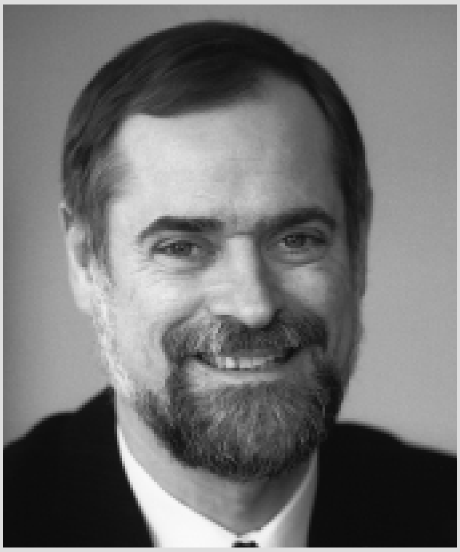
OPINION

The Low-Wage Sector – Worth a Try!



Globalization has altered the economic framework for labor and has intensified communication, information, trade, and capital transfers. This process has aggravated the labor market position of less-skilled workers, especially in Europe, where they are now facing unemployment of dramatic proportions.

– Trying to moderate productivity growth by slowing down technological progress would be ill-advised, however. We should instead trust that a policy of encouraging the acceptance of information technology will quickly open new markets and create imployment. Policy-makers and companies should review their modernization strategies and analyze whether they are in fact creating new employment opportunities for less-skilled workers.

– A "qualification offensive" by both the government and the private sector could eliminate productivity deficits of less-qualified workers – within the limits of trainability, of course. This, however, would only bring relief in the medium run. It is furthermore questionable whether the market for further training is already flexible enough to master new challenges. A successful fight against unemployment does not depend on high-tech training but on a principal strategy for qualifying workers to perform simple tasks.

– A stronger demand for goods and services that are produced by less-skilled workers may bring about an increase in product prices (relative to those of other goods and services) and, consequently, a higher labor demand. But the government would have to cooperate, for instance, by systematically chipping away at regulatory restrictions in the service sector.

– A reduction of direct or indirect wage costs could lower the gross wages paid by firms. This would not only require an agreement on wage cuts in the low-wage sector but also drastic cuts in government spending that could affect, for example, retirement benefits. The generally high wage level is not what causes the current problems. Nonetheless, even in Germany simple tasks have to become cheaper, and the wage gap between low-income and high-income jobs has to be widened for at least a while.

So is the creation of a low-wage sector, as discussed in the German "Alliance for Jobs" talks, the right concept? Many of the proposed models suggest that Social Security contributions should be provided here, entirely or in part, by the government. This would allow labor market intervention from two sides: As firms profit from falling gross wage costs, they will demand more labor. Workers may earn higher incomes, which would make alternative transfer payments less attractive and encourage unemployed workers to accept a job.

Tempting though this may seem, it would be wrong to rely on subsidies in the low-wage sector to boost a larger supply of labor. An increased labor supply would only generate more employment if wages were allowed to drop under the pressure of competition. In reality, this is unlikely to happen in Germany. It is therefore important to concentrate on the demand side.

In a recent report, IZA evaluated one of the proposals put forward in the German "Alliance for Jobs" talks. The model in question is based on subsidies for employer contributions to Social Security. According to the study, the net burden imposed on public budgets would amount to DM 14.2 billion, while the net credit to Social Security would be DM 12.6 billion. This could help create up to 400,000 new jobs. The tax-payer would have to carry net costs of barely DM 4,000 per new job per year. Sounds like a pretty good deal! A model experiment could clarify whether this approach would at least ignite the initial spark for change in the labor market.

But there is ample reason to doubt that expensive long-term subsidies or a stabilizing low-wage sector will continue to be prudent policy options in the long run. Eventually, it will be up to the market to create demand opportunities and to assess qualifications. Assuming an increase in the demand for goods produced by workers who are now considered unskilled or less-qualified, worker's wages could also rise. This would be the ideal way to approach unemployment problem. The State could play an activating role by granting targeted business start-up loans for less-qualified workers, by lowering consumption taxes for goods from the low-wage sector, or by spurring government demand in this sector.

K. F. Zimmermann

IZA

Forschungsinstitut zur Zukunft der Arbeit

IMPRESSUM:

Herausgeber: Prof. Dr. Klaus F. Zimmermann
Redaktion: Holger Hinte
IZA, Postfach 7240, D-53072 Bonn
Tel. (02 28) 38 94 222, Fax (02 28) 38 94 210
e-mail: compact@iza.org
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