INTERNATIONAL TRADE UNION CONFEDERATION (ITUC)

Summary and Initial Commentary on "Trade and Employment: Challenges for Policy Research" - Joint ILO-WTO study, February 2007

The ILO-WTO paper "Trade and Employment", a literature review, looks at the theory and empirical results concerning how trade policies impact on the level and structure of employment, wages and wage differentials, incomes, and labour market institutions and policies. It further considers how labour market institutions and policies influence the outcomes of trade policies in terms of output, employment and distribution of income. The paper is divided into five sections:

- 1. Trade flows and employment
- 2. Trade and employment
- 3. Trade and inequality
- 4. The Role of Policy Makers
- 5. Conclusions

These are considered in turn below, with a summary of the ILO-WTO followed by trade union commentary (in italics).

1. Trade Flows and Employment

The paper states that most jobs are not directly linked to trade or foreign investment, and can be found either in non-tradable services in developed countries or in non-tradable agriculture or informal work in developing countries. This then implies that the domestic level of development and the domestic economy determines their job and income prospects.

This does not necessarily take sufficient account of the indirect impact of trade and foreign investment on national economies. However to the extent it is substantiated, it shows that trade and a focus on exports cannot be a single development strategy for developing countries. Furthermore, it indicates the importance of ensuring that trade liberalisation should not hamper domestic prospects for development and should allow for the creation of a domestic market, as well as the importance of policies that facilitate workers' transition from subsistence agriculture and informal work into formal employment (both trade and non-trade related).

The report further states that there has only been a slight increase in unemployment levels in developing countries, little change in levels of underemployment and overall numbers of working poor, although as the working poor in China and to a lesser extent India have decreased, this implies an increase in working poor in other regions, especially Sub-Saharan Africa. Growth of trade and investment flows has so far been highly concentrated, both in terms of a north-south divide, as well as, within the south, in a small number of developing countries (including India and China). This confirms earlier trade union analysis stating that the distribution of the benefits created by trade and investment has been unequal both within and between countries. It also confirms that many of the smaller and poorer countries, especially in sub-Saharan Africa are not benefiting and are even losing out through further liberalisation.

2. Trade and employment

The paper notes that there is agreement (among economists) on the positive gains of trade liberalisation, which restructures the economy and makes the country better of overall, but that this does create short term adjustment.

It should be noted that this "win-win" assumption would be challenged by many economists as being dependent upon assumptions of a perfect market, and only producing positive results in that context. However, it can certainly be agreed that restructuring is a major impact from trade liberalisation, one that is recognised and that occurs in practice. Two questions are therefore important in this regard. One is with regard to the level and pace of liberalisation which will determine the level and pace of restructuring and adjustment, and which should be a consideration in trade negotiations. The second question is that of how governments should design adjustment policies. Although discussed subsequently in the paper, much more attention needs to be given to this.

Trade liberalisation leads to a change in the relative demand for workers. Some workers' skills will be less in demand than others, and the former group of workers will be affected negatively either in terms of remuneration or in terms of their chances to find a job. Labour market characteristics (such as search frictions and minimum wages) can explain why trade reform may result in unemployment rather than just wage effects.

Job reallocation takes place not just between sectors but also within sectors. Trade liberalisation allows the expansion of the most productive suppliers, in all sectors. Jobs are lost in all sectors for those suppliers who cannot compete at the international level. There is a positive correlation between exporting and productivity levels which appears to come from the fact that high productivity plants are more likely to enter foreign markets. Trade appears to promote national income and welfare by facilitating the growth of high productivity plants, not by increasing productivity growth at those plants.

The point that high productivity is a key factor in determining competitiveness should lead policy-makers to encourage high labour standards, requiring the presence of trade unions and good industrial relations, since these are factors conducive to a high level of productivity.

The paper notes that the effect of trade on employment depends on a large number of country specific factors. One difficulty is to distinguish the different possible causes of employment changes, another is the choice of methodology and data sets. Two observations are made in the paper, that in developing countries unemployment is to a significant extent affected by so-called job queuing for privileged jobs, and that unemployment rates do not appear to be systematically higher in more open economies. For developing countries, studies recognise that there are significant transitional problems that need to be faced, although there are benefits for employment and wages over the long run. The paper states that a series of case studies on the effects of trade liberalisation show a considerable dispersion in the net impact on employment, that small declines in employment can hide substantial job churning, and that some of the important losers from globalisation will be formal sector workers in protected industries.

This latter effect is exactly what the ITUC has been referring to in its studies on the NAMA negotiations, whereby tariff cuts stand to lead to losses of good quality jobs in the formal economy.

The paper further mentions that from a poverty perspective, export led growth in the textiles and apparel sector only had a small effect on poverty (in one case, Madagascar), because a large majority of the poor has been unable to enjoy the new employment opportunities given their lack of skills, and as most of the poor reside in rural areas where the employment effect is small.

This shows the importance of placing less emphasis and reliance on export industries and attraction of foreign direct investment (FDI) for development of economies, and the need to focus more on the creation of a domestic market.

Regarding trade and income levels, the paper notes that the relationship is not conclusive. It further notes that a recent study on wage effects of trade reform in developing countries reports that wages grow faster in economies that do integrate with the rest of the world. The paper further notes that openness can have a negative impact on wages in the short run, but then can improve in only a few years.

It is acknowledged in the paper that it has neglected other aspects of quality of employment, such as safety and health and other indicators. The main reason they give is the absence of data.

It would be important to get more research on the trade-productivity relationship and on the productivity-wage link. Trade union experience would indicate that productivity growth is not always translated into an increase in wages. The indication that openness will have a positive impact on wages at least in the long run also requires more research, especially in cases where union repression takes place such as in EPZs, where such an outcome seems highly implausible.

Although this section in the paper is supposed to address the quality of employment as well, there is no mention of the quality of employment apart from wages and productivity - the analysis therefore falls short in this area. Issues such as the exploitation of workers in export processing zones (EPZs), to take just one example, are wholly overlooked, as are broader questions relating to the impact on quality of employment.

3. Trade and Inequality

In theory, trade of developed countries with developing countries will lead to more inequality in developed countries due to less demand for low skilled workers, and less inequality in developing countries due to higher demand for unskilled labour, hence higher wages for the workers concerned.

The paper notes that in reality, "wage premiums" (increases in the wage differential between high-skilled and low-skilled labour) have increased, which indicates that low wage skilled earners have been losing out, due both to trade liberalisation and to technological change.

In addition to changing the level of demand for certain types of labour, trade may affect the sensitivity of labour demand to wage changes - in other words, it can increase the elasticity of labour demand. In an open economy, employers would be more likely to threaten to lay off workers when they demand higher wages than in a closed economy. Labour demand elasticity may also increase due to an increase in FDI. In the supply chain it is easier to substitute foreign labour for domestic labour. Increased globalisation is also associated with more fragmentation of production, in turn associated with a more elastic (i.e. rapidly responsive) demand for unskilled labour.

The report thereby corroborates the increasingly common experience of trade union negotiators of employers threatening to shift production to less unionised, hence cheaper, plants in other countries unless wage demands are moderated – or in some countries, of employers threatening workers that if they even join a trade union, their companies will relocate in that manner.

The paper notes that such an increase in the price elasticity of the demand for labour could affect the position of workers through different channels. It may lead to higher labour market volatility, lower labour standards or benefits, a lower bargaining power of workers, and/or increased difficulties for governments to carry out redistributive policies.

The report cites research by Rodrik which finds that costs or benefits from trade are usually divided between workers and employers and that how these are divided depends on the elasticity of demand for labour. An increase of this elasticity will increase the share of costs for workers. More elastic labour demand will also react more quickly to economic shocks, leading to more insecurity among workers. The easy replacement of domestic workers by foreign workers leads to loss of bargaining power.

Empirical evidence on the effect of trade liberalisation on labour demand elasticity is mixed. Some is consistent with a causal relationship between globalisation and worker insecurity. A number of academics have argued that increases in economic insecurity may generate more demands for social insurance while others have suggested that globalisation limits the capacities of governments to provide such compensation.

The increase in elasticity of demand for labour thus has several effects that weaken the position of workers and trade unions, as well as governments. It would be important to have more research into the effect of trade liberalisation on labour demand elasticity.

Empirical work on trade and wage inequality for industrialised countries gives different results. Some attribute a small role to trade, others a substantial one. For transition economies it is difficult to get results because of the many changes at the same time in these countries. In developing countries there are mixed results on the effect of trade on wage inequality. In East Asia the unskilled-skilled wage gap narrowed, except for ambiguous results in the Philippines. In Latin America trade liberalisation has coincided with an increase in income and wage inequality.

Further research in this area should look at the difference that is made by the presence or absence of strong free trade unions in the respective countries – an area this report did not consider. One would certainly expect to find much reduced wage inequality in countries with effective, independent trade unions.

According to Currie and Harrison, the wage impact of liberalisation depends crucially on the nature of product market competition. If increased product market competition reduces the relative price of low-skill intensive products, trade could have perverse wage-inequality effects.

Wage inequality only provides limited information on income inequality, and given the divergence between capital and wage income, it is also important to look at income inequality. Empirical work on the impact of trade reform on income inequality has found divergent results. There has been an increase in the Gini coefficient in China.

Trade union studies have also shown increased income inequality in countries such as the US over recent decades, at the same time as trade has expanded.

The paper notes that Lopez finds that improvements in education and infrastructure, and lower inflation, increase growth while reducing inequality, leading to a win-win outcome. On the other hand, financial development, trade openness and a decrease in the size of government, while raising productivity and growth, are associated with increases in inequality so leading to a "win-lose" outcome.

It is important to note that improvements in education and infrastructure require government funding while trade liberalisation, by cutting tariff revenue, generally reduces government income. This could be a serious problem for resource-constrained developing countries, in particular.

4. The Role of Policy Makers

This section begins by summarising the preceding finding in the paper that effects of trade liberalisation on incomes and employment differ significantly across countries. This can be caused by different specifics in countries, including by differences in institutions. There seems to be evidence for the existence of a trade-off between economic efficiency and workers' protection. However, the impact of job security legislation depends on its design, on whether it protects workers or employment positions.

This conclusion would lend support to a "flexicurity" system in which workers are protected but not job positions as such. Of course, in many countries systems of social security, and political considerations, are such that it is currently unlikely that adequate social protection for workers could be provided – hence this approach could be in effect extremely difficult to implement.

The paper looks at instruments of labour market policy, both income support and active labour market policies (ALMP) to facilitate transition through relocation and re-

education. The paper notes that there is a lack of social safety nets in developing countries and that when available, they are essentially confined to workers in formal economy jobs. The paper notes that there is a need for expansion of such social security nets. Evidence on the effect of ALMPs is scarce and mixed. One outcome is that public works and skill development programmes are often poorly designed in developing countries. Examples of adjustment funds are the US Trade Adjustment Assistance Programme that specifically targets workers that have lost their jobs as a result of changes in trade flows. A similar programme has been proposed in Europe.

This reflects the concern of trade unions that social safety nets in developing countries are hardly developed and that therefore trade liberalisation should include such policies, and that they need to be expanded in developing and industrialised countries alike. One implication could be that the discussion on Aid for Trade should incorporate the need for international assistance for adequate adjustment policies, in particular with regard to the design of income support and active labour market policies during the transition period following trade liberalisation.

The paper notes that the concern of certain developing country governments that effective enforcement of trade union rights will undermine their comparative advantage has little empirical support. Furthermore, respect for trade union rights has positive effects through enabling effective social dialogue. Kucera and Sarma find robust relationships between stronger freedom of association and collective bargaining (FACB) rights and higher total manufacturing exports as well as between stronger democracy and higher total exports, total manufacturing exports and labour intensive manufacturing exports. FACB do not harm the export potential of developing countries and may even stimulate it.

The paper further notes (Neumayer and Soysa) that there is no evidence of a race to the bottom in FACB rights. There are fewer trade union rights violations in more open economies and the extent of an economy's penetration by FDI has no statistically significant impact on trade union rights. They conclude that globalisation might not be beneficial for outcome-related labour standards but is likely to promote process-related standards of freedom of association and collective bargaining.

Other studies, such as the OECD's 1996 and 2000 reports on Trade and Labour Standards, have also concluded that over the long run, there is no negative correlation between freedom of association and increased trade growth. However in the short term, trade union rights certainly do suffer both due to the belief of many governments and investors that curtailing trade union activity stimulates higher foreign investment by keeping wages in check, and because in high-labour intensity sectors such as much textiles, clothing and footwear production, it certainly can be profitable in the short-term to keep wages low. This report does not consider such factors.

Forteza and Rama look at the impact of minimum wages, non-wage costs, level of unionisation and size of government employment on the capacity to adjust, and propose that countries where organised labour is potentially influential are more likely to experience recessions immediately before adjustment and slower recovery afterwards, whereas growth performance is not affected by the level of minimum wages and nonwage costs. Spector argues that more intense competition may cause wages to fall in the long run, even when general equilibrium effects and the long-run adjustment of the capital stock are taken into account.

Regarding the informal economy, the report notes that there could be both positive and negative outcomes of trade reforms. Trade reforms can expose establishments in the formal economy to increased foreign competition. These establishments can then reduce labour costs by cutting wages, replace permanent workers with part-time labour, or out-source work outside the enterprise to establishments in the informal economy.

Firms in the formal economy may also lay off workers who are then unable to find employment except in informal and unprotected work relationships. In other cases however, globalisation can also create new jobs for wage workers and for the selfemployed through an expansion in export oriented activities, which could reduce the size of the informal economy.

The report further notes that the extent of labour market regulation, especially employment protection, will influence the distribution of employment between informal and formal work in the aftermath of trade liberalisation but that empirical evidence is limited and inconclusive.

There seems to be a lack of adequate research into the effects of trade reform on the relationship between informal and formal employment relationships in developing countries, which, given the numbers of people potentially affected, requires far more attention.

Concerning redistribution of benefits, the paper looks at tax policy, concluding that increasing mobility of capital restricts governments' possibilities to redistribute income from capital to labour. It notes that some have called for tax harmonisation or international tax coordination to reduce downward pressures on taxation of capital income.

Another theoretical consideration relates to possible efficiency losses from redistribution – which does not appear to be borne out by cases where research has been done, where the costs of "compensating losers" remained modest and never rose above 5% of the net benefits from liberalisation.

Again there is need for getting more research undertaken on the issue of taxation and redistribution, given the unequal distribution of benefits and costs from trade liberalisation.

Regarding education policies, the paper notes that they are likely to be increasingly important. National education policies can determine whether countries and individuals can reap benefits from innovation and change. The paper refers to the need for adjustment of educational systems to enable workers to cope with new production systems (from primary materials to intermediate and finished products) and the importance of on the job training.

Countries with a high human development index (HDI) have a high level of tertiary education. There is a large FDI inflow in countries with high numbers of

scientists and technicians. The paper further notes that such education policies do not result from market forces, and should form part of global development policies.

The paper points to the role of infrastructure, because the supply response to trade liberalisation is important as is the employment intensity of that supply response. The quality of infrastructure has a large impact on trade flows. The authors note that port efficiency is especially important as time to market matters more than before (especially in textiles and clothing).

Regarding the role of financial markets, the paper notes that credit constraints for small business can result in a significant adjustment burden for the economy as a whole. The opening up of the financial sector can increase efficiency, but can also have negative distributional consequences. Rama argues that the main threat for workers comes from international capital movements and financial crises. This is also emphasised by van der Hoeven and Lübker.

With regard to the pace of trade liberalisation it is noted that the implementation periods are important but that the literature gives little guidance on ideal periods.

5. Conclusions

The paper concludes that no simple generalisations on the relation between trade and employment can be made. Factors influencing the trade-employment relationship are FDI, the composition of trade, the role of technological change, and the impact of greater openness on the elasticity of labour demand. Initial conditions in countries, labour market institutions and the implementation period of trade liberalisation further affect the tradeemployment relationship.

The report states that globalisation can be good for most workers, provided that the appropriate policies are in place; but that distributional implications should not be ignored.

In developed countries especially, the report argues that technological change explains more of skill premium increases than does trade. In developing countries, factors such as FDI and relocation, skill biased technical change, and the emergence of China play a role in explaining changes in wage inequality, all indicating that there will increasingly be a shift in demand towards skilled labour in developing countries as well. Increases in skill premium and income inequality represent serious challenges, the report states, and there are no clear solutions. There is no agreement on how to design appropriate redistribution policies.

Expenditures on education and on infrastructure are pro-poor policies, the report argues, the absence of which can increase the inequality resulting from trade. Empirical evidence on the impact of trade liberalisation on informal working relationships is limited.

Gradual liberalisation combined with well targeted adjustment programmes are likely to lower adjustment costs and increase benefits, and social protection schemes in developing countries are necessary and should be expanded. A trade off exists between efficiency and insurance (i.e. protection of workers), but if insurance policies are well designed, this trade off need not be very steep.

The report concludes that trade policies and social policies clearly interact and therefore require greater policy coherence.

All in all, the paper puts together a considerable number of research outcomes that support many points of trade union analysis regarding trade and employment (i.e. with regard to the danger of negative distributional effects from trade; the use by employers of the threat to transfer production, as a tool in collective bargaining to keep wages low; the importance of paying attention to the pace and level of liberalisation; the potentially high adjustment costs; the need for accompanying policies such as social safety nets and ALMPs; and the need for policy coherence between trade and social policies).

The paper raises a number of additional areas that need further investigation such as the effects of trade reform on informal employment relationships (and whether there is evidence for trade liberalisation leading to shifts from formal to informal work, or the opposite), on the effects of trade openness and FDI on freedom of association, on the right set of adjustment and accompanying policies ("what works and what doesn't"), and on the need for, and design of, redistribution policies.

The paper does not address some issues that are of key importance and that require further focus and research, including EPZs, gender, the effect of China on wages and employment in other developing countries, and the impact of trade liberalisation on the quality of employment.

Neither does the report address the fundamental issues of whether trade can in some cases cause a reduction in output and growth not just sectorally but on an aggregate basis at national level, hence jeopardising any positive employment outcome; and what forms of trade policy are most geared to achieving the optimal development outcomes.

Nonetheless, the publication of the paper heralds an important start in ILO-WTO cooperation, as called for in the recommendations of the World Commission on the Social Dimension of Globalisation, and perhaps starting to give effect, for the first time, to the provisions of the 1st WTO Ministerial Conference of 1996 regarding the need for ILO-WTO collaboration. There is a need for further joint work to pursue the areas for further research referred to in the report and those indicated above.