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Trade and Employment: The launch of a ground-breaking ILO-WTO study

The launch of the first jointly conducted study of the International Labour Office (ILO) and the Secretariat of the World Trade Organization (WTO) on 19 February was a historic milestone in the difficult relationship between these two organizations. ILO Director-General Juan Somavia commented at the meeting of the ILO Working Party on the Social Dimension of Globalization (WPSDG) on 26 March that the study marked an “important institutional breakthrough”. WTO Director-General Pascal Lamy was a driving force from the outset and reiterated his commitment to continue the collaboration. Since it took eleven years after the WTO Ministerial Conference in Singapore and five years after the last discussion at the WPSDG to come to this first visible result of collaboration, it almost drew off the attention from the subject of the study, entitled “Trade and employment: Challenges for policy research”.¹ It features one of the key challenges arising from globalization, i.e. how to overcome the “jobless growth” dilemma and how to increase employment opportunities – in particular for the poor – by adequate labour and social policies. ILO’s latest *Global Employment Trends* shows once more the relevance by indicating that despite sustained global economic growth and increasing volumes of world trade, the global unemployment rate has remained at the high level of 6.3 per cent in 2006.² Productive, decent and adequately paid jobs are crucial to lift people out of poverty. According to the *Global Employment Trends*, “full, productive and decent employment” will thus be added as a new target to the Millennium Development Goals in 2007.

The relationship between trade and employment: What does research tell us?

The impacts of global trade flows on employment have become a contentious issue for policy-

¹ See ILO / WTO: Trade and employment: Challenges for policy research, Geneva 2007, (www.wto.org/english/res_e/booksp_e/ilo_e.pdf).

² See ILO: Global Employment Trends, Geneva 2007.

makers, researchers and the media. Economic globalization has widely been perceived as a process of shifting labour-intensive industries from developed to developing countries (“offshoring”), while skills- and capital-intensive industries in developed countries are increasing. The study cautions that the majority of the world’s working population is employed in non-tradable economic activities and only indirectly affected by trade. It highlights the interactions of trade policies, and labour and social policies, taking into account academic literature and empirical evidence. The key messages are summarized in the following paragraphs.

Trade leads to job destruction and job creation

Trade liberalization leads to a restructuring of economic activity and employment reshuffling across but also within sectors. The latter finding is remarkable since it contradicts with traditional trade theory and has especially two implications: First, retraining costs for displaced workers are lower and search periods are shorter if these workers remain in the same sector. Second, it is increasingly difficult for policy-makers to predict which sectors will face job losses since almost all sectors can be at risk. In general, jobs are destroyed in the less competitive parts of the economy, while new jobs are created in firms with higher levels of productivity that can compete internationally. In the short term, the net effects can be positive or negative – depending on country specific factors, e.g. the functioning of labour markets. In the long term, efficiency gains are likely to result in positive overall employment effects.

Trade affects labour demand and wage inequality

The study argues that there is a relationship between the openness of an economy and the sensitivity of labour demand to wage changes (“price elasticity of labour demand”). It states that the mere possibility of trade and the threat

of delocalization in a global production network might weaken workers' bargaining power. Notably, this results not only from trade between industrialized and developing countries, but also from trade among similar countries ("intra-industry trade"). Many industrialized and some developing countries also experienced increases in the wage differential between high-skilled and low-skilled labour ("skill premium") during periods of trade liberalization. This increased inequality is mainly triggered by inflows of foreign direct investment and technological change.

Arising challenges for policy-makers

Policy-makers are confronted with mainly three challenges to cope with the consequences of trade liberalization on employment: First, workers who are displaced by trade reforms typically face a period of unemployment and often need assistance to find a new job. Policy-makers are expected to facilitate the transition between jobs by applying the adequate labour market policies. In general, they can choose between passive income support during the time of unemployment (insurance system) and active labour market policies that aim at facilitating re-employment. The US and EU additionally provide displaced workers with special trade adjustment programmes. The choice of the right policy mix depends on country specific characteristics and whether workers can find a job in the same sector again or must be retrained. An interesting approach is the "flexicurity" model, which seeks to protect workers and overall employment, rather than specific jobs. Many developing countries, however, lack social safety nets and the ones that are in place only apply to the small share of formally employed workers. Moreover, developing countries face the challenge of transferring large numbers of workers from the agricultural and urban informal sector into formal employment.

Second, trade opening will only gain the necessary public support if the benefits are widely shared by the population. This requires adequate redistribution policies in the form of income or consumption taxes. However, the study admits that there is no agreement on how to design such mechanisms appropriately. This is bad news for developing countries, which face increased income inequality, while lacking functioning redistribution policies.

Third, wider access to and improved quality of education systems are increasingly important in a globalized world, which requires individuals to constantly change and adapt to new situations.

Education levels also determine a country's absorptive capacity, i.e. its capacity to adopt new technologies and develop them further by innovations. It is difficult to predict what skills are needed for future employment. Thus, more important than teaching people specific skills is to teach them how to learn, which enables them to learn independently what they might need in their working life ("lifelong learning").

The role of *infrastructure* has been continuously emphasized as a crucial factor for facilitating trade. This includes different areas, such as physical (export) infrastructure, border procedures, finance and telecommunications. In this context, WTO's aid for trade initiative is expected to bring about some improvements.

Need for further research and coherence

The study itself identifies the need for further research on the linkage between trade and the informal economy as well as the design of redistribution policies. Trade unions call for considering the employment effects in export processing zones, where not only taxes but also labour standards tend to be much lower than outside these areas. Moreover, the linkage between trade and gender, the inclusion of trade in services and the "China effect" require further attention. Guidelines for conducting employment impact assessments of trade reforms are also urgently needed.

Most countries are in a continuous process of restructuring their economies, forced either by trade liberalization or domestic factors. This poses the challenge of establishing the appropriate and coherent policy framework that maximizes the benefits and mitigates the (labour) costs of trade reforms. In this context, the study has two positive implications: At national level, the paper is expected to trigger a tripartite policy dialogue, which could result in a more participative, comprehensive and legitimate process. At multilateral level, the study was a successful though small step towards greater coherence. The future challenge will be to move from "neutral" research collaboration towards institutionalized cooperation – as e.g. called for by the EU – which could even lead to jointly planned trade-related technical assistance and capacity building projects.

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