

Executive Summary

The aim of this study is to identify, for both developed and developing countries, the requirements for successful trade-related structural adjustment. It addresses ways to reallocate labour and capital to more efficient uses in response to the emergence of new sources of competition, technological change or shifting consumer preferences, while limiting adjustment costs for individuals, communities and society as a whole. Adjustment, as used here, thus refers to the use of a range of policy instruments to facilitate adaptation to a structural (rather than transitory or cyclical) change in the economic environment. A summary of policy recommendations is to be found below under “Recommendations for Good Practice”.

The relationship between trade and the adjustment process has many dimensions. While *trade policy* can be a trigger for adjustment – as the phase-out of the MFA undoubtedly is – it can also be a brake on adjustment – as in the persistence of trade policy distortions in agriculture or the restrictive rules of origin in sensitive sectors such as textiles and clothing or motor vehicles. But *trade and trade capacity building* can be an integral part of the adjustment process itself. This is evident, for example, in the way in which the international sourcing of IT and business process services offers significant labour cost arbitrage, enabling companies in international and maturing markets to pursue cost-cutting strategies.

Recognition of the importance of structural adjustment derives from a dynamic analysis of the economy and the desire to reap the benefits of economic growth and welfare by taking advantage of evolving conditions of competition and productivity. In this light, OECD Ministers stressed more than a quarter of a century ago the need to promote “adjustment to new conditions, relying as much as possible on market forces to encourage mobility of labour and capital to their most productive uses” (“Policies for Adjustment: Some General Orientations”, Council Communiqué of 15 June 1978).

Structural adjustment has been studied and discussed from a variety of perspectives and in many forums. Since the 1978 Communiqué was issued, many of the basic challenges have remained, including some specific sectoral ones. In many respects, the perspective on structural adjustment is the same, with broad recognition of the benefits of open markets and of the need for flexible responses – by both governments and industry – to emerging challenges. But the context of the present study is different in many important ways from that of some 25 years ago. Changing societal values, the fuller engagement of non-OECD countries in international economic activity and accelerating technological change¹ have increased the complexity of global economic interaction through trade and investment. Opportunities for developed and developing countries alike to benefit from this interaction have also been strengthened. Moreover, whereas earlier work on the subject of structural adjustment had approached the issue from the standpoint of neoclassical economics, with a particular emphasis on efficiency, today there is greater concern with considerations of equity. More attention now focuses on the differing impact that change – or response to change – has on different groups within or between

countries. Some firms or workers are demonstrably less able to adapt than others; some countries are more severely challenged than others.

Societal values have changed significantly since the late 1970s. Concerns about the environmental effects of economic activity now have a greater influence on both production methods and consumer preferences. Awareness of the economic and social implications of climate change has grown, particularly in sectors strongly affected (as the fisheries sector is by the El Niño phenomenon). In addition, there is fuller recognition today of the importance of sound governance for the economy. Brought into stark relief by the Asian financial crisis, governance appears as a crucial issue at both the national level, through significant movement towards reinforcement of markets via privatisation and regulatory reform, and the firm level, through the pursuit of better corporate governance.

More actors now occupy the global economic stage. China in 1978 was only just embarking on the reforms which have enabled it, now, to be a major force in the world economy. The fall of the Berlin Wall in 1989 opened the way for central and eastern European countries to shift to a market orientation. Developing countries have progressively emerged with a stronger voice and a bigger role in the multilateral trading system.

The growth in the number and range of economic actors has contributed to an intensification of globalisation. A driving factor has been the accelerating pace of technological innovation in recent years, particularly in the field of information technology. One indicator of globalisation has been the rapid growth in international trade and investment flows. At the same time, the determinants of market openness have evolved and become more complex. Since the late 1970s, two rounds of multilateral trade negotiations have been completed and have led to significant reductions in MFN tariffs and the reduction or elimination of many quantitative restrictions. They have provided for discipline in sensitive areas like agriculture, textiles and clothing and trade in services. Global market integration now requires liberal conditions not only in respect of tariffs, but also in terms of non-tariff barriers applied at and behind the border. The multilateral trading system itself has evolved since earlier studies on structural adjustment. Regional and bilateral agreements have come to play a much greater role within the multilateral system, with preferential rules of origin exerting a strong influence on patterns of trade and investment in certain sectors, such as textiles and clothing or motor vehicles. The GATT has given way to the WTO, where the process of dispute settlement now plays a central role in the management of international trade relations.

In all of the sectors examined in this study, a liberal trade environment is found to complement the adjustment process (aided in certain cases by the judicious use of trade safeguards²). At the same time, with the intensification of public concerns about globalisation, making the case for open markets requires greater attention to the costs that liberalisation may entail, costs that may be more strongly felt by workers than by the firms or industries in which they work.³

The nature of the adjustment challenge is highly differentiated:

- It differs from one sector to another, for example between agriculture, where employment is declining, and health services where it is expanding, with the demographics of ageing creating a particularly acute adjustment challenge.
- It differs between different groups in society: producers, consumers and taxpayers are likely to have diverging short-term interests as they may be affected differently by the

adjustment process. The employability advantage from training appears to be lower for women than for men.

- Strong impacts on individuals may translate into modest economy-wide effects. The frequently cited 55 000 jobs estimated to be lost quarterly in the United States because of the international sourcing of business process services is small in comparison with the more than 7 million jobs destroyed on average every quarter as a result of the normal functioning of the US labour market. Moreover, while there has been stable structural change in employment patterns within the service sector over the past two decades, labour adjustments between agriculture, manufacturing and services have actually declined in OECD economies.
- For countries, the adjustment challenge may differ, depending on their level of development. Developing countries face specific trade-related adjustment challenges relating to preference erosion and revenue loss, and formerly high levels of protection from international competition and low levels of productivity and technological sophistication may result in a broader vulnerability. High levels of debt, inadequate infrastructure, weak intellectual property rights, capital shortages and poor governance often compound the challenges.

The differentiated nature of the adjustment challenge means that recommendations about good practice need to be approached with care. It cannot be assumed that an approach which has worked in one sector will *necessarily* work in another, or that good practice for one country or group of countries will *necessarily* translate into good practice elsewhere. The adjustment challenge faced by developing countries differs both in nature and extent from that faced by the advanced industrialised economies. So therefore does the required policy mix and the ability to implement policies. The challenges faced by vulnerable developing countries will require particular attention, in terms both of their own domestic policies and of multilateral action and co-operation. This being said, the cases and peer reviews on which this study is based suggest that a common set of underlying principles of good practice permeate all sectors and tend to be widely applicable across countries, albeit with differing degrees of emphasis.

All countries will benefit by adopting, at the national level:

- Macroeconomic policies that promote stability and growth.
- Labour market policies that help develop human skills and adaptability and facilitate labour mobility across occupations, firms, industries and regions, while providing adequate assistance to those who experience adjustment costs as a result of structural change.
- An efficient regulatory framework that achieves regulatory objectives, while keeping the regulatory burden on enterprises to the necessary minimum, fosters competition and helps ensure genuine market openness.
- A strong institutional and governance framework that favours structural reform, while enhancing social dialogue and thus public understanding and acceptance of reform measures.
- Liberal trade and investment policies that support structural adjustment by contributing to growth, innovation and competitiveness and are implemented over a period gradual enough to enable affected parties to adapt and short enough to avoid policy reversal. Because of downstream linkages, particular benefits are likely to arise

from the liberalisation of trade in services; if account is taken of service barriers, the effective rate of protection for some agricultural and manufacturing industries actually turns negative, meaning that services barriers contribute to effective taxation rather than protection of these industries.

From within this broad menu, poorer developing countries will need to give particular attention to building sound institutions, fostering an appropriate macroeconomic framework and the removal of any anti-export bias, improving firms' access to finance and infrastructure, developing human capital and reducing their own often high barriers to trade. There may be opportunities for a joint package of tariff and tax reform which does not compromise government revenue.

Governments are strongly encouraged to pursue reform across these different policy areas in a complementary, broad-based way to promote acceptance of change, by helping ensure that those disadvantaged by one reform benefit from another and to foster synergies between policies. The combined effect of complementary policies will be greater than the sum of the parts, not least by creating an environment conducive to innovation and technology diffusion that will enable countries to move up the value chain. The key to successful structural adjustment lies less in individual policies than in their interaction. The benefits of a liberal trade regime, for example, will only be fully realised in an economy with appropriate macroeconomic policies, efficient labour markets and a regulatory environment which facilitate mobility of workers and the entry and exit of firms, and an education system which enables skills to match evolving needs. It follows that government should seek, to the greatest extent feasible, to pursue policy reforms in parallel. There may, however, be circumstances when a particular sequence of reform is called for. But there is no blueprint. Many policy initiatives can be advanced as the essential prerequisite of structural adjustment: trade liberalisation, to ensure resources do not migrate to protected sectors; investment liberalisation, to ensure a macroeconomic multiplier effect; reform of industrial relations, to ensure prior labour market preparedness; reform of competition policy, to avoid abuses of dominant position in post-deregulation markets. In fact, the case studies suggest that the actual sequence of these and other policies will finally depend on what is politically feasible in the country concerned.

Governments are also encouraged to rely, as much as possible, on generally available measures to address adjustment costs, including through the tax and social security system, for reasons of both equity and efficiency. In some cases, however, targeted measures may prove effective for addressing certain aspects of the adjustment process, such as to correct for market failure or to address political economy concerns; but when used, these measures should be transparent, cost-effective and compatible with general safety net arrangements. Should it be considered necessary, for example, to use safeguard measures, it is important that their potential benefit in providing breathing space for – and public acceptance of – structural adjustment exceeds the costs they entail.

While appropriate policies adopted at the national level are, for all countries, at the heart of a successful adjustment process, bilateral, regional and multilateral co-operation plays a significant complementary role. Multilateral action is of particular importance for promoting the mutual interests of trade liberalisation, locking in domestic reform and building mutual confidence between enterprises and the societies in which they operate. Multilateral action – through the Doha Development Agenda, the work of international financial institutions, donor co-ordination and greater efforts to improve compliance with ILO core labour standards – is also essential for addressing the multiple adjustment

challenges facing developing countries, particularly the most vulnerable among them. Special attention needs to be devoted to those, relatively few, countries for which preference erosion causes a net welfare loss (of up to -0.4% on a per capita basis) from trade liberalisation. Continued concerted efforts will be needed to improve the supply-side capacities of the poorest developing countries, to diversify their economic activity and to build sound institutions so that they can begin to avail themselves of the full range of policy options identified in this study, some of which, such as certain labour market policies, are currently beyond their reach.

The study has two parts. In Part I, Chapter 1 examines the nature of the challenges faced in each of the eight sectors that are examined in the case studies in Part II.

Chapter 2 then looks at the domestic framework for structural adjustment in OECD countries and addresses structural policies that facilitate adjustment, allowing labour and capital resources to be transferred to more efficient uses in the wake of trade-related displacement and technological change. It draws on existing and ongoing studies, including the OECD Growth Study, the Jobs Strategy and ongoing stocktaking of structural reforms. The policies examined to facilitate the effective deployment or redeployment of labour include benefit and social protection policies, employment protection legislation, job-search assistance, education, training and other active labour market policies. Although the policy implications are drawn from OECD members' experience, they are relevant for all but the poorest countries.

Next, Chapter 3 identifies successful examples of structural adjustment, seeking to distil good practice and draw lessons for both developed and developing countries from the country-focused case studies that can be used to help meet the challenges identified in this report. It also draws on relevant policy lessons from studies of the domestic policy framework of OECD countries. These lessons are put into a trade policy perspective, consistent with the principle that trade policy should facilitate economic efficiency and complement rather than substitute for adjustment. In providing pointers to good practice, the chapter seeks to answer a number of key questions. What structural adjustment policies are likely to be effective and efficient? How do equity considerations affect policy choice? How do policies in different areas interrelate and what might this mean for policy sequencing? What are the respective roles of policy action at the national, regional and multilateral levels?

Part II contains a series of detailed sectoral case studies that provide the underlying source material for much of the analysis contained in this study. Eight sectors were chosen for particular attention: agriculture, fisheries, textiles and clothing, steel, shipbuilding, motor vehicles, health services and international sourcing of IT and business process services. They were chosen because they represent both “old” and “new” areas of activity, although the pervasive nature of technological innovation often blurs this distinction; they impinge upon the interests of both developed and developing economies; and they represent some of the most acute and far-reaching challenges facing the world economy, now and in the near future.

Notes

1. While there is no agreed measure of accelerating technological change, growth in the scale of R&D and patenting activity, along with rises in multi-factor productivity and the transfer of technology from industrialised to developing countries suggest considerable dynamism in both the size and spread of technological innovation.
2. This linkage is enshrined within the WTO Agreement on Safeguards, which recognises in its Preamble “the importance of structural adjustment and the need to enhance rather than limit competition in international markets” and stipulates (Article 5.1) that safeguard measures can be taken “only to the extent necessary to remedy serious injury *and to facilitate adjustment*”.
3. It was pointed out by J. David Richardson that a century or more ago, workers passed through a skills-education revolution that prepared them via public education to move from agricultural and craft jobs into manufacturing and arms-length service production. Today's workers need to pass through an analogous technical and global skills revolution.

Trade and Structural Adjustment: Recommendations for Good Practice

On the basis of the cases examined in this study and other experience gained in the OECD peer review process, governments in both developed and developing countries are recommended to:

1. *Rely, wherever possible, on **generally available measures to address adjustment costs**, including through the social security and tax system, in order to help improve the benefits from openness while reducing adjustment strains.*
2. *Ensure that targeted adjustment measures, should these be considered necessary for reasons of economic efficiency or political economy, are:*
 - 2.1. *Time-bound, with a clear exit strategy.*
 - 2.2. *Decoupled from production.*
 - 2.3. *Aimed at re-employing displaced workers.*
 - 2.4. *Compatible with general safety net arrangements.*
 - 2.5. *Cost-effective.*
 - 2.6. *Transparent and accountable.*
3. *Foster an adjustment-enabling environment, through the promotion of **macroeconomic stability** and growth, which supports the effective functioning of labour markets and the economy in general, and which, particularly in the case of developing countries, complements the process of trade liberalisation by:*
 - 3.1. *Removing anti-export bias and maintaining appropriate exchange rate policies.*
 - 3.2. *Encouraging tax reforms to offset declines in government revenue resulting from tariff reductions.*
4. *Adopt sound **labour market policies** which facilitate the reallocation of workers towards higher productivity employment and so help economies – and their citizens – reap the gains from trade. These entail:*
 - 4.1. *Income-replacement benefits that provide adequate income security for displaced workers while fostering their reintegration into employment. Thus, welfare benefits should support work incentives and not be used as a way to withdraw displaced workers from the labour force (as has often been the case with early retirement and disability schemes).*
 - 4.2. *Active labour market programmes, including job-search assistance, counselling, training, moving allowances and proactive measures in anticipation of mass layoff. These entail:*

- 4.2.1. *Active bipartite co-operation between management and workers' representatives and wider tripartite co-operation with the government in accordance with national practice.*
 - 4.2.2. *Realistic assessment of workers' labour market opportunities and adjustment assistance needs.*
 - 4.2.3. *Use of external specialists in the case of large-scale layoffs.*
 - 4.2.4. *Programmes that are of sufficient duration to provide real support while also discouraging complacency.*
 - 4.2.5. *Complementary support via income-replacement benefits.*
- 4.3. *Employment protection policies that achieve a balance between lessening adjustment costs and not restricting business dynamism.*
- 4.4. *Flexible wage-setting systems, pension portability and fluid housing markets.*
- 4.5. *Education and training systems that foster the development of human capital and help ensure that labour skills meet evolving labour market needs.*
5. Foster a sound **regulatory and competition environment** which permits transformation within firms as well as entry and exit across sectors by facilitating mergers and shifts in corporate culture, keeping regulatory barriers on enterprises to the necessary minimum and reducing the trade-distortive effects of domestic regulation through the reinforcement of:
 - 5.1. *Transparency.*
 - 5.2. *Non-discrimination.*
 - 5.3. *Avoidance of unnecessary trade restrictiveness.*
 - 5.4. *International harmonisation of standards.*
 - 5.5. *Streamlined conformity assessment.*
 - 5.6. *Vigorous application of competition principles.*
6. Foster a strong **institutional and governance framework** that will favour structural reform, while also enhancing public understanding and acceptance of reform measures, via:
 - 6.1. *Effective ex ante policy evaluation, including analysis of whether proposed structural reform is in the overall interests of the community.*
 - 6.2. *Independent review processes to ensure that benefits will outweigh costs while avoiding conflicts of interest.*
 - 6.3. *Mid-term and ex post evaluation to help ensure that policies will be modified if necessary in light of actual experience as well as unanticipated difficulties.*
 - 6.4. *Effective social dialogue based on a well-functioning consultative process between the government and the public, including the private business sector.*
 - 6.5. *Sound public institutions for managing the services and incentives provided to investors, importers and exporters.*

7. Adopt **liberal trade policies**, that support structural adjustment by contributing to economic growth, fostering competitiveness and innovation, improving access to essential imports and encouraging synergies between countries with different areas of comparative advantage, and which:
 - 7.1. Maximise the particular welfare and flow-on benefits which arise from the liberalisation of trade in services.
 - 7.2. Are implemented over a time period long enough to enable affected parties to adjust but short enough to avoid back-tracking.
 - 7.3. Rely sparingly on the use of safeguards, with a careful assessment of whether their potential benefits in providing breathing space for – and greater public acceptance of – structural adjustment justifies the cost they entail.
 - 7.4. Maximise opportunities for associated flows of foreign direct investment.
8. Undertake reforms across different policy areas in a complementary, **broad-based** way, in order to maximise cross-policy synergies and to reduce resistance to structural change, by helping ensure that those adversely affected by one reform may benefit from another.
9. Foster **bilateral and regional initiatives**, where regulatory co-operation can foster opportunities through trade or ease adjustment strains in particular sectors, and where trade-related adjustment and opening can be undertaken among bilateral or regional partners as a transition, or complement, to wider multilateral commitments.
10. Foster **multilateral co-operation** in the adjustment-related and interlinked areas of:
 - 10.1. **Trade and finance**, by avoiding mutually destructive trade policy retaliation, helping lock in domestic reform, while addressing in particular adjustment-related concerns of developing countries, via:
 - 10.1.1. A sustained commitment to the trade-liberalising and rules-strengthening objectives of the Doha Development Agenda.
 - 10.1.2. The effective application of special and differential treatment for developing countries.
 - 10.1.3. Strengthened disciplines on the provision of officially supported export credits.
 - 10.1.4. Enhanced co-operation by the WTO, the World Bank and the IMF to ensure greater coherence in global economic policy making.
 - 10.2 **Capacity building**, via:
 - 10.2.1. Effective co-ordination of the WTO, IMF, World Bank, ILO, bilateral donors and other multilateral agencies to help reinforce developing-country institutional and supply-side capacities.
 - 10.2.2. Co-ordination of donor activities.

10.3. Corporate responsibility and core labour standards, via:

- 10.3.1 *Ongoing efforts to enhance the effectiveness, transparency and timeliness of the implementation of the OECD Guidelines for Multinational Enterprises.*
- 10.3.2 *Ongoing application of the OECD guidelines relating to corporate social governance in the provision of official support for export credits.*
- 10.3.3 *Ongoing application of core labour standards and promotion of decent work, notably by the promotion of the ratification of the relevant conventions and through continued enforcement of the ILO Declaration on Fundamental Principles and Rights at Work.*