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Is Social Europe Fit for Globalisation?

Brief for Policy Makers

Based on a study on the social impacts of globalisation

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Based on a study on the social impacts of globalisation²

Globalisation is more an opportunity than a menace

1. The present study argues that globalisation is much more an opportunity for added growth than a social menace. However, the benefits of globalisation cannot just be assumed to happen and, with an increased pace of change, it is inevitable that there will be losers as well as winners, with marked social consequences.

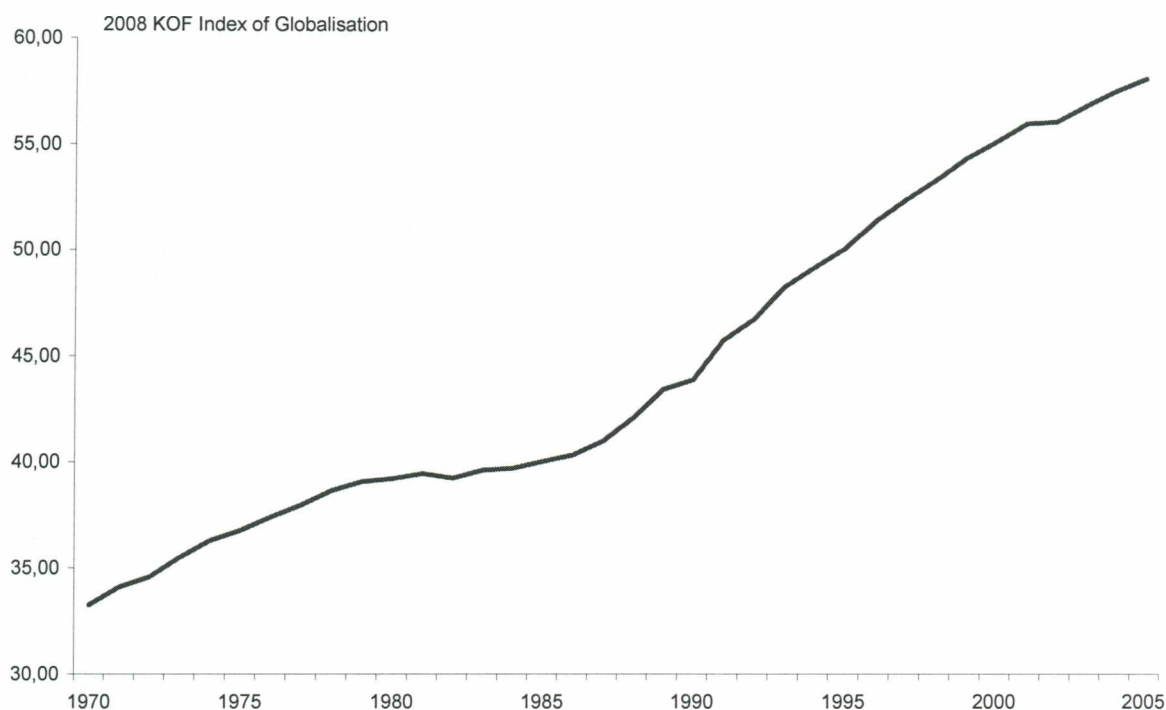
What is globalisation ...

2. As a phenomenon of the late 20th and early 21st centuries, there can be little doubt that globalisation is something that resonates widely. Yet it is not easy to pin-down conceptually or empirically, and can best be understood as the outcome of inter-actions between a number of drivers of change and the responses of economic actors to them. Globalisation manifests itself in the integration of markets and supply-chains, the development of a global capital market and the rapid spread of new or enabling technologies, but it also – more controversially - encompasses cultural convergence.
3. Among the most significant drivers of change that have given rise to globalisation are policy decisions to open markets (notably through successive rounds of reduction of tariff and non-tariff barriers), a lessening of regulation (e.g. on capital movements and product standards), cultural openness to foreign goods and services (tourism, demand for more diverse food and other products), and lower transport and communication costs. In addition, disparities in living standards and earnings, together with differences in demographic trends in different parts of the world have shaped migratory pressures.
4. Globalisation's effects are evident from data on the rising share of trade and, especially, foreign direct investment in GDP. For example, stocks of foreign investment have risen tenfold as a proportion of GDP since 1970. A composite index of globalisation, compiled by the Swiss Institute for Business Cycle Research shows that globalisation has been on an interrupted upward trend since 1970 (see figure 1) and shows no sign of abating. This index brings together economic variables (trade and investment), social variables (including tourism and communication flows) and political inter-connections of different sorts for nearly every country in the world. The extent of the fall in the costs of communication costs is striking: a three minute phone call between New York and London that would have cost US\$ 293 (at today's prices) in 1931 and US\$ 1 in 2001 is now just a few cents - for a vastly better connection. Similarly, total freight costs for trade between developed countries now account for less than 4% of the value of trade.

¹ The views expressed in this document are those of the authors and do not necessarily represent those of the European Commission.

² Contract VC/2005/0228

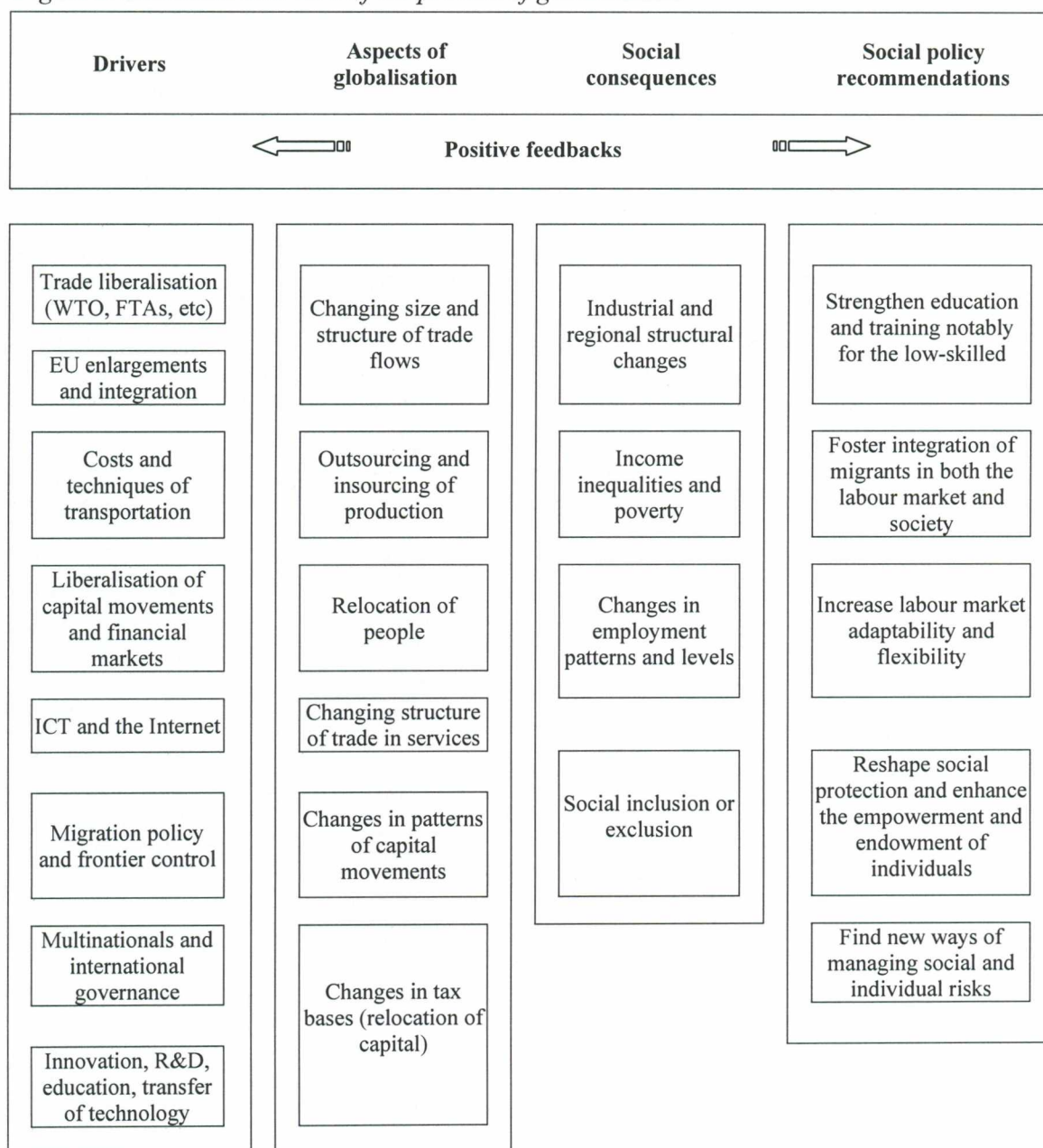
Figure 1 The unrelenting rise of globalisation



Source: Swiss Institute for Business Cycle Research (2008).

5. More recently, there has been an upsurge in the extent of migration into the EU, prompted in part by conflicts in other parts of the world, but attributable more to economic motives as workers in other countries seek better opportunities than are available at home. In many EU-15 countries, immigration from the recently-acceded Member States has also been substantial, fanning fears about the social consequences and burgeoning demands on host country social protection systems, despite the compelling evidence that migrants do not abuse these systems.
6. The process of globalisation, including its drivers and social consequences, is summarised and illustrated in figure 2. The main drivers (enablers) are on the left-hand side, various aspects of the globalisation process in the middle part and the (potential) social consequences and the policy recommendation in this report on the right-hand side.
7. Yet globalisation is not a static phenomenon and there is no certainty that it will either continue along the same path or remain a predominantly transatlantic phenomenon. Indeed, it has already acquired more of an 'Asian face', notably with the emergence of China (and, now, India) as rapidly expanding economies. As they evolve from low-cost competitors in mass markets to become major consumer markets, they can be expected to become increasingly innovative and to contribute to the development of new technologies, rather than simply importing technologies.

Figure 2. Schematic overview of the process of globalisation



8. Increasingly, too, businesses are finding new ways of sub-dividing economic activity between nations. In particular, an emerging trend is for tasks within the value chain to be 'unbundled' and traded between nations, rather than whole products or services. As a result, the crude idea that it is the unskilled who lose from globalisation while highly qualified workers gain has to be replaced by a more subtle analysis. India, today, competes not just on the cost of its unskilled workers in producing mature mass manufactured goods such as clothing, but also in skill intensive areas such as software development or medical diagnostics.

Globalisation brings aggregate benefits ...

9. Globalisation is not a zero-sum game in which the losses of some are exactly matched by the gains of others. On the whole, the gains exceed the losses, but in assessing the benefits of globalisation and the social impact, three issues need to be taken into account.
 - The gains are not uniformly distributed across individuals, regions and countries.
 - The costs of globalisation are more likely to be concentrated in the short-run, while benefits will take longer to materialise. So the very speed of the globalisation process is part of the policy challenge.
 - The gains will not accrue automatically, but will depend instead on successful adaptation which, in turn, means undertaking appropriate and timely competitive, regulatory and social reforms as well as investment in education, research and infrastructure.
10. The principal benefits of globalisation arise from the scope it affords on the supply-side for increased specialisation, enhanced diffusion of technology, and a competitive spur to innovation and productivity growth. Consumers gain from lower prices and increased choice, while an often overlooked benefit on the demand side is that emerging markets offer rapidly growing sales opportunities for European companies.

... but there are undeniably adverse consequences

11. The potential threats from unfettered globalisation encompass distributive impacts, such as adverse consequences for specific groups and regions, issues of cultural hegemony, potential environmental damage and geo-political disruption. Threats may also arise to the stability of public finances and from social tensions associated with migration.
12. Yet even for some of those who might be seen as victims of globalisation, it is important to stress that:
 - There are offsetting effects such as the boost to real incomes benefit from lower prices of imports.
 - Job losses resulting from international competitive effects are small in scale compared with normal 'creative destruction' due to constant structural change in product and labour markets.
 - The pressures on social protection budgets from population ageing are much more extensive than those from globalisation: in fact, off-shoring of low-value jobs and focussing on high value jobs can be seen as a logical answer to a declining labour force.
13. Many in Europe fear the developments linked to globalisation and are pessimistic about the outlook for the values, institutions and policies that have underpinned post-war Europe's success and way of life. Opinion polls testify to the strength of these fears, with more EU citizens regarding globalisation as a threat to their jobs, rather than an opportunity. Some argue that - to use a much touted expression - a 'race-to-the-bottom' in social policy and provision is inevitable.

What are the core policy challenges?

14. Many of the fears surrounding globalisation are greatly exaggerated and, even where justified, tend to rest on an incomplete analysis of the process. It follows that to view globalisation as an inexorable and threatening force is, simply, unwarranted. This message has to be repeatedly articulated and explained to citizens. However, it is clear that

globalisation will be a bumpy ride, that it cannot be ignored as a major determinant of the well-being of Europeans, and that it will require extensive and sensitively applied adjustment policies.

15. The most important message for policy makers is that a range of policy responses will be required for the EU and its Member States to ensure that the effects of globalisation are, on balance, as positive as possible. A core challenge is to achieve economic flexibility with better social protection in order to create an environment capable of making the best use of the opportunities offered by globalisation. In this context, social policy has a vital role to play, not least in endowing people with capabilities, with a premium on active policies that intervene early rather than passive, reactive policies. The policy challenges of globalisation can be grouped under three main headings.
 - Equipping the economy to compete in the globalising age, which means investing in the activities of the future as well as adapting the EU economy to cope with the demands of climate change, ageing and new sources of competition;
 - Smoothing adjustment, recognising that globalisation will require economic and social change that will impose costs and require redeployment of resources;
 - Improve socio-economic governance so as to facilitate these changes, with the EU and the Member States acting together, while also ensuring that underlying aims such as sustainable development are taken into account.
16. The Lisbon strategy is a response to globalisation. Its primary aim is to reposition the EU in the global economy, but it is important to recall that the strategy also has as key goals creating employment and ensuring social cohesion.
17. This strategy that targets growth and jobs is not enough and needs to be complemented by effective policies to protect those who lose from globalisation. Much can be achieved by re-training and other active policies aimed at re-deploying workers, but there will be some groups beyond the reach of such measures. Modernised solidarity policies should, therefore, be seen as an essential weapon in the policy armoury.
18. While labour market policies have to be at the forefront of an adaptation strategy, a coherent and complementary strategy for social protection and social inclusion remains vital. The ease with which adjustment can be achieved will also be shaped by the degree to which Member State governments are prepared to co-operate, both within the EU and in wider fora to prevent a race to the bottom with regard to social or environmental standards, notably. Regulatory fragmentation and the dominance of national regulatory regimes could result in a zero- or even negative-sum game. Effective co-ordination processes at EU level can help address a lack of global governance and reduce this risk. The governance challenge is to ensure that the existing processes (including Lisbon, the Sustainable Development Strategy and the open method of co-ordination of social protection and social inclusion) are 'owned' and accepted by Member States, but also do not conflict in their aims and orientations.

Policy responses to globalisation may further increase uncertainties...

19. Adjusting to globalisation implies policy developments that will, in turn, have social impacts and create uncertainties that need to be managed as social risks. Labour turnover can be expected to become higher, putting a premium on the transferability and adaptability of skills, but also on suitable forms of flexibility in the workplace as well as in activating individuals. Active labour market policies are an important part of the answer, but they are not a panacea and need to be complemented by other policies. In

addition, it is essential that such policies are well designed and offer appropriate incentives. An implication is that policy learning and experimentation are needed to find solutions that are effective, as well as attuned to conditions in the different Member States.

... but can also favour the capacity to adjust.

20. Many reforms, notably the reforms envisaged in the Lisbon agenda, will improve the benefits/costs ratio of globalisation in the long-term. Yet it also has to be acknowledged that structural adjustment can have short-term costs, some of which may have a negative impact on social cohesion that makes them politically awkward to implement. However, in this perspective it is important that whatever measures are envisaged to counter negative social impacts should favour, not hamper, the adjustment to changing conditions.
21. Compared to the US, the EU has been shown by the EU's Economic Policy Committee to be less effective at re-employing workers who lose their jobs as a result of restructuring (whether induced by globalisation or not). There are, however, marked differences between Member States in this regard, with the implication that there are lessons to be learned from those who manage best.
22. To the extent that it is the lower skilled who are most vulnerable to the effects of globalisation, there are grounds for labour market policies aimed specifically at these groups. However, it has also to be recognised that globalisation does not stand still. The most probable scenario for globalisation is that the main trends will broadly continue over the next fifteen years. Thus, it is reasonable to expect further increases in trade intensity, financial market integration and the spread of technology. Whether and how the very speed of this process can and should be managed may be part of the policy consideration at the highest level but is considered to be beyond the scope of social policy.
23. However, solutions are needed to the problem that many of those most affected by globalisation are the least able to re-connect to the labour market. A way forward is an 'active inclusion' policy in which there is support for minimum incomes and access to quality social services, as well as labour market support. Services such as child-care may well be part of the equation, not least for target groups such as female migrants.
24. Early intervention to improve the quality in particular of basic education should, in addition, be part of a shift in emphasis in the welfare state to prevent the emergence of social problems.

Globalisation is not the only rationale for reinventing the welfare state...

25. Responding to globalisation is only one rationale for 'reinventing the welfare state' and would miss a trick if it meant no more than 'compensating' those who suffer most from more intense international competition. Policy mechanisms and institutions have to be adapted to the changing economic environment, recognising that ensuing social effects are not always directly attributable to globalisation, and can often be the result of ultimately doomed attempts to protect jobs or to maintain wages at uncompetitive levels in sectors where global competition is intense.
26. The core of a social policy response is in the following main policy domains: education and training; immigration and integration policy; labour market reforms; and the re-shaping of social protection to bolster its role in activation. There is, in addition, an international governance dimension to consider, especially in the light of the EU's commitment to international obligations as part of its Sustainable Development Strategy.
27. With regard to training and skills, these can and should be enhanced by due attention to the level of education of vulnerable target groups. It is especially important to extend adult training and learning beyond those who already have a high level of educational attainment.
28. In relation to migration there is an evident need for new more comprehensive policies to promote the social integration of different types of migrants into the economy and society of the host country. An active approach to the inclusion of immigrants should, therefore, be part of solidarity. Moreover, national migration policies are bound to have externalities for other Member States, so that establishing common principles and approaches is a pressing matter.

The European social model is not doomed!

29. The empirical evidence for an erosion of social provision is, quite simply, striking because of its absence. Social protection outlays as a proportion of GDP have remained remarkably stable over the last two decades and it is noteworthy that some of the most successful economies in Northern Europe achieve high employment rates and a much greater degree of income equality than in other parts of the world, while also retaining large public sectors. Similarly, the data show continuing progress towards widely supported social aims such as diminishing gender imbalances in pay and employment rates, even though these gaps remain sizeable. The inference to draw from these observations is that it is not the extent of welfare provision, but how it is configured that most affects competitive success.
30. The European social model is not doomed - far from it - and the idea that only free market approaches disregarding any social goals are consistent with sustained prosperity is clearly wrong. Indeed, the success of the smaller open economies testifies to the scope for prospering, quite possibly also thanks to their extensive and generous welfare states.