



Growing Inequality:
a Novel Integration of
transformations research

Globalisation: Ways to cope with the unequal distribution of gains and losses

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POLICY BRIEF #4



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GI-NI contributes to an inclusive Europe of shared prosperity by providing a better understanding of the changes and joint impact of three major transformations: technological progress, globalisation and migration; and offering policy and governance solutions to better equip citizens and companies for future challenges, securing more equal opportunities and outcomes. The project team uses a multidisciplinary research approach with international stakeholder engagement throughout the project.

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The GI-NI project tackles how to reduce inequality and improve skills situations in the European Union (EU) considering three major transformations: technological progress, globalisation and migration. This policy brief contributes to a better understanding of ways in which EU and national policymakers could cope with the increasing inequality that comes with the overall gains from intensified trade and foreign direct investment. It provides recommendations for policies at the national and EU level aimed at mitigating the negative consequences for inequality without sacrificing the gains.



Key points

- For economies as a whole, increased globalisation brought substantial welfare gains. The distribution of these gains, however, has been very uneven. In many advanced countries, especially medium-skilled and low-skilled workers have experienced negative labour market outcomes of increased imports from e.g. China;
- Workers exposed to the negative impacts of increased imports are not always able to adapt to this situation. Often, such workers decide to stay put, rather than moving to other regions with better labour market prospects or switching to other occupations (or business functions), which are less exposed to negative consequences of trade;
- Our research shows that workers who are exposed to increased import competition are more likely to move to other regions or switch to other business functions than workers do not experience such a change;
- German workers who moved earned higher wages and were more satisfied with their jobs than workers who did not adapt to increased import competition. Workers who switch to a different business function also earned a higher wage than workers who did not adapt, but their job satisfaction was similar. For Dutch workers who switched occupation also experienced positive effects. Their job satisfaction was higher;
- The results of our research suggest that the negative effects of increased globalisation for workers who are disproportionately exposed to import competition could be alleviated by domestic policies that make it easier to adapt to this phenomenon. Workers who adapt tend to fare better than workers who do not. Such policies could be related to a variety of themes, such as housing, pensions and education (including up- and reskilling in later stages of life).



Context: globalisation, inequality and skills

Ever since the classic treaty of David Ricardo in the early nineteenth century, economists have stressed the positive implications of free trade between countries for their welfare. Several mechanisms have been proposed that cause these welfare gains. If foreign suppliers are allowed to serve the domestic market, consumers generally have more choice and are more likely to find the variant of a product that they prefer most. Prices as faced by consumers are driven down because domestic firms can exert less market power if they face competition from foreign firms. The most well-known mechanisms, however, relates to the welfare-enhancing effects of specialisation. Free trade will induce firms to behave in such a way that countries specialise in producing those good that they can produce relatively cheaply (relatively to other countries), because of productivity differentials and/or differences in the degree to which production factors (such as capital goods, but also labour with various skill levels) are available in countries. These mechanisms have led many economists to advocate free trade, by stressing the positive consequences for welfare of all economies involved.

More recently, however, negative consequences of increased trade have caught the attention, both of academics, policymakers and the general public. In just a few years (roughly between 2002 and the global financial crisis in 2008/2009) China became a manufacturing powerhouse, sometimes referred as the “Factory of the World”. Trade liberalisation, further reductions in transportation costs (containerisation) and especially rapid advances in information and communication technologies permitted this. Almost in parallel, several Eastern European countries integrated into the European economy, at the time they became members of the EU. These significant changes led to situations in which the most advanced countries specialised in activities (such as R&D, management, and marketing-related activities) that mainly require high-skilled workers, while many activities related to fabrication

of products (the 'factory work') were offshored to Eastern Europe and China by firms that saw opportunities to reduce their costs of production. Research that is by now known as the 'China shock-literature' (e.g. Autor et al.) shows that medium- and low-skilled workers in advanced countries have gained much less from this globalisation of production processes than their high-skilled counterparts. Inequality in terms of employment opportunities and wages along the wage and skills dimensions has increased. It is important to note, however, that these effects are generally stronger for countries that had a relatively large manufacturing sector before the wave of globalisation started.

The inequality-increasing effects of intensified trade and foreign direct investment have led to a backlash against globalisation, and increased protectionism. This effect has been reinforced strongly by concerns about weak enforcement of intellectual property rights protection in China ('technology stealing'), the collapse of trust in the Russian government following the start of the war in Ukraine and the aftermath of the Covid pandemic. Governments have restricted the freedom of firms to do business with suppliers and customers in countries they feel particularly concerned about and firms themselves are reconsidering their sourcing strategies. They weigh the gains from having activities performed in cheap but distant locations against the risks involved and sometimes decide to reshore these activities, or relocate them to less risky places. The term 'deglobalisation' has been used increasingly frequently over the past few years.

The tendencies as just described do by no means mean that policymakers should not be concerned about the inequality aspects of globalisation anymore. First, it remains to be seen to what extent governments will continue limiting trade with China. The strong presence of China in networks of global supply chains has driven down consumer prices in Europe considerably. In view of the recent concerns about soaring inflation in the EU, further restrictions regarding trade with China might be considered unattractive. Second, reshoring means that activities are brought back, but not necessarily that this leads to better labour market outcomes for the workers who performed these activities before they were offshored. Computers and robots might be deployed instead. Hence, the inequality will not automatically be undone. Finally, since the end of the global financial crisis, trade in business services and other services used as intermediate inputs by firms has been rising at a much faster pace than trade in goods. In view of the ever-increasing opportunities to supply such services over long distances, globalisation might well change in nature rather than in degree. Consequently, continued globalisation might hit workers with other capabilities and skills than those who were hit in the first part of this century. Concerns about the effects of globalisation on inequality remain warranted.



Critique of existing policy options

Currently, politicians seem to have polarized opinions about what could be done.

The first group has the opinion that globalization has gone too far and that countries (or groups of similar, like-minded countries) should get more self-sufficient again. The often-used term 'strategic autonomy' reflects this, although it also conveys the feeling that geopolitical tendencies point towards a bipolar or more probably multipolar world, consisting of blocks of countries). The most important downside of this policy option is that the aggregate welfare gains of free trade are sacrificed to fight inequality. As discussed above, such policies will imply upward pressures on prices. Hence, consumers will be worse off, and domestic industries will be less competitive. Insofar the reshored activities cannot be performed more cheaply by machines, robots and computers, workers will be needed. In several European countries, labour markets are currently extremely tight. This implies that other types of jobs cannot be fulfilled. Given the fast ageing of the populations of many European countries, it is not very likely that the tightness of labour markets will appear to be a short-lived phenomenon.

The second group of politicians focuses on the welfare gains from trade and tends to argue that the negative implications for smaller groups of workers are a temporary phenomenon. If labour markets are sufficiently flexible, workers who 'are competed away' by workers elsewhere who are qualified for the job and cheaper will manage to find a job in an industry or activity that is in higher demand, possibly because of trade-induced specialization. Research has shown, however, that the negative implications are often long-lived. The jobs into which these people could transfer often require capabilities and skills that the workers hit by intensified trade do not have and cannot acquire in the short run. Moving to regions where the type of occupation they had before trade intensified is also often a hurdle that is too high, for various reasons.

Policy Recommendations for EU and national policymakers

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Our research (the results of which should be corroborated by additional studies) suggests that raising the resilience of workers who are 'at risk' of the negative implications of increased globalisation could be enhanced by facilitating two types of adaptation, moving to other regions or switching to jobs in a different occupation or business function. Policies at the national level and policies at the EU level could complement each other.

The policies should enhance the opportunities of workers to be flexible.

- Policymakers cannot do much regarding the sacrifices that need to be made regarding social networks of workers and their families. Frequently, however, housing-related constraints play an important role. If it is difficult to sell or buy a house, or taxes associated with buying houses are high, workers whose job is at risk will find it harder to adapt by moving. Flexible housing markets can lower hurdles to adaptation.
- Policymakers can also lower the costs of adapting to import competition by streamlining pension regulations. In several European countries, workers who adapt by switching from one occupation to another face problems regarding institutional savings for the period after retiring. If job switches do no longer affect the expectations regarding post-retirement income negatively, workers will be less discouraged to adapt by finding jobs in different occupations.
- Switching between occupations or business functions is often hampered by a lack of skills. Workers in one occupation do not possess the required capabilities to be productive in a different one. Well-designed upskilling and reskilling policies could help in lowering such barriers. Policies regarding life-long learning could be helpful in this respect, provided that the educational activities that workers engage in are not exclusively related to the job they have. If, instead, firms and workers would be stimulated to also invest in skills they do not have but might be relevant in other occupations or even functions, these workers would be more resilient against changes in the intensity of import competition and it would be easier to adapt.

In summary: protectionist trade policies can support the groups of workers whose income and well-being are at risk due to increased globalisation, but at the expense of the overall gains in welfare that trade liberalisation brings. Domestic policies, however, can also support these workers, without missing out on the welfare gains.



Conclusions

Increased global trade has generated sizable welfare gains. The unusually rapid globalisation in the 1990s and 2000s have shown that these gains are often very unequally distributed over groups in society. Sizable groups suffer from the negative consequences of import competition, losing their jobs, experiencing low wage growth and not feeling satisfied with their jobs. For these groups in society, these negative impacts are larger than the gains of trade they experience in terms of lower prices for the products they buy. The voice of these groups has become louder. Policymakers thus face the challenge in designing policies that alleviate the negative consequences of trade as felt by these groups of mainly low- and medium-skilled workers, in order to continue to reap the economy-wide benefits of trade liberalisation.

In this policy brief, we report on outcomes of research that focuses on the labour market outcomes of two types of workers who adapt to increased import competition. The first type adapts to these threats, by either moving to another region (where job prospects are better) or by switching to a job in a different occupation (which is less at risk). The second group type does not adapt and stays put. By and large, we find that the labour market outcomes for the type of workers that adapt in one way or another are better than those who do not act in this respect. In summary, adapting pays off and helps in mitigating the negative consequences of trade.

These outcomes suggest that national and EU-wide policies that make it easier for workers to adapt to import competition are worthwhile to consider. Such policies could be related to housing, pensions and education (including reskilling and upskilling). Lowering the costs of adapting to shocks seem a promising way to reducing the inequalities associated with globalisation.

References for further reading

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