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Most economists have concluded that trade with developing countries has at most a minor impact on employment and wages in industrialized nations. Adrian Wood, however, argues that trade with the South has played a major role in depressing the demand for less-skilled labor in the North, as seen in the earlier chapters of his book, and in the related article summarized in this section (see "How Trade Hurt Unskilled Workers"). In the concluding chapter of his book, summarized here, Wood examines the available responses to the effects of trade for developed countries.

MOTIVES FOR INTERVENTION

Trade has increased the aggregate welfare of Northern nations, by providing consumers with inexpensive imported goods. However, it has harmed workers (and owners of immobile capital) in the specific industries most affected by foreign competition. It has also lowered the demand for less-skilled workers throughout the economy, perhaps by as much as 20% by 1990.

Is it appropriate for governments to take action in response to the decline in the demand for unskilled labor? There are three possible motives for intervention. First, policy intervention could promote efficiency; this is most relevant where wage rigidities limit the market demand for unskilled labor, as in Europe. Second, because unskilled workers and their families are among the poorer members of society, it seems inequitable that they should be made even poorer by trade that benefits the nation as a whole. The third motive is related to equity, but conceptually distinct: falling wages and rising unemployment lead to social corrosion, including increased crime, drug abuse, racial tension, homelessness, and other forms of degradation and decay. Such problems predate recent labor market trends -- but they are clearly made worse by those trends.

PROTECTIONISM AND EDUCATION

There are four possible policy responses: trade barriers, education and training, increases in the demand for unskilled labor, and redistribution of income. Of the four, trade barriers are the least desirable. The best arguments for protectionism -- sheltering infant industries, achieving economies of scale, and stimulating innovation -- do not generally apply to richer countries facing competition from poorer ones. However, there will be recurring political pressure for protectionism for workers affected by trade, unless better means of promoting equity are adopted.

Education and training are in many ways the most attractive solution to the problems caused by trade. While trade causes a decrease in the demand for unskilled labor, education and training cause a decrease in the supply of unskilled labor (and a corresponding increase in the supply of skilled labor). Those who remain unskilled also benefit, since their type of labor becomes scarcer, improving their prospects for employment and wage increases.

However, there are limitations and difficulties facing a labor strategy of education and training. Since educational initiatives are usually expensive, it is necessary to consider the sources of financing. New taxes to fund such programs will inevitably be paid (directly or indirectly) largely by workers. If taxes fall differentially on unskilled workers, the problems of equity and social corrosion will be worsened. If, as seems more feasible, the taxes are largely borne by skilled workers, then there will be a decline in the after-tax rewards to skills, and hence a decline in the market incentives to acquire and use skills. This disincentive partially offsets the benefits of educational efforts that are intended to increase the supply of skills. In a poorly designed program, the financing disincentive could even outweigh the educational benefits, resulting in a net decrease in skilled labor; policies must be carefully designed to avoid such perverse outcomes.

EMPLOYMENT PROGRAMS AND REDISTRIBUTION

A third option is the use of taxes and public expenditure to boost the relative demand for unskilled labor. In theory this could be done via a payroll tax/subsidy scheme, giving employers a subsidy for hiring unskilled workers and taxing them when they hire skilled workers. More realistic options include a progressive payroll tax, taking a larger percentage of higher-wage employees' pay -- or public works programs, such as the U.S. adopted in the 1930s.

When relative wages of skilled and unskilled workers are flexible, as is nearly true in the U.S., then there is no efficiency justification for boosting the demand for unskilled labor. In this case the market reflects the relative need for different grades of labor. It may still be desirable to increase demand for unskilled labor in order to improve equity or reduce social corrosion. On the other hand, when relative wages are rigid, as in much of Europe, then job-creating initiatives can be supported on efficiency grounds as well. Labor market rigidities mean that the wages of unskilled workers are above the opportunity cost of their labor; this reduces the demand for unskilled labor below the most efficient level. Government programs that raise the demand for such labor may move the economy toward the optimal level of unskilled employment.

A final option is redistribution of income from skilled to unskilled workers through income taxes and transfer payments. Redistribution is already practiced on a large, though varying, scale in most Northern countries; it is typically designed to benefit low-income people in general, or families with children, and addresses many other social goals in addition to the welfare of unskilled workers. Any new initiative must be carefully integrated into a country's existing systems of redistribution.

If wages are flexible, the analysis of redistribution to unskilled workers is very similar to that of subsidies designed to create jobs, as discussed above. Economists are familiar with the idea that the ultimate incidence of a subsidy to unskilled workers, or to their employers, depends on the

elasticities of supply and demand functions, not on who actually receives the subsidy. However, voters and politicians may have a preference for subsidies to workers rather than their employers -- making direct redistribution more feasible than job-creation efforts.

If wages are rigid, job creation and income redistribution are no longer analytically similar. In this case there is less need for supplements to low wages, and more need for transfers to the unemployed. Despite some reductions and restrictions in recent years, Northern countries generally accept government income transfers to the unemployed.

ALTERNATIVE POLICY PACKAGES

No one policy alone is likely to be effective. Trade protection should not in general be part of the policy package for a Northern country; the other options may all play an important role. The first step should be to assess the maximum scope for cost-effective education and training programs, i.e. programs for which the positive effect on the supply of skilled labor outweighs the disincentive effect of increased taxes. The remaining gap should be filled by demand-side and/or redistributive programs.

In America, where wages are flexible and there is less social concern about inequality than in other countries, one might question whether to implement *any* demand-side or redistributive programs. However, reduction in social corrosion is important for any society, and there is some ethical concern about poverty in all countries. Since job-creation subsidies and income redistribution are analytically equivalent in a flexible wage economy, the choice of policy will be dictated by political practicality. A combination of education and training with income supplements for low-income workers appears the most appropriate.

In Europe there is greater concern about inequality, and wage rigidity means that there are additional efficiency arguments for public policy intervention. Job-creation subsidies and redistribution are not equivalent in a rigid wage economy, and Europe already has extensive income redistribution programs. Here the most appropriate package is a combination of education and training with a progressive payroll tax that creates an incentive for employers to hire low-skilled workers. The simplest way to implement such a tax would be to modify the existing structure of employers' social security contributions.

Finally, what are the costs of being wrong -- that is, the costs of doing too much, or too little, because the underlying analysis was mistaken? If the recommended policy initiatives are adopted, but trade turns out to be a smaller problem than assumed here, the cost is that unneeded education and training, job creation, and income redistribution initiatives were undertaken. On the other hand, if nothing is done, but trade does turn out to cause large labor market problems, the resulting cost would be measured in increased, unalleviated poverty, unemployment, inequality, crime, urban decay, and other forms of social corrosion. The costs of doing too much appear far more bearable than the costs of doing too little.