



TRADE AND JOBS

Some myths...

- *Trade destroys jobs* – The overall employment effects of trade are positive. While the opening of markets may contribute to structural adjustment and job loss in specific firms or sectors, it also creates more economic opportunities and, over time, new jobs. On the other hand, protectionism has significant negative employment effects, for example, by cutting off access to quality inputs for domestic industries, constraining innovation, and inviting retaliation (OECD, 1998 and 2009a).
- *Trade exacerbates inequality and drives down income* – In fact, open economies tend to deliver higher incomes (OECD *et al.*, 2010). Recent OECD work examines the relationship between wages and trade in 55 countries and 40 industries, showing that imports tend to bring wages up for skilled workers (Stone and Cavazos, 2011). OECD studies find no conclusive evidence that trade systematically causes inequality. Rather, factors such as government transfers, access to employment, and investment in human capital play much more important roles in determining the distribution of income.
- *Trade leads to a “race to the bottom” for working conditions* – The ICITE study by Flanagan and Khor (2011, forthcoming) points to a positive relationship between market openness and working conditions. OECD (2000) finds respect for core labour standards can contribute to growth and efficiency, while countries with weak respect for labour standards do not experience an export performance advantage.

Some facts...

- In Chile, a worker in a sector open to trade and investment gains an average **€1100 more per year** than a worker in a relatively closed sector.
- Exporters account for **90% of aggregate skill upgrading** on average within plants in Korea. Moreover, exporting increases the returns to research & development (R&D) spending and skills upgrading.
- In the service sector in Germany, offshoring of material inputs **reduces an individual’s probability of becoming unemployed** by 60%.
- In Japan, while domestic demand for labour (hours) decreased by 0.4 of a percentage point during 2000-06, **export-driven demand for labour increased by 0.14 percentage points**.

Some preliminary findings...

- **Greater market openness is a necessary condition for sustained improvement of economic performance**, including improved productivity, higher incomes and new job opportunities. Of the nine ICITE studies that consider job creation in relation to trade, all found positive results for at least one substantial segment of the economy.
- **Trade opening must be complemented by other policies in order to ensure inclusive growth**. Trade creates new economic opportunities, allowing countries to leverage previously under-utilised assets and human capital. All 10 ICITE studies highlight differential trade effects on various groups, with impacts highly dependent on institutions, economic framework conditions and related policies.
- **Complementary policies, including education, active labour market policies, labour market flexibility, infrastructure development and social protection are essential to facilitate adjustment, inclusion and capacity to benefit from trade liberalisation**. Such policies can affect demand for skills (discussed in seven of 10 ICITE studies) and address labour market rigidities or segmentation (issues emerging in six of the ICITE studies).

Introduction

Over the course of the last half century, the global expansion of trade has reshaped the world economy. Trade liberalisation has enabled economies to reap the benefits of specialisation and focus more productively on what they do best, through the sectors where they demonstrate comparative advantage. Trade has fuelled competition, innovation and economies of scale, allowing the world to ration its finite resources more efficiently. As a consequence, consumers (both individuals and businesses) have enjoyed better prices and increased choice, while competitive firms have gained reliable access to needed inputs and larger markets. Greater market openness goes hand in hand with better economic performance in both developing and developed economies and it has contributed to lifting millions out of poverty.

At the same time, there have been very real adjustment costs. The relationship between trade and jobs is positive, but also complex. While trade is only one of many variables that influence labour markets, it can be very important in certain contexts. Trade is clearly correlated with net employment creation, increased real incomes and enhanced productivity, albeit with significant variation depending on local conditions. While some of these conditions – such as geography – are relatively fixed, others can be influenced by institutions and policies. Government decisions help shape important complements to market openness such as the supply of qualified labour, the ability of the labour market to adjust to new economic opportunities, the availability of social protection to facilitate adjustment and redistribute gains, and the adequacy of other inputs, such as physical infrastructure.

The current weak economic recovery and the slow pace of job creation in many countries have heightened interest in the potential role of trade in stimulating lagging labour market performance, as well as concerns about the cost of adjustment. How can trade liberalisation stimulate economic growth? What conditions must be in place to optimise the outcomes for society as a whole, and for vulnerable segments of society? How does experience vary across countries and are there transferrable lessons?

This brief provides an OECD Secretariat assessment of initial findings from work under the **International Collaborative Initiative on Trade and Employment (ICITE)**, an on-going project of 10 international organisations aiming to improve understanding of the relationship between trade and jobs and to develop practical advice that better informs policy decisions.¹

Why does trade matter for jobs?

While the positive relationship between trade, growth and economic development is well-documented, the relationship between trade and jobs begs further analysis. This is in part because trade is only one of the factors affecting labour market outcomes, and in part because complementary policies matter a lot in determining outcomes. There are at least six distinct ways in which trade can influence labour markets, either by affecting employment, wages, or the level of risk.

- **Employment level:** By affecting relative demand for a country's products, trade can affect the aggregate level of employment in a country, either increasing or reducing demand for labour.
- **Jobs distribution:** By promoting reallocation of resources from least productive firms and sectors of the economy to the most productive ones, trade may lead to restructuring with employment

¹ Participating ICITE partner organisations include: ADB, AfDB, ECLAC, IADB, ILO, OAS, OECD, UNCTAD, World Bank & WTO. The views expressed in this brief do not necessarily reflect those of OECD member countries or ICITE partner organisations.

effects within and across various sectors. Depending on the sector, this adjustment may affect absolute employment levels or the demand for workers by location, gender or level of skill.

- **Overall wage levels:** By promoting increased competition and driving innovation and increased productivity, international trade can influence overall wage levels in a country. Historically, greater trade openness has, on average, been associated with higher levels of income.
- **Wage distribution:** Trade can also impact wage inequality, though it is not a major contributor compared, say, to technological change (OECD, 2011). Where there are trade-related effects, the direction of change may vary, with trade either reducing or exacerbating inequality depending on its effects on demand for labour by sector and by type of labour (e.g. high skilled versus low skilled).
- **Innovation and dynamic gains from trade:** By providing access to a greater variety of inputs and unleashing competitive pressures, trade serves as an important channel for technology transfer, innovation and increased productivity (Onodera, 2008). OECD research confirms that trade indeed drives productivity and spurs innovation and entrepreneurship (Miroudot *et al*, 2009; Stone and Shepherd, 2010).
- **Level of risk:** Trade may also produce so-called second-order effects associated with risk to labour market participants. By increasing global linkages, trade may infuse domestic systems with greater short-term volatility due to greater exposure to external shocks. At the same time, it is these same global linkages that decrease dependence on domestic demand, fuel innovation and growth.

Actual labour market outcomes of trade liberalisation depend on a multiplicity of factors, including the degree of “openness” or exposure to the global marketplace, underlying structure of a country’s economy, institutional strength and orientation, labour market rigidities, the level of human capital development, robustness of social safety nets, adequacy of infrastructure and other elements. To be able to predict accurately the possible impact of market openness on a given economy and provide appropriate policies in a timely fashion, policymakers must understand well the channels through which trade can influence jobs and supplementary factors required for achieving optimal results.

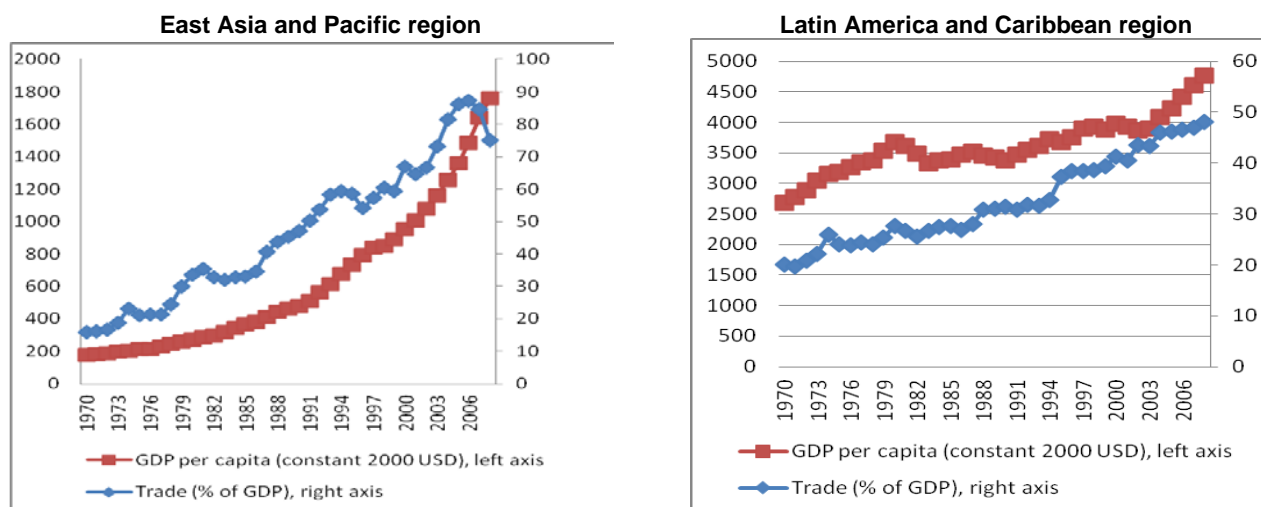
Trade, jobs, wages and working conditions

Through an ambitious research agenda, the ICITE project is helping to provide further empirical evidence as an input to fact-based policy formation. Some preliminary insights are already emerging from ICITE country case studies (Table 1) and three regional ICITE conferences held in 2011 (in Africa, Asia and South America). Overall, the picture is positive, confirming the view that trade bears significant potential in driving growth and employment, subject to the implementation of a coherent policy framework.

- **Job creation:** OECD estimates show that even under recession conditions further liberalisation among the G-20 economies leads to improved labour market outcomes (Dee *et al*, 2011). Namely, a 50% reduction in tariffs and non-tariff measures can lead to increases of 0.3% to 3.4% in employment for low skilled workers and between 0.7% and 5% for high skilled workers. Moreover, ICITE studies illustrate that commonly feared aspects of globalisation – such as offshoring – may, in fact, improve labour market outcomes. For instance, in Germany offshoring of material inputs reduced the risk of being unemployed both in the services and manufacturing sectors (Görg and Görlich, 2011).

- Working conditions:** A forthcoming ICITE study compares a broad sample of open and closed economies around the world between 1970-2000 and finds that openness was associated with improved working conditions (Flanagan and Khor, 2011, forthcoming). Also, in terms of fatal accidents and life expectancy, open economies fare significantly better than closed ones. An ICITE case study of Japan provides a confirming example of improved conditions. During 1995-2006, trade openness there was associated both with an increase in the number of workers employed and a reduction in the number of hours each worked on average (Kiyota, 2011). Exports in manufacturing created more jobs and better working conditions, while also creating jobs in non-manufacturing sectors through inter-industry linkages.
- Wages and incomes:** According to Flanagan and Khor (2011, forthcoming), open economies outperform closed economies most notably in terms of pay. Workers in the manufacturing sector in open economies benefitted from pay rates that were between 3 to 9 times greater than those in closed economies, depending on the region. An ICITE study jointly prepared by ECLAC and ILO for the case of Chile (Friedman *et al.*, 2011) finds that sectors open to trade and investment deliver a wage premium and are characterised by higher levels of unionisation. In 2008, a worker in a high-openness sector in Chile earned on average about €1100 more per year than a worker in a low-openness sector. Moreover, besides driving wages up, trade also positively affects incomes by lowering prices of goods and services as a consequence of increased competitive pressures. As a result, trade has played a crucial role in helping sustain per capita income growth (Figure 1).

Figure 1. Evolution of per capita GDP and trade intensity (trade as % of GDP)



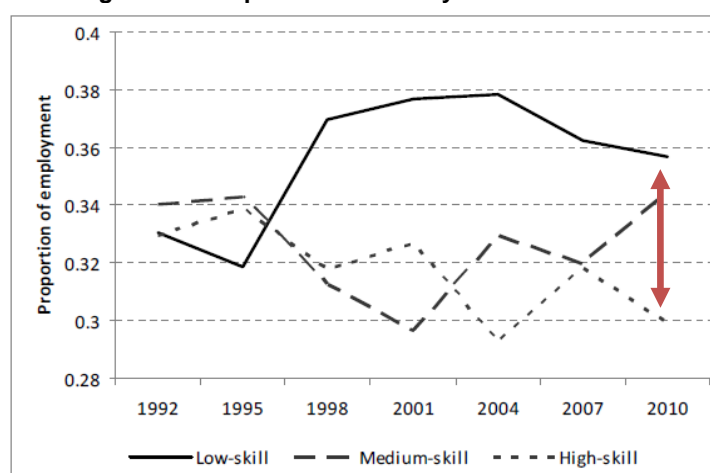
Source: World Bank (2010), World Development Indicators

Complementing an open trade policy

Apart from verifying the positive role of trade, ICITE case studies also provide insight into policy areas that interact to shape the labour market outcomes associated with trade liberalisation. The discussion in the foregoing sections highlights some of the complexity in the relationship between trade and employment, as well as some of the diversity in the policy challenges faced by countries around the world. In particular, four policy areas emerge as particularly important across countries and regions in allowing societies to reap full benefits of trade and facilitate smooth adjustment.

- **Labour market flexibility:** Long-term OECD studies such as the Jobs Strategy (OECD, 2006) highlight the role of employment flexibility in enabling firms to adapt to changing economic conditions and the role of wage flexibility in ensuring that markets are able to transmit clear signals to workers and firms. Undue labour market rigidities can impede the ability of openness to deliver anticipated labour market benefits. For example, trade liberalisation has provided new export opportunities for French firms, to which they have successfully responded. Trade has helped to increase productivity and global competitiveness of French firms. However, the increase in exports has, surprisingly, not had a positive echo in terms of employment (Kramarz, 2011). An ICITE case study suggests market rigidities have led to relatively high labour costs and encouraged increased outsourcing. This highlights the importance of a coherent policy approach that permits markets to respond positively to changing patterns of demand.
- **High-quality education and training:** Trade contributes to accelerated innovation and technological change, which can increase the demands for workers to adapt to change (OECD *et al*, 2010). Appropriate education and training are important inputs to human capital development needed for such adaptability. In several of the ICITE case studies, trade is found to be associated with increased demand for skilled labour. For example, in Korea, most skill upgrading in firms was accounted for by exporters. In Chile, relatively high returns to skills and experience were found, with increased demand for skills in open sectors. Poor-quality education, an inadequate skills set or shortages in the number of skilled workers, however, may affect countries ability to profit from these benefits of globalisation. For example, over past two decades Mexico has experienced a large expansion in the total number of skilled workers. Nevertheless, the share of high-skilled, high-pay jobs actually declined. Despite hopes that trade opening through the North American Free Trade Agreement (NAFTA) would benefit skilled workers in Mexico, allowing the country to move up the value chain, Mexico has tended to capitalise on its abundant supply of low and medium skilled labour (Figure 2). In view of increased global competition, one factor that may contribute to this result is the relatively weak performance of educational systems in Mexico, which continues despite substantial improvement in recent years (OECD, 2009b).

Figure 2. Occupational shares by skill level in Mexico



Source: Campos-Vazquez and Rodriguez-Lopez (2011)

- **Social security systems and active labour market polices (ALMPs):** Globalisation is associated with intensified economic change, and adjustment to such change can mean dislocation for some workers

and challenges in matching them with available vacancies or equipping them for new employment opportunities (OECD, 2007). An appropriate safety net, tailored to the specifics of a country, can make a substantial contribution in this regard, while ALMPs are an important instrument promoting reintegration of dislocated workers. As such, those two approaches are complementary and facilitate adjustment. An ICITE case study of Denmark highlights the “flexicurity” approach, which promotes the ability of employers to adjust their labour demand to changes in economic conditions, while providing relatively generous support to dislocated workers, subject to important requirements. Namely, the unemployed are required to seek employment or engage in training to acquire skills needed in the labour market. The ICITE case study of Italy shows that while trade brings benefits of specialisation, it also increases competitive pressures, which may render employment more precarious for some segments of society (Iapadre, 2011). In Italy, which has a large shadow economy, the social protection system faces substantial challenges in assisting displaced workers. For example, workers on so-called non-standard labour contracts comprise a substantial share of the labour force, but are not entitled to standard social protection. This highlights the importance of a coherent and comprehensive social security system in order to boost the resilience of society to changes related to globalisation.

- **Business climate and infrastructure** – Ensuring an appropriate business climate is an important part of the mix in creating jobs, trade related or otherwise. Beyond sound macro-economic policies, the OECD Jobs Strategy points to such elements as appropriate wage-setting machinery, taxes and labour- and product-market regulations (OECD, 2006). Several of the ICITE country studies (e.g. France, Mexico and Spain), point to areas for improvement in this regard. In the context of trade, particularly in a developing country context, other elements such as inadequate infrastructure can also play a critical role. As noted in the recent *Aid For Trade* report by OECD and WTO (2011), “The quality of infrastructure is one of the most pervasive binding constraints to export growth, productivity increases, and increases in national incomes.” Shortfalls in business climate and infrastructure can impede the capacity to seize upon economic opportunities arising from market openness or to ensure full labour market benefits from trade.

What next for trade and jobs?

While the relationship between trade and jobs is complex, available empirical evidence points to substantial potential for positive labour market outcomes, as long as appropriate complementary policies are also in place. In practice, there has been a clear tendency for openness to contribute to rising incomes, new jobs and better working conditions. A growing body of fact-based policy analysis underway at OECD and through the ICITE project is providing insights as to the kinds of policies that may be most helpful in promoting improved labour market outcomes. From this work, it is clear that a dynamic approach to policy design is needed in order to respond appropriately to the changing nature of economic challenges, some short-term and others longer term in nature. Moreover, we also know that protectionism carries a substantial economic cost for consumers and the labour market, and thus offers no alternative to market openness. Given an appropriate policy framework, OECD analysis indicates that further market opening, with respect to tariff and non-tariff measures for goods and services, can deliver economic benefits including for labour markets (OECD *et al.*, 2010). In the midst of sluggish recovery in the global economy and fears of “jobless growth”, there is every reason to pursue the option of further market opening.

Table 1. ICITE Country Studies – Illustrative Trade and Labour Market Outcomes, Policy Implications

	Jobs	Wages	Human capital	Policy issues
Chile (Friedman et al., 2011)	N/A	A wage premium & high unionisation in open sectors.	Relatively high returns to education & experience.	Trade creates econ. opportunities & increases demand for skills in open sectors.
Denmark & Spain: Comparative Study (Arnal, 2011)	Exports to non-EU countries are positively, but weakly, correlated with increased employment. Factors other than trade appear to be the main drivers of employment.	Trade is not strongly related to changes in income inequality (hourly wages) between high and low skilled workers in Denmark or Spain.	Improving the supply of skills in the labour market remains a competitive challenge.	Denmark – “flexicurity” model; Spain – dualism in the labour market, but important recent reforms aim to reduce this.
France (Kramarz, 2011)	Growth in firm-level export intensity is associated with job losses; growth in import intensity with job gains.	Cites previous finding of a positive relationship between high wages, outsourcing & employment declines.	N/A	Labour market rigidities increase costs for firms to employ necessary work force in France, fuelling outsourcing & decreasing local jobs
Germany (Görg and Görlich, 2011)	Offshoring: of goods inputs in a sector reduces unemployment risk, of services inputs may increase service sector unemployment risk. Trade may decrease temporary workers’ job security.	Increased trade intensities have low impact on wages in general due to a rigid wage bargaining system; but a positive effect for temporary workers in services.	N/A	Increased competitiveness in the service sector could be positive for employment. Temporary workers may require additional support.
Italy (Iapadre, 2011)	Exporting is associated with sustained labour demand (especially in manufacturing) & increased specialization. Substantial non-standard employment and informal sector.	Increased wage gaps between white collar & blue collar workers. International competition from developing countries can exert negative pressure on wages.	Exporting associated with skill upgrading. Promotion of innovation requires deepening of human capital.	Need for accessible & effective social protection, with effective assistance and incentives. Need improved protection for workers with non-standard contracts.
Japan (Kiyota, 2011)	Exports increase labour demand. Goods exports positively influence demand in other sectors. Weak domestic final demand offsets these effects.	Rates of wage growth have declined in recent decades.	N/A	Reform of labour law increased flexibility, permitted adjustment via working hours rather than numbers of workers.
Korea (Hahn and Park, 2011)	Exporting drives up the proportion of skilled labour in firms. Rate of overall manufacturing job creation declined, but productivity increased.	In manufacturing, increasing proportions of the total wage bill went to non-production workers.	Substantial skill upgrading within exporting firms, including large firms & heavy R&D investors.	Trade fuels demand for skilled labour & technological change: active labour market policy can assist with skills & adjustment.
Mexico (Campos-Vázquez & Rodríguez-López, 2011)	Due to NAFTA, relatively large increases in demand for low skilled labour in Mexico, but high-skill jobs have remained stagnant.	Employment increases have been the largest for low wage occupations.	A large pool of skilled labour, but bottlenecks remain: credit, education, investment, labour market inflexibility.	Policies to address bottlenecks may bolster ability of the economy to reap the benefits of trade.
South Africa (Sandrey et al., 2011)	Regional liberalisation in agriculture could yield job increases in primary (1%) & secondary (1.5%) agriculture.	Regional liberalisation in agriculture increases wages more for unskilled & non-whites vs. others.	Similar job gains for skilled & unskilled labour (despite dualism in the market).	Inclusive benefits from regional opening in agriculture: non-whites, females and unskilled labour gain.

More information

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