The Two-way Interaction Between Globalization and Labour Market Policies

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ABSTRACT  Labour market and social policies both affect and are affected by the process of trade liberalization and globalization. This two-way interaction and the feedback effects are the focus of this paper. The analysis is mainly conceptual—but examples are illustrated throughout, based mainly in the context of labour markets in North America, Latin America and the Caribbean basin. Attention is paid to outlining the mechanisms whereby globalization and trade liberalization affect labour market and social policy initiatives, and the extent to which these pressures will lead to a harmonization of legislative and policy initiatives, and if that harmonization will necessarily be downward to the lowest common denominator. The paper concludes that: (1) the pressures will lead towards policy harmonization; (2) the harmonization generally will be downwards; (3) such harmonization is not always negative as generally perceived; (4) efficient regulatory and social policy initiatives will survive and indeed expand, with the “rent-protecting” ones under most pressure to dissipate; and (5) pure distributional or equity-oriented initiatives that have no positive feedback effect on efficiency, unfortunately, will also be under jeopardy to dissipate, and this is a serious policy concern. Alternatives for addressing this concern are discussed, as are their associated problems.

1. Introduction

From a labour market perspective, the impact of trade liberalization is conventionally analysed in terms of its adjustment consequences for labour and how they affect such outcomes as wages, employment and wage inequality. This is leading to an increased demand for policy initiatives to deal with the adjustment consequences of trade liberalization and economic integration. At the same time, however, the ability of governments to supply such initiatives may be increasingly constrained by the forces of trade liberalization and globalization (hereafter usually referred to as either liberalization or globalization). This growing demand and decreasing supply of policy initiatives is creating a tension—albeit, we later argue, a healthy tension—that calls for creative initiatives in the policy-making process with respect to labour market issues. It also calls for a deeper understanding of the underlying causal mechanisms that link
globalization and social policy, and the two-way interaction whereby social policies both affect and are affected by the globalization process.

The purpose of this paper is to analyse this two-way interaction—the impact of social policy on the liberalization process and the impact of liberalization on the social policy-making process. The analysis will focus on the conceptual level, with examples used for illustrative purposes, drawn mainly from experiences in labour markets in North America, and particularly in Latin America and the Caribbean basin. The paper begins with a discussion of the effect of social and labour market policy on the process of liberalization and globalization. It then turns to the effect of globalization on the social and labour market policy-making process, outlining the mechanisms whereby globalization affects labour market and social policy initiatives, and the connections that are necessary for governments not to be able to sustain such initiatives.

The analysis is conducted in the broader context of both the deepening and widening of economic integration under globalization. The deepening refers to the various dimensions of integration, including trade liberalization, capital flows, foreign direct investment, labour and human capital mobility and technology transfer. The widening refers to the spatial aspect involving extensions across broader regional dimensions.

The labour market initiatives relevant to this context include:

- Collective bargaining legislation governing the collective bargaining process.
- Employment standards legislation in such areas as minimum wages, hours of work, advance notice and termination requirements.
- Anti-discrimination and human rights legislation.
- Health and safety and workers’ compensation.
- Income maintenance programmes like unemployment insurance.
- Adjustment assistance programmes in such areas as training, mobility, job search and labour market information.

2. Effects of Labour Policies on the Labour Adjustment Process

The effect of labour market and social policy initiatives on the labour adjustment process depends in large part on the nature of the policy initiative. In that vein, it is important to make a distinction between active adjustment assistance and passive income maintenance programmes (Gunderson & Riddell, 1995).

2.1 Active Adjustment Assistance

Active adjustment assistance programmes facilitate the workings of markets and encourage adjustment in the direction of basic market forces, often from declining sectors and regions to expanding ones. For that reason, such policies can deal with adjustment consequences on both the “down side” (plant closings, layoffs, underemployment) in the declining sectors and regions as well as the “up side” (labour shortages, job vacancies, skill bottlenecks) in expanding sectors and regions.

Active adjustment assistance policies generally include ones that enhance human capital formation, such as education, training, mobility and job search. The provision of labour market information is an important component of that adjustment process, especially as it can facilitate the optimal amount of human capital formation by indicating the education and training needs and the location of job openings to facilitate job search and mobility.
With respect to human capital formation, a key question is: What is the appropriate role of the different stakeholders (employers, employees and their representatives, and governments) in the financing and provision of these programmes? Governments run the risk of unnecessarily spending scarce resources on initiatives where the private parties themselves have an incentive to invest. This can lead to a displacement of private sector activity if, for example, governments support training programmes that would have been undertaken by employers in the first place. It can even lead to perverse results if, for example, government spending on elite higher-level education fosters a brain drain of the very people who could most help internal development.

In that vein, governments should focus their intervention on areas where there are well-defined market failures in the provision of such adjustment assistance initiatives. That is, rather than asking: What adjustment programmes seem to foster competitiveness and the efficient allocation of labour?—the question should be: What are the well-defined market failures that inhibit the private parties themselves from undertaking adjustment initiatives that foster the efficient allocation of labour? Research efforts should help to identify those market failures.

It is well known, for example, that the private market fails to provide the socially optimal amount of labour market information, given that such information has public goods characteristics; the benefits are generally available to all users with the use by one not detracting from the use by others and it is not feasible to exclude non-payers from using the services. Obviously, private markets can and do exist in this area as evidenced by executive placement agencies. Nevertheless, the public goods nature of much of the information merits an important role for governments, certainly for the general workforce.

Similar issues apply to the well-known poaching problem that applies in the area of training that is generally usable in a wide range of firms. Such broad-based generic training is increasingly regarded as important given the market needs for flexibility and adaptability. Private firms may not have an incentive to pay for such training for their employees since they run the risk of losing their trainees to other firms that do not train but simply poach by offering a higher wage. In such circumstances the firm that provides the training may pay double, first for the training and then for the wage premium necessary to retain the trained employee. Workers have an obvious incentive to pay for such training (perhaps by working for a lower wage in return for the training) since they reap the benefits through the higher wage. However, they may be reluctant to pay given the uncertainty over the returns from such an investment over which they have little control, and they may not be able to pay for such training because of liquidity constraints. Furthermore, they may not be able to borrow to finance otherwise profitable training because of a capital market imperfection, whereby they cannot use their human capital as collateral to finance the loan since banks cannot repossess the human capital in the event of a default. Also, there is a moral hazard problem in that they can influence the returns to their investment depending upon their subsequent work decisions.

What is less emphasized is the potential market failure that can exist with respect to innovation in the area of developing efficient workplace and human resource practices internal to firms. Firms may not have sufficient incentive to innovate in this area of developing “best practices”. They would bear the full cost of such innovation but they cannot reap the full returns since the successful ones would be quickly emulated by other firms, including their competitors. Innovating firms would have only some short-run advantage until competitors “caught up”. The problem essentially arises because innovations in the workplace cannot be patented, unlike innovations in product
markets. In such circumstances, private markets will yield less than a socially optimal amount of innovation with respect to workplace and human resource practices internal to firms, just as they would yield less than a socially optimal amount of innovation with respect to product development if patents did not exist. Even if a successful workplace innovation occurs, it may not be diffused optimally to other workplaces since the innovating firm has an incentive to hide the success, especially from competitors.

These examples are simply meant to illustrate possible market failures with respect to active adjustment assistance programmes that could otherwise enhance productivity and competitiveness by “greasing the wheels” of markets and facilitating adjustment in the direction of market forces. By focusing their intervention efforts in such areas of well-defined market failures, governments can ensure that their scarce resources are not dissipated and that their actions do not simply displace actions that would have occurred in the private market in any case.

2.2 Passive Income Maintenance Programmes

Passive income maintenance programmes provide income support or insurance for those who are adversely affected by the adjustment consequences of liberalization and globalization. In contrast to active adjustment assistance programmes which facilitate and encourage adjustment by providing assistance only if there is an adjustment in the direction of market forces, passive income maintenance programmes can discourage adjustment in the direction of market forces by providing income support when there is no adjustment. They encourage the “stay” option by supporting the stay decision, in effect blunting the market incentives to adjust.

By discouraging constant marginal adjustments (e.g. mobility of younger persons or persons who are willing to move or change jobs), passive income maintenance programmes can lead to a build-up of latent pressures that are likely to lead to more severe and costly inframarginal adjustments if the adjustment inevitably occurs. Such inframarginal adjustments can occur in such forms as mass layoffs or plant closings affecting whole communities and older workers with families.

Passive income maintenance programmes include unemployment insurance and social assistance or welfare payments. Government bailouts of failing firms (perhaps to save the jobs in those firms) can also be thought of as an indirect income maintenance programme. Ironically, some of these programmes, like unemployment insurance, can also discourage marginal adjustments in such areas as reduced hours or wage concessions as mechanisms to absorb negative demand shocks. This is because the income support is provided only in the event of the all-or-nothing unemployment event concentrated in the hands of a few, not for more marginal adjustments to wages or hours spread over the firm’s workforce. The same can apply to bailouts if they inhibit wage concessions and hours reductions if a bailout is anticipated.

2.3 Safety Net to Reduce Resistance to Change

Even passive adjustment assistance programmes that inhibit adjustment from declining to expanding sectors or regions can facilitate overall market adjustments by reducing resistance to otherwise efficient changes, such as those associated with globalization, trade liberalization and technological change (Blank, 1994; Rodrik, 1997). In effect, they may provide a “safety net” that makes workers more willing to accept change because of the insurance that is provided. Some programmes, such as unemployment insurance, may also be used to finance efficient job search (Berry, 2001, p. 25). In
essence, equity and efficiency need not clash—indeed, equity may facilitate efficient change. While passive income maintenance may provide a “safety net”, active adjustment assistance programmes can go one step further in fostering efficiency by providing a “trampoline” effect, enabling those who are adversely affected to bounce back into the labour market.

The degree of employment security provided to Japanese workers through their lifetime employment system, for example, contributes to their willingness to accept—indeed embrace—technological and other changes that would otherwise jeopardize their jobs. In such circumstances, employees provide loyalty and commitment to their organization in return for the commitment given to them as employees. Such long-term employment prospects with the same firm also facilitate firms’ investing in the training of their employees.

2.4 Quasi-fixed Employment Costs

Many labour policies can have a quasi-fixed cost component attached to them in that they increase the fixed costs associated with hiring a new employee. Such costs are not incurred if the incumbent employees work longer hours or more intensely, or if non-standard employees (limited-term contracts, subcontracting, self-employment, temporary help agencies and some part-time employees), who are not associated with such fixed costs, are utilized.

The fixed costs can arise because of natural reasons associated with recruiting, hiring and training new employees; but they can also occur from legislative initiatives (common in Latin America) that increase the costs of terminating employees’ contracts (e.g. advance notice, severance pay and the possibility of unjust dismissal claims). Such costs of terminating employees’ contracts become quasi-fixed costs at the hiring stage since, in the decision to hire a new employee, employers build in the expectation that they may have to terminate that employee’s contract and incur these quasi-fixed costs. In such circumstances, in the face of demand expansions that may be uncertain, the employers may rationally be reluctant to hire new employees (Amadeo & Horton, 1997, p. 11). Instead, they expand the hours of their existing employees (even if that means premium overtime pay), or increase the intensity of their workload (even if that means stress and morale problems), or use subcontracting or temporary help agencies (even if that is expensive).

Quasi-fixed costs of hiring new employees may also arise if payroll taxes have a ceiling beyond which no further taxes are paid. This can be common for unemployment insurance or workers’ compensation or pension plans. If the payroll tax is simply a percent of payroll or earnings then the same amount of tax is paid whether the firm expands by hiring more workers or working the existing workforce longer hours. However, if there is a ceiling beyond which no further tax is paid for an employee, the firm has an incentive to work that employee longer hours (and not pay any more payroll tax) rather than hiring new employees (and having to pay the payroll tax).

In effect, such legislated quasi-fixed costs of employment may bias the labour market adjustment process towards amortizing those quasi-fixed costs over longer hours and more intense working conditions for incumbent employees, and away from hiring new employees to meet demand expansions. This phenomenon may be increasing to the extent that these legislative quasi-fixed costs have increased, and to the extent that liberalization and globalization have increased the uncertainty over whether demand expansions are long term. This in turn can account for greater reliance on non-standard employment on the one hand, and longer hours and more work intensity
of the core workforce on the other hand, so as to absorb demand fluctuations. In effect, the more the existing workforce is protected by labour legislation, the greater the degree of bifurcation or polarization between the core workforce of the formal economy and the peripheral workforce of the informal economy.

2.5 Multiple Role of Wages in Serving Market and Social Objectives

Labour market policies often alter wages as an element of social policy. Minimum wages, for example, are designed in part to alleviate poverty and, sometimes, to provide an incentive for persons voluntarily to leave income maintenance programmes for the higher market wage. “Fair wage” legislation may require employers to pay a certain wage if bidding on government contracts. Wage control programmes can be instituted by governments to control inflation. Equal pay for equal work laws can require that females be paid the same as males in similar jobs, or in the case of pay equity or equal pay for work of equal value, that they be paid the same as in male jobs of equal value as determined by gender neutral job evaluation systems.

All these policy initiatives serve legitimate social purposes; but they use the wage as the mechanism for achieving social objectives. As such, wages are called upon to serve various social purposes: alleviate poverty; provide “fair wages” or “living wages”; curb inflation; facilitate macroeconomic stability; and redress discrimination. Wages are also called upon to serve a variety of market functions: to allocate labour to its most efficient use; to encourage human capital formation by investing in education, training, job search and information; to reduce labour shortages; and to reward merit and encourage work effort. Wages also often have a status function both in society and in the workplace. In the case of efficiency wage premiums wages may affect productivity as well as being a payment based on productivity. In such circumstances, when a single instrument or price—in this case the price of labour—is called upon to serve so many functions, it is not surprising that it may falter in achieving these objectives.

Altering the wage mechanism to curb poverty is particularly questionable given that poverty is largely an issue of the gap between family needs and family income. Wages only relate to the family income component and that depends upon the lifetime wages and employment of different family members as well as non-labour income. Using minimum wages to curb poverty, for example, is at best an exceedingly blunt instrument (Benjamin, 2001), since it affects the wages of only one family member, their low wages may be a temporary phenomenon associated with being a youth, they may be in a family of multiple earners, and they may have high non-labour income. Furthermore, it may have perverse effects if it reduces the employability of the person (Riveros, 2001) or deters them from taking a low-wage job in return for training that may enhance their future lifetime earnings. In such circumstances, it may be best to allow the wage mechanism to serve its market functions in the hope that this will enhance productivity and reduce the need for social programmes in the first place.

2.6 Importance of Internal Efficiency as a Precondition for External Competitiveness

In the more integrated global economy with trade liberalization, there is growing recognition that it is crucial that labour and social policies within a country (or region) enhance internal competitiveness as a precondition for the country or region being externally competitive with the global economy (Gunderson, 2001). In essence, there is a growing premium on reducing the internal barriers to competitiveness within countries or regional trading blocks.
There are a variety of areas where this can be done in the labour policy area. Harmonization of credentials and skills or trades or education standards can facilitate the internal mobility of labour from declining sectors and regions to expanding ones within a country or region. This can occur in the form of standardized credentials or mutual recognition of credentials, as well as in removing barriers created by unnecessary occupational licensing, including residency requirements. Eliminating government procurement policies that favour local bidders fosters their efficiency and reduces the cost of providing public infrastructure. Eliminating excessive public sector pay premiums can also save on the cost of providing public infrastructure and reduce any spillover effect that any excessive public pay premium may have on private sector wages, as well as the bifurcation that often exists between protected public sector jobs and private sector jobs. Governments getting their own “house in order” can be an important precondition for expecting other employers to be competitive. Removing the internal tariff and non-tariff barriers to trade within a region can foster the internal efficiency and economies of scale that may enable the region to compete with other emerging trading blocks. The controversial privatization and deregulation policies, properly handled, can also foster internal efficiency. Providing labour market information that is broadly based across the country or regional trading block can foster internal mobility and efficiency.

Clearly, there is a wide range of labour market policies that can facilitate internal competitiveness within a country or within regional trading blocks, and these can foster international competitiveness. This is obviously crucial under globalization and increased trade liberalization.


The previous discussion focused on the effect that labour market and social policies can have on the competitiveness of a country and hence on its ability to compete in an increasingly integrated world under globalization and trade liberalization. This section focuses on the relationship in the other direction—the effect of globalization on a country’s labour market and social policies. The emphasis is on outlining the various mechanisms whereby globalization affects a nation’s labour market and social policy. This, in turn, will shed light on the key issue addressed in a subsequent section: whether the pressures will lead to the loss of the ability of nation states to sustain independent labour and social policies, leading to harmonization to the lowest common denominator.

3.1 Inter-jurisdictional Competition for Investment and the Associated Jobs

In a globalized environment with freer trade and capital mobility, countries will be under increased pressure to compete with other countries for business investment and the jobs associated with that investment. With reduced tariffs and reduced foreign ownership restrictions, employers are more able to locate their plants or to outsource in different countries, connected by sophisticated communication and transportation systems, and to export throughout the world. Financial capital is also more mobile and quick to take advantage of arbitrage opportunities.

In such circumstances, countries are under more pressure to compete for that business investment and the associated jobs. One way to compete is to reduce costly regulations including those associated with labour and social policies. In effect, at the
political bargaining table where social and labour policies are negotiated, business (especially multinationals) have more clout because of their more credible threat of relocating their investment (Langille, 1996).

In theory, this should lead to “Tiebout-type” sorting (Tiebout, 1956), where individuals and firms locate in part on the basis of tax-expenditure “packages” (including policy packages) that best match their preferences and needs. Firms that want minimal labour regulations but perhaps are willing to pay for public infrastructure, for example, would locate in jurisdictions that provide such tax-expenditure packages. In practice, of course, such markets are likely to be extremely “thin”, not characterized by large numbers of competitive buyers and sellers. Nevertheless, there is likely to be some sorting along a spectrum ranging from low regulations and taxes with low public services and infrastructures to more regulations and taxes in return for more public services and infrastructures.

3.2 Emulation of Best Practices by Organizations and Policy-makers

The process of economic integration through trade liberalization and foreign investment increases interaction across countries. Such interaction in turn fosters the emulation of “best practices” across organizations (Chaykowski & Gunderson, 2001). Unfortunately, best business practices may not mean best social practices. In some cases, they may coincide. If, for example, training or health and safety practices are particularly effective in one country, they are more likely to be adapted by trading partners or through the process of foreign direct investment. However, other practices that may be effective from a business standpoint, such as outsourcing to contractors who evade minimal labour standards, may not advance social objectives.

The emulation of best practices across more integrated economies may also occur in the policy arena. The greater interaction that occurs across countries provides more information to policy-makers on what works and what does not work in all phases of the policy process—design, implementation and enforcement.

The increased integration fostered by trade liberalization and globalization can promote policy integration in a variety of areas pertaining to product standards, environmental standards, patent protection, intellectual property rights, common currency and common security concerns. In such circumstances, it is easier to foster the standardization of policy initiatives with respect to labour standards and labour policy initiatives.

3.3 Behaviour of Multinationals

Multinationals are more prominent under trade liberalization and globalization and the behaviour of multinationals becomes an important mechanism affecting labour and social policy (Gunter, 1992). In general, the wages and working conditions of multinationals in the host country in which they operate are better than the wages and working conditions of domestic employers; hence, they reduce the need for labour and social policies to improve such wages and working conditions.5

This behaviour reflects a carry-over of multinational corporation (MNC) behaviour in their home-base country where wages and working conditions are generally better than in the host countries in which they operate. More importantly, however, it reflects a concern for their brand name and public image in the global product market—an image that can be tarnished by expossé of bad working conditions. Generally, we think of the demand for labour as being a derived demand—derived from the demand for the
products produced by firms and hence affected by the product market conditions under which products are sold. In the case of brand-name multinationals, the process also works in the other direction. The demand for the product is in part derived from the demand for labour and hence affected by the labour market conditions under which the product is produced. Brand-name multinationals live by their image—hence they are also vulnerable to dying by their image. This is recognized by social activists who can credibly threaten to discredit multinationals if they provide bad wages and working conditions.

In such circumstances, multinationals may try to distance themselves from the conditions under which products are produced by outsourcing to domestic producers who may be more willing to produce under “sweatshop” conditions. Even here, however, multinationals can be vulnerable if those linkages are made public.

Although there is considerable controversy in this area, multinationals generally reduce the need for labour and social policy initiatives by improving the wages and working conditions in the host countries in which they operate. Furthermore, they are more vulnerable to enforcement pressures.

3.4 National Treatment Requirements in Trade Agreements

National treatment requirements in trade agreements can provide another mechanism through which trade liberalization affects domestic labour and social policies. Under such requirements, countries that impose regulations on imports are required to impose those same regulations on similar domestically produced products. The intent of such requirements is to inhibit such regulations on imports as being used as a non-tariff barrier to trade.

3.5 Countervailing Duties for Social Programmes that may be Interpreted as Subsidies

Countervailing duties in trade agreements can be another mechanism through which trade liberalization affects domestic labour and social programmes. Such duties can be imposed on imported goods if they are seen to have subsidies provided by the exporting country. The intent is that the countervailing duties imposed by the importing country would offset the cost reduction associated with the domestic subsidies of the exporting country and hence provide a “level playing field” for domestic producers in the importing country.

To the extent that labour and social policies in the exporting country could be interpreted as providing an “unfair subsidy” to exports, then the threat of countervailing duties could exert pressure to eliminate such policy initiatives. Establishing the “subsidy” component of such exports is difficult, however, since many of the policy initiatives are paid out of general tax revenues. It would not be feasible to argue, for example, that the exports of a country embodied government education subsidies, in part because that component could not readily be determined and in part because the subsidies would come out of general tax revenues and hence involve higher tax costs.

3.6 Migration and Labour Mobility

To the extent that migration and labour mobility are enhanced by globalization and economic integration, they can have a complicated effect on labour and social policies. Since migration generally involves moving away from areas of low wages and poor
working conditions towards areas of better economic opportunities, such migration can reduce the need for social policies in the economically depressed areas.

Migration, however, can also involve the “best” individuals leaving an area, as in the case of the brain drain or simply the most motivated and talented people—the very people who could otherwise foster the development of the area they leave.6 In such circumstances, migration can be destabilizing, inducing a more rapid decline in the region they are leaving and fostering pressure to provide social programmes for such regions.

Migration can also occur to take advantage of more generous social programmes if there are no residency or other requirements to inhibit such opportunistic migration. In such circumstances, jurisdictions may be reluctant to provide such social programmes since they would simply serve as a “magnet” to attract migrants, and they would repel taxpayers who would have to pay for the programmes. Such a process would make it difficult for a progressive jurisdiction to sustain its generous social programmes.

4. Linkages that are Necessary for Downward Harmonization

The previous discussion focused on the various mechanisms whereby globalization and economic integration affects a nation’s labour market and social policy. This section focuses on whether this process will lead to the loss of the ability of nation states to sustain independent labour and social policies, and if so whether there will be downward harmonization to the lowest common denominator.

In general, the mechanisms discussed were ones that would pressure countries to place more emphasis on the cost consequences of the labour market and social policies. This was particularly to attract capital and business investment and the jobs associated with that investment, and to ensure that their policies were not considered as subsidies to their exports or to attract migrants. In that vein, the harmonization would generally be downwards towards the lowest common denominator—the country that imposes the least excessive regulatory costs.

There are various linkages, however, that are necessary for such downward harmonization of labour laws and policies to occur (Gunderson, 1998a, 1999). Specifically, the laws must be enforced; they must impose a net cost to employers in that the costs must exceed the benefits; the costs cannot be shifted backwards or forwards; firms must respond to these costs in terms of their investment and plant location decisions; and countries must respond to this threat by adjusting their labour and social policies. Each of these linkages will be discussed.

4.1 Policies Must be Enforced

It is well known that labour policies that are “on the books” may not be enforced and there can be a huge gap between de jure and de facto in this area.7 Laws may be passed to give a good appearance to the public and the international community, but they may not be enforced for various reasons. Strict enforcement may discourage business investment. It may also consume scarce government resources, and it may simply be too costly for some governments to enforce strictly the labour laws. Enforcement may also give governments some discretion to enforce in selective situations, but to not enforce in others. Not enforcing laws that are passed, however, can also encourage disregard for the rule of law in general, and this can have obvious repercussions. Since enforcement is more difficult in the informal sector and for non-standard jobs, employ-
ment may shift to the uncovered informal sector and towards non-standard employment in response to legislative initiatives in the formal sectors.  

4.2 Laws and Policies Must Impose Net Costs to Employers

Even if laws are enforced, they must be costly to employers to discourage investment. While labour laws are generally costly to employers, they can also yield benefits that can offset at least part of the costs. In essence, it is the net costs that will influence employer behaviour.

Policies that require advance notice in the case of layoffs or plant closings can enable efficient job search that can benefit other employers. Health and safety regulations can reduce costly accidents. Pension regulations can ensure the viability of employer-sponsored pensions. Anti-discrimination and human rights policies can enhance employee morale and reduce discord over diversity at the workplace. In a global market-place, accommodating diversity can be “good business” given the diversity of the supplier and customer base.

Other policies can provide a public infrastructure that facilitates competitiveness. This can be the case with human capital policies that support basic education, training, job search and labour market information. Regulations on hours of work and overtime can reduce accidents and perhaps unemployment by “sharing” the work.

Other labour and social policies can save on public and private expenditures elsewhere in the system and hence on the tax costs of providing such services. Health and safety regulations can reduce health-care expenditures. Advance warning legislation can save on unemployment insurance expenditures. Social policies in general can “buy” social stability and save on the incredible social expenditures that arise from tensions between the “haves” and the “have nots” (Berry, 1997; Gindling & Berry, 1992, p. 1612).

4.3 Costs Cannot be Shifted Backward or Forward

For labour policies to impose costs on employers, it must also be the case that the costs cannot be shifted backward to employees or forward to consumers. In many cases, however, the costs can be shifted backwards to employees in the form of the acceptance of a lower compensating wage in return for the benefit of the policy (Ehrenberg, 1994; Gunderson & Riddell, 1995). This can be the case, for example, with a health and safety regulation that yields a safer workplace. It can also be the case with payroll taxes that are levied on employers for such programmes as pensions, unemployment insurance and workers’ compensation (Kesselman, 2001).

Shifting costs forward to customers in the form of higher product prices may be more difficult in a world of trade liberalization and global competition where customers have alternative markets. Nevertheless, even if markets are lost because of cost shifting, this is entirely appropriate if the higher cost of the regulation reflects the true social cost of producing the product. This can be the case, for example, with respect to health and safety regulation and payments for workers’ compensation—the product price should reflect the true social cost of producing the product, including the social cost of workplace accidents and diseases.
4.4 Firms Must Respond to the Costs in Terms of their Plant Location and Investment Decisions

Even if the labour laws are enforced, imposing net costs on employers which cannot be shifted backward or forward, for such costs to lead to downward harmonization employers must respond by not locating plants or investments in countries that are associated with such costs. Unfortunately, there is very little evidence on the extent to which plant location and investment decisions are affected by such costs of labour regulations and social programmes, compared with other factors such as access to markets or resources or transportation costs, taxes or regulations in other areas (Gunderson, 1998b). The issue is further complicated by the fact that labour regulations are often associated with other factors that can attract investment, such as enforceable contacts, law-and-order, a public sector infrastructure and established property rights. Employers may willingly accept some costly labour regulations when they are bundled with these other aspects that make countries attractive from a business perspective.

4.5 Jurisdictions Must Compete for the Investment on the Basis of Reducing Regulations

Even if costly labour regulations deter business investment, for that to lead to downward harmonization of labour regulations and social policies, countries must want to compete for that business investment and the associated jobs by reducing their labour laws and social policies. They may do so, but they may not, if they are willing to “pay the price” of their policy initiatives by forgoing such investment. They may collectively not want to compete on the basis of what they may consider as socially unacceptable labour and social standards. If that means lost trade and investment opportunities, that is a price worth paying for sustaining independent labour and social policies.

This collective decision could come from a democratically elected populace that willingly accepts, for example, a smaller economic pie that is more equitably shared. Or it could come from political élites who control a country and have more to gain by not having their economy open to globalization and foreign investment.

4.6 Summary of Linkages

While globalization and trade liberalization put pressure on governments to reduce their costly labour and social policy initiatives, for that pressure to lead to a harmonization of policies to the lowest common denominator the following linkages must prevail: the policies must be enforced in a manner that imposes cost; the costs of the policies must not be offset by their benefits; the costs to employers cannot be shifted backward to labour or forward to customers; the costly regulations must influence the investment and plant location decisions of firms; and countries must compete with each other for the investment and associated jobs by reducing their labour and social regulations. A break in any one of those linkages can break the connection that would lead to downward harmonization to the lowest common denominator.

While these linkages are not all likely to prevail, the fact remains that they are more likely to be prominent under globalization, trade liberalization and broader and deeper economic integration. Many policies are enforced; the costs likely exceed the benefits to employers (otherwise they would not resist their existence and generally oppose such regulatory initiatives); the costs cannot be shifted fully backward to workers or forward to customers; the regulatory costs do influence investment and plant location decisions;
and countries (and even jurisdictions within countries) do compete for the investment and associated jobs by paying attention to their costly labour and social regulations. Hence, the pressure is likely to be towards the harmonization of labour and social policy initiatives and that harmonization is likely to be towards the lowest common denominator.

5. The Positive Side of Policy Harmonization

The previous discussion has highlighted what is generally regarded as a negative effect of globalization and trade liberalization—it will be more difficult for countries to maintain their independent labour market and social policies in the face of pressures for downward harmonization. As indicated, this is likely to occur. However, there is also a more positive aspect to such pressures.

First and foremost, the policies that are likely to dissipate are those that have no positive feedback effect on efficiency and competitiveness. As discussed, many of the policy initiatives do have such positive feedback effects, and such policies are likely to survive—indeed thrive—under globalization (Gunderson et al., 2001, p. 64). Furthermore, they are likely to be emulated and adopted as best practices by other countries once their positive effects become apparent, leading to the possibility of upward harmonization with respect to the policies.

In contrast, regulations that purely protect the rents of interest groups are most likely to dissipate since they are not efficiency enhancing. It is the case that pressures from globalization and trade liberalization may stop governments from doing things they want to do, but it can also stop them from doing things they “ought not to do”. Entering into that arena can be taken as a form of pre-commitment whereby governments reduce the freedom they have in their policy-making process, compelling them to focus on efficiency-enhancing regulations.11

Governments can obviously still follow whatever policies they choose12—whether those choices are driven by the general population or élites who control the political process. The cost of those choices is now made more explicit in terms of their effect on investment and the associated jobs. The costs are not as hidden behind tariff walls or devalued currencies.

Multiple equilibria are possible in the policy-making process, just as they are in market processes. Some countries may provide an extensive public infrastructure in return for higher taxes and more extensive regulations, while others provide the opposite. These optimal combinations may also differ depending upon a country’s stage of development and they may change as their impacts become more apparent. For example, a less developed country may try to compete in the global market-place by providing a low-tax, low-regulatory environment to attract investment and jobs. If this process enhances growth and development, part of the increased wealth may be diverted to social programmes and improved labour standards, especially if it is apparent that sharing in the gains ensures that they will continue into the future.13

This rather rosy picture of a policy-making process constrained by market forces under globalization and trade liberalization is subject to an important caveat—and it is a caveat that may be the Achilles heel of this process. Pure equity-oriented distributional policy initiatives that have no positive feedback effect on efficiency will be difficult to sustain in this environment for reasons outlined earlier—they may serve as a magnet to attract recipients and repel those who would pay in the form of taxes or regulations. Yet such initiatives are entirely appropriate for governments—indeed they may be the prime role for governments. Furthermore, the evidence suggests that the
market-oriented changes associated with globalization, trade liberalization and technological change are leading to increased labour market polarization. In essence, the demand for policy initiatives to deal with the adjustment consequences of the market-oriented changes is increasing just at the same time as the ability of governments to provide those initiatives is being circumscribed by the same forces.

To the extent that these issues are beyond the purview of any one government, international responses are appropriate, but these will be difficult given the reluctance of governments to yield sovereignty in these areas. A wide range of international initiatives have been proposed, but all have associated problems. Labour standards can be imposed as part of trade agreements to restrict competition based on poor labour standards, but these are generally regarded by the developing countries as thinly disguised protectionism on the part of the developed countries that push for such standards (Bhagwati, 1994). Labour side accords, such as the NAFTA accord, require trading partners to enforce their own internal labour regulations, but again this is often regarded as a form of protectionism on the part of the more developed countries since they already tend to enforce their labour laws. They are also often thought of as a largely token, non-enforceable requirement, although they can provide the foundation for subsequent initiatives (Abbott, 1995). Corporate codes of conduct (Compa & Darricarré, 1996; Blainpain, 2000) and multinational “best practice” guidelines (Blainpain, 2000; Teubner, 1997) can raise labour standards, but these are voluntary and may not get at the worst practices from outsourcing to domestic producers. Consumer boycotts against products produced under “sweatshop” conditions can be effective against brand-name products (Erickson & Mitchell, 1996), but these can be difficult to enforce and they target only some producers. Social labels indicating the conditions under which the products were produced can enable consumers to make informed choices and make purchases based on what they perceive to be the social content of the product (Freeman, 1994). A more extensive form of international assistance would involve “social funds” being transferred from wealthier countries to poorer countries that are part of trade pacts (as occurs in the European Union) to enable the poorer countries to harmonize their social policies upwards towards those of the wealthier countries (Sapir, 1996).

Each of these initiatives can have some effect on improving labour standards and social policy that otherwise may dissipate under globalization and trade liberalization; but they all have associated problems ranging from ineffectiveness to thinly disguised protectionism if they are effective. The hope, of course, is that the efficiency gains arising from globalization and trade liberalization will become more widespread across the population, perhaps assisted by active adjustment assistance programmes. If this does not occur, then the policy challenge will be to deal with the increased inability of governments to sustain pure equity-oriented policies—the old efficiency–equity trade-off in an international form.

6. Summary and Concluding Observations

Labour market and social policies both affect and are affected by the process of trade liberalization and globalization. This two-way interaction has important feedback effects for both labour markets and the policy-making process.

Labour market and social policies affect the trade liberalization and globalization process through various ways: active labour market adjustment policies; passive income maintenance programmes; safety nets to reduce resistance to change; legislation creating quasi-fixed employment costs; policies that alter wages and wage structures; and
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policies to facilitate internal competitiveness as a precondition for external competitiveness. Working in the other direction, trade liberalization and globalization can affect labour market and social policies through various mechanisms: inter-jurisdictional competition for investment and the associated jobs; emulation of best practices by organizations and policy-makers; the behaviour of multinationals; national treatment requirements in trade agreements; countervailing duties for social programmes that may be interpreted as subsidies; and migration and labour mobility.

The main policy concern that arises is that these forces may make it increasingly difficult for governments to provide policy initiatives, while at the same time the need for such initiatives is increasing so as to deal with the adjustment consequences of trade liberalization and globalization. That is, the global pressures may be leading to a harmonization of legislative and policy initiatives, with that harmonization being downward to the lowest common denominator, just at the time when the need for such initiatives is greatest.

This downward harmonization need not always occur, however, for a number of reasons: policies that are excessively costly are not always enforced; policies have benefits that may offset many of the costs; costs can often be shifted backwards to workers or forwards to consumers; firms may not respond in their investment and plant location decisions; and governments may not respond to the threat of capital mobility by altering their policy initiatives. While there are these counter-forces at work, the analysis of this paper leads to the conclusion that global pressures will lead towards policy harmonization and that the harmonization generally will be downwards.

Such harmonization is not always negative, however, as generally perceived. Efficient regulatory and social policy initiatives will survive and, indeed, expand, with the “rent-protecting” initiatives being under most pressure to dissipate. The main concern is that pure distributional or equity-oriented initiatives that have no positive feedback effect on efficiency, unfortunately, will also be under jeopardy of dissipating.

Potential solutions to deal with this and related issues include: labour standards as part of trade agreements; labour side accords; corporate codes of conduct; consumer boycotts; social labelling; and the use of social funds. Problems with these “solutions” were outlined, ranging from ineffectiveness to thinly disguised protectionism. As such, the main international policy challenge in the area of social and labour market policy under globalization remains dealing with the increased difficulty of governments in sustaining pure equity-oriented policies.

Notes

2. The issue of underinvestment in training in Latin America is emphasized in Berry (2001) and Berry & Méndez (1998). Possible market failures that can lead to underinvestment in training are discussed in Gunderson & Riddell (2001b).
3. Gunderson & Riddell (2001a). Cortázar (2001) outlined negative effects of unemployment insurance (UI) in terms of increasing unemployment and fraud through people working in the underground economy while collecting UI. To alleviate these problems, he recommended mandatory UI savings accounts that the individual worker can draw on if unemployed. These would also replace the traditional high severance payments that are prominent in Latin America.
4. In spite of the reasons why minimum wages may be an exceedingly blunt instrument for reducing poverty, Morley (1995) and Lustig & McLeod (1997) found that minimum wage increases have been associated with reductions in poverty in Latin America.
5. Evidence of multinationals providing better pay and working conditions than domestic producers in the host countries is provided in Lim (1976), OECD (1999) and Jenkins
A. Downes et al. (1990), although Forrest (1993) found that multinationals in Guadalajara, Mexico, did not do so.

6. Discussions of such migration are provided in Myrdal (1957) and Gunderson (1996).

7. For a discussion of the lack of enforcement in Mexico, see Areous (1994).

8. This legislative-induced shift to the informal sector is discussed in Harrison & Leamer (1997), Lee (1997), Maskus (1997) and Portes (1990). The growth of non-standard employment in the USA, Canada and Mexico since the mid-1980s is documented in a recent report of the North American Agreement on Labour Co-operation (NAALC, 1996) and discussed in Roberts et al. (1996).

9. With respect to the growth dimension, Rama (1995) found that labour regulations such as minimum wages, severance pay or mandatory benefits tended not to have a negative effect on output growth, based on data from 30 Latin American countries.

10. Evidence that foreign direct investment is not attracted to countries of low labour standards is discussed in Stern (1999, p. 21).

11. This is analogous to the idea that the main rationale for NAFTA was not so much to get the direct benefits from free trade, but rather to “lock in” the market-oriented reforms that were occurring in Mexico (Prestowitz et al., 1991).

12. See Banting et al. (1997) and Banting & Simeon (1997).


14. Berry (1997, 2001), Cline (1997), Richardson (1995) and Wood (1996). Feenstra & Hanson (1997) found that foreign direct investment by the USA in Mexico increased inequality in both countries by increasing the demand for skilled labour in Mexico and reducing the demand for unskilled labour in the USA.


References


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