CESifo, the international platform of Ludwig-Maximilians University's Center for Economic Studies and the Ifo Institute for Economic Research

The EEAG Report

on the European Economy

2008

Europe in a Globalised World

Economic Outlook
The Falling Dollar
Globalisation and Jobs
Globalisation and Industrial Policy
Global Warming

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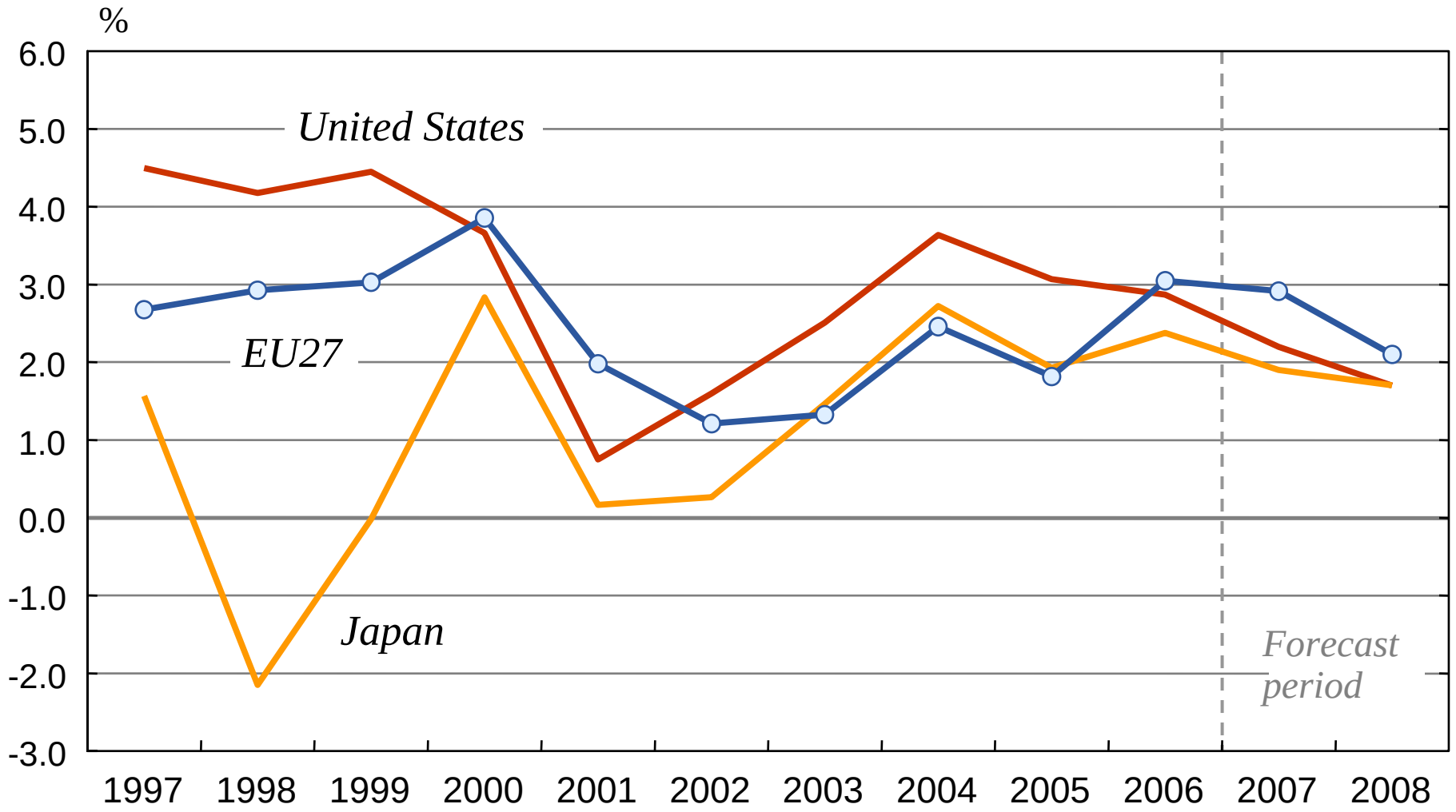
The european economy: Macroeconomic outlook and policy

Fig. 1.22

Economic growth by region

Real GDP percentage change from previous year



Source: Bureau of Economic Analysis; Eurostat; ESRI; 2007 and 2008: Ifo Institute forecast.

Forcast for the US

- Fairly optimistic
- GDP growth falls from 2.2 percent last year to 1.7 percent this year
- 16 percent fall in house prices from 2007 to 2008
- Private consumption grows by 1.8 percent this year
- Smaller falls in house prices than in the UK, Finland and Sweden in the early 1990s
- Less vulnerable situation
- Monetary and fiscal policy stimulus

Table A.3

Key forecast figures for the euro area

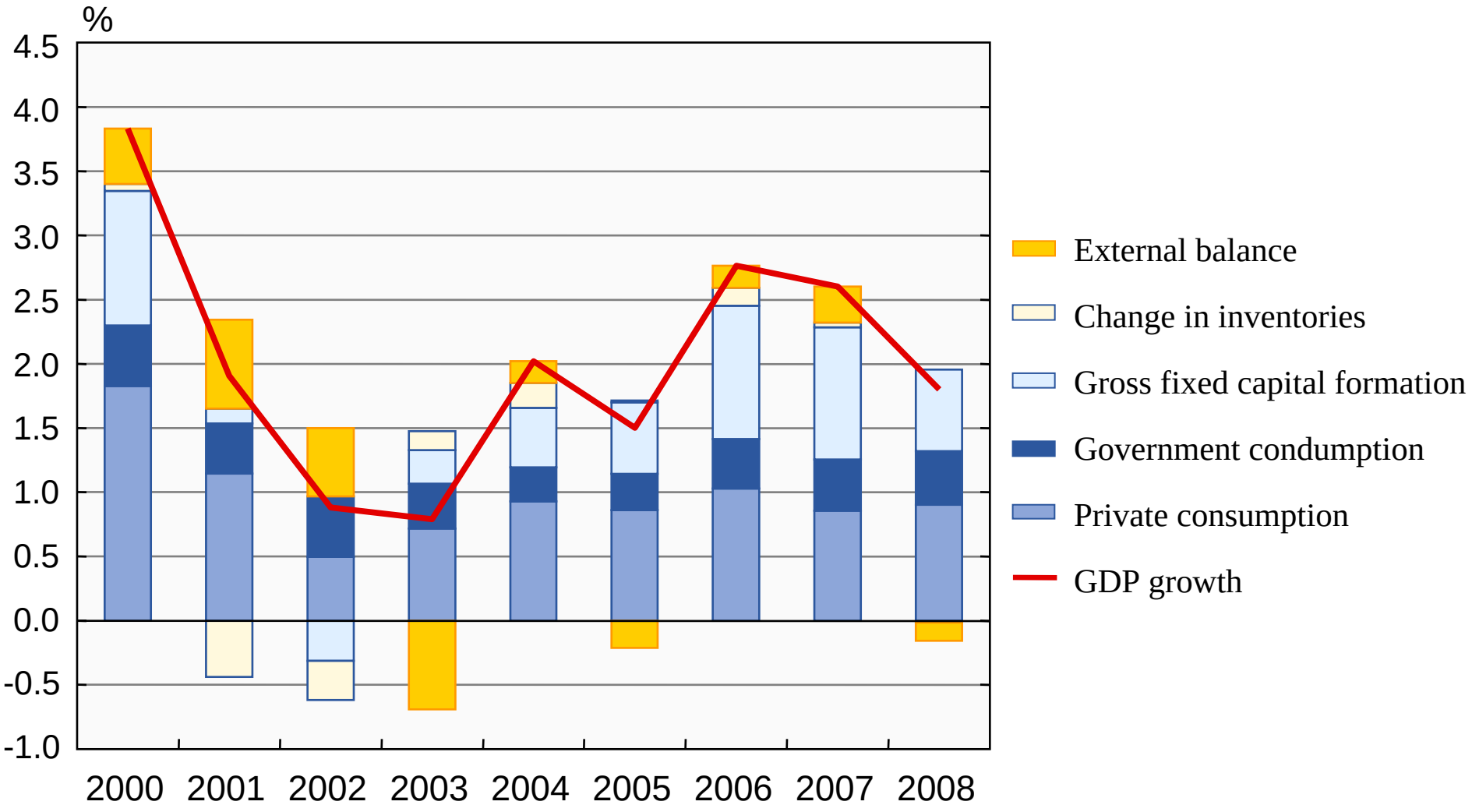
	2006	2007	2008
	Percentage change over previous year		
Real gross domestic product	2.8	2.6	1.8
Private consumption	1.8	1.5	1.6
Government consumption	1.9	2.0	2.1
Gross fixed capital formation	4.9	4.8	2.9
Net exports[a)]	0.2	0.3	-0.1
Consumer prices[b)]	2.2	2.1	2.4
	Percentage of nominal gross domestic product		
Government fiscal balance[c)]	-1.5	-0.8	-0.9
	Percentage of labour force		
Unemployment rate[d)]	8.2	7.4	7.2

[a)] Contribution to change in real GDP (percentage of real GDP in previous year). – [b)] Harmonised consumer price index (HCPI). – [c)] 2007 and 2008: forecasts of the European Commission. – [d)] Standardised unemployment rate.

Source: Eurostat; 2007 and 2008: forecasts by the EEAG.

Fig. 1.27a

Contribution to GDP growth in the euro area[a)]



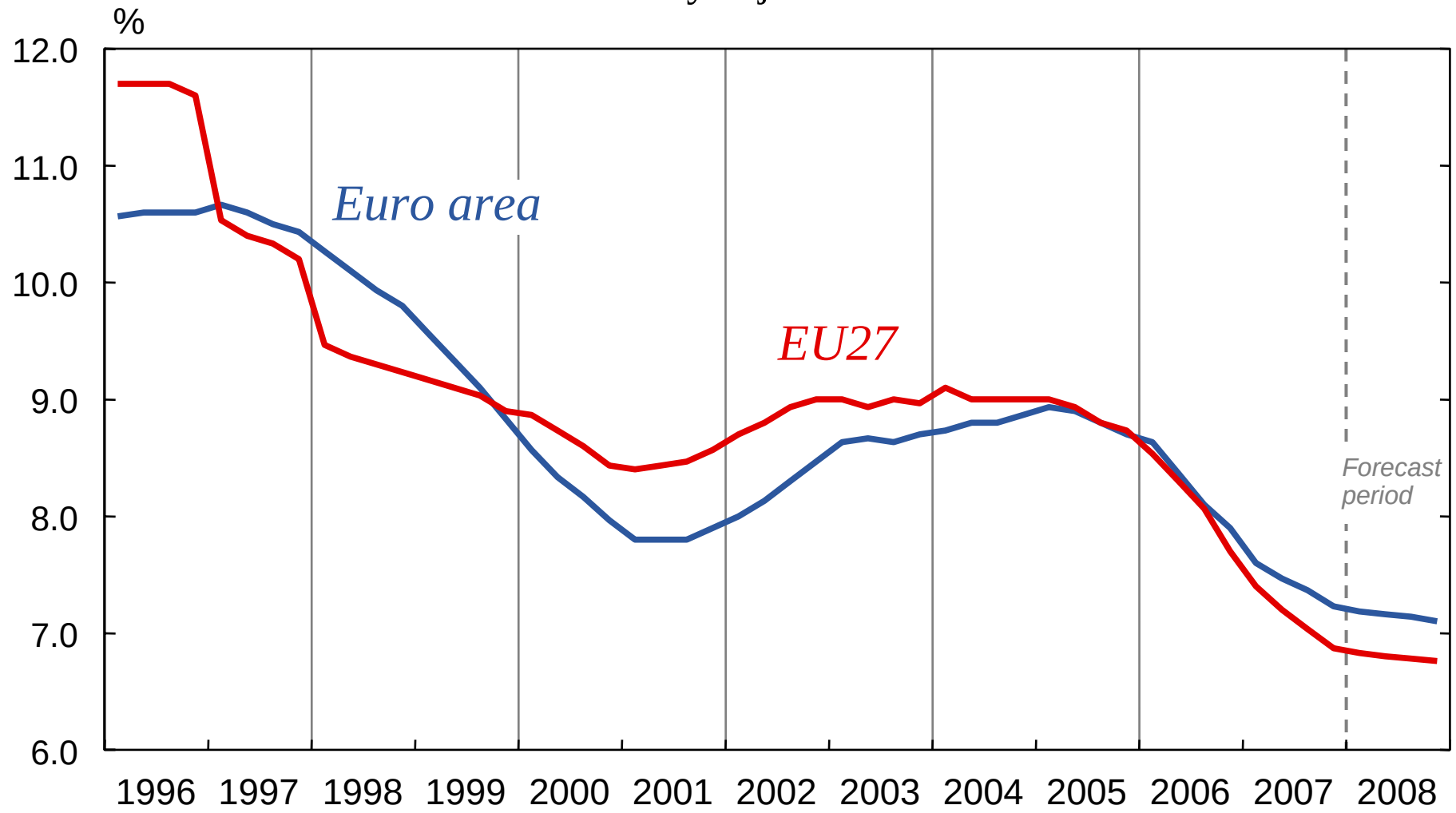
a) Real GDP at market prices (prices of the previous year).

Sources: Eurostat; Ifo Institute calculations and forecast.

Fig. 1.28

Unemployment rate in the euro area and the EU27

Seasonally adjusted data

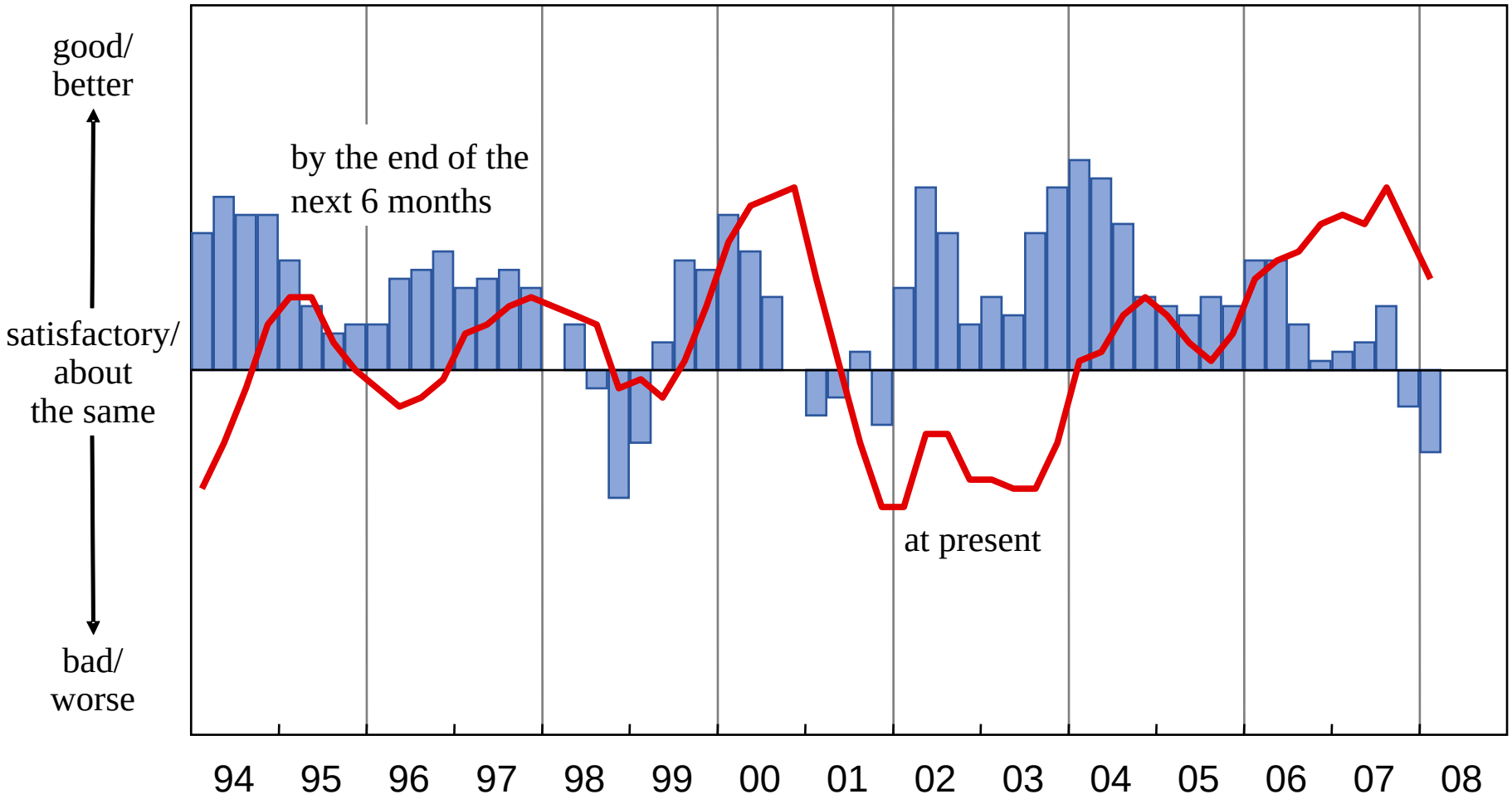


Sources: Eurostat; Ifo Institute calculations and forecast.

APX2 1.1

World

Economic situation

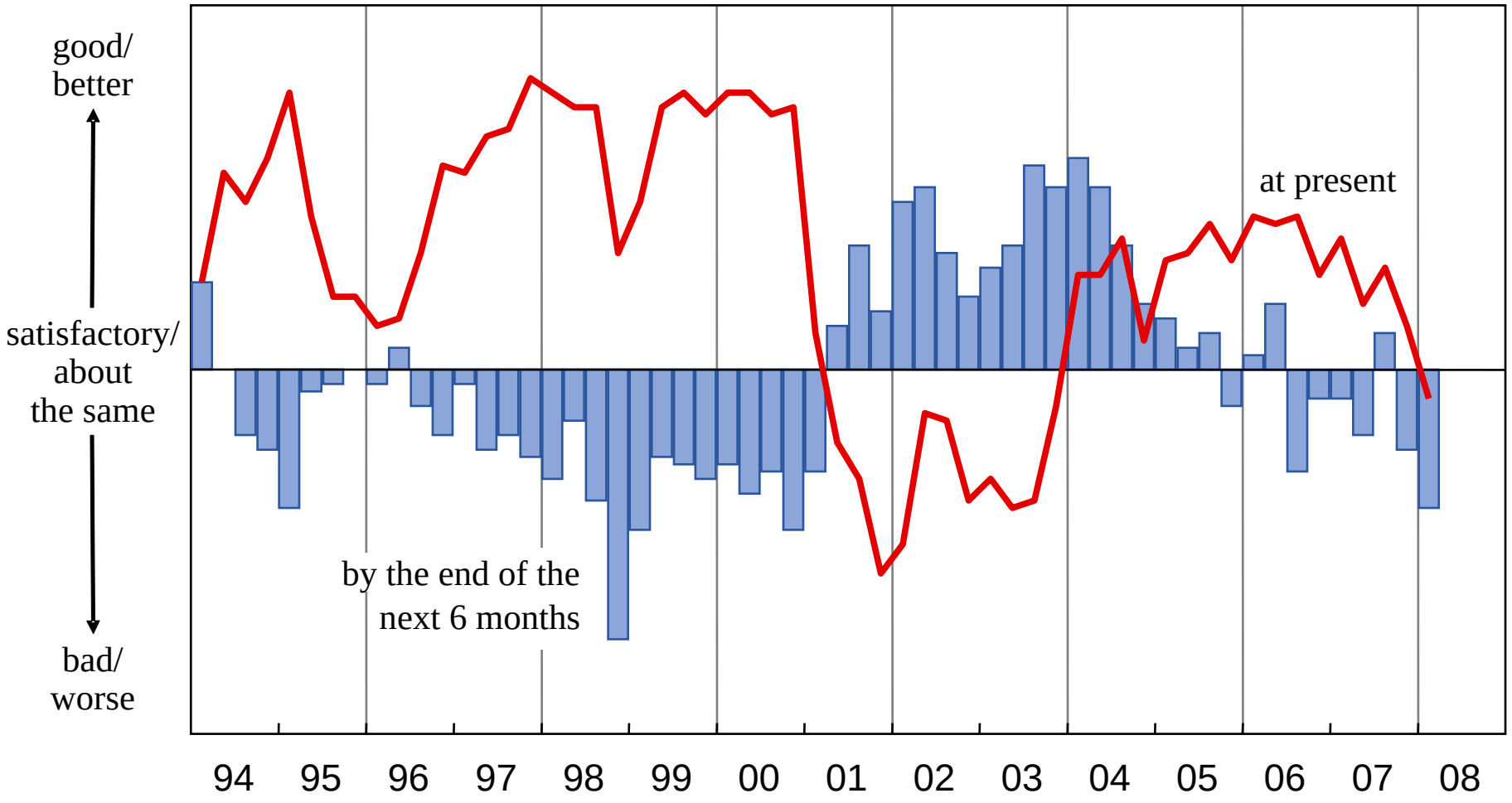


Source: Ifo World Economic Survey (WES) I/2008.

APX2 1.2

USA

Economic situation

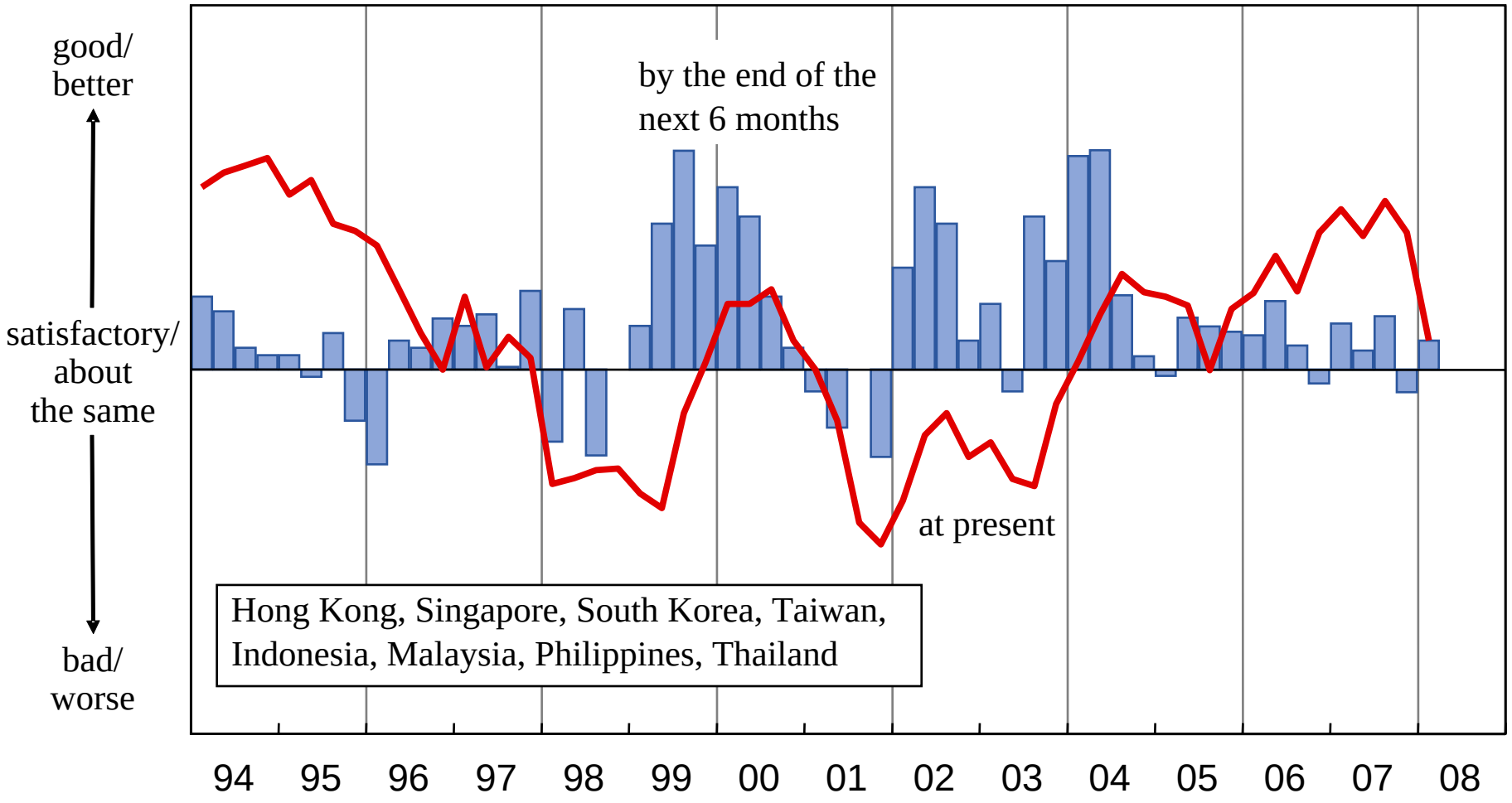


Source: Ifo World Economic Survey (WES) I/2008.

APX2 1.4

ASEAN and East Asian NICs

Economic situation

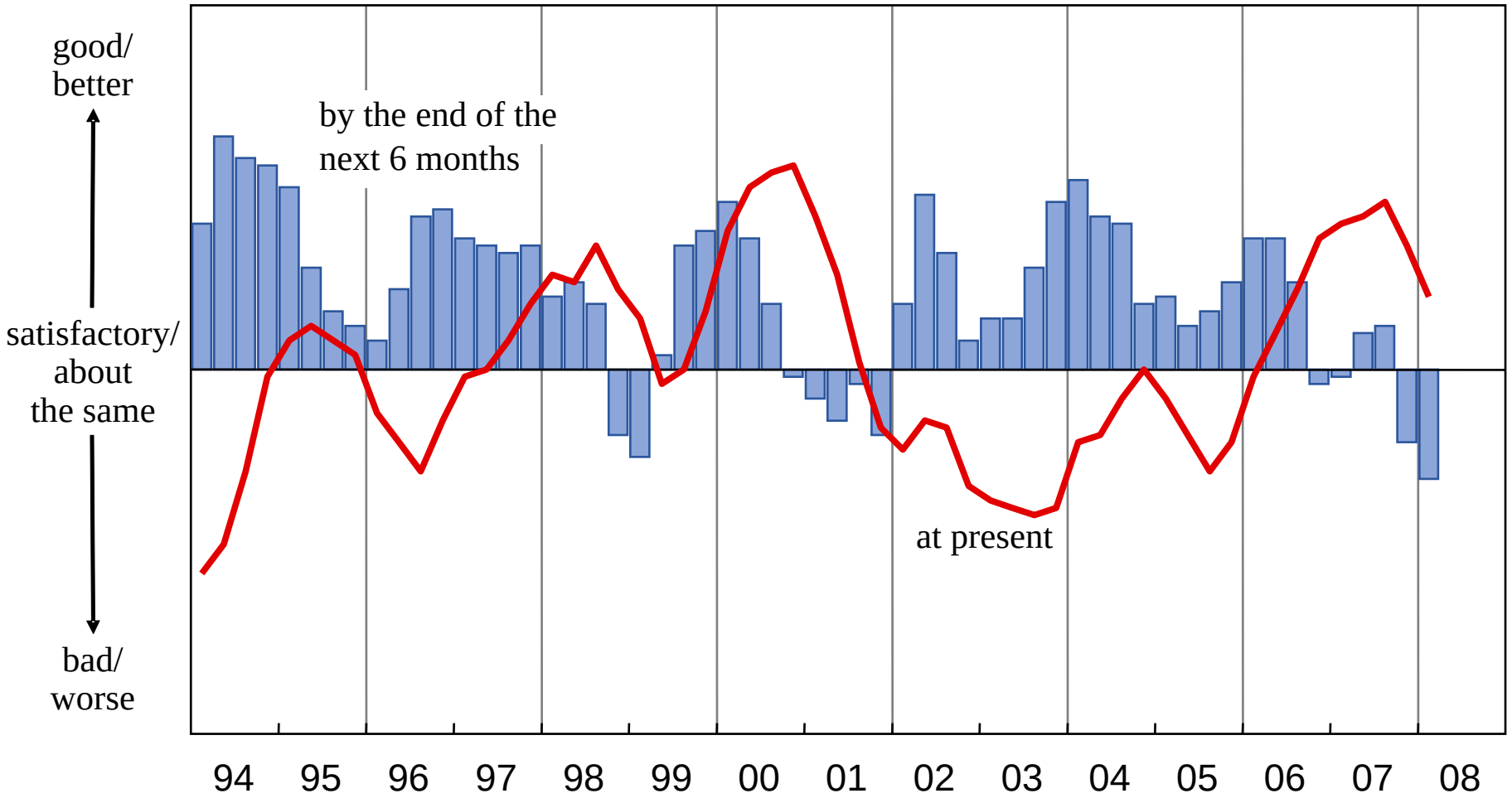


Source: Ifo World Economic Survey (WES) I/2008.

APX2 2.1

European Union (15)

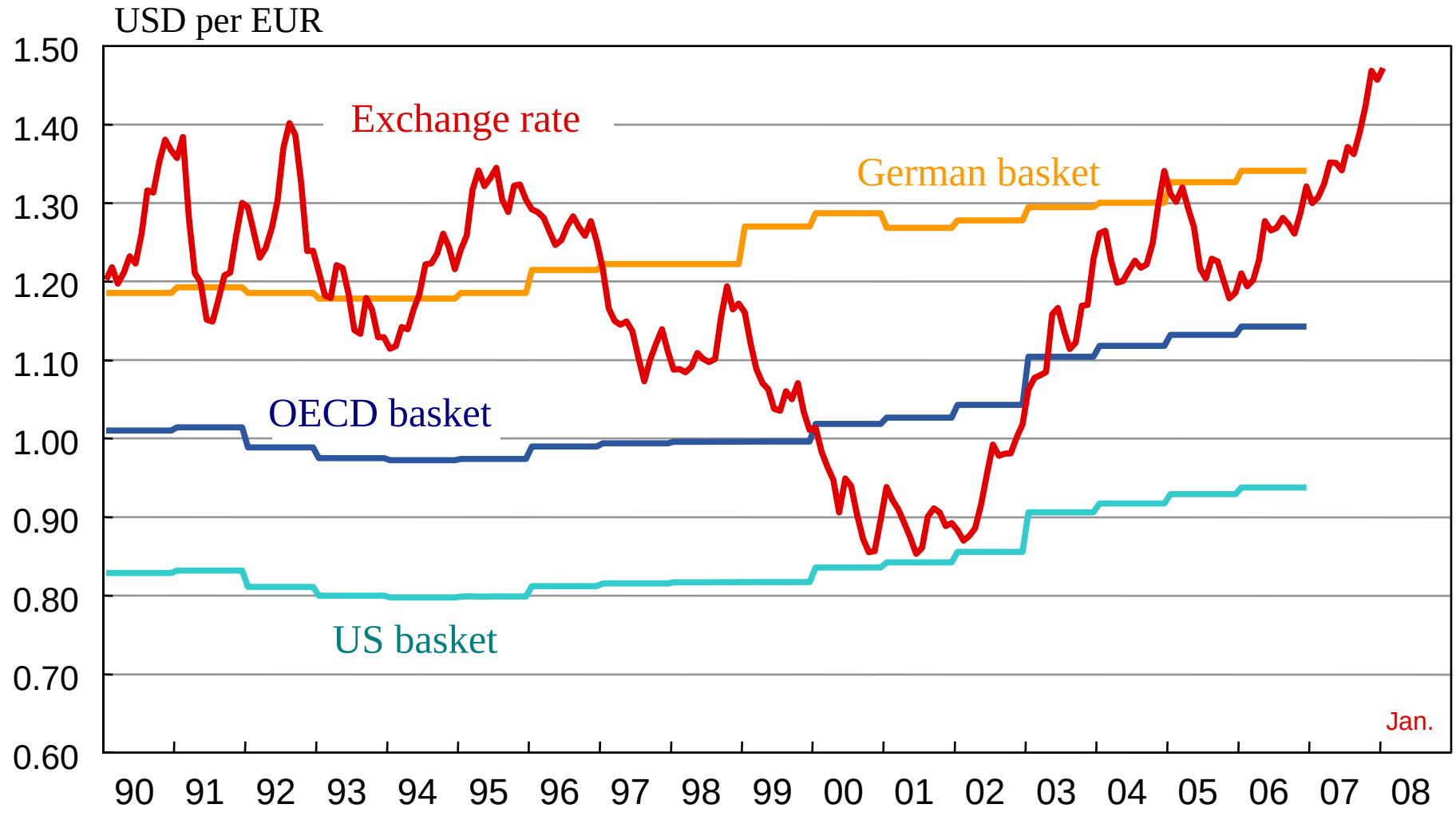
Economic situation



Source: Ifo World Economic Survey (WES) I/2008.

Fig. 1.5

Exchange rates of the euro and PPPs

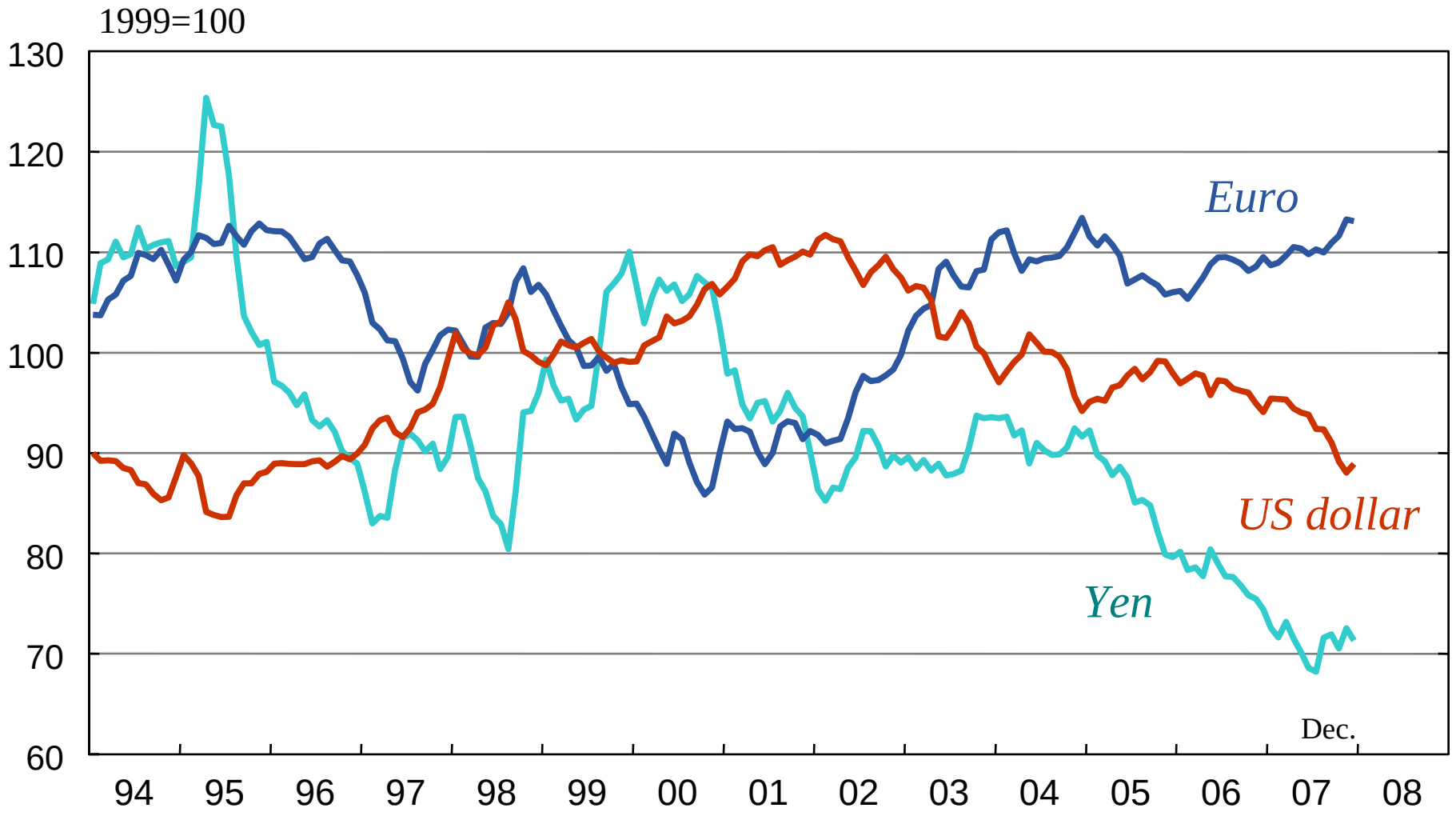


a) The exchange rate is based on monthly data, while PPPs are given at an annual frequency. Different PPPs are computed with respect to the different consumption baskets in the United States, the OECD and Germany. See footnote 8, Chapter 1, EEAG (2005).

Sources: European Central Bank, Federal Statistical Office, OECD and calculations by the Ifo Institute.

Fig. 1.20

Real effective exchange rates[a)]



a) Real effective exchange rate; deflator: relative consumer price indices.

Sources: OECD, Main Economic Indicators; Ifo Institute calculations.

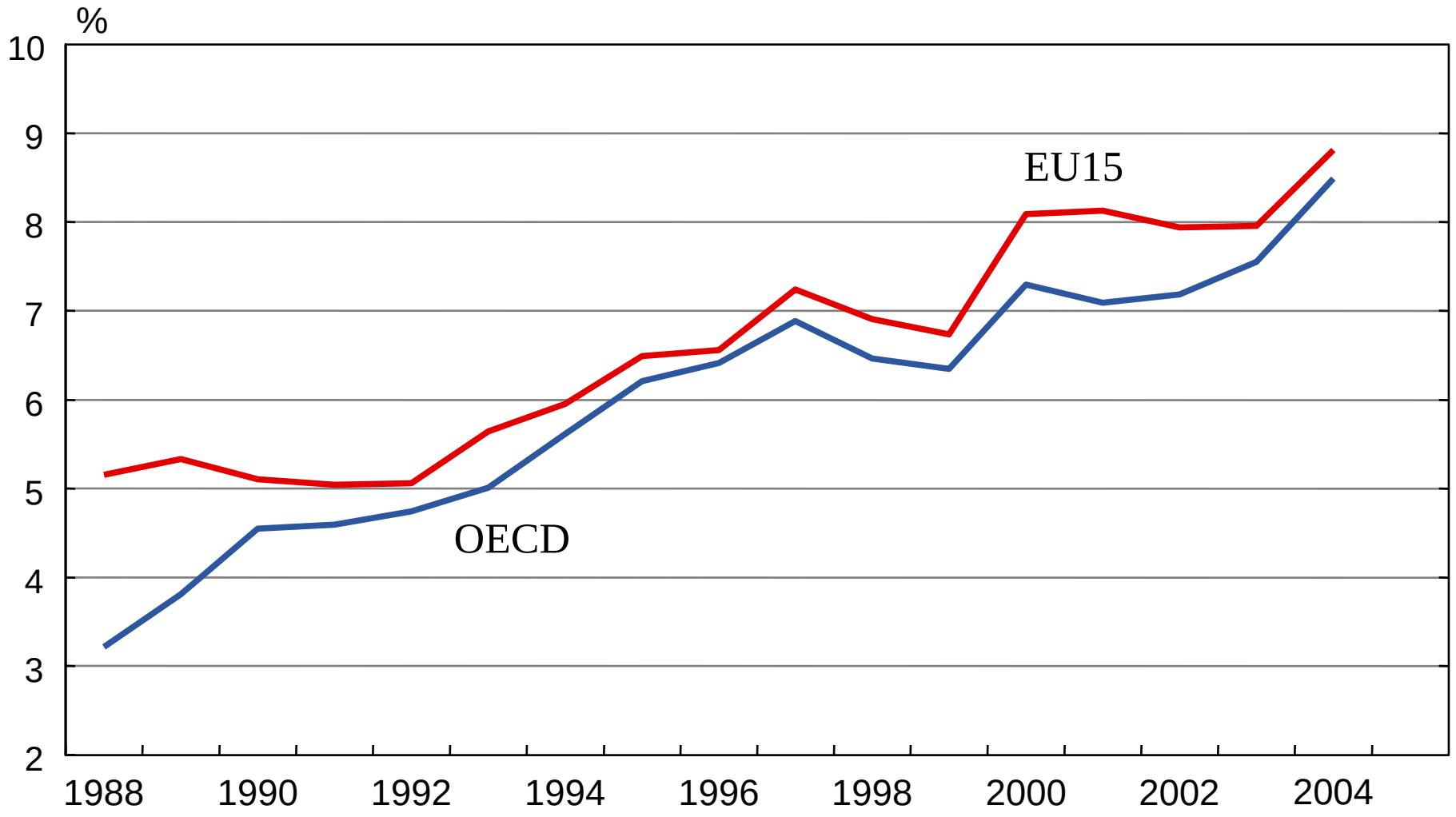
The Effects of Globalisation on Western European Jobs: Curse or Blessing?

Our message

- **Standard argument**: Integration with low-wage economies causes unemployment if labour markets are rigid
- **Our message**: Trade integration and factor mobility are important determinants of the amount of rigidity
  - Globalisation is likely to reduce rigidities
  - Adverse employment effects are unlikely
  - Positive employment effects are more likely
- **The main policy challenge:** Not to defend employment, but to allocate the gains from globalisation in a fair way

Fig. 3.2

Trade-to-GDP ratios vis-à-vis low-wage economies

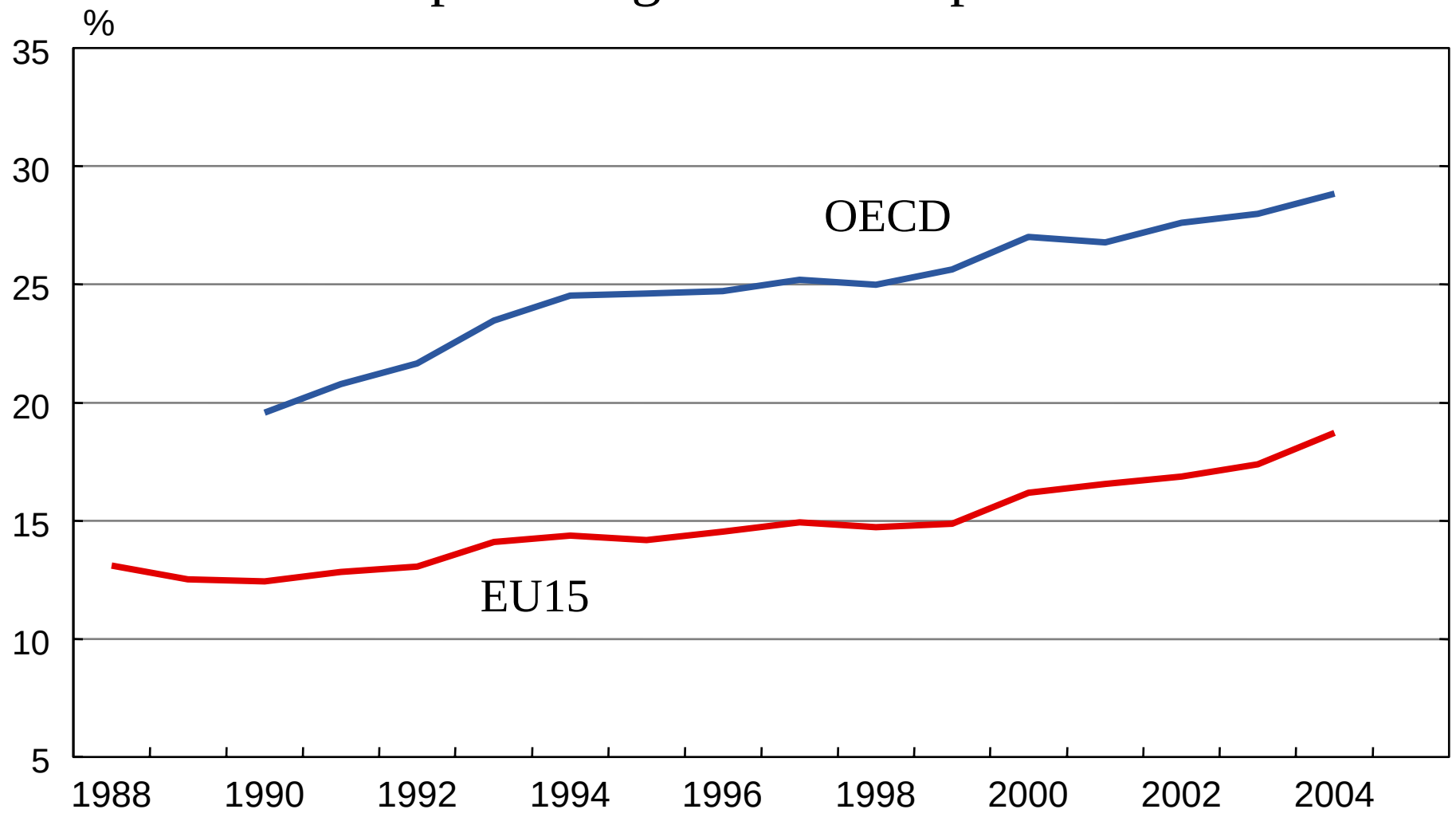


Note: Low-wage economies are defined as non-OECD, non-OPEC countries. See also Figure 3.1.

Source: OECD STAN Bilateral Trade Database; calculations by the EEAG.

Fig. 3.3

Imports from low-wage economies as a percentage of total imports

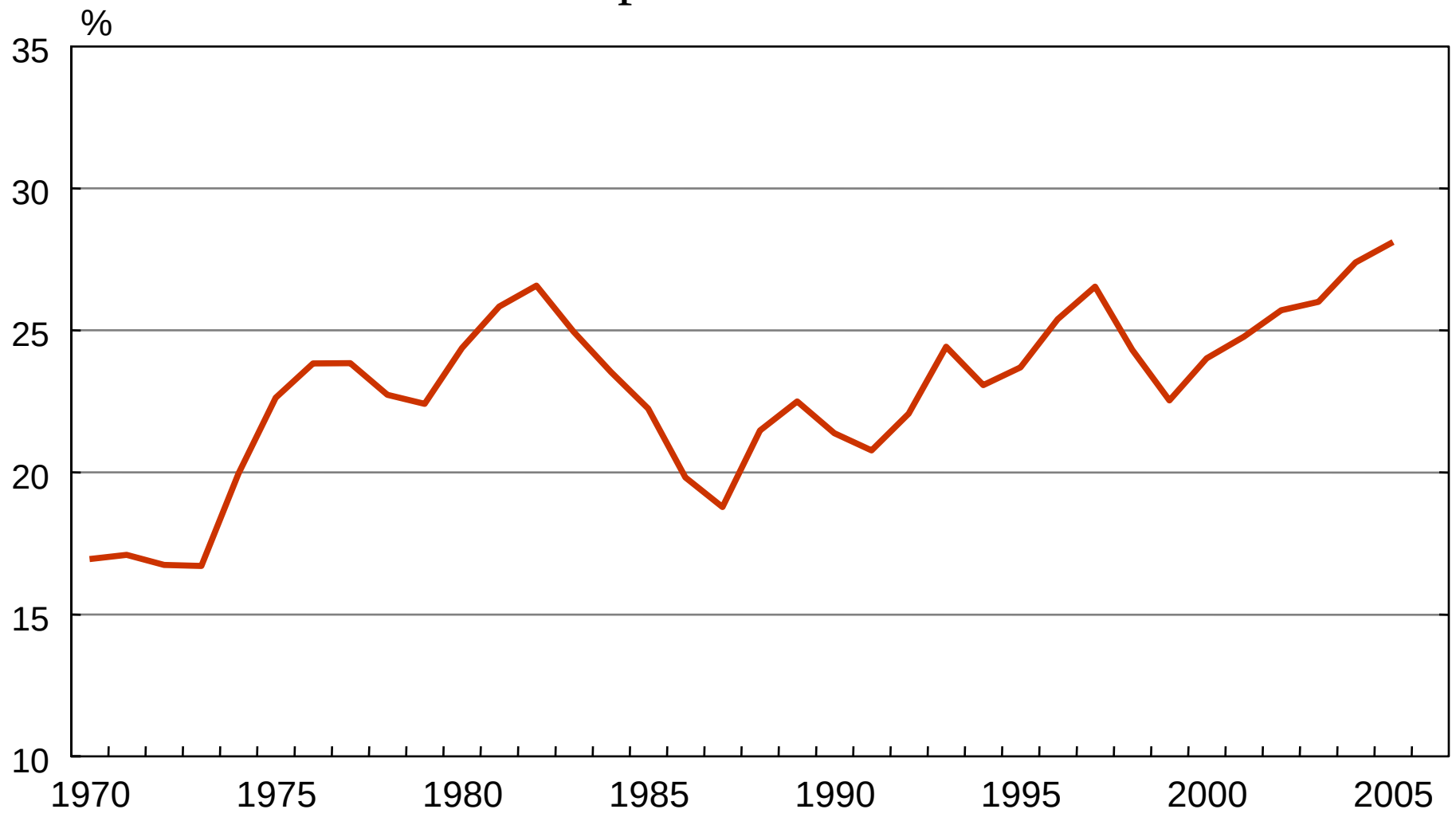


Note: Low-wage economies are defined as non-OECD, non-OPEC countries. See also Figure 3.1.

Source: OECD STAN Bilateral Trade Database; calculations by the EEAG.

Fig. 3.6a

Share of low-wage economies in global gross fixed capital formation



Note: Low-wage economies are defined as non-OECD, non-OPEC countries.

Source: UNCTAD FDI database; calculations by the EEAG.

Standard trade theory

- Advanced economies – abundant in physical and human capital – specialise in capital-intensive goods
- Both overall wages and the relative wage of less skilled become lower than otherwise
- There are aggregate gains that could in principle always compensate the losers

Trade with rigid wages

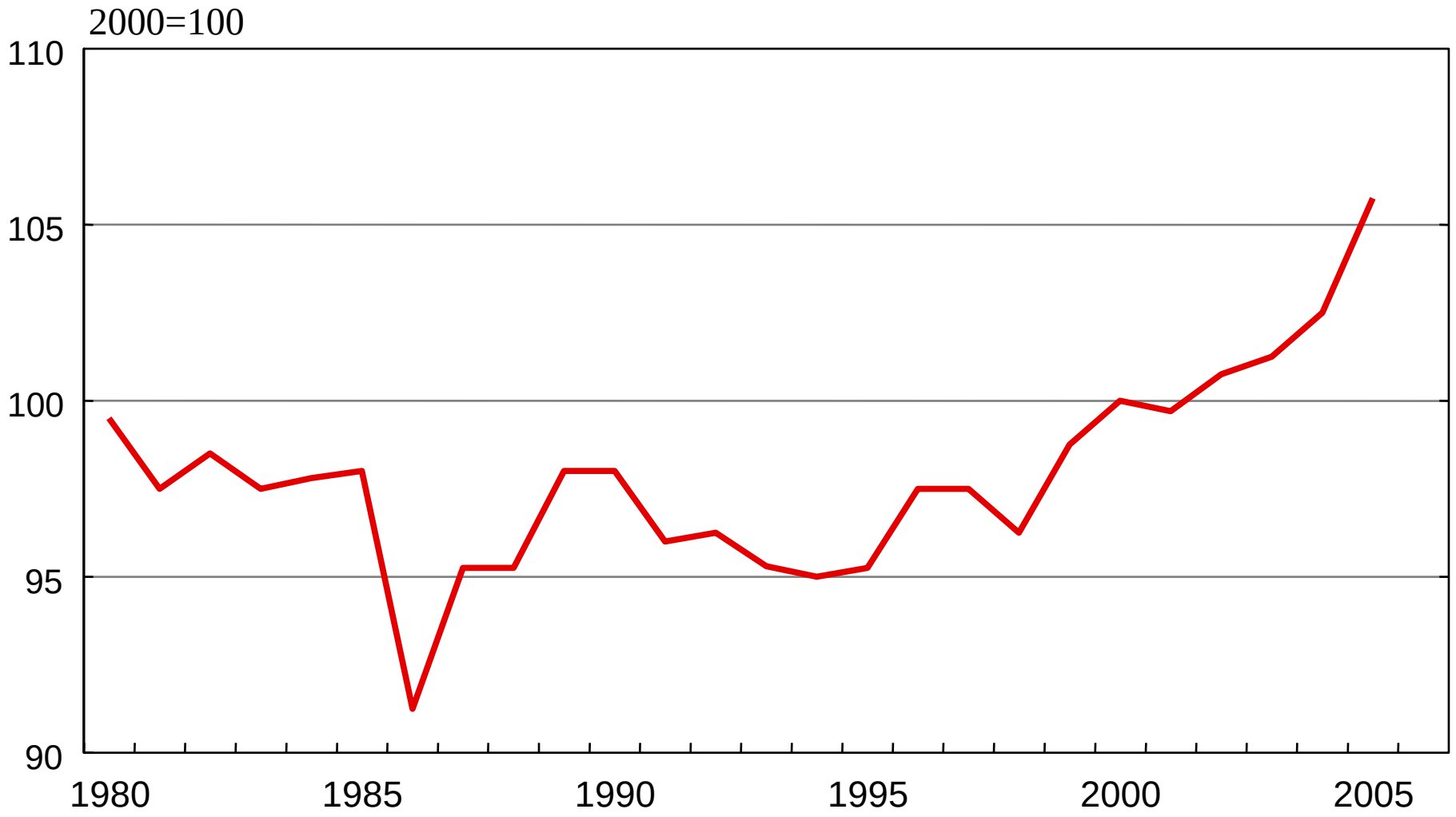
- Overall unemployment and/or unemployment among the low-skilled
- Overspecialisation and overexpansion of trade
- The potential aggregate gains do not materialise

Six arguments for why globalisation might be good for employment

1. Positive scale effects from cost savings associated with international outsourcing
2. Stronger competition reduces firms' price-cost mark-ups
3. Union wage restraint because employment becomes more sensitive to wage increases
4. Bargaining strength of employers increase because of offshoring threat
5. Incentives for deunionisation and deregulation when there are smaller rents for employees to appropriate
6. Terms-of-trade gains have implied that the real consumption wage (the wage relative to consumer prices) could increase without any increase of the real product wage (the wage relative to producer prices)

Fig. 3.9

Non-oil terms of trade for advanced economies

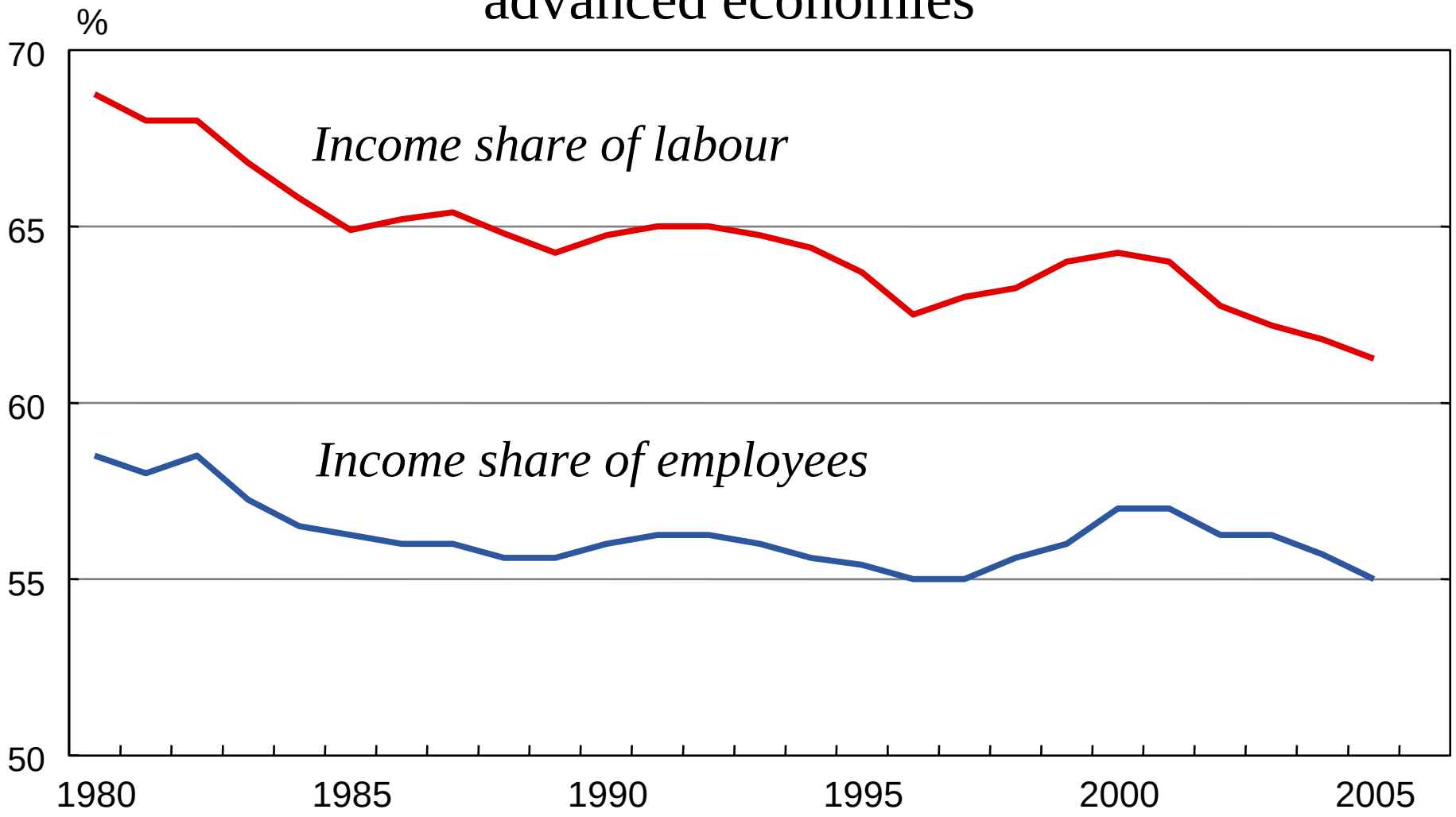


Note: The non-oil terms of trade show the price of export relative to import goods ignoring oil. Advanced economies include Canada, France, Germany, Italy, Japan, the UK and the US.

Source: IMF, World Economic Outlook, October 2007.

Fig. 3.8

Income shares of employees and labour for advanced economies

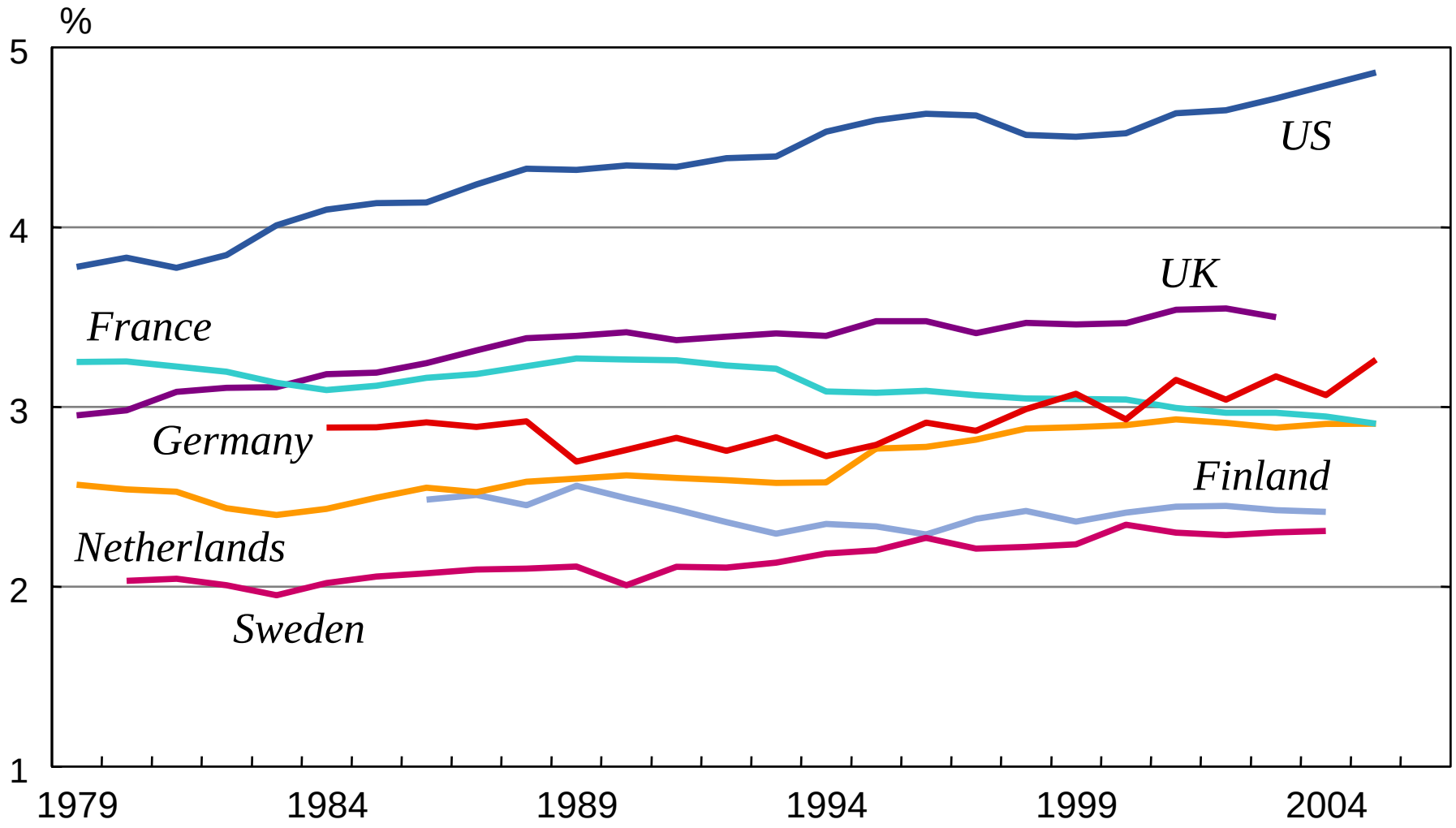


Note: a) The income share of employees is the ratio of employees' labour compensation to value added. b) The income share of labour is the ratio of labour compensation of employees and “non-employee” workers to value added. c) Advanced economies include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Portugal, Spain, Sweden, the UK, and the US, weighted using series on GDP in US dollars from the World Economic Outlook database.

Source: IMF, World Economic Outlook, October 2007.

Fig. 3.7

Earnings inequality



Note: Earnings inequality is measured as the earnings ratio between the 90th and the 10th percentile of the earnings distribution.

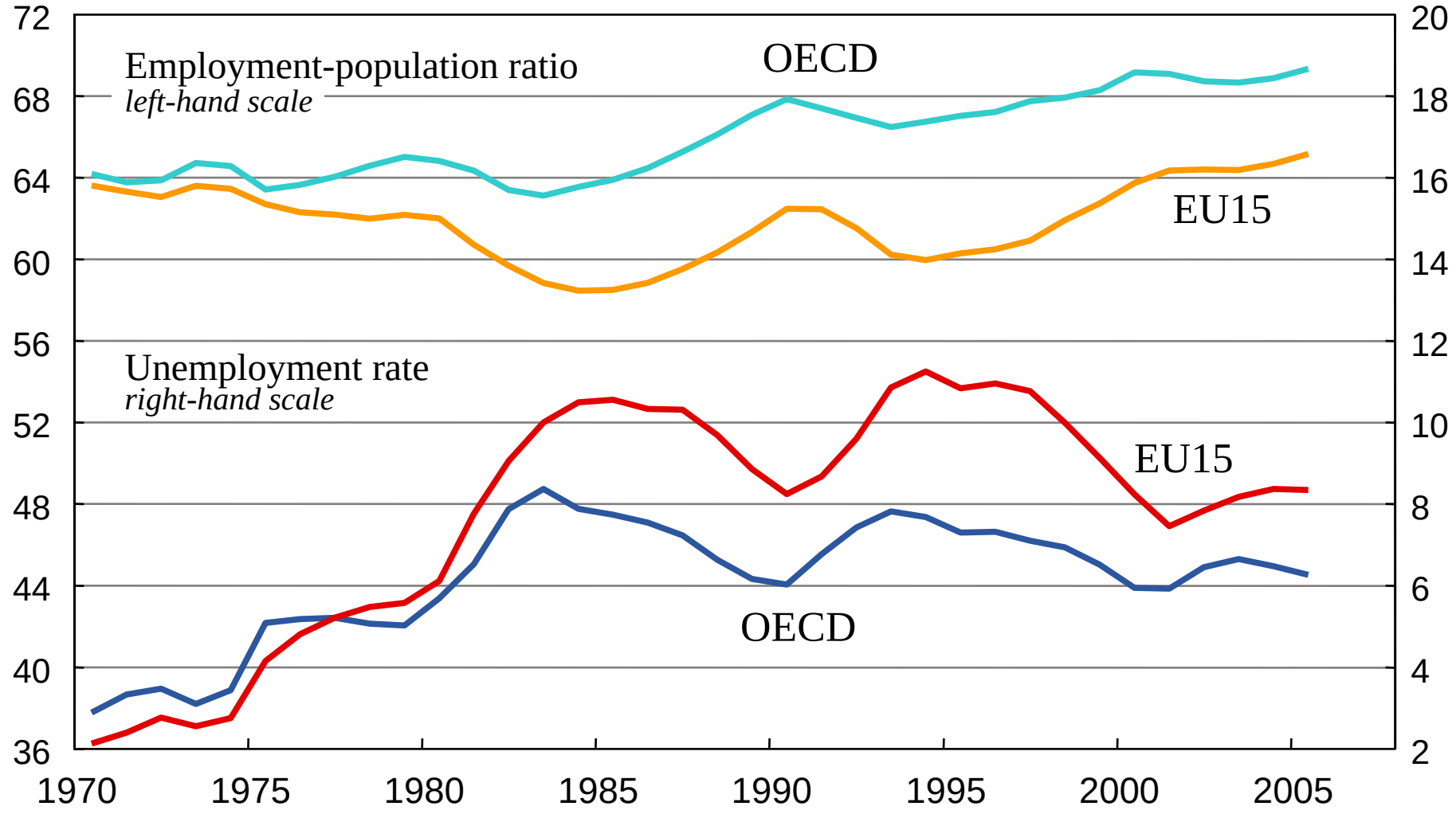
Source: OECD.

Empirical research

- Main focus on how wage dispersion has been affected by globalisation
- Most earlier studies did not find substantial effects
- Stronger effects in more recent studies of international outsourcing
- Surprisingly little research on how overall employment has been affected

Fig. 3.10

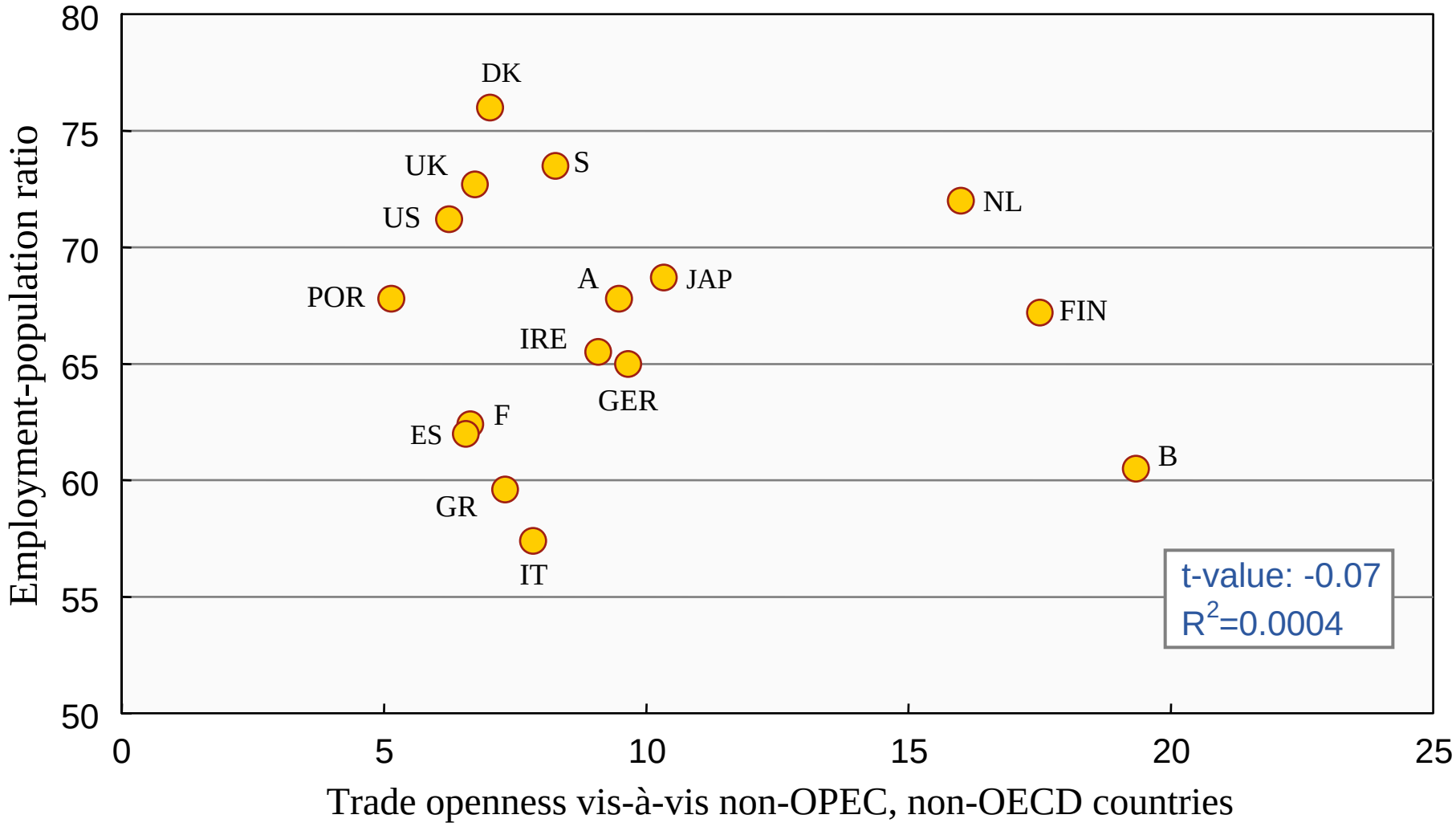
Employment and unemployment



Source: OECD Employment and Labour Market Statistics Database.

Fig. 3.12

Trade openness to low-wage economies and employment, 2004

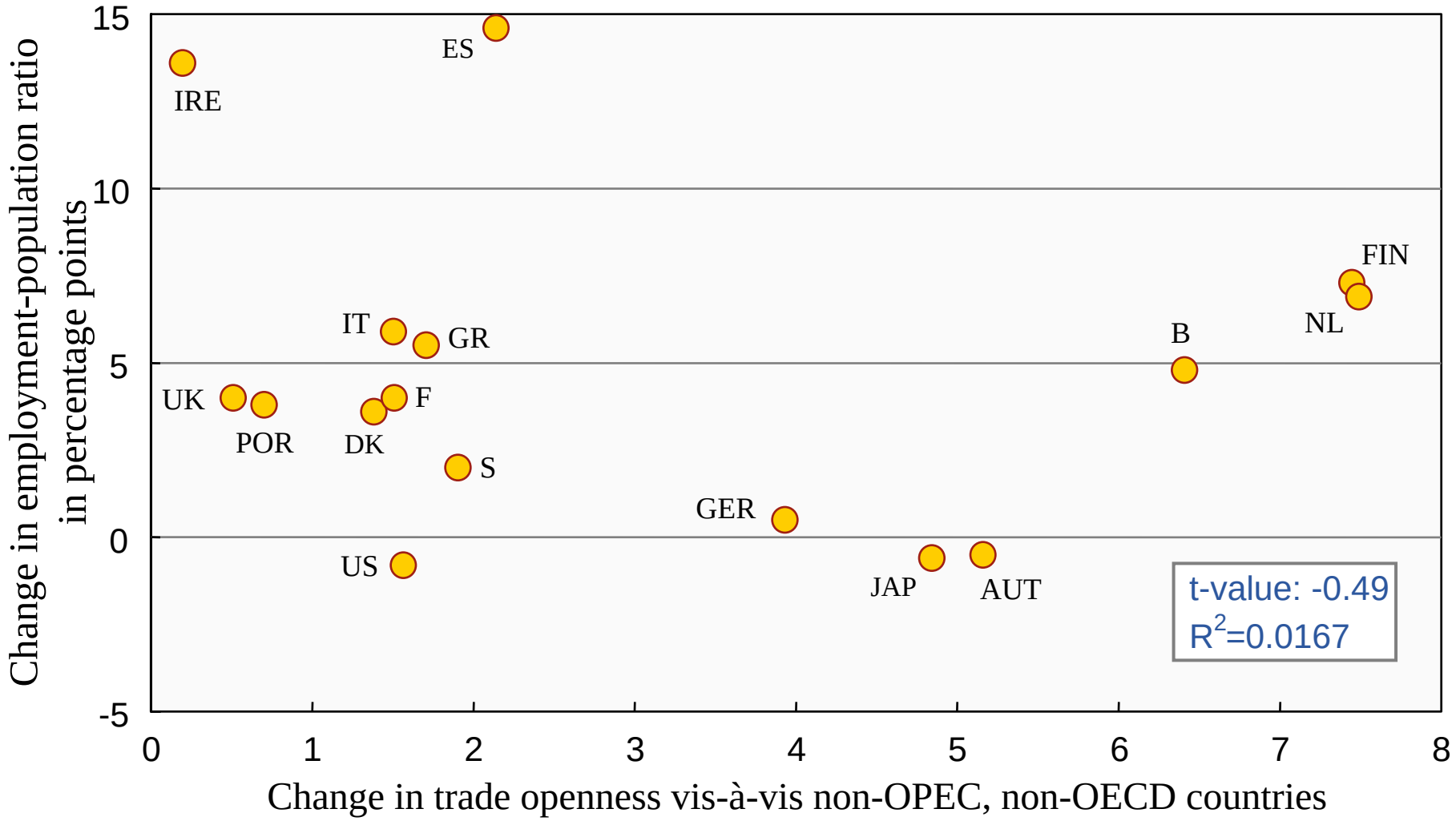


Note: Trade openness is defined as exports + imports as a percentage of GDP.

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

Fig. 3.15

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

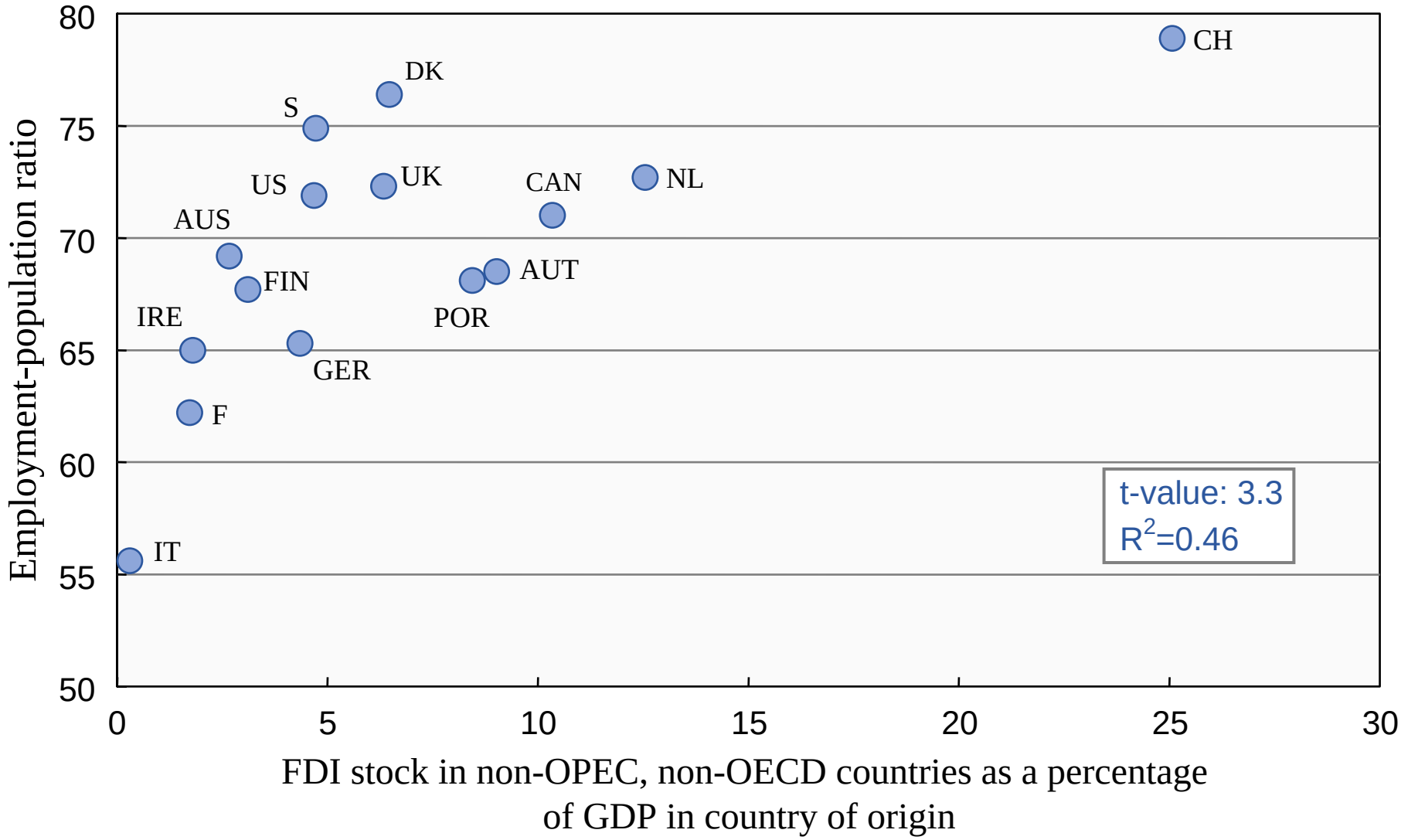


Note: Trade openness is defined as exports + imports as a percentage of GDP.

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

Fig. 3.13

FDI stock in low-wage economies and employment-population ratio, 2002



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

Econometric evidence

- Studies of labour demand: how is the relation-ship between employment and wages affected by international outsourcing?
- This does not answer the question how employ-ment is affected when we take account of the effect on wage rigidity
- But evidence suggests that positive scale effects may outweigh negative substitution effects of outsourcing

New empirical material

- **Standard procedure:** Explain (un)employment variations across countries and over time by a number of ”institutional variables” and cyclical conditions

  - unemployment benefit replacement rate
  - union density
  - degree of ”corporatism” in wage bargaining
  - tax wedge
  - extent of product market regulation
  - output gap

- OECD Employment Outlook (2006): work by Bassanini and Duval

Our approach

- Augment OECD (un)employment regressions with globalisation variables
  - trade openness vis-à-vis low-wage economies
  - import dependence vis-à-vis low-wage economies
  - FDI in low-wage economies
- No or positive employment effects of globalisation variables

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.

What is the policy problem?

- It is not employment
- It is instead to ensure a fair sharing of the gains from globalisation
- And to do this without measures that in themselves cause employment problems

What not to do?

- Adhere to rigid employment protection
- Increase long-term unemployment benefits
- Impose high minimum wages

Measures to contemplate

- Retraining and re-education programmes
- Government severance pay systems
- Wage insurance
- Employment income tax credits for low-paid workers

The policies have pros and cons

- No adverse effects on the incentive to take up job offers
- But:
  - Difficulties to identify education/training needs
  - Severance pay systems are potentially expensive and can be abused
  - Wage insurance impairs the allocative role of wages
  - Phasing-out of employment tax credits raises marginal tax rates
- **Overall conclusion: Think very carefully about how large ambitions one should have**