

The Brussels Economic Forum - Renewal in Europe

Protecting People or Protecting Jobs?

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1 Introduction

Thank you Ms. chairman. Globalization does challenge policy makers and citizens in Europe. If handled with care, we have a lot to win. However, if not, we may not be in a position to reap the benefits of globalization in the way we used to. To that end, the ability to adapt labour market policies and social models in an intelligent way will be crucial.

2 The challenge of globalization

Many have already painted the picture of globalization and its impact on our economies¹ so I will not repeat that.

But as we all know, the phenomena is not new. On the contrary, globalization has long been acknowledged as a main driver for

¹ It has brought about a number of long-term trends representing challenges and opportunities for Europe. *First*, the process of rapid growth of global demand due to the high growth in key emerging markets, notably China and India, is changing the economic world map. *Second*, the pattern of trade and investment is changing drastically. Whereas international trade has increased rapidly over the last decade, investment has grown even more, and both trade and investment flows are increasingly directed to countries previously not well integrated in the global economy. *Third*, production is becoming increasingly specialized and dispersed. Global sourcing of production and services is now a fact in many industries. *Finally*, the speed of technological change is increasing, putting an even higher premium on skills and education. Developed economies now face competition from emerging economies in high-skill industries demanding more focus on R&D and innovation to stay competitive.

growth. For example, a recent review by the European Commission suggests that as much as 30% of the gains in living standards in EU 15 since the 50's can be attributed to growing international integration. The common view is also that countries that have pursued protectionist policies have experienced lower economic growth than have more open economies.

Another, very important fact, is that **at the aggregate level** there is no evidence of net job losses resulting from globalization,^{2 3}. However, this is not to say that nobody gets hurt, because they do! Individuals, industries, regions are often hurt in the short run by necessary structural changes due to globalization and/or rapid technical changes. Thus, there is a wide spread fear that globalization means increasing job losses and downward pressure on wages. As a result, we see signs of increasing protectionism throughout Europe/the Industrialized world.

Among policy makers and academics, such reactions tend to be blamed on ignorance: People simply do not understand the wonder of openness. The fact that free movement of capital, goods and services and people will eventually result in a more efficient

² The European Commission: The Impact of globalisation on Labour markets in the EU".

³ Data for 15 OECD countries over the period 1900-2000 show that the high-import-competition industries within manufacturing only accounted for 4 per cent of total employment on average.

division of resources. From which we will all gain. At least in the long run.

Now, if ignorance is the problem, the solution is obvious. We simply have to illuminate people. This task is complex enough. However, protectionism is a rational response for individuals exposed to risk. Therefore, along with structural reform, the answer is also about risk management.

And, as put by Rodrik: *Intellectual arguments will not win hearts and minds unless there are concrete solutions on offer. Trade protection, for all its faults, has the benefit of concreteness.*⁴

3 The role of labour market institutions in this setting

So what are the most likely outcomes when it comes to necessary structural reforms on the labor market as a result of globalization, rapid technical changes or other sources that call upon reforms.

In the public and academic debate most arguments supports the idea that globalization will lead to a deregulation of the labour markets. A deregulated labour market (e.g. no minimum wage, less generous benefits, weaker unions and a minimum of labour

⁴ Rodrik (1997). *Has Globalization Gone too Far?* California Management Review, Vol. 39, No.3 Spring 1997.

market legislation) is regarded as the only way to avoid mass unemployment when economies are opened up for trade and are undergoing rapid technological change. In search of best practices in e.g. Europe, much focus has been on the “employment miracles” that has taken place in economies that have a deregulated labour market.

However, a growing body of economic research⁵ shows that a deregulated labour market may not be the only likely scenario. Looking at data there seems to be a positive relationship between the openness of an economy and the generosity of a variety of social welfare benefits and labour market characteristics. One explanation for the positive correlation between social protection and openness to trade is that more government intervention and social insurance is asked for when countries act under more volatile conditions. Thus, it is not unlikely that the European constituents’ desire for protection from economic volatility will remain due to further globalization and rapid introduction of new technology. And countries will probably be able to maintain distinct labour market regulations (if there is imperfect mobility of capital, labour, goods and services) if they are willing to bear the costs of those regulations. (One should bear in mind that the incidence of

⁵ See, for example: Agell J (1999) “On the benefits from rigid labor markets: norms, market failures and social insurance. *Economic Journal*, 109; Krueger A (2000) “From Bismarck to Maastricht: the march to European Union and labor compact. *Labor Economics*, 7. Rodrik (1997) “Has globalisation gone too far?” *Institute for International Economics*, Washington DC.

many social protections already falls on the workers.) How high these costs will be is of course important to monitor.

Here the developments of the Nordic countries are of interest to study. Why are they performing well despite its regulated labour market and large public sector? Perhaps, in line with the discussion above, both the stick and the carrot work when it comes to labour market regulations. A compressed wage structure, a generous social security system, active labour market policy, strong unions and minimum wages, can all be regarded as an insurance that increases people's willingness to take on risks and thus become more flexible and willing to take on necessary changes, such as occupational or geographical mobility.

4 The Political Economy of Structural Reforms

There is a need for reform throughout European economies. Yet, sufficient action has not been taken. In my opinion, the starting point must be that we can't expect people to embrace structural adjustment (following globalization) unless they have a good chance to participate. The challenge for governments is therefore to facilitate for people to adapt by providing institutions that insure their future opportunity. But this cannot be through short-term responses such as subsidizing industries, which are no longer

competitive or designing policies that discourage people from employment. Instead the role of governments is to provide people with the tools necessary to meet the challenges of globalization. Policy makers must focus on the employability of individuals. And to ensure that people can find employment, can earn a decent income from work, and are protected from poverty.

What does it actually take to launch structural reform? I guess the answer differs between countries, time periods and very important to recognize is the notion that one-size-does –not-fit-all. With that kept in mind, let me however provide you with a few observations from introducing structural reforms in Sweden.

Structural reforms usually come about due to two types of crisis:

- Crisis now (e.g. in the early 90's with a budget deficit over 10% of GDP and a three year period of negative growth. Everybody knew that something had to be done.)
- Crisis ahead (**Tax reform** when marginal tax rates over 100%, suspected tax evasion, and to small tax bases. **Pension reform** when the old one was no longer financial sustainable. Increase **labor supply** since we have the challenge of demography ahead of us.)

First, in Sweden politicians have had to spend a lot of time on being **pedagogical** on why reforms are necessary and they have to be very **clear and persistent** about their message. Our experience is that people can accept a lot of hardship as long as they understand the reason why.

One starting point could be to establish an awareness of the problem by providing the public with a solid and transparent analysis of the problem. An independent commission is best suited for such an analysis.

Second, Politicians have to recognize that most people are risk-averse and worry about changes. Our experience is that people have to feel reasonably secure if they are to accept necessary structural changes. Losers have to be compensated or you have to make sure that everybody loses!

In Sweden we are partially relying on, what we call, “*social bridges*” to enable people to move from old to new sectors, from old to new occupations. These bridges involve unemployment insurance to protect people against income losses combined with strong gate keeping and adherent sanctions, ALMP (to increase their productivity and to test people's willingness to work) and a strong emphasis on job seeking. Our experience is that this helps people to accept necessary changes.

Third, our experience is that reforms are best introduced as a package, where people feel that everyone contributes and bear some of the burden. Different separate ad-hoc measures will only have limited chance of success. By presenting reforms in a package, it becomes clear to pressure groups that they are not the only ones asked to make sacrifices.

To conclude

First, structural reforms in Europe are necessary in order to reap the benefits of globalization in the way we used to! But it is also necessary to remember that structural changes are always necessary in an Economy, not just due to globalization.

Second, make people accept changes I think politicians have to provide people with tools to adapt by providing institutions that secure their future opportunities.

Third, we need much more research on these matters. One important questions to ask would be; What works and what does not when it comes to institutional design and employment? We do know that institutions interact, but not how. This means that countries can learn from each other. However, it probably also means that there is no *one-fits-all* solution. We cannot borrow one par-

ticular institutional feature from one country as it may perform differently depending on the overall institutional setting.

To shed some light on this question I think the LMWG under the Economic Policy Committee can be of significant help since we have a new database that gives information of structural reforms that takes place in the EU community.

At last, my own personal answer to the question in the headline of this session is unambiguously Protect People not Jobs!!