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Since the second half of the 1970s the United States and Western Europe have experienced a widening wage premium for skills and a significant increase in labor market instability and insecurity. This article examines the impacts of globalization upon workers (especially low-skilled workers) in the North. It focuses on how trade affects the relative demands for skilled and unskilled workers, increasing the ease with which domestic producers can be substituted across national borders through outsourcing or foreign direct investment. One result is an inward shift and a flattening of the demand curves for low-skilled workers, reducing their average wages while increasing the volatility of their wages and hours worked. Another result is increased inequality in earnings within skill-groups.

CONSEQUENCES OF TRADE WITH COUNTRIES HAVING ABUNDANT UNSKILLED LABOR

> A cornerstone of traditional trade theory is that trade with labor-abundant countries reduces real wages in rich countries -- or increased unemployment if wages are artificially fixed. Indeed, in the standard factor-endowment model, trade creates gains for nations precisely by altering the relative domestic scarcity of factors of production such as labor.... if one believes that trade has been a source of many of the good things that advanced industrial economies have experienced in the last few decades, one is forced to presume that trade has also had many of the negative consequences that its opponents have alleged. [12]

In spite of this logic, most trade economists are in the curious position of crediting expanded trade with the "good things" just cited, while minimizing the negative impacts of trade on developed countries jobs and wages.

The Heckscher-Ohlin-Samuelson trade models provide solid theoretical reasoning for the belief that increased exposure to trade with low-income nations will increase the skill premium in the North. Against this background recent empirical studies have asked: how much has trade reduced the demand for unskilled labor in the developed nations? The answer is commonly "some, but not a whole lot." The reasons for this answer are, first, that North-South trade flows are small; the bulk of international trade takes place among industrial nations with similar factor endowments. Second, the theory states that more skilled workers can gain higher wages only if there is a corresponding fall in the relative price of goods produced with low skill-intensity.

Absent evidence for such a relative price-shift, economists infer that shifts in wages must stem from causes other than trade.

However, looking beyond Heckscher-Ohlin theory, one can see a much larger role for trade in recent wage inequalities. For example, Adrian Wood notes that import competition has driven out many low skill-intensive activities in the developing world, while inducing labor-saving technological change in the industrialized world. "Calculations of the implied factor content of trade that look at existing factor proportions in the remaining import-competing activities therefore underestimate the reduction in the demand for unskilled workers as a consequence of trade." [14-15]

Technology is the leading alternative to trade as an explanation for the recent rise in wage inequality. In fact, these two forces are highly interdependent. Even while theoretical arguments continue, most trade economists would agree that trade can account for somewhere between ten to twenty percent of the rise in wage inequality during the 1980s. This is by no means a small number, and it has been derived by taking a very narrow cut of the issues.

CONSEQUENCES OF A MORE ELASTIC DEMAND FOR WORKERS

Economists have largely focused on looking at how far the demand curve for low-skilled labor has shifted, with less emphasis on the implications of the fact that, as economies become more open to foreign trade and investment, the demand for labor becomes more elastic. The reason for this increased elasticity is that employers and consumers can substitute foreign workers for domestic workers by investing abroad or by importing the products made by foreign workers. "[I]ncreased substitutability of low-skilled workers across borders affects three key ingredients of the employment relationship: the incidence of nonwage costs, volatility of earnings and hours worked, and bargaining in the workplace." [17] It is important to note that North-North trade, while having little effect on the overall demand for unskilled labor, does increase opportunities for substituting workers within the now enormous, tightly-integrated market of the developed world. The resulting contribution to elasticity of demand for (especially low-skilled) labor has been largely overlooked as economists have focused on the effects of North-South trade.

INCIDENCE

Labor standards can be seen as a tax on employment resulting in a shift up the labor supply curve by an amount corresponding to the per-worker cost of introducing the standard. Elasticity determines how the cost is distributed between workers and employers; the more elastic labor demand is, the more difficult it is for workers to make other groups in society -- especially employers -- share such costs. Thus, in industries where the demand for labor has become more elastic and competition has made employers more cost-sensitive (because there is a smaller cushion of rents), higher labor standards cost workers in terms of jobs as well as wages. "Hence, globalization makes it difficult to sustain the post-war bargain under which workers' pay and benefits steadily improved in return for labor peace and loyalty." [19]

VOLATILITY

As globalization causes labor demand curves to flatten, there is greater instability in the labor market. Shocks in demand can result in much greater volatility in both earnings and hours worked. Such an increase in volatility has been well documented in the United States where, according to a study by Gottschalk and Moffitt, it appears that one-third of the widening of the measured earnings distribution results from an increase in earnings instability. This increase is nearly double for the least-skilled groups. These numbers do not in themselves explain the underlying causes for the changes, but the facts are "consistent with a picture of labor markets in which greater openness to trade interacting with short-term fluctuations in labor demand (or labor productivity) has resulted in greater inequality across and within skill groups and greater instability in wages and employment." [22]

This can be shown in the following numerical exercise. Suppose that an individual firm faces a labor elasticity of one in the short- to medium-run. In addition, assume that trade has resulted in an increase in the elasticity of demand for labor from -0.5 to -0.75. One could then calculate that the standard deviation would increase by twenty-nine percent.

Via increased churning in labor markets, globalization can contribute to inequality in other ways. Job-specific skills may constitute a larger share of earnings for less-educated workers than for college graduates. Since less-educated workers are subject to longer unemployment spells and larger wage cuts upon reemployment, this also puts downward pressure on the relative wages of less-educated workers as a whole, widening the skill premium.

BARGAINING

As seen above, increased substitutability of labor affects the balance of power between workers and employers. Because the focus of academic economics has been on perfectly competitive settings where wages are determined in spot markets, solely on the basis of marginal productivity (with no room for the influence of bargaining power), this effect of trade has received relatively little attention.

To the extent that wages are, in fact, determined through bargaining, an increase in the substitutability of workers results in a lower share of the rents that go to workers; unions also become weaker. Richard Freeman has estimated that about one-fifth of the rise in U.S. wage inequality is due to the decline in unionization. In Europe, where unions are stronger, the effect has been shifted to an increase in unemployment. In general, the rise in global competitiveness has caused a change in norms, lowering expectations, especially for the low-skilled workers whose bargaining power has been most eroded.