



OECD

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**TOWARDS A MORE  
OPEN TRADING SYSTEM  
AND  
JOBS RICH GROWTH**

# **Towards a More Open Trading System and Jobs Rich Growth**



## Trade, Growth and Employment

### The available evidence...

- While the relationship between trade and jobs is complex, it is clear that trade contributes to economic growth. Open economies grow faster than closed ones, while trade restrictions stifle productivity and growth, and often tax the poor disproportionately.
- Trade can create new and better jobs as productivity improvements translate into higher skill and higher wage jobs. Wages in more open sectors are systematically higher than in closed sectors.
- Trade can also improve working conditions. The effects may be direct, or indirect, through the stimulus it gives to growth. Workers in open sectors often enjoy shorter working hours, fewer accidents and improved life expectancy.
- Imports do not increase unemployment; there is no systematic link between national levels of imports and levels of unemployment.
- Off-shoring and outsourcing from developed countries more often complement rather than replace domestic jobs, and often provide higher wage opportunities in developing countries.
- Open services markets can play a vital role in improving productivity and competitiveness both in manufacturing sectors that are users of services as well as in the services sectors themselves.
- Trade has no systematic effect on income inequality, although it can tilt wages in favour of higher skilled workers. Technological change and tax, spending and education policies are much more important in influencing income distribution.

### ...and the implications for policy

- Protectionism is the wrong response to perceived trade-related and wider economic concerns and will invariably be counter-productive.
- More open markets are a necessary but not a sufficient condition for inclusive growth, job creation, and overall prosperity. Complementary policies are also needed.
- The nature of these complementary policies varies by country, but generally includes: public investments that improve domestic supply capacity (Aid for Trade can be important in this respect), macroeconomic and structural policies and governance institutions that create a positive climate for private investment, and active labour market and social protection policies that facilitate needed structural adjustments (i.e. protect workers, not jobs).
- Particularly in today's economic environment, trade and other structural policies have a potentially much more important role to play in boosting growth and jobs, without undue additional stress on budget deficits. While this is best achieved via a strengthened rules-based multilateral trading system, plurilateral, regional, and national initiatives are also viable options.

## Introduction

1. Over the course of the last half century, the global expansion of trade has reshaped the world economy. Trade opening 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 lower 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 developed and developing economies and it has contributed to lifting millions out of poverty.

2. At the same time, there have been significant adjustment costs. Subject to the appropriate policy framework, the relationship between trade and jobs is generally positive, but also complex. While trade is only one of many variables that influence labour market outcomes, it can be very important in certain contexts. Trade is clearly correlated with 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, the investment climate and the adequacy of other inputs, such as physical infrastructure.

3. The current weak economic recovery and the slow pace of job creation in many countries have raised concerns about a possible spiral of protectionist measures by governments. But these same conditions have also heightened interest in the potential role of trade in stimulating lagging labour market performance. How can trade opening stimulate economic growth? What conditions must be in place to optimise the outcomes for society as a whole, and for vulnerable segments of society? Given the dominant role of services in all economies, how can services trade be promoted? Is the emergence of regional and global value chains an opportunity or a threat to trade-related growth and job creation?

4. This document highlights findings from the *International Collaborative Initiative on Trade and Employment (ICITE)*,\* along with relevant information on recent trends in protectionist pressures and on the role of regional and global value chains in goods and services trade. This paper has been prepared by and is under the sole responsibility of the OECD Secretariat, with a view to enable an informed discussion by Ministers of actions that could be taken to reduce the risks of protectionism and to open markets further, in particular for services sectors.

## Resisting Protectionism

5. Global economic and trade growth is slowing markedly and many countries are faced with high or growing unemployment and debt levels. According to the OECD's latest Employment Outlook the unemployment rate is still in excess of 8% and 47 million people are unemployed across the OECD area.<sup>1</sup> Multilateral trade negotiations at the WTO are at an impasse, and many governments are looking towards various forms of plurilateral, regional and bilateral arrangements to maintain or expand market openness.

6. In 2009 trade collapsed and fears were expressed of a spiral of self-defeating discriminatory and protectionist measures. By and large this was avoided, and the restraint shown by governments was

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\* Participating ICITE partner organisations include: ADB, AfDB, ECLAC, IADB, ILO, OAS, OECD, UNCTAD, World Bank & WTO. Views expressed in this document do not necessarily reflect those of ICITE Partner Organisations.

rewarded with the rapid recovery in trade flows which has been an important factor in maintaining economic momentum in the intervening years.

7. While the situation today is not the same as in 2009, pressure for governments to resort to protectionist measures is once again emerging. Institutions charged with monitoring trade policy all report increasing numbers of restrictive measures. Thus far there continues to be less resort to classic trade measures, but an apparently growing trend towards various, more subtle discriminatory measures that favour local producers and suppliers, among them discriminatory investment measures, local content requirements and a battery of technical and regulatory measures. These measures create uncertainty which itself is detrimental to trade and are less transparent than explicit border measures. There is a clear danger that restrictions build up incrementally, slowly stifling trade and ultimately weakening growth.

8. OECD analysis has repeatedly demonstrated the negative effects of all forms of protectionist measures on growth and on trade in both the country taking the measure and on its trading partners.<sup>2</sup> Typically, import restrictions will inflict a fall in both imports and exports of the country implementing the measure and in its partner countries and both will also experience losses in GDP. The nature of modern trade, not least the emergence of regional and global value chains, means that protectionist measures will invariably cut off a country's own firms and industries from needed goods and services inputs.<sup>3</sup> The negative effects of protectionist measures are also compounded if trading partners retaliate, as is inevitable. It is imperative that governments abide by the commitment made at the G20 and again at the WTO during the most recent Ministerial Conference in December 2011, to resist protectionism in all its forms.

9. New analysis by OECD to assess the likely impact on trade and growth of *stylized* forms of policy measures that have recently been introduced will be available at the time of the forthcoming WTO-OECD-UNCTAD monitoring report (i.e. June 2012).

### **Pursuing Trade, Growth and Jobs**

10. Governments today need to eliminate trade barriers and create the conditions in which more rather than less trade can occur; trade remains one of the important structural policy tools open to governments to stimulate their economies. The positive relationship between trade, growth and economic development is well documented, while the relationship between trade and jobs is more complex. 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 those outcomes.

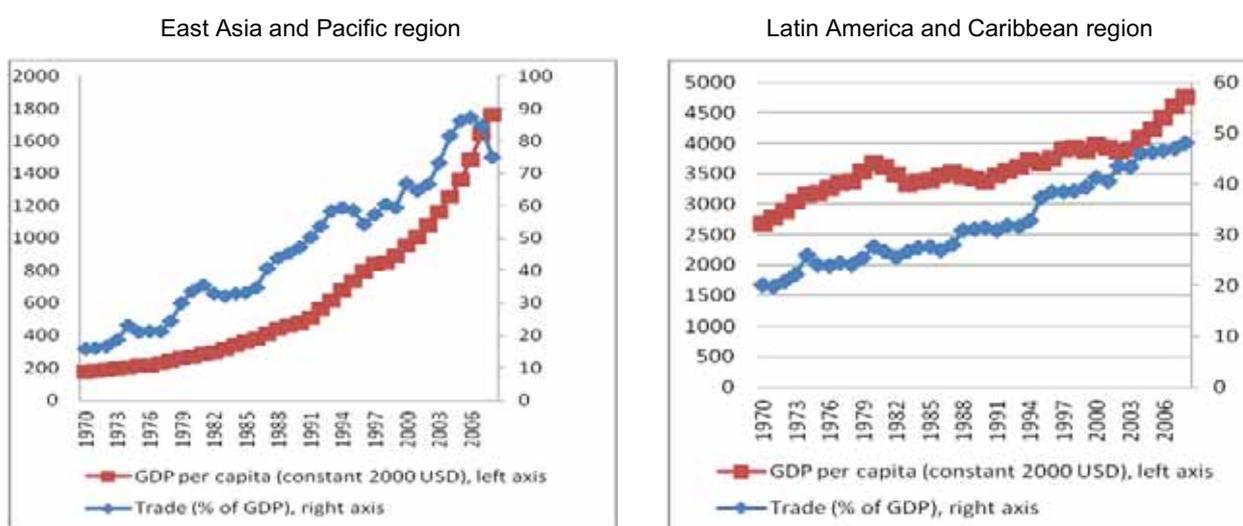
11. Actual labour market outcomes of trade opening depend on a multiplicity of factors, including the degree of "openness" or exposure to the global marketplace, the underlying structure of a country's economy, institutional strength and orientation, labour market rigidities, the level of human capital development, robustness of social safety nets, adequacy of infrastructure and other elements. Overall, the ICITE results confirm the view that trade bears significant potential to drive growth and employment.

- **Growth and productivity:** The abundant literature on effects of trade on growth has converged on the view that trade plays a strong and positive role in the growth process. The full contribution of trade to growth is realised when supportive policies are in place – especially a stable macroeconomic environment, a positive investment climate, flexible labour markets, and adequate safety nets. Moreover, the higher incomes associated with trade-led growth are associated with higher real wages. One important channel through which trade affects incomes and wages is through its effects on productivity. In country after country, the power of both exports and imports to raise productivity growth – and thus the wages in firms in the tradable sectors – has been demonstrated. For instance, in Indonesia reducing tariffs on final goods imports by 10% has been shown to increase productivity by 1% while the same reduction on

intermediate inputs increased productivity by 3%.<sup>4</sup> Similarly, trade liberalisation in Brazil triggered faster productivity growth in export industries.

- **Job creation:** OECD's estimates show that, even under recession conditions, further liberalisation among the G20 economies leads to improved labour market outcomes. 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.<sup>5</sup> Moreover, ICITE studies illustrate that commonly feared aspects of globalisation, such as off-shoring, may in fact improve labour market outcomes. For instance, in Germany off-shoring of material inputs reduced the risk of being unemployed both in the services and manufacturing sectors.<sup>6</sup>
- **Working conditions:** One important ICITE study compares a broad sample of open and closed economies around the world between 1970 and 2000 and finds that openness was associated with improved working conditions.<sup>7</sup> 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. Exports in manufacturing created more jobs and better working conditions, while also creating jobs in non-manufacturing sectors through inter-industry linkages.<sup>8</sup> One reason why trade can impact positively on working conditions in developing countries is because companies respond to the views of their consumers which are in turn influenced by NGOs advocating for better working conditions.<sup>9</sup>
- **Wages and incomes:** Open economies outperform closed economies most notably in terms of pay.<sup>10</sup> 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 finds that sectors open to trade and investment deliver a wage premium and are characterised by higher levels of unionisation.<sup>11</sup> In 2008, a worker in a high-openness sector in Chile earned on average about EUR 1 100 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 competition. As a result, trade has played a crucial role in helping sustain per capita income growth (Figure 1).

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



Source: World Bank (2010), World Development Indicators.

## Complementing an Open Trade Policy

12. Apart from verifying the positive role of trade, ICITE case studies also provide insights 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* 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.<sup>12</sup> Undue labour market rigidities can impede the ability of openness to deliver anticipated labour market benefits. An ICITE case study of Australia looks at adjustment in the context of a significant improvement in terms of trade caused by the commodities boom.<sup>13</sup> Australia's high degree of labour flexibility has enabled larger increases in GDP and average real wages and has ensured that the benefits are more widely distributed than would otherwise have been the case. Several countries, among them Italy and Spain, are currently considering or implementing reforms that go in the direction of increasing labour market flexibility with a view to improving overall economic and employment outcomes.
- **High-quality education and training:** Trade contributes to accelerated innovation and technological change, which can increase the demands for workers to adapt to change.<sup>14</sup> 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.<sup>15</sup> In Chile, relatively high returns to skills and experience were found, with increased demand for skills in open sectors.<sup>16</sup> For example, an ICITE study comparing the experience of Denmark and Spain (Arnal, 2011) notes that differences in education have been an important factor determining the extent to which workers have been able to adapt to business cycle fluctuations and progressive introduction of new technologies. In 2008, 74% of the population in Denmark had completed at least upper secondary education, compared to 54% in Spain, which combined with effective training opportunities rendered the labour force more mobile. Education is thus an important element of the required policy set allowing trade openness and high job turnover to be compatible with robust employment.
- **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.<sup>17</sup> 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.<sup>18</sup> But, workers on so-called non-standard labour contracts, who 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 macroeconomic policies, the OECD Jobs Strategy points to such elements as appropriate wage-setting machinery, taxes and labour- and product-market regulations.<sup>19</sup> Several of the ICITE country studies (e.g., France, Mexico and Spain),<sup>20</sup> 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),<sup>21</sup> “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.

### Opening Markets for Trade in Services

13. One clear pattern in the structure of the global economy over the past twenty years has been the shift towards services. Services have assumed increased importance in all country groupings, accounting for the largest share of GDP in high-income (71%), middle-income (57%) and low-income countries (45%). Cross-border services trade accounts for about 20% of total trade and services trade contributes 10% to global GDP.

14. The largest services trade volumes are in travel, transport and other business services, while trade growth has been strongest in computer services, finance, and other business services. But in comparison to goods, trade in services remains relatively low and stagnant owing in part to high rates of border and behind-the-border protection.

15. The role of competitive services sectors is increasingly acknowledged as an important determinant of growth.<sup>22 23 24</sup> Services tend to be inputs into the productive process, and as a consequence are a driver of productivity growth as well as sources of new employment. In many OECD countries, for example, services accounted for more than one half of productivity growth between 1990 and 2002. In India, services liberalisation led to productivity increases in manufacturing of almost 12% for domestic firms and over 13% for foreign firms.<sup>25</sup> Openness in financial and telecommunications services has been shown to be particularly important. In some studies, full openness was associated with growth rates of up to 1.5 percentage points faster than other countries.<sup>26</sup> This is because services imports generally are characterised by the liberalisation of both foreign and domestic access to markets and because foreign suppliers to domestic market often bring in new technologies or product differentiation advantages.

16. Going further, recent OECD work suggests that asymmetric patterns of liberalisation – that is, higher world-wide trade barriers in services as opposed to goods – may have played a role in the build-up of large current account imbalances.<sup>27</sup> Since services account for most non-labour costs of production, reforms that would improve the efficiency of services should be a major focus of policy in deficit countries, complementing policies to switch the pattern of expenditure and reduce net consumption. In surplus countries, where services barriers are relatively higher than in deficit countries, expanding domestic consumption and investment should also focus on services such as financial intermediation, insurance, retail distribution, and related logistics. Expanding the scope for international trade and investment in services can help generate the required structural changes.

17. Recognising the crucial role of services in contributing to future trade, growth and job creation, OECD has embarked upon a major new initiative to build a regulatory database of services regulations,

encompassing all services sectors and all countries that are or aspire to be major services providers. This qualitative database will be complemented by quantified indices of services trade restrictiveness (the Services Trade Restrictiveness Index – STRI), thereby providing the information needed for effective domestic and multilateral services policy reforms. All OECD and major emerging economies, which together have much to gain from opening trade in services, are invited to join this initiative.

### **Understanding the Role of Regional and Global Value Chains**

18. Another major structural change relevant for trade opening is the emergence of regional and global value chains. The whole process of producing goods, from raw materials to finished products, is increasingly carried out wherever the necessary skills and materials are available at competitive cost and quality. Advances in information and communications technologies have helped make this possible for both goods and services. While manufactured goods still account for the largest share of international trade (75%), improvements in technology, standardisation, infrastructure growth and decreasing data transmission costs have all facilitated the sourcing of services from abroad. In particular, “knowledge work” such as data entry or research and consultancy services can easily be carried out via the Internet and e-mail, and through tele- and video-conferencing.

19. So the “value chain” for any particular business – the value added by different processes or activities at each stage of production – is now regional or even truly global in nature, rather than national. This international fragmentation of production is a powerful source of increased efficiency and firm competitiveness. Today, more than half (56%) of world manufactured imports are intermediate goods (primary goods, parts and components, and semi-finished goods), and 73% of world services imports are intermediate services.<sup>28 29</sup>

20. This heightened integration has implications for the impact of trade and investment barriers both on the country implementing the measures and on the global economy. When an economy is part of a vertically-integrated chain with complex ownership structures, a disturbance in any part of the link can disrupt the entire chain. Policies that restrict access to foreign sources of intermediate goods and services will also have a detrimental impact on a country’s position in the regional or global supply chain. Because tariffs on intermediates would increase the cost of production and reduce overall competitiveness, firms could be discouraged from investing, or even from maintaining investment, in a country. Tariffs on intermediate inputs that typically cross borders several times are cumulative; they can thus add up to impose punitive costs on downstream users and eventually final consumers, and as a consequence stifle demand. As such, trade restrictive policies are more likely to produce firm closings and job losses – the very outcomes they were designed to prevent.

21. As goods and services cross borders many times before being purchased by final consumers, traditional trade statistics also count these transactions multiple times, leading to a highly distorted picture of reality. In response, OECD and WTO have launched an initiative to measure trade on a value added basis. In contrast to current indicators of gross trade flows, value added statistics would provide an accurate view of the underlying economic importance of trade. By identifying where value is being added, it will be possible to identify accurately where income and jobs are created. In addition, it will allow for a more accurate picture of bilateral trade imbalances.<sup>30</sup>

### **Conclusion**

22. It is clear that protectionism carries a substantial economic cost for firms, employees, and consumers. It is also clear that while the relationship between trade, growth and jobs is complex, more open economies grow faster than closed ones. Trade opening generally contributes to positive labour market outcomes, raising incomes and creating jobs. There will be more and more inclusive growth if

companion policies are also in place. These complementary measures vary according to the needs and capacities of individual countries, but in general they include: investments in improving domestic supply capacity (initiatives such as Aid for Trade are important in this respect), macroeconomic and structural policies and governance institutions that create a positive investment climate; and active labour market and social protection policies that facilitate needed structural adjustment.

23. With these conditions in place trade will drive growth and productivity to higher levels and generate higher wages and contribute to improved working conditions. Although trade may increase skill premiums among salaried workers, trade is not responsible for the growing inequality observed in many societies - education, fiscal and social policies are much more important. Off-shoring and production sharing arrangements are more often complements than substitutes for jobs in high income countries while providing job creation and high wage opportunities in developing countries.

24. The case for further market opening in services is compelling, and would provide a significant boost to productivity as well as to jobs and wages in countries at all stages of development. Ongoing efforts to better understand the nature and behaviour of firms involved in global value chains will improve our understanding of how and where value is added and how jobs are created. Measuring trade in value-added terms will clarify the benefits that accrue to economies from both importing and exporting and put an end to the mercantilist paradigm that seeks access to the markets of others for exports while maintaining protection against imports.

## NOTES

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