Globalisation and unemployment

Impact of globalisation on unemployment and income inequalities

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I. Introduction

Does Globalisation raise income inequality? And does Globalisation have a significant impact on unemployment? Possible answers to those questions are related to controversial views, which mainly rely on theoretical models trying to explain and measure effects of a globalising world. This paper will focus first on empirical models, which examine the direct effect of globalisation on wage inequalities and unemployment in order to discuss solution approaches and policy proposals afterwards.

II. Literature review

In this section I will review the related literature for the relationship between Globalisation, inequality and unemployment. Since those models follow economic aspects instead of social and political aspects, non-economical global factors are ignored in this overview.

There are two principal theories with different views engaging with trade liberalisation and employment. The first one is known as the neoclassical trade model of comparative advantages. David Ricardo developed this model, stating that countries engage in international trade even when one country's workers are more efficient at producing every single good than workers in other countries. More precise this model demonstrates that different factors of production specialize in different economic activities and this depends on the relative productivity differences, especially the labour as a physical unit and differences in technology. Therefor a liberalisation of trade creates employment in both the country of origin and its trading partners. (Example for the Ricardian Model)

The second model competing with the Ricardian model assesses the trade between two countries with varying specialties and the equilibrium of trade depends on the factor endowments. This Heckscher–Ohlin model indicates that a country produces and exports the goods, which it has the abundant factors and a country imports the goods, in which cannot be produced efficiently. This means international trade between those economies might have a negative effect on employment in a labour-scarce economy with spillover effects on workers' income. The trade relations between China, as the labour-abundant and the United States, as the labour-scarce economy provide a typical example of this model. Chinas inequality issues in the context of globalisation can be measured by the average Gini coefficient. China's Gini Coefficient is averaging in the recent decade (2004-2013) 0.482, which is close to the dangerous line 0.5. In contrast, North America with 0.411 is 0.07 away from China. These existing inequalities are of course not only related to free trade. Social issues and Chinas efficiency first guidance for instance do have a significant impact on disparities among wealth and income as well. Still causality between free trade and income distribution can be observed by using the Gini coefficient or other comparative methods as rough indicator.

These theories reveal, that the main focus lies on trade liberalisation, rather than unemployment and globalisation. However, economic globalisation by definition must also involve financial capital flows and foreign direct investment. So besides the knowledge coming from both models we should add further aspects to address the questions of this essay.

We can identify three important measures of globalisation, which economists mainly include analysing the unemployment rate of an economy: The trade balance, the capital account and offshoring. The first two arise from macro economical measures and refer to the balance of payments, whereas the third describes the relocation of a business process from one country to another. In other words, concentrating on offshoring might demonstrate the movement of jobs by linking economic globalisation with unemployment, while the components of the balance of payments provide in-depth research and theoretical evidence for inequality and unemployment.

Jayadev (2007) has analysed that due to an increase of capital account openness economies across the globe suffer a loss of labour share, meaning that enhanced capital mobility is consistent with lower wages per worker. Another argument in favour of an adverse effect of financial globalisation on labour markets comes from a model developed by Stiglitz (2004) saying that financial market integration leads to increased volatility of income and lower welfare growth. More precisely this model indicates by opening capital markets the variability of wages may increase, which causes a higher inequality of wages in an economy of a specific country.

With respect to the process of offshoring, a relation between foreign direct investment and effects on the labour market can be established. Agarwal (1996) identifies different forms of investors' motivations, which can have an impact on employment: natural resources seeking, market seeking and efficiency seeking. Natural resources and market seeking FDI is likely to create jobs in the home country, while efficiency seeking FDI might cause an increase of unemployment due to export substitution and reimports to the host country. There are plenty more empirical studies, which find positive and negative effects running from FDI to labour demand. This should just provide a broad view on the theoretical notes on economic components related to financial globalisation and highlighting its relevance.

The Ricardian trade model was criticised in the past. Blinder's study (1988) admits that a tendency towards free trade generates gains and losses, with the latter overshadowing the former and recommends to "pursue a vigorous full-employment policy so that displaced workers will be quickly reemployed." Another opposing study by Baldwin (1995) on this subject says that domestic factors had played a much more important role in the evolution of employment than trade. Of course it must be said that at that time effects of global factors, like FDI were almost neglected and therefor not well explored. However, it must be noted that as global dependency has increased, job dependency is also likely to have risen over time. Several Papers analysing the effect of globalisation on unemployment enable different views and address the issue that classical trade models cannot show the impact of trade on unemployment. Dutt (2009), Felbermayr (2011) and Gozgor (2014) develop models, which show that globalisation is job creating and has a positive effect on the unemployment rate. However Gozgor for instance considers only G-7 countries with the largest advanced economies of the world. So these results might not be representative for every economy and we can't make a general statement on this issue. On the other hand Helpman, Itskhoki (2010), Mitra and Ranjan (2010), are convinced that globalisation due to differences in labour market regulations and trade liberalisation can have a positive or negative relationship between trade and unemployment.

To conclude the literature review, we observe that there is no consensus between trade models on the effect of globalisation, which is mainly because they consider trade liberalization as dependent variable and are not directly concerned with the relation between globalisation, inequality of income and unemployment. To fulfil the economic definition of globalisation we distinguish additionally to classical models between different channels (trade balance, capital account and offshoring) through which unemployment rate and wages can be affected by the process of globalisation in financial terms or investment decisions. Even if empirical evidence on the link between labour markets and financial globalisation is rather scarce it can be said that large capital flows may provoke adverse welfare implications on employment and income. However international trade and specific conditions, such as wages, skills or labour market regulations are clearly driven by globalisation, only the direction of these causalities is not always unambiguous.

III. Policy proposals

In this section we want to introduce proposals for globalisation policies based on the above-mentioned empirical literature.

It is highly recommended to consider first global factors that have a demonstrable influence on the progress of globalisation. A functioning solution can only be developed efficiently if these circumstances affecting globalisation are taken into account. So in the following I summarize briefly some components related to the rate of unemployment, without putting them in context with policy proposals. Advance in technology in certain industrial ventures may replace employees eventually. Large multinational companies, which suffer due to a loss of reputation, may loose a bigger stock of employees. According to seasonal fluctuation only a smaller necessary workforce is necessary during off-season (e.g. in the agricultural sector). And with respect to developing countries, political unrest is another significant issue that may affect labour markets. Misleading government policies in general may ignore impacts of globalisation on economy and employment. Such determinants are not considered in all empirical models mentioned before but do have an evidently detrimental effect on unemployment and consequently on income inequalities. Nevertheless it must be said that it is problematic to prevent these global factors and therefore explains why economists attribute less importance to such events.

With regard to income inequality, two aspects should be covered, which, although not necessarily need to be linked to a study, can be considered as starting point for the successful implementation of globalisation policies, especially in developing countries. First action to be taken by the government is to provide an effective education system (Payne, 2013). Education has been found to be a decisive element for economic development, and for the reduction of global inequality. Education besides improving life expectancy provides job opportunities and improves income levels. Another fundamental aspect to consider is corruption in society (Payne, 2013). A high level of corruption often misdirects resources, not necessarily to where they are most needed. This in turn continues to lead to global inequality. Individuals, or interest groups therefore must all speak out against corruption and demand full governmental accountability to create a basis that decreases the risk of income inequality within a country and globally to a minimum.

Theoretical explanations show that the liberalisation of financial markets and low restrictions increase unemployment. So, would it be sensible and in the interest of the common wealth to isolate foreign financial markets in order to reduce unemployment? Obviously the answer is a clear no. This would ultimately reinforce the protectionism that already characterises trade relations across the globe (e.g. trade tariffs introduced by the US and China) and shift the problems to the political level eventually. To make my point clear, I refer to Stiglitz's statement (2005 & 2017): globalization is oversold. In other words, in order to reshape the distribution of power, an economic policy must be established that creates the means to transfer wealth and income from those who have benefited from globalisation to those who are disadvantaged, to achieve a balance in the long term. It is highly desirable that these trends be reversed, not by the absolute protectionism mentioned above, but by a mitigated form that manages to control financial markets, while providing enough freedom to let them unfold. Therefore I recommend a control of capital flows by means of tariffs, which does not aim to prohibit foreign capital. This kind of capital control is based on the ideas of Keynes (1943) and allows supporting exports of local companies and at the same time to protect young industries in their development entering markets.

Under the same logic but with respect to offshoring, it would be advisable to protect national employment by training the new generation to be able to specialize in, for instance, personally-delivered services. The background to this is that the analysis of offshoring and the resulting effects on the labour market no longer distinguishes between high-skilled and low-skilled workers, but between personally-delivered services and impersonally-delivered services (some of which require high technical skills). To put it plainly, as globalisation implies a permanent change of job requirements, especially in skill intensive sectors, human capital has to be built in a way that allows for flexibility and adaptability of the workforce to guarantee employment. Specific training may be largely left to the market. However, there is reason for governments to support human capital formation. A larger share of skilled labour delivers social benefits in terms of greater flexibility in responding to economic change.

To conclude the essays it has to be made clear that developing policy proposals involves multiple components, which have to be considered (e.g. global factors, determinants affecting inequalities) in the first place. Still I have to admit that an ideal solution to reduce unemployment or income inequalities in a given country can't be designed by only referring to empirical literature, since they come up with different results. This leads to the fact that there is hardly any consensus on what is right or wrong about it. Globalisation is a matter of controversy. However some aspects of the globalisation process have been successful in reducing unemployment. To continue this process and to minimize inequalities it is necessary to help workers to cope with the consequences of globalisation rather than restricting the process of globalisation itself. The latter would in deed also reduce the opportunities to reap the benefits of globalisation.