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Overview

Ensuring robust employment growth as the economic recovery gains traction is a priority for governments. International trade has demonstrated its importance in stimulating growth, productivity, development and job creation in all of our countries.

While protectionist pressures have largely been resisted thus far, continued vigilance to avoid back-sliding is required. But this alone is insufficient; governments should now embrace an ambitious trade liberalisation agenda in support of the recovery.

An immediate opportunity is available in the form of a successful conclusion to the WTO Doha Development Agenda negotiations. Doing so would increase business confidence, solidify the essential role of a rules-based, multilateral trading system that promotes the interests of all trading nations, and deliver new economic opportunities.

At the same time, public concerns about uncertain economic prospects and the impacts of open markets demand attention.

Trade is essential to enable long term economic development and employment growth. But open markets alone are insufficient; they must be accompanied by complementary policies that enable individuals and firms to exploit the benefits of more open markets, while assisting those who are negatively affected by liberalisation to adjust.

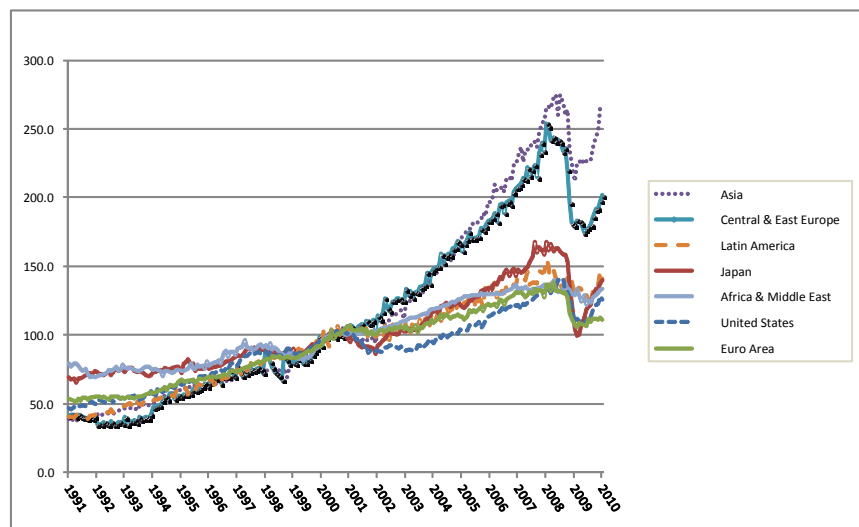
After the trade collapse

There is growing evidence that with the worst of the economic crisis behind us, recovery is finally getting underway in many countries. Flagging domestic demand was a prominent feature of the crisis and it contributed to the more than 12% collapse in trade in 2009.¹ In their March 2010 report to the G-20, the OECD, WTO and UNCTAD noted the resumption of growth in trade, and the WTO subsequently forecast an expansion of world trade of 9.5% for 2010. While this annual rate of growth is among the highest over the past two decades, it still does not bring trade volumes back to their pre-crisis levels.

Trade can play a catalytic role in the recovery. Since the advent of the multilateral trading system the volume of world exports of manufactures has expanded at double the pace of world GDP. Although the recent recession was associated with the worst decline in trade in recent history, it did not reverse the fundamental shift to a more globalised world economy (Figure 1). Such resilience is reassuring; economic inter-linkages among nations are providing important channels for mutual reinforcement in a sustained recovery.

A strong, rules-based multilateral trading system (MTS) is essential for this to happen. In fact, the MTS proved invaluable during the crisis, as countries generally demonstrated reserve in imposing protectionist measures. However, some policy responses to the crisis had implications for trade and these will need to be rolled back (Box 1).

**Figure 1. World export trends, 1990-2010
(by region, 2000=100, Volumes)**



Source: CPB Netherlands Bureau for Economic Policy Analysis (www.cpb.nl)

The economic recovery remains fragile in most OECD countries and in many cases government stimulus continues to play a large role in propping up demand. On the other hand, many emerging markets are growing at or above the pre-crisis rates. As OECD Chief Economist Padoan noted earlier this year in his interim report on the economic outlook, OECD countries have already benefited through trade linkages from strong activity growth in major emerging-market economies, including China, India and Brazil.²

Further market opening would provide a boost to both business confidence and

1. For a detailed analysis of the trade fall, see OECD 2010b

2. Padoan (2010), p. 2.

economic opportunity. Current multilateral trade negotiations are lagging, but a successful conclusion to the Doha Development Agenda is both desirable and feasible, even in the short term – but governments must act.

Box 1. Responding to the economic crisis: implications for trade policy

This box highlights trade policy conclusions and recommendations from a major study* undertaken by the OECD's Trade Committee in response to the financial and economic crisis that started in 2008.

The fall in global trade in 2009 is explained by several factors: the collapse in demand, the drying up of trade finance, a larger fall in demand for highly traded goods (such as machinery and transport equipment) relative to less traded goods and services, and the vertically integrated nature of global supply chains.

Resort to protectionist measures was relatively muted and these measures did not play a significant part in explaining the fall in trade – only about 1% of world imports were affected by new trade restricting measures. The rapid and coordinated G20 response to ensure adequate trade finance was available for viable transactions seems to have been effective.

Given their sheer size, stimulus measures taken to rescue sectors of systemic importance (such as banking) or to preserve jobs (as in the automobile industries) or to stimulate growth (such as consumption tax reductions) or “buy national” measures may be more significant in terms of their potential impact on trade than direct trade policy measures.

But dollar for dollar, direct trade restricting measures have the most strongly negative impacts on both trade and growth.

Open markets and the restoration of a level playing field will be a necessary condition for a sustained recovery; this means addressing policies with both direct and indirect impacts on trade. The OECD report recommends:

- An immediate roll-back of the most obvious trade distorting measures, continued resistance to protectionist pressures, and an ambitious and balanced conclusion of the DDA that will deliver further market opening,
- Removal, as conditions normalize, of the exceptional measures taken by governments to support trade finance,
- Removal of discriminatory provisions from all stimulus measures,
- Continued restoration of competition policy disciplines and withdrawal from the banking sector as appropriate, recognizing that further international coordination is needed to avoid regulatory arbitrage,
- Phase out of the economy-wide demand-side measures to address demand shortfalls as appropriate, and continued support for active labour market policies to address unemployment and adjustment challenges,
- Continued international coordination of steps to “exit” from extraordinary measures as economic conditions permit; further attention to address specific needs in less developed countries and persistent global macroeconomic imbalances.

* See OECD 2010a and 2010b.

Why trade matters

Trade promotes exploitation of economies of scale and specialisation, helps transfer innovation, and improves consumer choice. The openness of markets to competition can provide a powerful incentive for allocation of resources towards their most productive use. Overall, the results can be tangibly measured in terms of economic growth, productivity, a higher standard of living, further innovation, stronger institutions and infrastructure, and even promotion of peace. Open economies grow faster than closed economies. The World Bank has reported that per capita real income grew more than three times faster for developing countries that lowered trade barriers (5.0% per year) than other developing countries (1.4% per year) in the 1990s.

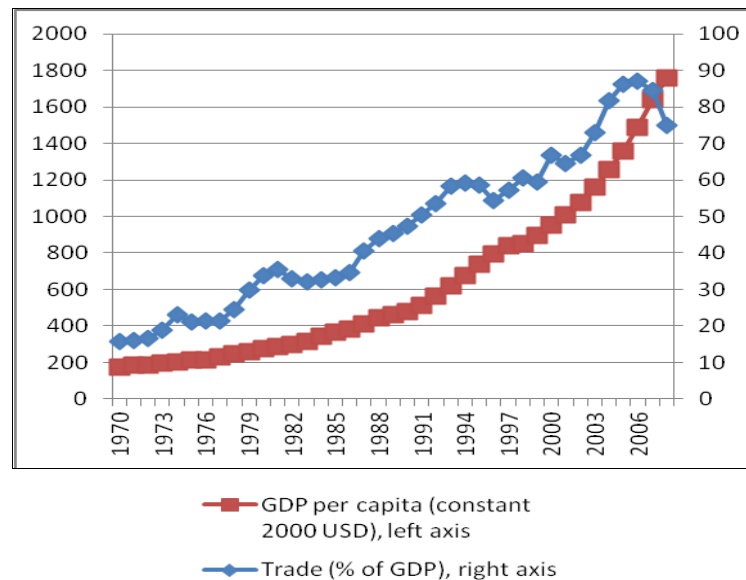
Global production networks account for a large share of international trade, with final products that embody value added at various points around the world. These networks are engaging not only large multinationals but also increasingly small and medium size enterprises. For manufacturing industries, the share of foreign inputs in domestically-produced goods increased from 38% in 1995 to 44% in 2005, and foreign-owned firms in OECD countries now account for almost a quarter of

manufacturing employment on average (OECD, 2009).³

Productivity growth is at the heart of economic progress. Recent OECD analysis highlights the benefits of openness and lower trade costs. At the sectoral level, trade drives the reallocation of resources toward more productive firms, leading to their expansion and the contraction or exit of relatively unproductive firms from the market. Studies of openness also show that increased competitive pressures induce organizational change and production upgrading, which in turn boost within-firm productivity.⁴

In East Asia and the Pacific, where virtually all countries have embraced outward-oriented development strategies, both trade and GDP have grown hand-in-hand (Figure 2). This impressive performance was accompanied with equally impressive poverty reduction. According to World Bank data, while in 1981 some 93% of the population in this region lived with income of less than USD 2 per day, by 2005 this figure had fallen to 38%.

Figure 2. Evolution of per capita GDP and trade intensity (trade as % GDP), East Asia and Pacific Region



Source: World Bank (2010), World Development Indicators, on-line edition.

Imports play an important role in achieving this type of economic performance, in part because they serve as an important channel for technology transfer. Openness to trade provides access to a greater variety of imported capital goods and intermediate inputs that embody new technology. More broadly, openness to imports and exports increases the effective size of the markets for intermediate suppliers and final goods producers, raising the returns to innovation for those engaged in production networks. The ability to market innovations globally makes it possible to profit from greater specialisation and to engage in research-intensive production. OECD analysis (see Miroudot *et al.*, 2009) shows that for 29 industries in 11 OECD economies a higher inflow of foreign intermediate goods was associated with higher productivity. Part of this effect was due to more advanced technologies embodied in foreign inputs and part was due to reduced inefficiencies as final goods producers moved closer to the technology frontier.

3. China is an impressive example of the interlinkages, attracting large amounts of inward foreign direct investment (USD 108 billion in 2008), importing intermediate products and re-exporting value-added products, often via operations of multinational corporations. In 2004, for example, China became the largest exporter of ICT products (USD 180 billion); at the same time its ICT imports included a large share of components used in further processing (amounting to USD 97 billion). For further details, consult the information for China at www.oecd.org/ict.

4. OECD (2003) *The Sources of Economic Growth in the OECD Countries*, pp. 87-89

Why trade matters for jobs

In their communiqué following the 2009 G20 Summit in Pittsburgh, G20 leaders stated that: “The process of recovery and repair remains incomplete. In many countries, unemployment remains unacceptably high. The conditions for a recovery of private demand are not yet fully in place. We cannot rest until the global economy is restored to full health, and hard-working families the world over can find decent jobs.” Underlying this statement is an acknowledgement of the harsh labour market impacts of the recent economic crisis and the need to respond. During the height of the contraction, many countries placed an emphasis on sustaining labour demand and reinforcing their social safety nets including out-of-work benefits, though discussion of exit strategies is gaining increased attention.⁵ The resumed growth in trade volumes will have a key role to play in the shift to a more sustainable economic recovery, one that is less dependent on government support. Today, many jobs depend on both imports and exports.

The relationship of trade to employment is complex. The productivity enhancing processes discussed above are often associated with labour market adjustment, including both job creation and job destruction. OECD studies (2005a and 2007) confirm that globalisation and openness are associated with high employment levels *provided that* openness is accompanied by a coherent policy framework that facilitates structural adjustment and addresses labour market and social concerns.

As with productivity, imports can also play a positive role with respect to employment. Imported inputs are increasingly used in local value-added production, with the output often destined for export markets. In fact, most trade is in intermediate products and services: over 50% of goods trade and almost 75% of services trade. Take the example of the Boeing 787 Dreamliner, the production of which is creating significant new employment in a number of countries. To build this aircraft, the wings are produced in Japan, the engines in the United Kingdom and the United States, the flaps and ailerons in Canada and Australia, the fuselage in Japan, Italy and the United States, the horizontal stabilizers in Italy, the landing gear in France and the doors in Sweden and France. The production involves 43 suppliers spread over 135 sites around the world collaborating for their mutual benefit. More broadly, whether used for domestic production, consumption or re-export, imports can give firms access to new technologies and critical inputs at competitive prices, making it possible for these firms to become more competitive.

Trade is important not only for employment, but also for household income. More open markets allow countries to concentrate economic activity in areas where they excel and to trade for goods and services in areas where they are less efficient. For example, one oft-cited study examined a sample of 150 countries and found that on average a 1% increase in the ratio of trade to GDP was associated with an increase of between 0.9 and 2.0% in per capita income.

In the course of market opening, the distribution of income can be affected as increased numbers of workers benefit from higher paying trade-related employment while some workers may face income loss as a consequence of the adjustment process. While this highlights the importance of social safety nets and adjustment assistance, there is evidence that the process is a transitional one. A recent paper examines this issue and concludes that while gradual trade liberalisation may initially increase inequality it eventually leads to decreased inequality as a greater share of firms engages in the international economy and become more productive, paying better wages.⁶

5. For more on the impact of the crisis on employment and OECD recommendations on the policy response, visit www.oecd.org/employment.

6. Helpman, Itskhoki and Redding (2010)

Liberalise or “protect”?

The global economic crisis risked becoming a crisis of globalisation, with serious potential effects on recovery and future prosperity. While the crisis placed strains on the global trade system, participant governments generally resisted protectionist urges. Nonetheless, some measures were taken. Among OECD countries, all but three implemented either international trade or industry support measures (OECD, 2010b).⁷ A recent IMF Staff Paper examines a broad range of measures taken around the world and finds that trade did indeed decline for products where trade measures were imposed. Fortunately, the measures were narrowly defined and their negative impact on overall trade was small at about 0.25%. Still, there is no latitude for complacency. The world economy is far more integrated than it was in 1929, implying that impediments to trade today would have even larger repercussions for the global economy.

Experience has shown the high cost of policies aiming to avoid trade-related structural adjustment with the goal of “protecting” jobs. Such policies are counterproductive, temporarily saving jobs in vulnerable sectors often at the expense of higher paying jobs in competitive sectors of the economy. For example, one study of the quantitative restrictions in autos, steel and textiles in the US in the mid-1980s put their annual cost at USD 242,800 (in 2009 dollars) per protected job.⁸ Removing these restrictions could have led to large employment gains in other sectors, and even in the auto sector, whose domestic competitiveness was penalized more by these restrictions than it was helped. Delaying inevitable adjustment almost invariably translates into greater longer-term hardship than would be the case if policies of market openness were pursued.

Complementing an open trade policy

While trade is an essential component of sustainable economic growth, complementary policies are also needed in order to realise full benefits. In other words, the positive results from trade liberalisation are not automatic; other policy choices matter as well. Among the most fundamental is the establishment of an adequate system of economic governance, including institutions and rule of law, which are crucial for property rights and for lowering transaction costs. Further policy complements such as a sound regulatory framework and appropriate labour market, macroeconomic and investment policies together can facilitate the allocation of resources to increasingly productive employment while ensuring an adequate social safety net and adjustment assistance (OECD, 2005b).

In a forthcoming paper, OECD analysis (see Stone and Shepherd, 2010) points to three policy areas that appear likely to play an important role in realising “dynamic gains from trade”. These include removal of barriers to entrepreneurship and competition, promotion of science, technology, education and R&D, and regulation and other measures to ensure adequate availability of factors of production (capital and labour).

The WTO initiative on Aid For Trade operates with OECD support and is working to ensure that developing countries are able to realise the benefits of market openness by building their capacity to trade. A greater focus on such supply-side capacity is pre-requisite to attaining the benefits of open markets, and more can be done to identify and to remove the binding constraints to less developed economies pursuing trade-related economic opportunities that flow from further liberalization.

7. OECD (2010b) discusses some of the trade measures taken by OECD countries (e.g. Table 1.8). The three OECD countries that did not implement international trade or industry support measures were Iceland, New Zealand and Norway. Several European Union members did not take specific national actions, but were nonetheless party to European Union trade measures.

8. De Melo and Tarr (1990).

What next for trade?

Trade did not cause the current crisis, and it is already contributing to recovery. It will be an essential component of any realistic policy framework for continued, sustainable development. This is because the economic well-being of a nation is linked closely to the availability of resources and the productivity of its workforce. Trade operates in a variety of ways to positively affect both, notably through promotion of competition, specialisation and innovation; it also provides an important channel for international technology transfer. With appropriate complementary policies, trade can contribute on a sustained basis to productivity growth, quality job creation, and increased consumer choice. Protectionism simply cannot deliver the goods - or the services - in any of these areas.

An immediate opportunity for further trade liberalisation already exists: conclusion of the WTO Doha Development Agenda (DDA). Much of the framework for such a multilateral accord has been negotiated over the past nine years. The remaining negotiating issues are not insurmountable. Action to conclude the DDA would increase business confidence, solidify the essential role of a rules-based, multilateral trading system that promotes the interests of all trading nations, and deliver new economic opportunities.

As the world economy shifts from crisis to recovery, the OECD is working concretely to:

- support successful conclusion of the WTO Doha Development Agenda through provision of timely analysis, a forum for policy dialogue, and evidence-based advocacy;
- analyse the trade effects of policy actions taken and provide advice on appropriate next steps to enable trade to contribute more to the recovery;
- support the goals of Aid for Trade initiatives and contribute to associated analysis of binding constraints to trade, and
- help ensure rules-based disciplines on government-supported export credit measures.

OECD is also pursuing a trade policy research agenda with short and long term dimensions. In the short term, more can be done to clarify the relationship between trade and employment, and the relationship between trade and growth more broadly. Governments today are confronted with sceptical publics who, in the face of economic shocks and future uncertainty, quite naturally look for “protection” and greater security for themselves and their families. The benefits of a policy mix that provides short term relief through active labour market and social policies, alongside medium and longer term opportunities through more open economies, must be better articulated.

The OECD is also looking beyond the recovery, with a view to preparing for the “new normal”. The post-crisis environment is not likely to be a return to “business as usual” – but what will that new environment look like? There are essential trade-related issues that warrant investments now in order to anticipate and prepare for future opportunities and challenges: How will global trade imbalances be addressed? How will global production networks evolve? How will economic, environmental and social interests be pursued by governments? How can we ensure that policies that regulate activity in the services sectors – by far the largest part of our economies – are conducive to trade, growth and ultimately societal well-being? These are some of the questions that the OECD Trade Committee is addressing with the overriding objective of ensuring that trade plays its vital role in the recovery, and beyond.

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More information

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