Technology, not globalisation, drives wages down

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We have recently witnessed a flurry of comment in the US on the long-running stagnation of wages. Many believe that the future livelihood of the "middle class" is also at risk.

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Lou Dobbs of CNN, the labour groups' think-tank Economic Policy Institute and nearly all the Democrats newly elected to Congress believe that globalisation has much to do with the economic distress of the working and middle classes. Therefore they have coherence on their side when they want to lean on the door – even to close it – on trade with poor countries and occasionally on unskilled immigration from them.

Proponents of globalisation, however, find themselves in a politically implausible position: they typically skirt around and hence accept this "distributional" critique of globalisation – yet nonetheless propose that those adversely affected should accept globalisation but be aided so as to cope with their affliction in other ways.

As it happens, globalisation's supporters are on firmer ground than they fear. Examine the common arguments linking globalisation to the distributional distress and little survives.

First, all empirical studies, including those done by some of today's top trade economists (such as Paul Krugman of Princeton and Robert Feenstra of the University of California, Davis), show that the adverse effect of trade on wages is not substantial. My own empirical investigation concludes that the effect of trade with poor countries may even have been to moderate the downward pressure on wages that rapid unskilled labour-saving technical change would have caused.

Second, the same goes for the econometric studies by the best labour economists regarding the effects of the influx of unskilled illegal immigrants into the US. The latest study by George Borjas and Larry Katz of Harvard also shows a virtually negligible impact on workers' wages, once necessary adjustments are made.

Can it be that globalisation has reduced the bargaining ability of workers and thus put a downward pressure on wages? I strongly doubt this. First, the argument is not relevant when employers and workers are in a competitive market and workers must be paid the going wage.

As it happens, fewer than 10 per cent of workers in the private sector in the US are now unionised.

Second, if it is claimed that acceleration in globalisation has decimated union membership, that is dubious. The decline in unionisation has been going on for longer than the past two decades of globalisation, shows no dramatic acceleration in the past two decades and is to be attributed to the union-unfriendly provisions of the half-century-old Taft-Hartley provisions that crippled the ability to strike.

Has the outflow of direct foreign investment reduced the amount of capital that might have helped to employ unskilled labour at home and hence contributed to a decline in wages? As I look at the data, the US has received about as much equity investment as it has lost over the past two decades. One cannot just look at one side of the ledger.

The culprit is not globalisation but labour-saving technical change that puts pressure on the wages of the unskilled. Technical change prompts continual economies in the use of unskilled labour. Much empirical argumentation and evidence exists on this. But a telling example comes from Charlie Chaplin's film, Modern Times. Recall how he goes berserk on the assembly line, the mechanical motion of turning the spanner finally getting to him. There are assembly lines today, but they are without workers; they are managed by computers in a glass cage above, with highly skilled engineers in charge.

Such technical change is quickly spreading through the system. This naturally creates, in the short-run, pressure on the jobs and wages of the workers being displaced.

But we know from past experience that we usually get a J-curve where, as increased productivity takes hold, it will (except in cases where macroeconomic difficulties occur and are not addressed by macroeconomic remedies) lead to higher wages.

So why has there been no such significant effect in the statistics on wages for almost two decades?

I suspect that the answer lies in the intensity of displacement of unskilled labour by information technology-based change and in the fact that this process is continuous now – unlike discrete changes caused by past inventions such as the steam engine. Before the workers get on to the rising part of the J-curve, they run into yet more such technical change, so that the working class gets to go from one declining segment of the J-curve to another.

The pressure on wages becomes relentless, lasting over longer periods than in earlier experience with unskilled labour-saving technical change. But this technical change, which proceeds like a tsunami, has nothing to do with globalisation.

The writer is university professor at Columbia University and senior fellow at the Council on Foreign Relations. The author of In Defense of Globalization, to be reissued with an afterword, he is finishing a new book entitled Terrified by Trade