Lecture 3

Global Cheap Labor Economy

- SAP's generate several economic results
    - Wide regulation of wages and labor
    - Significant decline in real and nominal wages
    - Emergence of global cheap labor economy
- Ongoing movement of labor to cheap labor zones in developing countries
    - Early 60's, especially in labor intensive manufacturing industries
- Relocation of industry first directed toward several export zones; Taiwan, Hong Kong, Singapore, South Korea. Growth from 70's to 90's.
- World economy no longer based on traditional division of labor
    - Developed countries high tech industries, services
    - Developing countries primary manufacturing
        - Major producer of many final products
        - Problem is it **did not help** the national economic interest of the country, but served the interests of the developed or OECD countries.
    - This change led to complete elimination of the contribution of manufacturing sector as main force behind the socio-economic development of the third world countries

Several consequences

- Development of worldwide cheap labor export
- Low costs of production
- Reduction in producers' earnings
- Major decline in producer surplus
- Poverty itself becomes an input in the cheap labor economy

- Higher retail and wholesale prices and profit
- Demise of import substitution policies, decline in production for internal market

Why?

- IMF, World Bank, WTO
    - Encourage exports
    - Promote philosophy that exporting is the only way of achieving economic success
    - Base their argument on theory of comparative advantage
        - Country should specialize according to their comparative advantage
        - Labor in abundance at very low cost in these countries; these nations should specialize in production in labor-intensive industry for export purposes
- Large group of countries producing same product; creates competition. Different export zones competing to export to the same buyer (OECD)
    - This competition along with limited demand lowers wage rate, oversupply of goods, forced to cut prices. -> export revenue decline, purchasing power declines, aggregate demand decreases
    - Further pressure on them to maintain competitive position; introduce further cuts in wages; they want to reduce costs of production = further cuts in export prices.
    - Large impact on their development; large dependence on revenue from exports
    - Creates inverse effect on world economy

        - Over production, over supply, reduction in export prices, revenue affects global income
        - Reduces world aggregate demand for goods and services

Two factors effecting real earnings

- Cuts in wages and labor costs
- Decline in consumption

SAP's encourage relocation of manufacturing industry from developed countries to cheap labor zones in developing countries.

- Does not promote prosperity
- Generates negative effect
- Slows growth of international economies
- Massive unemployment in both developed and developing countries
- Reduction in real earnings

Did not create viable economic sector
Did not stimulate social development
Did not stabilize their industry sector relationship with the rest of the world
.:. Does not guarantee development of developing country

Results of Cheap Labor Economy

- Increase in global unemployment
- Led to reduction in wages -> reduces prices
- Income declines -> aggregate demand declines

- Production capacity declines in both developed and developing countries
    - Demand for output goes down, demand for input goes down
- Continuous decline in real and nominal wages
- In developing countries, share of wages of the GDP declines
    - Today the world average is 13% in the developing world
    - In the developed countries it is 40%
- Plant closures in north America, Europe
    - Moved to cheap labor zones in developing world
    - Further unemployment
    - Cost of maintaining social program increases

Cheap labor exporting zones theoretically help the national economies; promote the world economy. But it has had an inverse effect. Instead, it negatively affects the world economy; they were based on reducing the wage rate -> that having a direct effect on consumption, aggregate demand, and income.