

CEP
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economic policies

**Trade and Employment -
An Overview**
Joint WTO/World Bank
Trade and Poverty
Forum

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Trade and Employment
An Overview

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Theoretical Considerations

- Trade models often incapable of explaining changes in employment levels: full employment assumption and perfectly flexible labor markets
- Traditional theories help identify winners and losers from trade across sectors and factors of production
 - Specialization expands comparative advantage sector(s) and contracts others
 - Real returns to relatively abundant factor rises (eg skilled workers), falls for others (eg non-skilled workers).

Theoretical Considerations (cont'd)

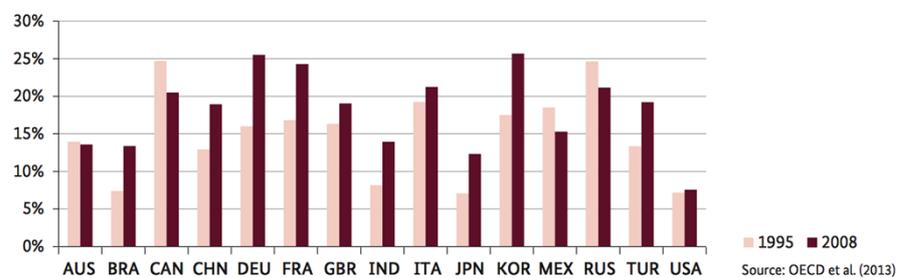
- Intra-industry trade
 - Modern theories explain winners and losers from trade through productivity differences, where economic activity reallocates from least to most productive firms *within* a given sector

- Trade in tasks
 - Increased fragmentation of production processes calls for new generation of trade models where the *tradability* of a service or a task associated with a job determines how the job is affected by trade rather than the associated level of skill required or the economic sector

Trade and Jobs – the Long Term

- Potential job creation from greater trade integration can be very significant
- Countries have become more interdependent over time

Figure 1: Jobs sustained by foreign final demand, as a % of total employment



Trade and Jobs – the Long Term

- However, great heterogeneity in country experiences make the role of trade policy less obvious in isolation
- Successful trade policy has been supporting positive structural change, i.e. expanding sectors with denser linkages with the rest of the economy
- Specialization vs diversification of exports and the role of (trade related) industrial policy
- Import competition can drive labor from exiting firms into less productive segments (eg in agriculture and informality)
- New data suggests that trade policies should encourage development of industries with high domestic labor content

Trade and Jobs – the Not-So-Long Term

- Adjustment costs resulting from import competition are ubiquitous and significant
- The size depends not only on trade reform, but also on factors like labor market regulations, workers' skill sets, access to credit etc.
- Adjustment costs found to be small on aggregate (compared to overall gains from trade), but substantial and lengthy for particular industries and/or workers
- Some evidence for higher adjustment costs in developing countries
- However, most studies are industry-level (manufacturing) and do not take general equilibrium effects into account

Trade, Job Quality and Distributional Effects

- Trade liberalization may increase wage inequality through at least 3 channels:
 - Differential rewards for skill
 - Occupation-specific import competition
 - Productivity premia in trading firms
- Trade seems to favor good working conditions and the quality of jobs more generally
- The link between trade and informality remains unclear
- Participation in international trade promotes female labor participation