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OECD Employment Outlook

Editorial

Addressing the globalisation paradox

Globalisation holds the promise of better living standards, but is sometimes perceived as a threat

The debate about the social impact of globalisation is characterised by a paradox. On the one hand, most economists highlight the lessons from economic history, namely that more open markets tend to be associated with greater prosperity. Indeed, freer trade and foreign direct investment (FDI) help realise the welfare gains associated with exploiting comparative advantage. They also intensify competitive pressures, thereby encouraging firms to innovate and adopt new technology – which, in turn, spurs economic growth and supports job creation. In sum, globalisation is a win-win process for OECD and non-OECD trading partners alike. On the other hand, however, there is concern in the public opinion in many OECD countries about the risks that globalisation may entail in terms of jobs and wages.

This paradox reflects the unprecedented scale of globalisation…

This paradox can be explained, first of all, by the unprecedented scale of globalisation. The range of countries which participate in globalisation is much broader than was the case in earlier episodes of international economic integration. In particular, Brazil, the Russian Federation, India and China (the so-called BRICs) are becoming major trade and investment partners. For instance, over the past 15 years, total trade grew by over 50% as a proportion of GDP in the Russia, it nearly doubled in China and more than doubled in Brazil and India. This has entailed a major increase in the number of workers whose outputs compete on world markets – as shown in Chapter 1, the BRICs account for 45% of the world labour supply, compared with less than one fifth for OECD countries as a whole.

More fundamentally, a unique feature of the ongoing process of globalisation is that it concerns many labour-intensive services as well – and not just primarily industry as in the past. This is because globalisation goes hand-in-hand with the rapid adoption of information and communications technology. New technology and declining transportation costs, facilitate the fragmentation of the production of both goods and services, and offshoring of certain tasks to other countries. In short, most firms and workers are directly or indirectly competing in today's world economy.

… and coincidences with wider earnings inequality and perceptions of job insecurity

A second factor explaining the globalisation paradox is that economic integration is occurring in the context of wider earnings inequality and perceptions of job insecurity. Over the past two decades, the share of wages in national income has tended to fall in the majority of OECD countries. Also, 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. As to job insecurity, so-called "objective" indicators do not show any clear trend. Nevertheless, workers in a number of OECD countries are increasingly worried about their ability to keep their current jobs.

Globalisation is not the major factor behind these concerns, which still need to be addressed to avoid a backlash

Chapter 3 shows that trade deepening and offshoring is indeed a potential source of vulnerability for workers. An analysis covering trade and labour market developments since 1980 shows that jobs and wages have become more vulnerable to external shocks. This might have reduced the bargaining power of workers, especially low-skilled ones, which may therefore contribute to explain the falling share of wages in national income. There is also some evidence that offshoring, or the threat of it, may be one of the driving forces behind the increase in the vulnerability of jobs and wages. This is because offshoring allows firms to respond more flexibly to shocks via changes in the mix of production at home and abroad.

True, the consensus in the empirical literature is that the contribution of globalisation to increased earnings inequality or job insecurity is quite modest compared with other drivers such as technological change. Nevertheless, it is crucial to address these concerns: 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.

Well-designed domestic policies are crucial, encompassing…

In this respect, it is crucial for policy makers to realise that they can play a major role in making the most from globalisation and reducing workforce adjustment difficulties. Countries with similar trade and FDI patterns – even members of a regional trading area – have widely different employment and unemployment rates and wage disparities. And this reflects different policy settings among countries.

The Restated OECD Jobs Strategy of 2006, highlighted in last year's *Employment Outlook*, provides an effective policy benchmark to help create more and better jobs in a globalising world. The findings of Chapter 2 suggest that pro-employment reforms in line with the Strategy may help realise the growth potential associated with globalisation.

…first, removing barriers to the expansion of sectors where comparative advantage lies…

Maintening barriers to the creation of new businesses or to the expansion of sectors where comparative advantage lies will significantly limit the gains from globalisation. Reducing these barriers will help 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.

... second supporting the mobility of workers rather than protecting jobs which have no future...

Globalisation requires mobility to ensure that workers are not trapped in jobs which have no future. In this regard, tying dismissal regulations to existing jobs will tend to weaken workers' mobility opportunities. This is especially problematic when these jobs are located in declining sectors, while new jobs are available elsewhere in the economy. However, a 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. The OECD Jobs Strategy provides several examples of innovations on how to provide adequate workers' protection against dismissal, while at the same time reducing some of the drawbacks of traditional severance pay systems – *e.g.* the so-called "flexicurity" approach.

...third, ensuring adequate social protection and making it employment-oriented...

It is essential to compensate job losers through social protection systems which are employment-friendly. Reintegrating displaced workers is a task which requires efforts 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 adverse trade shocks that affect disproportionately certain low-skilled groups or are concentrated in particular localities, the overriding need is to aim for good *general* policies to cope with adjustment difficulties.

In this regard, one way of ensuring high re-employment incentives for job losers is to provide them with low benefits. Another approach, however, is to provide adequate benefits hand-in-hand with "activation" policies which increase the re-employment opportunities. As documented in Chapter 5, such activation policies include, in particular, effective job-search assistance and compulsory participation in a labour market programme after a period of unemployment, backed by moderate benefit sanctions, if necessary. Experience shows that such policies, if well-designed, work.

...and finally, supporting the low-skilled through make-work-pay policies and lifelong learning

The low-skilled are a particularly disadvantaged group in the face of globalisation. In OECD countries, freer trade and FDI, combined with skill-biased technological change, tend to reduce the demand for unskilled labour relative to that for skilled labour. This requires renewed efforts to improve workers' skills, notably by taking steps to improve the functioning of training markets and enhancing incentives for both firms and workers to invest in lifelong learning. This needs to be complemented with well-targeted public support to improve learning opportunities of the low-skilled who, in all countries, have less access to on-the-job training than skilled workers.

Meanwhile, make-work-pay policies will help not only those who otherwise would not be able to find a job, because of globalisation or any other reason, but also those on low-paid jobs. Many countries that have introduced make-work-pay policies also have a minimum wage that, set at an appropriate level, acts as a floor to reduce the risk that the provision of in-work benefits leads to lower pay. Finally, Chapter 4 shows that low-skilled employment can also be supported by making the funding of social protection more "progressive" and by shifting from social contributions to tax bases which fall on broader population groups, and not just wage earners.

The bottom line is that well-designed domestic policies are instrumental for enhancing the benefits from globalisation while addressing the adjustment and inequality concerns. These policies would also help strengthen public support for freer trade and investment policies, and promote perceptions that globalisation is an opportunity for all.

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