

Executive Summary

Skills development is key to more inclusive trade

Over recent decades, the global economy has experienced a profound transformation, mostly as a result of the joint forces of trade integration and technological progress, accompanied by important political changes. Increased trade integration has helped to drive economic growth in both high- and low-income economies, lifting millions out of poverty in emerging and developing countries. Since the global financial crisis of 2007–08, however, trade, productivity and income growth have decelerated. At the same time, trade is increasingly perceived as leaving too many individuals and communities behind.

Reaping the benefits from global trade and effective integration into global markets goes hand in hand with the adoption of new technologies, improved forms of work organization and productivity increases. Given the role of skills in trade, it is vital to put a strong emphasis on skills development. Human capital is one of the principal enablers of trade growth and economic diversification, and is also an important “buffer” facilitating the adjustment to more open trade. Appropriate skills development policies are key to helping firms expand their export activities; they are also key to helping workers who lose their jobs make a smooth and rapid transition to new jobs with equal or higher wages. These two effects reinforce each other. For trade to grow, it needs to be more inclusive; and more exports offer more employment opportunities.

Skills development policies constitute one among many policy instruments available to governments to make trade inclusive by enabling firms and workers to participate in trade, by lowering adjustment costs and by distributing more evenly the benefits of trade and technological progress. Other active labour market policies (ALMPs), such as job-search assistance or activation strategies, passive labour market policies such as unemployment insurance, and social policies, as well as complementary policies such as housing or credit market policies, can also be used to lower adjustment costs, while various instruments are available to redistribute the gains from trade or technology to those whose skills are less in demand because of those changes.

The level and composition of skills in a country affect its participation in trade

The level and dispersion of skills in a country's workforce influence its trade pattern and may also affect its export performance. The average skill level of workers, and the distribution of skill levels among workers in a country, contribute to determining its comparative advantage and export diversification, as do the areas of skills specialization and the quality of skills.

Countries with responsive skills development systems are more successful in putting skills to use in tradable activities, with corresponding impacts on trade. Skills development policies are therefore an important ingredient in strengthening and developing a country's overall comparative advantage, or that of specific internal regions, whether in existing activities or in higher-productivity activities, which in turn strengthens its position in the global economy.

Work by the ILO, under the Skills for Trade and Economic Diversification (STED) programme, finds that businesses in developing countries face common challenges in terms of the capabilities that they can deploy so as to participate effectively in international trade. These important challenges consist in addressing common features of market demand in a globalized world, such as cost efficiency, quality, responsiveness and product differentiation, as well as common features in good management practices and work organization. Key general targets for skills improvement include core work skills, technical skills and management skills including human resource management.

The need for strong capabilities in these areas is not limited to developing countries. They are also needed where regions within a developed country have been affected negatively by an employment shock and are having difficulty in adjusting to the new conditions. In such situations, regions in developed countries often need to build comparative advantage in new high-productivity activities, and are likely to face many of the same constraints as their developing-country counterparts. The literature on local economic development in developed countries supports the need to develop comparative advantage in activities rooted initially in local strengths, and places a heavy emphasis on investment in skills as a basis for this.

Trade affects the demand for skills in several ways

There are four main mechanisms through which trade affects the relative demand for skills. First, trade raises the demand for products in which countries have a comparative

advantage. This increases the demand for factors used intensively in the production of those goods and services. In countries with a comparative advantage in skill-intensive sectors, trade thus increases the demand for skilled workers. Second, international trade leads to firm selection, whereby the least productive firms may be driven out of business and the most productive firms expand. More productive firms tend to employ relatively more skilled workers and have higher returns to skills, which translate into a higher relative demand for skills. Third, as the costs of offshoring fall, the least complex and locationally dependent stages of production that were still performed onshore in high-income economies relocate to low-income economies. These newly offshored tasks are nevertheless more complex compared to the already offshored stages, which increases the average complexity of tasks performed in both types of country and pushes upward the relative demand for skilled workers everywhere. Fourth, lower trade costs may induce skill-biased technological change – that is, a change in the production technology that favours high-skilled over low-skilled labour by increasing its relative productivity and, therefore, the relative demand for it – in both exporting and import-competing firms in both developed and developing countries. This also contributes to increased demand for skills.

Empirical evidence shows that trade induces skills upgrading in both developed and developing economies

In developed economies, recent trends suggest that trade and offshoring are associated with a decline in the employment share of middle-skilled workers. Import competition from low-wage countries also pushes firms to increase their product quality and/or investment in research development, increasing their demand for high-skilled workers. Moreover, international trade alters the types of skills that are demanded. In particular, middle- and high-skill occupations that require social interaction, communication and non-routine abstract thinking experience the most significant increase in demand.

The available evidence from developing economies shows that trade affects employment composition through the adoption of new technologies. This comes about both by giving exporters incentives to invest in more productive technology and by making imports of technology-intensive capital goods cheaper. New technologies are complementary with high-skilled labour and often replace low-skilled labour, leading to skills upgrading.

Trade affects the wage distribution by increasing the returns to skills

In both developed and developing countries, trade-induced increases in the skill premium (the ratio of the wage of high-skilled workers to the wage of low-skilled workers) have contributed to wage inequality where skills supply has not been responsive. Furthermore, in some developed economies the decrease in the relative demand for jobs that require routine and non-abstract tasks has led to polarization of the wage distribution, whereby employment in middle-paid jobs has decreased relative to that in high- and low-paid jobs. This tendency towards greater wage inequality results from the presence of labour market frictions and from unresponsive skills supply systems. It is also important to stress that while trade plays a role in wage inequality, other factors, such as technological progress, are even more important determinants.

An appropriate skills supply increases gains from trade and improves their distribution

An adequate response of the supply of skills to changes in the demand can substantially improve overall labour market outcomes. For instance, skills upgrading in reaction to, or in anticipation of, increasing demand can dampen the impact of trade on wage differences and instead increase the employment shares of skilled workers. Skills mismatches, on the other hand, can amplify the impact of trade on the skill premium, lead to higher unemployment for certain skill groups and constrain expansion of successful firms through shortages of certain skills. Recent studies provide indirect evidence that the differences between the skills of workers who lose jobs and the skills required by expanding firms, and therefore skills mismatches, may be substantial.

Both education policies and incentives in the labour market shape the way people invest in their education. Addressing this area is a long-term process. Continuing education and training, both at universities and in the form of technical and vocational education and training (TVET), and on-the-job training, can help workers cope with the big changes in demand for skills which are in varying degrees triggered by globalization.

Available responses

There are common themes across countries in the constraints on matching skills supply to demand. These are usually more severe in developing countries than in their developed

counterparts, which have been focused for longer on developing information systems to identify and anticipate skills needs, on improving their education and training systems, and on strengthening workplace learning.

There is room for countries at all stages of development to adjust their responses. The need and scope for less developed countries to adjust is greater, but even for developed countries the challenges of adjusting to trade-connected shocks to employment may heighten the priority they place on skills development with a view to inclusive trade.

Important principles that may be helpful for responding effectively to skills needs related to trade include the following:¹

- **Policy coherence:** Connecting trade and skills policies requires coherence in policy between these and related policy areas.
- **Social dialogue:**² This is central to making skills systems responsive to the needs of industry, including those industries producing tradable goods and services.
- **Broad access to education, skills development and lifelong learning:** Low-skilled workers, workers who lack transferable skills, workers whose learning skills are weak, and workers whose skills are at risk of obsolescence benefit less from trade and are vulnerable to technological change or to a trade-connected employment shock.
- **Targeted training for displaced workers and/or workers at risk of displacement:** Reskilling may be required to allow workers to move to a different occupation or a significantly different job, whether because their original job became unnecessary or because change offers a good opportunity.
- **Investing in training for employed workers:** Training for workers at all skill levels is a necessary part of implementing effective strategies, in order to underpin the capabilities needed in markets for tradable products and services. Addressing impediments to adequate investment in skills by and for micro-, small and medium-sized enterprises (MSMEs) is especially important in strengthening value chains, including domestic supply chains, and in ensuring inclusive access to training for the workers they employ.
- **Core work skills:** Strong core work skills, such as team working and problem-solving, are a vital underpinning for employability, and for business performance, complementing the technical skills required for specific types of jobs. Strong core work

skills across the labour force contribute to the inclusiveness of growth, and provide a good starting point for offsetting the tendency of trade to widen income inequality.

- **Skills needs analysis and anticipation:** Tradable industries are especially subject to changing skills needs. Forward-looking skills needs analysis and skills anticipation are needed to inform policy coherence and social dialogue, and to inform decision-making by all relevant partners.
- **Labour market information (LMI) and employment services:** Effective LMI and employment services systems are required to provide and communicate the information that all actors need to inform their thinking and decision-making. Employment services also have a broader role in training displaced workers and in matching them to available jobs.
- **Quality and relevance in skills development:** In order to meet industry skills needs, education and training for skills development has to meet appropriate quality standards, and its content must be relevant to the needs of the industry that it aims to meet.

Skills development is not the only available type of response. Migration, internally within a country or between countries, can also play a role. Where there are skills shortages, measures to increase participation in the labour force, for example through promoting higher female participation can also contribute to the solution. Sometimes, better recognition of existing skills is also part of the solution. Systems for recognition of prior learning (RPL) can make the availability of existing skills more visible to employers, benefiting both employers short of skills and workers in need of work, and easing workers' access to continuing education.

Endnotes

- 1** Recognizing that the situation and appropriate responses can be different in each country.
- 2** “Social dialogue is defined by the ILO to include all types of negotiation, consultation or simply exchange of information between, or among, representatives of governments, employers and workers, on issues of common interest relating to economic and social policy. It can exist as a tripartite process, with the Government as an official party to the dialogue or it may consist of bipartite relations only between labour and management (or trade unions and employers’ organizations), with or without indirect government involvement. Social dialogue processes can be informal or institutionalized, and often it is a combination of the two” (<http://www.ilo.org/ifpdial/areas-of-work/social-dialogue/lang--en/index.htm>).

