

Globalisation, Jobs and Wages

Are we seeing a new type of globalisation?

Is globalisation reducing the number of jobs?

Are rising imports a source of insecurity?

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Introduction

Open trade and investment policies can be a powerful force for raising living standards. Economists have long emphasised this point and it is confirmed by much research. For example, the OECD's Growth Study estimated that a 10 percentage point increase in trade openness translates over time into an increase of around 4% in per capita income in the OECD area. The recent dynamism of China and India demonstrates how trade and investment liberalisation can make a major contribution to raising incomes and reducing poverty in developing countries.

But while trade raises overall income and welfare, some workers may lose from globalisation. This is most evident in the case of workers displaced from sectors that contract in the face of import competition. And it is little consolation to someone who has just lost their job that overall living standards are rising in their country, or that new jobs are being created in other sectors.

This may help explain the marked contrast between the overwhelmingly positive assessment of globalisation by economists and the ambivalence revealed by public opinion polls. While a substantial majority of the public typically agree that freer trade yields benefits to business and consumers, many also endorse statements such as, "freer trade costs more jobs than it creates" or "the relocation of jobs to countries where wages are lower is a major economic problem". Globalisation also appears to serve as a flashpoint for concerns that inequality is rising.

Such doubts suggest that continuing political support for trade and investment liberalisation cannot be taken for granted. These doubts also indicate that it is timely to reassess whether there is anything about the current phase of globalisation which could increase the vulnerability of workers to foreign competition and, if so, how governments should react.

The OECD has just conducted such a reassessment and this *Policy Brief* summarises the main lessons from that exercise. ■

Are we seeing a new type of globalisation?

Globalisation has a long pedigree, but recent increases in international economic integration are unprecedented in several ways which might be thought to make workers in OECD countries more vulnerable. Two recent developments in world trading patterns which are frequently mentioned are the rising importance of large emerging economies, especially China which is now the world's third largest exporter, and the increased prominence of international production networks, including offshoring.

The rapid integration of large, low-wage countries like Brazil, China, India and Russia into the world economy may have exacerbated anxieties that OECD workers were becoming less competitive internationally. These four countries (the "BRICs") now represent 45% of world labour supply, compared with less than 20% for the 30 OECD countries. The BRICs are also increasingly open to trade and investment. Over the past 15 years, total trade as a proportion of gross domestic product (GDP) grew by over 50% in Russia, nearly doubled in China and more than doubled in Brazil and India. Standard trade theory suggests that this development could be a source of increased job insecurity or downward pressure on wages for low-skilled workers in OECD countries, at the same time as it offers a boon for consumers in the form of lower prices.

Another novel feature of the ongoing wave of globalisation is that it goes hand-in-hand with the rapid adoption of information and communications technology (ICT). Such technology makes it easier to fragment the production of goods and services, and to outsource certain tasks to other countries. This "great unbundling" has extended the reach of globalisation to domestic activities where workers were previously sheltered from direct international competition. The offshoring of services such as customer information call centres has increased rapidly in recent years, for example, although its importance in domestic production remains far smaller than that of goods offshoring. ■

Is globalisation reducing the number of jobs?

It is sometimes asserted that foreign competition – especially from China and other labour-rich emerging economies – will drive most jobs in high-wage countries out of the tradable sector and into the non-tradable sector. The shift out of manufacturing into services is sometimes taken as an indication that this process is already underway. However, such a process could not be sustained and it is unlikely that trade will result in a reduction in overall employment in the long run. OECD countries that imported but did not export would soon run out of the foreign exchange required to finance their imports, requiring them either to stop importing or to resume exporting. Neither the scale of the emerging economies nor the increasing prominence of offshoring changes the logic of "mutually advantageous trade", in line with the principle of comparative advantage.

Does trade then create as many jobs as it destroys? This question is difficult to answer, because it is impossible in many cases to say whether trade is responsible for the creation or disappearance of any particular job. What is clear is that globalisation is compatible with high employment rates, provided the right domestic policies are in place. Indeed, employment-population

ratios have risen and unemployment rates have fallen during the past decade in most OECD countries, even as trade and foreign direct investment (FDI) deepened. Similarly, employment is not systematically lower in the countries which are most open to trade and FDI (Figure 1). Indeed, employment rates are highest in the Nordic countries and Switzerland, all very open economies. ■

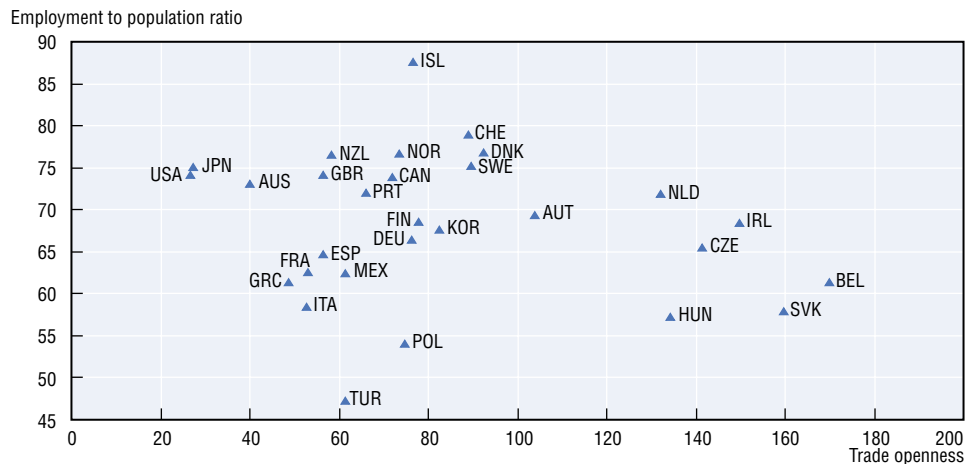
Are rising imports a source of insecurity?

The labour market plays a crucial role in reaping the potential gains from globalisation by facilitating a shift of jobs from declining sectors or occupations to expanding ones, in line with changes in comparative advantage.

However, this labour market adjustment is not always smooth because many workers displaced from declining sectors are poorly positioned to move into newly-created jobs in export sectors, which may be located in different regions or require different qualifications. Trade-displaced workers are thus at risk of prolonged unemployment or of finding that they need to accept a substantial pay cut in order to get a job. Although trade is a source of insecurity for workers, increased imports appear to account for only a modest share of total job displacements. Furthermore, good domestic policies can reduce the adjustment cost born by displaced workers.

OECD analysis confirms that foreign competition reduces employment in the most exposed industries, and that imports from non-OECD countries have a stronger impact on displacing jobs than intra-OECD trade. This difference makes sense. A large proportion of trade between OECD countries is intra-industry trade (e.g. the same country both exports and imports cars), which limits the impact on employment in that sector. By contrast, inter-industry trade plays a larger role in trade between OECD and developing countries, since the often large differences in input prices and technology lead to sharper patterns of industrial specialisation. As a result, more jobs tend to disappear in import-competing industries such as the manufacture of clothing and consumer electronics.

Figure 1.
AGGREGATE EMPLOYMENT IS NOT SYSTEMATICALLY RELATED TO TRADE OPENNESS¹
Trade openness and the employment-population ratio, 2005 (percentage)



1. Trade openness defined as the sum of exports and imports as a percentage of GDP.

Source: OECD Employment Outlook 2007.

The impact of offshoring on employment is quite complex. As certain stages of production are sourced abroad (i.e. local production is replaced by imports of intermediate goods and services), production becomes less labour-intensive in the home country and employment falls for any given level of output. However, offshoring also raises productivity, permitting lower prices and higher profits which, in turn, lead to higher sales. The additional hiring due to improved competitiveness and higher sales appears to be sufficiently large to offset the job losses due to the fall in labour intensity. Adjustment difficulties may nonetheless result, since skill requirements for the newly created jobs tend to be higher than those for the jobs lost. ■

Is globalisation boosting inequality?

Even if globalisation has not created an overall shortage of jobs, workers may have had to make concessions on wages or working conditions to remain employed. One indication this may have happened is that the wage share of national income has declined since 1980 in most OECD countries. This means that average wage growth has not been keeping pace with the growth in labour productivity, even as trade and FDI have grown rapidly. This is consistent with globalisation having eroded the bargaining power of workers. However, many other factors could play a role in explaining the fall in the wage share. For example, firms may have adopted progressively more capital-intensive technologies during this period. Such “capital-deepening” could cause the wage share to decline even in the absence of any decline in the bargaining power of workers.

At the same time, wage inequality has been rising in most OECD countries. In 16 of the 19 countries for which data are available, the earnings of the 10% best-paid workers have risen relative to those of the 10% least-paid workers since the mid-1990s (Figure 2). Trade theory suggests that growing trade with developing countries could have played a role in causing earnings inequality to rise in OECD countries, by depressing the wages of low-skill workers. Although it is very difficult to single out the effect of trade, the data suggest that globalisation through increased offshoring has contributed to shifting labour demand away from less skilled workers and hence to rising earnings inequality.

However, other factors – in particular, computerisation and other technological advances that create demand for more skilled labour – have probably been more important. The fact that wage inequality has also tended to increase in developing countries, including the BRIC economies, is consistent with skill-biased technical change having played a major role in raising skill requirements. ■

Are globalised labour markets more volatile?

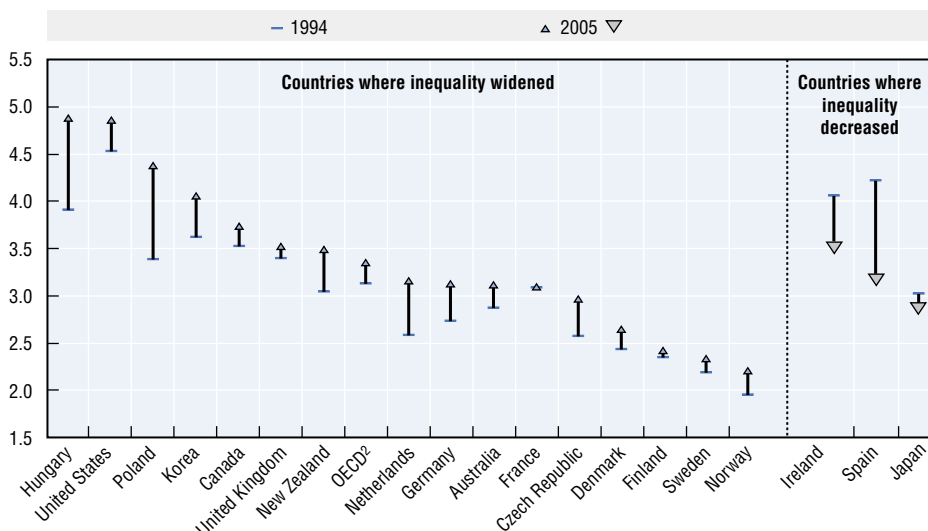
While economists have long emphasised that the increase in trade resulting from more open markets creates temporary adjustment costs for workers, it is also possible that globalisation could permanently increase their insecurity by making labour markets more volatile. In economies that are more open to trade and investment, firms may be more exposed to international “shocks”, such as exchange-rate fluctuations, and require more flexibility to adapt to global market conditions. Globalisation may also change the way the

labour market adjusts to demand shocks (whatever their origin), by making employment and earnings more responsive to changing business conditions. In particular, firms which have established international production networks may find it particularly easy to reallocate jobs across international borders in response to changes in relative wages in different countries. This could expose the workforce to greater insecurity. It might also tend to weaken the bargaining position of employees and help to explain why the wage share of national income has fallen.

OECD analysis confirms that exchange rate movements affecting the competitive position of an industry also have a significant impact on job security and earnings: as foreign competition intensifies, job stability declines and the wages of workers who continue in the same job are more affected by changing economic conditions. This link between greater exposure to global competition and instability is strongest for workers with relatively low levels of education and job tenure. Moreover, as industries become more open to trade, this link between globalisation and potential instability for workers is likely to strengthen.

OECD analysis also suggests that sectoral employment has become more responsive to changes in labour costs during the past several decades and that offshoring probably has been one of the drivers of this trend. An adverse trade shock in an industry that makes intensive use of offshoring is estimated to translate into job and wage losses that are approximately three times larger than those that would result from an equally large shock in a low offshoring industry. The rise in the responsiveness of employment and wages to demand shocks has been strongest in manufacturing industries,

Figure 2.
EARNINGS INEQUALITY HAS TENDED TO WIDEN
Ratio of the 90th to 10th percentile earnings¹



Note: The figure shows that in all countries except Ireland, Japan and Spain, the earnings of the 10% best-paid workers increased more than the earnings of the 10% least-paid workers, over the 1994-2005 period (i.e. earnings inequality widened).

1. Full-year, full-time workers. The data shown are consistent over time, but not entirely comparable across countries owing to differences in pay reporting periods and coverage of workers.
2. Unweighted average of countries shown in the figure.

Source: OECD, Earnings Distribution Database.

where offshoring is most prevalent. However, the growing practice of services offshoring suggests a similar trend could also emerge in the services sector.

Although there are good reasons to conclude that globalisation is a potential source of diminished job security, data for OECD countries suggest that overall job stability has not changed much during the past decade. This could mean that the impact of globalisation in making labour markets more volatile has been only modest and has been offset by other factors tending to reduce labour turnover. For example, there is evidence that business cycle fluctuations in output and employment have become more muted, perhaps due to improved monetary policy. ■

Are popular concerns justified?

So, has globalisation made OECD workers increasingly vulnerable? There is no simple, “yes or no”, answer to this question. Clearly, popular concerns about how foreign competition is affecting workers deserve to be taken seriously. The evidence does show that the expansion of trade is a potentially important source of vulnerability for workers. This is particularly true for workers most exposed to import competition or least prepared to navigate in labour markets characterised by intensive restructuring, rising skill requirements and employers who are increasingly sensitive to differences in labour costs.

However, popular concerns also appear to be exaggerated in many cases, focusing on highly visible exceptions rather than the general rule. Indeed, trade appears to have made only a modest contribution to the upward trend in inequality in recent decades, while evidence is lacking for a general increase in insecurity. Perhaps of greatest importance, recent experience confirms that the right mix of domestic policies can generate strong labour market performance, even in very open economies. ■

What should governments do?

The “bottom line” lesson for policy makers would seem to be that the impact of globalisation on labour markets is manageable, but international economic integration makes it all the more urgent to enact pro-growth and pro-employment policies which ensure that political support for open trade and investment will not be eroded by excessively high levels of insecurity or inequality.

Which types of labour-market policies are required in response to globalisation? Several broad policy orientations can help to maximise the gains from trade and assure that workers share fully in those gains:

- Trade deepening – especially the rapid integration of large developing economies into the global trading system and the expansion of international production networks – is constantly generating new opportunities for specialisation in production (and undermining old specialisations). A first prerequisite for workers to benefit from globalisation is that businesses seize these opportunities. Policies that facilitate innovation and business formation are crucial in this context.

- Policies to enhance mobility in the labour market are also crucial to help individuals and firms to seize emerging opportunities in the world economy. Measures ensuring that workers flow from declining to expanding activities, as the economy restructures itself, are likely to be particularly important. Well-designed employment protection legislation can contribute to efficient labour reallocation. It is counterproductive to defend jobs that have become uncompetitive, but there is a role for moderate advance notice requirements and severance pay, structured so as avoid penalising voluntary mobility. Since foreign competition is continually changing the structure of labour demand, it is also important that wage-setting institutions allow relative wages to adjust to changing market conditions.
- Employment-oriented social policies can help to reconcile income security for workers with efficient mobility in the labour market. As is emphasised in the Restated OECD Jobs Strategy relatively generous welfare benefits can be consistent with high employment rates and efficient worker mobility. But these benefits must be combined with mutual-obligations/activation policies which increase re-employment opportunities while mitigating the disincentive to work embodied in generous welfare systems. “Make work pay” measures may also be required to make sure that globalisation does not push low-skill workers into working poverty.
- While in-work benefits combined with moderate minimum wages can shore up the incomes of low-skill workers, they do not improve longer-term career prospects. Skill development opportunities for low-educated workers are also required to limit low-pay traps and the rise in earnings inequality, as skill requirements rise.

Governments can help to sustain political support for international economic integration by fostering an open and well-informed discussion of the benefits and costs of globalisation. To be credible, such a discussion needs to frankly acknowledge the costs of globalisation and also take account of wider concerns about economic insecurity and inequality. Most importantly, governments need to explain how their policies are addressing those concerns while also supporting international economic integration. Further research clarifying how globalisation is affecting workers’ well-being would contribute to the success of these discussions, by helping to ground them in fact rather than unfounded fears or unrealistic hopes. ■

For further information

These issues are analysed in greater detail in Chapter 3 of the OECD *Employment Outlook 2007*. For more information about this Policy Brief and OECD work on globalisation and structural adjustment in labour markets, contact, Alexander Hijzen, e-mail: alexander.hijzen@oecd.org, tel.: +33 1 45 24 92 61 or Paul Swaim, e-mail: paul.swaim@oecd.org, tel.: +33 1 45 24 19 77, or visit www.oecd.org/els/employmentoutlook.



For further reading

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