How MNEs Help Mobilize Rural Labor for Industrialization, Alleviating Poverty (as have done across East Asia): Is the “America First” Policy a Threat?

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Abstract

Emerging markets' comparative advantages in labor-intensive, basic manufacturing industries play a vital role in an export-driven takeoff for industrialization. In this age of globalization, MNEs are the crucial booster of such a takeoff by providing technology, skill training, and marketing channels, especially for export back to their home countries via cross-border supply chains. This "MNE-assisted" approach facilitates the mobilization of poor (subsistence) rural people as industrial workers more effectively than the self-reliant strategy of infant-industry protection. Since extreme poverty resides mostly in the rural areas, poverty alleviation occurs as a consequence—as is attested to by East Asian experiences. Yet, this export-driven strategy—accommodated especially by the United States, the world's largest export market for emerging economies—appears in jeopardy, now that the U.S. has initiated the "America First" policy to protect national interests. Is the strategy still effective to kick off industrialization?

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1. Comparative advantage as a vital input in an industrial takeoff
   1.1. Superiority of basic manufacturing over resource extraction

In the early phase of industrialization, emerging markets exhibit comparative advantages in endowed-factor-intensive goods (i.e., natural resources and labor-intensive manufactures). Natural resources for export are normally exploited in a highly capital-intensive manner, requiring advanced technology, machinery and extraction gear—on a large scale. This means emerging markets tend to be continuously dependent on foreign interests, even though host governments can gain a share of profits as the key source of revenues. And these revenues can be reinvested in economic development. In most cases, furthermore, the public will also benefit from income transfers and government spending on education, health, infrastructure facilities, and other public welfare programs. Yet, this modality to kick-off an industrial takeoff risks the instability of government revenues, since primary exports are subject to boom-and-bust cycles. Besides, it usually boosts the size and power of state, often leading to red tape, corruption and inefficient uses of revenue. Above all, it gives well-paid jobs only to a small minority of well-educated, skilled local workers (e.g., engineers, machine operators and skilled miners) and does not provide employment opportunities to a mass of unskilled people who are unemployed or underemployed and stuck in dire poverty—especially in rural/agricultural areas. The upshot is an unbalanced social structure consisting of a very small minority of high-income earners and a large majority of jobless, or meagerly paid, poor people. In other words, such a resource-focused strategy is accompanied by all sorts of "resource curse" that foil sustainable catch-up growth.

In contrast, labor-driven takeoff (i.e., making the best use of abundant labor to produce labor-intensive goods) can build a stronger, long-lasting foundation for industrialization. Low-end, basic manufacturing activities (like apparel and sundries making) for export to the advanced world's big markets require large numbers of low-skilled or unskilled (but easily trainable) workers. In fact, any aspiring economy that adopts this takeoff approach gives a chance for people to uplift themselves from poverty by their own efforts through employment. Consequently, poverty alleviation occurs most effectively in a market-driven way at the beginning stage of catch-up when an undeveloped economy exploits its comparative advantages in labor-intensive basic manufactures. Historically speaking, therefore, the "have-nots" (i.e.,
those countries that are indigent in resources but abundant in labor) are ironically blessed, whereas the "haves" are cursed—in their respective approaches to economic development.

With regards to the role of comparative advantage in catch-up growth, conventional trade theory assumes that each economy's comparative advantage is ready-made in perfect shape—with no additional input or institutional support needed. In practice, however, it is seldom exploitable immediately. It usually needs additional inputs in such areas as finance, organization skills, export marketing and labor training, thereby necessitating state involvement and/or private business partners (i.e., comparative advantage *supplementation*). These necessary inputs used to be locally procured under infant-industry protection and promotion, but such a self-reliant, autonomous approach took time—and often failed—to accomplish a successful takeoff.

### 1.2. MNEs and comparative advantage magnification

In an era of globalization, expeditious help comes from foreign multinational enterprises (MNEs) that are good at detecting and exploiting both existing and potential comparative advantages across the world as they eagerly search for low-cost locations and develop supply chains. They can provide all those missing elements instantaneously in one package. Moreover, MNEs not just supplement comparative advantages fully but also *amplify* their strength (i.e., comparative advantage *magnification*) through their *superior* capacities. This makes low-wage manufactures even more competitive, boosts an export-driven catch-up and favorably affects host countries' trade balances even further. These effects represent the *pro*-trade type of MNEs' operations,\(^1\) and are what emerging host countries want to capitalize on to kick-off industrialization.

Also, emerging markets' institutional arrangements are normally in poor shape at the start, hindering international trade and investment. For example, a high level of government involvement in, and excessive regulation of, business activities are pervasive, blocking the market-guided road to an export-driven takeoff and private-sector growth. This is the very reason why so-called "trade facilitation agreements" are mediated by the World Trade Organization for reducing regulations and cutting red tape among those emerging markets that are determined to promote trade as an engine of growth.\(^2\) And when these countries are eager to attract MNEs as development partners, they are more likely inclined to deregulate and create business-friendly ecosystems. In this sense, MNEs also play a crucial role in inducing and facilitating institutional reforms.

2. Agriculture-to-industry labor shift and abject poverty reduction

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\(^1\) See Kojima and Ozawa (1984) and Chapter 4 in Ozawa (2016).

\(^2\) For example, Sub-Saharan Africa, the least developed, low-income region, requires the longest time to process exports: "nearly 200 hours of inspections, regulations, and paperwork" compared to only 15 hours in high-income countries, as is reported in "Trade deals: Trying for Anything," *Economist*, Feb. 4, 2017.
It is well known that the starting phase of successful industrialization is characterized by the mobilization of labor from the countryside to new-born industrial centers, a mobilization that can supply low-wage labor for industries, local entrepreneurial businesses, and foreign MNEs' investment projects. The rural sector is where dire poverty mainly exists, and labor is either unemployed or underemployed, barely eking out living. Once the economy takes off for industrialization, rural laborers can begin, at least, to earn wages (however meager they may be) or receive industrial wages that are higher than those in the rural, subsistence sector—and in most cases sufficiently high enough to support their families left behind in the rural communities. This is the typical pattern of labor migration from rural to urban areas, with income transmissions out of migrants' savings in a reverse direction. At the same time, this continuously ample supply of poor people at low wages enables industry to extract profits, which in turn are reinvested into business expansion, further accumulating capital and powering labor-driven industrialization. For a while, industrial wages are not likely rise until an existing reservoir of rural labor is sufficiently tapped. This phenomenon of labor shift from the (non-marketized) subsistence sector to the (marketized) modern sector as a vital driver of growth is posited in Arthur Lewis's well-known "unlimited labor supply" theory of development.3

And once a successful takeoff exhausts the available excess supply of rural labor, wages rise so long as the industrial sector continues to grow. In fact, industrial growth is even stronger when it is export-driven—i.e., comparative advantage based (though not examined in Lewis' model), since export prices are naturally higher than pre-trade domestic prices—hence, an incentive to sell overseas and earn extra profits (as investable capital). Furthermore, an expansion of labor-intensive industries spurred by exports makes the return to labor (i.e., wages) higher than that to capital (as postulated in the so-called "Stolper-Samuelson theorem"4). This is because successful exports result in more specialization in, and more expansion of, comparatively advantaged industries (i.e., more output of labor-intensive goods) —therefore, even further poverty reduction. In this sense, the Lewis model also can be reinterpreted as a theory of market-driven poverty alleviation during an export-led takeoff, even though Lewis himself was concerned solely with a process of capital accumulation in a closed economy as the engine of industrialization under capitalism and did not pay attention to the poverty issue, particularly in terms of international trade and MNEs' investment.

Also, noteworthy is that the shift of labor from the rural to the urban, industrial area involves females as well as males. In fact, the former may often exceed the latter in number, since the start of industrialization creates more jobs suitable for young females. In general, they are more disciplined and more patient—and above all, more dexterous with their fingers and hands for

3 Lewis (1951).
4 Stolper and Samuelson (1941). This theorem says when any factor is used most intensively producing a good for export, its price rises more proportionately than the price of the good for which the factor is used as an input.
manual works than their male counterparts in such industries as apparel, textiles, toys and other sundries. These are the most common, labor-intensive production activities in which labor-abundant emerging countries can have strong comparative advantages in the initial phase of catch-up with the employment of female labor. (Another aspect left unexamined by Lewis.)

In short, the activation of rural labor as industrial one is a clear indicator of a successful industrial takeoff in emerging markets. And it is also the key mechanism for poverty alleviation—and for providing income-earning opportunities for poor people, especially for females who are traditionally non-participants in the labor market. This transitional period of structural change is a necessary prelude to the subsequent growth phase of a consumer-oriented economy that relies more on domestic demand than on export demand. Full mobilization of unemployed or underemployed rural people is a necessary condition for a rise in consumption, which signals a critical transition to the next phase of growth.

3. East Asia's poverty reduction, labor-driven tandem takeoffs and sustainable catch-up

East Asian experiences best illustrate how labor-intensive, low-end production (mostly prompted and/or organized initially by foreign MNEs), has recently contributed to dire-poverty reduction in the region, meeting the first UN Millennium Development Goal (MDG) of poverty reduction (1990-2010), five years ahead of the 10-year deadline. In 1990, according to the 2015 MDG Progress Report of Asia and the Pacific (latest available report that uses the 2011 US$1.90-a-day PPP poverty line), as much as 60.2 percent of people in East Asia and the Pacific region lived in extreme poverty, but in 2013, only 3.5 percent did—the greatest achievement exceeding any other regions' performances and unprecedented in human history (United Nations, 2015). Furthermore, "With some of the world's most dynamic economies, and more than half of the global population, Asia and the Pacific region has helped drive the world towards the Millennium Development Goals" (Vox Media, 2016). In fact, there are still significant differences in poverty levels among regions, indicating sub-Saharan Africa is the worst case—followed by South Asia. (Khokhar, 2016).

An important question is, then, why East Asia has been so much able to meet the MDG of poverty reduction much faster than any other region? We know that growth is the prerequisite to market-enabled poverty mitigation. Yet, growth alone is not sufficient for full explanation.

5 In this connection, it should be stressed that although MNEs’ role is positive overall, their complicated supply chains, “licensed manufacturing,” and overseas subsidiaries, notably in emerging markets, are susceptible to tragic industrial accidents that severely damage host communities, as evidenced in Bangladesh’s garment industry (as suppliers to MNEs) in 2013 when several factory collapse and fires exacted a heavy toll on workers, mostly female. The worst example is the Bhopal gas-leak accident in India caused by the locally controlled subsidiary of Union Carbide in 1984, a tragedy that killed tens of thousands of people, leaving some half a million people with respiratory problems.

6 Unfortunately, South Pacific island economies (like Tonga and Fiji) have been laggards in poverty reduction—in sharp contrast to East Asia, pulling down the overall performance of the "East Asia and the Pacific" region.
What matters most is *how--and in what specific way*--such high growth occurred in that region alone. In other words, growth modality is crucial. And most importantly, all the successful catch-ups in East Asia *started out* with labor-intensive, basic manufacturing industries that can extricate poor people out of extreme poverty as discussed above.

What is more, export-driven growth across East Asia didn't occur all at once simultaneously. Instead, it has taken place in tandem succession over time. Even before the initiation of the MDG in 1990, a phenomenal catch-up had already occurred first in Japan (a re-catch-up after the devastation of the second world war) and then in the NIEs (Hong Kong, Singapore, South Korea and Taiwan), not just eradicating abject poverty but also even raising their overall living standards close to those in the advanced West. And the ASEAN-4 (Thailand, Malaysia, the Philippines and Indonesia) followed by China (which opened its doors for the outside world in 1978, but would take over the ASEAN-4 soon afterward) were already in steady catch-up. Most recently, furthermore, Vietnam, Cambodia and Myanmar have begun to take off. In this sense, this type of tandem growth came to be popularly described as "flying-geese (FG)" formation of economic development in the region (*inter alia*, Akamatsu, 1962). And one common characteristic in all these East Asian economies' phenomenal takeoffs for catch-up is the mobilization and activation of rural labor to drive exports to earn precious foreign exchanges that can solidify official reserves and deal with the balance of payments problems that arise in the early phase of development. Also, this type of tandem catch-ups can also be described as "comparative-advantage relaying in labor-intensive industries," a phenomenon that stems from staggered transmigrations of low-end manufacturing across the region—with an export focus on advanced countries’ markets.

This staggered feature is important. If all these economies had pursued such an export-driven catch-up simultaneously at once, the advanced West would be inundated with imports, which might have triggered protectionism. However, these staggered export drives have been accepted by the importing advanced economies, since low-end manufactured imports from each taking-off country have been *relayed* over time from one advanced country to another, thereby keeping such imports at an acceptable level each time. Besides, if all the economies pushed exports simultaneously, those already cheap exports from industrialization beginners would drive down their prices even more simply under the pressure of oversupply. This nullifies the effectiveness of such a takeoff strategy. In other words, the so-called “fallacy of composition” was avoided.

Furthermore, the staggering makes it easier--increasingly *each* time--for the subsequent round of takeoff due to accumulating opportunities to learn from the experiences of those previous rounds. For example, China’s takeoff must have been expedited by the experiences of the three

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7 This theory was originally introduced by Kaname Akamatsu in the 1930s. For its updated, reformulated versions, see Ozawa’s trilogy (2005, 2009, and 2016).
8 For an analysis of this phenomenon, see Chapter 6 in Ozawa (2016).
earlier rounds (involving Japan, the NIEs, and ASEAN-4), since it was in a much more favorable position than those already taken-off neighbors to learn from their knowledge accumulations. This is an important source of sequential latecomers’ advantage down the hierarchy of economies, what I call “learning from neighbors’ successive earlier experiences” (i.e., an FG-driven positive externality).

4. China as Africa's new leader?

The successful flying-geese formation in East Asia is the very reason why in 2009, sensing the rising Chinese wages that would soon compel MNEs to move factories to new low-cost locations, the World Bank called upon China to make investments not just in resource exploitation and infrastructure development but also more in low-cost manufacturing to spark an industrial takeoff in sub-Saharan Africa, a region that badly needs employment opportunities for its vast masses of poor people, who ought be mobilized for productive work as the main driver of an export-driven takeoff. True, China has already emerged as the most significant investor in the region, especially in manufacturing in such host countries as Ethiopia, Mauritius, Nigeria, Tanzania and Zambia. Yet, the prospects for sub-Saharan Africa's industrial takeoff led by Chinese manufacturing investment are still unpromising due largely to local political instability—and the availability of alternative new factory locations in China's own vast inland and neighboring countries.10

Be that as it may, the World Bank recognizes the crucial role of labor-intensive industries as the most effective initiator of emerging markets' industrialization and poverty reduction and the role of MNEs as the most powerful agent to tap the huge reservoir of unused human resources in the host economies (the two crucial points stressed above). Indeed, India that began a rapid catch-up by initially jumping into the modern information and communications industry via call centers and back-office services soon realized--having learned from China in particular--the criticality of labor-intensive manufacturing for poverty reduction. It started a "make-in-India" campaign to attract foreign MNEs that would be interested in abundantly available, low-wage labor in the country.

5. Open up for MNEs' investment--and the backlash effect of offshoring

The strategy of MNE-assisted, export-driven takeoff has come to be widely adopted in the emerging world. And it is in many ways different from, and more expeditious than, the old-style Hamilton-List "infant industry" protection model. In this context, as the first step to industrialization, Torfinn Harding and Beata Javorcik put it succinctly, "Roll out the red carpet

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9This was widely reported in the news media. See, inter alia, "China and World Bank in Talks to Establish Industrial Zones in Africa," Financial Times, December 4, 2009.
10Ozawa and Bellak (2010). For an expanded, updated version, see Chapter 6 in Ozawa (2016).
and they [i.e., MNEs] will come."\textsuperscript{11} Indeed, this strategy has worked wonders for many emerging markets that properly prepared themselves for opening (via export-processing zones) and welcoming foreign MNEs as partners to kick off industrialization. Clearly, the advanced countries', especially the U.S.'s, willingness to keep their vast rich markets for imports from emerging markets was a necessary condition to accommodate the latter's export-driven takeoffs. The former has been tolerating the ever-bulging imports from the emerging world on expectations that the latter's growth would create more export markets for advanced economies.

However, the flipside of MNE-enabled "comparative advantage magnification" in emerging host markets is necessarily "comparative disadvantage magnification" in MNEs' home countries. President Trump's "America First" policy reflects the backlash against job-offshoring and import outsourcing relentlessly pursued by MNEs. And his remark about the "carnage" means job losses, factory closures and dilapidated communities—sores of trade adjustment problems. At present, the only long-lasting measure to help the adversely affected workers and communities is the "trade adjustment assistance (TAA)" program (to subsidize worker retraining and community revival), which has nevertheless proved unsatisfactory, despite repeated tweaking over the past fifty years ever since its inception under the 1967 Trade Act.

In this respect, it is true that "Tough talks will not bring back \textit{old} jobs," as recently argued by Martin Wolf, a popular op-ed writer of \textit{The Financial Times}.\textsuperscript{12} But, President Trump's jawboning with the U.S. market as leverage—and a tariff threat (i.e., "If you sell in America, produce here—or else tariffs") has already cajoled MNEs into pledging to retain \textit{current} jobs and even create more \textit{new} jobs in the U.S., the richest and most open market in the world. Besides, Wolf still considers the TAA program "the best response" to the ever-aggravating negative impact on the U.S.—contrary to the program's actual poor results that ignited the Trump revolution in the first place. In fact, it even facilitates job-offshoring by MNEs, since they are not held directly responsible for—and exonerated from—the social costs they leave behind in the form of unemployment and blighted communities. Business as usual would not work anymore.\textsuperscript{13}

6. Conclusions: An end of the "roll-out-the-carpet" strategy?

Given this latest political development in the U.S., doesn't President Trump's browbeating approach to restrict job-offshoring and outsourced imports mean an end to the effectiveness of emerging markets' "roll-out-the-red carpet" policy? Here, we must realize, however, that what President Trump, as well as his supporters in the "fly-over" states, is most concerned about is \textit{not} really a loss of old jobs in such labor-intensive, low-end manufacturing as garment stitching and toy making. The new U.S. administration knows these jobs are \textit{no longer} compatible with the

\textsuperscript{11} Harding and Javorcik (2012).
\textsuperscript{13} The analysis in this paragraph draw on Ozawa (2017).
advanced, current stage of the U.S. industrial structure. They are clearly things of the past and cannot remain competitively in today's America. Moreover, the administration is fully aware that trade is more effective than economic aid in helping emerging markets industrialize.

Instead, it is rather higher value-added, large-scale manufacturing, such as auto assembly, heavy industry, and other skill-based factory jobs that used to be (and still are) the backbone of America's middle class. This type of jobs has moved mostly to China and Mexico largely at the hands of MNEs (through job-offshoring and technology transfers in response to high wages at home). These low-middle-income countries are naturally bent on developing higher value-added industries, thus farther climbing the ladder of development to join the advanced world, now that their takeoff periods are over. They have most recently entered a new catch-up phase of developing knowledge-based (i.e., "created"--instead of "endowed") comparative advantages in steel, machinery and automobiles, a phase that is destined to engender rivalry and conflicts with the advanced world. (According to the FG theory, this period is predictable in the evolving relationships between the advanced and the emerging worlds. It is identified as the "homogenization" period.) Particularly, China has already encountered considerable political resistance from the former as it strives to shift its growth efforts away from the initial phase of export-driven, low-end manufacturing--hitherto even encouraged by the advanced world--towards building up the more knowledge-driven, higher value-added phase of manufacturing than ever. These rapidly catching-up countries have started to nurture their own industries and national champions as competitors vis-à-vis foreign MNEs through state involvement. Besides, despite of their having already attained middle-income status, they continue to seek privileges as poor nations under multilateral trade deals. As a result, some advanced countries, especially the U.S., are calling for correcting uneven playing fields. Therefore, the middle-income countries, especially BRICS (Brazil, Russia, India, China and South Africa) and Mexico, are the ones that should be most worried about the Trump administration's "America First" policy.

So far as those low-income countries that are about to takeoff are concerned, the advanced world's high-income markets for low-end manufactures should--and will--remain open, as analyzed above. Hence, there will still be opportunities for export-focused, labor-intensive basic manufacturing (in which the U.S. and other advanced countries are no longer interested--and which even China is willing to discard as its wages rise) to play the role of a powerful kick-starter for catch-up industrialization.

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14 MNEs' low-wage-seeking drive overseas can maximize profits but diminishes social welfare at home. In other words, job-offshoring and outsourced imports may have been carried out to an extent of overdoing it to the detriment of the U.S. economy. What is more, the benefits from trade liberalization have diminished after many rounds of liberalization, while its social costs have soared, especially under multilateral trade deals. A new era of bilateral pacts--not only between nations but also between nationalist states and MNEs--to protect national interests is dawning (Ozawa, 2017).

15 This is described in Akamatsu's seven-stage growth model (Akamatsu, 1962). For a further elaboration, see Chapter 3 in Ozawa (2009).
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