The Case for an International Minimum Wage in the Context of Free Trade

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January 2005

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Submitted in fulfilment of requirements for the degree of Master of Commerce (Honours) in Economics

School of Economics and Finance
University of Western Sydney

January 2005

Declaration of Originality

This work has been produced for the fulfilment of the degree of Master of Commerce (Honours) in Economics at the University of Western Sydney. No part of this thesis has been presented for any degree before and it, to the best of my knowledge, contains no copy or paraphrase of work published by another person except where due acknowledgment is made in the text.

Acknowledgments

I am grateful to my supervisor Associate Professor Brian Pinkstone, who provided me with valuable advice and guided me the whole way through this research project. It was with his encouraging assistance that I was able to complete this work.

I am also grateful to my co-supervisor Dr Bill Lucarelli for his encouraging and excellent comments, which were essential to the development of this research.

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Introduction

Minimum wages and work standards have been regulated in almost all countries around the world, however the level of these standards and the strength of implementation differ considerably. Minimum wages are usually higher in industrial countries but in many third world countries are either set at levels close to or below subsistence, or are not enforced at all. The increased ability of some third world countries to produce and export manufacturing goods, combined with the liberalisation of international markets, has seen the gap between wages in the two groups of countries become more significant over time. The acceleration of the globalisation process over the last two decades, however, has led to the question of minimum wages gaining recognition as a significant international issue. This study will discuss the issue of an international minimum wage as a means for promoting international economic growth and reduction of global poverty.

Under neo-liberal globalisation prices are becoming internationalised and borders for companies, capital and goods minimised, but restrictions on the movement of labour not only remain in force, they are being enforced with greater vigour. Labour is restricted by national borders and wages, for the same jobs, differ up to seventy-fold among different countries (Chossudovsky 1997: 41). It is important to highlight that there was almost free movement of labour around the world before 1914 and wages differed by a factor of only five (Emmanuel 1972: 46). Despite increased productivity in third world countries, poverty is increasing; “UNDP reports that 80 countries have per capita incomes lower than a decade ago. Sixty countries have grown steadily poorer since 1980” (Gates 2001). At the same time, many workers in industrial countries are losing their income and welfare. In the US minimum wages in real terms have remained almost the same in the last 20 years and “the work-year for the typical American has expanded 184 hours since 1970” (Gates 2001).

With a race to the bottom in terms of wages and a lack of labour standards in international trade agreements, many people are increasingly working for subsistence wages. The number of people living in poverty (under US$2 a day based on the Purchasing Power Parity 1993 dollar) has risen from 2.4 billion in 1981 to 2.7 billion in 2001 with 1.1 billion people living in absolute poverty (earning less than US$1 a day) (Ravallion 2004 and McKay and Baulch 2004). In a world with millions in poverty and many industries facing overcapacity as global production grows, economic recession and socio-economic crises become increasingly likely.

Due to deteriorating terms of trade, third world countries gain much less for their labour on the world markets and are often unable to produce products to satisfy their own needs. For example, some third world countries have become producers of computers, but instead of this increasing their income it has reduced the price of computers in international markets. On the other hand, as a result of increasing productivity, the quantity of employed labour decreases but the gains go to corporations: "The world's 200 largest corporations account for 28 percent of global economic activity while employing less than one quarter of one percent of the global workforce" (Gates 2000). This is important when we take into account that the headquarters of these large corporations are usually located in industrial countries and therefore their profit goes directly to investors in these countries.

The history of ideas about internationalisation of labour solidarity and labour rights goes back to the Marxist literature of the nineteenth century. However, in recent times especially, after the resurgence of neo-liberalism in the 1990s and standardisation of the financial and goods markets under the World Trade Organisation (WTO), the issue of an international minimum wage has become more important. Supporters of minimum wages include governments in industrial countries, non-governmental organisations (NGOs), trade unions in industrial countries as well as international trade unions (AFL-CIO 2004), human rights groups and intellectuals. Some trade unions in industrial countries support international work standards in response to the threat of corporations to move factories to low wage countries, which has placed downward pressure on wages in the industrial countries (Anderson 2001: 5). Supporters of an international minimum wage in the third world countries are mainly trade unions, non-governmental organisations and intellectuals (Singh and Zammit 2004: 1–2).

Some politicians argue that an international minimum wage discriminates against the employment of less-preferred workers (like black workers who are willing or have to work for lower wages) because the white trade unions supported a minimum wage under apartheid in South Africa (Williams 2003). In addition, many governments in third world countries oppose international minimum wages because of theoretical (ideological) issues created and developed by neo-liberal economists as well as the fear of the double standards that industrial countries usually use against them:

> The United States and France have agreed to place demands for international standards on wages and working conditions on the agenda at the next GATT negotiations. U.S. officials will doubtless claim they have the interests of Third World workers at heart. Developing countries are already warning, however, that such standards are simply an effort to deny them access to world markets by preventing them from making use of the only competitive advantage they have: abundant labour. The developing countries are right. This is protectionism in the guise of humanitarian concern (Krugman 1996: 67).

There are some international minimum labour standards legislated under the auspices of the International Labour Organisation (ILO), mainly in the form of core labour rights such as the right to have unions. However, the ILO has no power to implement such standards. There are some core human rights and labour standards under the United Nations (UN) conventions but these are not related to trade agreements (Singh and Zammit 2000). Clearly there are major political and institutional impediments to the establishment of an international minimum wage; these, however, are beyond the scope of this thesis. The issue taken in this study is the economic arguments for an international minimum wage standard in the context of free trade agreements.

The approach taken in this study is that an “international wage standard” is necessary for an increasingly globalised economy. Minimum wage standards have been established in the industrial countries from the late nineteenth century but few theorists have examined this measure as a global solution for unemployment, poverty and economic recession. An international solution is important in a world where national economies are increasingly becoming more interdependent, making it more difficult to maintain a welfare state in the framework of the national state.

The hypothesis in this study is that labour standards (rights) need to be integrated into the globalisation process via an international minimum wage implemented through international organisations and free trade agreements. In effect this will bring the benefits of Keynesian theories on effective demand to the global economy. In other words, an increase in minimum wages around the world will modify the income gap and increase consumption, increase health and education of the masses across the globe and, thus, their productivity. In other words, increased effective demand will reduce overcapacity and economic recession in the global economy.

The focus of the thesis is on the determination of wage standards in the world economy, looking primarily at the minimum wage standards in the developing countries as a minimum wage standard is clearly related to minimum wages in these low wage countries. The thesis will propose that the world economy (both industrial and third world countries) would benefit from a global wage standard as this would increase the masses’ income and therefore world aggregate demand, which would in turn increase world production and growth. The argument of the thesis is developed on the basis of the labour theory of value and the Keynesian theory of effective demand. Key alternate approaches to the determination of wages under capitalism will be discussed. The experiences of NAFTA (the North American Free Trade Agreement) will then be used to test two of these approaches (Heckscher-Ohlin theory and unequal exchange theory) against recent historical evidence.

Literature Review

Minimum Wage Studies

In the classical literature there are two main perspectives on the minimum wage issue. One supports government intervention in the economy, whilst the other opposes any government intervention. Liberalism advocates no (or minimum) government intervention and opposes minimum wage standards. Liberals believe that a minimum wage standard is an economic restriction that violates the principles of free market economy. They argue that freer trade is necessary to increase market activity and that the market will create enough jobs and welfare by itself. The world order today is influenced mostly by the (neo)liberal model that is based on the Western countries' premises. Liberalism is based on Adam Smith's approach and the theories of neo-classical economists like Samuelson and Heckscher-Ohlin who have developed the liberal case for free trade.

While Smith's insights have influenced many schools of economic thought, the neo-liberalism model specifically applies his theory in its strict, orthodox sense. According to Smith, when every individual employs capital to promote his or her own interest, they will promote the domestic economy because (it is implied that) all capital will be used productively in the system. In this way, the individual's self-interest will promote society's interests: "he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention" (Smith 1993: 292).

The neo-classical response to the unemployment problem is "cutting wages" until the economy reaches full employment. In this view, when wages decrease it will be more profitable for firms to employ more (cheap) labour and expand production. However, experience of economic crisis has not supported this argument, since in the Great Depression of the 1930s lower wages did not solve the unemployment problem (Hunt 1992: 503–04).

Traditional Marxian economics does not support the introduction of a minimum wage standard as a historical solution to the contradiction of capitalism, but rather aims to eliminate the wage system (and capitalism) in its entirety. Marxist theory demonstrates that in a capitalist system all the means of production are held by a minority of society whilst the majority (workers) receive only a fraction of the total production. There is no room to expand production because of the limited consumption of workers. Therefore, the economy often faces an overproduction problem of commodities that cannot be sold domestically and cannot be exported if other countries are facing the same problem. This results in periodic crises in the capitalist production system. Marx's view about the value of wages was that in the capitalist system the payment of labour (wages) is equal to a socially given "subsistence level" for the reproduction of labour while the total goods produced by labour are greater than this level (Marx 1991: 274). In the free market system, workers have no control over the means of production and they have to sell their own labour under conditions imposed by the capitalist system. Without control over the means of production the only commodity labour has to offer is its own labour power. This makes it easier for the capitalist to buy labour in the market at less than the value it produces, and thus to transform money into capital and accumulate it (Marx 1991: 272–73).

The essential product of capitalist exploitation is surplus-value. Surplus-value is the difference between the value necessary to produce something and the value at which that product is sold. But it is not realised by selling or buying capital, it is realised in the production process by the exploitation of labour power. This study supports the main idea in Marxian theory that unemployment and economic crises are a result of an imbalance between the (needs of) the productive forces in society and the social relations of production, and that this imbalance will induce poverty for a large part of society. To solve the economic imbalance Marxist theory recommends revolution, and Marxists generally do not believe that the existing capitalist system can be reformed. Keynesian principles, however, indicate that at least the worst effects of capitalism can be ameliorated.

Keynesian economics is important in economic theory because it was the first coherent attempt to demonstrate the necessity of government intervention in the economy, and that capitalism and the free market are not in practice self-regulatory and are unable to allocate resources effectively. Keynes emphasised that distribution of income was biased in a laissez-faire economy and society suffered from underconsumption (Keynes 1998). Keynes's theories were accepted widely in industrial countries after the Second World War and this led to broad support for the concept of the welfare state in most advanced industrial countries. Keynes suggested that the level of national income was a function of aggregate supply and aggregate demand. He showed that consumption and saving are dependent on income and on individuals' preferences as well as objective factors like the interest rate and inflation.

There have been a number of recent studies focusing on minimum wages in individual countries and many authors have explored the ways in which change in minimum wages can affect employment, welfare, consumption and investment in an economy. Studies on minimum wages have been undertaken from a range of perspectives, including quantitative analysis, socio-economic approach (of particular importance for this study) and theories of trade and their impact on the distribution of income.

The classical view on wages is that an increase in wages will lead to a decrease in employment. In the *living wage symposium* Pollin shows that "according to his analysis, there is no statistical correlation between unemployment and the minimum wage …" (Follette 2000). He explains that a rise in unemployment would follow from the law that when the price of something goes up, all other things being equal, demand goes down. But the fact is that all else rarely remains equal when minimum wages go up. Card and Krueger (1995) analysed the effect of minimum wages in Texas and found a weak positive effect of minimum wages on employment. This study, however, has been subject to criticism on the basis of the social factors that were not taken into account. Boadway and Cuff (1999), in a research paper, found that a minimum wage could increase unemployment, but the gain in social welfare (enhanced by a redistribution policy) could offset the cost associated with unemployment.

Neo-liberals and big business support economic inequality as a drive for growth, and many of the International Monetary Fund (IMF) and the World Bank (WB) development programs are based on this interpretation of the benefits of inequality. By the 1990s inequality had grown in most countries in the world (UNDP 2001: 18), mostly as a result of intensifying competition in industrial countries and the underlying policies of IMF and WB programs in third world countries. In its 1995 report, the World Bank estimated that many countries had fallen behind as a result of the liberalisation of trade. For example, per capita income in Sub-Sahara African countries had fallen since 1987 by 25 percent (Petras and Veltmeyer 2001). The relation between inequality and growth has been the subject of much controversial research, some of which will be briefly presented here.

The International Labour Organisation (ILO) has undertaken several studies into minimum wages, and most of their research supports the benefits of work standards. In one survey Catherine Saget (2001) distinguishes between increases in employment and reduction of poverty. Saget believes the reduction of poverty is of greater concern: “in the developing world, policy makers are not only concerned with the impact of the minimum wage on employment, but also with its impact on the level of poverty” (Saget 2001). Her finding about the effect of minimum wages on poverty differs from conventional economic predictions. She found that minimum wages have an insignificant effect on employment and “the level of the minimum wage (in dollars) is a negative and significant determinant of the level of poverty” (Saget 2001: 22). This finding is important, however it must also be realised that in many cases the level of development determines the opportunity for a higher minimum wage.

Ravallion (1997) has conducted research on the relations between inequality and growth, and his findings are significantly opposed to that of liberalism. Ravallion found that the initial distribution of wealth does influence the poor’s share in rising average incomes: “if inequality is sufficiently high, countries which would have very good growth prospects at low levels of inequality may well see little or no overall growth, and little progress in reducing poverty, and even a worsening on both counts” (Ravallion 1997). This is because inequality cannot increase infinitely. In another analysis focusing on inequality and economic growth, Aghion et al (1999) found that redistribution of wealth can foster growth (because of imperfect capital markets and human capital) but that growth, in turn, can result in inequality (through the effects of education and technology). Their research supports the need for a permanent redistribution policy (Aghion et al 1999).

Basu et al (1998) developed the theory that with a fall in aggregate demand for labour, it is more likely that the supply of labour will increase. This is because when the demand for labour falls, families send more of their members (women or children) out to work to secure the family’s income. They call this the “added worker effect” (Basu et al 1998). This finding supports the case for a more regulated labour market and better wages or work standards for those who work. Despite the claims of liberalism, a minimum wage can reduce adult unemployment through the reduction of child labour. This is important when it is taken into account that there are 200 million children working around the world today, almost all of them in developing countries (ILO 2004).

North gives a more comprehensive explanation of economic growth in terms of institutional development. He analyses economic growth as a result of “[t]he gradual development of informal norms of behaviour that have become deeply imbedded in the society …” and “economics and political institutions that will permit impersonal exchange”. North rejects economic theories that set government intervention against laissez faire on the basis that: “[t]he argument is empty because there is an implicit assumption that the rules of a ‘laissez faire’ economy are a natural result that occurred without the active participation of government and will fall into place by themselves …” (North 1995). North, however, emphasises that his essay is a general study of factors that can enhance economic growth and tries to open a new way of thinking about economic growth far removed from the conventional prescriptions.

Bourdieu and Benedicte (1999) propose a more general hypothesis on economic change. They argue that social forces from non-economic spheres are necessary for economic change (Bourdieu and Benedicte 1999: 19). For them not only theory and recognition of the problem are important, but social consciousness and support to make a socio-economic change through institutional and legal regulation are needed. The eight-hour working day was not purely a result of academic theories but was an outcome of the resistance and activity of those who most suffered from long working hours. The establishment of May Day as an international workers' day for promoting the eight-hour working day was part of this resistance (Bourdieu and Benedicte 1999: 9).

In their study Singh and Zammit (2004) argue that "[t]he reason that developing countries are unable to implement labour standards quickly is not because their governments are corrupt or perverse, but largely because of the structure of their economies and their economic circumstances" (Singh and Zammit 2004: 5). They also argue that current globalisation based on free capital movements is not in the interest of labour both in the North and the South and suggest that government restrictions on capital and finance are necessary to support growth. They also suggest that while international labour standards are important, they are better achieved by supportive means such as provided by the ILO rather than punitive powers such as the WTO (Singh and Zammit 2004: 33).

Experience of Industrialisation in East Asia

The experience of some East Asian countries of economic growth and rapid industrialisation is one of the important cases of economic development in the world. The success of these countries has been presented by neo-liberalist economists and the World Bank as the result of liberalisation and export oriented policies. But newer studies show that those countries which have been successful have followed both export oriented and import substituting policies under strong government control (McVey 1992: 12; see also Edwards 1993). In his study on Taiwan, Wade (2004) questions the method and time period used in some neo-classical literature and argues that, at a time of rapid growth, Taiwan had one of the highest economic protection policies among the third world countries (Wade 2004: 114). In fact, control the over economy was not driven by a democratic government, rather by a military government which had strict control over society: “Korea and Taiwan for most of the postwar period have not only been subject to military rule but have been militarised societies” (Matthews and Ravenhill 1994: 75). In this part the experience of Japan, South Korea, Taiwan and Malaysia will be presented and the ways in which government, enterprise and labour relations were organised in these countries will be explored.

Japan is not a newly industrialised country, in fact, Japan’s process of industrialisation started in the eighteenth century with other traditional (European) industrial countries, but its rapid growth in the 1960s and 1970s is important and it led to Japan’s socio-economic relations becoming a source of inspiration to other, mainly East Asian, countries. Johnson argues that Japan’s socio-economic structure differs from “the Leninist command economies” as well as “the Anglo-American free enterprise economies” which believes that any government intervention is inefficient (Johnson 1987: 137). Like most other industrial countries, much of the central planning in Japan was due to preparation for the war (Sheridan 1998: 20).

The roots of Japan’s new economic system go back to the early reforms after the First World War. The writings of Kawakami Hajime (1917) had a great influence on Japan’s economic reforms. In his book, *Tale of Poverty*, Hajime explained that Japan has not been able to reduce poverty through economic growth. This is because the problem of poverty has its root in social and economical relations and “unequal distribution of national wealth”. Despite his ideas being regarded as naive, he had a great influence on society through many of the union activists and leading liberal reformist economists “who were active in the Central Labour Relation Commission as well as other government economic and labour councils and committees which shaped Japan’s employment systems following World War I” (Sheridan 1998: 19).

According to Sheridan, Japan’s economic growth was mainly due to its organisational system in which labour unions co-operated with enterprise and government on the basis of the nation’s economic growth. Under “the 1955 politico-economic order” leaders of labour unions decided to co-operate with government and business in order to achieve economic growth and this was “the beginning of Japan’s ‘miracle’ years” (Sheridan 1998: 21–22). In this system labour could keep increased wages in line with economic growth as its compromise. In this corporate approach “Government and business are required to share roles, with government drawing up plans and public policy for industrial and economic development, and business promoting a harmonious and productive labour management system based on a corporate welfare system within the economy” (Sheridan 1998: 21). Government’s role was to mobilise labour and business to expand the economy and hence, create full employment and equality. This pattern of labour relations was followed by other East Asian countries, especially South Korea and Taiwan, but it was not so “harmonious” as presented above: “Japan has to be more creative than the other two because it is less authoritarian. All three nations compensate labour for its decreased political role through policies of comparatively equitable distribution and automatic wage increases tied to increases in productivity” (Johnson 1987: 151).

South Korea and Taiwan followed the Japanese pattern of industrialisation in the form of national mobilisation for growth, but Korea and Taiwan were more militarised societies. Government planned long-term economic goals and even decided which firms would enter into which industry. Government influenced business by incentives and disincentives to achieve its goals: “much contrary to the philosophy of trade liberalisation, the import of completed goods was strictly controlled in the form of tariff and non-tariff barriers … Korean economy’s reorientation towards export may be better understood as a process of propagation of economic nationalism or of national mobilisation for development, rather than of trade liberalisation” (Pak 1998: 83). In the period of high growth all banks were under the control of government and were used as a key instrument of government central planning (Wade 2004: 165).

Much Korean and Taiwanese economic planning resulted from the international situation in which the US supported these small countries against other big countries in Asia and the influence of communism: "… Cohen (1975) in fact argues that the open-door policy toward foreign capital is rooted less in economic considerations than in a desire to maintain political and military alliances" (Deyo 1989: 48). As a consequence of this policy, these countries received much economic aid from the United States: "In Taiwan over the 1950s economic aid equalled about 6 per cent of GNP and nearly 40 per cent of gross investment, and military aid was even bigger than economic aid … From 1946 to 1976, the United States provided $12.6 billion in economic and military aid to South Korea" (Woo-Cumings 1998: 334). Economic growth in Korea and Taiwan is due to many different factors of which the most important were government central planning, co-operation between business and labour, economic nationalism, Japan's experience, the international economic and political environment, US subsidies and privileged access to the US market, and the Vietnam War.

Although Korea and Taiwan are known as export oriented countries, they followed strong import substitution policies during the period 1950–1970: "They are the only countries in the sample [9 countries] where import substitution contributed as much as one-third of manufactured growth in any sub-period" (Wade 2004: 84). In Taiwan the government acted as direct investor and many enterprises were owned by government (MacIntyre 1994: 5). And only four banks were officially private in 1980, which amounted to 5 percent of the total banking system (Wade 2004: 161). Besides government established enterprises there was widespread government support for the private sector: "Incentives and pressure are brought to bear on them through such devices as import controls and tariffs, entry requirements, domestic content requirements, fiscal investment incentives, and concessional credit. … the state nevertheless has provided subsidized design help, subsidized credit, and quantitative import restrictions" (Wade 2004: 111).

Labour relations in Korea and Taiwan were much the same as in Japan, but in Japan life-time employment was more widespread and labour had more political freedom: "It seems that through a combination of authoritarianism, free labour markets, and paternalism, Korea and Taiwan achieved labour relations roughly similar to Japan's"

(Johnson 1987: 150). The authoritarian government in Korea made rules and imposed them on enterprises and unions without consulting them. However, despite the example of Japan, Korean business was not an equal partner to the government (Pak 1998: 93–94). Government planning and rapid economic growth reduced unemployment and induced a shortage of labour which increased wages (Deyo 1989: 24). Indeed, “wages have grown at about the same rate as, or slower than, the growth of labour productivity (output per person), except for short inflationary periods in the early and late 1970s” (Wade 2004: 57). Deyo explains that with rapid economic growth in East Asian employment, real income and standards of living have increased. The social consequence of the economic growth was a reduction of industrial conflict and thus increased legitimacy of government, giving more room to government to promote its policy (Deyo 1989: 5–6).

In Malaysia intervention of government took mainly the same forms as in South Korea and Taiwan but here government intervention was directly used to achieve redistribution of income to increase the economic and political power of Malays relative to other ethnic groups: “The heavy industries policy thus became a vehicle for simultaneously achieving two not very compatible objectives: an economic goal, of accelerating the pace of industrialisation; and a social and political one, of redistributing national income to help the Malays who were the group least active in the industrial sector” (Bowie 1994: 177). Bowie argues that Malaysian elites have never believed in the free market or that the free market can be effective in promoting equality in the distribution of income (Bowie 1994: 190). As early as 1994, Bowie was concerned that the lack of transformation of technology to Malaysia, and the entrance of newcomer countries with cheap labour (like Thailand and China) to the world markets would diminish the rate of growth in Malaysia. And even worse, with recent liberalisation of the markets capital could flow out of the Malaysian market and cause serious problems (Bowie 1994: 191). This concern has already been realised by the Asia crisis in 1997. Earlier in 1980, in an ILO organised symposium, concern was raised about the size of the export markets in developing countries and it was concluded that: “In view of the possible limitations of markets in developed countries, it is important to evaluate the possibilities of expanding trade among developing countries" (ILO 1980: 48).

Often government intervention creates rent-seeking activities, but in the case of East Asia this problem was avoided through "the creation of contests based on contingent entry and limited terms of protection" (Kim and Ma 1998: 129) and "the existence of mass nationalism in Korea and a widespread public-private agreement on economic goals" (Johnson 1987: 138). Enterprise has acted on the basis of the profit maximising criteria but government has "defined the framework" and guided the private sector through incentives and disincentives (Pak 1998: 85).

One of the most recent fast-growing countries in Asia (and the world) is China, where real income and standards of living have grown substantially. Possibly governmental control and fixed wages are more common in China than any other country in Asia. Despite China's opening to the free market in the last decade, most of the GDP is still generated by government. Qian and Weingast (1998) argued that the old state-owned enterprises in China are inefficient but the alternative has not been non-governmental enterprises, rather, newly created township-village enterprises, which are owned by township and village governments, and are highly efficient (Qian and Weingast 1998: 255).

The case of East Asia shows that government intervention can be positive if it is based on the nation's socio-economic needs and supported by the majority of the population. Competitiveness in international markets does not come through passive government policies in regard to international prices. Rather governments should manipulate the economic framework to encourage labour and enterprise to take part in international competition. With growing competition and increased globalisation, governments in labour intensive countries (in other words, poor countries) should not only act within the domestic markets but at the international level to achieve better prices for their labour.

Theories of Trade and Distribution of Income

There are various theories of trade and its effect on the distribution of income between and within countries. Two of the most influential theories are those of Heckscher-Ohlin and Emmanuel, which will be briefly presented. Heckscher-Ohlin trade theory suggests that comparative advantage is primarily determined by differences in factor abundance. Based on the H-O model a country will tend to produce relatively more goods that use its abundant resources intensively and, therefore, export those same goods. Changes in relative prices, induced by trade, cause the relative price of the abundant factor (used in export goods) to increase and the relative price of the scarce factor to decrease in the domestic economy. This makes the owners of the abundant factor gain relative to the owners of scarce factors. Based on this theory, third world countries have an abundance of cheap labour and by free trade, the price of their labour will increase and be equalised with the price of labour in the international market (one price for labour everywhere). Therefore, over time, unemployment and poverty will be eliminated (Heckscher and Ohlin 1991: 57). Problems with this theory include: (1) it assumes both countries produce both goods; (2) technologies are the same; (3) the price of a good is exactly equal to the cost of producing it, and most importantly; (4) cheap labour is a result of natural differences between countries and not a result of restrictions in the international economy and the labour market.

With the independence of colonies after the Second World War, the importance of the terms of trade between the centre and periphery was recognised by some scholars and led to the development of theories of “unequal exchange”. Emmanuel has developed a comprehensive theory of unequal exchange that will be presented in later chapters. Emmanuel argues that the terms of trade are important in determining the way in which countries can gain from trade. He uses Marx’s approach on value and price to develop a theory of price that is determined by factor costs. He also rejects theories that claim prices are determined by equilibrium in demand and supply of goods in the international market. Emmanuel shows that there was a small difference between wages among different countries in the early nineteenth century. But this difference increased over time and average wages in industrial countries were up to 15 times more than average wages in the third world countries by the late 1960s, taking into account differences in productivity of labour in different countries (Emmanuel 1972: 46–47). He argues that this gap between the prices of labour is a result of international trade whose premises were constituted in the early colonising stage. Labour is undervalued in the third world countries and, therefore, these countries obtain a smaller share of international income. With less income third world countries will have less accumulation of capital and fewer opportunities for expanding production and technology. This negative circle will intensify itself and the gap between cheap-labour countries and expensive-labour countries will increase: “thus poverty begets poverty” (Emmanuel 1972: 131).

A common factor throughout most studies on minimum wages is a focus on the elasticity of supply and the effect that minimum wages have on other factors like employment and growth. The fact is that much research is based on data limited in time and to the experience of one country. It is possible that an increase in minimum wages in an individual country will increase prices and worsen competitiveness of that country in the international environment (at least in the short term). However, while an increase in minimum wages at the international level may change the relative prices and competitiveness of a particular country, international prices and global effective demand will be affected as well. Therefore discussion on the value of labour, effective demand and the development history of the international labour force is necessary to understand the forces which determine minimum wages across the globe. Although the total effect of changing minimum wages would be difficult to measure in quantitative terms, the experience of countries which have entered regional economic agreements on trade (with and without supportive labour standards and minimum wages) can be used to estimate the influence of free trade on income and poverty.

The North American Free Trade Agreement (NAFTA) provides a good contrastive case study to test whether free trade can be beneficial between a first world country like the United States and a third world country like Mexico (see Lawson 1997 on contrastive analysis). Based on the Heckscher-Ohlin model if a country produces and exports goods that use the abundant factor, it can succeed in international trade and the price of its abundantly endowed factor will rise and be equalised with the international price of that factor. If this theory were correct, free trade between Mexico and the United States should have increased exports, which were cheap labour intensive, from Mexico to the United States and, over time, the price of labour in Mexico should have increased towards the level of that of the United States. The theory of unequal exchange claims the opposite: that cheap labour is a result of historical–institutional development and the gap between wages in industrial countries and the third world countries is much more than that implied by the difference in the productivity of labour in these countries. This means that with the same productivity, labour is valued less in third world countries and, therefore, with existing prices, trade transfers value from third world countries to the industrial countries. Moreover, the gap between third world countries and industrial countries will tend to increase over time. Based on this theory, NAFTA should have resulted in a decline in the price of labour in Mexico and the wage gap between the United States and Mexico should have increased (as far as labour is not protected in Mexico). This study provides data about changes in wages under NAFTA, especially in Mexico, to test the strict neo-liberal version of the Heckscher-Ohlin model against unequal exchange theory. It is argued that the unequal exchange theory has greater explanatory power because it is more consistent with the evidence. Finally, it is argued that there is strong theoretical support from across the spectrum of economic analysis for suggesting that an increasing international minimum wage standard would prove the most effective method for improving the lot of the world's poor.

Chapter 1

Smith and Marx on the Value of Labour

Adam Smith

As stated previously, there are two mainstreams in economic thought today. One advocates free markets with no or very little government intervention in the economy. This school of economists is known as neo-classical and neo-liberal. Most other economists support intervention in the economy by governments (or other social and political organisations). The most important classical economist, who leans towards the first group, is Adam Smith. He is named not only as a founder of liberalism, but also as founder of the modern political economy. Smith has been one of the most controversial economists in history and many of his theories are relevant today. Smith has influenced economists other than liberals. For example, Blaug suggests that "Marx's theory of historical materialism" had its origin in Smith's wealth of nations (Blaug 1997: 59). Smith's theories about the origins of private property, inequality, the state and the value of labour will be presented in this chapter and minimum wages will be discussed in the light of these theories. Adam Smith (1723–1790) lived in the early period of industrialisation in England, when manufacturing production was growing and the export sector was getting more and more important in the economy. However, the industry structure of that time was far from the monopolistic giant enterprises which characterise capitalism in the twentieth century.

The Origins of Private Property, Inequality and the State

Smith believed that the production and distribution of the material necessities of life is the most important determinant of a society's social structure. He divided the history of social structures into four stages: hunting, pasturage, agriculture and commerce. He argued that each stage had its own system of production and distribution of economic necessities that in turn determined the social structure at the time and the structure of government (Smith 1993: VII). But this relationship was not deterministic and there were great differences between societies.

In the first stage of societal history, the hunting society, there were no property rights, no division of classes and therefore no reason for a state. There were no personal advantages of authority and subordination to individuals. There was no inequality because of universal poverty (Smith 1993: 410). Everything produced by each individual was used by him or herself and “[i]n that original state of things, which precedes both the appropriation of land and the accumulation of stock, the whole produce of labour belongs to the labourers. He has neither landlord nor master to share with him” (Smith 1993: 63). In the next stage of societal history the productivity of labour increased, division of labour occurred and “All things would gradually have become cheaper” (Smith 1993: 63). A smaller quantity of labour could produce a higher level of production and this opened the way for the future exchange of things (products).

Smith mentioned that private property was not common in the early stage of history but it became common after that. “As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed, and demand a rent even for its natural produce” (Smith 1993: 47). Natural resources that were previously available to the labourer for free would need to be paid for once they become the property of the landlord. Smith believed that land is valuable because it is scarce. According to Smith, private property started because the poor loved “present ease” and were essentially lazy, or lacked a passion for riches. On the other hand the rich had more “avarice” and more “ambition”. Smith suggests they had “passions much more steady in their operation, and much more universal in their influence”. To Smith, the origin of inequality appears because of personal qualification of individuals. All of these made it possible for a group of people to gain possession of all land as their own private property (Smith 1993: 407–08). Therefore, landlords had the right to obtain rent for their land and the labourers who needed the land (to cultivate) had to pay the rent. Smith believed that inequality started in the shepherd’s age with private property and developed a “degree of authority and subordination which could not possibly exist before” (Smith 1993: 412). He also asserted that: “wherever there is great property, there is great inequality” (Smith 1993: 408).

Despite the fact that Smith believed private property did not exist in the early stage of history and that it was developed in a social-historical context, Smith accepted it as given for current society and developed his political economic writings on the assumption of existing property rights. He divided all sources of revenue into three groups: wages, rent and profit where the latter two are due to the ownership of land and capital. Smith recognised all property rights and sovereign right, as were common in eighteenth-century England and Europe. Later, his views about property rights and the legitimisation of the state power were questioned by Marx. Today, property rights have been somewhat modified compared to those in Smith’s time. Workers can have property and shares while to Smith this would have been unlikely. In industrial countries, those who have property do not necessarily have absolute power over labour. There are powerful trade unions and work standards that protect the labour from the vicissitudes of a completely free market.

Private property and inequality developed a need for maintaining order in society, and there was need for a sovereign power to protect the rich from the poor: “Civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all...” (Smith 1993: 413). The sovereign’s role in society is not just to simply support the rich, but to control the necessary institutions and laws to maintain order for long-term economic and social activities. Smith argues that in “commercial society” (capitalism), the “sovereign’ (government) has some duties to maintain growth and wealth in society. These duties are mostly to maintain law and order, but economic activity is the responsibility of the individuals:

> “the sovereign has only three duties to attend to; first, the duty of protecting society from the violence and invasion of other

> independent societies; secondly, the duty of protecting … every member of the society from the injustice or oppression of every other member of it. … thirdly the duty of erecting and maintaining certain publick works and certain publick institutions …” (Smith 1993: 392).

Public goods, Smith writes, are those goods that are not in any individual’s interest to produce because they are not profitable (Smith 1993: 392). Goods, such as schools and roads, are important for the general benefit of society, therefore, the government must take over their production. But Smith, as we see later in this essay, is very conservative about the role of the government in the economy and he recommends that government intervention should be as minimal as possible.

The revenue of the government comes from two different sources. First “from some fund which peculiarly belongs to the sovereign or commonwealth” and second “from the revenue of the people” that is, taxes (Smith 1993: 445). Smith further explains that funds belonging to the sovereign consist of either stock or land and the revenue that the sovereign receives from it is in the form of profit or interest. From this it can be concluded that Smith accepted government ownership and investment in the economy. This part of Smith’s theory about government ownership and investment is not much discussed in the economic literature and Smith himself does not clarify the extent to which government should be allowed to own or invest directly. On the whole, Smith was for minimal government intervention in the economy.

Smith’s Approach to the Labour Theory of Value

With increased productivity and division of labour, an individual can supply only a part of the commodities he needs by his own labour and most commodities consumed by him come from the labour of other people and, therefore, a person is regarded “rich or poor according to the quantity of that labour which he can command, or which he can afford to purchase” (Smith 1952: 13). Smith argued that the value of any commodity depends on the labour that has been used in producing that commodity. He concluded that “[l]abour, therefore, is the real measure of the exchangeable value of all commodities” (Smith 1952: 13). In another place, Smith clearly emphasises that “labour was the first price, the original purchase-money that was paid for all things. It was not by gold or by silver, but by labour, that all the wealth of the world was originally purchased” (Smith 1993: 36).

Smith further explains that all goods produced in a country during a year are originally resolved in three parts according to their source of revenue: the wages of labourers, the rent of landlord and the profit of masters. All of the other sources of revenue are resolved into these three main categories (Smith 1993: 50–51). To Smith land and stock are productive as well as labour. The value of commodities is not exactly adjusted to their actual value of labour but in part also depends on the demand for it and its usefulness as well as its supply. Smith argues that all prices that are paid must go to some sources of production that have made the product valuable. These prices of value are in Smith’s terms: wages, profit and rent. Hunt believes that Smith limited the value of every commodity to the value of labour used to produce it in the first stage of society. But when land was monopolised by landlords, “price came to be sum of three component parts, wages, profit, and rent” (Hunt 1992: 60–61).

The wages of skilled workers (servants) should be determined at the level that they can reproduce themselves and gain the education they need during their lifetime. An equilibrium will naturally be developed by the increase or decrease of the society’s demand for skilled labour (Smith 1993: 81). Labour is a common value estimated for all commodities, but it is difficult to measure the different quantities of labour. Furthermore, the time used by a labourer is different for any product; for example one hour of hard labour can equal more than two hours of easy business. Smith divided value into two different types: one is the ‘value in use’ that expresses the utility of some particular object; the other is ‘value in exchange’ that is the power of purchasing other goods.

In Smith's economics the ratio of the three different sources of revenue is determined by market equilibrium and competition. Blaug (1997) calls it a "partial equilibrium analysis" because Smith's equilibrium is based on the terms of demand and supply, and wages are determined by the condition of the market (Blaug 1997: 38). In the labour market workers want to get more and masters want to give less and with powerful masters, workers get a subsistence wage to survive. In fact, this is not what workers "take" but what masters "give" to keep the production process on track. In Smith's economy it is given that workers have no choice or rights, other than to work as a means of production that maintains the reproduction of the existing system and the accumulation of capital, which Smith saw as vital for the survival of the economic system.

The point at which the wage–profit equilibrium will balance is based on the condition of production forces and productivity at the time. There is an "actual rate of wages", a certain rate below which it is impossible to reduce wages further at any time. This "actual wage" is determined by a minimum wage that is sufficient to maintain labour. This means, in Smith's terms, it must be sufficient for a family of four to maintain the capacity to work over (a generation) time. From Smith's writing, one can infer that this "actual rate of wages" is dependent on the cultural and social context; however, wages can sometimes increase above this minimum when there is excess demand for labour but this will not last in the long term (Smith 1993: 65–67).

Smith distinguishes between the wealth of a country and its growth and explains that any increase in wages is dependent on economic growth: "Though the wealth of a country should be very great, yet if it has been long stationary, we must not expect to find the wages of labour very high in it" (Smith 1993: 70). Later, Smith indicates the various factors that may lead to economic stagnation using England, North America and China as examples. The essence of Smith's theory of growth appears to be based on the social, cultural and institutional context, so that a country like the US could have better growth and higher wages than China despite the fact that China had greater wealth. But Smith does not make clear the extent to which this institutional framework affects the economy and, above all, he does not seem to believe that government is responsible for and integrated with it.

Mechanism of the Free Market or Natural Liberty

Smith's theory of the free market is known as the "invisible hand", but the reality is that he used this term very few times. His main expression for perfect competition in a market was "the obvious and simple system of natural liberty". This "system of natural liberty" according to Smith, is the result of each individual's actions based on self-interest in the market; "Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men" (Smith 1993: 391). Smith writes about "laws of justice" but he does not explain what these "laws of justice" are and which section of society will legislate them. Some authors believe that Smith's theories of "laws of justice" are explained in his other work, *The Theory of Moral Sentiments* as a complementary book to *The Wealth of Nations* (Peil 1999).

Smith explains that the interests of labourers and masters are the opposite of each other, but given they do "not violate the laws of justice" and control of the "sovereign", this conflict will lead naturally to harmonious competition (Smith 1993: 391). This implies that, in the long term, masters (capitalists) know that they must pay for the existence of the labourer, his family and their education or training. And they (masters) "naturally" will pay this wage (cost of labour) at any time. If masters are not aware of this, or they will not pay this "natural wage", the market cannot find equilibrium and there will not be any "natural liberty".

According to Smith when every individual employs capital to promote his own interest, he will automatically promote the domestic economy. In this way, the individual's self-interest will become aligned with society's interests: "he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention" (Smith 1993: 292). There is an underlying optimistic assumption here that all capital used by the individuals will be productive. Smith even argues that pursuit of self-interest will be more effective for society than were an individual to consciously promote society's interests: "By pursuing his own interest he frequently promotes that of the society more effectively than when he really intends to promote it" (Smith 1993: 292). However, Smith does not explain why efforts that are self-interested should lead to better results than efforts to promote the social interests. This system of liberty works on "harmonious competition", which involves the need for workers to work for those who have property rights. There is again an underlying assumption that those who have property rights will work consciously (with full market information) for their own interests. However, it appears that Smith takes it as given that capitalists or landlords know all about long-term needs in the economy and they will determine wages that can be maintained for at least "one generation". He does not mention any institution or government action which ensures such forward planning but instead simply refers to "the laws of justice". To what degree this law of justice operates is not explained, but from Smith's writings it appears that 'justice' is essentially embedded in competition and the laws of supply and demand, which determine real prices in the economy over the long term.

To Smith it should be better for the economy if there were more producers and retailers to compete with each other. The greater the competition, the cheaper the price of commodities, which he assumed naturally benefits the society. Smith does not deny the possibility of the development of monopolies and market imperfections, but he believes that this is not an important problem: "Some of them [retailers], perhaps, may sometimes decoy a weak customer to buy what he has no occasion for. This evil, however, is of too little importance to deserve the publick attention …" (Smith 1993: 215). Smith ignores the role of monopoly in the economy despite his writings about mercantilism and the ways in which monopoly raised mercantile profits and decreased the rate of wages and other sources of revenue (Smith 1993: 355–57).

Some new studies argue that in Smith's economy individuals act within a system of institutions and comprehensive interaction based on ethics and social order rather than being egoistic actors in a supply–demand system. Fitzgibbons (1995) points out that Smith's moral theory was revolutionary in the mid-eighteenth century and could be recognised as anti-religious. To him, Smith's moral theory is still important and can influence existing liberal societies that have "high standards of living but declining civic values". At this time, Smith's contribution could have more weight on human responsibility and less on the invisible hand (Fitzgibbons 1995: 194). Lux (1990) argues that Smith used the term "economic liberty" to emphasise the market mechanism against the intervention of the monarch in the economy that was an important issue at that time (Lux 1990: 23). He points out that Smith had made "it quite clear that self-interest must be tempered by justice" and advocating self-interest without justice is a crime (Lux 1990: 199). Werhane (1991) believes that the invisible hand is a dependent variable in Smith's economics. The market is dependent on the actors and their optional operations, which is based on pluralist justice. Self-interest in Smith's definition is not a simple economic self-interest but the desire of a person for co-operation, fairness and social compassion (Werhane 1991: 109–10). Peil (1999) points out that any interpretation of Smith should be based on both *The Wealth of Nations* and *The Theory of Moral Sentiments* because the books are complementary. He argues that Smith in *The Theory of Moral Sentiments* tried to explain the values and rules by which individuals are restricted and obliged to act as members of the society. He argues that Smith's economic thought should be considered in its original context with classical economic concepts and not with the concepts of the modern economics: Smith's economic thought should "be understood within the context of the classical division of philosophy into logic, natural philosophy and moral philosophy" (Peil 1999: 8–9). Marshall (1967) argues that Smith was pessimistic about businessmen as well as the government and he wanted a sort of "atomistic society", where no individual or group holds the power to authorise his or her own interests. To maintain this system, Smith focused on individuals interacting in a free market rather than government intervention, not just because government intervention was more evil but because it was inefficient as well (Marshall 1967: 44–45).

While these more recent studies point to the complexity of Smith’s views, a fundamental problem remains; this is that despite Smith’s acknowledgment of the conflict between labourers and masters, his approach is ultimately based on (a market created) harmony between them. As was explained above there is the need of the labourer to work with land and capital, which encourages him to work for masters who have a monopoly on property. Here, Smith sidesteps his theory of property rights, which was developed by monopolisation of land by those with more “ambition” and “avarice”.

Smith’s Theories on Labour and the Level of Wages

Smith’s contributions to political economy opened up the discussion about labour-value, the market mechanism, prices and market equilibrium. Henderson (in Wood 1983) believed that despite the ambiguousness of *The Wealth of Nations*, Smith developed “theories of the process of the economic systems and the pricing of particular commodities”. He argues that Smith originated the theory of value in the process of production and in the value of labour (Wood 1983: 2).

The best criticism of Smith’s harmonious system can be drawn from his own writings, where he explains how masters are privileged in society, are supported by the state and possess the economic power to hold out longer in disputes than labourers thus containing wages at levels compatible with the needs of capitalists. Despite Smith’s main conclusion that the contract between masters and labourers is undertaken as an act of free will and that their opposing interests lead to harmony or what he calls “the obvious and simple system of natural liberty”, he is clearly aware that in this contract masters are more powerful and will dominate the situation:

> It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms. The masters, being fewer in number, can combine much more easily; and the law, besides, authorizes, or at least does not prohibit their combination, while it prohibits those of the workmen. We have no acts of

> parliament against combining to lower the price of work; but many against combining to raise it. In all such disputes the masters can hold out much longer … masters, ... though they did not employ a single workman, could generally live a year or two upon the stocks which they have already acquired. Many workmen could not subsist a week … (Smith 1993: 65).

As seen in the statement above, masters have traditional power integrated into the society over time and it appears to be natural that they have control over wages, institutions, market, government and civil power. However, Smith emphasises that masters cannot have absolute power to reduce wages to an unacceptable level. There is an "actual level of wages" that is based on the subsistence level for labourers to survive and masters cannot reduce wages further than this level. In fact, this "actual level of wages" was the normal wages paid in England at that time. The conditions described by Smith show that it was the master's power that drove wages down to the 'actual level of wages' (Smith 1993: 65–67). This situation has changed in England in the last two centuries not by the masters' goodwill, nor simply by economic growth and productivity, but mainly by workers' struggle and government regulations.

In explaining the condition in which masters and labourers acted in England, Smith continues: "Masters are always and every where in a sort of tacit, but constant and uniform combination, not to raise the wages of labour above their actual rate …. We seldom, indeed, hear of their combination, because it is the usual, and one may say, the natural state of things which nobody ever hears of …" (Smith 1993: 65–66). Based on this description of the situation of the labourer in eighteenth-century English society we can conclude that the labour market (like land) was already monopolised and the price of labour (wages) was determined by the monopoly of the masters. Smith recognised and formulated the view that "masters" have structural power in capitalism and that the situation reproduces itself and lets masters remain in power while workers from the start cannot have the opportunity to become equal partners and achieve a better life. In a society where wages are based on the subsistence level, the labourers' destiny is already determined and labourers will get little opportunity to develop their abilities to take part in social activities:

> [T]he man whose whole life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become … the uniformity of his stationary life naturally corrupts the courage of his mind ... It corrupts even the activity of his body … (Smith 1993: 429–30).

These sections of Smith's writings where he outlines the way in which socio-economic forces of capitalism intensify the power of the masters and undermine the situation of the labourers, have been largely neglected by mainstream economists.

Marx

Marx is one of the key contributors to political economy. To Marx it was important to change the world and not just to interpret it: "The philosophers have only interpreted the world, in various ways; the point, however, is to change it" (Marx, Engels and Lenin 1976: 13). Therefore, Marx's ideas are mainly revolutionary ideas that are aimed at changing the life and history of societies. This change is not a matter of choice but based on historical evolution. To Marx, economic activity is the most significant determinant in history, but social and cultural factors are important and have a dialectical relation to economic activities. Marx believed that "[t]he history of all hitherto existing society is the history of class struggles" (Marx and Engels 1967: 57).

Marx did not believe in simply regulating the labour market, but rather on eliminating the market and the pricing of labour as a commodity. He believed that all production and capital is produced by labour and that wages should be as high as total production would permit, without any profits in the form of a return to the ownership of means of production. However, a part of output should be saved as capital for the next period of production. Marx believed that inequality between human beings is not natural and it did not exist in pre-class societies. In this chapter the main views of Marx on political economy will be reviewed and a critical study of Marx by other authors will be presented. The main topics of Marx's ideas that will be reviewed here are: labour-value, surplus-value, surplus population, crisis and Marx's view about the increase in wages under capitalism.

Development of Capitalism

Marx saw the capitalist mode of production as a historical stage that develops means of production and the world market but at the same time produces contradictions between the productive forces and the social (or property) relations within which they develop (Marx 1991: III. 359). The capitalist system destroys small-scale and domestic producers and creates a world market. However, this does not solve the antagonism between the productive forces and capitalist social relations; on the contrary, it promotes this contradiction (Marx 1990: I. 635). His argument is that in the historical formation of capitalism, there have been many small producers with small amounts of capital or land. As capitalism matures, these small producers turn into either labourers or capitalists. Marx calls this process "primitive accumulation" because it forms the first stage of the growth of capitalism (Marx 1990: I. 874–75). This accumulation is a result of initial inequality in the ownership of the means of production, which then increases over time. To Marx, primitive accumulation has been a result of exploitation, war and reproduction of inequality throughout history: "In actual history, it is a notorious fact that conquest, enslavement, robbery, murder, in short, force, play the greatest part … as a matter of fact, the methods of primitive accumulation are anything but idyllic" (Marx 1990: I. 874). Primitive accumulation in the capitalist system intensifies the antagonism between classes because most small producers lose their capital and fall into the working class, becoming sellers of labour power. According to Marx, this process involves two transformations: first, "all social means of subsistence and production" are transformed into capital;

second, most producers become “wage-labourers” and a small minority come to own all of the social means of production (Marx 1990: I. 875).

Marx’s Theory on the Value of Labour Power

Marx points out that “[l]abour-power exists only as a capacity of the living individual” and to maintain the individual’s existence, a subsistence level of living is necessary. In the capitalist system the payments that labourers receive (wages) are equal to this “subsistence level” although the total goods produced by the labourer are more than this level (Marx 1990: I. 274). In the free market system, workers have no control over the means of production and they have to sell their own labour power under conditions imposed by the capitalist system. Without control over the means of production, the only commodity the labourer has to offer is his or her labour power. This makes it easier for the capitalist to buy labour in the market to transform it into capital and accumulate it (Marx 1990: I. 272–73). Marx distinguishes between *commodities* and *products*; a *product* is an article produced by a person for his or her own need, but a *commodity* is an article produced to satisfy some social need. Therefore, to produce a commodity the producer has to be subordinated to the “*division of labour within society*” (Marx 1970: 34).

For Marx the payment to the labourer is only a fraction of what the labourer produces and the rest is taken by the capitalist as profit. Therefore the existing price of labouring power (wages) is not equivalent to the value it produces but a price determined by the capitalist (market) system (Marx 1990: I. 342). When labour power has to be sold as a commodity in the market, its value will be determined, like other commodities, by the “*value of the necessaries* required to produce, develop, maintain, and perpetuate” it (Marx 1970: 46). In Marxian terms these necessaries are measured by the quantity of (social) labour necessary to produce them (Marx 1970: 45). But the total product of a labourer is more than the total product necessary to reproduce his or her labour power. For example, for a worker who works 10 hours a day possibly only 5 hours of his or her work is necessary for reproduction of his or her labouring power and the other 5 hours work will go to capital in the form of profits. In this case, the market value of this labour power (wage) is 5 hours of labour (not including raw materials) but the commodity produced by this labourer is valued at 10 hours of labour (Marx 1970: 50).

Through the exchange of labour (as a commodity) in the market it appears that "the value or price of the labouring power" is "the price or value of labour itself". While in fact only one part of the worker's labour is paid (Marx 1970: 50). This unpaid labour was more visible under feudalism when a serf worked three days on his own land for himself and worked three other days of the week on his lord's land (Marx 1970: 51). Marx's approach clarifies the fact that it is *labour power* (or the capacity to labour) that the labourer sells in the market and not the *labour* which the worker performs (Marx 1970: 44). In Marxian terminology, the labour which the worker actually performs is defined as its use-value, which consists of paid and unpaid labour, and what the worker gets as a wage (paid labour) is the exchange-value of labour power. When the labourer wants to exchange his labouring power as a commodity, he sells his labour for its exchange-value and its use-value is not important for him. However, for the capitalist it is use-value that is important, for without the use-value of labour the capitalist will not realise any exchange-value in the form of produced commodities (Mandel 1971: 84–85).

Labour has a double aspect in the capitalist production system. On the one hand, labour power is a commodity and its price is determined by supply and demand in the market. On the other hand, the labourer is a human being who has to sell himself in the market and therefore sells control over his value-creating capacity to the capitalist. Another problem with labour as a commodity is that the value of labour in the market is already determined, before the labourer comes to the market. Moreover, the labourer usually has to perform his work first, before the wage is paid (Marx 1990: I. 277). The capitalist theorists do not care why labour is dependent on the market as a commodity and they refer this situation to nature (e.g. Smith). However, Marx believed that this situation is a result of social relations of power introduced with the development of capitalism, and a historically specific form, which will eventually disappear (Marx: 1990: I. 273).

The value of a commodity is not just based on the quantity of labour used to make it but also on the productivity of labour (Marx 1970: 62). Marx argues that: "*The values of commodities are directly as the times of labour employed in their production, and are inversely as the productive powers of the labour employed*" (Marx 1970: 39). The value of labour used as a quantity for measuring the value of all (other) commodities is a relative and historically specific measure, for which Marx uses the term "social labour". Social labour is abstract and independent from the individual labourer's productivity, power and skill. Rather, it is dependent on the average productivity of labour in a society in a given time:

> … many points are involved in this qualification of "Social [labour]". In saying that the value of a commodity is determined by the *quantity of labour* worked up or crystallized in it, we mean *the quantity of labour necessary* for its production in a given state of society, under certain social average conditions of production, with a given social average intensity, and average skill of the labour employed (Marx 1970: 37).

Equilibrium of prices based on the supply and demand for commodities, and labour as well, are accepted by Marx, but this equilibrium is always around the natural prices, which are based on the value of (social) labour used in those commodities; "… *if* supply and demand equilibrate each other, the market prices of commodities will correspond with their natural prices …" (Marx 1970: 41). Marx uses Adam Smith's definition of natural prices in which; "The natural price … is the central price, to which the prices of all commodities are continually gravitating" (Marx 1970: 40).

Surplus-value

Profit is not introduced by "buying and selling" but from the exploitation of labour. In Marxian theory, the basic element in capitalist exploitation lies in surplus-value[i]. The value created by the labourer (use-value) is more than the value necessary to reproduce his or her labour power. That part of labour-value which goes to reproduction of labour power, wages, is defined as the exchange-value of labour (Grundrisse 213–14 cited in Mandel 1971: 84–85). Surplus-value is the difference between the value created by the use-value of labour and the exchange-value of labour (wages). Surplus-value is not released by selling or buying capital, it is released in the production process from labour. For example, a labourer needs to work 4 hours a day to produce all necessary goods for his own consumption. But if he works 8 hours, the next 4 hours will be extra work that will be realised in profits and thereby accumulated. This accumulation does not help the labourer but the capitalist because it is the capitalist who has control over capital and the labourer does not gain any extra advantage for this extra work. Accumulation of capital is based on the surplus-value which is realised from the labour power: "If a day's labor was required in order to keep a worker alive for a day, capital could not exist, for the day's labor would be exchanged for its own product, and capital would not be able to function as capital and consequently could not survive …" (Grundrisse 230 cited in Mandel 1971: 83). To Marx, constant capital is a result of labour and can be conceptualised as "dead labour" (Marx 1990: I. 342).

Surplus Population

In the capitalist system, there always has been unemployment. Marx asserted that this is an inseparable part of the capitalist mode of production, which he called the army of unemployed or "surplus population". The capitalist system produces wage-labourers who sell their work in the market based on the supply and demand criteria. Therefore the first advantage of surplus population for the capitalist is to push down the price of labour power. The second advantage of a surplus population is securing the dependency of the workers to the capitalists by securing oversupply of labour in the market (Marx 1990: I. 935). Furthermore, all classes will pay for this part of the population and the labourer will be dependent on the "mercy of others" (Marx 1973: 609–10).

Today, the "reserve army of labour" or "surplus population" exists in all countries in the world to put downward pressure on wages. In mainstream economics the "reserve army of labour" is defined as the "natural rate of unemployment"

(McTaggart et al 1999: 31.10–16). Unemployment is less in the industrial countries than in the developing countries, therefore the downward pressure on wages tends to be greater in the developing countries.

Overproduction of Capital alongside Poverty of the Masses

Marx divides total production in a society into two main parts; means of production and means of consumption. Commodities which are used in the process of production are among means of production, and commodities which are used for individuals' consumption are means of consumption (Marx 1992: II. 471). Because the aim of capitalists is to accumulate capital, the ultimate goal of the production process in capitalism is towards producing means of production. The immediate goal, however, is selling in the market to realise profit. To Marx the market for consumption products is limited because the masses (workers) do not have enough purchasing power. Consequently capitalists continually expand production of the means of production to find markets among other capitalists. This reproduction of capital can expand employment and consumption, which will lead to an economic boom, and increases production of surplus-value. But over time, a great quantity of commodities cannot be sold because there is limited consumption for them. Therefore there will be an overproduction crisis, which in today's economics is called "over investment" or "over capacity". Competition for selling this excess physical capital decreases prices and makes invested capital even less profitable. Then a crisis breaks out because of declining demand for means of production (and consumption) and due to the fact that capital cannot realise acceptable rates of profit (Marx 1992: II. 156–57).

Marx explains that crises are a part of the nature of the capitalist system for two main reasons. First, and most generally, the capitalist production system is not planned and is essentially anarchical. It is created by different producers who will maximise their own profit in competition with other capitalists without regard for overall economic stability. But the most important specific reason for a crisis is the declining rate of profit, which makes extra investment unnecessary and at a point even dangerous because the greater the investment, the higher the ratio of constant capital to variable capital rises and hence, the profit rate falls (Marx 1991: III. 367). For the capitalist, it is the value of capital, and the profit made by it, that is important from the start to the end of the production process. Means of production are not used for developing the quality of life of the population and productive forces, but for accumulating capital. When payment to the labourer has been minimised to a subsistence level, a bigger part of the population has insufficient income to consume and commodities produced cannot be sold at profit, therefore the economy tends towards a situation where there is "unoccupied capital on the one hand and unemployed working population on the other" (Marx 1991: III. 359). Unoccupied capital is in fact overproduced capital that is accumulated to produce more profit, and it leads to an overproduction of commodities. Therefore there is always a conflict between the productive forces and the social relations of capitalism, which takes the form of surges of overproduction relative to social demand (Marx 1991: III. 359).

Marx thus emphasised the contradiction between poverty and overproduction in capitalist society and looked forward to a social system (socialism) where production would be directed towards labourers' consumption and not towards the overproduction of capital. Capitalists are not interested in pursuing this course because those who have control over capital seek only immediate profit. There is an important footnote in *Capital* that highlights Marx's view on the consumption of the masses:

> The workers are important for the market as buyers of commodities. But as sellers of their commodity – labour-power – capitalist society has the tendency to restrict them to their minimum price. Further contradiction: the periods in which capitalist production exerts all its forces regularly show themselves to be periods of over-production; because the limit to the application of the productive powers is not simply the production of value, but also its realization. However the sale of commodities, the realization of commodity capital, and thus of surplus-value as well, is restricted not by the consumer needs of

> society in general, but by the consumer needs of a society in which the great majority are always poor and must always remain poor (Marx 1992: II. 391).

Marx’s View on Wage Determination

For Marx the value of labouring power is determined by two elements; physical and social. The physical element relates to the labourer’s physical life, production, consumption and reproduction of his physical existence. The length of the working day is limited by the physical capacity of the labourer. The social element that forms the value of labour is determined by the “traditional standards of life” in each country. It depends on the social values and needs based on the social conditions (Marx 1970: 72). The minimum and maximum rates of profit and wages depend on the limits that circumscribe the physical and social determinants of labour power: “The maximum of profit is, therefore, limited by the physical minimum of wages and the physical maximum of the working day” (Marx 1970: 74). There can be unlimited variations between these two extremes. Consequently, the maximum of wages, with given technology, productivity and the length of the working day, will be limited by the (minimum) rate of profit, which is that at which capital cannot perform as capital (that is, the return on capital is so low that investment will cease). The actual wage is fixed through a continual struggle between capitalists and labourers where capitalists try to reduce wages to the minimum physical level and increase the length of the working day to its physical maximum (Marx 1970: 74).

Marx’s view of the determination of wages differs from that of Smith, for whom the economic laws of supply and demand work by private settlement between the working men and the capitalists. For Marx an increase in wages needs “general political action” because in a “merely economic action capital is the stronger side” (Marx 1970: 74). In many cases the struggle for increasing wages is just a struggle to offset the decrease in wages that had occurred at the time of crises/recession. Therefore this struggle is necessary to achieve an equilibrium based on the natural price of labour: “If, during the phases of prosperity, when extra profits are made, he [the worker] did not battle for a rise of wages, he would, taking the average of one industrial cycle, not even receive his *average wages*, or the *value* of his labour" (Marx 1970: 69). Engels supports Marx's view on trade union struggle and argues that the struggle of trade unions is, in fact, necessary to achieve an equilibrium wage under capitalism: "The law of wages is not upset by the struggles of Trades Unions. On the contrary, it is enforced by them" (Engels 1977: 12). Engels argues that wages are fixed by bargaining power and where labour organisations are weak they are beaten by capitalists; therefore, there is a need for powerful labour organisations to increase wages (Engels 1977: 11–12). Mandel in his introduction on the Appendix in *Capital* explains that the collective strength of workers when organised into a union, provides them with the power to pressure capitalists into paying higher wages (Marx 1990: I. 946-47). Marx explained that the action of capitalists and the reaction of workers are influenced by factors such as "the value of money, the extent or the intensity of labour extracted, the fluctuations of market prices, dependent upon the fluctuations of demand and supply, and consistent with the different phases of the industrial cycle" (Marx 1970: 70).

A general rise in the rate of wages will increase the price of necessaries. As a result of this more capital will move to production of necessaries and less capital will be spent on luxuries. Therefore, the ratio of necessary and luxurious products will change but, Marx argues, the total price of commodities will remain the same. Finally, "[t]he general rise in the rate of wages would, therefore, after a temporary disturbance of market prices, only result in a general fall of the rate of profit without any permanent change in the prices of commodities" (Marx 1970: 11).

Marx emphasises that the struggle of the working class for an increase in wages is an important factor in capitalism; however, he explains that wages cannot exceed a certain level, based on the level of productivity, social power relations, and the ratio of variable capital to constant capital. To Marx, any increase in wages will provide only a small increase in the amount of paid labour and will not be enough to threaten the production of surplus-value (Marx 1990: I. 769). Wages cannot increase to such a level, due to the existence of the reserve army of workers (see earlier section on surplus population). Pressure from newcomers to the labour market will halt the increase of wages and even push them below the average (Marx 1991: III. 363). To the capitalist, it is not important how short the working day of labour is but how short is the time to produce a certain amount of commodities (Marx 1990: I. 438). Therefore, through increased productivity it is possible to shorten the working day or increase wages. Marx, in *Capital*, explains that the ratio of surplus-value to wages is dependent on (1) the length of the working day, (2) intensity of labour and (3) the productivity of labour (Marx 1990: I. 655). Thus, it can be inferred that wages can be increased under capitalism, by increasing productivity, while the ratio of profit to capital remains the same.

Technology is one of the important factors that can improve productivity of labour and can provide a base for higher wages. On the other hand, an increase in wages can increase productivity by forcing capitalists to improve machinery and productivity of labour. Marx is congratulatory towards British economist David Ricardo for presenting this important law: “Ricardo has justly remarked that machinery is in constant competition with labour, and can often be only introduced when the price of labour has reached a certain height, but the appliance of machinery is but one of the many methods for increasing the productive powers of labour” (Marx 1970: 75–76). An increase in wages can not only improve the situation of the labourer, it can expand production through improvement of productivity of labour and an increase in investment on machinery. From the experience of Great Britain in the period 1849 to 1859 Marx concluded that a general rise in real wages expanded the productivity of labour, the market for labour, and the market for commodities, despite a shortening of the working day which was brought about by government regulation under pressure from the working class. So the latter was associated with: “a great increase in the number of factory hands employed, a continuous fall in the prices of their products, a marvellous development in the productive powers of their labour, [and] an unheard-of progressive expansion of the markets for their commodities” (Marx 1970: 14).

Conclusion

Despite the fact that Smith is known as a liberal economist for his theory of "natural liberty", much of the argument for a regulated labour market can be drawn from his writings. His writings about powerful masters who can tolerate more economic difficulties than labourers in a conflict situation, and labourers who carry out limited functions during their lives and thus lose their ability to take part in social activities, are very realistic and provide a powerful demonstration of the socio-economic structures that are in place in capitalism. Smith was the first economist to discuss the origin of private property and concluded that the rich obtained their rights to property as a result of "avarice" and "ambition". Another revolutionary idea of Smith's is his theory on the value of labour as the mainspring of production and his conclusion that it was "by labour, that all the wealth of the world was originally purchased" (Smith 1993: 36).

The main weaknesses of Smith's political economy arise from his lack of attention to the formation of monopolies, imperfect information on markets, uneven competition between masters and labourers, long-term economic planning and the role of institutional and organisational frameworks in society. Smith is realistic about the socio-economic structures that are in place to determine minimum wages, but he relied mainly on the goodwill of masters (and their knowledge of market forces) for the payment of labourers and not labourers' struggle for higher wages and standards of living. Historical developments in the situation of labour indicate that outcomes are not simply determined by the will of capitalists, otherwise subsistence wages would predominate. Reductions in the working day and the increase in minimum wages in industrial countries have been mainly achieved through working class struggle and strikes. Trade unions are important organisations in all high wage countries, and they directly influence wages, work standards and the political context. In the third world countries independence from colonial powers was achieved via social struggle and wars, not the goodwill of capitalists or the free market. The level of growth and productivity are important factors in increasing wages but experience shows that in those cases where powerful trade unions are absent workers with the same productivity can earn up to 70 times less (based on nominal exchange rate) (Chossudovsky 1997: 41). Moreover, it is not just the power of local trade unions that is important in international wage fixation but also international forces (economic, political and military) that act to generate the wage gap between developed and developing countries. Neo-liberal polices today thus recall a Smithian world in which wage levels are dependent on the goodwill of capitalists.

Marx’s theories of labour power, surplus-value and wages have been presented briefly in this chapter as a means to throw some light on the problem of poverty coexisting with the problem of overproduction under capitalism. Not surprisingly Marx’s account of the labour theory of value has been heavily criticised by conservative economists. But questions have also been raised by post-Keynesians, especially Steedman (1977), and even leading Marxists such as Mattick (1969) and Meek (1977). Nevertheless, following Becker (1977), Marx’s contribution to political economy remains extremely important and is perhaps the most advanced and internally consistent model with which to interpret the economic world; “because of its correspondence with historical evidence in general and because of its usefulness as an analytical engine for garnering new insights, the surplus-value hypothesis may be regarded as an essential and viable part of any reasonable effort to understand the world we live in” (Becker 1977: 45).

Marx believed that the major contradictions of capitalism cannot be resolved but he did suggest that wages can be increased based on the improvement of technology and productivity of labour, and even by reducing the level of profit to a certain degree. The extent of any increase in wages for Marx is dependent on both subsistence needs and the historical development of social factors. This dependency is not passive and deterministic: the class struggle is a part of the social elements that dialectically influence the well-being of the labourer and the historical development of the means of production. The labourers’ struggle is important to achieve equilibrium in the labour market as capitalists naturally will decrease wages to minimise costs to obtain immediate profit. The struggle of the working class is a necessary (social) factor which increases and maintains higher levels of wages and this “higher level of wages” is a part of social and physical factors that will, in turn, influence both social and physical factors in the future. While Smith believed that increasing wages can be left to the market equilibrium or individual contracts and the goodwill of the capitalists, Marx suggested that socio-economic organisations such as trade unions and governments are important to develop and maintain higher wages. With regards to Marx’s writing on internationalism (Marx and Engels 1967), it can be concluded that Marx would have supported the struggle for an international minimum wage.

Chapter 2
Theories of Imperialism and Underconsumption

To understand the relation of developing countries to developed countries and terms of exchange between them it is necessary to study imperialism. This is because economic and political relations between developing and developed countries are based on the early phase of globalisation and the expansion of industrial countries that ended with the colonialisation of the rest of the world.

Hobson's Explanation of Underconsumption

John Atkinson Hobson (1858-1940) provided a comprehensive explanation of the disproportion in consumption and production in the capitalist system and how this leads to excess capacity and the export of capital. To understand the mechanism of the export of capital, loans, international debt, and the relationship of third world countries with industrial countries today, it is necessary to study Hobson's writings on imperialism. He explained how imperialist countries influenced the world economically, politically and socially, even impacted on a country's belief system. He described how labour in third world countries produced under the command of the financiers of the industrial countries and the influence of this in determining what is produced, how much and at what price in third world countries.

To Hobson, all the expenditure on armaments, wars, risky foreign policy, even social reforms in England served certain classes and business interests but not the whole nation (Hobson 1968: 46). Hobson believed that the apparent mess and chaos in the socio-economic system was instead structured to further the interests of some classes in the society.

> But careful analysis of the existing relations between business and politics shows that the aggressive Imperialism which we seek to

> understand is not in the main the product of blind passions of races or of the mixed folly and ambition of politicians. It is far more rational than at first sight appears. Irrational from the standpoint of the whole nation, it is rational enough from the standpoint of certain classes in the nation (Hobson 1968: 47).

According to Hobson the imperialist-based foreign policy of England was aimed at controlling profitable markets for investment (Hobson 1968: 53). This investment abroad for profit is the most important factor in the economics of imperialism. By studying the exports and imports of England, Hobson found that income from foreign investment was much greater than income from the export and import of goods (Hobson 1968: 53). In search of profit, investors in industrial countries tried to minimise their risk by relying on public resources and encouraging the government to take over more foreign territories (colonies) for more profitable investments (Hobson 1968: 56). These investors had control over large amounts of stocks and shares, and created artificial fluctuations by their speculations.

To Hobson the most important feature of imperialism is the seeking of foreign markets for investment. Imperialism regulated output and prices for the home market whilst dumping surplus goods at lower prices in other markets (Hobson 1968: 77). Imperialism is economically based on the strong organisation of industry and finance markets, supported by governmental means, to secure surplus capital (Hobson 1968: 106). Another aspect of imperialism is the creation of public debts. This not only enables the investors to escape taxation, but creates the opportunity for profitable investment at the expense of the public (Hobson 1968: 108). Hobson compared the growth of spending on the military and war with the increased value of colonial trade in England from 1884 to 1903 and found a strong positive correlation between them. He explained that the increase in military expenditure was for the protection of the colonial market and opening of new markets. Imperialism was born through "free trade" but rested upon protectionism (Hobson 1968: 65–67).

Imperialism is the result of excess production over consumption in a society; goods are produced that cannot be sold at profit. To Hobson "[i]t is this economic condition of affairs that forms the taproot of Imperialism" (Hobson 1968: 81). If the consumption of the masses increases to match productivity growth, there will be no excess of product, no urgent need to seek new markets (to sell them) and therefore no grounds for imperialism. By "no excess of products to sell abroad", Hobson does not mean foreign trade will be unnecessary. There will be room for foreign trade, but in the form of trade for goods that are produced more cheaply abroad in exchange for goods in which the home country has a comparative advantage (Hobson 1968: 981). He affirmed that trade should be based on the consumer's needs, not on the producer's profit motive (Hobson 1968: 88). This could result in full employment in the home country on the basis that "human needs are illimitable" and would rise with a rise in productivity. The problem of excess production was a matter of the distribution of wealth and the wage system. Hobson argued that in the contemporary distribution system "wages are based upon cost of living, and not upon efficiency of labour" (Hobson 1968: 83). He gave as an example two mines of different quality in which the workers are paid the same wages while the greater advantage of the richer mine goes to the owner of that mine.

Lower prices are the result of free competition and lead to stagnation of production. Thus large sums must be wasted on advertising and there will be more incentives to search for new markets. The result is crisis and economic collapse where capital and labour become unemployed. Hobson rejects the claim that imperial expansion is the result of progressive industry: "*it is not industrial progress that demands the opening up of new markets and areas of investment, but mal-distribution of consuming power which prevents the absorption of commodities and capital within the country*" [emphasise is from Hobson] (Hobson 1968: 85). This underconsumption of the masses is the basis of what Hobson calls "over saving" and the root of imperialism. This over saving was obtained by rents and monopoly profits (Hobson 1968: 85). Hobson referred to statistics from Mr Rowntree that showed one-fourth of the population in England were "living at a standard which is below bare physical efficiency" (Hobson 1968: 88). During this period there was much hunger and illness in England whilst a vast amount of resources was squandered on fighting to secure foreign markets.

To Hobson, the solution to this "false economy of distribution" and its fruit "imperialism" was "social reform" to raise the aggregate demand in the economy and substitute better forms of consumption which would be more "educative and stimulative" (Hobson 1968: 88). "*The only safety of nations lies in removing the unearned increments of income from the possessing classes, and adding them to the wage-income of the working classes or to the public income, in order that they may be spent in raising the standard of consumption*" [emphasise is from Hobson] (Hobson 1968: 89). Here, Hobson presents a theory of consumption, effective demand and public spending long before Keynes presented his theory of effective demand. At the time of writing, Hobson had neither experience of the two world wars with huge government spending in industrial countries nor the experience of the Soviet Union. Hobson is even more progressive than Keynes when his response to the problem is public spending to raise the "standards of consumption" while Keynes includes "pyramid building" and "wars" as part of the solution when necessary (Keynes 1998: 128–31).

Hobson made a great contribution to political economy by identifying chronic underconsumption in capitalism and showing that it leads to export surplus supply and imperialism. Hobson explained that there is a need for selling excess products and capital as well as access to raw materials and cheap labour which motivates industrial countries to invest in third world countries under aid, loan or (recently) development programs. Hobson could forecast the unification of industrial countries as financiers against other nations, but he could not realise that there is a deep conflict between industrial countries as well. Thus Hobson could not forecast the two world wars, which in fact were industrial countries' battles for colonies. However, Hobson developed theories of effective demand and suggested that the income of the working class should be increased or the public sector expanded to raise the standards of consumption. This increase in wages of the working class, especially of workers in the third world countries, is clearly needed in the dual international economy that comprises the world market today.

Keynes and Effective Demand

While Hobson had little effect on mainstream economic thought, John Maynard Keynes, who developed the underconsumptionist position, certainly did.

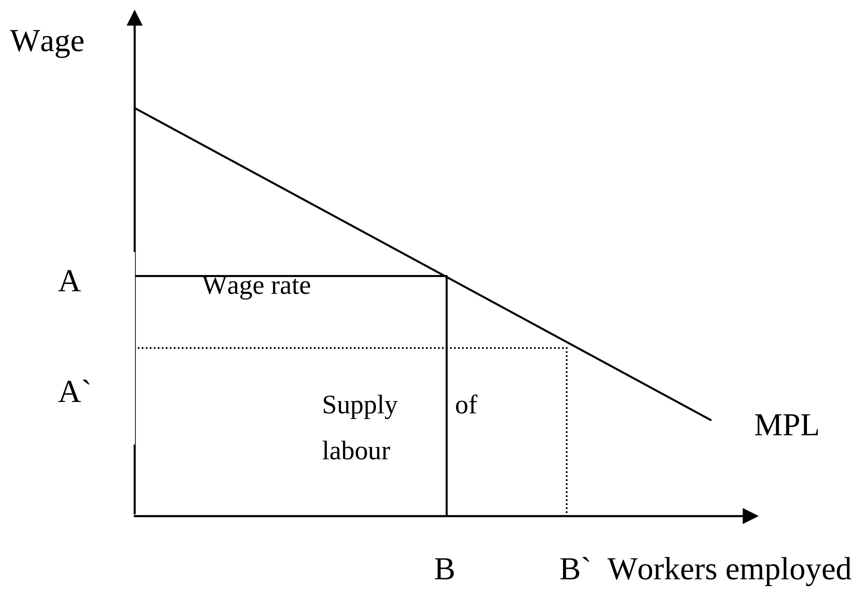
Increased rates of economic growth and standards of living in the industrial countries after the Second World War were due partly to post-war reconstruction and partly to government spending and fixing of higher minimum wages and social benefits for low income people. Government spending and the increase in the income of the lower classes were themselves a result of various factors, such as the experience of government intervention during the war (which was known as the "war economy"), the experience of the Soviet Union, trade unions' struggle and Keynesian economics of effective demand, which advocated vast government spending programs. Keynes was not the first economist to be aware of the effect of consumption on the economy, but he was the first one who developed a precise economic model for effective demand within the framework of the capitalist system. Keynes provided comprehensive theories about expectations, interest rates and money, but in this section the emphasis is on his theories on effective demand, aggregate supply and aggregate income/output.

Keynes affirmed that "[a]ll production is for the purpose of ultimately satisfying a consumer" (Keynes 1998: 46). In an economy with wages at subsistence level there cannot be much opportunity for consumption by the masses. There will only be luxurious consumption by the upper classes and reinvestment in capital goods. There will naturally be limited room for investment when the majority in a society are living in absolute poverty and demand for new products is limited. To understand the importance of Keynesian economics, it is necessary to examine neo-classical economics before Keynes because this approach had a wide-ranging influence on economic policy in industrial countries before the Second World War. A review of neo-classical economics is important also because neo-liberalism, today, is mainly based on neo-classical economics.

Determination of Wages and Employment in Neo-classical Economics

In neo-classical economics the levels of total employment and total output were determined by the production function where labour and capital were substitutable. In the short term, the quantity of capital is held constant; the demand for labour is then determined by the value of the marginal productivity of labour (MPL). With a given demand for labour, total output could be determined by wages. The relation of wages and employment to total production, in neo-classical economics, is shown in graph 1. The MPL line represents the marginal productivity of labour that is decreasing with an increasing amount of employment.

Graph 1. Neo-classical Determination of Wages and Employment – Output



Source: Hunt 1992: 501

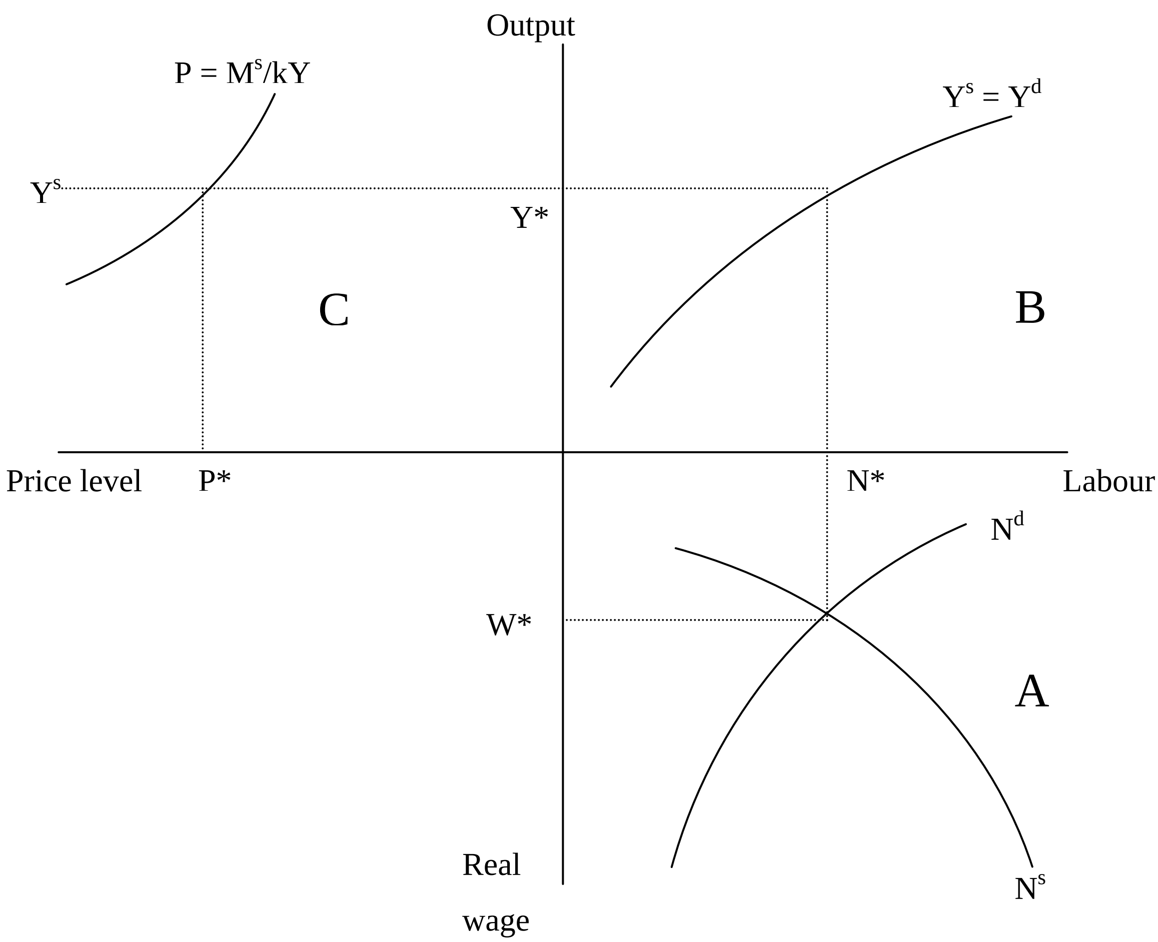
With a decrease in wages, total employment tends to increase. Neo-classical economists denied that any involuntary unemployment existed because by maximising profit, producers were willing to hire labour up to the level of the marginal productivity of labour. Therefore any unemployment was due to the height of wages and that labourers were not willing to work at a lower rate of wages. Based on the neo-classical model, if wages are equal to the marginal productivity of labour, there will not be any aggregate demand problem and all income will normally be spent and all products will be consumed (this is known as Say's law) (Hunt 1992: 500–02).

In the neo-classical view, the interest rate, naturally, determines a balance between saving and investment. If interest rates are high, people can save more for more consumption in the future. A high level for the interest rate is associated with a high level of saving and a low level of investment. People will invest less because it will cost more if they want to borrow funds for new investment (Hunt 1992: 503). Investment is a negative function of interest rates and saving is a positive function of interest rates because people will save more with higher interest rates in order to consume more in the future (Keynes 1998: 166).

Based on neo-classical economics, there are three leakages and three injections in the economy: saving–investment; import–export; and taxes–government spending. Through the free market of interest rates, the saving–investment market comes into balance; through free trade, import–export comes in balance; and by a balanced budget, taxes–government spending comes to equilibrium. Equilibrium in these three markets means that aggregate demand will automatically come into equilibrium with aggregate supply. The only problem in an economy in recession is high wages. If labour could accept lower wages there could be no involuntary unemployment and no recession. Therefore during the Great Depression "even those neoclassicists who were the most humane and sympathetic to the plight of workers could recommend nothing but a general cut in all wages" (Hunt 1992: 504).

In graph 2 panel B presents the product market with output, Y, on the vertical axis and labour, N, on the horizontal axis. The positively sloped curve, Y^s, is the aggregate production function. Since in neo-classical economics it is accepted that supply creates its own demand (Say's law), the supply function, Y^s, can represent the demand function Y^d as well. In this case, there is no excess production and no overcapacity.

Graph 2. The Neo-classical Model of Labour and Output



Source: Palley 1996: 28

Panel A in graph 2 represents the labour market with labour, N, on the horizontal axis and real wages on the vertical axis. N^s presents the labour supply schedule and N^d denotes the labour demand schedule that is derived from the marginal product of labour. For neo-classical economics there will be an equilibrium in employment in the labour market, N*, that is the point where the labour supply curve, N^s, intersects the labour demand curve, N^d.

Equilibrium in the labour market determines equilibrium in wages, w*, and output, Y*. In this concept "Output and employment are therefore determined in the labour market, and in this sense the equilibrium is supply constrained: the critical constraints are the availability of labour, and the production technology" (Palley 1996: 28). Panel C in the model represents the money market. Since the output, Y*, is determined in the labour market by real wages, the equilibrium level of output is independent of the price level. Therefore the aggregate supply curve is horizontal in the price–output diagram. In this case, prices are determined in the money market by adjusting the money supply, M^s, to the money demand, kPY. Therefore, with $Y^s = Y^d$ and if wages are flexible to equilibrate supply–demand in the labour market, there will be no involuntary unemployment.

Effective Demand in Keynesian Economics

Keynes accepted most neo-classical theories about the marginal productivity of labour and the disutility of employment for workers as well as the correlation between interest rates and investment–saving. However, Keynes introduced some new determinants to these functions. He suggested a consumption function where the level of consumption was positively dependent on the level of income and, naturally, dependent on the level of saving. "Granted, then, that the propensity to consume is a fairly stable function so that, as a rule, the amount of aggregate consumption mainly depends on the amount of aggregate income" (Keynes 1998: 96). According to Keynes, an increase in income, ΔY, will increase consumption by a smaller amount, ΔC. In mathematical terms, ${}^{dc}/_{dy}$ is positive and less than unity (Keynes 1998: 96). The other part of increased income will be devoted to saving. An increase in income ΔY causes saving to increase by ΔS at a lower rate: $0< {}^{\Delta s}/_{\Delta Y}<1$. The increase in consumption spending would decline at higher income levels, because at lower levels, almost all income would be spent on immediate basic needs;

> … apart from short-period changes in the level of income, it is also obvious that a higher absolute level of income will tend, as a rule, to widen the gap between income and consumption. For the satisfaction of the immediate primary needs of a man and his family

> is usually a stronger motive than the motives towards accumulation … (Keynes 1998: 97).

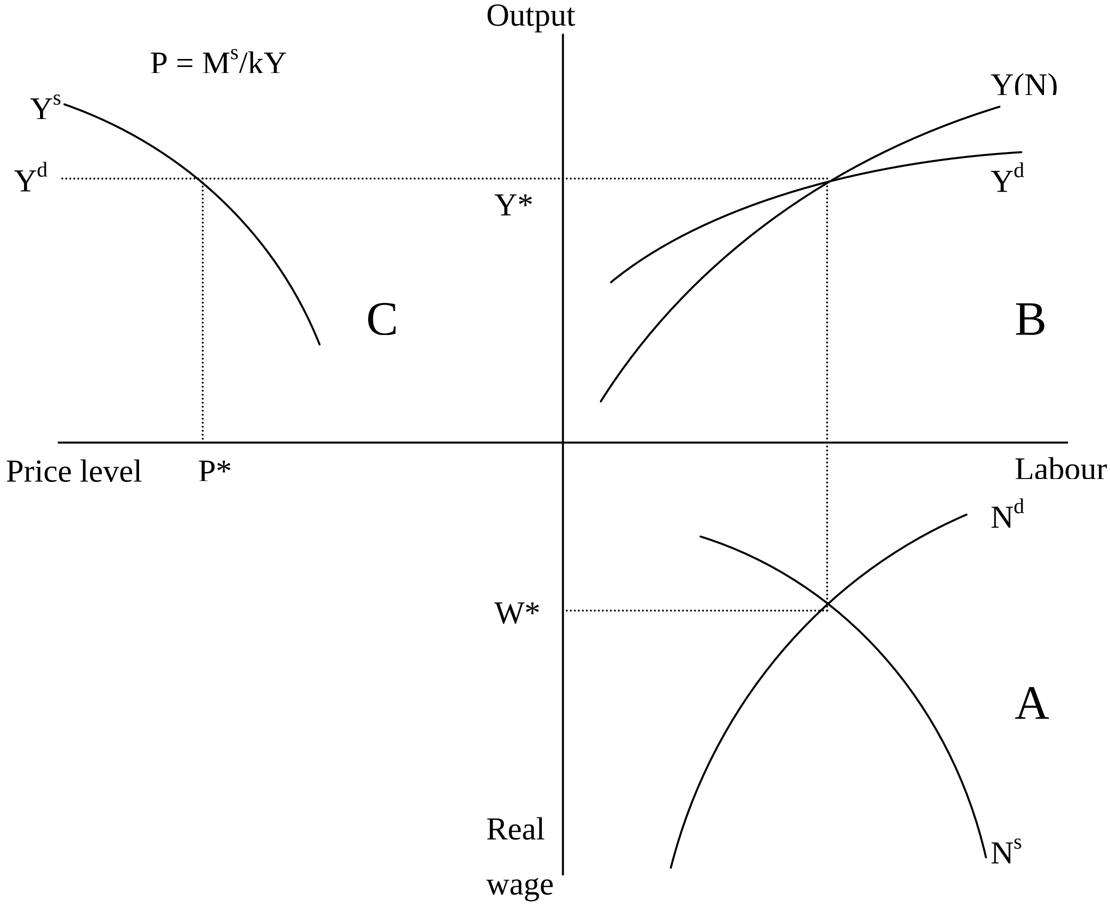
Keynes assumed that aggregate consumption depends on (1) the amount of income, (2) the objective circumstances (like nominal income, interest rates and expectation for future income), and (3) individuals' subjective needs, psychological propensities, habits, and the distribution of income (Keynes 1998: 90–91).

With a low level of effective demand, the level of production will be low despite the marginal productivity of labour being higher than the marginal disutility of employment. This can lead to a situation of involuntary unemployment where the labourer will work with existing wages but because of relative over-investment and overcapacity, unemployment will be at a high level.

> This analysis supplies us with an explanation of the paradox of poverty in the midst of plenty. For the mere existence of an insufficiency of effective demand may, and often will, bring the increase of employment to a standstill before a level of full employment has been reached. The insufficiency of effective demand will inhibit the process of production in spite of the fact that the marginal product of labour still exceeds in value the marginal disutility of employment (Keynes 1998: 30–31).

In the supply constrained model the aggregate supply curve is horizontal and is independent of the price level. In the demand determined model the aggregate demand curve is horizontal and is independent of the price level. In both models output is independent of the price level. However, in the supply constrained model unemployment is a result of price rigidity while in the demand determined model unemployment is a consequence of insufficient demand for output (Palley 1996: 31). In the Keynesian model, it is possible to have an equilibrium where aggregate demand and aggregate supply intersect without full employment: "That is to say, effective demand, instead of having a unique equilibrium value, is an infinite range of values all equally admissible; and the amount of employment is indeterminate except in so far as the marginal disutility of labour sets an upper limit" (Keynes 1998: 26).

Graph 3. Keynesian Model of the Labour Market and Aggregate Supply –Demand



Source: Palley 1996: 29

Excess products and lack of consumption force governments to search for new markets. Keynes argued that international trade should be something more than a struggle for finding new markets. By achieving full employment in the domestic economy, nations do not need to struggle for new markets and surplus trade. He argued that "under the system of domestic *laissez-faire* and an international gold standard … there was no means open to a government whereby to mitigate economic distress at home except through the competitive struggle for markets"

(Keynes 1998: 82). Kalecki (1990) explains that the effect of government spending (borrowing) is mainly the same as, for example, spending (borrowing) by the foreign government to buy domestic products. Therefore, instead of encouraging (or forcing) foreign governments to open their markets, governments can absorb the excess products in the domestic economy by extra investment in the domestic economy (Kalecki 1990: 165–73).

In this study focus is on that part of Keynesian economics which supports the importance of consumption, employment and government intervention in the economy to redistribute income rather than investing in “pyramids and war” (see Keynes 1998: 128–31). The huge gap between wages in the developed and developing countries and the excessive overcapacity in the world market alongside the masses in poverty, show that the importance of effective demand has been ignored in the world economy. Since the supply side of the economy has been internationalised, there is considerable justification that Keynesian policies of demand management should be applied on the international level through macroeconomic co-operation, particularly via increasing minimum wages.

Rosa Luxemburg

Rosa Luxemburg (1963) further developed the theory of imperialism and explained how imperialism changes the mode of production in other countries to suit imperialism’s mode of production. She provided examples of imperialistic intervention in third world countries and explained the economic basis for such intervention. Her study is still relevant regarding the economic relationship between industrial countries and third world countries and the reasons for trade. According to Luxemburg, capitalist development is dependent on non-capitalist forms of production. Capital needs a natural economy to provide a market for export of surplus-value, and as a supplier of natural resources, cheap labour and reserve labour for the wage system (Luxemburg 1963: 368). However, utilising these resources in the non-capitalist societies is problematic because the forms of production in a natural economy are not suitable for a capitalist mode of production.

In Luxemburg's view, a capitalist economy makes a number of changes in a natural economy to facilitate capitalist methods of exploitation. These changes are, broadly, to ensure access to resources like land and mines; to "liberate labour power" and force it to become wage labour; to create a commodity economy; and to separate trade and agriculture (Luxemburg 1963: 369). Luxemburg describes the impact of the capitalist economy's influence on the non-capitalist society as essentially conflictual. The non-capitalist economy naturally protects its social organisation and lifestyle. This will result in conflict when the capitalist system attempts to change the old lifestyle: "Capital must begin by planning for the systematic destruction and annihilation of all the non-capitalist social units which obstruct its development" (Luxemburg 1963: 370). Capital cannot be accumulated without the integration of a capitalist mode of production into a natural economy. This change in the mode of production, if left to natural processes, could take hundreds, even thousands, of years: capitalism therefore accelerates the process by force: "the method of violence, then, is the immediate consequence of the clash between capitalism and the organizations of a natural economy which would restrict accumulation" (Luxemburg 1963: 370–71).

Luxemburg argues that imperialism needs cheap labour, raw materials and new markets for consumption, and that this leads to investment in the colonies. To create surplus-value, imperialism has to change the mode of production in other economies and encourage commodity production. This change is based on the mother country's needs and naturally leads to conflict with the old ways of living and national interests of the host country (colony). Today, changes in the mode of production in third world countries to serve the needs of the capitalistic core is achieved by different means; one of which is the "development programs" constructed and implemented by the World Bank and the IMF. These programs aim to decrease the costs of production and increase exports to industrial countries. The goal of such programs is to increase exports regardless of the basic rights of the people.

Lenin

V. I. Lenin criticised imperialism from a Marxist perspective with consideration to the earlier writings on the subject such as those of Hobson and Luxemburg. To Lenin, imperialism was born out of the concentration of production in the hands of a few producers. Lenin supported his position with data regarding production processes in the large capitalist countries such as the United States, England, France and Germany. In the case of the United States, for example, Lenin noted: “Almost half the total production of all the enterprises of the country was carried on by one-hundredth part of these enterprises!” (Lenin 1999: 35). Lenin divided the historical formation of monopolies into three different periods. The first period, from 1860 to 1870 was the highest stage of free competition, and the time when monopolies appeared. In the second period, after the economic crisis of 1873, cartels developed but they were still rare. In the third period, cartels became an important part of the economy, and then, after the crisis in 1900–03 “capitalism [had] been transformed into imperialism” (Lenin 1999: 38).

Lenin believed that in a capitalist economy surplus capital will not be spent on raising the living standards of the masses but will be exported to less developed countries. Because the purpose of capital investment is maximising profit, capitalists prefer to export capital to the most profitable areas. Lenin explains that “in these backward countries profits are usually high, for capital is scarce, the price of land is relatively low, wages are low, raw materials are cheap” (Lenin 1999: 71). Loans are used as a means of encouraging the export of commodities by the creditor, and in this way the export of capital can be seen as a means of concession and corruption. A loan can sometimes even be used as a condition for buying armaments (Lenin 1999: 73). Initially, the home market was divided between cartels, syndicates and trusts and then the world market provided the opportunity for the big monopolies to expand their sphere of influence (Lenin 1999: 75).

The role of colonies is important in an imperialist economy. In establishing colonies, the imperialist nations employ the methods of monopolisation, eliminating competition, ensuring the supply of materials and maintaining vital political connections. To Lenin, “non-economic super structures” are important to maintain control and “domination”. These non-economic structures are political, social and ideological aspects that are created by finance capital and in turn support its dominance (Lenin 1999: 88). Neo-colonialism, or the “semi-colony” as Lenin called it, resulted from the exertion of financial control over a country which was not under territorial control. Lenin referred to Schulze-Gaevernitz’s study on British imperialism in his description of the phenomenon of the “semi-colony”: “South America, and especially Argentina is so dependent financially on London that it ought to be described as almost a British commercial colony” (Schulze-Gaevernitz, quoted in Lenin 1999: 89).

Lenin identified five core features of imperialism:

1) the concentration of production and capital and the development of monopolies;
2) the merging of bank capital with industrial capital and the development of “finance capital” and a financial oligarchy;
3) the export of capital on a large scale instead of the export of commodities;
4) the formation of international monopoly associations that divide the world among themselves;
5) the division of all the territories in the globe between the capitalist powers (Lenin 1999: 92).

Referring again to Schulze-Gaevernitz, Lenin noted that the national income of England almost doubled in the period from 1865 to 1898, while the income from abroad increased ninefold during this period. This shows how important investment outside England was for its economy. Both Schulze-Gaevernitz and Lenin assumed that the tendency in Europe to become *rentier* states would grow and the burden of hard work would shift to the other countries: “Europe will shift the burden of physical toil – first agriculture and mining, then the rougher work in industry – on to the coloured races, and itself be content with the role of rentier, and in this way, perhaps, pave the way for the economic, and later, the political emancipation of the coloured races” (Lenin 1999: 104).

Lenin's response to scholars who claimed that exports of finance were corrupt and costly to the home country but exports of goods were more natural and could develop the home industry, was that exports of goods are in fact dependent on the exports of capital and finance and their "swindling tricks" (Lenin 1999: 114). In fact it is the export of finance by swindling and other "unnatural" means such as war that opens markets abroad for further export of goods. To Lenin, capitalism cannot be reformed and poverty is inherent in the nature of capitalism. Growth in international exchange and the uneven development of enterprises, branches of industry and countries are also characteristic features of capitalism: "for both uneven development and a semi-starvation level of existence of the masses are fundamental and inevitable conditions and constitute premises of this mode of production" (Lenin 1999: 70).

By using data from earlier research, Lenin showed that, by 1900, the entire globe had been divided between the colonial powers, leaving no more territory for occupation. But Lenin did not reject the possibility of redividing the globe, even seeing this as inevitable: "territories can only pass from one 'owner' to another, instead of passing as ownerless to an 'owner'" (Lenin 1999: 82). It is unclear here whether Lenin has ignored the native people as owners or is simply using the capitalist expression to explain the world. Lenin rejected Kautsky's belief "that international cartels, being one of the most striking expressions of the internationalisation of capital, give the hope of peace among nations under capitalism" (Lenin 1999: 80). To Lenin this internationalisation is rather a capitalist internationalisation whereby certain groups of capitalists or countries make economic alliances in a struggle for colonies and influence (Lenin 1999: 81). Two world wars and several regional wars and revolutions in different countries support Lenin's theory of internationalisation driven by multinational monopolies.

Using statistics from a number of industries, Lenin explained that productivity in Germany had grown rapidly relative to that of England from 1892 to 1912, but the area of colonies these two powers owned remained the same during this period. He concludes that to overcome this imbalance between imperialist powers there is no way other than war (Lenin 1999: 99). On the other hand, Germany's superiority in productivity does not mean superiority of free trade but superiority of one of the rivals over the other: "If Germany's trade with the British colonies is developing more rapidly than Great Britain's, it only proves that German imperialism is younger, stronger and better organised than British imperialism, is superior to it; but it by no means proves the "superiority" of free trade" (Lenin 1999: 112).

Much of Lenin's account of the primary features of imperialism remains relevant today. Formation of monopolies, export of capital and formation of international monopoly associations are still characteristics of capitalism in the twenty-first century. Division of the world between international monopolies was already described by Hobson. However, Lenin explained that imperialists will redivide the world between themselves by wars. As a Marxist writer, Lenin believed any radical change in this world order could only come through revolution and anti-colonial wars. To him, any reduction of the power of monopolies and increase in wages required class struggle and ultimately force. Lenin's general analysis has been confirmed by the fact that during the twentieth century the independence of colonies was mainly achieved by struggle, war and revolution.

Baran and Sweezy

Labour is mainly divided through national borders, but it is also divided within a nation by racial issues. In this part, the mechanism of US imperialistic intervention in recent decades and the use of racism to divide labour within the US economy will be briefly reviewed through the work of Baran and Sweezy. Baran and Sweezy (1973) studied the relation of the American economy and its expansion in the world to growth in the relative size and importance of its military spending and concluded that US militarism was not for defence against the Soviet Union, as was claimed, but for controlling the economic and political world order to expand American imperialism (Baran and Sweezy 1973: 184–85). To Baran and Sweezy, militarism has the further aim of controlling and misleading the masses of the country. "It is not that armed force under capitalism is used only in the international sphere. In every capitalist country, it is used to dispossess, repress, and otherwise control the domestic labour force" (Baran and Sweezy 1973: 179). In the imperialist world order there is a "hierarchy of nations" where the top of the hierarchy is the United States, which exploits all other countries. A number of other industrial countries are in the next rank of this hierarchy and they also to some extent exploit other countries and are exploited in turn by the United States, according to their position in the hierarchy. Those countries at the bottom of the hierarchy are exploited but do not exploit other countries (Baran and Sweezy 1973: 179). Therefore, it is claimed, the United States' militarism is needed to control this hierarchy and maintain its own position of international superiority.

To Baran and Sweezy, the reason for the United States' economic expansion was stagnation in the home market and the higher profits available from investment abroad. To support this claim, Baran and Sweezy cite statistics from Jersey Standard, the largest industrial corporation in the United States, to show that profits from abroad are almost two times more than the amount invested, while profits from the domestic market are almost half of the assets invested there (Baran and Sweezy 1973: 193). Baran and Sweezy further support this claim of an increasing trend toward investment outside the United States and the establishment of multinational companies with a quote from *Business Week* (US):

> In industry after industry, U.S. companies found that their overseas earnings were soaring, and that their return on investment abroad was frequently much higher than in the U.S. As earnings abroad began to rise, profit margins from domestic operations started to shrink … This is the combination that forced development of the multinational company (Baran and Sweezy 1973: 195).

Imperialism creates privileged groups among workers and splits them from the masses of the proletariat. The same premise is followed in imperialist immigration policies. By placing migrant workers in less privileged positions the home country workers are privileged by default, and thus imperialism makes the proletariat movement corrupt and bureaucratic (Lenin 1999: 105–08). The race problem is another aspect of capitalism. Baran and Sweezy claim that racism was created basically to justify colonialism and the exploitation of coloured labour. But with the development of capitalism, particularly imperialism, the social structure became differentiated and different “social strata” and “status groups” were developed in a hierarchical form based on income and other social advantages or disadvantages like race. As a result, each status group has superior or inferior feelings regarding other groups. These relations of superiority–inferiority are crucial in pitting different groups within a capitalist society against each other and making exploitation easier. Thus, according to Baran and Sweezy, racism in the US constitutes a social structure developed over time by monopoly capital. One of the economic consequences of this socially structured inequity is illustrated by the fact that while non-whites made up 11 percent of the US work force, they accounted for up to 25 percent of all long-term unemployment and, for the same job, the so-called coloured races were paid less (Baran and Sweezy 1973: 256).

The Search for Markets in the 1990s

In today’s world, overcapacity and overproduction of commodities, raw materials and even consumption goods are very common. From oil and coffee to fiber optics there is over production in the market: “only 2.5 percent of all the fiber optics that have been laid out throughout the nation [the USA] are now operating” (Business News 2001) and “only 72 percent of global steel production is being used – part of an ongoing trend of overcapacity” (BCG 2002). These situations occur in a world in which 2.4 billion people are without access to basic sanitation and 2.8 billion live on less than US$2 a day (UNDP 2001). Usually liberal economists deny or ignore these facts, but these are the most important facts that economics should respond to in a steadily more globalising economy.

While industrial countries permit monopolies in their own markets, they insist on opening up third world country’s markets: “the more advanced industrial countries declined to open up their markets to the goods of the developing countries … while insisting that those countries open up their markets to the goods of the wealthier countries" (Stiglitz 2002: 7). The IMF and the World Bank persuade developing countries to reduce public spending on education and health, and privatise their infrastructure and natural resources under these development programs. These programs not only change the economic mode of production in a country but also bias the form of consumption and the type of production towards international monopolies: "In other words, loan money earmarked for infrastructural projects is largely "recycled" in favour of multinational contractors … the PIP [Public Investment Programme] under the supervision of the World Bank is predicated on enlarging the external debt while contributing to the demobilisation of domestic resources" (Chossudovsky 1997: 61).

The entire IMF and the WB policies are based on plans in which all third world countries are restructured to produce for export to the same markets, namely Europe and North America. As a result, third world countries face oversupply for their products and have to cut prices even more. The IMF and WB insist that third world countries eliminate government subsidies and align domestic consumption prices with those in international markets, while wages are to be determined in the "free market", which means less regulated or no labour markets in the third world countries: "Whereas prices are unified and brought up to world levels, wages (and labour costs) in the third world and Eastern Europe are as much as 70 times lower than in the OECD countries" (Chossudovsky 1997: 41). Imperialist policies are designed not only to reduce wages in the third world countries but to depress wages in the industrial countries as well. Thus average real wages in the US economy grew only 0.25 percent a year during the 1980s and 1990s, while the historic growth has been 2 percent a year (Singh and Zammit 2004: 11). This is despite the fact that the growth rate of GDP and average real private consumption in the US has been more than 3 percent during this period (OECD 2002).

Conclusion

Keynes, like Hobson and Marx, believed that in the capitalist system there is excess investment over consumption and the market cannot use this excess investment effectively. However, unlike Hobson, Keynes believed that it is not the lack of consumption that directly results in overcapacity but an imbalance between the propensity to consume and propensity to invest (Keynes 1998: 368–70). This is because through an increase in income people will save a higher proportion of their income (the multiplier effect) and therefore there will be less aggregate consumption than aggregate income. Possibly it is Keynes' emphasis on multipliers that led him to support governments' unproductive investments (like military investment) (see Keynes 1998: 129). Keynes recommended governments borrow the excess saving and invest it where private enterprise does not invest. Keynes presented a comprehensive model of effective demand that is dependent on aggregate income (and thus employment). He also argued that the economy can come into equilibrium without full employment; the interaction between the rate of investment and propensity to consume will determine the volume of employment but real wages can be fixed over this level providing governments take over the less profitable investments (Keynes 1998: 29–30).

The problem of insufficient demand has another dimension in the international economy. To maximise profit, capitalists prefer to export capital to foreign countries, where the rate of return is highest, instead of investing in consumption goods in response to the masses' needs in the domestic economy. In the search for cheap labour and raw materials in less developed countries, imperialists need to change the mode of production and infrastructure in these countries. Therefore, despite colonialisation being formally abolished, financial, political and military means are used by industrial countries to maintain control over the ex-colonies (developing countries). The situations in industrial countries is better than that of the third world countries but privatisation, casualisation of jobs and decline of real wages relative to productivity have been common trends in the last two decades in the industrial countries as well.

The experience of fast growing East Asian countries in the 1950s and 1960s supports Keynes' position on government spending to create employment and welfare. In this chapter we have reviewed the historical intervention of imperialist countries in third world countries; however, the conclusion is not to reject any trade between third world countries and industrial countries but to understand the basic elements of this relationship. It is important that third world countries be involved in any development program so they can assert their own interests. As Hobson argued, the solution to excess investment is to increase the income of the working classes and direct production to serve the demands of the productive forces.

Chapter 3

Theories of Trade and the Distribution of Income

Today, world economic policy is influenced by big international actors like the International Monetary Fund, World Bank, the Group of Eight Industrial Countries, WTO, United Nations and some individual countries or economic unions like the United States and European Union. In this international or steadily more globalising economy, movements of capital, finance and goods face few barriers. Goods can be exchanged between countries with little or no restrictions (under WTO tariffs on goods are 3 percent) and prices are becoming more and more internationalised. But labour is exempt from this “free market” or “global economy”; it is almost impossible for labour to move, for example, from Indonesia to Australia or from Mexico to the US despite the fact that the two latter countries possess the most liberalised economies and both are members of NAFTA. Despite the internationalisation of prices, the price of labour (wages) differs up to 70 times between the rich and poor countries (Chossudovsky 1997: 41). The IMF and the World Bank policies are influenced by neo-liberal trade theories, more specifically, the Heckscher-Ohlin trade theory, which assumes that if capital and goods are mobile, the price of factors like labour can be equalised by trade even when the labour factor is immobile. Therefore, the Heckscher-Ohlin theory will be presented here and its empirical validity will be evaluated.

Heckscher-Ohlin Trade Theory

The Heckscher-Ohlin theory was developed before the Second World War when the lack of labour movement was mostly because of technological and cultural restrictions rather than political restrictions. Even though the means of transport were less developed at that time, movement of labour was more common than today. For example, at that time there was a huge movement of labour mainly from Europe to the United States, Canada, Latin America and Australia (Stalker 2000).

Heckscher's theory, which is used in a very narrow form by (neo)liberal scholars, was an attempt to approach the "nature of foreign trade" and its effect on the economy:

> At best, however, this article cannot pretend to be more than a first and purely theoretical account, since the subject is not only difficult but also very broad. If the following sketch inspires others to continue the study of this subject, my goal will have been reached, even if I prove to have been mistaken in some respects – a possibility that can by no means be ruled out (Heckscher and Ohlin 1991: 44).

Heckscher rejects Ricardo's theory of foreign trade, which is based on the labour theory of value, and develops a neo-classical (marginalist) approach based on comparative advantage in the relative abundance of factors of production. Heckscher argues that if the same proportion of the same factors with the same price is used for a good in two different countries, there will be no trade because goods will be produced with the same price in both countries and there is no reason for exchange. Therefore on assumption that the same technique is used in both countries, there must be differences in the price of factors and/or differences in the proportion of factors used to have different prices for goods. In Heckscher's theory, factor prices are important in developing relative prices in different countries (Heckscher and Ohlin 1991: 47).

What makes prices of factors of production differ in different countries is their relative scarcity. With the same scarcity of factors of production, prices of factors will be the same, and therefore, in a situation with the same technology and the same size of the economy, trade will not appear. So Heckscher's theory is based on the difference between factors of production; all other economic factors must be the same and factors of production must have a different relative scarcity: "A difference in the relative scarcity of the factors of production between one country and another is thus a necessary condition for differences in comparative costs and consequently for international trade” (Heckscher and Ohlin 1991: 48).

There are several basic assumptions in H-O theory that make it very limited. Some of these assumptions are as follows: (1) there must be differences in the relative scarcity of factors of production and different factor proportions between countries; (2) techniques are the same in different countries; (3) there is no substitution in consumption; (4) there is no substitution in the use of the factors of production (Heckscher and Ohlin 1991: 54–56); (5) the advantages of large-scale production are ignored; (6) production functions display a constant return to scale and are identical in all countries; (7) commodities use the same factors at all factor price ratios and transport costs are neglected; (8) there is perfect competition in commodity and factor markets and demands are identical and homogeneous in all countries (Maneschi 1998: 184). Heckscher accepted the assumption of “same technique” as essential for his trade theory and emphasised that “ … it is equally certain that differences in technique lead to differences in factor prices” (Heckscher and Ohlin 1991: 58).

Heckscher uses United States agriculture and textiles as examples. The abundance of land in the US induced a higher return per unit of labour compared to Europe and therefore wages increased. This made the price of textiles in the US increase. Thus the US exchanged its agricultural products for textiles from Europe. Trade between the US and Europe appeared because the relative price of land and labour was different in the US to that of the world, and this was because of the relative scarcity of land and labour not because of the difference between the quality of labour in the US and Europe. “The relatively high price of textiles was caused by the disproportion between land and labor as compared to the situation in the rest of the world, not by differences in labor quality”. Therefore scarcity of labour in the US made wages higher and rent lower in the US than in the Europe (Heckscher and Ohlin 1991: 57–60).

In a situation with free trade, the US would export (land intensive) wheat to Europe and import (labour intensive) textiles and this trade would grow until the price of labour in the US decreased to that of the international level; but prices would not become perfectly equal. There will be a “harmonic state of equilibrium” (Heckscher and Ohlin 1991: 57). Trade will diminish by the equalisation of factor prices but trade will not disappear because if so the difference in prices will appear again. Therefore trade will tend to equalise factor prices: “The effect of interregional trade can be described, in summary, *as a tendency to eliminate the drawbacks of limited divisibility and mobility of the factors of production*” (Heckscher and Ohlin 1991: 92).

In this “harmonic state of equilibrium” differences in the factor prices will almost disappear with trade without any movement of factors of production: “On the contrary, the differences in comparative costs inevitably disappear as trade expands. Differences in the relative prices of factors of production are thus eliminated even in the absence of movements of these factors, provided that techniques are the same in the trading countries” (Heckscher and Ohlin 1991: 54). In the real world, this means that the price of labour will be equalised between the third world countries and the industrial countries. For example, unskilled labour will have almost the same price in all countries (Heckscher and Ohlin 1991: 57).

Countries must have the same proportion of their scarce factors to other component factors to be able to use their own scarce factor effectively: ““Harmonic equilibrium” demands, in other words, that each country must have enough of its *most scarce* factor so that the proportions of factors in each branch of production can be the same as the corresponding proportions in other countries” (Heckscher and Ohlin 1991: 59). This is an important assumption that makes the theory much narrower. If a country does not have enough of the component factors, or not enough of the scarce factor, it cannot be competitive in a free market. In fact labour is abundant in the third world countries but capital is scarce, while in industrial countries, which are usually larger countries with much bigger economies, the ability to control the factors of labour and capital is much greater and it is easier to create the right proportion between factors. Heckscher concludes that free trade will bring factor price equalisation even if there is no movement of factors: “Under the assumption of the same technique in all countries, it follows that nothing is lost, either in the individual country or in the world as a whole, by the fact that the factors of production remain where they are” (Heckscher and Ohlin 1991: 57).

Heckscher argues that every restriction on trade is a loss for the world as a whole, but if there should be a restriction it is better to be by taxation rather than by protection because “[t]axation has the advantage over protection that it does not result in economic losses for the country as a whole, such as the changes in production and reduction of trade that are the inevitable consequences of protection” (Heckscher and Ohlin 1991: 68).

Ohlin explains that interregional (international) trade will increase demand for factors of production which are abundant in the country and usually used in the export of goods. Increased demand will increase the price of these factors and decrease demand for the scarce factor used in imported goods (Heckscher and Ohlin 1991: 91). That means, in the case of skilled and unskilled labour, in developing countries demand for unskilled labour will increase and demand for skilled labour will decrease. Ohlin explains that if factors are mobile there will be equalisation of prices by factor movement and there will be no reason for trade. But wherever it is easier to exchange goods, trade will take place and equalisation of prices of goods will equalise prices of the factors. If labour is not mobile, by the trade of goods, the price of labour will be equalised: “The mobility of commodities is thus a substitute for that of factors” (Heckscher and Ohlin 1991: 115).

An Analytical Approach

We assume that skilled and unskilled labours are two different factors of production, which is accepted in Heckscher’s terminology[ii]. We accept that skilled labour absorbs more advanced and larger amounts of capital. On the other hand, unskilled labour absorbs low technology and less amounts of capital (like producing shoes for Nike or coffee production). Then in the long term, countries which have more skilled labour will have more advanced capital and countries which have unskilled labour will attract (and develop) less advanced capital. On the other hand, developed countries will reproduce (train) more skilled labour. Just as the cheap factor, land, can contribute to cheaper agriculture and advancing this industry, the factor, unskilled labour, will contribute to those industries that use this factor intensively. Thus, over time, countries with skilled labour will reproduce more skilled labour and countries with unskilled labour will reproduce more unskilled labour. This effect was already recognised by Heckscher: “when supply reactions are taken into account, foreign trade tends to increase the relative differences in the supply of factor of production in different countries” (Heckscher and Ohlin 1991: 60). The experience of countries which opened for trade but did not support their labour and infant industries confirms this tendency. By opening to trade Vietnam did not attract aeroplane production but coffee production. The same is happening in Mexico under NAFTA. Industries in Mexico are mostly producing spare parts and semi-industrial products. It is less likely that Silicon Valley or the New York Stock Exchange would move to Mexico.

Ohlin uses the Australian example where land is abundant and labour is scarce. Therefore land is cheap and wages are high. Australia produces sheep and wool more cheaply than other countries. He concludes: “Exports from one region to another will on the whole consist of goods that are intensive in those factors with which this region is abundantly endowed and the prices of which are therefore low” (Heckscher and Ohlin 1991: 90). Based on this argument the coffee-producing countries have been “endowed” with the appropriate factors of land and labour; and therefore, with the opening of trade, prices of their products should have increased to that of the international price and the price of their factor product (wage) should have increased to the international level. The equalisation of prices in the international market has happened but not by increasing the price of Vietnam’s coffee (and wages) but by decreasing the international price to the cost of producing it, which is the subsistence wage in Vietnam (see Mathiason 2001 and Mathiason and Tooher 2001).

To the extent that labour standards are ignored in some less developed countries, industrial countries will prefer to reproduce more “unskilled labour” there. Industrial countries can, therefore, export unemployment and problems associated with it to these peripheries. On the other hand, being specialised in skilled labour, in a world of competition for innovation and new technology, is an advantage in itself. By producing extra cheap labour in the periphery (what Marx called “the reserve army of the unemployed”) the centre keeps wages low there, and at the same time the cost of producing and maintaining the reserve army of the unemployed will be paid by the periphery.

It appears that Heckscher was aware of the unequal distribution of income under free trade. To him, international trade will change the distribution of income between and within countries and between different sectors. “Thus, when factors of production are immobile, foreign trade inevitably assures neither maximum wages per worker nor maximum total return to the working population as a whole” (Heckscher and Ohlin 1991: 67). Heckscher recommends a redistribution policy combined with free trade to achieve the best maximum utilisation in the economy: “Nevertheless, free trade, when combined with a deliberate redistribution of income, is the best commercial policy …” (Heckscher and Ohlin 1991: 68). But Heckscher does not clarify what the “deliberate redistribution of income” would involve or how it could be achieved. More importantly, he does not explain how income can be redistributed when free trade (between countries) fails to assure “total return to the working population” (a country). Despite the fact that Heckscher argues for redistribution of income under free trade, neo-liberal policies implemented by the World Bank, IMF and WTO dismiss any redistribution policy on the basis that any redistribution will interfere with and distort the free labour market and will therefore lead to inefficient market outcomes. However, even in terms of H-O theory, a redistribution of income could occur by setting and increasing an international minimum wage which would also have an advantage over tariffs and taxes, since those who produce will directly benefit from a reasonable income. A distribution of income via international minimum wages can be more effective than a redistribution of income by tariff and taxes because the latter can lead to rent-seeking activities.

New Trade Theories

There have been many attempts to explain the causes of trade and why some nations have been more successful others. New trade theories pay more attention to the dynamic developments such as increasing returns to scale, external economies, differentiated products, imperfect competition such as monopolistic competition, oligopoly, the existence of multinational corporations and intra-industry trade.

Grossman and Helpman (in Maneschi 1998), argue that it is important to understand whether spillovers are international or national. When spillovers are international and technology is the same everywhere, the factor endowments will determine the pattern of trade. But when spillovers are national or partly national, a type of Ricardian comparative advantage appears to be relevant. These spillovers can be created by learning-by-doing, and productivity increased by national accumulation or investment in research and development (R&D). Therefore history and national particularities are important. This model recommends political intervention to stimulate advantages in advanced technology. Grossman and Helpman recommend that the South must invest more in R&D to fill the gap (Maneschi 1998: 209). While this is correct, there are many cultural (such as preferences in consumption and education) and historical aspects that must also be taken in account. Technology gap models argue that advanced economies are more productive in all industries but most productive in the more technology-intensive industries. Firms that win the R&D race monopolise the product for a period of time, and enjoy the higher prices; later this product can be produced with a lower cost in the South (Maneschi 1998: 208). Under WTO this monopolisation of invention is protected by intellectual property rights up to 30 years.

Leamer (Maneschi 1998) shows that the effect of factors on trade is much smaller than what is predicted by H-O theory. He found that (given the same technology) developing countries are abundant in most factor endowments (Maneschi 1998: 220). In a research paper Trefler concludes that: “rich countries appear scarce in most factors and poor countries appear abundant in all factors.” This is partly because developed countries' endowments are more productive than those of developing countries (Trefler 1995: 1).

Krugman develops the model of dynamic comparative advantage based on the Arrow's theory of learning-by-doing and increasing returns model. He found that the patterns of specialisation and timing (history) of these patterns are important (Maneschi 1998: 207). Krugman and Obstfeld (1994) argue that the best explanation of international trade is the Ricardian model based on differences in technology between countries. For example, the US exports computers and aircraft because it is more efficient in producing these goods than producing automobiles and steel. The reason why countries differ in technology is a matter for new research (Krugman and Obstfeld 1994: 79).

Maneschi (1998) traces many of the new trade theories back to Adam Smith rather than the models of Ricardo and Heckscher-Ohlin. Maneschi believes that new trade models are closer to Smith's productivity theory, which implies that a country's competitive advantage over other countries depends on the history of that country's production and the division of labour which has been developed over time. This evolutionary productivity theory challenges both H-O, with its exogenously given natural resources, and Ricardo's theory with its orthodox treatment based on a given technology. Smith believed that the division of labour is limited by the extent of the market both domestically and internationally (Maneschi 1998: 222).

Unequal Exchange Theory

Marxian theories of imperialism indicate that the early stages of imperialist intervention were mainly based on the colonialisation of a country (territory) and direct exploitation of raw materials and labour (slaves). However, in the more advanced stages of imperialism, exploitation is mainly through market mechanisms. These market mechanisms result in "unequal exchange" between the two groups of countries. Unequal exchange theory was developed after the Second World War when most third world countries gained their independence. Emmanuel (1972) presented a comprehensive model on unequal exchange and explained how terms of trade dictate who will benefit from trade. In this part Emmanuel's theory will be presented and the international division of labour will be reviewed in the light of this theory.

To Emmanuel there is a difference between the mobility of factors in international markets and in national markets. In national markets both capital and labour are mobile, but in international markets labour is no longer mobile. This immobility of labour makes the level of wages vary between countries and therefore the prices of productions. Emmanuel agrees with Ricardo's theory of comparative advantage but he emphasises that Ricardo's theory does not determine in what proportion two countries will gain from the mutual advantages of trade (Emmanuel 1972: xii). By using Ricardo's example of comparative advantage (see table 1) Emmanuel shows that the best solution is not that England specialises in cloth and Portugal in wine, as Ricardo concludes, but that England exports its capital to Portugal and produces both wine and cloth there. In this case there can be an absolute optimum with producing both products using 340 hours labour rather than 360 hours labour in the case of specialisation (Emmanuel 1972: xiii).

Table 1. Ricardo's Model of Specialisation in Trade (hours of labour used)

	Before Specialisation			After Specialisation		
	Wine	Cloth	Total	Wine	Cloth	Total
Portugal	80	90	170	160	-	160
England	120	100	220	-	200	200
			390			360

Source: Emmanuel 1972: xii

Emmanuel distinguishes four different situations in which comparative and/or absolute advantages of trade have different results in two countries with two factors:

1) Both factors are mobile: rate of profit and wages are equalised and absolute costs determine the form of specialisation.

2) Both factors are immobile: comparative costs determine the form of specialisation.

3) The capital factor is immobile but the labour factor mobile, thus the comparative cost law is fully applicable.

4) The capital factor is mobile but the labour factor immobile, thus differences in wages do not affect profits, because profits become equalised by capital mobility (Emmanuel 1972: xxxiii).

Emmanuel refers to the United Nations' publication in 1949 which highlighted the deterioration of third world countries' commodity prices in international trade (International Affairs, Moscow, 1963 cited in Emmanuel 1972: xxv). This report made some development economists pay attention to the unequal exchange involved in the terms of trade between manufacturing nations and producers of primary products. External aid did not solve the problem of decreasing commodity prices because developing countries had lost more by the fall in the prices of raw materials relative to manufactures than they had received in aid from industrial countries (Emmanuel 1972: xxv). Loans could not solve this problem either because the interest payments in servicing these loans were a new problem for third world countries. By referring to the United Nations' and the IMF's data, Emmanuel shows that a large number of third world countries had become net exporters of capital (Emmanuel 1972: 45).

Emmanuel rejects the theory of the weak income elasticity of demand for primary products on the basis that much of the third world countries' agricultural exports are luxury products (Emmanuel 1972: xxvii). He also rejects the theory of the "worsening of the terms of trade for primary products" and compares some developing countries' products like sugar, petroleum, coffee, cotton and cocoa with some industrial countries' products like Scotch whisky, French wine, soap and Swedish timber and argues that the first named products are more industrialised while prices of the former products are declining but prices of the latter products are still increasing (Emmanuel 1972: xxxi).

As an alternative approach, Emmanuel uses Marx's labour theory of value and prices of production to show how prices are determined by factor costs: "Marx's price of production is not the price at which at a certain moment demand is equal to supply … The equilibrium price of a product is that at which the branch producing this product is in equilibrium" (Emmanuel 1972: 5). He uses Marx's model of price determination in which there are two inputs, constant capital, "c", and variable capital, "v" (see table 2). There are three branches that in total produce 360 units and their total value added is 120 = $\sum v + \sum m$, where "v" is variable capital (wages) and "m" is surplus-value. Rate of surplus-value is 100 percent and total capital is 300 = $\sum c + \sum v$. Therefore the general rate of profit is:

$\sum m / (\sum c + \sum v) = 60 / 300 = 20\%$.

Table 2. Two-factor Economy with Different Constant and Variable Capital and the Same Rate of Profit

Branches	c Constant Capital	v Variable Capital	m Surplus Value	V Value c+v+m	T Rate of Profit $\sum m/(\sum c+\sum v)$	p Profit T(c+v)	L Price of Production c+v+p
I	80	20	20	120	20%	20	120
II	90	10	10	110		20	120
III	70	30	30	130		20	120
	240	60	60	360		60	360

Source: Emmanuel 1972: 21

By a 50 percent increase in the general rate of wages in table 2, the ratio of wages to profits will be as follows:

Table 3. Increase in Wages in the Model Presented in Table 2

Branches	c Constant Capital	v Variable Capital	m Surplus Value	V Value c+v+m	T Rate of Profit ∑m/(∑c+∑v)	p Profit T(c+v)	L Price of Production c+v+p
I	80	30	10	120		10	120
II	90	15	5	110	$9\ ^{1}/_{11}$ %	$9\ ^{6}/_{11}$	$114\ ^{6}/_{11}$
III	70	45	15	130		$10\ ^{5}/_{11}$	$125\ ^{5}/_{11}$
	240	90	30	360		30	360

Source: Emmanuel 1972: 23

In table 3 the price of production has changed overall except in branch I, which has the average of organic composition of capital. Emmanuel explains that classical economists before Marx assumed that wages were determined by physiological subsistence and therefore wages were always fixed and independent of the market. “Since this wage level was predetermined, so likewise was the level of profit, and, the organic compositions being given, all the equilibrium prices were determined” (Emmanuel 1972: 24). However, in Emmanuel’s model, wages are determined by the institutional and historical framework within a minimum at subsistence level and a maximum determined by the value created (including surplus-value).

Despite the tendency to equalisation of profits in the world economy, the price of labour has diverged in the last two centuries. During 1850 to 1914, there was almost free movement of workers around the world and wages for an unskilled worker varied from one to five across the globe (Emmanuel 1972: 46). Emmanuel, however, estimated average wages in developed countries were 20 times more than average wages in the developing countries at the time of his writing in 1969 (Emmanuel 1972: 47). In addition to wages, labour in industrial countries enjoys social wages, which are much less, or do not exist at all, in the third world countries (Emmanuel 1972: 48). Some of the differences in wages are due to differences in productivity of labour, but the differences in existing wages are much greater than the differences in the productivity of labour. He calculated that average wages in industrial countries were 30 times more than that of developing countries when social benefits are included and 15 times more when the intensity of labour is taken into account (Emmanuel 1972: 48). Today, the situation is even worse; according to Landsberg (2002) a General Motors worker was paid US$19 an hour in the US in 1994, but this payment was US$1.54 in Mexico and even lower, at US$0.22, in China. This means there is an 80 fold difference between wages in the US and China.

Emmanuel distinguishes two essentially different categories of wages in the world economy: subsistence wages and the rest. This differentiation began with the growth of large-scale trade union struggles in the industrial countries from the 1860s (Emmanuel 1972: 49). And it was intensified by increasing the restriction on the movement of labour and immigration during the twentieth century. Although restrictions on labour movements have been accepted world wide, there has been much effort to expand and secure the free movement of capital. Emmanuel illustrates an economy with competitive capital markets and restricted labour markets and shows how the rate of profit will equalise despite different rates of surplus-value (see table 4).

Table 4. System A: Different Surplus-value with Equalised Rate of Profit

Branches	c Constant Capital	v Variable Capital	m Surplus Value	V Value c+v+m	T Rate of Profit ∑m/ (∑c+∑v)	p Profit T(c+v)	L Price of Production c+v+p
I	80	20	20	120	20%	20	120
II	90	10	10	110		20	120
III	70	30	30	130		20	120
	240	60	60	360		60	360

Source: Emmanuel 1972: 53

At the national level, where both capital and labour are mobile and general rates of wages are the same, surplus-value will tend to migrate from a branch with higher surplus-value to the branch with lower surplus-value (Emmanuel 1972: 53). Here, surplus-value is transferred from branch III to branch II; while branch III has a surplus-value of 30 and gives a profit of 20, branch II with a surplus-value of 10 gives the same profit.

Emmanuel assumes another system, B, with three branches and the same rate of surplus-value and the same general rate of wages as in system A but different constant capital and different rate of profit (table 5).

Table 5. System B: Different Surplus-value with Equalised Rate of Profit

Branches	c Constant Capital	v Variable Capital	m Surplus Value	V Value c+v+m	T Rate of Profit ∑m/(∑c+∑v)	p Profit T(c+v)	L Price of Production c+v+p
I	40	20	20	80		20	80
II	50	10	10	70	33 $^{1}/_{3}$%	20	80
III	30	30	30	90		20	80
	120	60	60	240		60	240

Source: Emmanuel 1972: 54

In the case that each system holds its own rate of profit, by exchange between the two systems, the aggregate price would be 360 for system A and 240 for system B. In this case one hour of labour power in system A can be exchanged, on average, for one hour of labour power in system B. That means, 120 units of A’s labour power is exchanged for 120 units of B’s labour power. The difference between prices comes from the value of past labour in the form of raw materials and equipment.

Further, Emmanuel assumes that free circulation of capital between the two systems takes place and therefore profit equalises (table 6).

Table 6. Equalisation of Profit Between Systems A and B

Branches	c Constant Capital	v Variable Capital	m Surplus Value	V Value c+v+m	T Rate of Profit ∑m/ (∑c+∑v)	p Profit T(c+v)	L Price of Production c+v+p
IA	80	20	20	120	25%	25	125
IIA	90	10	10	110		25	125
IIIA	70	30	30	130		25	125
IB	40	20	20	80		15	75
IIB	50	10	10	70		15	75
IIIB	30	30	30	90		15	75
	360	120	120	600		120	600

Source: Emmanuel 1972: 55

Before equalisation of the rate of profit between the two systems, the ratio of exchange prices between the two systems was 360A = 240B but now it is 375A = 225B (table 7). In this case commodities are exchanged in a new ratio that is 125A for 75B. Here the exchange-value of input capital and past labour has not changed but the difference comes from the added values which, instead of exchanging at 120A = 120B exchanges at 135A = 105B: A transformation of surplus-value from B to A is observed. Before equalisation, on average, one hour of A’s labour power was exchanged for one hour of B’s labour power, but after equalisation of the rate of profit between the two systems, this ratio is 27A to 21B units of labour power (Emmanuel 1972: 54–55).

Table 7. Sum of All Branches in Each System A and B

Country	c Constant Capital	v Variable Capital	m Surplus Value	V Value c+v+m	T Rate of Profit ∑m/ (∑c+∑v)	p Profit T(c+v)	L Price of Production c+v+p
A	240	60	60	360	25%	75	375
B	120	60	60	240		45	225
	360	120	120	600		120	600

Source: Emmanuel 1972: 55

Simplification in the model involves an assumption that total constant capital is consumed during a single cycle of production, which is not realistic. To develop a more realistic model, Emmanuel takes into account the difference between constant capital consumed and constant capital invested in his "two system model" (table 8).

Table 8. Two System Model of Exchange with Separate Constant Capital Consumed and Constant Capital Invested

Country	K Total Capital invested	c' Constant Capital Consumed	v Variable Capital	m Surplus Value	V Value c'+v+ m	R Cost of Production c' + v	T Rate of Profit ∑m /∑K	p Profit T(K)	L Price of Production c'+v+p
A	240	50	60	60	170	110	$33^1/_3$%	80	190
B	120	50	60	60	170	110		40	150
	360	100	120	120	340	220		120	340

Source: Emmanuel 1972: 59

Here all other factors are the same except total capital invested. The result is that while both countries use 170 units of their national labour, country A obtains 190 units of international labour but country B obtains 150 units (Emmanuel 1972: 60). In other words, for the product, which contains the same amount of the past and present labour, country A and B exchange at a rate of 190A = 150B.

To show the influence of wages on prices, Emmanuel uses another table with all factors equal except total capital invested and wages (table 9). Here the assumption is that productivity is the same and wages in A are 5 times more than wages in B (Emmanuel 1972: 62).

Table 9. Two System Model of Exchange with Different Capital Invested and Different Wages

Country	K Total Capital invested	c' Constant Capital Consumed	v Variable Capital	m Surplus Value	V Value c'+v+m	R Cost of Production c' + v	T Rate of Profit ∑m /∑K	p Profit T(K)	L Price of Production c'+v+p
A	240	50	100	20	170	150	$33^1/_3$%	80	230
B	120	50	20	100	170	70		40	110
	360	100	120	120	340	220		120	340

Source: Emmanuel 1972: 62

In this case the ratio of prices is 230A = 110B. The difference between the case of unequal capital and equal wages to the case of unequal capital and unequal wages is expressed in this formula: 1/1>150/190>110/230 (Emmanuel 1972: 61).

Table 10. Two System Model of Exchange with Same Capital Invested but Different Wages

Country	K Total Capital invested	c' Constant Capital Consumed	v Variable Capital	m Surplus Value	V Value c'+v+m	R Cost of Production c' + v	T Rate of Profit ∑m/∑K	p Profit TK	L Price of Production c'+v+p
A	240	50	100	20	170	150	25%	60	210
B	240	50	20	100	170	70		60	130
	480	100	120	120	340	220		120	340

Source: Emmanuel 1972: 63

Here all factors are equal except wages, which have made prices diverge into the ratio of 210B = 130A. "It thus becomes clear that inequality of wages as such, all other things being equal, is alone the cause of the inequality of exchange" (Emmanuel 1972: 61). The influence of wages on prices in relation to that of the influence of the organic composition and wages on prices is shown in the formula: 130/210>110/230. Emmanuel defines unequal exchange as the result of difference in surplus-value (wages) between systems in which rate of profit is equalised:

> *Regardless of any alteration in prices resulting from imperfect competition on the commodity market, unequal exchange is the proportion between equilibrium prices that is established through the equalisation of profits between regions in which the rate of surplus value is "institutionally" different – the term "institutionally" meaning that these rates are, for whatever reason, safeguarded from competitive equalisation on the factors market and are independent of relative prices* (emphasise is from Emmanuel) (Emmanuel 1972: 61– 64).

Emmanuel explains that wages are rigid and differentiated by geographical areas independent of the fluctuation of product prices. During the last twenty years the price of coffee, copper and sugar has fluctuated in a range of one- to three-fold or more, but there have been no changes like this in the wages of those who produce these goods in third world countries. Despite huge changes in the prices, wages in these branches have been at the subsistence level, with a little margin of error, at five cents an hour. At the same time, their European and American counterparts have earned 20 to 40 times more, depending on the particular country. Meanwhile, equalisation of the rate of profits means that capitalists in the third world have, over the long term, earned almost the same rate of profit as their colleagues earned in the international markets (Emmanuel 1972: 66).

In terms of technical progress, Emmanuel argues that the technique of producing whisky or French wine has not progressed in centuries but wages in these branches have increased many times while profits in these branches are the same as the international rate of profit. Yet the case of textiles is totally different. Despite the ultra modern plants in Egypt, India and Hong Kong, wages are still at a subsistence level (Emmanuel 1972: 82). Emmanuel uses timber and petroleum as an example to reject Nurkse's theory of why prices of raw materials decline. To Emmanuel, it is high wages that have made the price of Swedish timber high and not that the high price of timber has made Sweden rich:

> If my thesis is correct, then we shall have to say, for example, that it is not because it exports timber that Sweden has the highest standard of living in Europe, but that timber is expensive because it is produced in a country … where the working class, owing to certain historico-political circumstances which need not be examined here, has secured remarkable social conquests (Emmanuel 1972: 172).

Emmanuel rejects the classical economists who took into account only the biological aspect of the worker's needs. He confirms Marx's explanation that wages depend on the historical development of worker's needs, on the degree of civilisation, habits and social costs of reproduction in each country. "Nevertheless, in a given country, at a given period, the average quantity of means of subsistence necessary for the worker is also given" (Marx cited in Emmanuel 1972: 109). How trade unions can increase the standards of living is also dependent on these socio-cultural aspects:

> The effectiveness of the trade-union factor itself, and the outcome of collective or individual negotiation in general between wage earners and their employers, depends to a large extent upon the relation between what the workers are demanding and *what society regards, in a certain place and at a certain moment, as the standard of wages.* It depends on a certain *level of attainment*, which is itself the result of past struggles and evolutions (Emmanuel 1972: 119).

Emmanuel believes that development in Australia, New Zealand, Canada and, to a certain extent, Denmark and Holland was due to a combination of increased wages with technical progress. High wages were, therefore, not a result of the development but were the cause of it. High wages can induce technical progress and in turn, technical progress can increase wages, but there is no direct cause and effect between them. There have been situations in which economic progress occurred but wage levels did not increase, at least until institutional factors came into play; for example, Britain in the nineteenth century and Japan before the Second World War. In both cases, economic development ran ahead of the level of wages for several decades. Moreover, high wages can lead to industrialisation, if a national wage becomes protected by means of tariffs. This occurred in the United States after that country achieved independence (Emmanuel 1972: 124).

Emmanuel compared Canada, Australia and New Zealand with South Africa where the natural resources, settlement population, climate, source of capital and financial networks were similar in all these former colonies. However, the first three countries became among the richest nations in the world. At the time of his writing, South Africa was much poorer with a national income per capita almost one seventh of that of the three other countries. He argued the reason that South Africa did not develop was its cheap (and plentiful black) labour. Despite high wages for white workers, the average wage level remained relatively low. Emmanuel believed that if wages in South Africa had increased, with the monopoly it had in the export of gold at the time, the price of gold may have increased in international markets and this could have provided a base for the country's progress (Emmanuel 1972: 124–25).

Once a country progresses, it gets more opportunity for further capital accumulation and higher wages. With higher technology there will be a need for better educated labour. This in turn will increase wages and consumption. Expansion of consumption creates a larger market which attracts foreign capital and intensifies growth. Increased investment and accumulation increases the organic composition of capital, which is an important source for growth. This circle creates a cumulative causation, in other words "wealth begets wealth" (Emmanuel 1972: 130–31). Poor countries remain at the level of elementary physiological subsistence. Their surplus-value is transferred to the rich countries and this slows down their rate of accumulation. Their narrow markets cannot attract capital, therefore despite the low organic composition of capital and the low wages, there is huge unemployment that in turn puts downward pressure on wages and hinders the development of trade unions. Since labour is inexpensive, there is a disincentive to employ new technology; therefore the average organic composition of capital will remain under the international average. In other words, "poverty begets poverty" (Emmanuel 1972: 131).

In answer to how this negative circle of unequal exchange and poverty can be broken down, Emmanuel recommends diversification of products, intra-trade among third world countries, import substitution and increasing wages in export industries or taxes on exports, since a sudden increase in wages is impossible. He argues that while it is an advantage for countries with high wages to specialise and expand their external exchange, low wage countries must diversify their products and avoid external exchange (with high wage countries):

> Somebody has to benefit from these low wages. If the national capitalists cannot do this, owing to the standardisation of profits, and if it is not desired that the foreign consumer shall be the beneficiary, then only two solutions are left: a tax on exports that will transfer this excess surplus value to the state; and diversification of production through transfer of factors from the traditional exporting branches to the branches that can replace imports, which will enable the national consumer to benefit from the low national wage level (Emmanuel 1972: 267).

Emmanuel divides all branches of production in low wage countries into three components. First, the export branches where comparative productivity is very high compared to that of importing countries. Wages can be easily increased in these branches. Second are the branches which produce for domestic consumption and do not face foreign competition, like services, building, transport, food industries, etc. An increase in wages in these branches is not limited by foreign competition but it can create a gap between real wages and nominal wages. The third are branches which produce for domestic consumption and are subject to foreign competition. In a free trade system these branches cannot survive higher wages; therefore they should be protected by tariffs and taxes. This is what the United States did after its independence (Emmanuel 1972: 132).

When one low wage country starts producing a product, which has been usually produced in high wage countries, other low wage countries will soon copy it and the whole industry will be degraded from a high wage country product to a low wage country product. In this system what is deteriorated "is not the terms of trade of certain products but those of certain countries, regardless of the kind of products they may export or import" (Emmanuel 1972: 266). Therefore it is better for low wage countries to trade, as much as possible, between themselves. If the government in a low wage country supports domestic production (and does not increase wages), surplus-value will be accumulated in the hands of domestic capitalists and it can be transferred abroad by domestic capitalists rather than by unequal exchange. In this case it is better that governments nationalise foreign trade (Emmanuel 1972: 147).

In his study, Emmanuel focused on the role played by unequal exchange in an abstract economic model with free trade and the assumption that there are no market imperfections. Emmanuel was well aware of the effects of monopolies, "non-tariff barriers" and even wars on an economy. However, his presentation was limited to the effects of unequal exchange. Some newer forms of monopolies and intervention have been developed since Emmanuel's writing. These include the IMF's adjustment programs, loans, or recently produced "intellectual property rights" which hinder third world countries from producing products that have been first invented by industrial countries. "While competition characterises material commodity production in the developing countries, the channels of international trade as well as the wholesale and retail trade markets in the advanced countries are controlled by corporate monopolies" (Chossudovsky 1997: 86). The "brain drain" is another process, fostered by strict immigration policies in industrial countries aimed at securing their high skilled and high wage societies. Africa lost 60,000 of its professionals during 1985–1990 and has been losing 20,000 per year since then. By contrast in Canada, of the 205,000 planned immigration admissions for 1997, up to 113,000 were under business or skilled categories (Stalker 2000: 107–08).

Critics of the theory of unequal exchange question that if there is a higher return in third world countries, why does most Foreign Direct Investment (FDI) go to the industrial countries? In fact, in a world where the rate of profit is equalised, it does not matter whether investment goes to the New York Stock Exchange or to India. Third world countries' production is usually less capital intensive; moreover, in the third world all products have lower value (in terms of dollars). Therefore, less FDI is necessary to produce the same quantity of products.

Today, restrictions on the movement of labour are greater than at the time of Emmanuel's writing. Movement of labour is not seen as a natural phenomenon or an economic necessity but as a disease that comes from "underdeveloped countries", and there are huge forces to restrict the inflow of cheap labour from the low wage countries to high wage countries (See for example the case study analysed in chapter 4). Even where national borders did not exist, after the collapse of the Soviet Union, the IMF and World Bank plans were to create new borders (Chossudovsky 1997: 233). This is happening in a world where all borders for finance and capital are being eliminated. As a result, the gap between wages (income) in the first and third worlds is growing ever greater: "While global per capita income tripled over the period 1960–94, there are now a hundred countries with per capita income lower than in the 1980s" (Stalker 2000: 139). The competitive race to the bottom between the third world exporters has added to deflationary pressures in the world economy. In the last two decades labour markets have been targeted, even in industrial countries, and real wages, as well as social wages, have been reduced or kept well below the rate of growth of productivity. As reflected in a report by the Bank for International Settlements (2003), this process is due to the supply side policies dominating the world in the last three decades (Borio et al 2003).

Conclusion

The Heckscher-Ohlin trade theory has very limited explanatory power because of its unrealistic assumptions. In fact, the idea that "foreign trade inevitably assures neither maximum wages per worker nor maximum total return to the working population as a whole" (Heckscher and Ohlin 1991: 67) and the consequent need for "redistribution of income" violate the equalisation of factor price prediction. On the other hand, if the original qualifications made by Heckscher are accepted in full, then support for an international minimum wage standard remains compatible with even this highly influential neo-classical analysis of trade and income. However, newer trade theories, which include less restriction and more realistic assumptions in general, see the process of development as complex and in need of historical and socio-economic explanation. Labour is not simply viewed as a passive factor whose price is determined by an abstract market, rather it is seen as a factor that not only can be developed in a socio-economic framework but also can create and develop markets.

Emmanuel shows that when there are differences in wages between two groups of countries and the rate of profits has been equalised, value will transfer from the low wage countries to the high wage countries. This doesn't mean necessarily that high wages in industrial countries are a result of low wages in third world countries or low wages in the third world countries are the result of high wages in industrial countries. In other words, it does not mean that value is transferred from workers in the third world countries to workers in industrial countries. The low wages in the third world countries are instead due to the capitalist system, which restructures third world economies towards the needs of the industrial countries, suppressing wages and inducing inefficiency and underconsumption in the process. Therefore an increase in wages in the third world countries doesn't require a decrease in wages in the industrial countries, but rather it would reduce overcapacity and the funding for speculative capital movements.

The downward pressure on wages exists in industrial countries as well as the third world countries, but the situation in industrial countries is better because of, as Emmanuel pointed out, the past trade union struggles and socio-economic maturity of the industrial countries. Wages in low wage countries are a fraction of the total price of products in the international markets (see table 11). This means an increase, even a doubling, in subsistence wages in the world will have only a fractional impact on prices of products and the rate of international profit. However, an increase in subsistence wages will have a huge impact on the poor and the economies of the third world countries. To solve the problem of unequal exchange Emmanuel recommended a tax on exports, together with import subsidies and the expansion of trade between the third world countries. The issue of fixing (and increasing) international minimum wages raised in this study is, however, fully consistent with the theory of unequal exchange. A minimum wage implemented in all countries simultaneously would be the simplest and most direct way to address the income problems of the world's poor. It would not rely on the indirect effects associated with export taxes or import tariffs, nor would it require specific protection of wages in the non-exporting industries. At the same time its benefits would go primarily to workers in the third would, where the historical burden of institutional factors has weighed most heavily on wages.

Table 11. Coffee-Hierarchy of Prices in International Markets (US dollars)

	Price	Cumulative Share of Value Added (%)
Farm gate	0.25–0.50	4.00
International FOB	1.00	10.00
Final retail	10.00	100.00
Illustration based on approximate FOB prices (early 1990s) and retail prices in the North American market (early 1990s). Farm gate prices vary considerably from one country to another.		

Source: Chossudovsky 1997: 88

Chapter 4

A Case Study

This chapter will contrast the extreme neo-liberal version of the Heckscher-Ohlin model and the unequal exchange approach regarding the differences between prices of the factors of production, mainly wages, in the US and Mexico under NAFTA. The Heckscher-Ohlin model asserts that by free trade, prices of factors of production (i.e. labour) will equalise in the international market and, following this, the gap between developing and developed countries will diminish. By contrast, Emmanuel's theory argues that the low prices of labour in developing countries are due to unequal exchange and the terms of trade. Therefore, to increase the living standards of labour requires policies to change the terms of trade.

In order to test the two theories, we will focus on NAFTA and the United States–Mexico relationship. This is a good example of two economies with minimum barriers on trade, mobile capital and finance but restricted labour markets. In fact NAFTA is a free trade agreement between the United States, Canada and Mexico but the focus in this study is only on the US and Mexico because both countries have large populations and the key contrastive difference is that one is developed while the other is not. Mexico is a developing country with a GNP per capita of US$5,070 and a PPP at US$8,790 (see graph 15). It has some developed industries like oil, automobiles and small-scale manufacturing and a large skilled and unskilled labour force that gives the country the opportunity to produce manufacturing goods and compete in term of wages with the US labour force. Consequently, the US and Mexico provide a good case for contrasting analysis of the Heckscher-Ohlin and unequal exchange approaches.

Contrastive Analysis

Contrastive analysis may be understood as a methodology which focuses on explaining key points of contrastive evidence in terms of key differences between alternative theories (Lawson 1997). In this section the two major theories on free trade and equalisation of income will be formulated and compared to find out which of them is more consistent with the data from the US and Mexico under NAFTA. The H-O model is formulated as proposition A:

A country will tend to produce relatively more goods that use its abundant resources intensively and, therefore, export those goods that embody abundant factors. Through free trade, the relative price of the abundant factor (used in export goods) will increase and approach the international factor price. In the case of Mexico, the abundant factor of production is “labour” and its price, in the less liberalised Mexican market before 1994, was much less than the price of labour in the US at that time (even in industries with similar productivity). Therefore, the price of labour in Mexico should have increased after NAFTA was enforced.

The theory of unequal exchange challenges this hypothesis and can be formulated as proposition B:

Prices of goods are mainly determined by the prices of the factor costs. The difference in prices of developing countries’ products with that of the developed countries is caused by unequal exchange, the terms and conditions of trade that were formed in the past colonial system. Production of developing countries is undervalued (with a certain amount of labour used with the same productivity) compared to that of developed countries and this unequal exchange will intensify, over time, the gap between high wage countries and low wage countries. High wages will provide greater opportunities for industrial countries to gain more from trade and therefore they will accumulate more capital to invest for the next period of production. High wages also mean higher education and higher living standards for the labour in developed countries. Therefore productivity increases and wealth will reproduce itself. Based on this theory, labour in Mexico was cheaper than labour in the US before 1994 and NAFTA should have intensified this gap over time.

In this chapter data for the Mexican and American labour market will be used to investigate whether there is any evidence that can support or reject the main hypothesis in each of the two approaches and, if so, how significant the evidence is. To do this, some previous studies of the labour market in NAFTA and the benefits that NAFTA has had for the two NAFTA countries are used. In addition, evidence from statistical year books, the World Bank, the OECD, the International Labour Organisation (ILO) and various minor sources has been interrogated to improve the reliability and diversity of data/sources.

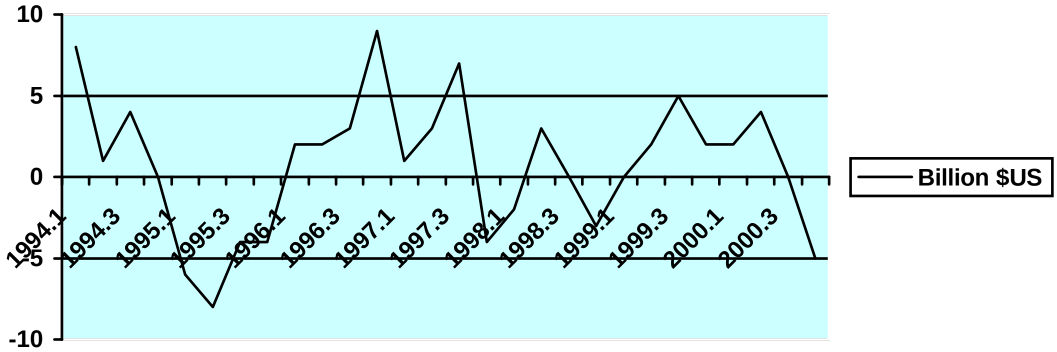
The Effect of NAFTA on the United States and Mexico

The NAFTA was introduced under the influence of neo-liberal policies, which suggested that a range of tangible economic benefits would accrue to Mexico as a developing country. In particular foreign investment, trade and the situation of labour were all expected to improve strongly.

Financial Volatility

Under NAFTA, most barriers on the capital flows were lifted and the Mexican market became more open to speculative money (capital) transactions. These speculative capital transactions have made the Mexican economy vulnerable (see graph 4) and have been big factors in the outbreak of the economic crisis in Mexico both in 1994 and 1997 (Anderson 2001: 4).

Graph 4. Portfolio Investment Flows

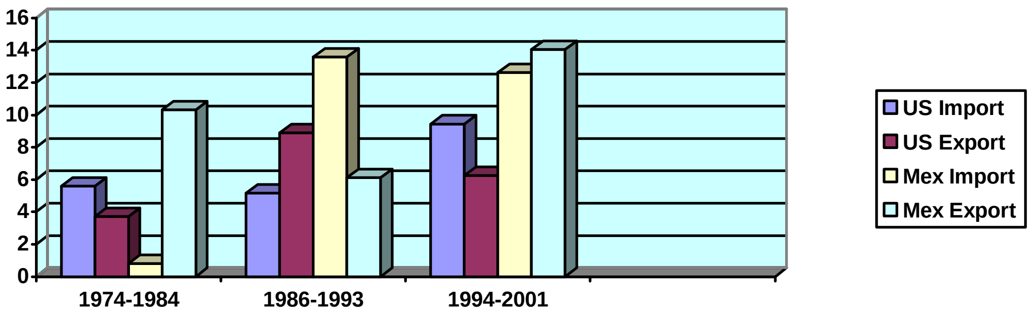


Source: Banco de Mexico cited in Anderson 2001: 4

Exports and Imports

For Mexico the average annual growth of real exports of goods and services in the 8-year period before NAFTA was 6.13% and in the same period after NAFTA was 14.04%. Mexican average annual growth of real imports of goods and services in the period 1986–1993 was 13.58%. This was reduced to 12.61% in the period 1994 to 2001. The average annual growth of total real imports of goods and services in the US was 5.15% in the period 1986–1993. It was increased to 9.44% in the period 1994 to 2001. Average annual growth in real exports decreased from 8.9% in the eight years before NAFTA to 6.25% in the same period after NAFTA. Trade has increased totally between the two countries but the trend has been a further increase in exports from Mexico to the US. Increased trade in both countries is consistent with both H-O and unequal exchange theories.

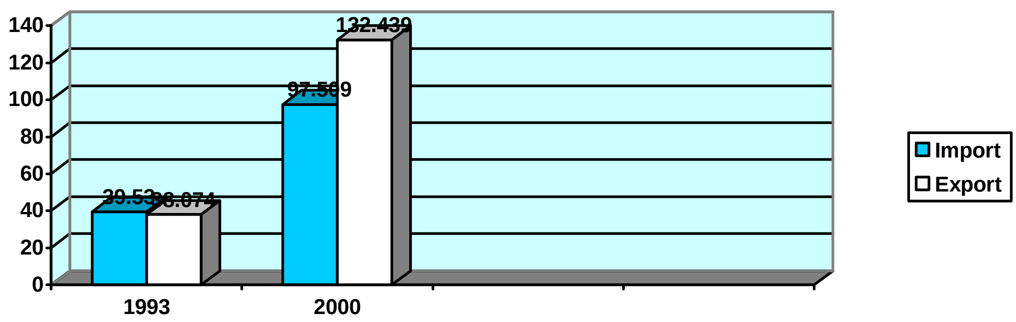
Graph 5. Average Annual Percentage Change in Real Exports and Imports in the US and Mexico 1974–2001



Source: Tables in OECD 2002

In 1993, Mexican exports to the United States were worth $38 billion, but in the year 2000, six years after NAFTA was implemented, were worth $132.4 billion. The total value of manufacturing exports from Mexico increased by 19.7% each year between 1995 and 1999, but some of these exports contain imported components or intra-firm trade; therefore, the increase in the real value of these exports was 16% in this period (Anderson 2001: 12).

Graph 6. Mexican Imports and Exports to the US, billions of constant 1992 dollars



Source: Economic Policy Institute 2001: 4

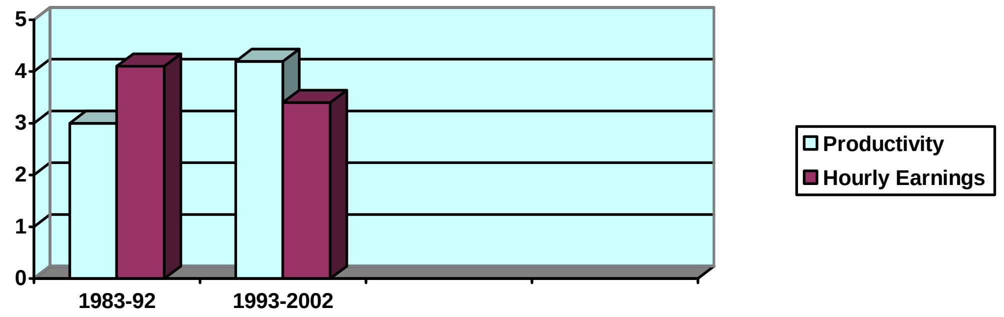
The Mexican economy has become more export-oriented and at the same time, more dependent on the US economy. After the US economic downturn in 2001, the Mexican economy contracted by 1.4% and production in Maquiladoras area near the US border fell by 9.2% and Maquila employment fell by 20% (Landsberg 2002: 9).

Productivity and GDP Growth

Arguments in favour of the NAFTA and free trade are based on the expectation that exports, productivity and therefore wages will increase. For the US, wages have increased less than the rate of productivity growth and in Mexico real wages have decreased despite a large increase in productivity. In the US, the average annual growth of productivity rose from 3.0% in the period 1983–1992 to 4.2% in the period 1993–2002. Despite the increase in productivity, the ten-year average growth of hourly earnings in the US has declined from 4.1% in the 1983–1992 period to 3.4% in 1993–2002 (OECD 2001).

Many plants (and workers) in Mexico have the same productivity as those in the US, but Mexican workers receive wages far below their American counterparts. For example, General Motors paid its US workers US$19 an hour and its Mexican workers US$1.54 in 1994. Productivity in the Mexican auto sector rose by 10.3% during 1994 to 1999, but auto sector wages fell by 20% (Landsberg 2002: 7). Under the H-O model, when productivity rises (automatically), the price of labour rises, while under the unequal exchange model, when a product becomes a third world country's (cheap-labour country's) product its price will decline. In this case, by increasing productivity the auto industry is becoming a product of the third world countries and wages in this sector are falling, which supports the unequal exchange theory. Even though Mexican wages are below the pre-NAFTA level, Mexico does not produce cheaply enough compared to China and factories are moving from Mexico to China in search of cheaper labour: "While the average labor cost for assembly plants in Mexico is now around $2 an hour, China's figure is 22 cents. Although plants in Mexico are more sophisticated, the country has failed to develop a network of local suppliers that would make it hard for manufacturers to leave as the Chinese catch up" (*Economist* cited in Landsberg 2002: 9).

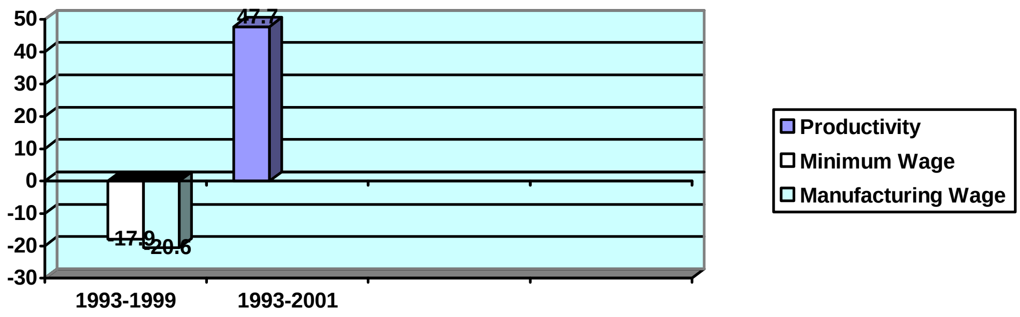
Graph 7. Annual Percentage Change in Hourly Earnings and Productivity in the US



Source: OECD 2001: *Economic Outlook*

Finally, at an aggregate level, manufacturing productivity in Mexico rose by 47% between 1993 and 2001, whilst minimum wages have decreased by almost 18% (Anderson and Cavanagh 2002: 2).

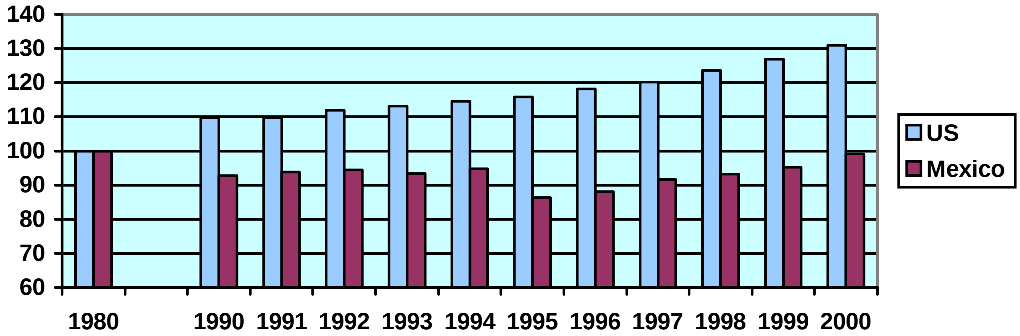
Graph 8. Percentage Change in Manufacturing Productivity, Real Minimum Wage and Real Manufacturing Wage in Mexico



Source: Anderson 2001: 2 and Economic Policy Institute 2001: 19

Value added per person employed in the total economy increased by 6.1% in Mexico and 15.8% in the US during 1993–2000. That means, value creation per worker is growing 2.5 times faster in the US than in Mexico and the gap is increasing between the two countries (see graph 9).

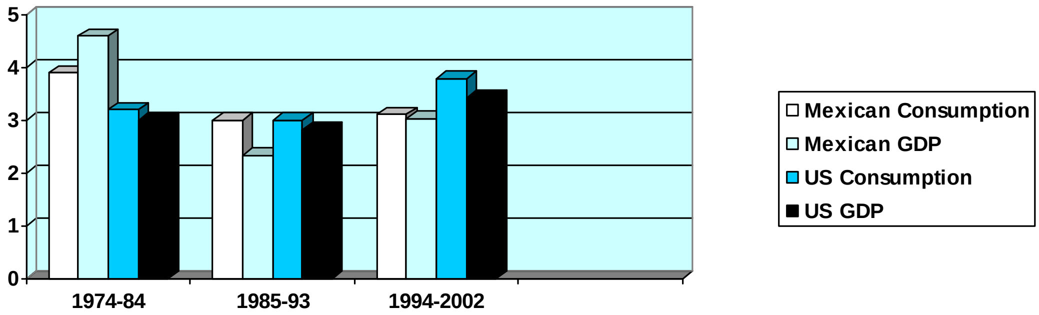
Graph 9. Value Added Per Person Employed, Total Economy (1980 = 100)



Source: Tables in ILO 2002

Average annual growth in real GDP in Mexico was 4.6% in the period 1974–1984, which decreased to 2.34% in the last 9 years before NAFTA and again increased to 3.03% in the next 9-year period after NAFTA. The average annual growth in real private consumption expenditure in Mexico was 3.9% in the period 1974–1984 and fell to 3.0% in the last 9 years before NAFTA but increased to 3.11% in the same period after NAFTA (OECD 2002). This is a slightly positive change in GDP and consumption in Mexico but the level of poverty has increased, which means this growth had little benefit for workers in the country as a whole (see graph 19).

Graph 10. Average Annual Percentage Change in Real GDP and Real Private Consumption in the US and Mexico



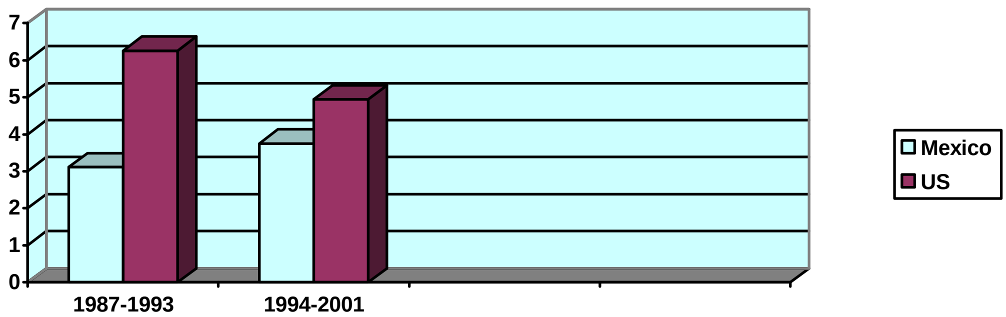
Source: Tables in OECD 2002

The average annual percentage change in real GDP in the US was 3.0% in the 1974–1984 period which decreased to 2.82% in the 9-year period before NAFTA and increased to 3.43% in the 9-year period after NAFTA. The average annual percentage change in real private consumption in the US was 3.2% in the period of 1974 to 1984, which slightly decreased to 3.01% in the 9-year period before NAFTA and increased again to 3.8% in the same period after NAFTA (OECD 2002).

The Labour Market

The average unemployment rate in Mexico during the 7-year period prior to NAFTA was 3.11% and increased to 3.75% in the 8-year period after NAFTA. The average unemployment rate in the US in the 7-year period before NAFTA was 6.26% but declined to 4.94% in the 8-year period after NAFTA (see graph 11). In another estimate from the OECD (2001), the average unemployment rate in the US was 6.8% in 1983–1992 but had decreased to 5.1% in 1993–2002. This trend is in contrast to that claimed by H-O theory, which argues that by opening up trade the use of the abundant (and cheap) factor of production will increase, and countries will specialise in their more abundant factor, which means that employment should have increased in Mexico and decreased in the US. However the trends are consistent with unequal exchange theory which would anticipate stronger employment growth in the US in exporting industries.

Graph 11. Average Yearly Unemployment Rate in the US and Mexico



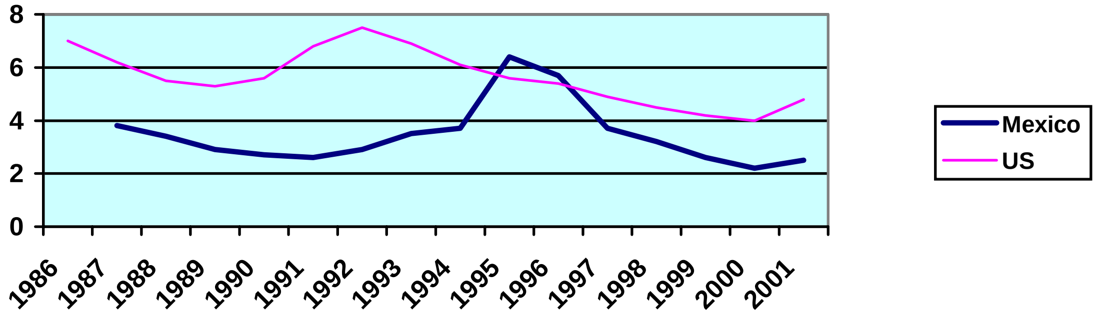
Source: OECD 2002: Table 14

The average unemployment rate in Mexico has been decreasing since the late 1990s from its peak in 1996 (graph 12). However, some scholars have been sceptical about Mexico's statistical evidence of employment growth during this period. According to official statistics, a person is defined as employed if that person had worked at least one hour in the week before the survey had taken place. "Under this definition, a person is counted as employed regardless of whether the person only works half time for no pay in a family business or works full time in a modern manufacturing plant" (Economic Policy Institute 2001: 15). In addition, with no unemployment insurance and no capacity for saving for low-paid workers in Mexico there are few workers who will register themselves as unemployed, rather they will accept any low-paid work they can get. The official statistics, therefore, fail to reflect the real amount of unemployment, particularly underemployment:

> … the Department of labor has recognized that 20 million Mexicans, who make up 50% of the economically active population (EAP), work in informal employment.
>
> … Noting this, we observe that the government has had no strategy to create institutional programs for employment, and the market is incapable of creating a balance between the supply and demand of labor. In other words, in Mexico there is an adjustment to the current

international division of labor, which exchanges international specialization by sector for international specialization by stage of production, and which favours exports that in the end are only assembly exports (Coordinating Committee of CASA Mexico 2001: 11).

Graph 12. Unemployment Rates in Mexico and the US (percentage)



Source: Tables in OECD 2002: *Economic Outlook 71*

A major reason that unemployment has been falling in the US and increasing in Mexico is that labour in the US is more educated and can secure its rights much more effectively than labour in Mexico. There are much stronger unions in the US and labour standards are traditionally higher in the US than in Mexico. Labour in the US is protected against the disadvantages of NAFTA. For example, in July 2001 there were 356,000 US workers who had qualified for a special NAFTA retraining program for people who lost their jobs but there are no such protections for labour in Mexico (Anderson 2001: 5; see also US Department of Labor 2003).

The situation in Mexico is totally different from that in the United States. Work standards are much lower than many other third world countries and are deteriorating:

The International Labor Organisation (ILO) states that Mexico is among the nations with the greatest number of complaints regarding violations to the right of free union association, discrimination against female workers and non-fulfillment of social and economic payments. According to the ILO, workers subject to collective bargaining contracts who attempt to form new unions face threats, abuses and unjustified firings. Mexico is in the top ten list for nations that systematically violate labor norms, including the right to strike and the right to collective bargaining (Coordinating Committee of CASA Mexico 2001: 11).

In addition to the increase in unemployment in Mexico, it is important to consider how the structure of the work force has changed during the years before and after NAFTA. Employment in industries which produce goods for export has almost doubled from 546,433 workers employed in 1994 to 1,085,735 employed in 2002; however, this employment has been mostly in the Maquiladoras area near the US border (Anderson and Cavanagh 2002: 1). Despite increased employment in export industries, overall waged employment has decreased in Mexico. The changes in the labour market structure are shown in the table 12.

Table 12. Labour structure in urbanised areas (percentage)

	1991	1998
Owner	4.8	4.0
Self-employed	16.6	22.8
Waged	73.9	61.2
Unpaid	4.6	12.0
Other	0.1	0.1
Total	100.0	100.1

Source: Economic Policy Institute 2001: 16

Table 12 shows that from 1991 to 1998 the number of traditional salaried workers declined by almost 17% and that of self-employed increased by 37%. The self-employed workers are mostly working in family businesses and have lower wages and benefits than salaried workers. During this period the share of workers aged 12 to 14 who had unpaid positions increased from 40% to 60% (Economic Policy Institute 2001: 16).

Trend of Change in Wages

Minimum wages are another indicator that can show the development of the labour market and the well-being of the low-paid group of workers. The purchasing power of minimum wages has been decreasing in Mexico from the beginning of the liberalisation of the economy in the early 1980s, but it has accelerated with the NAFTA and the 1995 Peso crisis. Purchasing power of minimum wages increased by 54% during 1934–1982 but it decreased by 69% during 1982–1999 (Coordinating Committee of CASA Mexico 2001: 12). Table 13 shows the minimum wage in Mexico using 1990 as a base year. In real terms the minimum wage has decreased throughout the 1990s in Mexico. Manufacturing wages increased in the early 1990s but declined by 20.6% after the introduction of NAFTA.

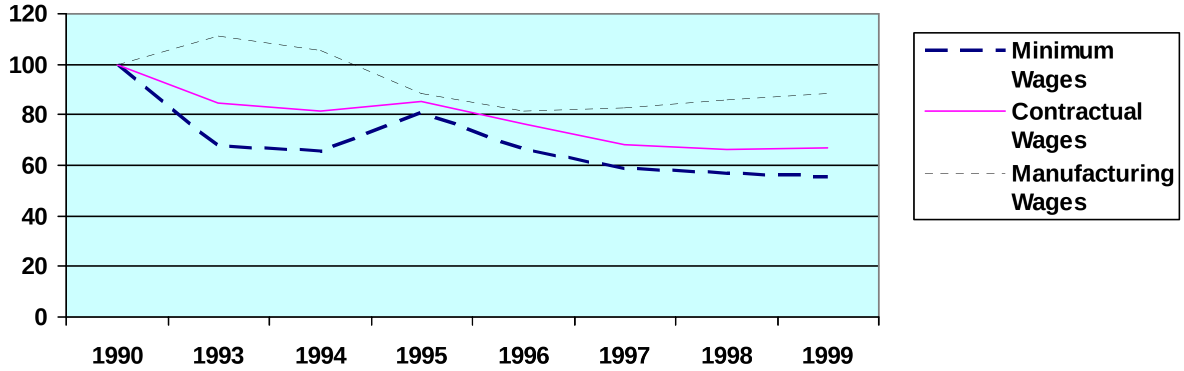
Table 13. Wages in Mexico 1990–1999 (1990 = 100)

Year	Minimum wage	Contractual wages	Wages in manufacturing
1990	100.00	100.00	100.00
1993	67.50	84.90	111.40
1994	65.80	81.50	105.20
1995	81.10	85.50	88.70
1996	66.50	76.60	81.20
1997	58.90	68.20	82.90
1998	56.90	66.50	85.70
1999	55.40	66.80	88.40
Change, 1993–1999	-17.9%	-21.3%	-20.6%

Source: Economic Policy Institute 2001: 19

Data from the World Bank supports the same trend in the change in minimum wages in Mexico and the United States. The minimum wage averaged US$1,343 per year in Mexico in the period 1980–1984 but decreased to US$768 in the period 1995–1999. Despite this reduction in wages, average hours worked per week in Mexico increased from 43 hours in the period 1980–1984 to 45 hours in 1995–1999. And value added per worker in manufacturing increased from US$17,448 to US$25,931 for the same periods (World Bank 2002b: WDI). These data concern the official level of the minimum wage, but in reality many Mexicans could not benefit from this minimum wage. About 19% of the economically active population in Mexico received less than the legal minimum wage in 1993 and this increased to over 21% in 1997 (Coordinating Committee of CASA Mexico 2001: 12).

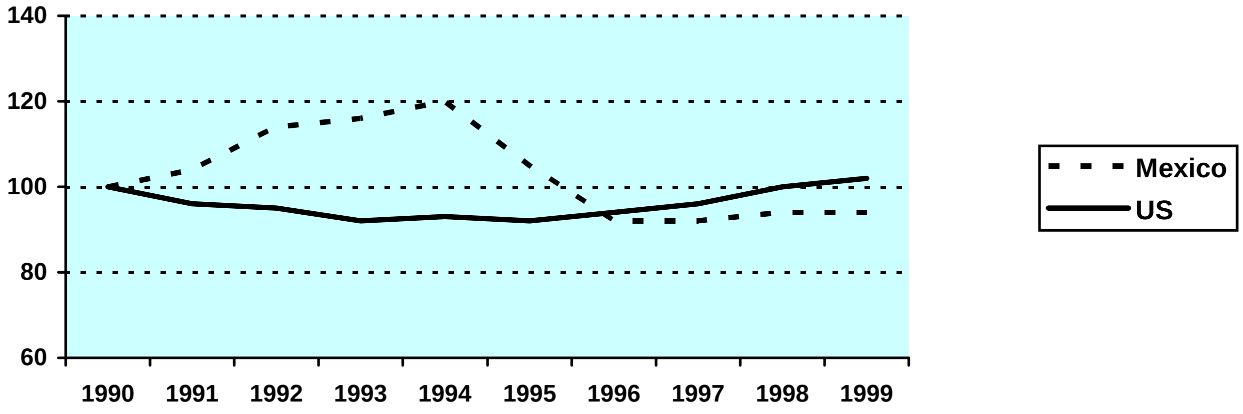
Graph 13. Wages in Mexico 1990–1999 (1990 = 100)



Source: Data from: Economic Policy Institute 2001: 19

In the US, the minimum wage was on average US$6,006 per year in 1980–1984 and increased to US$8,056 in 1995–1999. For the same periods as above, average hours worked per week in the United States increased from 40 hours to 41, value added per worker in manufacturing increased from US$47,276 per year to US$81,353. The value added per worker in manufacturing increased by 72.1% but the minimum wage increased by only 34.0 percent in this period (World Bank 2002b). Some studies have concluded that liberalisation of trade in the 1990s is responsible for at least 15–25% of growth in wage inequality in the United States (US Trade Deficit Review Commission 2000, 110–18 cited in Economic Policy Institute 2001: 9).

Graph 14. Real Manufacturing Wage Trends (1990 = 100)



Source: Tables in ILO 2002

In addition to the decline in wages, working conditions have been eroded and other non-wage benefits have been lost or have deteriorated. Table 14 shows how factors like end of year bonuses, participation in profits and insurance have been declining during the 1990s in the Mexican labour market.

Table 14. Share of Salaried Workers with Fringe Benefits in Urban Areas (percentage)

	1991	1998
End of year bonus	62.7	54.5
Participation in profits	19.2	15.4
Paid holiday	59.3	50.4
Credit for housing	13.3	21.8
Health insurance (IMSS)	45.5	42.7
Health insurance (ISSSTE)	7.0	4.6
Private health	12.5	9.3

Source: Economic Policy Institute 2001: 17

Despite an increase in total income in Mexico, the income of labour decreased during the 1990s. From table 15 it can be seen that the total income from labour decreased by 40% from 1991 to 1998. During the same period the share of salaried jobs decreased in Mexico. It is important to take into account that the average income of the self-employed was lower than that of the salaried labour force. Income of salaried workers had fallen by 26% while income of self-employed had fallen by 49% (Economic Policy Institute 2001: 12).

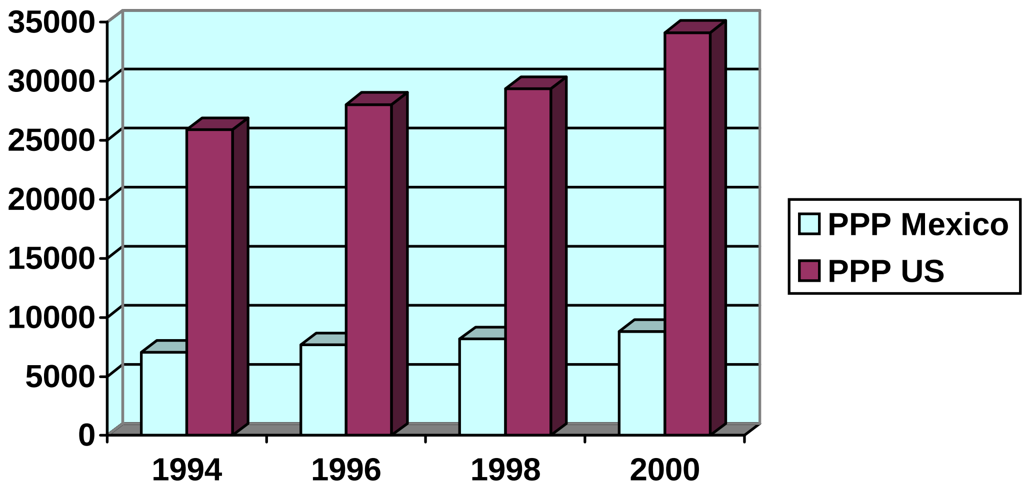
Table 15. Mean Hourly Income from Labour 1991–1998 (1993 pesos)

	1991	1998	Percentage change
Owner	20.53	10.71	-47.8
Subcontractors	12.47	n.a.	n.a.
Self-employed	7.71	3.89	-49.6
Co-operatives	4.22	7.01	66.2
Salaried	6.57	4.83	-26.6
Salaried, by piece or percentage	8.31	4.40	-47.0
Other	6.12	n.a.	n.a.
All	7.04	4.22	-40.0

Source: Economic Policy Institute 2001: 17

Purchasing Power Parity (PPP) is another indicator that can be used to compare the wealth and well-being of people in different countries. It indicates the quantity of goods and services that can be bought in each country by a certain income regardless of nominal prices and currency values (Dornbusch and Fischer 1994: 621–22). PPP of the US and Mexico are compared in graph 15 and table 16, showing that from 1994 to 2000 the PPP of both countries had grown but Mexico had a lower rate of growth. In other words, the economic gap between the two countries has been increasing during this period.

Graph 15. Purchasing Power Parity Per Capita in Mexico and the US (US$)



Source: Tables in World Bank 1996, 2000b and 2002a

Table 16. Percentage Change of PPP Per Capita in the US and Mexico 1994–2000

	1994	2000	% change from 1994
Mexico	7,050	8,790	25
US	25,860	34,100	32

Source: Tables in World Bank 1996, 2000b and 2002a

Based on the H-O model, export of labour intensive products in the country with abundant labour will increase after trade liberalisation and, therefore, wages will increase. But in this case wages in Mexico as a country with abundant labour have not increased but have decreased in absolute terms, despite the fact that employment in export industries doubled.

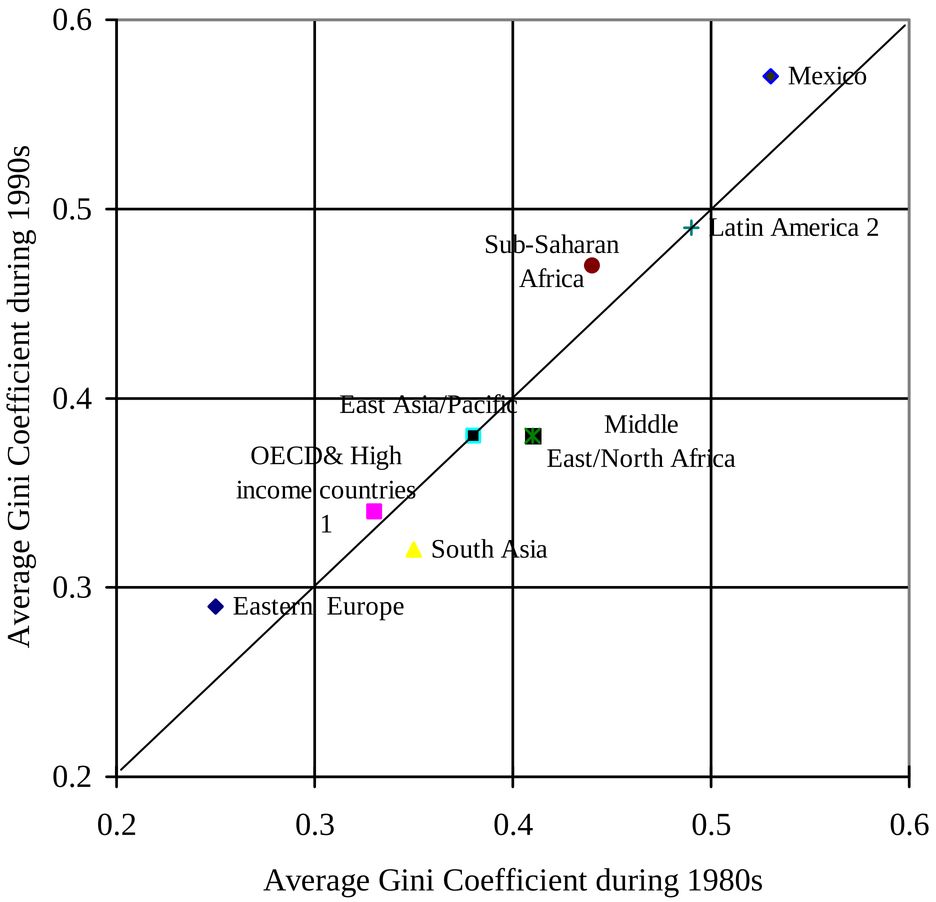
Loss of minimum and average wages in absolute terms in Mexico can be explained by Marxian theories, which argue that the role of an army of unemployed is necessary to keep wages down in order to maximise profits. In this case workers in

Mexico are used to put downward pressure on US wages. Mexican workers will do the job without any bargaining because most wages are close to or at subsistence level and workers have few unemployment benefits. In some cases, workers in Mexico have been used to reduce the bargaining power of unions in the US: "A Cornell University study of more than 600 union organizing campaigns found that in 62% of the cases, management fought the union by threatening to close the plant (Anderson 2001: 5).

Increased Inequality and Poverty

Real GDP, GDP growth and PPP per capita are indicators of the average wealth or income in a country, but they do not show the income of different groups and distribution of income. The Gini coefficient is a measure of inequality and has values between zero and one. The closer the Gini coefficient is to zero, the more equal is the distribution of income. Mexico's income inequality has been one of the highest in Latin America, which in turn exhibits one of the highest degrees of inequality in the world. Graph 16 shows the ratio of inequality in Mexico compared to some of the major regions in the world during the 1980s and 1990s. Inequality was high in Mexico in the 1980s and it increased during the 1990s (Corbacho and Schwartz 2002: 5).

Graph 16. World's Inequality Comparison between the 1980s and 1990s

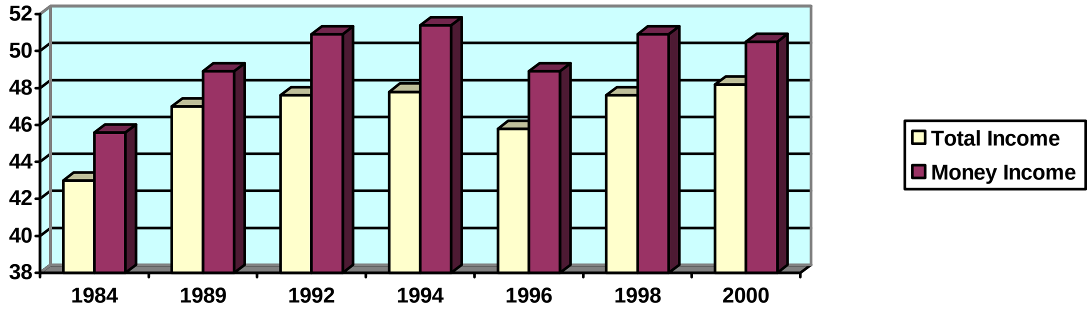


1. Excludes Mexico 2. Includes Mexico

Source: Corbacho and Schwartz 2002

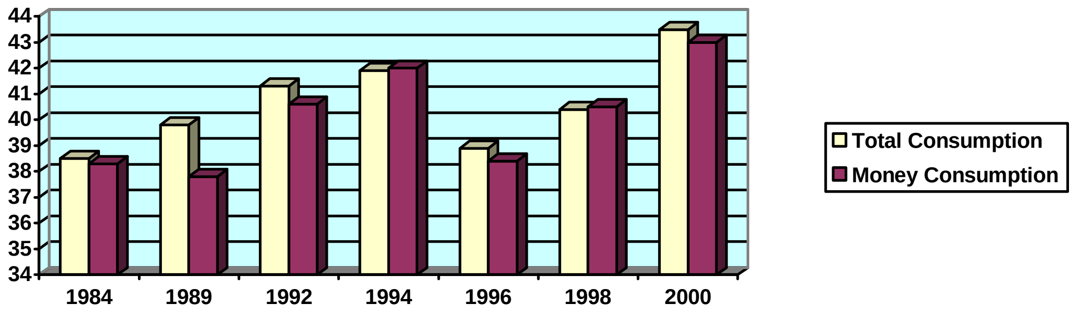
Corbacho and Schwartz (2002) use different estimations from different sources but their conclusion is that inequality in Mexico is among the highest in the world. Mexican income inequality increased during 1950–1975 from an already high initial level then declined during 1975–1984 after which it trended up again until 1994. After a slight decrease in 1996, inequality increased again up to a new high in 2000. "In 2000, the wealthiest 10 percent of all Mexicans received nearly 39 percent of the total income in the country, and the poorest 40 percent around 12 percent of total income" (Corbacho and Schwartz 2002: 12).

Graph 17. Gini Coefficient in Mexico Based on Current Income 1984–2000



Source: Corbacho and Schwartz 2002

Graph 18. Gini Coefficient in Mexico Based on Current Consumption 1984–2000

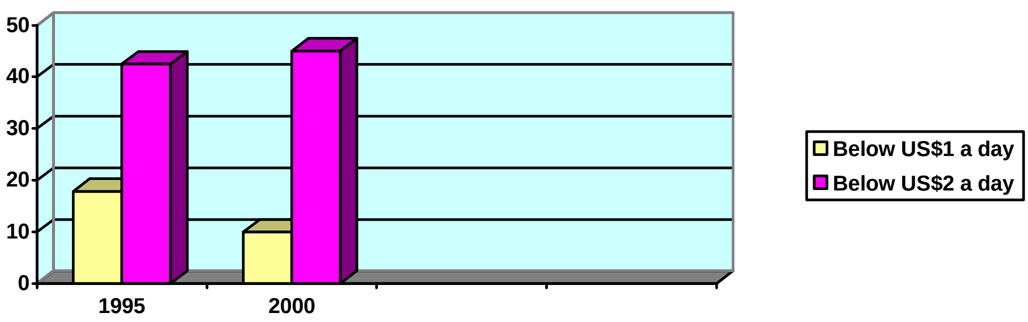


Source: Corbacho and Schwartz 2002

The above statistics on inequality in Mexico show that NAFTA has not been successful in reducing the extreme inequality and poverty in Mexico. Taking into account that total production and income have increased in Mexico during 1994–2002, increased inequality means that the working class has had little benefit from increased income. These results are totally in contrast to the H-O model, which argues that by trade liberalisation the price of the abundant factor will increase and, therefore, wages will increase in the labour intensive country towards the international level.

The level of poverty shows how much people with the lowest income benefit from an increase in national income. Since the introduction of NAFTA, poverty has increased in Mexico and many people who lost their jobs in salaried occupations had to accept those non-salaried jobs which were available. Reduction of salaried workers and an increase in unpaid labour or family businesses has thrown many Mexicans into poverty. Graph 19 shows that almost half of the Mexican population (100 million) are living in poverty. While real GDP and PPP have increased during 1994–2000, the number of the poor has slightly increased in these years, which means the income gap in Mexican society has increased.

Graph 19. Mexicans Living in Poverty (millions)



Source: World Bank 2000 and World Bank 2002c

Pro NAFTA Arguments

Most pro-NAFTA economists or organisations emphasise the increase in the volume of trade and exports within NAFTA rather than addressing the consumption and income effects. For example, the Office of the US Trade Representative (USTR)[iii] presents the benefits of NAFTA after five years in terms of increased exports and increased jobs created by these exports:

– During NAFTA's first five years, U.S. merchandise exports to Mexico increased 90 percent. U.S. merchandise exports to

> Canada … increased 55 percent. Together, this meant $93 billion in export growth from 1993 to 1998 – two fifths of the growth in U.S. exports to the world.
>
> – Jobs supported by U.S. goods exports to our NAFTA partners are estimated to total 2.6 million in 1998, an increase of 31 percent … (USTR 2003)

This report emphasises the growth of exports and jobs in the US but does not mention the increase in trade deficit in the US with Mexico nor the decrease in minimum wages in Mexico. It also reports an increase in the US's minimum wage but not the growth of inequality and illegal immigrants (low-paid workers) in the United States. The report also neglects to examine in any detail the environmental effects.

In another document by USTR, *NAFTA at Eight*, the same approach is adopted (USTR 2002b)[iv]. Via statistical evidence this article provides a good description of the increase in trade, exports and FDI in all three countries; but it does not report the negative effects of NAFTA like increased inequality, unemployment and poverty.

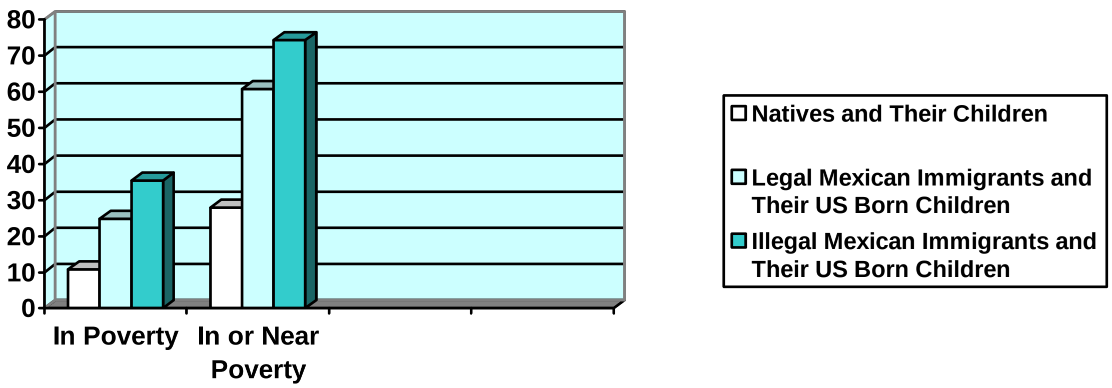
Externalities

The cost of border control

While borders for capital and financial flows have almost been eliminated under NAFTA, national borders for labour have been strengthened to restrict the movement of labour. In 1993, spending on immigration control by the US government was $967 million, but this was increased to $2.56 billion in 1999. The number of border patrol agents more than doubled in this period. Perhaps the biggest cost of this border control has been the loss of human life: "In 1999, 356 migrants died in desperate attempts to elude the patrol while crossing the border" (Anderson 2001: 7).

Because of massive poverty in Mexico, many people have sought a better way of life through emigration to the US, but this solution has not been very successful. Even if the poor can pass the border legally or illegally, they face poverty on the other side. Graph 20 shows that the percentage of poor among Mexican immigrants is much higher than the natives in the US and the percentage of poor among the illegal immigrants is even higher; more than 35%. The immigration of unskilled workers to the US is recognised as a social problem. Illegal immigrants keep wages of unskilled labour low in the US. This, as a problem for labour in the US, can be recognised as a significant opportunity for big business because many of the minor jobs are done by illegal immigrants who are paid wages lower than the official levels. Obviously, illegal immigrants have no social wage.

Graph 20. Estimated Poverty and Near Poverty by Legal Status for Mexican Immigrants and their US-born Children



The US-born children (under 18) of immigrants are included in the figures for Mexican immigrants and are excluded from the figures for natives. Near poverty is defined as less than 200% of the (US's) poverty threshold.

Source: Camarota 2001: 6

Natural resources

Privatisation and lifting barriers for foreign investment under NAFTA made it easier for foreign investors to have access to Mexican natural resources. This and the importation of cheap US agricultural products like corn have contributed to the destruction of land in Mexico. The relocation of US factories to Mexico in search of cheap labour has also increased pollution in Mexico. In some cases, many US industries have moved to Mexico because of the lower environmental standards there. Consequently, pollution in Mexico has increased significantly since NAFTA: "A Tufts university study reveals that air pollution from Mexican manufacturing has about doubled since NAFTA went into effect" (Anderson 2001: 3).

The Maquiladoras, which is recognised as the best result of liberalisation of the economy, has the worse pollution and working conditions. Average turnover rates are 15 to 25% of the labour force per month and "The average work-life of a Maquila worker is only ten years because of injuries, health problems, and the firing of women workers who become pregnant" (Landsberg 2002: 6). Hygienic standards are very low across the border and pollution is out of control:

> All along the border, the land, the water, and the air are thick with industrial and human waste. The National Water Commission reports that the towns and cities, strapped for funds, can adequately treat less than 35 percent of the sewage generated daily. About 12 percent of the people living on the border have no reliable access to clean water. Nearly a third live in homes that are not connected to sewage systems. Only about half the streets are paved (Landsberg 2002: 7).

Parallel with the exploitation of cheap labour, exploitation of natural resources is easier in Mexico than in the United States. Protected areas in the US constituted 13.4% of the total land area in 1999 whereas in Mexico the proportion was 3.5% (World Bank 2002b). Average annual deforestation in Mexico was 1.1% in 1990–2000 while that of the US was –0.2% (as a result of re-forestation). Exploitation of natural resources explains in part the increased productivity, GDP and consumption in Mexico. If the externalities associated with the destruction of natural resources in Mexico were taken into account, the effective real growth in GDP would have been much less than the official figures suggest.

Summary of Quantitative Evidence

During the years that NAFTA has been in effect, both average and minimum wages have decreased and the labour structure has totally changed in Mexico. From 1993 to 1999 minimum wages declined by 17.9% and wages in manufacturing decreased by 29.6%. The number of salaried workers decreased by 17% and the number of self-employed increased by 37%. Mean hourly income for labour decreased by 40% (Economic Policy Institute 2001). These are highly significant data that are completely inconsistent with the predictions of the H-O model.

Unemployment in Mexico increased from 3.11% in the 8 years prior to NAFTA to 3.75% in the 8 years after NAFTA, while in the same period unemployment in the US decreased from 6.35% to 4.94%. This is the essence of both H-O and unequal exchange theories. Based on the H-O model, through trade the more abundant factor (labour in Mexico) will be used more and an increase in demand for that factor increases its market price. In the case of the US and Mexico, the use of labour has decreased in Mexico and increased in the US, though much of the increase employment in the US can be result of other national and international factors, this change in employment in both countries is opposite result to that expected from the H-O model and completely consistent with the unequal exchange model.

GDP, real consumption and productivity have increased in both countries but the US has shown significantly more growth in these indicators than Mexico. This means that the gap between the two countries is growing and if this system of trade continues the gap will get wider. The core of unequal exchange theory is that expansion of trade can expand production and exports but the gains of trade will go to the country with the biggest economy and better technology, which allows the dominant country to determine the terms of trade. The increase in exports in both countries is consistent with both theories but exports from the US have been less than its imports from Mexico. So the US has developed a trade deficit with Mexico and covers this by exports of greater finance to Mexico. This is likely to support the theory of unequal exchange. In the long term, these results may lead to a deterioration of the Mexican economy and labour conditions since lower wages and health insurance and increased unemployment mean less education, poorer health and a lower quality of life for the masses in Mexico. These in turn will contribute to more unemployment and child labour and the growth of unskilled labour.

While real GDP and private consumption have increased in absolute terms in Mexico, the level of total poverty has increased. This means that the poor have not gained from this growth and the new wealth has gone directly to the already rich people or has been spent on luxuries. The increased gap between the rich and the poor is likely to have negative consequences for Mexican society. While minimum wages and social wages have been reduced in Mexico, they have been increasing in the US. It is agreed that this widening gap between the two countries is the reason why more people are willing to cross the borders illegally. These people will be recognised as "illegal immigrants" in the US and have to take inferior jobs with a payment around one-fourth or one-fifth of the minimum wage in the US. In fact, the problem in the existing world is not that "labour is immobile" but that labour is "forced to be immobile". With the existing technology and social condition (and culture), there are many more people willing to move for a better income across the world than are currently permitted by national barriers to migrate.

A brief summary of the evidence shows the trend of development in the US and Mexico under NAFTA is that productivity, GDP, exports and total consumption have increased as a positive result of NAFTA in Mexico. The negative effects of NAFTA in Mexico are a fall in minimum wages and the social wage and an increase in poverty, inequality and unemployment. Natural resources in Mexico are being destroyed at an accelerating rate. The positive effects of NAFTA in the US are an increase in employment, productivity, GDP, total real consumption, minimum wages, average wages and better protection of natural resources (like forests). The negative effects are a trade deficit with Mexico and an increase in inequality. Overall the income gap between and within the two countries has increased and the rate of increase in productivity and PPP is higher in the US than in Mexico.

Based on the evidence discussed here the Heckscher-Ohlin model (in its classic form used in NAFTA) should be rejected. The unequal exchange model should be reconsidered as an answer to the problem of poverty and the widening gap between developed and developing countries. The experience of the US and Mexico free trade agreement under NAFTA shows that when one country with less protected (less valued) natural resources and labour increases trade with another country with highly protected (and higher valued) labour and natural resources and with a better technology, the former will become the periphery in the new system and the masses, in particular, will lose as a result of the new trade regime.

Chapter 5

Conclusion

In this study we have approached the issue of a minimum wage in the international economy from three different theoretical perspectives: (1) the labour theory of value in the light of Smith and Marx; (2) theories of underconsumption and effective demand and imperialism from Hobson and Keynes, Lenin, Luxembourg, and Baran and Sweezy; and (3) trade theories, mainly the H-O model and unequal exchange theory. In addition, empirical evidence from NAFTA has been used to analyse the consequences of free trade under NAFTA on the US and, particularly, Mexico.

Both Heckscher and Emmanuel agree that free trade without attention to the terms of trade will increase inequality both within and between economies (Heckscher and Ohlin 1991: 68). Inequality is a source of economic instability and social unrest in the global economy because excess income and capital on the one hand and the lack of purchasing power on the other makes the world economy volatile and generates crises. In most theories of trade, problems like crises and the balance between consumption and production have not been addressed. These issues are important because trade booms have been generally associated with short-term economic booms, which are then followed by economic downturns that can lead countries to engage in trade wars. The most important example of this was the Great Depression in the 1930s. And the last trade boom in 1990s was followed by an economic crisis in the late 1990s, which is continuing. As a result, most countries in the world are aggressively devaluing their currencies, which in turn undermines the liberals' "free trade" (*Observer* 2003 and *Economist* 2003c). The problem of crises is not just for third world countries but industrial countries as well.

Emmanuel rejects the idea that differences in the price of third world countries' products relative to those of industrial countries are due to the type of products produced. He argues that third world countries produce primary, manufacturing and luxury goods but all of these products are cheaper compared to the same type of products in the industrial countries. Despite the fluctuation in the prices of the third world countries' products, wages have not changed and remain at the subsistence level. Average wages in industrial countries are almost twenty times more than those in the third world countries with the same productivity. Wages are institutionally fixed in different countries while the rate of profit tends to equalise around the world. Therefore there are two types of wages in the world; subsistence wages and the rest.

The unequal exchange hypothesis can be summarised as follows. Prices of goods are mainly determined by the prices of the factor costs. The difference in prices of developing countries' products in relation to those of the developed countries is determined by unequal exchange relations and the terms and conditions of trade that were formed in the past colonial era. Production of developing countries is undervalued (with a certain amount of labour used with the same productivity) in relation to that of developed countries and this unequal exchange will intensify, over time, the gap between high labour-valued countries and low labour-valued countries. The high price of labour will give more opportunity for industrial countries to gain more from trade and therefore they can increase the rate of accumulation. High wages also mean better education and higher living standards in developed countries. High wages increase consumption, investment and accumulation and attract foreign capital which is a source for more economic growth and gives in turn more opportunity for higher wages. In this way, "wealth begets wealth". Poor countries, on the other hand, remain at the level of elementary physiological subsistence. Their surplus is transferred to the rich countries and limits their growth potential. Their narrow domestic market cannot attract investment. Despite the low organic composition and the low wages, there is huge unemployment which in turn puts pressure on wage growth and hinders the evolution of trade unions. Low wages discourage the introduction of new technology. Thus "poverty begets poverty" (Emmanuel 1972: 131).

Evidence on Mexico under NAFTA, which shows an increase in unemployment and poverty (graphs 11 and 19) and a decrease in average and minimum wages (tables 13 and 15), refutes the extreme neo-liberal position that free trade, without attention to minimum wages, will lead to an improvement in overall welfare. The case study does support the original H-O position that free trade will promote growth in those exports that use the relatively abundant factor, which for Mexico is cheap labour, but may also involve an overall worsening of income distribution both within and between populations (Heckscher and Ohlin 1991: 67–68). The evidence therefore validates the original suggestion by Heckscher that policies designed to compensate losers from free trade should be put in place. Increasing minimum wages is clearly a means of achieving this.

Emmanuel's position on the deleterious effects of free trade on poverty and wages is vindicated by the case study. However, as shown in chapter 3, an increase in minimum wages is consistent with the thrust of Emmanuel's argument. Consequently, if the unequal exchange theory is right an increase in minimum wages in the context of free trade should have a tendency to promote economic growth and reduce poverty.

The Hobson-Keynes position also suggests that an increase in minimum wages will promote growth and development, as noted in chapter 2. Consequently, the thesis shows that there are strong theoretical reasons for believing that even in the context of a globalising world economy characterised by free movement of capital and commodities, with restricted movement of labour, a shift towards international minimum wage standards, which would be gradually increased over time, would help alleviate problems of global poverty.

An orthodox Marxist position, as adopted by Lenin and many other neo-Marxists, is that no market-oriented reform will prevent capitalist systems from going into crisis. For example, solving underconsumption problems will not eliminate other forms of crisis, such as those which stem from speculation in financial markets or the tendency of the rate of profit to decline as a result of the increasing organic composition of capital. Nevertheless, even from an orthodox Marxist position, the struggle for international labour standards and minimum wages is politically very worthwhile (in the same way that struggles to limit the length of the working day were politically important) since it will promote international labour solidarity among the masses of the world, even if it takes a very long time to achieve.

Implementation of an international minimum wage is a matter for future research. New research can focus on how minimum wages can be determined for individual countries considering the peculiarities of each country and its international competitiveness. Minimum wages are legislated in most countries in the world but in the third world countries, minimum wages are not high enough and have not been fully implemented. Therefore, co-operation between all countries, especially third world countries, is necessary to implement an international minimum wage. This co-operation can be achieved through:

1) multilateral trade agreements and organisations like the WTO and NAFTA;

2) international organisations like the United Nations and the ILO;

3) international interest organisations (such as OPEC) where countries which are exporting labour intensive goods can act under the same organisation to secure the price of their labour (products).

It is essential that all parties (countries) become aware that fixing an international minimum wage is a progressive policy with strong theoretical support and all parties in the international economy will gain from it. An increase in subsistence wages in the world is not a zero-sum game but can benefit all countries.

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Endnotes

[i] The rate of surplus-value: Marx divides total capital into “constant capital” c, and “variable capital” v. Constant capital is constituted by the physical capital and commodities that go into the production of goods. Variable capital is the labour used in the process of production. Thus the total capital has the form of $K = c + v$ at the beginning, but with this process no capitalist will produce for the market because no profit would be realised. The profit added in the production system will come from the surplus-value “s” that is produced by the labour. Therefore the final production process will find the form of:
$C' = (c + v) + s$ (Marx 1990: I. 320).

Marx, further, determines the rate of surplus-value as the ratio of surplus labour to necessary labour and calls it “an exact expression for the degree of exploitation of labour power by capital” (Marx 1990: I. 326). The rate of surplus-value is:
s/v = surplus labour/necessary labour.
From this, Marx determines the rate of profit as the ratio of surplus-value to the total capital:
$P' = s/K = s/(c+v)$ (Marx 1991: III. 141).

[ii] See Heckscher and Ohlin 1991 page 48: “… the term ‘factor of production’ does not refer simply to the broad categories land, capital, and labor but to the different qualities of each of these. The number of factors of production is thus practically unlimited.”

[iii] The US trade representative is a Cabinet member who serves as the President’s principal trade advisor, negotiator, and spokesperson on trade and related investment matters.

[iv] In this document (“NAFTA at Eight”) there is ample coverage with respect to increases in trade, FDI and exports in all three NAFTA countries, but with regard to

wages in Mexico we find only a brief comment that: “the export sector is the country’s leading job creation engine, accounting for more than half of Mexican manufacturing jobs gained between 1994 and 2000. These jobs pay nearly 40 percent more than those in the rest of the manufacturing sector” (USTR 2002b). The article thus gives a false impression that NAFTA has created jobs and increased wages in Mexico, for no mention is made of the many jobs that have disappeared or that the “higher” wages are still lower than 1994 levels.