

FRIDAY 27 APRIL 2007

# Guns, germs and globalisation

Globalisation is almost certain to prevail, but there will be short-term bumps along the way such as protectionist pressures and burdens of adjustment both in rich and poor countries, says **Duvvuri Subbarao**

**I**N HIS best-selling book, *Guns, Germs and Steel*, Jared Diamond, an environmental biologist, had argued that advanced civilisations originated and developed in Eurasia rather than in Africa, America or the Pacific because the former had the advantage of highly fertile lands and animals that could be domesticated. Having developed their agriculture by 1500, Europeans used their guns, steel and germs to dominate the rest of the world by military conquest and spread of disease. According to Diamond, it is not biology or race that explains the course of world history. Rather it is 'geography' which has been the sole determinant of the rise and fall of civilisations.

This 'geography is destiny' theory which ruled for much of our recorded history is now seriously challenged by the latest sweep of IT-enabled globalisation. Received wisdom today is that geography is irrelevant. No longer is a country's destiny tied down to its geographical location or its physical resources. In the era of knowledge-propelled globalisation, it is possible for countries to overcome these handicaps by exploiting their comparative advantage in human resources.

That blue-collar jobs shift across geographic boundaries in pursuit of cheap hands has long been part of conventional wisdom. But what is new is that increasingly white-collar jobs, once considered safe from foreign competition, are now being offshored. Advances in telecom technology and decline in costs have made it possible for workers from any part of the planet to provide services seamlessly to clients in rich countries. Hence the new catch phrases such as 'death of distance' and 'conquest of location'.

At one level, this trend defies the conventional theory of economics. Ricardo's celebrated theory of comparative advantage did recognise that production would be distributed around the world in accordance with comparative advantage. Accordingly, rich countries with abundance of capital will specialise in skill and capital-intensive goods while poor countries with abundance of labour will specialise in low



ZAHID ALI

skill, low-end goods. This theory that held sway for nearly 200 years has now begun to unravel. No longer is it the case that poor countries are locked into low-level manufacture; they are moving up the value chain rapidly to produce high end products such as computers, cameras and automobiles.

Does this mean that the theory of comparative advantage stands invalidated? The limitation of this theory is its assumptions. One such assumption is that capital and labour cannot move from country to country without significant costs. That is no longer true. Technological advances and financial deepening have made movement of capital and transfer of technology much simpler, and even seamless. Immigration of labour has been more restrictive but that has not been a problem because of the ease of outsourcing made possible by technology.

Possibly, it is more technology than globalisation that has turned the theory of comparative advantage on its head. No longer is it just low-end services such as data processing and call centres that are outsourced, but high end, skill-intensive services. Thus it is that financial analysts in Chennai provide tax consultancy to clients in Chicago; engi-

neers in Hanoi design roads and bridges for Hanover; and radiologists in Manila provide medical diagnostics for patients in Manchester. On the other hand, low-end services such as laundry, janitor services and taxi driving that remain location tied.

**W**HAT is the practical implication of this? The practical implication, especially for countries such as India, is that this could trigger a fresh wave of protectionism. Workers in rich countries are already quite resentful of jobs, particularly in high-end services, being outsourced. What hits them most of all is the erosion of their bargaining power. The number of jobs actually outsourced may be relatively small. The mere possibility of jobs being outsourced to low-cost centres is sufficient to force workers to keep their wage demands subdued. In the US, for example, over the last five years, the share of corporate profits in national income has increased from 7% to 13%. Conversely, the share of workers' wages has declined by a like proportion.

The reason why in rich countries, the gains of globalisation have accrued more to corporate profits than to labour wages has

a clear explanation and has to do with the globalisation of labour. As the IMF's latest *World Economic Outlook* (April 2007) says, as a result of the entry of China, India and the countries of the former Soviet Union into the global trading system over the last two decades, global labour force has expanded nearly four-fold. This new labour came in without bringing much capital with it thus sharply reducing the capital-labour ratio at the aggregate global level. Theory says that that should reduce the returns to the more abundant resource, labour, and raise the returns to the more scarce resource, capital. That is exactly what happened.

It is not as if workers have not gained from globalisation. Their wages have gone up, but they have gone up much less relative to corporate profits. What worries workers in rich countries is the combined impact of three simultaneous developments. The first is the globalisation of labour which has kept wages subdued. The second is the declining costs of IT and telecom which have made outsourcing of services very cost effective. The third is the rapidity with which emerging economies are moving up the value chain in terms of skills.

The IMF says that the US growth will slow down marginally in 2007 but that the chances of a full-blown recession are small. Even the threat of a recession can trigger protectionist pressures. These pressures will gain momentum as the US presidential campaign unfolds over the next year and a half. If the US succumbs to protectionist pressures, it will spread quickly and easily to Europe.

All through history, the process of globalisation has been relentless but non-linear. There were reverses in the past such as during the inter-war years but globalisation made a robust return each time. So will it be this time. Globalisation is almost certain to prevail, but there will be short-term bumps along the way such as protectionist pressures and burdens of adjustment both in rich and poor countries. Guns, germs and steel will eventually yield to globalisation, but not without hiccups.

(The author is a civil servant.  
Views are personal.)