How many jobs are offshorable?

Comments to Alan Blinder,
the Swedish Globalisation Council,

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Standard trade theory

- Trade between on the one hand regions abundant in physical and human capital and on the other hand regions abundant in unskilled labour

  - specialisation
  - aggregate gains from trade in both regions
  - changes in income distribution: possible falls in the relative wage of unskilled labour and in the aggregate real wage of all labour (relative to what it would be otherwise)

- Standard theory is applicable to **offshoring** as well

Trade theory with rigid labour markets

- Standard trade theory assumes perfect wage flexibility
- This does not apply to Western Europe
  - rigidities of both real and relative wages
- Then trade with countries abundant in low-skilled labour can create unemployment
- Aggregate welfare gains do not materialise
- Paradox: overexpansion of trade

Frictional unemployment

- Matching problems during transition if structural change is speeded up
- But weak empirical evidence of faster structural change in recent decades
- Are data aggregated the wrong way?
- But burden of proof on those who claim that globalisation/offshoring is causing much faster structural change

How does globalisation influence labour market flexibility?

- Globalisation is likely to make European labour markets much more flexible
- Globalisation might even raise employment in Europe

Mechanisms tending to raise employment

1. Increased competitive pressures reduce price-cost margins
2. Potential offshoring makes labour demand more sensitive to wage changes
   - lower trade union wage demands
3. Better bargaining position for employers
   - bargaining outcomes closer to employer objectives
4. Weaker incentives to uphold labour market institutions serving to help labour appropriate existing rents
   - rents are lower and employment costs of appropriating them increase

Regressions explaining (un)employment in a panel of OECD countries

- Unemployment benefits
- Tax wedges
- Union density
- Product market regulations
- Coordination of wage bargaining
- Output gap
- Trade with low-wage economies
- Outward FDI in low-wage economies

Table 3.8

Unemployment regressions

Dependent variable: Unemployment rate	(1) 1988-2003	(2) 1988-2003	(3) 1988-2003	(4) 1988-2003	(5) 1988-2003	(6) 1990-2003	(7) 1990-2003
Average replacement rate	0.094*** (4.55)	0.079*** (3.70)	0.085** (2.36)	0.076*** (3.67)	0.079*** (3.67)	0.016 (0.45)	0.104*** (2.84)
Tax wedge	0.259*** (8.77)	0.252*** (8.55)	0.075* (1.68)	0.217*** (8.66)	0.251*** (8.34)	0.045 (1.17)	0.085 (1.61)
Union density	0.004 (0.16)	0.004 (0.16)	-0.298*** (3.94)	-0.002 (0.07)	0.004 (0.16)	-0.169** (2.23)	-0.329*** (3.82)
Employment protection	-0.319 (0.85)	-0.337 (0.91)	0.207 (0.48)	-0.565 (1.51)	-0.325 (0.82)	-0.194 (0.44)	0.306 (0.69)
Product market regulation	0.327 (1.28)	0.324 (1.29)	-0.055 (0.17)	0.473* (1.96)	0.322 (1.25)	0.461 (1.46)	-0.008 (0.02)
Corporatism	-2.280*** (4.89)	-2.290*** (4.93)	0.000 (0.000)	-1.945*** (4.39)	-2.288*** (4.90)	0.000 (0.000)	0.000 (0.000)
Output gap	-0.474*** (13.51)	-0.485*** (14.62)	-0.564*** (8.04)	-0.479*** (13.50)	-0.485*** (14.53)	-0.580*** (9.73)	-0.572*** (7.54)
Total trade openness				-0.071*** (6.00)			
Trade openness vis-à-vis low-wage economies	-0.255*** (3.41)			0.003 (0.04)			
Total imports relative to GDP					0.005 (0.13)		
Imports from low-wage economies relative to GDP		-0.501*** (4.59)			-0.509*** (3.97)		-0.083 (0.49)
Total outward FDI stock relative to GDP						-0.073*** (5.20)	
Outward FDI stock in low-wage economies relative to GDP			0.102 (0.52)			0.413** (2.45)	0.188 (1.02)
Observations	311	310	103	307	310	103	98
Time and country fixed effects	yes	yes	yes	yes	yes	yes	yes
Adjusted R-squared	0.70	0.71	0.80	0.73	0.71	0.84	0.81

Notes: t-values are given in parentheses. * significant at 10 percent; ** significant at 5 percent; *** significant at 1 percent.

Table 3.9

Employment regressions

Dependent variable: Employment-population ratio	(1) 1988-2003	(2) 1988-2003	(3) 1990-2003	(4) 1990-2003	(5) 1982-2003
Average replacement rate	-0.074* (1.85)	-0.048 (1.20)	0.021 (0.37)	0.026 (0.46)	-0.073* (1.71)
Tax wedge	-0.233*** (4.95)	-0.221*** (4.69)	-0.031 (0.32)	0.050 (0.48)	-0.243*** (5.25)
Union density	0.052 (1.30)	0.054 (1.35)	0.466** (2.44)	0.373* (1.87)	0.102** (2.05)
Employment protection	0.513 (1.00)	0.549 (1.08)	-0.170 (0.14)	-0.108 (0.09)	0.739 (1.24)
Product market regulation	-0.531 (1.22)	-0.498 (1.17)	-0.553 (0.71)	-0.981 (1.26)	-0.586 (1.30)
Corporatism	0.609 (0.77)	0.634 (0.81)	0.000 (0.000)	0.000 (0.000)	0.634 (0.77)
Output gap	0.394*** (7.54)	0.413*** (8.11)	0.301*** (2.93)	0.305*** (3.12)	0.395*** (6.60)
Total trade openness				-0.119** (2.23)	
Trade openness vis-à-vis low-wage economies	0.449*** (4.38)				0.525*** (3.77)
Imports from low-wage economies relative to GDP		0.901*** (5.95)			
Net outward FDI stock relative to GDP					-0.030* (1.76)
Outward FDI stock in low-wage economies relative to GDP			0.640** (2.08)	0.972*** (2.72)	
Observations	311	310	103	103	279
Time and country fixed effects	yes	yes	yes	yes	yes
Adjusted R-squared	0.63	0.65	0.66	0.67	0.62

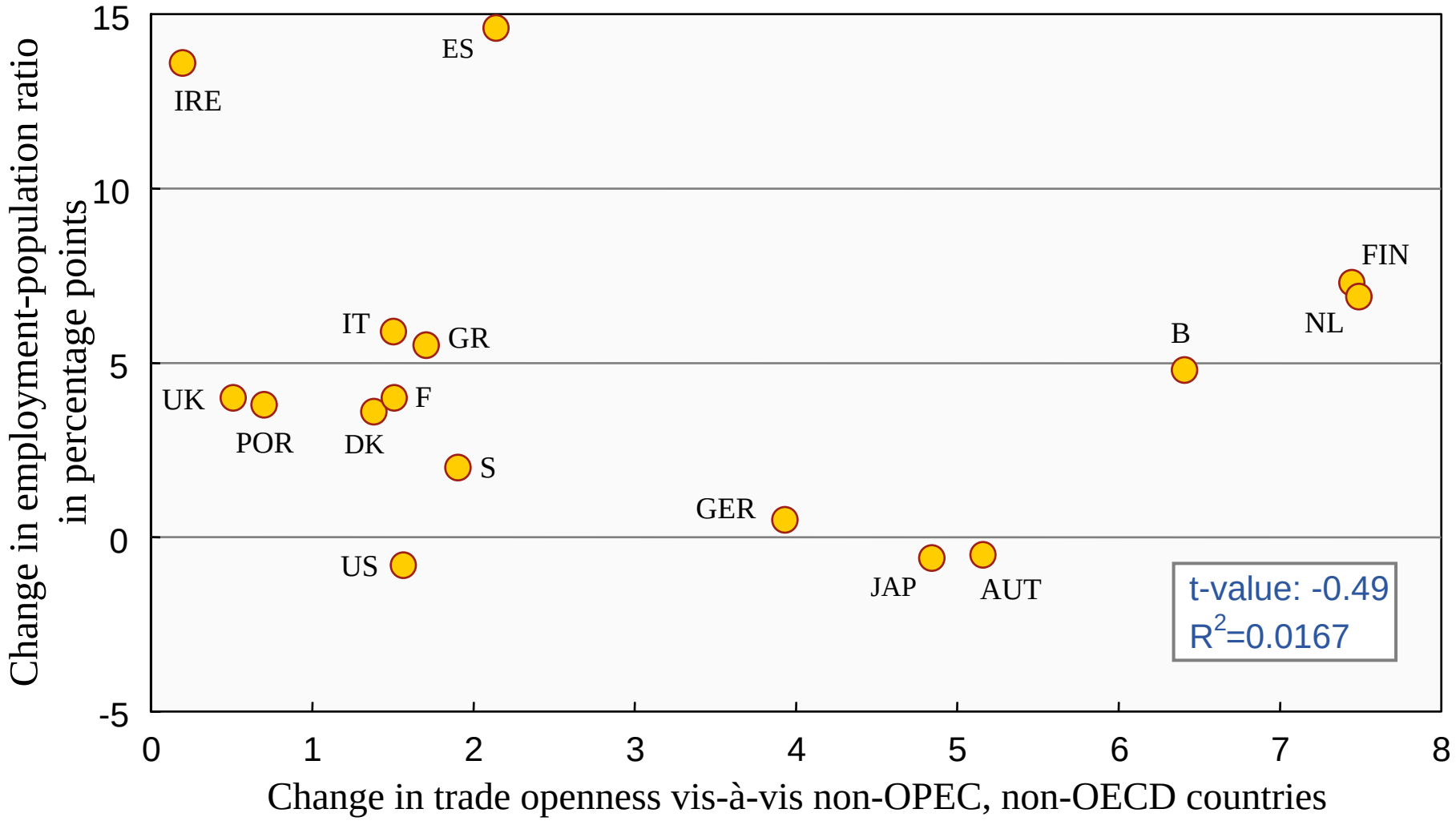
Notes: t-values are given in parentheses. * significant at 10 percent; ** significant at 5 percent; *** significant at 1 percent.

Results

- Very little support for adverse employment effects of globalisation
- Positive employment effects or no significant effects

Fig. 3.15

1994-2004 changes in trade openness to low-wage economies and in employment

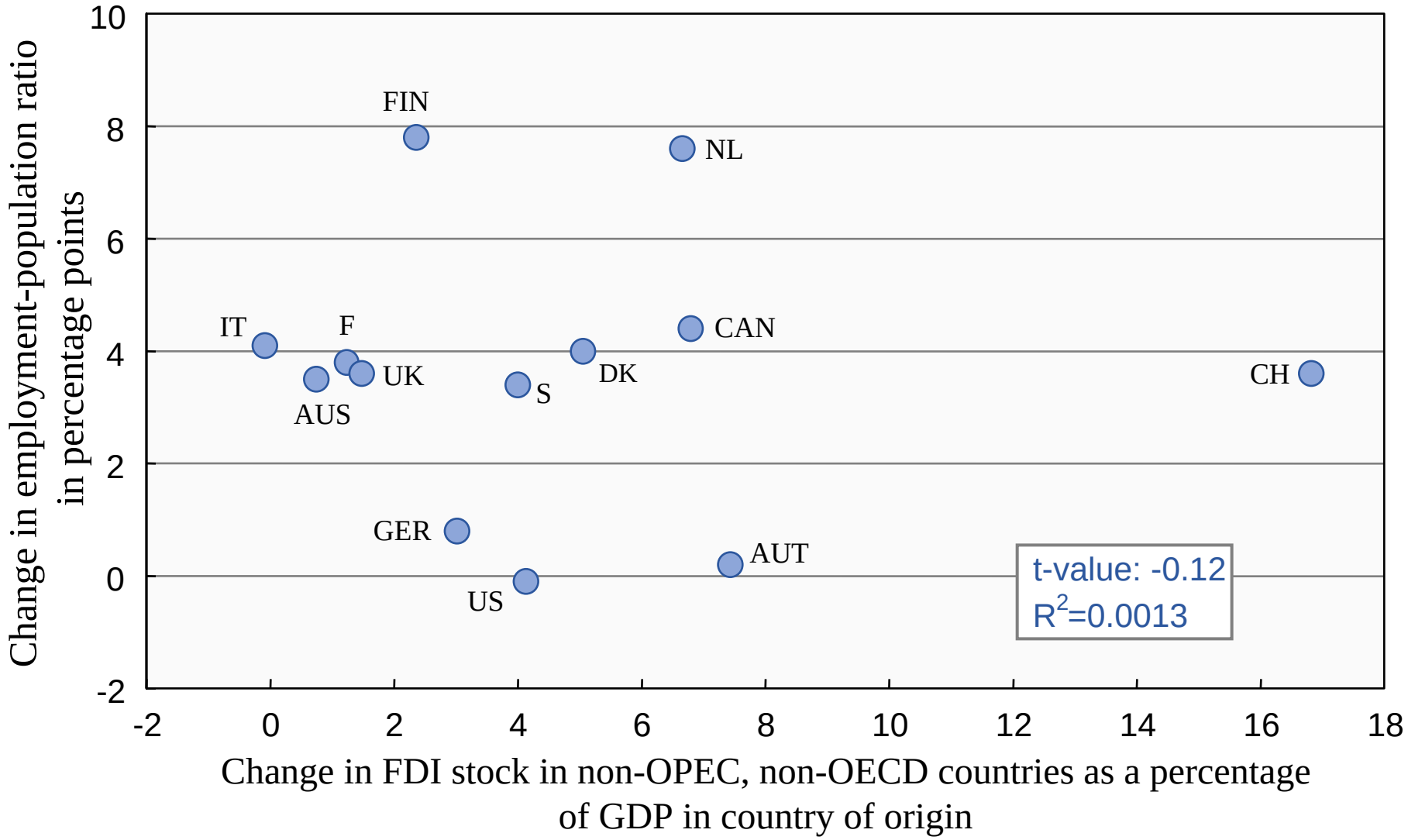


Note: Trade openness is defined as exports + imports as a percentage of GDP.

Sources: Trade data: OECD STAN Bilateral Database jointly with WDI GDP data; employment-population ratio: OECD Labour Force Statistics.

Fig. 3.16

1994-2002 changes in FDI stock in low-wage economies and in employment



Sources: FDI and GDP data: UNCTAD FDI Database; employment-population ratio: OECD Labour Force Statistics.

My view

- Globalisation is not negative for Western European employment – it is probably beneficial
- This does not mean that globalisation is unproblematic
  - income distributions shifted in favour of capital
  - many wage earners could lose or at least get disproportionately small share of the gains

Dividing line between winners and losers

- Skill level not so important
- Alan’s contribution:
  - personal and impersonal services more important
  - some ”personal services” may not be offshorable but could meet competition from posted workers (building sector)

Two types of income distribution effects

- Income losses for individual employees who are displaced
- Income losses for whole groups of employees (also those who stay on) because demand for certain jobs is reduced

Possible government or other collective interventions

- Unemployment insurance
- Severance pay
- Wage insurance
- Labour market retraining
- Employment tax credits
- General education

Unemployment insurance

- Strong case for generous benefits during transition period
- But weak case for high long-term benefits
  - incentive to take on new jobs is reduced
  - particularly true if pace of structural change accelerates
  - low wages on new jobs mean high ***effective*** replacement rates

Severance pay

- Government or collective insurance run by central labour market organisations
  - not conditional on unemployment
  - hence no negative effects on job search
  - no effects on employers´ incentives to hire and fire
- Such a system is in plaace for private-sector blue-collar workers in Sweden
  - ”omställningsförsäkring”
  - ”avgångsbidrag” 25000-40000 SEK for workers older than 40
- This system could be extended

Wage insurance

- Insurance against wage losses for displaced workers
- More adequate intervention than unemployment insurance if main income loss is from permanently lower wage
- Incentives for job search are strengthened!
  - subsidy is paid out first on taking up a new job
- But allocative function of wages is weakened
- How far should the welfare state go?
- Wage insurance exists in Sweden for central government employees
  - full compensation for two years
  - 50 per cent compensation for two additional years

Labour market retraining

- Both compensation and restructuring device
- Integral part of Swedish labour market policy since the 1950s (Rehn-Meidner model)
- Bad outcomes in the 1990s has led to too probably too large reduction in volumes
  - but better results to be expected now
  - this expectation is confirmed by recent studies
- Problems
  - six-month courses may be too short in knowledge-based economy
  - should courses be open only to unemployed?

Antal kvarstående deltagare i arbetsmarknadsutbildning (3-månaders glidande medelvärde) januari 1999 till december 2005

Employment tax credits

- Earned income tax credit in the US focused on low-income groups
- Not possible in Sweden

  - too high marginal effects from phasing out

  - expensive measure
- Not adequate measure if globalisation hurts certain types of jobs rather than the unskilled in general

Various tax reforms

	Degree of self-financing	Income distribution (P90/P10)
No reform	-	2.92
Employment tax credit I	0.71	2.86
Employment tax credit II	0.69	2.84
Employment tax credit with gradual phasing out	0.40	2.82

Source: Swedish Fiscal Policy Council

General education for youth

- Difficult to pinpoint expanding activities in advance
- How does one teach adaptability and flexibililty?
  - mathematics
  - natural sciences
  - communication skills
- Don’t forget less fancy jobs!
  - carpenters, plumbers etc.
  - health and old-age care

My main points

- Personal and impersonal services is important distinction
- Globalisation/offshoring unlikely to reduce employment in Western Europe: more likely to increase it
- Likely income distribution effects
- But very difficult to judge their magnitude: I am skeptical to Alan's huge numbers
- Increased role for collective severance pay arrangements and labour market retraining
- Perhaps wage insurance
- But beware that government interventions do not create larger problems than the ones they try to address!
- Does globalisation really pose larger adjustment problems than other ongoing changes in the economy such as technical change?