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CREATING MORE AND BETTER JOBS IN A GLOBALISING ECONOMY

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There is heated debate regarding the labour market effects of globalisation. Most economists emphasise the welfare gains which are associated with freer trade and investment, as specialisation of production in line with comparative advantage will translate into higher output and greater consumption possibilities. And freer trade and investment will intensify competition, thereby encouraging firms to innovate and adopt new technology. This, in turn, may spur economic growth and support job creation.

Nevertheless, globalisation is sometimes perceived as a source of job losses and growing labour market insecurity. The increased international integration of large, low-wage countries like Brazil, China, India and Russia may have exacerbated these anxieties. These four countries combined now represent 45% of the world labour supply, compared with less than one fifth for OECD countries as a whole. They are also increasingly open to trade and investment –for instance, over the past 15 years, total trade grew by over 50% as a proportion of GDP in Russia, it nearly doubled in China and more than doubled in Brazil and India.

There is also a feeling that some groups benefit more than others from globalisation. The fact is that globalisation is occurring in the context of wider wage inequalities. In 16 of the 19 OECD countries for which data are available, the earnings of workers at the top of the wage distribution have risen relative to those of workers at the bottom since the early 1990s. The distribution of market income has also widened in many countries since the mid-1980s. But most of this increase occurred before 1995. Since then, there has been no further trend increase in market income inequality despite this being the period when China and India made serious inroads into world markets for goods and services.

This note examines the employment policy challenges arising from the ongoing process of globalisation. It first discusses labour market opportunities and challenges for G8 countries arising from the current process of globalisation. It then turns to policy implications. In particular, the note considers how pro-employment policies recommended in the Restated OECD Jobs Strategy can help enhance the benefits from globalisation and reduce adjustment costs, through measures that enhance labour market efficiency while also meeting social goals.

A. What are the labour market opportunities and challenges of globalisation?

Globalisation entails higher incomes and welfare

History demonstrates that globalisation holds the promise of better living standards for the economy as a whole. For example, according to the OECD Growth Study, a ten percentage point increase in the ratio of trade to GDP is associated in the long run with a 4% increase in per capita income. Also, there is some evidence that more open economies tend to grow faster than less open ones.

To realise these opportunities, adjustment is needed –and this can be painful for some workers

The labour market plays a crucial role in the realisation of the potential gains from globalisation by facilitating a process of “creative destruction”.¹ Indeed, to realise the welfare gains of globalisation, it is crucial that sectors and firms where comparative advantage lies are able to seize the new opportunities. This in turn requires a transfer of jobs from declining sectors

¹ In this regard, the labour market effects of globalisation are similar to those arising from technological change.

or occupations to expanding ones. Transferring resources to more productive uses as quickly as possible is an important driver behind increased living standards and sustained growth.

Workforce adjustment is not painless, however. In the United States, 63% of workers displaced from jobs in high-international-competition manufacturing industries are re-employed within two years after job loss.² In the EU-15, this is the case of only 52% of displaced workers. Moreover, workers displaced in the United States experience an average pay cut of 13% once re-employed, with one-quarter experiencing earnings losses of 30% or more. By contrast, earnings are unchanged on average for European workers becoming re-employed following the loss of a job in manufacturing. Overall, this suggests that adjustment occurs mainly through pay cuts in the United States and through lengthy unemployment spells in Europe.

A novel feature of the ongoing globalisation wave is that the adjustment challenge now concerns a broader range of jobs than in the past, when mainly unskilled labour and industrial sectors were affected. Indeed, an important characteristic of the ongoing globalisation process is that it goes hand-in-hand with the rapid adoption of information and communications technology. Such technology facilitates the fragmentation of the production of goods and services, and outsourcing of certain tasks to other countries. This has contributed to extend the reach of globalisation to more service sectors. Consequently the ongoing process of globalisation entails job gains and losses within sectors, as well as between them.³ In short, adjustment opportunities and challenges potentially concern a broader range of jobs, both skilled and unskilled, in services and goods-producing sectors.

The fact that adjustment is not painless for workers, combined with growing recourse to outsourcing (or the threat of it), may have made employment and wages more vulnerable to shocks such as abrupt exchange-rate changes or the emergence of new foreign competitors.⁴ This might be one factor behind the trend decline in the share of wages in national income (and the associated trend rise in the profit share) observed in a majority of countries over the past two decades (Figure 1).⁵ The wage share declined more in low-employment G7 countries (France, Germany and Italy) than in the most of the other G7 countries. However, the wage share has also trended downwards in Japan and the United States –in the latter country, in marked contrast with previous long-standing stability.

In order to maximise the gains from globalisation, labour markets need to support rapid worker adjustment towards expanding sectors, firms and occupations. There is also a need to address widening wage inequalities and perceptions of job insecurity. Public support for furthering international economic integration (and the structural reform agenda more broadly) could wane if the perception that many workers do not benefit from it takes root. Globalisation may become an easy target if most workers feel increasingly vulnerable to external shocks or believe they are falling behind high-income groups, even if research continues to indicate that the actual contribution of globalisation to these trends is probably quite modest, compared with that of technological change.

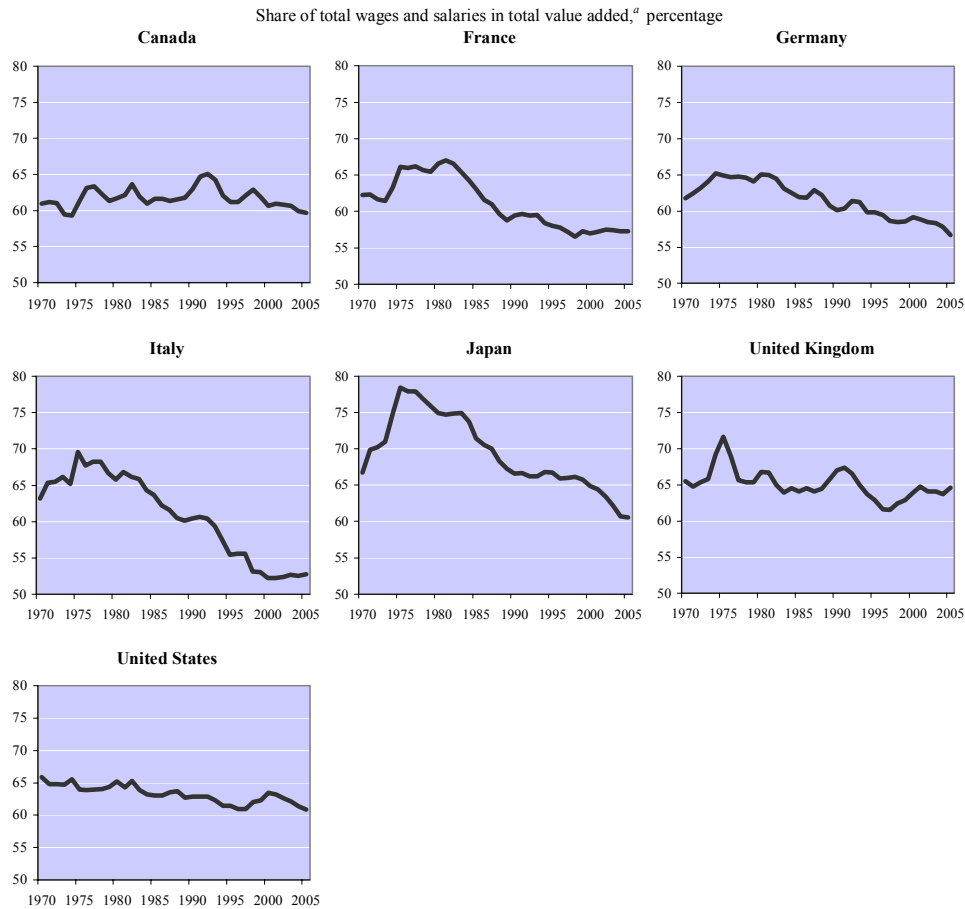
² See OECD *Employment Outlook* (2005), Chapter 1, Paris.

³ See Richard Baldwin (2006), “Globalisation: the great unbundling(s)”, Paper for the Economic Council of Finland. It should, however, be stressed that the extent of outsourcing is often exaggerated in the media – see OECD (2007), *OECD Employment Outlook*, Paris (forthcoming in June), and OECD (2007), *Offshoring and Employment*, Paris (forthcoming).

⁴ See OECD (2007), *OECD Employment Outlook*, Paris (forthcoming in June).

⁵ IMF (2007) analyses in detail the factors behind falling wage shares. ILO/WTO (2007) provides a broader literature review.

Figure 1. Share of wages in national income



a) Total labour compensation, including employers' social security and pension contributions and imputed labour income for self-employed persons.

Source: OECD estimates.

B. What can policies do to promote employment opportunities arising from globalisation and reduce adjustment costs?

As noted above, countries with similar trade and investment patterns – even members of a regional trading area – have widely different unemployment rates and wage disparities. Looking at the unemployment trends in the G8 over the past 15 years suggests rather different country experiences, even though the process of globalisation gathered momentum throughout all of the countries concerned (Figure 2, Panel A). Unemployment rates fell in Canada, Italy, Russia, the United Kingdom and the United States. They rose in France, Germany and –from low levels— Japan. Outside the G8, Ireland and Spain are the two OECD countries which have achieved the most impressive gains in employment. And these are also two countries which have become considerably more open to international trade and investment. A look at the evolution of employment rates confirms that there is no obvious relationship between globalisation and aggregate employment outcomes (Figure 2, Panel B).

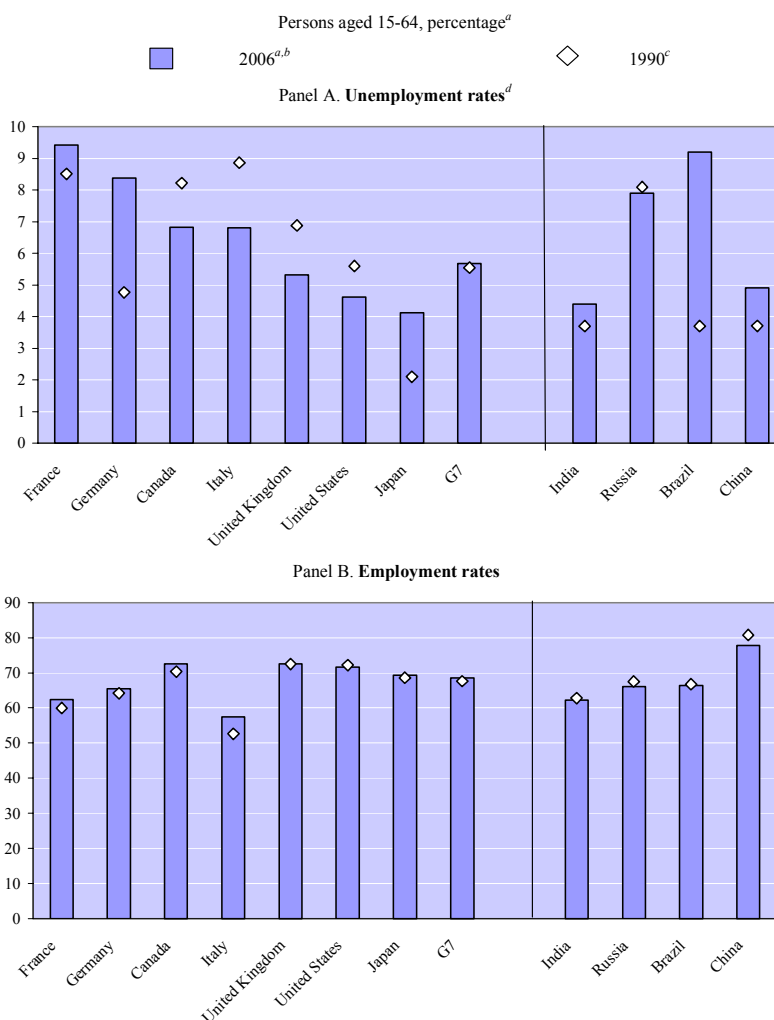
This suggests that the actual impact of globalisation depends crucially on national policy settings and institutions. Good economic policies can enhance the adjustment capacity of the economy, increasing the gains in overall living standards from trade, while also enabling workers to benefit from better career prospects and mitigating excessive inequality of household

incomes. The Restated OECD Jobs Strategy of 2006 provides an important benchmark on how to achieve this.

Helping firms and individuals seize the new opportunities

Anti-competitive product-market regulations may create barriers to the creation of new businesses or the expansion of sectors where comparative advantage lies. Such anti-competitive regulations may have particularly detrimental effects on output and employment in industries characterised by a large share of relatively small firms or by high entry and exit rates, like the business service sector. Inefficiencies in financial markets and distortions created by the tax code may reinforce entry barriers by raising capital costs for such firms. Several service industries, such as transport, professional services and retail trade, are also subject to heavy sector-specific regulations in many OECD countries, with potentially detrimental effects on employment and productivity.

Figure 2. Employment and unemployment rates in G7 countries, Brazil, China, India and Russia, 1990 and 2006



a) G7 countries are ranked by decreasing order of the unemployment rates in 2006.

b) 2005 for the employment rates and the unemployment rates of the BRICs.

c) 1994 for India and Russia.

d) Standardised unemployment rates for the G7 countries. Unemployment rates for Brazil, China, India and Russia are not always comparable with OECD data, reflecting in particular the high incidence of informal employment in some of these countries.

Source: OECD Employment Outlook 2007 (forthcoming).

Reduced barriers to competition, entrepreneurship and growth are instrumental in strengthening the economy's capacity to adjust and to absorb displaced resources. In particular, such policies may unleash the considerable potential of the service sector as a source of job creation. OECD work provides robust evidence that measures in this area stimulate job creation, while also boosting productivity and real incomes –to the extent that greater competition puts downward pressure on consumer prices, raising the purchasing power of wages.⁶

Facilitating mobility through well-designed employment regulations

Globalisation requires mobility to ensure that workers are not trapped in jobs which have no future. In this regard, overly-strict employment protection legislation (EPL) may reduce mobility by constraining firms' ability to cope with a rapidly changing environment. Since firms' firing as well as hiring practices are likely to be affected by the restrictiveness of EPL, both the inflow to, and outflow from, unemployment could potentially be reduced. In addition, when severance pay is tied to the existing job, workers with a permanent contract and long tenure will have limited incentives to change jobs voluntarily. This is especially problematic when these jobs are located in declining sectors, while new job opportunities are available elsewhere in the economy. Finally, overly-strict employment protection of permanent contracts, combined with a loosening of EPL governing temporary contracts, has also been associated with a surge in the use of temporary contracts in several OECD countries. While this may lessen the impact on firms' hiring and firing practices, it also divides the labour market into segments providing different levels of protection, thus making it difficult for temporary workers to move to permanent jobs, acquire a career and realise their productivity potential.

However, a certain degree of employment protection, like advance notification of plant closing or other large-scale layoffs, may reduce adjustment costs by providing all interested parties time to plan and implement the necessary adjustments. Reasonable advance notice to workers and governmental bodies is often a prerequisite for cooperation between the firm, its workers and public employment services in preparing for imminent job losses.

It is also possible to provide adequate workers' compensation against dismissal, while at the same time reducing some of the drawbacks of traditional severance pay systems. For instance, Austria replaced in 2003 its traditional dismissal compensation system with individual saving accounts that workers can carry with them in the event of changing jobs –thus facilitating mobility. Making legal procedures more predictable and limiting interference of the judicial system in the case of fair dismissals is also important. Indeed, in the context of increased economic risks associated with globalisation, legal uncertainties are especially detrimental to recruitment under permanent contracts. This is probably why employers in the Netherlands have increasingly recourse to a dismissal system which is predictable –though more expensive in terms of severance pay than the traditional system.⁷ Finally, in Denmark, dismissal procedures are relatively light and workers' protection is mainly provided through a generous, work-oriented benefit system –the so-called Danish “flexicurity” system.

⁶ See OECD (2007), *Economic Policy Reforms: Going for Growth*, Paris; and OECD (2006), *OECD Employment Outlook*, Paris.

⁷ In the “dual” dismissal system of the Netherlands, employers can opt for a relatively short (Court-based) procedure which entails relatively predictable dismissal pay. Alternatively, they can process the dismissal case through the traditional route, i.e. labour authorities (Centers for Work and Income). In the latter case, dismissal procedures take much longer than with Courts –though dismissal compensation tends to be much less. Interestingly, recourse to Courts, instead of the traditional route, has been increasing over the past decade.

These innovations show that it is possible to reform too-strict EPL in a manner which strikes a balance between the need for flexibility and workers' security.

Compensating the losers through employment-oriented social protection

Reintegrating displaced workers is particularly challenging and involves policies to ensure sufficient job opportunities and hiring incentives, as well as employability. While time-limited targeted policies might be envisaged in some cases, particularly in the face of trade shocks that affect disproportionately certain low-skilled groups or are concentrated in particular localities, the overriding advice from the Restated OECD Jobs Strategy to countries is to aim for good general policies to cope with structural adjustment problems, whatever their origins.

In particular, countries' benefit systems play an important role in the reintegration of displaced workers. Unemployment benefits help cushion the cost of adjustment for the affected individuals. However, if benefit systems are badly designed, work incentives can be poor for workers who have to change jobs as unemployment benefits based on past earnings can be very high relative to potential post-displacement wages.

One way of ensuring high re-employment incentives for job losers is to grant them low benefits levels and of limited duration. Another approach, however, is to implement well-designed mutual obligations/activation policies which increase the re-employment opportunities while mitigating the work dis-incentive effects embodied in generous welfare systems. This includes in particular effective job-search assistance and compulsory participation in a labour market programme after a period of unemployment (as is done in Australia, the United Kingdom and some Nordic countries); this is backed up by the threat of moderate benefit sanctions if the jobseeker does not take steps to search for work actively or improve employability.

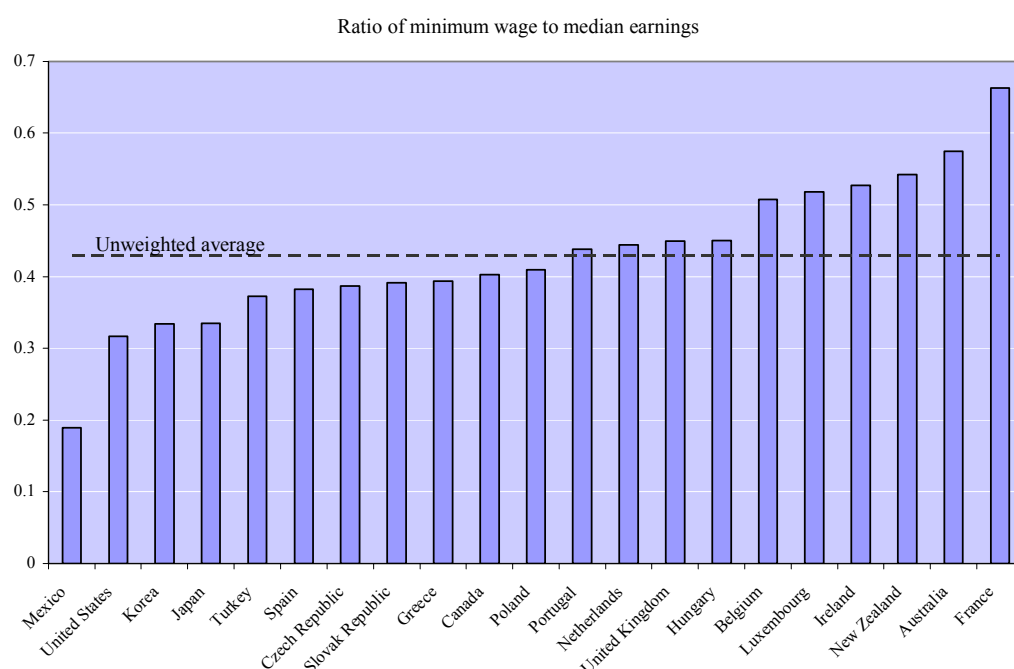
A general principle for effective activation policies is that each person should receive a comprehensive package of treatments that corresponds to his or her specific needs. This raises the question whether trade-displaced workers tend to require a different mix of treatments than other clients and, if so, whether the services that they receive are suitably tailored to their specific situation on the labour market. Workers from import-competing sectors in decline are likely to possess obsolete skills for which little demand exists in expanding industries. Therefore, compared with other jobseekers, these workers may be more in need of training programmes that enable them to upgrade their skills or acquire new ones, on top of more standard job-search assistance. In cases where trade-related structural change has suppressed local demand for labour, employment services may also need to maintain a broad geographic scope to include areas where employment is more buoyant. In this context, measures that facilitate geographic mobility may be helpful. Relocation grants and mobility assistance may be required to facilitate moving or simply to permit travel for interviews.

Promoting employment and earnings prospects of low-skilled workers

Low-skilled workers are a particularly disadvantaged group in the face of globalisation. In OECD countries, freer trade and investment, combined with skill-biased technology, tend to reduce the demand for unskilled labour relative to that for skilled labour. This will exert downward pressure on the relative wages of unskilled workers. If these wages do not respond accordingly, there is a risk of higher unskilled-labour unemployment. And if wages do respond so that employment is maintained, the result may be higher working poverty –except if lower social contributions on low-paid work help cushion the effects of lower wages on the take-home pay of workers.

There is a need to develop so-called “make-work-pay” policies to help not only those who cannot find a job, because of globalisation or any other reason, but also those who struggle to make ends meet relying on low-paid, precarious employment. One option is an increase in minimum wages. A minimum wage set at a low level (like in the United States –see Figure 3– especially before the recently-decided adjustments) may require significant in-work benefits in order to reduce the risk of working poverty. However, a minimum wage set at too high a level may hinder employment prospects for low-productivity workers (especially in the presence of high social security contributions, like in France).

Figure 3. **Relative gross minimum wages in OECD countries, 2005**



Source: OECD minimum wage and median wage database.

Experience shows that “making work pay”, through in-work benefits (like the Working Tax Credit of the United Kingdom or the Earned Income Tax Credit of the United States) combined with a moderate minimum wage can be effective --particularly for certain groups at risk of joblessness and in-work poverty such as lone parents. Even in relation to the overall labour force, employment gains can still be significant. The expansion of the in-work payment in the United Kingdom in 1999 is estimated to have increased total employment by 0.4% of the labour force, for example.

Many countries that have introduced make-work-pay policies also have a minimum wage that acts as a floor to reduce the risk that the provision of in-work benefits leads to lower pay. However, in countries where wage floors are set through collective agreements, there is less of a need for setting a minimum wage in combination with in-work benefits. This is the case in Germany –though it seems that, even in this country, a growing number of workers are not covered by collective agreements, which may require introducing some sort of wage floor suitably differentiated by industry or age group.

Critics of make work pay policies point out that, although some people are encouraged to work by such policies, others (in particular, second earners in a household) face a reduction in work incentives. However, it is possible to design in-work benefits without such effects – by

basing them (at least in part) on *individual*, not just family incomes, as in France and the Netherlands. Also, it has been argued that the net cost per job created by make work pay policies is exceptionally high. This is true – net costs of €40,000 per job created, or even more are commonly found. But this observation misses the point: make work pay policies are *not* just an employment measure; they are a way of redistributing income to those who have found a low-paid job as their route back to work. These people deserve help. The fact that make-work-pay policies provide such assistance, *and* create jobs, means that they can be a cost-effective way of redistributing income.

In-work benefits *cum* moderate minimum wages will not fundamentally improve the career prospects of low-skilled workers. Thus, improving skill development opportunities for low-educated workers is important as well. Better skilled workers are more mobile across occupations, industries and regions than their lower skilled counterparts. They also face a lower risk of layoff. And, when they lose their job, better skilled workers have a relatively good chance of obtaining new employment.

This reinforces the need for implementing the skill development pillar of the Restated OECD Jobs Strategy, which encompasses i) reducing early school failure and achieving high-quality initial education; ii) strengthening the links between initial education and the labour market; and iii) promoting incentives on the part of both workers and firms to invest in human capital, complemented with well-targeted public support.

However, policy implementation may be complicated by the fact that it has become easier for firms to fragment and outsource many tasks. This fact has two implications. First, the firm – which is the main provider of training in all countries— may have less incentives to train its workers who may have to move to another firm. The risk of “poaching” of trained workers is one which has always existed, but it may have increased as a result of globalisation. This may call for greater emphasis on training systems targeted on individuals rather than firms. Second, a broader implication concerns the unpredictability of skill requirements. This poses a challenge to education policy, especially in “dual” systems (like in Germany) which include the possibility of combining study with work experience from an early age. There may be a case for either starting practical study at a later age and/or lengthening the period of study until a later age so as to ensure that all youth acquire much stronger generic skills than is presently the case. In this regard, the successful French experience of tertiary vocational education offers an interesting case in point.

Concluding remarks

The policies advocated here are instrumental for enhancing the benefits from globalisation while addressing some of the adjustment and distributional concerns. Such an approach i) supports the transfer of resources from declining sectors and occupations to expanding ones, but also ii) provides security to workers in the form of employment-oriented social protection. The relative importance of each of the two planks depends on country preferences and institutions. But what is important is to move ahead with a coherent, successful package.