

The Relative Impact of Different Forces of Globalisation on Wage Inequality: A Fresh Look at the EU Experience

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In recent decades, the globalisation of economic activities has expanded rapidly through both international trade and the fast expansion of international production networks as well as international investment, particularly in the form of foreign direct investment (FDI). At the same time, international migration has reached unprecedented levels as people migrate in search of better labour market opportunities elsewhere and to escape poverty, political unrest, war or the consequences of climate change.

In advanced countries, these developments have sparked a heated and partly controversial debate as to the economic and social consequences of globalisation. In this context, labour market effects have received a fair amount of attention particularly since ongoing globalisation is seen to go in tandem with rising income inequality and high unemployment among low-skilled workers. In fact, there is broad agreement among economists that globalisation harms some groups in society while benefiting others. In particular, through the substitution of migrant for native workers or the exploitation of offshoring and outsourcing opportunities of low-skill-intensive tasks, globalisation is considered to reduce the demand for and subsequently the wages of native low-skilled workers. As a consequence of this wage squeeze among low-skilled workers, inequality is increasing.

Understanding the underlying causes of inequality is fundamental to devising policy measures. Hence, this paper studies the effects of three forces of globalisation, namely immigration, value chain trade and FDI, together with different worker and firm characteristics, on wage inequality of native workers in a sample of 14 old (OMS) and new (NMS) EU Member States between 2008 and 2013.

This paper makes several contributions to the literature. First, from a methodological perspective, based on results from Mincer-type multilevel wage regressions, it applies the Shapley value decomposition method of Shorrocks (2013) to decompose wage inequality for native workers. This allows us to shed light on the various sources of wage inequality and helps us to determine the relative contributions of the three different dimensions of globalisation, in addition to different individual worker and firm characteristics, to observable wage inequality of native workers in the EU. Traditionally, the effects of immigration, trade and FDI are analysed separately which makes it impossible to determine their relative roles for wage inequality. The simultaneous analysis of all three dimensions of globalisation in this paper provides a clearer picture in this respect. Second, it compares results for three different inequality measures, namely the Gini index and two Generalised Entropy Indexes (GE(0) and GE(2)), which all place different weights on different segments of the wage distribution. This allows us to draw a more differentiated picture and identify the particular wage segment and wage group which is more strongly affected – positively or negatively – by the three forces of globalisation of interest. Third, the split of the overall period under consideration (2008-2013) into a crisis period (2008-2010) and a post-crisis period (2011-2013) allows us to examine the relative contributions of immigration, trade and FDI to wage inequality from a dynamic perspective.

The data for this analysis are drawn from different sources. Data on individual worker characteristics stem from the European Union Statistics on Income and Living Conditions (EU-SILC). Trade indicators are drawn from the World Input-Output Database (WIOD) from which we calculate various measures of value-chain (VC) trade. Data on inward and outward FDI stocks in each industry is taken from Eurostat and OECD while information on migration is taken from the EU-LFS.

The results show that globalisation has very mixed and country-specific effects on wage inequality among native workers and generally contributes little to it: taken together, immigration, trade and FDI

explain between 1 per cent and 20 per cent of overall wage inequality among native workers. However, in view of data issues related to the high level of aggregation of the three measures of globalisation and the fact that individuals' labour market participation decisions could not be taken into consideration, these results need to be considered the lower bound of the overall effect of globalisation. The three dimensions of globalisation play different roles in different countries and while migration and FDI contribute the most to wage inequality in the OMS, trade is the key source of wage inequality in the NMS. Furthermore, immigration, trade and FDI have different effects across the wage distribution which are mostly felt by medium-wage earners. In important countries of immigration, such as Greece or Italy, immigration contributes the most to inequality at the centre and the top of the wage distribution. Moreover, trade and FDI enhance wage inequality in both OMS and NMS, but the consequences are felt in different wage segments. In the more skill-abundant OMS, trade and FDI increase wage inequality the most at the centre and top of the wage distribution, while in the more low skill-abundant NMS, the associated increase in wage inequality is strongest at the centre and in some cases also at the bottom. In some European countries, trade and FDI also contribute to lower wage inequality, which is however only true for the tails of the wage distribution and is most pronounced at its top.