Technical Meeting on Policy Coherence,
ILO, Geneva, 2-3 November 2004

Enhancing the Employment Impact of Globalization

A discussion note prepared by the ILO

1. Introduction

The goal of generating more decent jobs in the global economy is largely overlooked in international policies. While there is general acknowledgement of the importance of the issue in the mandates of international organizations, there is, at the same time, no concerted effort to address the issue. The Policy Coherence Initiative on Growth, Investment and Employment is an attempt to improve upon the status quo.

The basic rationale is as follows. If the objective of employment creation is given more serious attention in the policy formulation process, there are reasons to presume that significant improvements can be achieved over the current situation. The current implicit assumption is that if we get macroeconomic, financial, trade and aid policies right good employment outcomes would follow automatically.

There is insufficient evidence to support such a benign neglect of the employment objective. High unemployment and underemployment remain serious problems in many parts of the world and the current process of globalization has given rise to new stresses in labour markets. There is no discernible improvement in the global employment situation during the last two decades of globalization. Compared to the fifties and sixties, open unemployment in the industrialized countries is significantly higher. Data for developing countries is patchy and less reliable, but taken as a whole, they do provide serious grounds for concern. Open unemployment rates are surprisingly high in a number of these countries, contradicting the conventional wisdom that unemployment is not an option in developing countries without systems of unemployment insurance. At the same time there is evidence that precarious and low-productivity employment in the informal sector has expanded as a share of total employment. This reflects the slow growth of employment in the modern sector.

We cannot prove in advance that better outcomes can indeed be achieved through making employment generation a key goal of international policies. But it is incumbent upon us to test this hypothesis given the seriousness of the employment problem and the importance of employment generation as a means of distributing the benefits of globalization more widely.

2. Neglect of the Employment Objective

Employment problems are not explicitly acknowledged in the current agenda for international policy. Employment is not the central goal that it should be in the Millennium Development Goals or the PRSP process. Yet expanding opportunities for the poor to obtain more productive and better-remunerated jobs in either wage or self-employment is a powerful means of pulling the poor out of poverty. This process not only raises their incomes but, accompanied by the right complementary policies, can also contribute to reducing important non-income aspects of poverty. Specifically, if job-creation occurs in a context where fundamental rights at work are universally respected then the process will also contribute significantly to the social inclusion

and the economic and political empowerment of the poor. This is by virtue of the fact that fundamental worker rights ensure freedom from non-economic restraints holding down the poor such as labour market discrimination, forced and bonded labour, and child labour. These rights also include freedom of association and the right to collective bargaining that are basic enabling conditions for giving voice and political influence to all workers, including the poor among them.

It is true that there is implicit recognition of the employment issue in poverty reduction strategies since they typically do deal with programmes such as micro-finance, the development of rural infrastructure, increasing agricultural productivity, and support to micro-enterprises. These are all programmes that are aimed at raising the incomes of, and employment opportunities for, the poor. To this extent it might be argued that the problem is indeed being addressed in practice if not in name. What this overlooks, however, are the wider potential benefits of making employment an explicit and central objective. Doing this would provide an analytical and policy framework for addressing the employment creation in a comprehensive rather than in the current piecemeal fashion. With such a framework complementarities between individual programmes can be identified and exploited. At the same time, it will properly direct attention to meso and macro level factors that can potentially contribute to better overall employment outcomes. Hence making employment a central goal in poverty reduction strategies is more than a semantic quibble; it can potentially make a substantive difference.

By extension, we can also regret the fact that employment is largely no longer a central objective of national policies. The prevailing focus is on macroeconomic stability and economic liberalization with a view to enhancing international competitiveness in a rapidly globalizing world economy. This is seen as the route to maximizing the national benefits from globalization. This would also naturally deliver collateral benefits such as higher growth and more employment creation. But there is little evidence to date to validate this viewpoint insofar as employment is concerned. As is the case with international policies, there is a high potential pay-off to testing the opposite hypothesis, namely, that making employment a central objective of national policies could result in better employment outcome without compromising the objectives of growth and macroeconomic stability.

3. Current anxieties over globalization and employment

At the same time the attention that the employment issue does receive is largely on negatives such as anxieties in the industrialized countries over the transfer of jobs to the developing world and the potential ‘race to the bottom’ in employment conditions and labour standards in global production systems. While these issues do indeed have to be dealt with in order to maintain support for globalization, they should not deflect attention from the more important positive agenda of what can be done to enhance the overall employment impact of globalization.

The latter point can be elaborated as follows. On the issue of the North-South transfer of jobs, the fundamental anxieties of Northern workers are understandable notwithstanding the evidence so far that the magnitude of job losses from trade, the outflow of foreign direct investment, and outsourcing of services has been small. Taken together with the compensating benefits derived by the industrialized countries, the situation does not call for a reversal of the process of globalization. The better alternative lies in finding means to achieve a higher overall rate of employment creation, strengthening the adjustment assistance given to workers affected by dislocation, and adapting to the new competitive pressures from developing countries. More

generally, it is also in the interest of the industrialized countries to support policies for contributing to higher and more stable rates of growth in the global economy. This is likely to boost growth and domestic employment creation in developing countries and hence attenuate some of the pressures of a global competition for jobs.

Similarly, on the issue of the quality of jobs in global production systems the solution does not lie in impeding the growth of these systems but in strengthening the array of initiatives that are on the policy agenda for eliminating abuse and ensuring steady improvements in productivity and the quality of jobs. This requires action on several fronts. If the root problem is excessive market power enjoyed by TNCs and major buyers in these global production systems then issues of anti-competitive behaviour will have to be dealt with. At the same time, cooperative solutions need to be found to mitigate any 'race-to-the-bottom' pressures arising from the competition for foreign investment and jobs among developing countries. This needs also to be supplemented by action to strengthen compliance with core labour standards and to promote collective bargaining within global production systems.

It is important to note in this context that boosting the overall rate of productive employment creation in developing countries will also contribute significantly to a solution to this problem of the quality of employment in global production systems. This will eventually raise the supply price of labour and reduce the need for workers to accept low quality jobs.

There is thus a basic commonality rather than a conflict between industrialized and developing countries in looking at the two currently most contentious issues with respect to the employment impact of globalization. If the industrialized countries can do more to achieve higher and more stable rates of growth in the global economy there will be multiple benefits for all. The North would benefit from higher growth and employment creation that would diffuse tensions over the perceived export of jobs and reduce protectionist pressures. The South would benefit from this in several ways. A significant source of jobs from the participation in global production system would be preserved and, more significantly, the potential gains from increased access to Northern markets and investment would remain open. At the same time higher growth in the global economy would provide a more supporting environment for them to boost growth and productive employment creation. This would in turn enable them to cope better with the adjustment costs of integration into the global economy and to share the benefits of globalization more widely through the rapid creation of more and better jobs.

4. Towards coherent policies: Problem Areas

It is doubtful whether there can be serious disagreement with the above vision of how important it is to achieve a higher rate of growth of output and employment in the global economy. Differences are more likely to revolve over whether it is feasible to improve over the current situation or over what needs to be done. The best we can do in the circumstances is to highlight a few areas that we believe to be worth examining in the search for policies to achieve better employment outcomes.

(i) Global Growth

Global economic growth could be higher and more stable if adjustments to current account deficits and exchange rate movements could be handled more smoothly and effectively. The problem lies mainly with the systemically important countries. A persistent misalignment and gyrations of exchange rates among the major reserve currencies is one aspect of the problem. This has its counterpart in a failure of balance

of payments to adjust smoothly that in turn results in frictions over the fair sharing of responsibilities for maintaining effective demand in the global economy. If these problems could be resolved growth in the global economy could be higher and more stable.
Apart from the obvious impact on developing countries through the growth and trade linkages, there are increasingly important impacts through boom-bust cycles in capital flows to these countries.

(ii) The External Environment for Developing Country Growth

The above problems deriving from the global impact of industrialized country policies creates an unstable environment for developing countries seeking to attain higher growth. The situation has become more difficult with the increasing globalization of financial markets. As more and more developing countries undertake financial liberalization, including of their capital accounts, they become increasingly exposed to exchange rate instability. This raises the risk premium faced by investors and therefore reduces the inducement to invest. At the same time the cost of borrowing often increases because the domestic interest rate has to be increased to maintain the exchange rate and the confidence of financial markets. The supply of savings is also volatile because of the significant presence of short-term flows in total foreign capital inflows. These short-term flows also often fuel asset bubbles in stock and real estate markets and other unproductive investments. In addition, liberalized capital accounts have also created pressures to hold large international reserves that have a high opportunity cost in terms of foregone domestic investments that could have yielded a higher rate of return.

While financial globalization holds out the potential of bringing about a greater flow of funds from capital-rich to capital-scarce countries, that potential has yet to be fully realized. Flows have been too unstable and the system has generated problems such as those raised above that have constrained the ability of developing countries to achieve higher rates of investment, growth, and employment creation.

(iii) Constraints on Macroeconomic Policies in Developing Countries

With increasing financial liberalization, developing countries also face new challenges to macroeconomic policy. A basic one is that of minimising fluctuations in real output. It is increasingly difficult to use counter-cyclical macroeconomic policy, to achieve this key objective. Firstly, it is extremely difficult to manage volatile short-term flows of foreign capital. They drive boom-bust cycles in the domestic economy that have particularly detrimental effects on the stability and potential growth of employment. Secondly, the use of counter-cyclical monetary and fiscal policy is heavily constrained in such a context. In the face of an outflow of funds interest rates have to be raised to stem this and to defend the exchange rate, hence having a pro-cyclical effect on the real domestic economy. Conversely, it is difficult to raise interest rates during a boom caused by a surge of capital inflows. The use of counter-cyclical fiscal policy during a downturn is also heavily constrained by the indiscriminate disapproval by financial markets of fiscal deficits. Consideration should therefore be given to the use of a full range of regulatory tools such as rules governing provisions, capital requirements, and other measures affecting conditions in credit and asset markets, including circuit breakers in stock markets, in order to limit the cyclicality of the financial system.

These inherent systemic problems are compounded by the prevailing orthodoxy in macroeconomic policy. This places the highest priority on maintaining price stability and sound public finances. Achieving higher and more stable levels of growth in real output and employment are at best secondary objectives, if at all. The implicit assumption is that achieving macroeconomic stability in the narrow sense of price stability and fiscal balance is the best available means of attaining these broader objectives.

This view often pre-empts the serious consideration of promising alternative approaches. For example, a narrow and rigid view on the limits to fiscal deficits rules out consideration of the argument that in a situation of excess capacity it would make sense to run a fiscal deficit to boost aggregate demand and employment. Similarly, the notion that there may be circumstances where, in the face of low investment, the only way to kick-start growth would be to raise public investment through running a fiscal deficit. Such a strategy could be justified if these investments are growth enhancing through mechanisms such the crowding-in of private investment or expanding the productive capacity of the economy. Put more starkly, the current policy orthodoxy indiscriminately rules out the possibility of a more pro-active role of the state in stimulating a process of private sector-led process of capital accumulation and growth.

The point could be extended to one of whether the current external orientation of economic policies is resulting in the relative neglect of domestic demand as a source of growth and employment creation. Not all cases of trade and related liberalization have led to successful export-led growth. In the less successful cases, trade liberalization has led to the loss of domestic productive capacity without compensating gains in the expansion of export industries. While there are obvious questions of domestic and policy reforms that need to be addressed in such cases, it may also be necessary at the same time to consider whether enough is being done to tap domestic demand. The latter question arises because from a global perspective not all countries can successfully pursue export-led strategies at the same time. The same question arises even when initially successful export-led growth runs into the limits of international market competition as is the case of some East Asian economies after the financial crisis. This concern arises out of the possibility that an exclusive focus on achieving export-led growth could result in the neglect of potential sources of domestic growth. For example, the drive to increase international competitiveness through cutting wage costs may result in a net reduction of aggregate demand that impacts negatively on overall output and employment. At the same time there may well be untapped opportunities for raising productivity and growth in the domestic economy through supporting policies and the stimulation of domestic demand.

This is part of the more general point that liberalization and structural reform need to be pursued as part of a coherent overall development strategy and not seen as panaceas to be always implemented as broadly and as quickly as possible.

(iv) The Informal and Rural Economy

A coherent development strategy has to deal with the important issue of how the informal economy can be integrated into the economic mainstream. A major part of the answer lies with the implementation of a successful poverty reduction strategy. A large part of the activities in the informal economy in low-income countries are simply a manifestation of deep-seated poverty. They are there because the poor have no better alternative means of survival; they do not have the assets, skills, and employment

opportunities to do any better. This implies that meeting these deficits has to be part of the basic strategy for dealing with the problem of the informal sector. A key element of this strategy has to be a higher overall rate of growth of productive employment driven by a successful growth strategy. This is likely to have the most powerful effect in progressively eliminating the misery of the informal economy.

Within this framework, it will be important to pursue policies to raise productivity in the informal economy. This includes demand-side policies such as promoting linkages between informal and informal sector enterprises through sub-contracting and providing marketing support to informal sector firms. Supply-side policies such as small enterprise promotion, the increased provision of public services such as education and training, and micro-finance schemes are also important. The successful application of such policies will accelerate the integration of the informal economy into the economic mainstream while also raising aggregate demand and employment creation.

Over and above this, legal and regulatory systems will also need to be reformed to remove obstacles to the movement economic activity from the informal to the formal economy. Levels of taxation and business start-up costs will obviously need to be reviewed from this standpoint. It is also important to find ways of provide informal sector producers with secure property rights since without this they are denied access to credit and capital and their activities are insecure.

The basic social injustice faced by workers in the informal economy where national laws either do not apply or are not enforced will also need to be addressed. A key aspect of this is that fundamental worker rights such as freedom of association and the right to bargain collectively are rarely enjoyed in the informal economy. This deprives workers in the informal economy a basic means of self-protection against exploitation and of influencing local and national policies that affect them. Similarly, it will also be important to extend basic social protection to workers in the informal economy.

Enhancing the employment impact of globalization in the rural economy poses a serious challenge both in a national and in an international context (as the various discussions around the Doha development round, especially those on agriculture, have demonstrated). In a national context, the rural and agriculture sector still provides the framework for many countries to confront poverty and substandard employment, as the majority of the poor are living or working in this sector. However in order to develop and be competitive at the world market, the policy agenda is focused on the non-rural sectors. This poses an important challenge for designing coherent national economic and social policies in terms of how the rural sector can provide employment and adequate incomes for often the majority of the population, while at the same time contributing to structural changes required for a faster industrial development. Such questions need to be pursued further.

(v) Labour Market Policies

Labour market policies have the dual function of protecting the interests of workers while supporting the goal of achieving higher growth and employment creation. Finding the optimal balance between these two functions is a constant challenge that has become more difficult with globalization. However, where that balance should lie is ultimately a political decision and not a technocratic one.

There is a global consensus on fundamental worker rights and a basic role of labour market policies is therefore to ensure that these rights are protected and advanced. Among these rights are freedom of association and the right to bargain collectively. They are intended to give workers voice and participation on issues affecting their conditions of work and welfare. By extension they also imply that workers and employers organizations should have voice and participation in the determination of, at the very least, labour market policies. Social dialogue should thus be an indispensable feature of the institutions governing the labour market.

In the current context of globalization labour market reform is a topical and contentious issue. It needs to be addressed but through social dialogue rather than through unilateral decision and implementation by governments based solely on the advice of technocrats. A reform programme based on a consensus arrived at through dialogue with the social partners is likely to superior on several counts. There will be the support necessary for their successful implementation thus avoiding wasteful conflict and resistance. The outcome will also be fairer, since it represents the best possible compromise between competing interests. It is also likely to be more effective in overall terms since it is the outcome of a process that allows all the relevant information, on the economic as well as non-economic aspects, on the reform issues to be taken into account.

A key challenge for labour market policies is to facilitate adjustments in the structure of economic activity necessitated by increasing globalization. A basic stance in responding to this challenge should be to strengthen active labour market policies that enhance the capacity of workers to move from declining to emerging economic sectors. These policies should include a wide range of interventions such as i) anticipating and overcoming labour and skill shortages in particular sectors ii) remedying market failures such as those relating to labour market information, the provision of on-the-job training, and the inability of workers to borrow to invest in their own training iii) and iv) measures to facilitate redeployment such as retraining and job-search assistance. Such policies all make significant contributions to raising productivity and growth and should be more widely adopted in developing countries, especially middle-income ones.

The above policies are, however, unlikely to be able to take care of the needs of all displaced and other unemployed workers. They will therefore need to be supplemented by measures to support the labour market reintegration and provide relief to unemployed workers. These measures include various training programmes and direct employment creation through public works, enterprises creation, and the provision of hiring subsidies.

Another important set of issues relate to the problem employment security. Globalization is eroding employment security through a higher rate of job creation and destruction as well as through the increasing incidence of informal and precarious employment. The former aspect of the problem has been dealt with in the preceding discussion of active labour market policies. These policies, supported by macroeconomic policies that ensure higher overall rates of output and employment growth in the economy, are the best means of counteracting the problem. The problem of informal and precarious jobs would also be attenuated in such a context. However, this latter problem is also related to key aspects of protective labour legislation such as employment security provisions and the level and mode of financing of non-wage benefits. The growth of precarious employment could be interpreted as an indication that these policies are being increasingly evaded by enterprises facing increasing

competitive pressures because they impose excessive rigidity and high fixed costs. Equally, however, they could simply reflect increasing market power of employers and a drive for higher returns in the context of lax enforcement of the legislation. The reform agenda needs to examine both possibilities and bear in mind that if existing provisions are indeed found to be inappropriate simple deregulation is unlikely to be the best solution. This would leave legitimate needs for employment security unmet. The difficult challenge of finding a better way of meeting these needs has to be faced as an integral part of the reform process.

(vi) Social Security and Social Protection

In order to enhance the employment impact of globalization key issues relating to social protection and social security policies also need to be addressed. There seems to be ample consensus in the international community that in many circumstances a reliance on growth and its trickle down effects is often a process that is too slow to fulfil the current international demand for a sharp reduction on poverty by the year 2015. The challenges to the current Millennium goals are indeed that re-distributive policies, especially social transfers through some basic social protection systems are required if the goals are to be attained. Moreover, the effect of such social policies can be greatly enhanced if these were also to facilitate adjustment, smooth final demand to enable stable growth, and contribute to increased productivity and productive capacity. There are encouraging signs that social protection systems can indeed play such a role.

Better social protection systems makes workers more mobile and can hence enhance adjustment. Furthermore increased expenditure on social security in times of an economic slowdown allows for a more stable level of final demand, needed to stimulate growth as indicated in paragraph 4 iii above. Moreover if social security systems complement the labour market policies described above in paragraph 4 v, especially in contributing to skill enhancement and re-entry in the labour market of various categories of workers, productivity and production can increase.

Hence one can make a strong claim to include a dynamic social protection system and redistributive measures as an integral part of a set of policies to enhance the employment impact of globalization. The specific elements of such a system need of course to be worked in a national context as part of a coherent set of policies.