

Impact of economic competitiveness on wages



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‘ The growth of low wage jobs is inevitable as national governments seek to promote economic competitiveness.’ Discuss.

1. Introduction

This essay discusses the hypothesis that governmental policies aimed at improving a nation’s relative performance in the global economy must lead to an increase in the low paid jobs. If considered in a global context the subject covers a wide spectrum. So the essay considers the United Kingdom’s (UK) economic experiences from the late 1970’s, with particular emphasis on the Thatcher era from 1979-1990 when the foundations for the UK’s economic reforms were laid. The profound change in economic management coupled with the rapid advances in communications and information technology has accelerated the effects of “ globalisation” and led to severe disruption in the UK labour market. Evidence exists that the erosion of the bargaining power of employees due to the twin effects of government policy and globalisation has exacerbated the decrease in real earnings amongst the less skilled workforce. However this vulnerability can be partially off-set by some of the benefits due to improvements in the UK’s international economic competitiveness and an effective mix of domestic labour market policies.

2. Economic Competitiveness: A Definition

For centuries, international trade has been the bedrock of the UK’s prosperity. Economists have long debated the effect of government policies on trade and national prosperity. In 1817 during the first stirrings of the industrial revolution David Ricardo developed an argument which can be summarised as: “ The classical theory of international trade and its role in <https://assignbuster.com/impact-of-economic-competitiveness-on-wages/>

economic development is based on the principle of comparative advantage. The comparative advantage paradigm states that a country performs better by concentrating on the production of those goods and services for which it possesses a comparative advantage over others, and then trade those goods for those of other countries.” [1]

Modern economic theory still supports the basic tenets of Ricardo’s argument, which was primarily developed as an attack on government’s protectionist agricultural policies at the time. Recent research, however, goes a step further. Michael Porter devised the concept of National Advantage [2] which argues that governments have a significant role to play in enhancing a nation’s comparative advantage when competing in the global economy. His “Diamond of National Advantage” (below) suggests that perusing policies that enhance company performance by, say, strict product standards, stimulating demand for advanced products, focusing on factor creation, with improved worker skills and stimulating rivalry by enforcing antitrust legislation will support the development of a strong and internationally competitive trading economy.

3. TheUKExperience

After the Second World War the UK government pursued policies to reduce unemployment through subsidies, direct support for industry, including nationalisation of some economically challenged sectors such as coal-mining, railways and a major automotive manufacturer, limiting external competition through protectionism. Trade policy was largely governed by favouring Commonwealth countries, through the “Commonwealth Preference”

arrangements. This approach was largely self-defeating as suggested by the Economist as early as 1960. “ A comprehensive system involving the granting of large margins of preference might be expected to have results of two kinds: it should ensure to exporters a larger share of the market than they would otherwise obtain, or enable them to charge higher prices for their goods than in non-preferential markets. An examination of Commonwealth Preference suggests that its effects in both directions are more limited than is implied by the support which it commands in the Commonwealth and the hostility it sometimes arouses in non-Commonwealth countries.” [3] In particular, it was in conflict with some of the concepts of the General Agreement on Tariffs and Trade, (GATT) formed in 1947 to promote economic recovery after the war by reducing barriers in international trade, particularly the reduction in tariff barriers.

The UK economy prospered under this regime particularly in the late 50's and early 60's but by the 70's the cracks were beginning to show. By the mid 70's it was obvious this economic model was not in tune with the needs of a modern nation in a rapidly changing world. Some of the old tenets were under scrutiny and the entrenched bastions of economic power were at loggerheads. In particular, the power of the union movement and the entrenched conservatism and resistance to change of management in the traditional industries such as coal, rail and manufacturing led to conflict and industrial disputation which were ruinous to the economic health of the nation.

Successive governments failed to address the underlying economic causes of the problems, until Margaret Thatcher became Prime Minister in 1979 with a <https://assignbuster.com/impact-of-economic-competitiveness-on-wages/>

new approach to economic governance. Her philosophy was not necessarily based on economic theory, although some of her advisors and ministers were well versed in Keynesian economics.

Her government embarked on a series of structural economic reforms including the privatisation of government-owned industries, deregulation of large swathes of UK economic activity, particularly financial services and the pursuance of an aggressive free trade agenda. “ What became known as “ Thatcherism” may have been an agenda which benefited corporate capital, as left critiques emphasize, but its ideological formulation was populist and it employed the petty bourgeois values of thrift, hard work, and family solidarity as the central justifications for privatization, tax cuts, reduction of state expenditure, and hostility to trade unions.” [4] Since that period it is true to say that “ Thatcherism.....was.... to become the ruling consensus of the British government soon established and exported around the world [5]

It is interesting to note that Thatcher’s economic policies predated Porter’s research outlined in section 2, as Hood and Young observed: “ While what has occurred falls short of a systemic approach to counteract market-distorting behavior or to build up created assets, there is little doubt that there have been consistent themes pursued since the Conservative government came to power in 1979. Deregulation, privatization, the restructuring of the handling of labour disputes, and so on have been driven by a clear philosophy concerning the role of the market and the negative economic and social effects of certain types of market distortions” [6]

4. Effect on Employment and Wages

As the Thatcher reforms began to bite, the short-term results reverberated around the UK. For example the industrial midlands in the late 70's was the heart of the automotive and machine tool manufacturing industries. By the mid 80's it was an industrial wasteland with acres of empty and derelict factory space with many thousands of workers displaced or redundant. This picture was repeated in many communities previously reliant on "smokestack" industries in the north and west of the UK. Anecdotal evidence suggested many of those displaced from manufacturing jobs had joined the informal self-employed workforce and those still in full-time employment had migrated to low-wage jobs in service industries such as retailing. This is backed up by comments from Organisation for Economic Cooperation and Development (OECD) which reports: "The labour market plays a crucial role in reaping potential gain from globalisation by facilitating a shift of jobs from declining sectors or occupations to expanding ones, in line with the changes in comparative advantage. However, this labour market adjustment is not always smooth because many workers displaced from declining sectors are poorly positioned to move into newly-created jobs in export sectors, which may be located in different regions or require different qualifications" [7] The International Labour Organisation (ILO) also echoes a similar theme: "Policies aimed at increasing competitiveness by lowering unit labour costs should consider the potential consequences on either workers (via wages) or firms and economic growth (via productivity). For example, on the one hand, an excessive and long-run emphasis on wage moderation may threaten a

country's productivity growth rate as it might discourage innovation and investment in human capital" [8]

In the longer term, however the overall benefits to the UK economy were substantial. The shift from a manufacturing to serviced based economy has brought significant benefits to the nation. " The UK, a leading trading power and financial centre, is one of the quintet of trillion dollar economies of Western Europe. Over the past two decades, the government has greatly reduced public ownership and contained the growth of social welfare programs. Agriculture is intensive, highly mechanized, and efficient by European standards, producing about 60% of food needs with less than 2% of the labor force. The UK has large coal, natural gas, and oil reserves; primary energy production accounts for 10% of GDP, one of the highest shares of any industrial nation. Services, particularly banking, insurance, and business services, account by far for the largest proportion of GDP while industry continues to decline in importance. Since emerging from recession in 1992, Britain's economy has enjoyed the longest period of expansion on record; growth has remained in the 2-3% range since 2004, outpacing most of Europe." [9]

Not everyone has benefited from this development. In relative terms the rich have got richer whereas the lower-paid workers have seen their relative position decline. " The UK's growth in wealth equality has been the fastest among the world's 30 richest and most developed countries. But in 2005, when the organisation compiled its latest data, the UK remained a more

unequal society than three-quarters of OECD countries, with the richest 10% earning nine times more than the poorest 10%.” [10]

5. Striking the Balance

Based on the UK government’s experience, seeking to promote economic competitiveness can be beneficial for the national economy overall.

“ Open trade and investment policies can be a powerful force for raising living standards. Economists have long emphasised this point and it is confirmed by much research. For example, the OECD’s Growth Study estimated that a 10 percentage point increase in trade openness translates over time into an increase of around 4% in per capita income in the OECD area.” [11]

However to mitigate the disruptive effects of such aggressive economic policies, suitable social policies should go hand in hand. For example policies to enhance labour mobility and relocation, income security packages linked to retraining to increase re-employment options, skill-development programs and minimum wage policies to limit low-pay traps. A balanced policy approach can help offset the growth and pervasiveness of low wage jobs.

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Footnotes

[1] Fidelis Ezeala-Harrison, Theory and Policy of International Competitiveness, page 4 Greenwood Publishing Group

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