

Simon Johnson: One Page Summary

15.223, class #2: Freer Markets, More Rules?

“Catching up” to rich countries’ productivity (output per capita) and income levels is hard to do. Most economies that have attempted to do so using a “closed economy” model, with little trade, have failed to sustain progress. Focusing on exports offers an alternative path to development – as seen in almost all the economies with rapid growth starting from a low base in 1960.

There is a ladder of productivity and value added that can be climbed. At the bottom of the ladder is low productivity and low wage activities – everyone produces food and simple clothing. For many countries, textiles and apparel offer the first rung on the international trade ladder.

As income levels and real wages rise, some low productivity activities will no longer be profitable – and the country will lose its competitive advantage in those products. There is pressure to “move up” to more complicated products, including electronics. This might start with simple assembly work but over time a workforce can acquire the skills needed for more complicated tasks. Over time, economies move more into capital goods, product design, and services.

As seen in the case of Hong Kong, the abilities and resources of entrepreneurs are a critical piece of economic development, allowing firms to manage activities across countries. In particular, the ability of local entrepreneurs to integrate into global supply chains has proved critical in the past 40 years.

Among other things, this provides an opportunity to young or rapidly expanding firms, for example that are close to the customer in the United States. They can outsource production and mix-and-match across suppliers around the world in a way that wasn’t possible 50 years ago.

The GATT, which later became the WTO, set in place rules for trade – and made it harder to take unilateral action restricting imports. The Multifibre Arrangement was a “temporary” program of quotas that was intended to protect jobs in the US and other rich countries. Among other things, it created the incentive for developing countries to upgrade. At the end of the Uruguay Round in 1995, MFA was scrapped – restrictions were phased out; some tariffs remain. Rich countries negotiated this in return for intellectual protection for entertainment, media, and pharmaceutical industries.

Has the system succeeded or failed – for whom within countries? Why haven’t we seen more protectionism (higher tariffs, quotas or other trade barriers) since the financial crisis of 2008? As China becomes richer, who will “get those jobs”?

Part of the post-war international system is the agreement not to take unilateral action against trading partners. Should exchange rate undervaluation be included in the same WTO framework, rather than being under the jurisdiction of the IMF? Why do emerging markets like to have current account surpluses and accumulate foreign reserves?

What kind of jobs are created and destroyed by modern trade? What happened to middle skill jobs in the United States? Probably this is mostly about technological change (information technology) but globalization/trade expansion pushes in the same direction.

On top of this, who is likely to pay for our collective mistakes leading up to the financial crises of 2008-11? What is the likely distributional outcome in (a) Iceland, (b) the United States?

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