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Globalization, Offshoring, and Economic Insecurity in Industrialized Countries

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Introduction

How can one dare speak of economic insecurity in the industrialized countries when the rate of per capita GDP in Germany is 120 times that in Uganda, the rate of unemployment in the United States is one-tenth of that in Nepal, or when the share of population below the poverty line in France is one-tenth of that in Zimbabwe? The question itself indicates that economic insecurity is a relative phenomenon. Those who are subject to a high risk of a sudden drop in income or wealth without adequate offsetting support are facing economic insecurity, irrespective of nationality or location. Hacker (2006: 20) defines economic insecurity as “a psychological response to the possibility of hardship-causing economic loss.” He notes, however, that “a feeling of insecurity is not enough to say someone is insecure. Insecurity requires real risk that threatens real hardship.”

By many accepted measures—real wage growth, inequality, labor’s share of national income, the incidence of long-term unemployment, the number of workers displaced by foreign trade, and investment—“real” economic insecurity in industrialized countries increased in the past 15–20 years. The period has also been one of rapid globalization, with international trade and capital flows reaching historic highs. The role of globalization in heightened economic insecurity has thus become a major topic of debate in the advanced countries. Throughout this chapter, we focus on six countries: Denmark, France, Germany,

Japan, the United Kingdom, and the United States. These countries represent a broad spectrum of the advanced industrialized world, and although all have expanded their exposure to international trade and investment they have not all experienced the same degree of increased economic insecurity. We also find that the *perception* of economic insecurity is strong in these industrialized countries, especially in the United States and in France.

The risk from a high level of real—and perceived—economic insecurity in the industrialized countries is borne by both the government and private households. Household consumption and borrowing patterns may reflect the burden of risk on the household private sector. This may partly depend on the private sector's expectation of government policy. While rising economic insecurity has in some cases resulted in increased demand for state-provided social protection, these demands have met various responses from business and government on the grounds that they raise production costs and reduce a nation's international competitiveness.¹ The new wave of economic insecurity has occurred in a variety of political contexts. Although offshoring² has increased in all industrialized countries and raised the degree of economic insecurity on average across the OECD, economic insecurity varies considerably across countries, depending largely on the institutions in place. The ILO index of economic security gives the following rankings for the six countries that are the focus of this chapter (Table 2.1).³

During the 1990s, a good deal of research aimed at showing that technological change rather than trade had been the principal source of labor market churning in industrialized countries. This chapter revisits this debate in the light of the evolution of the world trading environment, involving emergence of new and

Table 2.1 ILO economic security index

Rank	Country	Economic security index	Scores		
			Input	Process	Outcome
4	Denmark	0.91	0.812	0.930	0.949
7	France	0.83	1.000	0.914	0.698
9	Germany	0.79	0.871	0.785	0.759
15	United Kingdom	0.74	0.681	0.673	0.795
18	Japan	0.72	0.702	0.814	0.679
25	United States	0.61	0.261	0.662	0.762

Source: ILO (2004).

larger trading nations in the developing world, development of sophisticated global supply chains driven by lead firms in industry, financialization⁴ of the nonfinancial corporate sector in the major countries, and implementation of a number of regional free trade agreements that lower trade barriers and extend property rights protection to foreign investors.

This chapter addresses three central questions. First, what has been the impact of globalization, and specifically offshoring through trade and foreign investment, on economic insecurity in the industrialized countries? Second, what are the specific microeconomic and macroeconomic channels through which globalization impacts economic insecurity in these countries? Third, what political responses have best addressed rising economic insecurity without inflicting damage on other countries and in particular on the low-income developing countries whose export performance has been bolstered by the new wave of globalized production? (For more details regarding these questions, see Milberg and Winkler 2009.)

The main findings of this chapter are:

1. Since the mid-1970s most industrialized countries have experienced a rise in economic insecurity, and in many of them the burden of economic risk has shifted from the state and corporations to private households.
2. There are different models of state–market relations with respect to economic insecurity, ranging from the limited state role in the Anglo-Saxon model to a heavy state role in the Rhineland model and a hybrid model of “flexicurity”⁵ in Denmark and a few others.
3. International trade and investment increasingly occur within global supply chains, which have reached a level of growth and depth to constitute a “new wave” of globalization in which trade and technology are inextricably linked to an extent not witnessed previously. Offshoring would be unthinkable without low-cost information technology (IT), and IT would not be as low cost if not for the effective extension of global supply chains into low-wage countries.
4. The new wave of globalization has created new sources of gains from trade and new channels for transmission of economic insecurity arising from trade and investment. Moreover, as supply chains extend to high-tech goods and higher-skill services, there are massive possibilities for future expansion of offshoring, indicating that economic vulnerability will rise across all skill and education groups rather than falling entirely on low-skilled workers, as has been the case until recently.

5. Spreading and sustaining the benefits of offshoring depend on the domestic reinvestment of efficiency gains that offshoring brings. While offshoring has contributed to the rise in profit's share in the national income of most industrialized countries, they are also witnessing a fall in the investment rate, as percentage of both profit and GDP. Nonfinancial corporations are increasingly using profits to raise dividend payments, share buybacks, and purchase of other financial assets, rather than making productive investment.
6. Denmark's mix of labor market flexibility, ample social protection, and active labor market policies—so-called flexicurity—has successfully raised economic security in that country despite globalization. The US labor market flexibility, combined with relatively meager social protection in the face of rapid growth of imports from developing countries, has contributed to an unprecedented rise in income inequality and economic insecurity for a large share of the American population.
7. Given the macroeconomic consequences of offshoring, flexicurity arrangements alone are likely to be insufficient to sustain high levels of economic security in the industrialized world. Trade protection has largely been ruled out, but other policies involving redistribution and channeling of gains from offshoring to investment and growth are likely to be more important in the near future, as offshoring expands beyond low-skilled manufacturing workers.
8. Finally, the provision of a solid and portable set of social protection elements does not reduce a nation's trade competitiveness and in fact may raise it as increased worker security leads to greater possibilities for innovation and growth in productivity.

We begin with an overview of recent trends in economic insecurity and the different policy regimes in industrialized countries. Then we consider in detail how globalization and offshoring might have contributed to rising economic insecurity. We conclude with a discussion of the importance of combining creative macroeconomic and microeconomic policies in order to provide more security even as economic openness continues to grow.

Economic insecurity in industrialized countries

The period from 1950 to 1973 is widely referred to as the “Golden Age” of capitalism, but it may better be termed as the period of rising economic *security* for people in the industrialized countries. Not only did the OECD countries

experience rapid growth in real GDP, but also this growth was reflected in rising median wages, even more rapid improvements in median family income, relatively low rates of unemployment, falling inequality, and improvements in the post-Great-Depression system of social protection in most countries.

Since 1973 the industrialized economies have grown more slowly, as productivity growth has diminished. As can be seen from Table 2.2, all six countries in our sample had higher GDP growth rates during 1950–1973 than during 1980–2007. In some cases (for example, Japan, Germany, and France), the growth rate fell by more than half. Labor productivity growth follows a similar pattern. Over the entire OECD, total factor productivity growth fell to 1.5 percent per annum on average after 1985, from rates more than twice that during 20 years before 1973.⁶

The productivity growth slowdown occurred as the process of deindustrialization continued in all countries of our sample except Germany, and in many cases the pace of deindustrialization accelerated (see Figure 2.1).⁷ Manufacturing now accounts for between 12 percent and 15 percent of total value added in the United States, the United Kingdom, Denmark, and France. The two trends are not unrelated, as productivity in services, while difficult to measure, is widely recognized to be lower than productivity in manufacturing.

Table 2.2 Economic performance, golden age versus post-golden age (compound annual growth rates unless otherwise indicated)

	Denmark %	France %	Germany %	Japan %	United Kingdom %	United States %
<i>Gross domestic product</i>						
1950–1973	3.8	5.0	6.0	9.3	2.9	3.9
1980–2007	2.1	2.0	2.2	2.3	2.5	3.0
<i>Labor productivity</i>						
1950–1973	2.9	4.7	4.7	7.5	2.4	2.3
1980–2007	1.7	1.5	0.8	1.8	2.1	1.6
<i>Employment-to-population-ratio average</i>						
1960–1973	48.5	41.0	45.1	48.1	45.4	38.9
1980–2007	50.9	40.2	45.9	49.9	44.8	47.4
<i>Unemployment rate average</i>						
1956–1973	1.1*	1.9	1.3	1.5	1.8	5.0
1980–2006	7.2	10.1	7.6	3.3	7.9	6.2

Source: Authors' illustrations based on data from the Conference Board and Groningen Growth and Development Centre, Total Economy Database, January 2008 and OECD Labor Force Statistics.

*Average based on 1960, 1965, 1967, 1969–1973.

Figure 2.1 Share of manufacturing in value added, 1970–2006 (in %).

Source: Authors' illustrations based on data from OECD National Accounts Statistics.

Thus the increase in the importance of services in economic activity relative to manufacturing contributed to reductions in economy-wide rates of productivity growth. By some accounts manufacturing output growth is the main driver of productivity growth, following the so-called Verdoorn's Law.⁸ Moreover, the manufacturing sector traditionally offered jobs with high pay and employment protection, often the result of effective bargaining by labor unions. Service sector jobs vary in their skill requirement and pay, but generally offer lower wages and less job security and employee benefits, partly due to low rates of unionization in services industries, an issue we return to later. As the share of services sector has grown in employment and value added, productivity growth has fallen, certainly as compared to that in the "Golden Age."

Unemployment and inequality

More importantly for the purposes of this chapter, the post-1973 period has seen a significant increase in worker vulnerability in many industrialized countries. The average rate of unemployment (on a standardized basis) has been significantly higher in the post-Golden Age era compared to the rates of the 1956–1973 period. The extent of rise varies, ranging from slightly higher in the United States to more than five times higher in France, Germany, and Denmark (see Table 2.2). In most cases, the incidence of long-term unemployment (i.e. unemployment of duration greater than 1 year) also rose (Figure 2.2).⁹

The slowdown in GDP and productivity growth described earlier not only brought higher rates of unemployment, but also occurred along with a slowdown in the growth of wages. In the United States, real median wages

Figure 2.2 Share of long-term unemployed (>1 year) in total unemployed (in %).

Source: OECD Labor Force Statistics.

Table 2.3 Wage inequality, 1985–2005 (ratio of wages of top 10% of earners to bottom 10% of earners)

	1985	1991	2005
Denmark	2.2	2.2	2.6
France	3.1	3.3	2.9
Germany	2.9	2.8	3.3
Japan	3.1	3.1	3.1
United Kingdom	3.2	3.4	3.6
United States	4.1	4.3	4.9

Source: Wages per full-time employee are calculated based on OECD Labor Force Statistics.

Notes: 1985 wages only for West Germany, 1991 wages for Denmark, and 2005 wages for France.

have been effectively stagnant since the late 1970s.¹⁰ The result of these trends is that beginning in the 1980s, the labor share of national income began to fall across many industrialized countries. Since most labor force participants are not owners of capital, this trend in the labor share captures in a broad way the growing economic insecurity in the industrialized countries.

Even more dramatic than the rise in income inequality between wage earners and profit earners was the rise in inequality across wage earnings, and especially in the gap between the wages of skilled and unskilled workers. The rise in “wage inequality” has been much discussed and is documented for our six country sample in Table 2.3, which shows the ratio of wages in the top decile to wages in the bottom decile of the wage distribution for 1985, 1991, and 2005. Over the entire period, the inequality has been the greatest in the United States and the lowest in Denmark. Since 1985, France and Japan were the only countries not to experience an increase in inequality. In the other four countries, inequality began to rise after 1991, more pronouncedly in the United States and Germany.

The burden of risk

There are private and public responses to rising economic insecurity of workers. Households may borrow in order to insulate their spending patterns from earnings volatility. The rise in home equity loans in the United States and consumer credit in the United Kingdom are in part explained by such responses.¹¹ Rates of household saving out of disposable income fell during the 1990s for most of the countries in our sample (Germany and France being the exceptions), indicating the need for households to limit and reduce savings in order to maintain their consumption level (OECD, 2007a).

Government responses to economic insecurity also vary greatly. The US response was to privatize the burden of health insurance and pensions (see later). In other countries, there was a decline in unemployment benefits (Table 2.4). Among the countries of the sample, only Denmark and France increased spending (as percent of GDP) on active labor market programs since 1990, though in France the percentage has declined after 2000 (Table 2.4). Responding

Table 2.4 Labor market policy indicators

Public expenditures for active labor market programs (% of GDP)	1980	1990	2000	2003
Denmark	0.4	1.1	1.6	1.6
France	n.a.	0.8	1.3	1.1
Germany	n.a.	1.0	1.1	1.1
Japan	n.a.	0.3	0.2	0.3
United Kingdom	0.6	0.6	0.4	0.5
United States	0.2	0.2	0.1	0.1
Gross unemployment replacement rate (%)	1981	1991	2001	2005
Denmark	54.2	51.9	50.9	48.9
France	31.3	37.6	43.5	39.0
Germany	29.3	28.8	29.4	24.2
Japan	8.8	9.9	9.1	7.7
United Kingdom	24.2	17.8	16.6	15.6
United States	14.6	11.1	13.5	13.5

Source: Authors' illustrations.

Data: OECD Social Expenditures and OECD Tax-Benefit Models.

Gross unemployment replacement rate: The OECD summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations, and three durations of unemployment. For further details, see OECD (1994: chapter 8) and Martin (1996). Pre-2003 data have been revised.

to the rising economic insecurity, governments have also made changes in regulations on hiring and firing. However, these changes have gone in different directions, becoming less strict in Denmark, Germany, and Japan, and stricter in France, and to some extent in the United Kingdom (Table 2.5a and b).

More important than shifting the burden of risk are differences across countries in terms of the degree of labor market flexibility, level of unemployment benefits, spending on active labor market programs, and the level of pension benefits. Economic insecurity is higher where state protection is lower and/or social protection is more closely tied with employment. By looking at these three variables—strictness of employment protection legislation, gross unemployment replacement rate, and public expenditures on active labor market programs—we see some clear patterns in the government response to economic insecurity. We calculated an index of the strictness of employment legislation by setting the

Table 2.5a Strictness of employment protection legislation (higher values indicate stricter regulation on hiring and firing)

	1990	1998	2003
Denmark	2.3	1.4	1.4
France	2.7	3.0	3.1
Germany	3.2	2.5	2.2
Japan	2.1	2.0	1.8
United Kingdom	0.6	0.6	0.8
United States	0.2	0.2	0.2

Source: OECD Labor Statistics.

Info on EPL: The OECD uses the term Employment Protection Legislation (EPL) in the context of employment protection legislation generally. It refers to all types of employment protection measures, whether grounded primarily in legislation, court rulings, collectively bargained conditions of employment or customary practice. <http://stats.oecd.org/glossary/detail.asp?ID=3535>

Table 2.5b Union members as share of total labor force (in %)

	Union members/total labor force		
	1980	1991	2001
Denmark	60	61	63
France	14	8	8
Germany	29	30	19
Japan	22	19	17
United Kingdom	43	30	26
United States	18	13	11

Source: Authors' illustrations.

Data: OECD Trade Union Statistics, based on administrative data except for United Kingdom 2001 and United States 1991 and 2001 (survey data).

Figure 2.3 Strictness of employment legislation versus labor support in OECD countries, 2003 (Indexes, USA = 1).

Source: Authors' illustrations, *Data:* OECD (2005), OECD Social Expenditures and OECD Tax-Benefit Models.

Notes: The Strictness of Employment Legislation Index has been calculated indexing the USA = 1, that is, dividing the values of all other countries by the US value. Higher values indicate stricter regulation on hiring and firing. Labor support is an index (using equal weights) composed of the indexed (USA = 1) active labor market expenditures (as % of GDP) as well as the indexed (USA = 1) gross unemployment replacement rate. Higher values indicate a higher security level. Gross unemployment replacement rate: The OECD summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations, and three durations of unemployment.

US level of employment protection level as the base and calculating the relative levels for other countries. Similarly, we constructed an index of “labor support” by again taking the US level of gross unemployment replacement rate and public expenditure on active labor market programs as the base. A scatter plot of these two indexes is given in Figure 2.3. We next combine these two indexes, giving equal weights to each, into a single index.

Based on the values of these indexes, five distinct “models” emerge and they follow closely the groupings presented in Boeri (2002). On the lower left corner, we can identify an “Anglo-Saxon model” of low levels of regulation on hiring and firing and low levels of worker support. To this corner belong the United States, the United Kingdom, Canada, Australia, Ireland, and New Zealand. Countries on the lower right corner follow the “Mediterranean model” that combines relatively strict employment legislation and low levels of worker support. This group includes Greece, Portugal, Spain, Italy, and Norway. Countries on the upper right corner of the scatter plot—“the Rhineland model”—combine relatively strict employment protection legislation and high levels of worker support. To this corner belong France, Sweden, Belgium, and Germany. In the upper left corner are countries with relatively flexible labor markets and high

levels of worker support. We call this the “flexicurity model,” and its followers include Denmark, Finland, and the Netherlands.

Japan has always been difficult to categorize in these schemes because although the state supports only low levels of labor market and social protection, the private sector had traditionally supported long-term employment security. We would propose an “East Asian model” including Japan and Korea, both of which have greater employment protection than those in the Anglo-Saxon group in Figure 2.3. It would seem that the traditional role of the private sector in Japan has vanished to a great extent, as seen by the increase to European levels of Japanese long-term unemployment and involuntary part-time employment.

The flexicurity model has attracted a lot of attention because of a superior Danish performance in trade and employment and the unusual combination of policies, with flexibility in terms of hiring and firing and strong social protection for those seeking employment, including a high level of unemployment benefits and considerable levels of spending on active labor market programs.¹² Moreover, Denmark greatly exceeds other countries in terms of pension benefits relative to lifetime earnings (Figure 2.4). This system of flexicurity is in part the reason for Denmark’s attainment of a high level of economic security.

By many measures economic security is the lowest in the United States, and this is supported by the unusually high perception of insecurity and fear of globalization in the United States discussed in the next section. The United States, often lauded for the flexibility of its labor markets, also stands out in terms of its low levels of unemployment benefits and limited state spending on active labor market programs (Table 2.6a and b, Table 2.7, and Table 2.8). Moreover, over the past 20 years, the United States has experienced a dramatic shift in the

Figure 2.4 Gross pension replacement rates by earnings based on 2004 rules (% of median earnings).

Source: Authors’ illustrations. Data: OECD pension models. OECD (2006: 33–34).

Notes: For median income earner. The figures are “estimates of the level of pension people will receive if they work for a full career and if today’s pension rules stay unchanged.”

Table 2.6a Exports and imports of commodities

	Exports				Imports				Balance			
	(in Mio. USD)		(in % of GDP)		(in Mio. USD)		(in % of GDP)		(in Mio. USD)		(in % of GDP)	
	1991	2005	1991	2005	1991	2005	1991	2005	1991	2005	1991	2005
Denmark	37,708	83,311	27.6%	32.2%	34,253	74,987	25.1%	29.0%	3,455	8,324	2.5%	3.2%
France	213,367	434,425	17.2%	20.4%	230,770	475,999	18.6%	22.4%	-17,403	-41,574	-1.4%	-2.0%
Germany	402,737	977,794	22.3%	35.0%	389,095	777,439	21.5%	27.8%	13,642	200,355	0.8%	7.2%
Japan	314,525	594,941	9.2%	13.0%	236,744	515,866	6.9%	11.3%	77,781	79,074	2.3%	1.7%
United Kingdom	182,227	384,365	17.6%	17.5%	209,849	515,782	20.3%	23.5%	-27,621	-131,417	-2.7%	-6.0%
United States	421,706	904,339	7.1%	7.2%	509,193	1,732,321	8.5%	13.8%	-87,487	-827,981	-1.5%	-6.6%

Source: Authors' illustrations.

Data: OECD International Trade by Commodities Statistics, International Monetary Fund (IMF), CD-ROM via UNCTAD.

Table 2.6b Exports and imports of services

Services	Exports				Imports				Balance			
	(in Bn. USD)		(in % of GDP)		(in Bn. USD)		(in % of GDP)		(in Bn. USD)		(in % of GDP)	
	1991	2005	1991	2005	1991	2005	1991	2005	1991	2005	1991	2005
Denmark	14.3	36.3	10.4%	14.0%	10.4	33.4	7.6%	12.9%	3.8	2.9	2.8%	1.1%
France	80.1	116.0	6.5%	5.5%	63.7	106.1	5.1%	5.0%	16.4	9.9	1.3%	0.5%
Germany	64.1	154.9	3.5%	5.5%	90.0	202.9	5.0%	7.3%	-25.9	-47.9	-1.4%	-1.7%
Japan	44.8	110.2	1.3%	2.4%	86.6	134.3	2.5%	2.9%	-41.8	-24.0	-1.2%	-0.5%
United Kingdom	56.3	203.1	5.4%	9.2%	49.0	160.5	4.7%	7.3%	7.3	42.6	0.7%	1.9%
United States	162.6	376.8	2.7%	3.0%	118.1	314.6	2.0%	2.5%	44.5	62.2	0.7%	0.5%

Source: Authors' calculations, Data: International Monetary Fund (IMF), Balance of Payments, CD-ROM via UNCTAD

Note: 2004 imports and exports for Denmark.

Table 2.7 Offshoring intensity in Germany, the United Kingdom, and the United States 1992–2004 (imported inputs as % of total nonenergy inputs)

Year	Germany	United Kingdom	United States
<i>Goods offshoring intensity</i>			
1992	—	28.2	11.7
1993	—	29.5	12.7
1994	—	29.8	13.4
1995	12.2	30.7	14.2
1996	12.2	30.7	14.3
1997	14.8	29.7	14.6
1998	14.6	28.0	14.9
1999	15.4	28.0	15.6
2000	19.5	28.6	17.3
2001	19.9	28.1	—
2002	19.7	—	—
2003	20.5	—	—
2004	23.1	—	—
Growth 1992–2000*	59.1%	1.3%	47.9%
<i>Service offshoring intensity</i>			
1992	1.0*	1.4	0.2
1993	1.0**	1.6	0.2
1994	0.9**	1.6	0.2
1995	1.0	1.6	0.2
1996	1.1	1.8	0.2
1997	1.2	1.7	0.2
1998	1.4	2.0	0.2
1999	1.7	2.2	0.3
2000	2.0	2.4	0.3
2001	2.3	2.6	—
2002	2.2	—	—
2003	2.1	—	—
2004	2.1	—	—
Growth 1992–2000	100.0%	76.3%	61.1%

Source: Authors' calculations for Germany.

Data: Input–output tables, Federal Statistical Office.

*1995–2000 for Germany.

** German service offshoring intensities from 1992 to 1994 use unrevised input–output data. Service offshoring intensity = $\sum_i [(\text{input purchases of service } s \text{ by sector } i) / (\text{total non energy inputs used by sector } i)_t] * [(\text{imports of service } s) / (\text{production}_{st} + \text{imports}_{st} - \text{exports}_{st})]$. Weighted average across all sectors i by outputs at time t . Goods offshoring intensity is calculated equivalently.

Calculations for the United Kingdom: Amiti and Wei (2005). Data: input–output tables, UK National Statistics, IMF: Balance of Payments Statistics. Notes: UK data is not directly available, but can be reconstructed from Figure 2 in Amiti and Wei (2005).

Calculations for the United States: Amiti and Wei (2006). Data: input–output tables, US National Statistics, IMF: Balance of Payments Statistics.

Table 2.8 Merchandise imports by region of origin (% of total imports)

Denmark	1950	93.3	0.9	3.5	0.9	5.4	0.7
	1970	88.4	4.5	3.4	2.6	10.5	1.1
	1991	89.8	3.6	2.4	2.9	9.0	1.2
	2005	84.4	4.7	2.8	6.3	13.8	1.7
France	1950	52.7	9.3	23.9	8.4	41.6	0.4
	1970	77.2	5.8	8.2	6.8	20.8	1.7
	1991	80.7	5.6	5.9	3.8	15.2	1.8
	2005	78.8	4.7	6.3	6.0	17.0	3.2
Germany	1950	74.4	4.8	9.9	9.1	23.8	1.0
	1970	79.5	6.6	6.5	4.5	17.6	2.8
	1991	81.6	5.5	5.1	4.1	14.6	3.7
	2005	76.2	5.0	5.0	8.6	18.6	5.2
Japan	1950	60.7	8.2	8.2	21.5	37.8	0.1
	1970	54.4	13.4	15.3	14.1	42.9	2.6
	1991	49.2	25.1	9.2	14.9	49.3	1.5
	2005	32.5	26.5	10.4	29.2	66.2	1.4
United Kingdom	1950	58.3	8.4	12.5	14.6	35.5	1.8
	1970	70.5	10.2	7.6	8.4	26.2	3.0
	1991	84.3	6.6	4.4	3.0	14.1	1.0
	2005	71.8	8.3	6.7	8.0	23.0	2.6
United States	1950	43.2	15.5	25.0	14.0	54.5	0.7
	1970	72.6	14.0	7.6	5.2	26.8	0.5
	1991	59.5	24.0	7.5	8.6	40.1	0.3
	2005	46.2	22.0	8.7	21.8	52.5	1.3

Source: Authors' illustrations.

Data: UNCTAD. *Handbook of Statistics*.

burden of risk, from government to the households themselves. This has resulted from more volatile household income, increase in health insurance costs, a greater reliance on private (as opposed to public) pensions, and a continuation of government policies of low levels of unemployment benefits. Hacker (2006) describes these changes as “the great risk shift,” as governments and employers shifted the burden of insuring against a rapid decline in income to the employees and households themselves. In their long-term historical analysis of the US income distribution, Temin and Levy (2007: 5) argue that this deterioration of the social safety net, combined with the decline of other institutions such as trade unions, has been a source of the decoupling of growth of productivity and growth of wages.

Figure 2.5 Government and private health insurance coverage in 2005 (% of population).

Source: Authors' illustrations.

Data: OECD Health Data. Social health insurance data includes government and social health insurance data. France: Private insurance data for 2004. Japan: Governmental/social insurance data for 2004, private insurance data not available. United States: Private insurance data for 1995 and 2000 from US Department of Commerce Economics and Statistics Administration, US Census Bureau.

Figure 2.6 Number of people without health insurance in the United States.

Source: Authors' illustrations.

Data: US Census Bureau, Current Population Survey, 1988 to 2007 Annual Social and Economic Supplements. The number of people reported as of March of the following year. US Census Bureau (2007: 58).

As an indication of the changes in the United States, Table 2.5a and b shows union density in our sample countries since 1980, with the United States experiencing by far the greatest decline. The United Kingdom, following a similar model,

comes next, though unionization in the United Kingdom even in 2001 remained at a much higher level than in the United States. France's low rate of unionization would seem to be deceptive, since bargaining coverage of union agreements has remained very broad.

The United States also stands out in the area of health insurance. The United States is alone among our sample countries in not having universal health insurance coverage. There were 47 million people uninsured in 2005 in the United States, reflecting a steady increase in the number (and percentage) of people uninsured since the late 1980s (Figures 2.5 and 2.6).

Perceptions of economic insecurity

Popular perceptions of economic insecurity do not necessarily reflect objective measures of insecurity, but we find a generally high level of fear toward globalization among our sample countries and especially in the United States and France. According to the German Marshall Fund (2007), 34 percent of Americans and 38 percent of Europeans had a negative view of globalization. About half of Americans and Europeans think that "freer trade" results in more job loss than job creation. Between 2005 and 2007, American sentiment turned more against freer trade while European sentiment became less skeptical of the

Figure 2.7 Concerns about free trade (in % of respondents).

Source: German Marshall Fund (2007), Topline Data October 2007.

employment benefits of trade liberalization. Half of Americans and a slightly higher percentage of Europeans “saw the growth of China’s economy as a threat.” Across countries, the survey showed that the United States and France show the most skepticism toward international trade and investment (see Figure 2.7). Of all countries surveyed, these two showed the highest proportion of respondents, 40 percent in the United States and 36 percent in France, who “did not favor FDI.” This contrasted with 69 percent of English and German respondents who favored FDI.¹³ Adverse attitude toward globalization went along with pessimism regarding future. In the United States, 40 percent expect the next generation will have a lower standard of living, 62 percent said job security had declined, and 59 percent said they had to work harder to earn a decent living. Most striking, 75 percent said that “outsourcing work overseas hurts American workers.”¹⁴ While this expression of greater economic insecurity was the greatest among those with less education, expressions of higher economic insecurity were found for all educational categories.¹⁵

The contrast between perceptions of globalization in France and Denmark is clear from a recent survey that asked “what comes first to mind when you hear the word ‘globalisation?’” Fifty-seven percent of French respondents said

Figure 2.8 The perception of globalization (in % of respondents). Question: “There are multiple consequences of the globalisation of trade. When you hear the word ‘globalisation,’ what comes first to mind?”

Source: European Commission (2007).

that the word “globalization” evoked the “relocation of some companies to countries where labor is cheaper.” Among Danes, 47 percent responded that globalization evoked “opportunities for national companies in terms of new outlets” (Figure 2.8).

Globalization and economic insecurity

Connecting globalization to economic insecurity

All six countries of our sample experienced an increase in globalization (by various measures) in recent years, and in almost all cases our measures of economic insecurity also increased, most prominently in Germany, Japan, and the United States (Figure 2.9). Two countries (Denmark and the United Kingdom) experienced declines in the share of long-term unemployment and also had the lowest growth in involuntary part-time work (see Table 2.9).

A closer look at winners and losers from offshoring

Trade liberalization is known to create winners and losers, and the new wave of globalization is no different in this regard, although some of the mechanisms and distributional effects may be new. Figure 2.10 depicts the variety of ways in which offshoring impacts the labor market. Offshoring, on the one hand, lowers prices of inputs and outputs, raising the demand for both and thus the demand for labor too. In addition, lower input prices should raise profit margins and profits, leading to investment that should further raise productivity and output. These gains are labeled as the “mark-up,” and “scale” effects in Figure 2.10. On the other hand, offshoring weakens labor demand by replacing foreign labor for domestic labor, creating a “substitution effect.” It also reduces demand for labor by raising productivity, an outcome referred to as the “productivity” effect.

Not the entire rise in profits is recycled into investment and labor demand, and this constitutes an important leakage in the system. As we will see later, corporations may also choose to return their net gains to shareholders, and this has occurred through higher dividend payments and share buybacks. This strategy of financialization of the nonfinancial corporate sector also includes the purchase of financial assets and the acquisition of other corporations (merger and acquisition). Financialization represents a drain on labor demand and, as we will see later, may play an important role in the link between globalization and economic insecurity.

Table 2.9 Globalization versus economic insecurity, 1991–2005 (compound annual growth rate, unless otherwise indicated)

	Globalization (1991–2005)				
	Exports plus imports in GDP (%)	KOF Economic Globalization Index (%)	Imports from low-income countries in total imports (%)	Goods offshoring ¹ (%)	Service offshoring ¹ (%)
Denmark	1.9	0.7	5.6	n.a.	n.a.
France	1.3	0.7	3.3	n.a.	n.a.
Germany	2.8	1.2	5.4	7.3	9.2
Japan	2.8	0.8	4.9	n.a.	n.a.
United Kingdom	1.3	0.6	7.3	0.0	7.6
United States	2.0	0.5	6.8	5.0	6.1
	Economic insecurity (1991–2005)				
	Share of labor compensation in GDP (%)	Share of involuntary part-time workers in total employment (%)	Share of long-term unemployed in total unemployed (%)	ILO Economic Security Index 2004 (value)	
Denmark	–0.2	1.1	–1.4	0.91	
France	0.0	1.4 ²	1.3	0.83	
Germany	–0.6	14.6	3.9	0.79	
Japan	–0.2	12.4	4.7	0.72	
United Kingdom	–0.2	0.5	–1.7	0.74	
United States	–0.1	n.a.	4.6	0.61	

Source: Authors' illustrations.

Data: OECD, UNCTAD, KOF Index of Globalization 2008 (<http://globalization.kof.ethz.ch/>), Federal Statistical Office Germany, Amiti and Wei (2005a, b, 2006).

¹ CAGR for 1995–2004 in Germany, 1992–2001 in the United Kingdom and 1992–2000 in the United States.

² 1992 data for France.

Figure 2.10 is a simplification that considers all labor as one type, and leaves out some potentially significant indirect effects. Thus in addition to the direct effect of offshoring on employment and profits, economic research has also considered the effect of offshoring on different types of labor (skilled and unskilled, through the Stolper–Samuelson effect), the increased sensitivity of labor demand to wage changes at home and abroad, and the greater use of company threats to move production abroad to undercut bargaining power of unions and laborers.

Figure 2.9 OECD goods trade with China and India (as % of total OECD Goods Trade).

Source: OECD (2007c: 110).
Data: United Nations (2008), COMTRADE database.

Figure 2.10 Gains and losses from offshoring.

Source: Authors' illustration. Based on Amiti and Wei (2006) and Milberg et al. (2007).
Notes: Y^D = demand for output and L^D = demand for labor.

We briefly review the evidence on each of these channels before looking at the overall relationship between globalization and economic insecurity in the industrialized countries.

Profits and the profit share

We noticed that offshoring is one of the reasons behind the recent rise in the profit share of national income observed across industrialized countries. Figure 2.11 however shows the flip side, which is the decline in the labor share. Note that the

Figure 2.11 Labor compensation (in % of GDP).

Source: Authors' illustrations.

Data: OECD Annual National Accounts Statistics.

labor share in the United States has declined less than in other countries. This is partly due to the fact that the large levels of CEO compensation in the United States, including stock options, are officially counted in labor income.

A number of studies have confirmed the role of offshoring in changing the distribution of income between labor and capital. Most firm-level studies find that offshoring occurs when cost reductions can be achieved and are at least 40 percent of the labor cost.¹⁶ Focusing on the data for 2000–2003, Milberg et al. (2007) find that offshoring intensity is positively associated with sectoral profit shares in the United States. A number of recent papers have taken up the question of trade and the profit share at the aggregate level. Harrison (2002) studies the relationship between trade openness and functional distribution of income across a large number of countries and finds that (contrary to the prediction of Heckscher–Ohlin theory) openness is generally associated with a lower share of labor in national income. Harrison concludes that “rising trade shares and exchange rate crises reduce labor’s share, while capital controls and government spending increase labor’s share.” A study by the IMF (2005) finds that offshoring is a small, but significant negative factor in the determination of the labor share of income for a group of OECD countries. In this study, three aspects of globalization (related to prices, offshoring, and immigration) combined to play a large role in explaining the declining labor share. The study by Ellis and Smith (2007) finds no connection between openness and the profit share, but links the rising profit share to increased “churning” in the labor market. While

Figure 2.12 Gross capital formation (in % of GDP).

Source: Authors' illustrations.

Data: UN DESA Statistics Division and UNCTAD GlobStat Database.

the authors attribute this churning to technological change, it seems likely that it also results from some of the indirect effects of globalization discussed later.

It is important to recognize that the rise in income inequality (between labor and capital) is not inconsistent with the theory depicted in Figure 2.10. As Mann (2003) shows, offshoring may lead to positive net employment growth provided efficiency gains from offshoring are shared between consumers and producers and both these channels promote investment. The problem is that the increase in profit share has not generally resulted in higher rates of investment. In fact, as profit shares of national income increased, domestic investment has fallen, as can be seen in Figure 2.12.

There are a number of explanations for the decline in domestic investment. The simple fact is that less domestic investment is needed when significant portions of the production process (goods and services) are moved offshore. Thus decline in domestic investment of industrialized countries goes hand in hand with rise in investment rates of countries hosting offshoring activities, such as China (Figure 2.12).

An associated phenomenon, also shown in Figure 2.10, is the leakage of profits to the financial system. According to a number of recent studies, the decline in investment spending in the corporate sector is also tied with the shift in corporate strategy occurring in the 1980s, when the pressure on management was to “downsize” the corporation and “distribute” profits back to shareholders at a greater pace. This process of financialization that occurred in the nonfinancial corporate sector was supported by the possibility

Figure 2.13 Dividends plus share buybacks as percentage of internal funds: US Non-Financial Corporations, 1960–2006.

Source: Schedule Z.1 of the Flow of Funds Account from the US Federal Reserve Bank online database.

of moving operations abroad through foreign direct investment and arm's length subcontracting and focusing increasingly on "core competence," a process that allowed corporate managers to reduce domestic investment in order to meet shareholder demands for improvements in shareholder value. Stockhammer (2004) documents a marked increase in the share of nonfinancial corporations' value added going to interest and dividends since the late 1970s in the United States, the United Kingdom, France, and Germany. In a firm-level study of the US nonfinancial corporate sector, Orhangazi (2008) finds a similar relation between financialization and investment. Milberg et al. (2007), also focusing on the United States, show that the rising profit share, due in part to offshoring, occurs as the share of investment out of profits falls and the payment of dividends and the purchase of share buybacks rises (see Figure 2.13).¹⁷

Job displacement and earnings replacement

There are a variety of ways of studying job loss resulting from international trade. One of these focuses on old-fashioned direct import competition,

that is on the employment effects of a change in net exports, where these employment effects are typically based on a comparison of actual employment with employment levels that would have occurred if the trade balance (relative to GDP) had remained unchanged. Sachs and Shatz (1994) had found that trade reduced US manufacturing employment by 5.7 percent in 1990, and Wood (1994) put the figure at 10.8 percent for all developed countries, with a relatively larger share of the decline borne by unskilled workers in both studies. In general, these studies find employment gains where net exports rise and employment losses where they fall. These studies focus almost exclusively on the manufacturing sector. In our sample, for the period 1991–2005, the United States, the United Kingdom, and France experienced increases in their trade deficit in manufacturing, while Denmark, Japan, and especially Germany had improvements. The deterioration has been the greatest for the United States, and Scott (2007) calculates that the decline in net exports between 2001 and 2006 cost the United States the equivalent of 1.8 million jobs.¹⁸

Another line of research looks at the employment effects of foreign direct investment. This however captures only a portion of the effect of offshoring, because much of it takes place at arm's length. The results proved to be ambiguous. Muendler and Becker (2006) in a study of Germany, Brainard and Riker (2001) in a study of the United States, and Fors and Kokko (2001) in a study of Sweden found a substitution effect between employment at home and in foreign affiliates. Desai et al. (2005) and Borgia (2005) found complementarities between employment at home and in affiliates for US transnational corporations. Harrison and McMillan (2007) find that the effect of FDI on US employment depends on whether the investment is horizontal or vertical. Horizontal FDI, seeking to serve foreign markets, is found to reduce US labor demand, while vertical FDI, which seeks to reduce costs, increases the demand for labor.

An important measure of economic insecurity is the ability of workers displaced by trade to find a new job and not suffer a loss in earnings. Kletzer (2001) has done the most extensive analysis of the reemployment rate and replacement wage for workers displaced as the result of foreign trade. In a study of the United States for 1979–1999, she found that earnings losses from job dislocation are large and persistent over time. Specifically, she found that 64.8 percent of manufacturing workers displaced during 1979–1999 and one-fourth of those reemployed suffered earnings declines greater than 30 percent. For workers displaced from nonmanufacturing sectors, the situation is very

similar: 69 percent found reemployment, and 21 percent suffered pay cuts of 30 percent or more.

OECD (2005) did a similar study for 14 European countries for 1994–2001 and found that reemployment rates in Europe were lower than in the United States, but a much lower share of workers had earnings losses greater than 30 percent upon reemployment and 46 percent of workers had no earnings losses or were earning more than before displacement. Table 2.10 compares the United States and European situations for trade-displaced workers.

Trade versus technology: Skill-biased labor demand shifts

Labor economists studying rising income inequality in industrialized countries over the past 15–20 years often see the explanation in technological change. According to this view, the introduction of IT and IT-enabled tasks introduced a bias in the demand for higher-skill workers. The result of such “skills-biased technological change” was to raise income inequality, as the wages of higher-paid workers increased faster than those of lower-paid workers who experienced smaller gains or even, in some cases, a decline in wages.¹⁹

Table 2.10 Adjustment costs of trade-displaced workers

Industry	14 European countries: 1994–2001 ¹			United States: 1979–1999		
	Share reemployed 2 years later (%)	Share with no earnings loss or earning more (%)	Share with earnings losses >30% (%)	Share reemployed at survey date (%)	Share with no earnings loss or earning more (%)	Share with earnings losses >30% (%)
Manufacturing	57.0	45.8	6.5	64.8	35.0	25.0
High-International-Competition	51.8	44.0	5.4	63.4	36.0	25.0
Medium-International-Competition	58.7	45.7	7.0	65.4	34.0	25.0
Low-International-Competition	59.6	47.3	6.8	66.8	38.0	26.0
Services and Utilities ²	57.2	49.6	8.4	69.1	41.0	21.0
All sectors	57.3	47.1	7.5	—	—	—

Source: OECD (2005: table 1.3, p. 45) and Kletzer (2001: table D2, p. 102).

¹OECD Secretariat estimates based on data from the European Community Household Panel (ECHP) for Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom.

²Services for Europe.

Responding to the empirical findings, many international trade economists have reformulated the traditional two-factor model of trade to allow distinction between labor of high and low skill.²⁰

These models generally predict that trade liberalization would raise the relative demand for skilled labor in industrialized countries and thus raise the ratio of wages of skilled labor to wages of unskilled labor. These predictions are consistent with the observed increasing trends in income inequality in these countries.²¹ In sum, trade liberalization and technological change both can contribute to the rising wage inequality in industrialized countries. The debate concerns their relative role in the phenomenon.

Wood (1995: 57) finds that “trade is the main cause of the problems of unskilled workers” (see also Wood 1994). As the main force driving the process, he identifies increasing specialization of industrialized countries in capital-intensive manufacturers, while developing countries specialized in the production of labor-intensive goods. Wood estimates that between 1980 and 1994, 75 percent of the increased wage inequality in the United States was due to trade.

Feenstra and Hanson (1996, 1999, 2001) follow up the earlier results with a series of studies applying the extended trade model to the case of offshoring. They find that changes in offshoring between 1979 and 1990 explain between 15 and 40 percent of the rise in the wages of high-skilled workers relative to the wages of low-skilled workers in that period. In a study of manufacturing offshoring in the United Kingdom for the period 1970–1983, Anderton and Brenton (1999) find that trade accounted for 40 percent of the rise in the skilled labor share of labor income. Geishecker (2002) in a study of Germany in the 1990s finds that offshoring had a significant negative impact on the demand for low-skilled workers, explaining about 19 percent to 24 percent of the overall decline in the relative demand for low-skilled labor. Head and Ries (2000) estimate a similar model for Japan and find “a strong positive correlation between the change in the firm’s non-production wage share and a firm’s share of employment in low-income countries” (Feenstra and Hanson, 2001: 28). In their summary paper on the issue, Feenstra and Hanson (2001) find that offshoring accounted for 15–24 percent of the rise in the “non-production wage share” (i.e. the share of wages going to higher-skilled workers), while computer services and other high-tech services account for 8 percent to 31 percent of the shift to nonproduction labor.

Further research could not actually resolve the debate concerning relative roles of technology and trade in wage inequality rise. Also, there has been a debate about the timing of the technological change.²² By some accounts,

inequality began to rise well before new technology was integrated into production processes. Inequality actually fell during the late 1990s when the IT boom was the strongest. It also became clear that trade and technological change are interconnected, and increasingly so as global supply chains developed. For example, Wood (1995: 62) notes that “the pace and direction of technical change may be influenced by trade . . . So, however one looks at it, trade and new technology are intertwined: no story that excludes one or the other of them is likely to be the whole story.”

Despite these difficulties, the increased magnitude of, and public concern over, offshoring have spurred much empirical research on the labor market effect of offshoring in the 1980s and 1990s. Table 2.11 presents a summary of recent research, which covers studies of the United States, the United Kingdom, Germany and a recent study of all OECD countries, and covering both the manufacturing and service sectors. These recent studies by and large support earlier findings: offshoring in the production of goods and services leads to the rise of employment and wages of high-skilled labor and fall in the employment and wages of low-skilled labor.

Some recent research has focused separately on offshoring of services and examined its effect on overall employment. This focus is important because it gets away from the narrow theoretical confines of the Stolper–Samuelson theorem and the difficulty of testing it, and asks a more general question.²³ Their results are not fully conclusive, but they broadly indicate that across the OECD, offshoring of services has led to reductions in overall employment (see, e.g. Amiti and Wei 2004, 2006). Similarly, Schöller (2007a, 2007c) offers evidence of negative influence of service offshoring on German employment between 1991 and 2000. OECD (2007b) measures the effects of offshoring for 12 OECD countries, showing significantly negative effect of goods and services offshoring on manufacturing and service employment.

The perceptions of a strong link between globalization and economic insecurity cited at the beginning of this chapter are likely to be driven both by current reality and by predictions about the future. A number of recent studies predict a significant expansion of services offshoring. For example, Blinder (2005, 2007a, b) has done a detailed analysis of the US labor force, looking especially at jobs in services and the extent to which they are “personally delivered” or “impersonally delivered.” Personally delivered services cannot be delivered electronically, such as child care or garbage collection. Impersonally delivered services are those that can be delivered electronically without a significant loss of quality. These would include travel reservations and computer support (Blinder 2007a: 4). Blinder

Table 2.11 Labor market effects of offshoring: survey of literature

Source	Country	Industry	Sectors	Years	Effects of offshoring		
					Goods	Services	Overall
<i>Dependent variable: employment</i>							
Amiti and Wei (2004, 2006) ¹	United States	Mfg.	450	1992–2001	+	–	
			96		+	+	
Amiti and Wei (2005a, b) ¹	United Kingdom	Mfg.	69	1995–2001	±	+	
		Service	9		–	–	
Schöller (2007a) ¹	Germany	Mfg.	36	1991–2000	–	–	
Schöller (2007c) ¹	Germany	Mfg.	35	1995–2004	–	–	
OECD (2007b) ¹	12 OECD-count.	Mfg.	26	1995, 2000			–
		Service					–
<i>Dependent variable: high-skill employment</i>							
Feenstra and Hanson (1996) ²	United States	Mfg.	450	1977–1993	+		
Feenstra and Hanson (1999) ¹	United States	Mfg.	450	1979–1990	+		
Falk and Koebel (2002) ²	Germany	Mfg.	26	1978–1990	no ev.		
Ekholm and Hakkala (2006) ²	Sweden	Mfg.	20	1995–2000	+ ⁶		
					+ ⁷		
<i>Dependent variable: low-skill employment</i>							
Falk and Koebel (2002) ²	Germany	Mfg.	26	1978–1990	no ev.		
Geishecker (2002) ²	Germany	Mfg.	22	1991–2000	–		
Strauss-Kahn (2003) ³	France	Mfg.	not rep.	1977–1993	–		
Hijzen et al. (2005) ²	United Kingdom	Mfg.	50	1982–1996	–		
Ekholm and Hakkala (2006) ²	Sweden	Mfg.	20	1995–2000	– ⁸		
Geishecker (2006) ²	Germany	Mfg.	23	1991–2000	– ⁹		
Schöller (2007b) ¹	Germany	Mfg.	28	1991–2000	–	–	
<i>Dependent variable: high-skill wages</i>							
Feenstra and Hanson (1996) ²	United States	Mfg.	450	1977–1993	+		
Feenstra and Hanson (1999) ¹	United States	Mfg.	450	1979–1990	+		
Geishecker and Görg (2004, 2007) ⁴	Germany	Mfg.	21	1991–2000	+		

Source	Country	Industry	Sectors	Years	Effects of offshoring		
					Goods	Services	Overall
Geishecker et al. (2008) ⁴	Germany	Mfg.	not rep.	1991–2000	– ⁹		
	United Kingdom	Mfg.	not rep.	1992–2004	– ⁹		
Horgos (2007) ⁵	Germany	Overall		1991–2000	+		
		service			+		
		HS intensive			+		
		LS intensive			–		

Source: Authors' illustration.

¹Imported inputs/total nonenergy inputs.

²Imported inputs from same sector/output.

³Vertical specialization.

⁴Imported inputs/output.

⁵Several measures.

⁶To low-income countries.

⁷Inhouse-offshoring.

⁸Medium-skill employment.

⁹To CEECs.

estimates that 30 to 40 million current jobs (22 to 29% of the current American workforce) are likely to fall into the category of impersonally delivered services, and hence potentially subject to future offshoring. Blinder's analysis is notable not just because the potential labor market displacement is large, but because the displacement affects all skill levels of the US labor force. Blinder sees the potential wave of offshoring as driving a new industrial revolution, so that "the sectoral and occupational compositions of the U.S. workforce are likely to be quite different a generation or two from now. When that future rolls around, only a small minority of U.S. jobs will still be offshorable; the rest will have already moved off shore" (p. 27). Blinder's analysis shows that the distinction between high-skill versus low-skill labor that characterizes most of the research to date may be much less relevant in the near future.

Increase in the elasticity of the demand for labor

Rodrik (1997) and others have noted that greater openness to international trade would also raise the elasticity of labor demand with respect to both domestic and foreign wages. This increased sensitivity of labor demand to both domestic

and foreign wage movements is another result of rise of global supply chains and offshoring. Anderson and Gascon (2007: 2) describe the situation well.

However, there have been very few estimates of the relationship between trade openness and the wage elasticity of labor demand. Slaughter (2001) studied US manufacturing sector for the period of 1960–1991 and found that the elasticity of demand rose for US production workers (a proxy for lower-skill workers) but not for nonproduction workers during this period. The elasticity increase was the greatest in sectors that experienced the most offshoring and technical change in the form of more computer-related investment. Scheve and Slaughter (2004) find that FDI is the key aspect of globalization that raises the elasticity of labor demand. In a study of outward FDI by the UK firms, they find that higher FDI is associated with higher elasticity of labor demand and greater volatility of wages and employment.

Threat of job loss and wage suppression

A less easily quantifiable channel through which globalization and especially offshoring influence wages and job security is the threat by companies to move production overseas. Freeman (1995: 21) describes the phenomenon quite well.

The issue has received considerable attention from theorists, but there is little empirical analysis.²⁴ Bronfenbrenner (1997, 2000), studying the United States between 1993 and 1999, focuses more narrowly on unionization campaigns than on wages. She finds that a firm's mobility did raise the credibility of the threat to move production offshore, and it influenced the decision of workers regarding unionization. The study indicates that unionization drives have a much lower rate of success in firms with a credible threat of mobility than in those considered immobile. Similarly, Choi (2001) looked at detailed outward foreign direct investment by US manufacturers and found that increased outward FDI was associated with lower-wage premiums for union members during the period 1983–1996.

Conclusion and prospects for the future

This chapter has shown that the new wave of globalization has raised worker vulnerability in industrialized countries by increasing the likelihood of getting unemployed, reducing employment and wage growth, lowering the overall labor share of national income, and raising inequality between high- and low-skilled

workers. But vulnerability does not translate directly into economic insecurity. This depends on households' capacity to cope with the risk of sudden loss of employment and income and on national policies to absorb such risks. The decline in household saving and massive growth in household debt reflect in part the dwindling ability of households to cope with employment and income shocks.

Different industrialized countries have implemented very different sets of policies to cope with the situation arising from the new wave of globalization, and we have identified five "models." At one extreme is the Anglo-Saxon model represented by the United States and other Anglo-Saxon economies with lax hiring and firing regulations, low unemployment benefits, and very limited spending on active labor market policies. At the other extreme is the Rhineland model, represented by France and Germany, who have relatively high levels of employment protection, large unemployment benefits, and significant spending on active labor market programs.

Denmark and a few other countries seem to have combined elements of the two, devising a model of "flexicurity," characterized by labor market flexibility, high replacement income programs for the unemployed, and extensive active labor market programs. In recent years, France and Germany seem to be moving toward the flexicurity model, but are still far from reaching the Danish practice of this model.

The analysis of offshoring presented in this chapter indicates that flexicurity, as a way of managing state-market relations in a globalized economy, is probably not sufficient for ensuring economic security in the long run. What is instead required is rechanneling of the gains from offshoring away from finance and toward reinvestment in the domestic economy. Tighter labor markets driven not by unsustainable consumer debt but by productivity-enhancing private investment is the long-term key to "sharing the gains" from globalization.

This conclusion raises a question about the relationship between national policy and international competitiveness. It is often heard that greater state-provided social protection constitutes a cost to producers that reduces international competitiveness. The evidence, however, indicates that the opposite may be true. The provision of greater social protection does not unambiguously reduce a country's export competitiveness and in some cases may even increase it. In a study of OECD countries over the period 1978–1995, Milberg and Houston (2005) find that there are multiple paths to export competitiveness for industrialized countries. On the one hand, there is the "high-road" relying on innovation, high productivity, and high levels of compensation and job security

resulting from labor–management cooperation and state support for economic security. On the other hand is the “low road,” in which productivity growth hinges on intense conflict between labor and management rooted in job insecurity and a weak role for the state in guaranteeing social protection.²⁵ This conclusion also applies to the six countries studied in this chapter. Denmark and Germany, two countries with greater state intervention in sharing the burden of insecurity, have increased their trade surpluses considerably over the past 15 years, while the Anglo-Saxon countries have experienced massive trade deficit.

Over the past 15 years, the new wave of globalization has led to a rise in the share of profits in the national income and decline in the share of wages, increasing inequality in the society. Unless reversed, this tendency toward polarization is likely to get stronger as globalization gradually engulfs more sections of the labor force, including high-skilled and service sector workers, and thus spreads insecurity to wider sections of the population.

In industrialized democracies, such polarization and widespread insecurity may call into question the very merit of liberal trade policies and the efficacy of the traditional (Anglo-Saxon and Rhineland) arrangements between states and markets. The response may take a variety of forms, including a dangerous protectionist backlash. It is therefore urgent to formulate policies and erect an institutional structure that can address effectively the challenges raised by the new wave of globalization.

Notes

- 1 See Rodrik (1997) on the increased demand for social protection.
- 2 Offshoring is defined in this paper as the reallocation of production across various geographical locations to benefit from low labour costs and low taxes. In large part, this process has been facilitated by fast technological innovations in telecommunication and low transportation costs. The concept of comparative advantage has been redefined to place the emphasis on the ability of firms to “coordinate a geographically dispersed network of activities.” Levy (2005: 685).
- 3 The index combines measures of job security and social security, where the former includes income security and “voice representation security” and the latter measures “access to basic needs infrastructure pertaining to health, education, dwelling, information and social protection.” See ILO (2004).
- 4 The term *financialization* is used to describe the growing influence of financial markets and institutions on economic growth and development both in the

domestic and international markets. It refers to a qualitative change in the operational logic of corporations and business firms away from productive investment and into financial investments where quick and larger profits can be realized.

- 5 The term *flexicurity* has been used to designate a social security model that includes some flexibility in the labour market for the hiring and firing of workers with high levels of support for displaced workers. It is a model that has been adopted by Denmark, Finland and the Netherlands.
- 6 Howell (2005: table 3.2).
- 7 According to Kalmbach et al. (2005), the German data overstate the size of the manufacturing sector because many services are counted in manufacturing.
- 8 According to the Dutch economist Jake Verdoorn, faster output growth is associated with an increase in productivity due to increasing returns to scale.
- 9 We have used 1991 as a start point in much of the analysis so that German data reflect unification.
- 10 Temin and Levy (2007).
- 11 Barbosa-Filho et al. (2005) find that the deterioration in the US current account between 1995 and 2003 closely tracks the rise in health care spending by Americans. This indicates that Americans were not so obviously on a whimsical buying spree, as is so often claimed, but instead were trying to retain spending in the face of stagnant real wages and rapidly rising costs of health care.
- 12 See, for example, Clasen (2007).
- 13 Note that Scheve and Slaughter (2001) find that in the United Kingdom over 1991–1999 perceived economic insecurity was higher in those sectors with greater outward FDI.
- 14 Anderson and Gascon (2007: 1).
- 15 Even on the issue of perception of insecurity, there is conflicting evidence. Kierkegaard (2007: 11) shows that among European countries there is not a statistically significant relationship between “public anxiety” over offshoring (as measured by the Eurobarometer 63 of 2005) and the intensity of offshoring and offshore outsourcing.
- 16 See Milberg (2007) for a review of these studies.
- 17 It would appear that the relationship between offshoring and financialization is not just in one direction. A study of UK and Danish retail firms shows that the financial pressures on the UK firms led to much stricter conditions being imposed on foreign suppliers of UK firms compared to Danish firms. UK retailers were more aggressive in seeking low-cost suppliers and in pressuring suppliers to reduce prices. See Palpacuer et al. (2005) and Gibbon (2002).
- 18 Note that the author attributes 11 percent of this job loss to Wal-Mart’s imports alone.

- 19 For some early empirical analysis, see Berman et al. (1994) in the United States and Machin and Manning (1996) in the United Kingdom.
- 20 Wood (1994, 1995) pioneered this effort. He argued that capital could be ignored since with high international mobility capital had little differential effect across countries.
- 21 According to the Stolper-Samuelson theorem, trade liberalization should benefit an economy's abundant factor relative to its scarce factor. In a world of high- and low-skill labor, the industrialized countries were clearly relatively abundant in skilled labor and thus could expect to see the returns to skill rising in relative terms.
- 22 See Gordon and Dew-Becker (2007: section 5) for a discussion.
- 23 The theory has not gone un-criticized, both on grounds of relevance (see Samuelson 2004) and on the grounds of the difficulty of measuring high-skill and low-skill labour (see Howell 2002), and its weak predictive power for the case of developing (low-skill abundant) countries. See, for example, (Berg 2006).
- 24 See Burke and Epstein (2001) for an overview and Rodrik (1999) for a game-theoretic approach.
- 25 Belloc (2004) finds a similar result.

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