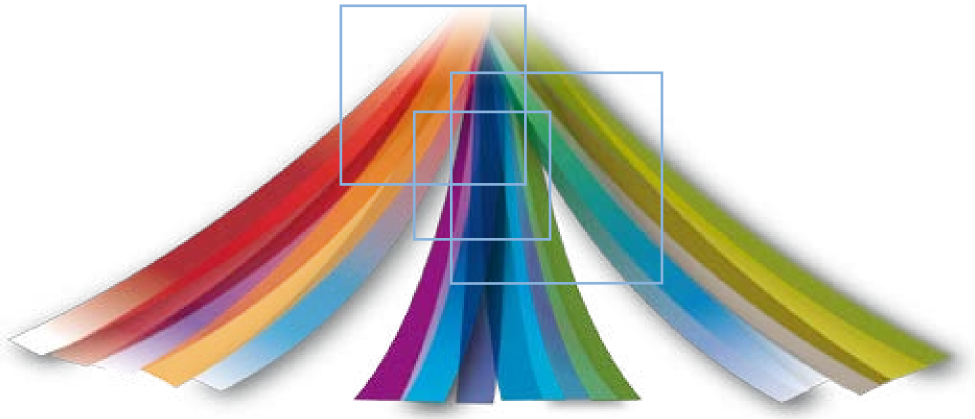
BRIEF Nº 13

GLOBAL JOBS PACT POLICY BRIEFS

International Labour Organization



COHERENT TRADE AND EMPLOYMENT POLICIES IN THE GLOBAL CRISIS

1. Executive summary

The global economic crisis has led to significant losses of jobs and pressures on real wages around the world. Many developing countries were not hit directly by the turmoil in financial markets, but suffered from the slump in global trade that followed. Globally trade is expected to have fallen by over 10 per cent in 2009 and some countries experienced export drops of over 50 per cent. Countries with significant levels of export concentration have in many cases been particularly vulnerable to the shock coming from global markets.

In countries with social protection schemes in place before the crisis, such schemes acted as automatic stabilizers against the trade shock. They could also be easily scaled up if considered necessary by policy makers. From a trade policy point of view such schemes have the advantage of not distorting trade. They are not in conflict with multilateral trade rules and – unlike sector specific support measures – are unlikely to face challenges under multilateral trade rules.

Globalization increases economies' exposure to external shocks, in particular if global markets become increasingly volatile. Creating fiscal space during times of growth should, therefore, be a priority for policy makers at national and international levels, as this will allow them to introduce mitigation measures in periods of crisis. Emphasis should also be given during growth periods to diversifying countries' export and higher value–added production structures in order to reduce vulnerability to external shocks, but also with an aim to industrialize and to raise income levels in developing countries. Strengthening administrative capacity in general and social protection systems in particular should also be a priority during growth periods. In particular, the need to build up fiscal space should not be considered a constraint for strengthening social protection systems.

2. Description of the policy challenges

Increased openness to trade and investment flows has increased countries' exposure to external shocks. This has become very evident during the recent financial economic crisis and during the preceding period of high volatility in commodity and food prices. In 2009, global trade flows fell by over 10 per cent with falls in individual countries sometimes reaching over 50 per cent. Recent ILO work on the nature and extent of the employment effects of trade shocks during the crisis has led to the following conclusions.

- The employment effects of the trade shocks have been significant in many countries and large in some, underlining the need for policy responses to take into account the trade-employment linkage. Employment effects have been particularly severe in countries with exports concentrated in the sectors that experienced the largest fall in trade during the crisis, e.g. iron and steel and products related to the automotive industry.

- The trade shock has often contributed to increased pressure on nominal wages, partly because it undermined the bargaining position of workers. Given that the global fi-

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nancial and economic crisis had been preceded by sharp hikes in global food prices, the resulting cuts in real incomes have been severe in some cases, in particular for poor workers who spend a significant share of their income on food.

- The employment effects of the trade shocks are not restricted to trading sectors but affect the entire economy. This happens through two channels: a reduced demand for supplies by exporting companies, and a general reduction in demand because of reduced incomes in the exporting sectors. It has been estimated that up to half of the employment effects triggered by trade shocks may be the result of such income induced effects.
- Trade shocks have an effect on the functional and gender distribution of income. The direction of that impact can be predicted reasonably well on the basis of traditional trade models.
- Volatility in global markets is likely to have long-term effects on economies because of their effect on investment decisions by companies and households. The household decisions most likely to be affected are migration and education decisions. Volatility can also have a long-term effect on the distribution of the gains from investment. For instance, this happens through its effect on the bargaining power of parties involved in the negotiation of agreements

In the context of temporary shocks to the trade environment, governments face the challenge to avoid the negative consequences on affected individuals becoming unbearable. They also face the challenge to limit the coverage of the employment effects triggered by the shock, i.e. to avoid the shock wave spreading through the entire economy. This should ideally be done in such a way that the adjustment capacity of the economy remains warranted. In other words, the economy should maintain its ability to bounce back onto a normal growth path once the shocks have passed.

With the levels of global financial and trade openness achieved – and maintained during the crisis – individual economies will continue to be vulnerable to external shocks. The number of crises has certainly increased global volatility, and there is a chance that external shocks will become more frequent in particular in commodity markets. Therefore, in the medium to long-run, policy makers face the challenge to reduce the economy's vulnerability to external shocks.

3. Policy options to address the challenges

Crisis mitigation measures

Policy measures that have been applied to deal with negative trade shocks can be divided into three categories: (a) trade related policies, (b) sector or company specific measures; and (c) non-sector policies targeting particular population groups or labour markets

a) Trade related policies

Import restrictions, export subsidies and export finance fall under the first category of policies. Import restrictions tend to be applied under the assumption that reduced imports stimulate domestic production. There is evidence that such measures can be counterproductive if they last too long or are unsupported by an industrial policy or, in the worst case, if they set off a vicious circle of increased protectionism across the globe. Policy makers at the global level have warned against a rise in protectionism and argued that such policies had fatal consequences during the global depression in the beginning of the century. The Global Jobs Pact also cautions against protectionism.

Export subsidies are forbidden under multilateral trade rules because they distort trade. They also have the potential to distort markets by creating excess supply. Multilateral rules exist that regulate the use of government supported export finance. One immediate fear arising from turbulences in financial markets during the recent crisis was that they would lead to a lower supply of trade finance which would further reduce trade flows. In response, G20 members pledged in the spring of 2009 to make at least US$250 billion available for trade finance over a two year period. Also developing and emerging countries offered facilitated access to trade finance during the crisis. However, there is evidence that companies often did not use these subsidized credits. This can be explained by the fact that 85-90 % of the fall in world trade during the crisis is estimated to have been caused by a fall in international demand. Easy access to trade finance does not help to overcome problems of failing demand.

b) Sector or company specific measures

Sector specific measures such as sector specific stimulus packages are not forbidden but can be challenged under multilateral trade rules. They have nevertheless been applied prominently during the recent crisis to prop up key sectors in distress and therefore preserve jobs. The financial sector remains the single most targeted sector in terms of numbers of measures, but it is closely followed in this ranking by the construction sector (that covers infrastructure measures). Taken together, textiles, construction, automotives, food and agriculture and tourism are targeted by more measures – in terms of numbers of measures - than the finance sector. While, like export subsidies, sector specific measures that try to help producers to do business as usual have the potential to distort trade and to lead to problems of oversupply, it is important to understand the industrial policy reasons and strategies linked to such specific measures.

Policy measures targeting infrastructure investments differ from other sector specific measures. Being less export oriented, support to infrastructure investments has a lower potential to distort trade. On the contrary, by lowering transport costs in the future, such investments are likely to be conducive to trade. In addition, the sector is considered to be highly employment intensive and thus has a high potential to create much needed jobs in periods of crisis. Perhaps the largest problem is to identify and launch useful investment projects quickly enough for them to become effective during the crisis. Another possible drawback of infrastructure investment as a crisis mitigation tool is that its main employment creation effect is probably in construction, a sector typically dominated by male employment. The gender impact of such measures should therefore be carefully considered, especially in countries where the main impact of the crisis is on female employment.

c) Non-sector policies targeting particular population groups or the labour markets

During the crisis, many countries reverted to measures that are cross-sector in nature and typically target those losing from the crisis. Such measures include measures targeting the labour market, measures targeting certain income groups (typically the poor) or measures targeting particularly vulnerable groups like the young or the elderly. Such measures tend not to be problematic from the point of view of the multilateral trading system as they are considered to be less distortional for trade. Such programmes are also generally considered to offer effective cushions against negative shocks and are strongly supported by the Global Jobs Pact. By focusing on relatively low income groups, these support measures have a high potential to support national demand. By acting across the economy the measures are likely to address both direct and indirect effects of trade shocks. Where relevant social protection schemes were in place before the crisis, they acted as automatic buffers without additional government intervention. They could also easily be scaled up in response to the crisis situation.

Reducing the economy's and individuals' vulnerability to external shocks

Export concentration has been an important determinant of the extent to which trade shocks have hit individual economies during the crisis. In low income countries where exports to high income countries comprise a large component of GDP, reductions in trade were particularly strong. Countries primarily focused on oil exports experienced marked declines in their exports and shrinking demand for consumer durables and investment goods and, reduced export volumes of those consumer durables and of commodities like iron and steel via global supply chains. In some small developing countries where simple manufactures comprise a large component of exports, the high income elasticity of demand of these goods contributed to a large decline in exports. There is also more general evidence that export concentration in a limited number of products or destination markets increases economies' vulnerability to external shocks. In periods of growth policy makers may thus want to consider pursuing policies that encourage more diversified export and higher value-added production structures, and promote sectors with high employment and income multipliers. Industrial development and well developed domestic and/or regional markets are key to reducing vulnerability and raising income levels in developing countries.

With the levels of global financial and trade openness achieved – and maintained during the crisis – individual economies will continue to be vulnerable to external shocks. It is of crucial importance to prepare economies for volatility and shocks during periods of economic growth. Creating fiscal space during times of growth should be a priority for policy makers at the national and international levels. However, emphasis should also be given during growth periods to strengthening administrative capacity in general and social protection systems in particular. Social protection systems represent automatic stabilizers in times of crisis and if they are in place before the crisis they can be rapidly scaled up or re-targeted if administrative capacity allows. The need to build up fiscal space should therefore not be considered a constraint for strengthening social protection systems. Strong social protection systems are a crucial element of a sustainable system of global trade and contribute to minimizing the negative growth effects of global volatility.

4. Conclusions and recommendations

Among the possible measures to dampen negative employment effects during crisis episodes, infrastructure components in stimulus packages stand out as having a strong potential to create employment in the short-run and for trade in the future due to reduced trade costs. Policies targeted towards specific sectors – though beneficial from an employment perspective in the short-run - may not meet expectations in terms of reducing economic slowdown, because the effects of the crisis quickly spread across sectors and because the needs of companies in struggling sectors are not always clear. Cross-sector income-support policies targeting specific population groups - like the poor, the young or the unemployed - do not have the latter disadvantage and have a significant potential to halt the slowdown in domestic demand and in domestic growth. Countries that already had such systems in place before the crisis were at a substantial advantage to give effective policy responses because the systems acted as an automatic buffer and could relatively easily be scaled up. Policymakers, including through tripartite involvement, may therefore want to consider strengthening social protection systems in periods of growth. The challenge is for this to be done in such a way that the overall economy maintains the level of flexibility and adaptability necessary in the current global economic environment. A well diversified export and production structure will also contribute to making economies less vulnerable to shocks.

5. Further reading and resources

- http://www.ilo.org/trade
- http://www.unctad.org//en/docs/wto_oecd_unctad2010d1_en.pdf