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Trade and Jobs

OECD
BETTER POLICIES FOR BETTER LIVES

MCM TRADE SESSION: TRADE AND JOBS

OVERVIEW

1. Ensuring robust employment growth is an ongoing priority for governments as the economic recovery gains traction. Open markets contribute to growth and better employment outcomes. Countries at all levels of economic development will benefit not only from the avoidance of protectionism but the further advancement of liberalisation.

2. Imports facilitate technological progress and the global spread of innovation, thus improving firm productivity and export competitiveness; and trade growth can contribute to global economic growth. Firms are outsourcing and offshoring in order to lower costs, acquire higher quality inputs, and generally improve their competitiveness.

3. Policies that restrict access to foreign sources of intermediate goods and services are more likely to produce firm closures and job losses – the very outcomes they were designed to prevent. They deny exporting firms access to cheap imported inputs that also embody better technology; loss of competitiveness ensues which almost invariably translates into greater long-term hardship for firms and for the workers they employ.

4. The links between trade liberalisation and employment are complex. The opening of markets creates opportunities. But for these to be realised and for the benefits to be spread widely, complementary policies are also needed. Such policies have two broad aims: to ensure that firms and workers are able to exploit the opportunities generated by new market openness, and to provide appropriate adjustment assistance and support to those who need it.

- **Trade liberalisation is good for welfare -** OECD work shows that for every one percentage point increase in the share of trade in national output, income levels rise by between 1 and 3 percent. OECD analysis also highlights the potential gains from liberalising intra-developing countries' trade that is subject to much higher tariff and non-tariff barriers than developed-developing or developed-developed countries' trade.

- **Trade liberalisation can be good for employment -** Indicative estimates from new OECD research show that a 50 percent cut in goods tariffs and non-tariff barriers by the G-20 countries could bring significant increases in employment, for both skilled and unskilled workers. The impact on unskilled workers ranges between 1 and 3 percent while the effects on skilled workers range from a modest 0.2-0.4 percent (Australia, Brazil, Indonesia, Italy) to a robust 2.3 to 4.9 percent (Netherlands, Mexico, United Kingdom). These results combine the effects of lower trade costs, higher investment, and higher productivity.

- **Services trade liberalisation should be part of the mix -** Goods still dominate trade, but increasing attention is focused on trade in services. A recent OECD analysis presents a model of the hypothetical scenario of a 50 percent reduction in FDI restrictiveness. The resulting estimates indicate that employment could potentially increase in the short-run by more than 1 percent. Estimates from the analysis also indicate that liberalisation in FDI for services would not lead to a short-run net loss of jobs in any of the G-20 countries.

5. Realising the benefits outlined above requires detailed knowledge of the sectors and the measures that restrict trade. This task is most challenging in the area of services trade, where regulatory barriers inhibiting the efficient functioning of markets are diverse. At the same time, services generate more than two thirds of gross domestic product globally and provide over 50% of employment in major economies. Efficient provision of services is vital for growth. Backbone services such as telecom and finance affect all other sectors of the economy, and education and health services directly affect the wellbeing of the people.

6. Further liberalisation of services trade constitutes a major economic opportunity in this regard, with potentially very positive labour market implications. OECD is examining market openness with respect to services trade, developing indicators for a Services Trade Restrictiveness Index (STRI) that will provide policy makers and negotiators with the information and measurement tools they require to identify barriers, improve the domestic policy environment, negotiate international agreements and open up international trade in services.

7. Developing and emerging economies face particular challenges and opportunities with respect to trade and employment. For countries aiming to promote export led growth, there are challenges of integration into global value chains, setting of appropriate policies with respect to FDI, reducing trade costs, and dealing with subsequent vulnerabilities to cyclical fluctuation in external demand, among others. Less developed countries may face additional binding constraints to trade expansion and job creation, requiring for example a greater focus on trade facilitation and capacity building. There may also be workforce related issues such as gender equality, human capital development, income distribution, social protection, and worker rights. For many countries the interface between trade and employment presents great economic promise but also challenges that need to be overcome for promise to become reality.

8. OECD is working with a large network of international organisations to better understand the mechanisms by which trade interacts with employment, with a view to informing future policy decisions. A central element is the International Collaborative Initiative on Trade and Employment (ICITE), which includes new research, a conference series and new publications.

9. In summary, maximising the quantity and quality of jobs will continue to be a high priority for policymakers as the global economy rebounds. Trade will constitute an increasingly important catalyst in this regard. Moreover, policies to promote further market opening can deliver expanded economic benefits for OECD countries and their emerging-market and developing-country partners when accompanied by appropriate complementary policies. An integrated policy package could include the following elements:

- Vigorous and concerted efforts to reduce barriers to economic integration by lowering trade costs and reducing discrimination in international trade, particularly in services;

- Greater investments targeted at the removal of binding constraints to trade in developing countries, for example, via Aid for Trade;

- At the multilateral level, fostering continued efforts to ensure an ambitious, balanced, comprehensive and timely conclusion to WTO negotiations under the Doha Development Agenda framework;

- Emphasis in new regional agreements to open markets with minimal distortions to third parties, taking into account WTO rules, "best practices," and the possibility of eventual multilateralisation;

- Continued efforts by the OECD and its partners to support reform through policy analysis, dialogue and public information designed to improve understanding of the relationship between trade and jobs.

TRADE AND JOBS, AND THE OECD

ISSUES PAPER

Introduction

10. Challenges with respect to trade and jobs – and the interface between the two issue areas – remain near the top of policy agendas for OECD members and partner countries around the world. Globalisation has been a critical force driving increased economic integration and structural change, resulting in greater employment opportunities and welfare, but also creating adjustment difficulties including in the labour market. Through its deep engagement on trade and employment, the OECD is able to provide statistics, analysis and policy recommendations, inform policy dialogue, and disseminate information to a broad range of stakeholders.

Trade and Employment Issues at the OECD: The First 50 Years

11. The founding *Convention on the Organisation for Economic Co-operation and Development*, which came into force on 30 September 1961, includes in its preamble an explicit reference to the importance of trade, recognising that "the further expansion of world trade is one of the most important factors favouring the economic development of countries and the improvement of international economic relations." Article 1 of the Convention provides a concrete mandate for the OECD to promote policies designed to "achieve the highest sustainable economic growth and **employment** and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy" and "contribute to the expansion of world **trade** on a multilateral, non-discriminatory basis in accordance with international obligations."[1] Thus, trade and employment have been priority issues for the organisation from the beginning. Indeed, the OECD's predecessor, the Organisation for European Economic Co-operation, had already been working on similar matters for over a decade at the time of the OECD's creation.

12. The OECD committees handling trade and employment issues, respectively, were both established on 30 September 1961. The Trade Committee and the Employment, Labour and Social Affairs Committee[2] have each pioneered analytical work, recommendations and legal instruments that have advanced policy in line with OECD aims as laid out in the Convention. Moreover, in their current mandates, both committees have elements underscoring the importance of co-operation and working relationships with other bodies of the OECD dealing with related issues. The institutional capacity to tackle horizontal policy issues at the nexus of trade and employment constitutes a real strength for the OECD. For example in 1996 and 2000, the two committees pioneered work on international trade and core labour standards, at a time when certain other international bodies were unable to tackle this topic. Additional examples of cross-cutting work abound, such as *Employment Outlook* chapters considering labour market implications of trade and globalisation or *Trade Policy Working Papers* analysing welfare implications of trade liberalisation. Broader examples – conducted under Ministerial mandates and reflecting the engagement of multiple OECD directorates – can be found in the lines of work undertaken during the 1990s in connection with the OECD *Jobs Study* and during the 2000s in connection with the *Trade and Structural Adjustment* project.

1 Bolding added here for emphasis.

2 The committee was originally known as the Manpower and Social Affairs Committee, but was retitled as the ELSAC in 1991.

13. Five decades of work on trade and employment issues at OECD have confirmed the validity and importance of the original mandates on promotion of trade and employment as stated in the OECD Convention. Maximising the benefits of trade and employment growth in the context of a sustainable development strategy is a perennial objective that can be advanced by the type of policy work at which the OECD excels. The international economic environment is dynamic, implying that policy innovation requires periodic review, assessment and revision. At the same time, some underlying principles and features are emerging as being consistently important. In the case of trade and employment, evidence points to the critical role of institutions, national and international, and to the need for a policy framework that includes, *inter alia*, steps toward further liberalisation, good governance and rule of law, and development of a healthy environment for business; nurture and cultivation of human and natural resources; and provision of an appropriate social safety net.

The Contribution of Trade to a Sustained Economic Recovery

14. The financial crisis that began in September 2008 ushered in the greatest economic challenge faced by governments since the Second World War. Transmission of the crisis to the real sector was almost immediate, with the volume of world trade contracting by 12.5 percent in 2009 –its sharpest decline in more than seventy years, and unemployment rising to levels not seen in some OECD countries for decades. Open markets are not the reasons for these job losses. While highly integrated international markets for goods and services may have acted as a channel for the propagation of the cyclical shock, the global recession was the result of macro-economic imbalances, financial sector malfunctioning and an inefficient regulatory framework - not of open markets. Moreover, openness to trade also helps economies recover more quickly as they are more adaptable and less dependent on limited domestic demand.

15. The reported large fall in trade in 2009 would have been smaller than 12 .5 percent had trade been reported in value-added terms, rather than in gross terms. This is the case because trade in intermediates represents 56 percent of goods trade and 73 percent of services trade. But what is critical to note in the present context is that trade in intermediates lies at the heart of productivity gains. OECD analysis at the country and industry level finds evidence that such trade has a positive impact on total factor productivity of industries (Trade in Intermediate Goods and Services) since foreign inputs embody the foreign technology. Furthermore, the OECD analysis distinguished between technological and efficiency changes and found a positive relationship between trade in intermediates and efficiency gains.

16. Barriers against imports of intermediates would be particularly detrimental to countries imposing them: companies participating in international production networks are likely to look for other suppliers when they perceive a risk of new barriers. Thus, firms in countries contemplating introducing import restrictions will, in addition to losing a major source of productivity gain, also pay the cost of such policies with a reduction in their exports and a negative multiplier effect on the entire economy through the local companies that indirectly depend on such trade.

17. Trade has rebounded toward pre-crisis levels, yet unemployment continues to persist at unacceptably high levels in most OECD economies. Not surprisingly, the need to support trade as an engine of growth and employment has once again become a high policy priority.

18. At the G-20 Summit in Toronto in June 2010, the OECD was tasked, together with the World Bank, WTO and ILO, to lead a study investigating the trade-jobs link, with the results to be presented at the G-20 Summit in Seoul in November. The study explored a wide variety of issues pertinent to trade and employment in the context of a fragile economic recovery and formulated key conclusions based on previous research and new economic modelling. It also offered evidence-based policy implications and recommendations, some of which we summarise here.

19. Clearly the global crisis hit workers hard, but the report notes that it could have been much worse if governments across the globe had not taken prompt and vigorous measures. Over 210 million people worldwide were estimated to be unemployed at the time of the study, an increase of more than 30 million since 2007. Unemployment increased in all regions in the world due to a slowdown in employment growth and growing labour forces.

20. The report stressed that trade could be a powerful protagonist in supporting recovery and job creation. Available evidence underscores how trade openness contributes to growth and employment, a process that is enhanced via appropriate complementary policies. Countries that have embraced openness have been more successful in sustaining growth and moving up the development ladder than those that have not. In addition to increasing efficiency, trade facilitates technological progress and the global spread of innovation. These deeper economic forces are the primary source of longer-term gains in productivity that are necessary to achieve higher levels of per capita incomes.

21. Despite the strong positive link between trade, growth and employment, welfare-enhancing structural change requires that inefficient sectors contract in order to allow for growth in more efficient areas. This reallocation can sometimes be slow, difficult and potentially incomplete. However, changing patterns of international trade are only one of the many drivers of this continuous movement of workers from declining to expanding firms. National governments have an important role to play in facilitating and expediting this process, as well as protecting the most vulnerable. Properly designed economic, labour market, education and social policies can serve to enhance the opportunities available to those who stand to gain from trade opening to actually do so and to help those who are displaced to develop new skills and find new opportunities. Particularly in less-advanced developing countries, the capacity to trade is sometimes limited by weak institutions and infrastructure, or other development constraints. The international Aid for Trade initiative is engaging donor and partner countries in an effort to tackle such binding capacity constraints.

22. Forward movement in trade and investment opening is a key element in establishing a sustainable recovery path. The G-20 countries demonstrated their willingness to act collectively to prevent a wave of protectionism during the crisis, and thus to preserve progress already made towards more open global markets. Nevertheless, the report noted that much more could be done in order to boost trade, growth, and employment. A concerted program of trade and investment liberalisation – starting with a renewed focus to conclude the Doha Development Agenda expeditiously – can provide a non-debt-creating source of stimulus for the world as a whole, while at the same time helping to achieve a more balanced global economy. The G-20 can play an important role in this regard. Based on the indicative results of new OECD research, the report estimated that a 50% cut in tariffs and non-tariff barriers by the G-20 countries would lead to significant increases in national income for all G-20 countries and their partners. The increase in growth is estimated to be generally in the range of 1%-4% for all but a few G-20 countries in the short run and up to 7% in the long-run. Estimates of the potential gains on the employment front are impressive as well, generally in the range of 1%-2.5% in the short-run and up to 5% in the long run.[3]

[3] These results are based on a computable general equilibrium (CGE) model of world trade that includes scale economies and imperfect competition. The CGE modelling approach allows for a consistent numerical tracing of policy effects across markets, sectors and countries. However, it should be acknowledged that the representation of labour markets remains a rough approximation of the complex interactions that exist in reality. In the study two specifications have been chosen that together shed some light on the range of possible labour market outcomes following trade reforms. In one scenario (recession scenario) we allow for involuntarily unemployed labour who would enter into employment at the given real wage rate as soon as an output expansion requires more labour to be hired. In an alternative, long-run scenario, labour markets always clear, there is no involuntary unemployment, and labour supply responds positively to rising wages.

23. The foregoing discussion does not take full account of the potential benefits from further market opening, as it excludes those that would result from service sector reforms. Services account for the majority of economic activity in advanced economies and a growing number of developing countries. Illustrative results from a recent OECD econometric study focusing on just one aspect of services sector reform (FDI) finds that a 50% reduction of FDI restrictiveness leads on average to a 7% increase in FDI.[4] This, in turn, can have labour market effects. In the short run, estimates from the study indicate that FDI liberalisation would have a small but positive effect on employment of skilled labour, ranging up to 1.4%. The estimate for unskilled labour is similar, with a short-run increase in employment ranging up to 1.2%. Furthermore, estimates from the study indicate that liberalisation in FDI for services would not lead to a short-run net loss of jobs in any of the G-20 countries. In the long run, when the G-20 economies are back to full employment, the estimates indicate that the impact of FDI liberalisation would be mainly felt in the shifts of employment between sectors and between skilled and unskilled workers. The gains from services liberalisation would be additional to the gains from goods liberalisation.

24. Trade liberalisation has complex labour market implications with respect to gender. Trade produces economic opportunities that can help to create jobs, including in sectors such as textiles and apparel where women are disproportionately represented.[5] Expanding employment opportunities for women can increase the household assets under women's control and thereby lead to greater investments in the health and education of future generations.[6] However, in many countries, the ability of women to capitalise on trade opportunities are constrained by lack of access to resources (particularly capital) and education, professional discrimination, and persistent wage gaps vis-à-vis their male counterparts, among other constraints. Moreover, women may also be heavily represented in sectors facing structural adjustment stress, for example, through their disproportionate representation in small scale agriculture in low income countries. Some of these challenges are being addressed as part of the Millennium Development Goals, including via special capacity-building programmes under the international Aid for Trade initiative. More broadly, OECD initiatives are seeking to address gender issues with respect to education, employment and entrepreneurship in order to promote equality. Such policies can enable women to better capitalise on the labour market opportunities afforded by trade liberalisation.

25. Moreover, the quality of jobs constitutes an important dimension to consider in this context. The growth of trade and investment may contribute to improvement of working conditions and promotion of international standards. Whilst it is the primary responsibility of governments to adopt respective national legislation, ensure its enforcement and implement internationally recognised standards, the companies, in particular the multinational enterprises (but increasingly also the small- and medium-sized ones) are encouraged to respect human rights and to promote high social and environmental standards, as well as good governance in their operations, including along the supply chain. The ongoing process of a review and update of the OECD Guidelines for Multinational Enterprises should contribute to achieving this goal.

Going forward

26. Trade and employment issues remain salient priorities for OECD. In 2010, we launched the International Collaborative Initiative on Trade and Employment (ICITE). This initiative, which will be

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4 The results range from zero in markets where FDI is already fully liberalised to 12% in the most restricted markets.

5 One OECD study found, for example, that women comprise between 53% and 90% of the employed in many export sectors in middle-income developing countries. See: Korinek, J. (2005), Trade And Gender: Issues and Interactions, *Trade Policy Working Paper No. 24*, OECD.

6 For more on the economic benefits of increased employment of women, see World Bank (2006), *Gender Equality as Smart Economics: A World Bank Group Gender Action Plan (Fiscal years 2007–10).*

implemented during the 2011-12 biennium, brings together 10 international organisations.[7] It constitutes a global effort to take stock and deepen our understanding of the relationship between trade and employment, including consideration of the policy implications. ICITE comprises a substantial wave of new research, 3 regional conferences (Asia, Africa and Latin America), a Global Forum on Trade event, and a series of working papers and publications aimed at diffusion of a substantial volume of new information on the topic. Succinctly put, the ICITE initiative is advancing with the objective of providing a better understanding of the mechanisms by which trade interacts with employment, with a view to promoting dialogue and developing policy-relevant conclusions.

27. While much work has been done on this vast issue area, in view of the complexity it is not surprising that gaps remain. ICITE will tackle some of the hard issues via an ambitious research agenda. The ICITE agenda is underpinned by two complementary research approaches including thematic reviews and country studies. Thematic studies under ICITE will tackle such issues as: wage implications of trade liberalisation; trade in tasks; trade, employment and gender; global value networks and productivity; trade, off-shoring and migration; employment implications of regional trade agreements; trade, employment and adjustment; the political economy of trade liberalisation; structural transformation and the evolution of employment; globalisation and labour conditions; trade, productivity and employment; trade and informal sector employment; and agricultural trade and employment; among others. While the thematic studies aim to consider issues across economies, the country studies will aim to consider trade and employment questions more deeply in a given economy. The country studies will cover a broad sample of OECD and developing economies, highlighting trade-related labour market developments and relevant institutions and policies. The results from the various research papers will provide an empirical foundation as a basis for policy dialogue in the three regional conferences and the Global Forum on Trade event that are planned for 2011. The material from all of this activity will feed into a synthesis publication planned for release in 2012 in time for the Meeting of Council at Ministerial Level.

28. Although the service sector is the main employer in OECD countries and a growing number of developing countries, its share in international trade – at about 20% – remains modest in comparison. While this reflects limited tradability of some services, it also reflects the continued existence of barriers to FDI and regulations on licensing and qualification requirements, and red tape that can be particularly burdensome to foreign suppliers. The economy-wide costs of these barriers can be significant. The cost and quality of producer services inputs such as telecommunications, distribution, and financial intermediation are key determinants of the competitiveness of firms. A rapidly growing body of evidence has documented the linkages between the efficiency of service sectors, the productivity of downstream companies that use the services as inputs, the skill-intensity of production, the demand for educated workers, and the wages that they earn. The policy implication is clear. Liberalisation efforts that reduce entry and operating costs for foreign services providers should stimulate investment and output, directly benefitting consumers, expanding economic opportunities and improving competitiveness of business. This in turn can have substantial labour market implications. Thus, it is natural that trade in services features prominently in the current OECD programme of work.

29. The OECD Trade Committee is in the process of creating internationally comparable data and analysis on ‘behind the border’ measures that affect services trade that would inform an ambitious liberalisation agenda for services sectors, and promote development and growth in both developed and major emerging economies. The Services Trade Restrictiveness Index (STRI) will be comprised of indicators covering major services sectors. Such indicators can contribute to analysis of trade agreements and benchmarking progress in market opening. The project is in a pilot phase covering selected sectors in OECD countries, but is being expanded to cover all sectors and major emerging economies.

7 Participating organisations include: ADB, AfDB, ECLAC, IADB, ILO, OAS, OECD, UNCTAD, World Bank and WTO.

30. The priority for the OECD Trade Committee over the coming months is to work closely, on a full and equal basis, with Brazil, China, India, Indonesia, Russian Federation, South Africa and other interested countries who are major services providers. In parallel with the development of the STRI, analytical work will continue with respect to the interaction between goods and services trade. Such analysis will consider two areas of substantial economic importance, with relevance to the labour market: the role of services as intermediate inputs in manufacturing and the role of services in linking international markets.

31. Another priority area for work with a number of emerging countries is export credits. The disciplines that are embodied in the Arrangement on Officially Supported Export Credits are housed in the OECD. They promote free and efficient trade by, *inter alia* eliminating subsidies and reducing trade distortions while creating a level, transparent and competitive playing field. A number of emerging countries have become major exporters and providers of export credits. Their participation in the Arrangement disciplines, including sharing in designing and implementing these disciplines, is important. A major step in this direction is Brazil's full membership as a Participant to the Aircraft Sector Understanding (ASU). More recently, Secretary-General Gurría invited China and Russia to join the ASU and the full range of OECD export credits' disciplines.

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