

# CONFERENCE ON 'GLOBALISATION AND THE KNOWLEDGE ECONOMY'

Paris, 9 October 2006

## ISSUES PAPER

Prepared by the OECD Directorate for Science, Technology and Industry (STI)

Globalisation raises policy challenges in many areas. Among these areas is the debate on the impacts of globalisation on production and employment in OECD countries. This conference discusses the evidence on the globalisation of value chains that emerges from work conducted in the OECD Directorate for Science, Technology and Industry (STI) over the past few years and examines some of the main issues that policy makers need to grapple with in relation to globalisation.

### 1. New evidence on globalisation and its impacts

\* The current phase of economic globalisation is mainly driven by strong growth in trade and foreign direct investment. Labour flows have been less important over the past decade, though they have increased in size.

\* Value chains have increasingly become globalised as ICTs allow companies to perform activities in whatever location that can help to reduce costs. The fragmentation of the production process across various countries has given rise to important restructuring in companies, as outsourcing and off-shoring activities have increased. Intermediate and final production is increasingly outsourced abroad.

\* International outsourcing of inputs may take place through arms-length relationships as well as within firms. Multinational firms play a key role as they co-ordinate production and distribution across many countries and shift their activities depending on changing demand and cost conditions.

\* The globalisation of value chains has resulted in a greater use of intermediates by companies, with a decline in the 'production depth'. In manufacturing, exports and imports of individual countries increasingly move together and grow faster than production. It has led to a rise in intra-industry trade and more international sourcing (imports) of intermediate inputs.

\* Global value chains are positively affecting the integration of certain developing countries into the global economy, notably Asian countries such as India and China. But globalisation is not purely a North-South phenomenon as trade and FDI of OECD countries are not overwhelmingly directed to developing countries.

\* Globalisation affects individual manufacturing sectors to different extents: high and medium-high technology industries are generally more internationalised than less technology intensive industries. But next to manufacturing, increasing internationalisation and off-shoring of services have been recently observed reflecting the growing tradability of services.

\* Globalisation does contribute to falling manufacturing employment and de-industrialisation of OECD countries, but only to a limited extent. De-industrialisation remains largely a domestic issue and is a consequence of high productivity growth in manufacturing and increased demand for services.

\* The process of globalisation has a variety of effects: positive as well as negative, dispersed as well as concentrated, short term as well as longer term. Typically the negative, visible, short term effects (e.g. employment losses) gain media attention and reach the public, as these are most easily measured while longer term indirect benefits are much harder to calculate.

\* Several studies have come up with a large estimates of the absolute number of jobs lost following the off-shoring of activities and jobs. However, these sizeable impacts on jobs in absolute terms appear modest when compared with the overall churning in the labour market due to technological development and changing consumer demand.

\* Fears for employment losses abound in developed countries, fuelled by the large differences in wage costs with developing countries such as India and China. Globalisation has been found to raise incomes and wages without undermining aggregate employment, however. But while globalisation may have only a minor impact on overall employment, disproportionate impacts on certain types of workers and regions are reported.

\* Globalisation of activities results in higher firm productivity. Firms that are engaged internationally through exporting/importing, and/or the activity of affiliates abroad, tend to perform better than purely domestic firms. Further on, foreign affiliates make important contributions to labour productivity growth in host countries.

## **2. Moving up the value chain**

\* OECD countries are moving to higher value added activities as lower value added activities increasingly go to lower cost countries. In order to compensate for their cost disadvantage, developed countries rely more on knowledge, technology and intangible assets. Specialisation in more traditional cost-based industries and activities seems a less viable option for most developed countries.

\* Trade of high and medium high technology industries has been growing faster than total manufacturing trade but differences among OECD-countries are substantial. Only a few OECD countries are specialised in high-technology manufacturing, with these industries contributing positively to the trade balance.

\* The share of knowledge-based “market” services continues to rise in all OECD countries.

\* The shift towards more technology and knowledge intensive activities and investment is also taking place in lower technology industries. Value added in these sectors has grown much more strongly than employment (indicating that productivity has increased sharply) and the R&D-intensity has increased more strongly than in other industries.

\* Also, a number of non-OECD countries, in particular China, seem to be moving up the value chain, thereby directly competing with OECD countries. The large inflows of FDI and imported technology embodied in FDI has structurally changed China’s trade over the last decade

as the commodity composition has been diversified from traditional industries into higher technology intensive industries.

\* China's trade surplus is however not due to high technology exports, but is still due to the large exports of lower technology industries. Part of the phenomenon of moving up the value chain in China, is due to assembly activities related to the growing imports of parts and components in China. The shift of China's trade pattern towards higher technology intensive sectors is largely driven by the international production sharing within the East Asian region through cross border production and trade networks.

\* The fragmentation of the value chain and the corresponding internationalisation pattern of manufacturing results also in multinational enterprises increasingly establishing R&D facilities away from their headquarters at many locations world-wide. While most of the internationalisation of R&D still takes place within the OECD area, developing countries are increasingly attracting R&D centres, although in terms of R&D investments this remains relatively small from a global perspective.

These observations bring about several *policy questions*:

\* Do OECD countries still have a manufacturing future? Will the competitive pressure of large emerging countries like China and India become too strong? Likewise, in which services activities can OECD countries safeguard their competitiveness?

\* Is moving up the value chain the only answer for OECD countries now that China is also upgrading its activities? Is China only assembling high technology exports, and if so, how long will this low value added assembly orientation last?

\* Why and how have some countries benefited more from economic globalisation than other countries in the past? To what extent does this relate to size, openness, and flexibility? Are there other key ingredients? Are the same policy measures valid for the current phase of globalisation with the 'economic' emergence of large countries like China and India?

\* What economic policies can be implemented to foster the competitiveness of a country as a whole? Is there still a place for a national economic development strategy?

\* How does globalisation affect different categories of firms e.g. SMEs and multinational enterprises? Has firm size become more important, as companies require economies of scale and scope, or is globalisation offering new opportunities for SMEs?

\* How can the negative distributive effects of globalisation be addressed without foregoing the positive consequences of globalisation?

\* Now that off-shoring is not longer limited to manufacturing jobs but also extends to services jobs, are the jobs of high skilled clerical and service employees also threatened?

\* Does the increasing internationalisation of R&D erode or "hollow out" the domestic knowledge base?

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