

NEW THINKING ON TRADE POLICY AND DEVELOPMENT

TRADE AND EMPLOYMENT



PSE

Socialist Group in the
European Parliament

With this new pamphlet, the Socialist Group continues its series of publications on 'A new approach to trade policy and development'. We have opened up this debate to contributions from external experts from various walks of life, so that they can compare their views with those of our Group members and enrich our analyses and proposals.

For this third pamphlet, after having dealt with the relationship between multilateral negotiations and bilateral negotiations and the link between sovereignty and trade policy, we have chosen the topic 'Trade and Employment'.

It is above all the great changes in the way world trade is organised which have prompted the Socialist Group to query the relationship between trade and employment. Indeed, the process of trade globalisation is leading to a growing number of relocations of companies, but also of workers; production methods and the international division of labour have changed substantially. The opening up of trade boosts certain sectors and certain countries but can also destroy thousands of jobs in other, more fragile, less competitive countries. The issue of the impact on working conditions in both industrialised countries and developing countries must also be addressed.

In this regard, the Socialist Group welcomes the recent publication of a joint WTO/International Labour Organisation (ILO) study on *Trade and Employment*¹. This document analyses the links between trade and employment to show when government intervention is necessary for trade liberalisation to have a positive global impact on employment. Along the same lines, the Socialist Group actively supports the promotion of ILO standards and decent work on a global scale. Given the multiplication of bilateral and regional agreements currently being negotiated between the EU and developing countries (ACP countries, India, ASEAN, Korea, etc.), the Socialist Group wants to ensure that each new agreement contains clauses stipulating that fundamental labour rights must be implemented effectively in the signatory countries.

From a multilateral point of view, in the context of the Doha Round (which, being geared to development, must distinguish itself from previous rounds), it is also essential that the links between trade and employment be dealt with more thoroughly, so that trade policies truly contribute to sustainable economic and social development in all countries.

In this pamphlet, the contributions from Eddy Lee (Director of the International Policy Group of the ILO), Esther Busser (International Confederation of Free Trade Unions - ICFTU) and Sandra Polaski (Senior Researcher at the Carnegie Endowment for International Peace) add substance to our own thoughts with a view to launching a debate on the complex relationship between trade and employment. We invite you to send your comments to the following address: pse-newtradethinking@europarl.europa.eu

Our next pamphlet will deal with the topic 'Trade and climate change'.

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¹ ILO/WTO, *Trade and Employment: Challenges for Policy Research*, Geneva, 2007, 124p. Also available from: www.wto.org/english/res_e/booksp_e/ilo_e.pdf

Trade and Employment: A Trade Union perspective

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Some positive developments

Employment impacts of trade and trade liberalisation have long been ignored by trade policy makers, in particular because the impacts were expected to be positive. This has now been replaced increasingly by an acknowledgement that trade leads to substantial employment displacement in the short term and potentially in the longer term. Even where the number of jobs remains the same or increases slightly, there is substantial job shifting when reallocation takes place. The recognition of this situation is indicated, for example, by the increased attention to the use of adjustment funds such as in the EU and US. In that sense such acknowledgement is a welcome step in the right direction, but it remains insufficient.

But far from enough

Trade and investment can also lock countries into certain production processes and thus certain types of employment, which do not necessarily have the capacity to lift large groups of the population out of poverty. Too little attention is given to which trade policies are required to create decent and productive employment. On the contrary, even right now trade policies that prevent the creation of decent and productive employment are widely pursued.

Trade and trade liberalisation have increased the wage gap in many countries. Income inequality has increased both within and between countries, although not only due to trade and trade liberalisation. It is clear that the role both of policymakers and of trade unions urgently needs to be reinforced in order to reap more benefits from trade agreements and to ensure a more equal distribution of these benefits. However the effect of more open economies is to reduce the bargaining power of both trade unions and of governments.

A need for decent work

Little attention has been devoted to the quality of employment so far. Not only the creation or the level of employment play a role, but also whether jobs that are created are of a better quality, respect workers' rights and provide a living wage. It makes little sense for good quality jobs to be destroyed and replaced by low quality ones. For example, one form of job stimulated by trade are the low quality jobs in export processing zones characterised by long working hours, an untenably high pace of work, repression of trade union rights and forced overtime. The overwhelming majority of employees in such zones are women. The consequence of such repression is that other governments are brought under pressure to reduce labour standards in order to compete with the low wages that repression of trade

union rights can obtain, as we see nowadays in particular as a result of competition with the huge repressed labour force of China. In consequence, far from leading to a positive outcome, trade causes a downward spiral in wages and working conditions in which trade union rights are reduced on a competitive basis, depriving the workers of protection at a time when it is most required.

To take further salient examples, employment in agri-processing is another sector employing many women which is characterised by long working hours and a high pace of production. Plantation work employs many women and also children who work under harsh circumstances for low wages, often exposed to pesticides that are sprayed on plantations while people work. And call centers are characterised by night work and disruption of social lives of workers.

Such trade related jobs generally are not the decent productive jobs that are so badly needed to lift people out of poverty and provide them with a decent living. They are characterised by the absence and even repression of trade unions, and have reinforced the global trend towards the casualisation and precarisation of employment.

A new approach to trade agreements

For all these reasons, trade agreements should not only be subject to prior assessment according to their impact on decent work, namely their impact on labour standards, social protection, productive employment and social dialogue, but must be designed with an aim to contribute to the objective of decent work. Trade should improve the respect for labour standards, lead to the creation of productive employment, increase the level of social protection and improve social dialogue.

Social dialogue is not only important to help workers adjust to changes in employment due to trade agreements, but must be used as a basis for the design and negotiation of trade agreements through consultations between workers, employers and governments and not just through business lobbying as is the case right now.

Provisions are required in all trade agreements to stop trade bringing about the undermining of labour standards, and agreements should furthermore require respect for labour standards and encourage such respect through positive incentives, built-in projects and development cooperation, particularly in the areas of labour legislation, inspection and enforcement.

Social protection needs increased attention in order to assist workers that lose their jobs both by providing unemployment benefits or equivalent schemes and through skills training and education programmes aimed at increasing the productivity and knowledge levels of workers.

And productive employment creation should be at the core of trade and trade agreements, to ensure that the shifts in production stemming from increased trade lead to gains in the number of productive jobs. This would require the design of labour market policies, fiscal policies, subsidies, technology and research, education and trade policies in a coordinated way in order to create decent jobs in the sectors identified as contributing to productive employment.

This puts trade policies and trade liberalisation in a different light. Trade liberalisation is not automatically beneficial for sustainable development and employment creation, but is so only under certain conditions. Many countries face huge inequalities in access to information, capital, technology and productive capacities, and need to be able to use trade and other policies to build competitive and productive industries and services. The huge push for trade liberalisation from countries that are already highly competitive such as the EU stands to result in inflexible trade agreements that would be highly detrimental for developing country economies, with disastrous effects for present and future prospects for the creation of decent work. The Commission's approach is particularly evident in its aggressive Global Europe strategy, its push for increased market access through EPAs and other bilaterals and in the NAMA negotiations, and its persistent efforts to include investment, competition, government procurement and intellectual property in trade negotiations.

What can the Socialist Group contribute?

The Socialist Group should therefore promote a mindshift in the EU's approach and push for the Commission to moderate its demands on developing countries in trade negotiations. It should also ensure an assessment in the European Parliament of any EU proposals for market opening in developing countries, taking into account the impacts these will have on decent work and the potential for productive employment in these countries. The current locking in of production systems in developing countries through trade and investment agreements will have a detrimental effect on the future development prospects of these countries.

Assessments should also address the implications of any proposals for market opening by the EU on decent work in Europe, and ensure that any shifts lead to a net increase in decent jobs, with sufficient protection in the case of job losses.

More research is also needed to identify the set of trade and other policies that can lead to optimal employment outcomes and under which circumstances.

And last but not least, the Socialist Group needs to maintain its long-standing support for the protection of decent work and core labour standards in trade agreements, such that trade unions can redress the power imbalances affecting workers in the globalisation process in order for its growing inequalities to be reversed.



Trade and Employment

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Countries do not trade for the sake of trading but rather to improve their living standards. As living standards are determined by employment for most of the population, the impact of trade on the quantity and quality of employment is a key indicator by which to measure its success and the desirability of further trade liberalization.²

Employment in an era of globalization

The current global economy has several characteristics that have raised concerns about the impact of trade on employment in both advanced and less-developed economies.

First, the end of the cold war led to the integration of two formerly separate economic systems, with a huge increase in the labor force available to firms in what is now a single global production system. The International Monetary Fund recently estimated that the available labor force had quadrupled in recent years.³ Workers in China, Russia, India and elsewhere, some with high skill levels, have joined the global labor market at much lower wage rates than those of similarly skilled employees in Europe.

Second, technological advances, especially in electronic data transmission, have allowed economic activities that previously required close proximity of employees performing separate aspects of the production process to be “unbundled”, with discrete tasks assigned to workers anywhere in the world. Differences in international wage levels can now be exploited across an increasingly wide range of skills. Jobs requiring advanced training have joined low-skill activities as candidates for international outsourcing.

Breakthroughs in technology have also increased the productivity of labor across the globe. A given rate of economic growth now produces fewer jobs than in the past, because fewer workers are needed to satisfy the increase in demand. This pattern has emerged in both developed and developing economies, including China. Increased trade disseminates high productivity technologies more rapidly and more broadly, partly due to global production chains that introduce the technologies to their far-flung suppliers and partly due to the increased competition when economies are opened to trade, which forces firms to improve their efficiency in order to survive.

A final characteristic is that large proportions of the workforce in many developing countries still engage in small-scale, low-productivity agriculture. When such countries have rapidly opened their agricultural sectors to trade with countries that have much more efficient (or subsidized) farms, many have seen rapid displacement of farmers or

² The term employment as used here includes all forms of occupation including self-employment and small-scale farming. Standard economic theory assumes that there is full employment; therefore trade will influence wage levels but not employment levels. However most economists recognize that unemployment and underemployment exist, particularly in developing countries, and that trade can affect overall employment levels as well as wage levels.

³ International Monetary Fund, *World Economic Outlook*, Chapter 5 “The Globalization of Labor”, April 2007. Available at: <http://www.imf.org/external/pubs/ft/weo/2007/01/index.htm>

increased rural poverty due to lower crop prices. As these countries try to expand employment in manufacturing and other sectors, they face competition from more advanced developing economies with higher productivity levels but equally low wages. Some have experienced net employment loss as a result of being crowded out of both agriculture and manufacturing.

Trade policies to improve employment outcomes

These twenty-first century characteristics do not negate the possibility that increased trade can improve living standards by increasing the efficiency of economies. However they do require a more careful evaluation of the employment impacts of trade than has been done in the past. We still have much to learn about the links between employment and trade under current conditions, but some lessons have emerged that can improve employment outcomes and mitigate harm to workers who lose from trade.

A first and rather easily implemented lesson concerns the knowledge base for policy making. Computable general equilibrium models can simulate changes in labor demand and wages that would likely be induced by trade liberalization. These models are increasingly realistic; however they have been underutilized with respect to labor market issues. Governments should step up their use to analyze potential employment impacts of proposed trade measures. It is important that the models represent labor markets as accurately as possible. Until recently, most modelers treated labor markets as if they were at full employment, which is unrealistic for many countries. In 2006, the Carnegie Endowment simulated the outcome of the Doha Round using an alternative approach for developing countries, incorporating actual unemployment rates and underemployment in rural areas.⁴ The results were strikingly different than those obtained with the full employment assumption. Some countries, such as China, were seen to gain much more from Doha when unemployment and underemployment were acknowledged in the model. However their gains came at the expense of other developing countries, which lost some of the gains projected under the full employment assumption. A subsequent modeling exercise at the World Bank largely replicated these results.⁵ The models can also be used to estimate the amount of transitional unemployment that would be induced by trade liberalization. All of this information is clearly useful to policy makers and planners. Such studies should be commissioned, preferably from several sources using alternative techniques, in advance of trade negotiations for all countries involved.

Other lessons concern the sequencing and pace of trade liberalization. The sequence in which different sectors are opened to trade can determine whether new jobs are created in gaining sectors before jobs are destroyed in import competing sectors. This is particularly important for developing countries where large proportions of the working population are engaged in agriculture, such as India. Trade liberalization that opens markets for exports of their manufactures or services could draw labor from agriculture to more productive and remunerative employment, alleviating poverty. However if agriculture

⁴ Sandra Polaski, *Winners and Losers: Impact of the Doha Round on Developing Countries*, Carnegie Endowment, March 2006. Available at: www.carnegieendowment.org/publications/index.cfm?fa=view&id=18083

⁵ Dominique van der Mensbrugge, "Modeling the Impact of Trade Liberalization: A Structuralist Perspective?", Global Trade Analysis Project (GTAP) Resource Number 2454, May 2007. Available at: <https://www.gtap.agecon.purdue.edu/resources/download/3332.pdf>

is liberalized at the same time, small-scale farmers who cannot compete at world prices will be displaced immediately, while manufacturing jobs are created only slowly as the sector is built up. The result could be long periods of increased unemployment and poverty. The least developed countries will require special trade privileges and development assistance. Even for diversified economies, gradual phasing of trade liberalization allows losing sectors and workers time to adjust.

A final lesson concerns the need for governments to provide assistance to workers who lose their jobs due to trade. Most European countries have unemployment and retraining programs that provide some support. However as global economic integration deepens, the pace of employment restructuring appears to have accelerated and a larger percentage of the work force is affected. There is much scope for improvement in the design and funding of these programs. Meanwhile, Europe's trade partners in the developing world seldom provide unemployment compensation or retraining to displaced workers. The costs of adjustment fall heavily on individual workers and poor households, which have little if any savings to survive a loss of income. Their governments may face daunting resource constraints that prevent them from providing meaningful help. Until now, trade adjustment assistance has rarely been provided by wealthy countries to their low-income trading partners. The issue has been mooted in some of the EU's dealings with African, Caribbean and Pacific countries. It deserves serious consideration in both bilateral and multilateral contexts.

In conclusion, policy makers should assess the impacts of trade on employment and plan trade policy to optimize labor market outcomes. They should also undertake complementary measures to cushion the impacts on workers who lose from trade, at home and in less-developed trading partners.



The Impact of Trade Liberalization on Employment

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Rapidly increasing flows of goods and services across national boundaries have been the most visible aspect of the increasing integration of the global economy in recent decades. This has been driven by a worldwide wave of trade liberalization such as the reduction of tariffs, quantitative restrictions and other non-tariff barriers to trade. As a result, average levels of tariffs and other barriers to trade have fallen significantly in the majority of countries in the world. These trade liberalization measures have been accompanied by the liberalization of policies towards foreign direct investment as well as wider liberalization measures, such as the removal of controls over domestic investment, deregulation of domestic product and labour markets, privatization and both internal and external financial liberalization.

However, trade liberalization has also been one of the most contentious aspects of globalization. Critics have blamed it for a host of ills, such as rising unemployment and wage inequality in the advanced countries; increased exploitation of workers in developing countries and a “race to the bottom” with respect to labour standards and employment conditions; the de-industrialization and marginalization of low-income countries; increasing poverty and global inequality; and degradation of the environment. These views have spread in spite of the fact that the benefits of freer trade, in terms of improved allocation of resources and consequent gains in productive efficiency and economic growth, are a basic tenet of mainstream economic analysis.

In this context, the impact of trade liberalization on employment is of particular significance. The level and structure of employment is a key determinant of economic welfare and influences to a large extent wage and income distribution and the quality of employment. These latter variables are clearly among the central points of contention in the debate over trade liberalization.

Trade Theory versus Reality

Standard trade theory recognises that the effects of increased trade will typically result in both job creation and destruction. Job creation will take place in the expanding export activities while some job losses will occur in industries producing for the domestic market in the face of cheaper imports. Nevertheless there is a strong presumption that the net employment effects will be positive after a relatively short period of adjustment. This is especially true for developing countries where trade is expected to increase the demand for unskilled labour and also reduce wage inequality between skilled and unskilled workers.

From this standpoint, there should be no question that trade liberalization is beneficial in terms of its growth, employment and distributional implications. Translated into policy terms

this would mean that unilateral trade liberalization would always be preferable to protection or import substitution. Moreover, strong advocates have extended this to the proposition that the sooner and more extensively trade is liberalized the greater the benefits will be.

However, this standard theoretical position rarely applies in the real world. They rest on the assumption that there is perfect competition, constant returns to scale, that resources are always fully utilised and that trade will always be balanced. This is clearly at odds with the real world where, especially in developing countries, market imperfections are common and where many branches of industrial production are characterized by economies of scale. In these circumstances, growth can be higher with trade restrictions than without. Similarly, the assumption that resources are fully utilised is rarely true in the real world, given the high levels of unemployment prevailing in many countries. In these circumstances, contrary to the comfortable predictions of smooth and costless adjustment in standard theory, trade liberalization can impose heavy adjustment costs in the form of a contraction of output, high unemployment and wide trade deficits.

Another reason for the discrepancy between theory and reality is that the nature of trade has changed quite profoundly since the time standard theory was formulated.⁶ Theory has not fully kept up with developments such as the rapid expansions of intra-industry trade, the expanding scope of trade to include many previously non-tradable service activities that can now be off-shored, and the growth of global production systems.

Empirical Evidence

The empirical evidence points to the fact that the employment effects of trade are not uniform across countries but are strongly influenced by country-specific and contingent factors. This emerges from both multi-country and single country studies. A recent multi-country study by the World Bank concludes that 'studies on the effects of trade show a considerable dispersion of the net impact on employment.'⁷ While reiterating the benefits of trade liberalization for both employment and wages over the long run it recognises that there are significant transitional problems that need to be faced. It also recognises that even 'small declines in employment may hide substantial job-churning.' An ILO study on the effects of the growth of trade on employment and wages in manufacturing five countries⁸ (China, India, Malaysia, Mexico and Brazil) also showed contrasting results. In the three Asian countries trade growth had a generally favourable effect on employment and wages. Apart from stimulating output growth, trade also increased the employment elasticity of manufacturing output.

In contrast these favourable effects were not observed in the two Latin American countries. In these countries manufacturing employment had not risen significantly or had fallen. Real wages of unskilled workers tended to decline and the wage differential between skilled and unskilled workers increased sharply. Other single country case studies also confirm this pattern of divergent results. For example in Zimbabwe it was found that the drastic liberalization implemented in the early 1990s resulted in a contraction of output and employment

⁶ Jansen, Marion and Eddy Lee *Trade and Employment: challenges for Policy Research* (ILO and WTO, 2007)

⁷ Dollar, David and Paul Collier *Globalization, growth and poverty :Building an inclusive world* (World Bank, 2001)

⁸ A.K Ghose *Jobs and Incomes in a Globalizing World* (ILO, 2003)

that was accompanied by a sharp increase in imports and a rising trade deficit.⁹ In contrast a study on Mauritius found far more favourable outcomes from trade liberalization.¹⁰

There is more uniformity in the empirical evidence on the effects of trade liberalization on wage inequality. Increases in the skill premium have occurred in both industrialized and developing countries. In the former countries this is in line with theoretical predictions but the opposite is true in the case of developing countries. In these latter countries the explanation probably lies in the new interaction between trade, FDI and technological change. For instance, increased outsourcing transfers low-skilled jobs from industrialized to developing countries but these jobs are in fact relatively skill-intensive in the context of developing countries. This tends to increase the skill premium. A related argument is that skill-biased technical change is being transmitted to developing countries through increasing flows of trade and FDI.

In both industrialized and developing countries trade liberalization and increased FDI increases the elasticity of the demand for labour. The increased possibilities for producers to relocate to lower cost countries weakens the bargaining position of labour and shifts the functional distribution of income in favour of capital. In addition the extent of employment reshuffling that occurs in the wake of trade liberalization is now probably greater than previously thought. Such reshuffling occurs not only across sectors but also within sectors making it more difficult for policy makers to predict which jobs will be at risk and where employment growth is likely to occur.

An important aspect of the effect of trade liberalization in developing countries is that of how it affects output, employment and incomes in the informal sector. This is important because a high proportion of total employment in developing countries is in this sector where the incidence of poverty is also typically high. A priori reasoning suggests that the effect can be both positive and negative but the limited empirical evidence that is available on the issue is inconclusive. This is obviously an important area for future research on the impact of trade on employment and poverty in developing countries.

Policy Implications

The foregoing implies that there is no basis for assuming that trade liberalization will automatically have a positive impact on employment. This can happen only if trade liberalization is handled as part of a coherent set of policies that pay adequate attention to the goal of employment creation. Trade liberalization needs to be accompanied by complementary policies such as the maintenance of an appropriate real exchange rate and macroeconomic stability; an institutional environment conducive to the growth of entrepreneurship and productive investment; well-functioning and appropriately regulated labour, product and financial markets; and, in the case of developing countries measures to enhance the capacity of poor producers and workers in the informal economy to benefit from trade liberalization. Finally, in view of the large adjustments that are likely to be required in the labour market and of the widespread problem of growing wage and income inequality, it is particularly important to introduce effective measures to support labour market adjustment and to provide adequate social protection to workers whose jobs and incomes are adversely affected.

⁹ Rattso, J., and R. Torvik 'Zimbabwean Trade Liberalization: Ex post evaluation' *Cambridge Journal of Economics* 22: 325-346

¹⁰ Milner, C., and P. Wright 'Modeling labour market adjustment to trade liberalization in an industrializing economy' *Economic Journal* 108: 509-528

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