATION

How does one go about determining what equity conceptions are "embedded" in U.S. social and economic relationships? There are a number of economic conceptions of equity (or fairness) in the philosophy of economics literature: equality of utilities or welfare (Sen 1973), envy-free allocations (Baumol 1986), the maximin principle (Rawls 1971), and others. However, rather than "look for" any of these conceptions in U.S. labor markets and income distribution, and run the risk of interpreting the latter to fit a particular theoretical conception, I adopt a more modest strategy regarding the content of equity, by modifying the equity conception of LeGrand (1991). LeGrand's view is that undesired "distributions that are the outcome of factors beyond individual control are generally considered inequitable" (p. 87). Essentially, he argues, if individuals have no choice in determining a situation, and then receive less than others, this is generally regarded as inequitable. Alternatively, situations which individuals have somehow chosen, even if they lead to distributions inferior to those others receive, are equitable. My modification of this conception is to say that many social institutions, especially those associated with the regulation of U.S. labor markets are in important degree the result of a series of historical social choices, and these social choices -- when the product of a broadly democratic process -- embed a sense of equity in the outcomes these institutions produce. Thus following LeGrand, if such labor

market institutions are dismantled or the social choices that produced them are somehow compromised, subsequent labor market outcomes, when inferior to previous ones, are inequitable. They are developments which are the product of factors beyond social control, and which individuals had no social choice in determining.

An example will help illustrate this idea of social choice. Current U.S. minimum wage laws are a type of institution that resulted from an historical political process that involved a social choice on the part of people in the United States. On the understanding here, that choice determines "equitable" wages for unskilled workers in U.S. labor markets, not so much in the sense that minimum wages are fair according to any of the philosophical conceptions above, or in the sense that U.S. minimum wage law is morally praiseworthy, but only because not paying minimum wages when society has chosen that they be paid is inequitable. On this version of LeGrand's view, when minimum wage laws are violated, society has no choice in determining a situation in which individuals receive less than society chose they should receive. Other examples that specifically pertain to the regulation of U.S. labor markets include laws pertaining to collective bargaining, workplace safety, unions, civil rights, discrimination, unemployment insurance, and so on. Such laws and institutions obviously inspire widely different interpretations of what equity means, and indeed just how equitable the outcomes are that these institutions produce is and will remain controversial. However, this only points to the flexibility of the conception of equity used here: however much people disagree on what equity is in a substantive sense or how much it is in evidence, they can still agree when institutions meant to produce "equitable" outcomes are prevented from doing so. Thus the modified LeGrand conception is a formal one in the sense of being susceptible to a range of historical applications. It is also, at least in the case of democratically arrived at social institutions, a conception defensive of the status quo.

What, then, are the equity costs of globalization? On the argument above, they are to be understood as the consequences of dismantling or otherwise compromising social institutions governing U.S. labor markets that help determine income distribution in the United States. Consider again U.S. minimum wage law. It has the purpose of placing a floor under the wages of unskilled labor, so that unskilled workers do not compete against one another by offering to work for lower and lower wages. Again, though the law has opponents, including both those who would like to see the law repealed and those who would like to see stronger wage protection for unskilled labor, nonetheless, as a labor market institution the law establishes the terms of "fair" competition among unskilled workers. Departures and violations of the law that permit workers to work for less than minimum wages, depriving other workers of employment, are thus inequitable. Yet this is basically just what is accomplished by outsourcing. When capital flows to locations outside of the United States, it escapes the legal space in which the law applies. It consequently weakens the scope of the law, and imposes an institutional equity cost on society. This is different than the cost outsourcing imposes directly on U.S. workers themselves, which is well explained in terms of changed labor market outcomes in the minority mainstream literature. Here the cost is not in terms of outcomes, but rather in terms of process and procedural fairness. Institutions meant to establish "fair" competition in markets embed equity in those markets by determining "rules of fair play." When these institutions are eroded, "fair play" is undermined, and anarchic competition with its potentially destructive effects on individuals plays a larger role in labor market functioning.

Marginalizing U.S. minimum wage law, however, is one of only many costly institutional effects of globalization and trade liberalization, since in general outsourcing and import competition expose much of U.S. labor market institutions to institutional competition with other national economies. In Europe, Maastricht has brought this lesson home in concern over "social dumping," in which capital moves to areas of weaker social regulation (Sapir 1996). Indeed, the Europeans have sought since the 1958 Treaty of Rome to prevent erosion of labor market and other social institutions that affect income distribution and general well-being through policies aimed at "social harmonization" or a leveling-up rather than down of social standards. Recently, for example, the

European Commission took the position that "competition within the Community on the basis of unacceptably low social standards, rather than the productivity of enterprises, will undermine the economic objectives of the Union" (Commission of the European Communities 1993: 59-60). Thus there is little reason to doubt that there are potentially significant institutional costs associated with globalization and trade liberalization. Moreover, there is little reason to doubt that these institutional costs have adverse effects on the lives of individuals.

I do not attempt to estimate the magnitude of the effects of institutional erosion on individuals caused by globalization and trade liberalization. But I do attempt to further characterize them in terms of the life prospects of individuals affected. The basic idea recalls Rodrik's argument (1997) that outsourcing creates a greater elasticity of demand for unskilled labor directly affecting wages and hours of unskilled workers. A more elastic demand for unskilled labor is one that makes that labor more easily substituted for. Similarly, labor markets less regulated by social institutions embedding rules of "fair" competition are labor markets in which workers' vulnerability to the adverse effects of free competition is greater. A social commitment to equity in the form of institutional protections tends to secure a regularity and stability in wages and hours for workers that is often absent when rules for "fair" competition do not apply. Just as importantly, however, it also secures a sense of security and confidence on the part of individuals that allows them to make long run plans with respect to household objectives, human capital acquisition, community development, and personal goals. Inability to plan for these things on the part of unskilled workers who are most affected by a weakening of rules for "fair" competition reinforces the deterioration in labor market outcomes for them caused directly by trade. Whereas, skilled workers tend to prosper in secure employment, guaranteed by unchallenged rules for "fair" competition, and accordingly strengthen their households, acquire human capital, form stronger communities, and achieve personal goals, more vulnerable unskilled workers are less successful in each of these respects, so that their human and social development is blunted by comparison.

Obviously these sorts of effects on individuals operate more in the long run than the short run. Thus on account of the multitude of factors operating on individuals and markets in the long run, differences between the life prospects of skilled and unskilled workers due to globalization may not be easy to demonstrate. To this one should add the difficulty involved in creating quantifiable measures of insecurity and vulnerability, whatever the cause. These, however, are practical problems, rather than the more intractable sorts of problems often associated with controversy over equity as a normative tool less serviceable than efficiency. Indeed an important rationale for modifying LeGrand's conception of equity is that its formal character allows us to see equity-damaging institutional change in cost terms, and thus to still operate within a (modified) gains and losses framework. With this in mind, I return in the concluding section to the question of policy toward trade and globalization, but now from a social economics perspective.

A SECOND LOOK AT POLICY, FROM A SOCIAL ECONOMICS PERSPECTIVE

The reason for looking at institutional equity costs as a way of approximating equity costs of increased wage inequality was to attempt arriving at a fuller view of the gains and losses from trade and globalization for policy recommendation purposes. Many mainstream economists might entertain the idea that such costs exist, but would still likely suppose that free trade is efficient. This reflects, I have argued, an unwillingness to count costs that depend upon value judgments, here namely, investigator values, such as that economic analysis needs to go beyond the market to institutions, and social values, such as may be said to be embedded in social institutions. Needless to say, the mainstream position is value-laden in its own way, the result of which appears to be a bias in favor of free trade. But might the upshot of the argument in the last two sections be that a social economic analysis is biased against free trade? Were this true it might be replied that social economic analysis and policy is no stronger than mainstream analysis and policy, only different according to its distinctive value commitments. I

believe, however, that a social economics of the international economy need not be biased against trade, and that in fact its method offers more solid ground for policy recommendation regarding globalization.

First, it does not necessarily follow that erosion of institutions embedding equity always requires halting the process producing this result. Equity does not always trump efficiency either in theory or in the real world any more than efficiency does equity, and most people, including social economists, would be willing to trade equity and efficiency off against one another if a reasonable method for doing were available. Second, the social economic treatment of institutions advanced here, which uses value assumptions to explain institutions, offers a means of thinking constructively about trade-offs between efficiency and equity that makes the weight given to efficiency or equity a matter of our understanding of the case at hand. Specifically, when we are able to assess the severity of the equity costs associated with institutional disruption, we are able to assess whether trade is efficient in terms of the gains and full costs it involves. This is not to say that there exists a neat formula which can be used to make such a determination, or that equity costs are straightforwardly assessed. It is rather to say that individuals whose history has produced the social choices creating particular institutions have a sense of their relative importance, and how serious any given challenge to them may be. Thus few would say that the current extent of low wage outsourcing has a serious enough institutional equity cost for U.S. minimum wage law to make the resulting costs from outsourcing and trade exceed the gains. But many did argue in connection with the side agreements on labor and the environment that were part of the North American Free Trade Agreement that 'fair play' either required harmonizing U.S. and Mexican labor and environmental standards, or free trade should not be allowed. In their view, the gains were not expected to exceed the full costs associated with the Agreement, where these costs included not only adverse labor market and environmental outcomes, but also erosion of social institutions created to establish 'fair play' on these terms.

Policy-making regarding the international economy, then, relies on concrete understanding of the historical circumstances surrounding economic and institutional development. This is the wider context in which the relationship between increasing wage inequality and internationalization of the economy must be examined. And it is a framework in which social economists, with their own history of concern over income distribution, have something to offer in debates which will likely continue to hold center stage.

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- (n1) Labor mobility in the form of immigration could also have an impact on the wages of low skilled labor. However, most research has shown little effect of immigration on U.S. wages (e.g., LaLonde and Topel 1989). Some also believe that, contrary to the predictions of standard theory, capital mobility also increases wage inequality in developing countries. I ignore this issue in this paper.
- (n2) See the Symposium, "Post-Fordism and the Nature of Work" (Review of Social Economy, June 1999).
- (n3) See Prasch (1996) for a fuller evaluation of the principle of comparative advantage.

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