

# Comments on Professor Eric Maskin's Slide Presentation

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# Excellent Presentation

- This is an excellent theoretical presentation on the impacts of globalization and technological change on inequality in labor income in poor countries;
- Unsatisfied with the standard Heckscher-Ohlin trade model with two countries, two goods and two factors of production, the paper presents a trade model under the current global production sharing or the break-up of production process into geographical separated stages. Cross border production is now allowed by a combination of lower transportation costs and communication costs and the removal of trade barriers. The same reasons allow cross border movements of factors of production, mainly labor and capital.

# Excellent Presentation.....

- The global supply chains have allowed countries to specialize in different stages of production process depending on their relative cost advantage and other economic fundamentals. The specialization increases trade in parts and components and final assembly within production networks faster than total trade in manufacturing;
- The new form of international specialization is larger in Asia, particularly China and India, and has brought prosperity to this region. The Philippines and Malaysia are now producers of spare parts and components of electronics and Bangkok area is now Detroit of this region.

# The Maskin's Model

- There are two countries in the model (the rich and poor countries) producing two consumption goods, namely; rice and computer;
- The rich country has workers of two skill levels, A and B, where  $A \geq B$ . The poor country also has workers of two skill levels C and D where  $C \geq D$ . Moreover,  $A \geq B \geq C \geq D$ ;
- There are many competitive firms in each country. Each firm is characterized by the same production process, in which there are 2 tasks, namely: a managerial (or skill sensitive) task and an assistant's (or relatively skill-intensive) task. A firm's output is determined by the skill levels of the workers who undertake the two tasks;

# The Maskin's model

- The model predicts that when the skill gap is too large between the rich and the poor countries, the “homogenous matching” prevails but when the skill gap is not too large, the “cross matching” prevails. Homogenous matching means high skilled workers will work with high-skilled workers and low-skilled workers will work with low-skilled workers. Cross matching means low-skilled workers will work with high-skilled workers;

# The Maskin's model

- In the globalized world, if the skill is too large, the low-skill workers in poor country will work with other low-skilled workers in the same country while the high-skilled workers work with high-skilled workers in the rich country;
- Inequality will increase in the poor country with the change of the matching structure from “cross matching” to “homogenous matching”. This is because globalization exerts downward pressures on the wage of low-skilled workers. Meanwhile, technological change only favors high-skilled workers;

# Policy Recommendation

- The model suggests that best way to reduce inequality in a poor country is through training and education to raise workers' productivity;
- Professor Maskin suggests the third parties should pay for worker education, namely:
  - \* domestic government;
  - \* international agencies, including NGOs;
  - \* foreign aid;
  - \* private foundation.

# Policies to tap potential from global supply change

- In contrast to other countries, Indonesia is not an active participant of global or regional supply chains. Indonesia has the least open economy and lowest FDI/GDP ratio among the ASEAN five countries;
- To attract FDI and tap the potential from the global supply chains, Indonesia needs to introduce radical supply-side reforms to reverse the a decade lost of competitiveness and boost long-term growth and create employment for her surplus of unskilled labor;



# Raising international competitiveness

- Structural reforms are particularly needed in input markets, from electricity, harbors, roads, airports, labor and land as well as the streamlining regulatory system to relieve the bottlenecks that were adding to production costs;

# Building strong and solid public institutions

- Public institutions play important role in promoting sustainable long-term economic growth. They perform the following economic functions in a market system that affect efficiency and equity objectives:
  - (i) To facilitate the development of effective and efficient market with low transaction cost by protecting property rights, enforcing contracts and providing law and order;
  - (ii) to regulate and substitute or correcting market failures. Banks and financial institutions, for example, need to be regulated and supervised to prevent socially costly bank runs and crises;
  - (iii) To stabilize the market including stability of macro-economy for allowing business and investment to flourish;
  - (iv) To address market failures by state-ownership in many state-owned enterprises.

# How to reduce inequality

- Professor Maskin model shows that globalization tends to increase inequality of labor income in poor countries. This can be corrected through reorganization of small economic units and through government policies to reduce disparities in wealth and income from capital and land, taxation and transfer:
- (i) reorganization of small farming and SME to allow exploitation of economies of scale, mechanization and thereby raising labor productivity;
- (ii) building strong and solid institutions;
- (iii) reducing economic rent;
- (iv) better redistributive impact of fiscal policy;
- (v) limited affordable social safety net: minimum wage legislation, unemployment insurance and health insurance.